

# **“Cooperatives” in Agriculture:**

**Focusing on the “Tennessee Processing Cooperative” Law**



**Rob Holland**  
***Center for Profitable Agriculture***

**UT Extension**

***<http://cpa.utk.edu>***

# **Focus on the “Tennessee Processing Cooperative” Law**

- **Overview & Comparisons of Business Structures**
- **History and Background**
- **Introduction to the “Tennessee” Law**

# Disclaimer!

*“Good discussions of business structures (especially those involving cooperatives) bounce back and forth, sporadically and often in a distracting way, between “federal” and “state” policies and perspectives!”*

**A “Cooperative”  
is a legal  
business structure!**



# Forms of Legal Business Structures

- Sole Proprietorship
- Partnership
  - General Partnership
  - Limited Partnership
- Corporation
  - Non-profit
  - For Profit
    - C Corp
    - S Corp
- (traditional) Cooperative
  - Marketing
  - Supply (feed, seed, fertilizer, natural gas)
  - Service (electric, telephone, farm credit, AI breeding)
  - Education
- LLC



# **“Primary” criteria affecting the selection of the best legal structure for a business**

- Who Controls the business?
- Where does Capital come from?
- Who is Liable?
- How are Earnings distributed?
- How are Taxes paid/incurred?
- What is the Business Lifespan?

# Comparing Different Forms of Business Organization

	<u>Control</u>	<u>Capital</u>	<u>Liability</u>	<u>Earnings</u>	<u>State F&amp;E Taxes</u>	<u>Federal Taxes</u>	<u>Lifespan</u>	<u>Organizational</u>
Sole Proprietorship	owner	owner	owner	owner	no	owner	owner	+2
Partnership	partners	partners	partners	partners	Gen. Partners = No, Limited Partners = Yes	partners	partners	+/-5
Corporation	Board	Stockholders	the business	stockholders	Yes	Double Tax	Continual	+/-10
Cooperative	Board	Members	the business	Members	Exempt	Once	Continual	+/-10
LLC	Members/ Owners	Members/ Owners	the business	Members/ Owners	Yes	Option: Partnership or Corporation	Continual	+/-10

# Background on Cooperatives

- Benjamin Franklin is credited with forming the first Cooperative business in the US - - 1752.
- The 1940s -- 1950s was the “Golden Age” of Farmer Cooperatives
- Most cooperative policy and legalities were developed during the “Golden Age”

# **“Cooperatives have traditionally been classified as:**

- Marketing: Milk marketing, vegetable marketing.
- Supply: Feed, Seed & Fertilizer Supply
- Service: Credit, AI breeding, dairy herd improvement.

# Farmer Cooperatives have been successful!

However . . .

the number of new cooperatives declined after the “Golden Age”



# “New-Generation” Cooperatives hit the scene in the 1980s and 1990s

- A “NGC” is not a legal business structure.
- NGC is a way to describe cooperative efforts that recognize modern (new generation) business practices.
- Many NGCs are legally organized as LLCs or Corporations.
- NGCs responded to the huge start-up costs required for many value-added processing enterprises.

# New Generation Cooperatives

- NGCs were started in many states, but not in Tn.
- Most NGCs “process” commodities into value-added products.
- NGCs created the concept of farmer members investing cash (capital) and committing commodities for delivery to be processed.
- NGCs are closed cooperatives. Closed to the number of members it takes to provide the processing capacity.

# The “Wyoming” Coop Model

- In 2001, Wyoming enacted a state law which would create a new, legal business organization structure.
- A “cooperative” that would add a significant element to the “NGC” structure.
- The added element allowed both patron and non-patron membership.

# Different types of membership?

- Patron Membership – typically farmer members, invests capital and commits to deliver commodities for processing.
- Non-Patron Membership – invests capital.



**The Wyoming model  
challenged the  
traditional  
“membership” of true  
cooperatives.**

# TIME OUT!



# Revisit some important issues.

- Legal Business Structures
- Businesses must be state chartered
- Federal and State Issues are at play
  - State Franchise & Excise Taxes
  - IRS Taxes
  - Securities (SEC)
  - Antitrust (Capper Volstead)
- Patron and Non-patron Members

# Tennessee Processing Cooperative Law

- The law was passed in May 2004.
- The law amends Title 43 [*Agriculture and Horticulture*] of the Tennessee Code by adding new chapters 38 – 70.
- The law was modeled after similar laws in Wyoming and Minnesota - - the only other states with a similar law.
- The law creates a new legal structure for business organization.

**The law is a hybrid of a traditional cooperative and an LLC.**

*Why do we need a new  
business structure  
with components from a traditional coop  
and an LLC?*

## □ **Traditional Coop Law:**

- Mandates strong organizational & operational principles
- Offers state and federal tax advantages
- Offers federal SEC protection
- Offers federal antitrust protection
- Is based on legal language that is outdated (Tennessee marketing coop laws were written in 1923)
- Does not allow non-member investors

## □ **LLC Law:**

- Offers membership/investor/capital flexibility
- Does not exempt the firm from state franchise and excise taxes.
- Allows for greater flexibility in obtaining capital.

# Processing Coop

- Control - - Board of Directors elected by members.
- Capital - - Members (fees, stock, retained earnings)
- Liability - - The “business” (members limited to investment).
- Earnings - - Distributed to members based on use of the coop (cash and/or equity).
- Federal Taxes - - Once (Income to the firm OR as income of the owner)
- State Taxes - - Exempt from Franchise and Excise Taxes
- Business Lifespan - - Continual
- Degree of Organizational Difficulty - - “+/-10”

# Why not just use the existing LLC law?

- Not specific to processing.
- Not specific to agriculture.
- Not exempt from state franchise and excise taxes.
- Not likely to be eligible for federal anti-trust protection.
- May not be eligible for federal IRS tax exemptions as a coop.
- Does not inspire the use of cooperative principles.
- Not protected under Federal SEC.

# Why not use the existing coop law?

- Based on practices and terms of the 1920s.
- Requires a minimum of 11 members (majority from Tn).
- Does not allow non-patron members.
- Does not clearly allow for processing by-products.
- Does not clarify that LLCs can be members.
- Does not allow directors to be non-members.
- Does not allow stock transfers to non-members.
- Does not allow much organizational flexibility through the by-laws.

# How can we summarize what the new law offers?

- A new structure to legally organize a business.
- Combines elements of a LLC and a Cooperative.
- Coop principles, outside/non-member investors.
- Exempt from state franchise & excise taxes.
- “May be” exempt from federal taxes and SEC registrations, protected under federal antitrust laws.
- Allows for capital to be raised from farmer members (patrons) and non-farmer investors (non-patrons).
- Patron membership based on delivery of inputs and capital invested.

# Additional Resources:

- PB1748 - - “Commentary and Overview for the Tennessee Processing Cooperative Law,” November 2004
- PB#### - - “Considerations for Membership/Investment in a Processing Cooperative,” December 2004
- USDA Cooperative Info Report #55 - - “Co-ops 101,” June 2003
- USDA Cooperative Info Report #7 - - “How to Start A Cooperative,” September 1996