Cleaning Up Equity Records

Managing & Keeping Cooperative Equity Current
March 30, 2005

Problems from inactive memberships

- Numerous Organizational Problems
- Numerous Operational Problems
- One study some years ago determined that about 20% of farmer cooperative memberships are held by persons who have left farming or quit patronizing the cooperative

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- Cooperative principles require purging of inactive members as part of a systematic program that ensures control is vested in users, benefits are distributed in proportion to use (on a patronage basis), and current users accept their obligation to finance current operations.
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- Statutes important to most cooperatives require termination of inactive memberships
- State cooperative incorporation laws
- The Capper-Volstead Act
- Others- Section 521 Exempt Cooperative must each year meet the 85% rule
  - Member have to be both agricultural producers and patrons of the cooperative each year

Having inactive members is in conflict with cooperative principles such as:
- A cooperative is owned and controlled by those who use its services.
- Benefits are to be distributed to those who patronize the cooperative in proportion to use.
- Cooperative are financed by patrons in proportion to uses.

User Control
- “Democratic control is one of the basis characteristics of a true cooperative association. The control as well as the ownership of the cooperative should be in the hands of the member-patrons. To adhere to this principle it is essential to retire voting rights of members who, for various reasons, cease to patronize their association.” Nellis Briscoe of Oklahoma State
When a person makes an application for membership the board determines that the person is eligible for membership. However over time every situation changes. The member will die, cease farming, take their business elsewhere, move away, or for some other reason no longer is an active user. These changes are often ignored by cooperatives.

Former patrons with membership status retain their right to vote, and control may gradually slip from the hands of active patrons. If former patrons are allowed to vote, they may press for the use of earnings to redeem retained patronage which can only reduce funds available for paying cash patronage refunds.

Restructuring
- Often cooperative restructuring in cooperatives takes the form of merger or consolidation among cooperatives
- Member approval is required for such reorganizations to occur
- Former patrons who retain voting rights in the cooperative have, at times, presented a serious obstacle to consummation of the restructuring plan
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- Investing for Expansion
  - The cooperative needs to invest in plant and equipment to further the business of the cooperative.
  - This can cause a conflict between current patron who usually favor the expansion to improve their farm operation.
  - Former patrons may seek to use funds to redeem their equity

- Cash Patronage Refunds
  - Inactive members can pressure cooperative leaders to use funds to redeem their equities rather than paying a high cash patronage refund.
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- Problems with purging inactive members
  - Person who are terminated may take offense to being taken off the voting list. This is a problem particularly if their equities have not been redeemed
  - Mistakes can be made in changing membership status
  - Updating membership rosters can cause short term increase in administrative cost.

Corrective Measures

- It should be noted that there are many difference practices, properly employed, that help to keep membership rolls current. The objective is to adopt practices that get the most results with the minimum ill effects.
- Generally as cooperative may adopt any reasonable scheme not expressly prohibited.

Corrective Measures

- The cornerstone of an effective program is a set of bylaws that anticipates problems before they become difficult to handle.
- Bylaws should be considered that require termination of a member who ceases to be a producer or simply stops patronizing the cooperative, provide procedural safeguards to ensure termination is justified, and explain the effect of a termination between the former member and the cooperative.
Corrective Measures

- Know what your bylaws say
  - Eligibility requirements
  - Retirements - % that can be paid in cash
  - Unclaimed Patronage Allocations - 2 Year
    - Please note cooperative equities are not subject to Oklahoma Escheat law.
  - Membership Termination
  - Use of Preferred Stock
  - Use of education reserve or retained earnings

Corrective Measures

- Automatic Termination
  - Bylaw could have a provision for automatically terminating a member if a person quit farming.
  - There should be procedural safeguards to assure that all members are treated fairly.
    - Cooperative should notify that the patrons membership is under review.
    - Patron should have the opportunity to meet with the board of directors to discuss their status.

Corrective Measures

- Equity redemption
  - The case is rare that at the time membership ceases for any reason the cooperative has the funds to redeem 100% of the equity.
  - Cooperative could redeem the initial payment and not the deferred patronage at the time of termination. It should be clear that the member's status has changed.
  - The plan for equity retirement would be explained to the former member.
Corrective Measures

- What ever plan or procedures the cooperative uses to keep equity record cleaned up it all comes down to the funds available.
- The cooperative that has a good retirement plan for termination and redemption will have better opportunity to balance the scale between equity retirement, cash patronage allocation, and voting rights.

Questions

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