1965

Ray Tanner and Edgar L. Vance for themselves and as a Class Action on Behalf of All Persons Similarly Situated v. Intermountain Farmers Association, aka Utah Poultry and Farmers Cooperative : Appellant's Reply Brief

IN THE SUPREME COU
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TANNER AND EDGAR L.
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Plaintiff - Appellants

vs.

MOUNTAIN FARM
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Defendant - Respondent

APPELLANT'S

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Clerk, Supreme

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IN THE SUPREME COURT OF THE STATE OF UTAH

RAY TANNER AND EDGAR L. VANCE for themselves and as a class action on behalf of all persons similarly situated,

Plaintiff - Appellants

vs.

INTERMOUNTAIN FARMERS ASSOCIATION, aka UTAH POULTRY AND FARMERS COOPERATIVE, a Utah Corporation,

Defendant - Respondent

Case No. 10306

APPELLANTS' REPLY BRIEF

FURTHER STATEMENT OF KIND OF CASE

Appellants amend their earlier statement of the kind of case to narrow the questions before the court for decision.

Appellants abandon their sixth cause of action for an injunction forbidding all patronage redemptions pending a proper accounting to plaintiffs by defendant.

Appellants also abandon their seventh cause of action seeking a court order of dissolution and winding up of the defendant.

MORE DETAILED STATEMENT OF FACTS

Respondent admits too much on page 3 of its brief in admitting that defendant was organized as an agricultural co-operative association in 1923. Careful examination of the organization articles of Incorporation of January 31, 1923 (R 319-22) show only a profit corporation of five incorporators investing $147,000 in common stock (Art. VII) to carry on "the general business of marketing poultry products and poultry".

Again careful examination of the amended articles of incorporation of defendant of December 27, 1923 (R 326-33) shows (R. 327) that the same five incorporators associate themselves

> " . . . as a corporation in pursuance of the provisions of the general incorporation laws of the State of Utah, and of the Agricultural Co-operative Association Act . . . "

Article XI expresses that "The primary purpose of the incorporators is not to make profits," but there is no contract with future members that all net proceeds of sales or savings will be allocated to the credit of future poultry producers, which is necessary for the creation of a non-profit marketing agent and trustee, cooperative, corporate association as required by the Agricultural Cooperative Association Act of Utah.

Then followed the long process—common to the very great majority of agricultural marketing associations in the United States—to create acticle and by-law contracts which would comply with the requirements for a true non-profit, corporate, marketing agent and trustee for its patrons, members and non-members alike.

To accomplish this purpose, the articles of incorporation were amended to greater or less degree in 1930, 1933, 1938, 1943, 1944, 1947, 1949, 1952, 1958, 1961 and 1963. (R. 334-382) and R 386-403). Those articles and the amended by-laws were introduced in evidence during argument on defendants motion to dismiss plaintiff's Second Amended complaint (R 383-385).

There is no copy of the marketing contract to disclose whether or not that document—often referred to in the articles of incorporation—bound the defendant to operate as a true non-profit marketing agent and trustee for its marketing and purchasing patrons.

MANDATORY ALLOCATION OF PATRONAGE NET MARGINS OF $10.00 AMOUNTS

ARTICLE X-A as amended Feb. 1, 1933 went a substantial way toward creating a hybrid cooperative—part non-profit agent and part profit entity (see: Farmers Cooperative Co. vs. V. Birmingham 86 F. Supp. 201, N.D. Iowa 1949). It requires that "Certificates of Interest" shall be issued to each holder of common stock covering net patronage margins from 1923 forward on annual operations representing:

> " . . . the aggregate of retains and scale-off deductions held by the assocation from the proceeds of the sale of products of such member marketed by the association and for which no prior Certificates of Interest or share of stock in the association has theretofore been issued. Provided, however, that no Certificates of Interest shall be issued for less than Ten Dollars ($10.00) nor for more than the highest multiple of Ten Dollars ($10.00) included within the total of such retains or deductions". (R 352).

PRIORITY OF CASH REDEMPTION ON A TRUE REVOLVING CAPITAL PLAN

This same amended Article X-A of 1933 specifically states the contract right of all patrons to have their oldest annual series of Certificates of Interest redeemed first on a revolving capital plan when accumulated patronage net margins made the redemption of Certificates of Interest practicable, as is alleged in the Fourth Cause of Action of Plaintiff's amended Complaint in partially quoting said amendment. This same amendment declared that the Certificates of Interest represented the property interest of the members along with any Special Investment stock owned.

NO MANDATORY ALLOCATION OF AMOUNTS LESS THAN $10.00

The amendment of ARTICLE XII on April 28, 1944 is stated ambiguously. The obligation of the corporate association to operate as a true non-profit agent and trustee for its members to allocate the net proceeds received annually from marketing operations, and to allocate the net savings of members purchasing feed and supplies in net patronage amounts less than $10.00, is not clearly stated.

OPERATING CAPITAL RESERVE BOOK-CREDIT ALLOCATIONS OR NOT?

The first sentence of ARTICLE XII, 1944 unequivocally declares that, "This association shall be operated for the mutual benefit of its patrons". However, a later phrase gives the Board power to place respective patrons' un-

allocated book credits in an operating "capital reserve" which plaintiffs allege was not but should be allocated. It reads:

> "... and all net margins, excess deductions, savings and increments and the proceeds realized in excess of costs, net needed to establish or maintain reasonable reserves for contingencies, *operating capital* or other necessary purpose of the business, shall be credited annually to the patrons of the association upon the basis of the respective contribution of each patron during the year to the business and margins of the association, or the permanent records of the association shall annually provide the necessary information for doing so at a later date; and such net margins, deductions, savings and increments and excess proceeds, *shall at all times be the property of the patrons, and not the property or profits of the association.*" (R 368)
>
> See also allegation Second Amended Complaint (R 90).

CONTINGENT DISSOLUTION PROPERTY RIGHTS IMPAIRED

It is important to point out the Amendment to ARTICLE XIV, THIRD, on May 2, 1947. It creates contingent property rights upon dissolution *in all patrons* (R 375) and to compare it with the illegal attempted and purported withdrawl of those rights by the later amendment of ARTICLE XIV on April 19, 1949 (R 378) declaring that the residue after distributions to holders of Certificates of Interest and Feed Certificates and *all uncertified credits* shall go to members on a dollar patronage basis *for the preceding seven years.*

RIGHTS OF PROPERTY TO REVOLVING CASH REDEMPTION SERIOUSLY IMPAIRED

In the amendments of April 19, 1949 of ARTICLE XI is observed the greatest violation of plaintiff's rights to priority of redemptionas alleged in plaintiff's Fifth Cause of Action. Prior to this date the contract right of members was to receive priority of cash redemption on a revolving capital basis. All cash redemptions must go to the oldest certificate holders. This amendment of ARTICLE XI provides for partially destroying the right to prior holders of the oldest patronage certificates by providing that cash allocations (redemptions) may be made to current patrons in "not to exceed fifty percent cash". (R 378)

Article XI was amended by adding the following to the present Article XI, to-wit:

> "In order to rotate the capital among those who are currently using the Association's facilities, not more than 50% of the net margins. excess collections, savings and increments shall be returned in cash to the patrons whose property it is, during the year in which the same accrued or in the next succeeding year, and the unpaid balance thereof shall be retained in the treasury until the net margins, excess collections, savings and increments which have accrued in prior years shall have been returned to the patrons entitled thereto or have been made available for such return."

This so-called amendment, purports to impair, substantially modify and partially destroy the capital property interests of plaintiffs at the option of the board of directors by permitting them to take up to 50% of the

cash, patronage accumulations available for redemptions of oldest patronage allocations and pay over the same to the current patrons rather than to the plaintiffs and other patrons entitled thereto by by-law contracts of Article XII, 1944, *supra*. This amendment, if followed in practice (and plaintiffs' complaint alleges it was followed in various years to an extent unknown) not only defeated and violated the plaintiffs' capital property interests in priority of redemption, but also defeated the indispensable cooperative principle of equality of burdens in providing corporate capital by the method of issuance of certificates and written notices of allocations of book credits. This equality of treatment requirement for a cooperative has existed in the Internal Revenue Code since the Revenue Act of 1926, Section 231 (12).

The Ninth Circuit Court Appeals declared:

> "In order to be a true cooperative, however, the decisions emphasize that there must be a legal obligation on the part of the association, made before receipt of income, to return to the members on a patronage basis all funds received in excess of the cost of goods sold. Such obligation may arise from the association's articles of incorporation, its by-laws or some other contract".
>
> American Box Shook Export Co. v. Commissioner (1946) 156 Fed 2d 629
>
> Accord: United Cooperatives Inc., v. Commissioner (1944) 4 T. C. 93 and Internal Revenue Act of Oct. 17, 1962, Sec. 17 PART III, sub-section 1388 (a) (1), (2) and (3).

The patron contract in 1947, *supra*, provided that all patrons had to supply capital to the association by accepting allocations for their net margins in paper allocations

at $10.00 par, either in Certificates of Interest on marketing operations or by accepting "Feed Certificates" as allocations for patrons' net margins for purchasing feed, and by accepting book credit allocations for amounts less than $10.00. Granting priority of cash redemptions of net patronage to current patrons of not to exceed 50% of patronage net margins violated the contract rights of priority and equality of treatment and purported to change the contract priority of former patrons to deferred contract claims to the patronage cash redemptions of current patrons at the option of the Board of Directors. This amendment, if followed in practice, a fact which plaintiffs are entitled to learn upon the accounting prayed for, gave cash to current patrons which should have been used to redeem the paper allocations of the holders of the oldest allocations. Defendants have the records and plaintiffs are entitled to an accounting to learn what actually happened. Were plaintiff's property interests in priority of cash redemptions actually paid in cash to later patrons?

As a result of the Internal Revenue Act of October 15, 1951 effective January 1, 1952, we finally find on December 30, 1952 an amendment making a true cooperative of the defendant. The earlier merely allocable *"Operating Capital reserve"* is now abolished and mandatory allocation of all net proceeds of sales and savings becomes the clear contractual rights of *PATRONS*, (*not MERELY MEMBERS*) by a succinct amendment of ARTICLE XII complying with the requirements of the 1951 Internal Revenue Act for organization and operation of a true cooperative, qualifying for so-called income tax exempt status.

"The Association shall be operated for the mutual benefit of its patrons. All net margins, excess deductions, savings, increments, and proceeds realized in excess of costs not needed to establish or maintain reasonable and proper reserves for depreciation, depletion, obsolesence and bad debts *shall be the property of the patrons and not the property of the association,* and such net margins excess deductions, savings, increments and proceeds realized in excess of costs, shall within eight months after the close of the fiscal year be credited to the patrons of the Association upon the basis of the respective contributions of each patron during each fiscal year to the margins of the Association. The association shall within the same eight months *notify each such patron* of the amount so credited to his Account" (R 388)

ARTICLE XI as amended April 22, 1949 theretofore requiring issuance of Certificates for each member *and patron* who by annual accounting had $10.00 of net patronage margins remained unamended in 1952. By the 1952 Amendment *supra*, allocations of patron's book credits for amounts less than $10.00 became a clear contract right of each patron.

VOTING MEMBERSHIP RIGHTS WHOLLY UNRELATED TO PATRONAGE PROPERTY RIGHTS

The articles make clear that only agricultural producers can be voting members; Art. X Amendment of April 22, 1949 (R 381). However as provided in the Internal Revenue Act of 1951 and earlier similar Acts, non-members, non-producers may purchase supplies and equipment up to but not exceeding 15% of the total dollar volume purchased by all purchasers from the

cooperative. See last sentence ARTICLE VI Amendment March 29, 1943 (R 356). Also agricultural products may be marketed for non-member patrons in an amount not to exceed the amount marketed for members ARTICLE VI Amendment March 29, 1943 (R 355). But the facts are that after the amendment of December 30, 1952 of Article XII, mandatory allocations of $10.00 certificates where a patron's margins annually reached that amount were to be issued to patrons and uncertificated book credits for less than $10.00 net patronage margins were to be allocated and duly noticed to all patrons. ARTICLE XII, *supra.*

Another fact is that patrons who purchased only animal feed could not become or maintain voting membership unless in 1943 to 1948 inclusive they purchased up to a minimum of $200.00 of feed annually, Article X, (R 358). The minimum qualification for gaining and holding a voting membership by those who only purchased feed was raised to $500.00 annually by paragraph 2 of Art. X as amended April 22, 1949 (R 384) and was raised again to a minimum of $1,000 annually by amendment of paragraph 2 of Art. X as amended Dec. 30, 1952. But as previously stated non-members were entitled to property rights the same as if they were members.

A controlling fact for the preservation of the contract rights of the plaintiff's which ripened into beneficiary property rights after sale of their products is that neither in the original articles of incorporation nor in any of the later amendments is there any statement of broad amending powers which might be construed as a saving clause for modification of the property interest of the plaintiff's

represented by their certificates and their rights to accounting for uncertificated book credits which should have been allocated and noticed and were not.

ARGUMENT

POINT I

PLAINTIFFS' COMPLAINT IS SUFFICIENT AND SHOULD NOT HAVE BEEN DISMISSED

The plaintiff's complaint alleges their equitable interest as beneficiaries in the assets held by the defendant as trustee and their right to sue for an accounting as such beneficiaries under the contract rights of the Articles and By-laws of defendant corporation as sets out with considerable particularity. Articles of Incorporation VII and XIII and By-law No. 16 among other articles provisions as establish plaintiffs' contract rights to certificated and uncertificated interest in the assets held in trust by the association for all patrons. (R. 90 & 92).

In Plaintiffs' fifth cause of action they set out the contract rights of the priority of redemption of property rights and allege the violation and impairment of those priority rights, by giving cash redemption priority to current patrons which is illegal and void. (See paragraph 5, R 95 and R 359 and R 378)

The plaintiffs allege that the operating capital reserve created, as illustrated by By-laws No. 16 regarding *operating capital*, should have been allocated and noticed to plaintiffs from the records which By-law 16 (c) 3

required the defendant to keep (R 94) and that in violation of said by-law agreement No. 16 (b) that the association "shall be operated for the mutual benefit of its patrons", it did not make the legally required allocations of the *operating capital reserve* (R 92) to plaintiffs and others similarly situated.

Plaintiffs allege that the defendant has marketed for them and claimants similarly situated their agricultural products for plaintiffs' benefit and not for profit of the corporation as an entity (R 89). This means only one thing, namely, that in marketing turkeys, poultry, and eggs, the defendant agreed to act and did act as the non-profit agent of plaintiffs in marketing their products and became their trustee of the net returns above costs of operation upon receipt of those funds, which should be accounted for according to the kind of product marketed. Accounting requires record keeping, determination of net gains of the pool, the individual allocations and due notice to patrons both as to certificates of Interest to be issued and as to patrons' uncertificated book credits due them, proportional to their respective patronage.

Plaintiffs allege that defendant has not accounted to plaintiffs for the said property interests, nor redeemed their certificates nor the uncertificated patronage book credits according to their priority rights on the revolving capital plan to which they allege they are legally entitled, and they pray for an accounting and then for payment of cash redemptions which should have been made to them according to their priority contract.

POINT II

PATRONAGE RECORDS SUSEPTABLE OF ALLOCATION AND RIGHT TO AN ACCOUNTING

In the evolution of agricultural marketing and supply cooperatives toward true cooperative organization and methods of operation the Ninth Circuit Court held that the keeping of patronage records from which later allocations could be made was sufficient to create a tax exempt cooperative where the Articles and by-laws declared that all net proceeds of sales and savings were the property of the patrons on a patronage basis. *San Joaquin Valley Poultry Producers Ass'n v. Commissioner* 136 F. 2d (C.C.A. 9th 1943) As previously stated mandatory allocation of all net patronage margins became the test of a true tax-exempt cooperative by the Internal Revenue Act of October 15, 1951.

A case squarely in point on plaintiffs' right to accounting is *Rhodes v. Little Falls Dairy Company* 245 N.Y.S. 432 (1930). In that case as in this the alleged cooperative placed a substantial portion of annual net gains into a so-called "sufficient working capital reserve" in the discretion of the Directors which was not allocated although records of pounds of butter fat were kept for each marketing patron.

The Court ordered the accounting for plaintiff and persons similarly situated and said:

> "The facts alleged in the complaint show a fiduciary relationship between the parties. It partakes in large measure of the nature of a joint venture, in which case an action in equity is maintainable for an accounting (Marston v. Gould, 69 N. Y. 220), and is

not unlike that of an agent who has been intrusted with his principal's money or property expended or dealt with for a specific purpose, in which case the agent is at all times amenable to the process of the court to show that his trust duties have been performed and the manner of his performance. Marvin v. Brooks, 94 N.Y.71; Hotel Register Co. of New York v. Osborne, 34 App. Div. 307, 82 N.Y.S. 609.

'It is not necessary that there be a technical trust. Equity will take jurisdiction where there is a relation of agency and confidence and the agent has received property of the principal for which he refuses to account.' Talmudic Literature Publishers, Inc. v. Lewin, 266 App. Div. 1, 2, 234 N.Y.S. 164, 166.

It also clearly appears that something more than a computation according to set figures will be necessary before it can be determined whether or not defendant has made proper distribution to plaintiff and other producers in like situation in the amounts to which he and they are entitled."

For full discussion of the problems involved in this case see Jensen, *The Collecting and Remitting Transactions of a Cooperative Marketing Corporation.* Law and Contemporary Problems, Vol. 13 Summer 1948 Duke University, 403-419, 408. The entire volume is devoted to 12 Articles on various phases of cooperative law. See *Ibid.*, Jensen, *Revolving Capital From Patronage Refunds* 536-608.

POINT III

NO AMENDING POWER RESERVED TO IMPAIR PROPERTY RIGHTS

In *Gary v. Saint Joe Mining Co.* 32 Ut. 497, 91 P. 369 (1907) this court held that under the general amending power found in the corporation statute, stock could not be altered from non-assessable to assessable stock against the opposition of one stockholder sticking to his contract rights.

However in *Nelson v. Keith O'Brien Co.* 32 Ut. 396, 91 P. 30 (1907) the Article on amendments provided that the articles "may be amended in any respect". This court held that that type of amending Article was a saving clause which gave the majority the right to make non-assessable stock assessable against minority dissenters for the advantage of providing capital for the corporation.

In the intant case there is no article in any of the articles of incorporation on power of amendment of the articles.

Thus the attempted substantial impairment of the rights of plaintiffs to priority of cash redemption on revolving capital plan could not legally be done by the alleged amendment which purported to give prior right to cash redemption to current patrons up to 50% of their patronage allocations. That later amendment ***supra*** attempts to illegally destroy the preference right to cash redemption of plaintiffs and person similarly situated.

POINT IV

SO-CALLED SALES TRANSACTION ENTITLED MARKETING SELLERS TO PATRONAGE ALLOCATIONS AS IF MARKETING AGENCY EXISTED

In the first trial of Tanner v. Utah Intermountain Farmers Association, Mr. Tanner repeatedly testified that what were called settlement sheets were merely advances on turkeys delivered for marketing and Judge Faux repeatedly said, in effect, in dealing with you Mr. Tanner the company acted as a profit corporation and if it made any profit above the amount paid to you it can keep it (and pay income taxes on it).

Mr. Tanner insisted, in effect, I am a member and entitled to the allocation of net patronage margins on my turkeys marketed by defendant no matter what you call the transaction (R 51-58).

Mr. Ela Emerson, a cooperative lawyer from Madison, Wisconsin writing in *Cooperative Corporate Association Law* 1950 by Jensen and others says:

> "Many Courts and many lawyers have been unable to adjust their thinking to the needs of this new creature and naturally they suspect it because they do not understand it. **517**
>
> We lawyers, who claim to know something about cooperative law, I believe, could spend many hours trying to educate other not-so-enlightened lawyers as well as legislators and judges on the subject, 'what is a cooperative?' "

The above is quoted in Reuschlein, Partnership and Incorporated Business, 1952, 60-61.

Judge Faux did not understand the legal nature of an incorporated agricultural of mutual cooperative association (R 51-59).

The case of *Clinton Co-op Farmers Ass'n v. Farmers Union Grain Terminal Association* 223 Minn. 253, 26 N.W. 2d 117 (1947) holds that a person having a membership and selling to his cooperative is entitled to have the so-called sale price regarded as an advance and the cooperative by its mandatory article and by-law contracts must allocate to him his proper proportion of net patronage margins similarly as allocations are made to members who accept the agency relation because the cooperative is legally bound to operate at cost and is as against its members not allowed to make profits on transactions with them.

POINT V

COURT ERRED ON RES ADJUDICATA

As regards the defense of res adjudicata we simply quote from Judge Hanson's order of dismissal of the complaint:

> "The Court was not impressed with the argument relating to res adjuricata, since the only party that this could possibly apply to would be plaintiff, Tanner" (R 78).

POINT VI

THE TRIAL COURT ERRED IN FAILING TO HOLD THAT TRUSTEES AND AGENTS ARE UNIVERSALLY OBLIGATED TO ACCOUNT

> "Wherever a trust exists the right to an accounting follows as a matter of course". 90 C.J.S. 83 Sec 377. "A suit in equity is a proper remedy to compel a trustee to account for trust funds or property". 90 C.J.S. 719, Sec 389.
>
> "The right to an accounting exists where the accounts are so complicated that they cannot be adjusted by a jury in a law action".

Gatudy v. Acme Construction Co. 196 Wash 562, 83 P. 2d 889 (1938).

The defendant was not only trustee but also marketing agent for plaintiffs.

> "Where a fiduciary relation exists between parties and facts are peculiarly within knowledge of one of them" (the defendant here) "an accounting lies".

Kieble v. Brown 123 Cal. App. 126, 266 P. 2d 569 (1954).

We respectfully submit that the order for dismissal be vacated and set aside and that the case be remitted to the trial court for further proceedings in accordance with equity.

Respectfully submitted this day of October, 1965.

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