

Contractual Dimensions of Farmer Cooperation

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Abstract

Farmers choose the timing, extent, and manner in which they wish to participate in the supply chain. Their participation is frequently defined by the rights and obligations of a production contract. In addition, farmers may market through a cooperative and actively engage in new roles as part of the supply chain. Following theoretical developments in corporate law and economics, such participation through a cooperative can be viewed as an innovative collection of contractual rights and obligations. When farmers use a cooperative, their contractual relationships expand significantly beyond those found in a production contract. Vertical, horizontal, and temporal dimensions of contractual relationships between farmers and new parties as well as among each other re-define the producer's new role in the supply chain. The boundaries between farmers and the entity through which or to which they sell their product change dramatically. The new relationships can be assessed and clarified using analytical techniques from contract law and economics.

Introduction

Producers choose the timing, extent, and manner in which they wish to participate in the supply chain.¹ The common mechanism for producer participation beyond merely marketing products once produced, is through some form of production agreement that establishes rights and obligations between the producer and a buying entity in the supply chain.² Most agricultural

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¹ The term “supply chain” is used rather than market chain, value chain, net chain, or other terms to emphasize farmers’ essential role as original suppliers of all products in the food system.

² For a recent survey of production contracting by USDA’s Economic Research Service, see MacDonald, *et al.* Further references to the large and growing literature on production

production and marketing contracts establish a legal relationship between a single party that purchases the product and a single producer of that product. The consequent set of rights and obligations is essentially “stovepipe” in dimension. The output of an identified producer sets the boundary for the producer on one side of the relationship and the purchase from that identified producer sets the boundary of the contractual relationship on the other. Beyond those boundaries no direct relationship exists. Even where a substantial proportion or all of a commodity is produced under contract, the participation of each producer in the total market system is limited.

The dimensions of relevant contractual relationships change quite dramatically where producers choose to market through a cooperative. This is true whether or not a formal marketing contract exists between producer-members and their cooperative.³ When a producer chooses to market through his or her own cooperative, that farmer becomes party to rights and obligations that extend to entities and circumstances not otherwise part of a typical production contractual relationship. The farmer member becomes a direct participant in segments of the supply chain not otherwise normally part of a production contract. The legal and economic significance is that of a new contractual set of rights and obligations that redefines producers’ participation in the supply chain.

Statement of the Problem

The problem presented is to describe and define, in the framework of contract, the differences between the rights and obligations that face a farmer who produces under the terms of a production contract with a non-cooperative buyer and the rights and obligations facing a farmer who produces a product and markets that product through the farmer’s own cooperative. While a range of inter-producer arrangements evidence “cooperation,” the analysis in this paper will focus only on incorporated cooperative business entities.

Three considerations suggest the utility of analyzing formal producer cooperation in terms of producer contracts. Rights and obligations voluntarily assumed by a producer are analogous in character whether the producer contracts with a proprietary buyer or adopts the rights and obligations of cooperative membership and patronage. The extent of such rights and obligations will, however, be quite different as discussed below. Nevertheless, the principle that individuals and businesses can make voluntary agreements that will be enforced by law is the same. Indeed, most such rights and obligations are enforced by applying essential principles of contract law with some modifications in the case of cooperative membership. In either case, a producer’s

contracts are not given.

³ Members are not necessarily patrons who use the cooperative and *vice versa*. Nor are all farmers who sell to a cooperative necessarily treated on a patronage basis. For purposes of this paper, however, farmers who are members will also be patrons and participate in the cooperative on a patronage basis.

contractual participation in the supply chain is established by voluntary agreement and can be enforced when one or more parties fail to meet obligations established in the arrangement.

Second, treating the rights and obligations of a cooperative member as another manifestation of contractual relationship of the general kind found between a producer and a corporate buyer is supported by modern developments in corporate theory. This view of a corporate enterprise emphasizes that producers define their position in the supply chain by rights and obligations sets that are either explicitly defined by an individual contract or that are stylized and generic in the case of membership in a cooperative corporate entity. Applicable corporate theory is summarized below.⁴

Finally, producers' economic choices are much the same whether the producer decides to take on the rights and obligations of a production contract, use a cooperative for marketing purposes, or both. The overall decision is how much to participate in the supply system beyond simple independent production followed by spot market selling. A sufficiently detailed and complicated contract may place the producer in nearly any position desired in the market place, though practicalities limit the usefulness of such a contracted structure. A substitute for an excessively detailed and complicated contract is suggested in corporate literature and is introduced here to describe cooperative membership and patronage.

Overview

The paper first describes the principles that define a corporate entity and those that add cooperative characteristics to such an entity. It then identifies explicitly stated contractual characteristics of a corporate firm with emphasis on the cooperative corporation. Principles ascribed to contract theories of a business firm developed primarily in the law and economics literature are described. Each producer is treated as a party to a contract set that includes not only the rights and obligations of a producer with respect to a buyer under a production contract, but the rights and obligations of a cooperative member.

The dimensions of contractual relations are described with respect to vertical boundaries, horizontal boundaries, temporal boundaries, and firm boundaries. Comparison is made between such dimensions as they are found in a stylized production contract and those that are inherent in a cooperative where the producer is a member and patron of a marketing cooperative. The dimensions of contracts created by cooperative participation are described from the producer's perspective.

⁴ An advantage of investigating corporate theory is that the considerable literature provides numerous instances where corporate law, contract law, and economics are integrated. See Salanié, the readings in Brousseau and Glachant, the readings in Ménard, and Bolton and Dewatripont for examples. One purpose of this paper is to begin extending this literature to principles specially applicable to cooperative corporate entities.

The paper enumerates substantive elements in contracts – elements found in most production contracts of interest. Implications of the new contractual dimension (contract plus cooperative participation) are investigated by comparing the substantive elements of contracts between a producer and a non-cooperative buyer with substantive elements that exist where the producer is a member of a marketing cooperative.

The Corporate Entity

Generally applicable corporate principles define the broad outlines of stakeholders' rights and obligations in an incorporated firm.⁵ Such rights and obligations are defined and implemented by incorporation statutes. They are further refined by internal documents including articles of incorporation, bylaws, member-cooperative contracts, and applicable cooperative policies. Principles of a business firm establish the basic parameters of internal relationships that may be viewed as contractual. Incorporation statutes describe in more detail the terms of such "contracts." Bylaws are themselves contractual agreements to which cooperative members are parties.

A broad description of modern American corporations can be stated in terms of principles. Corporate principles are sometimes summarized in a short list, as are cooperative principles, although not with the focus and attention devoted to cooperative principles. (Baarda (2003)). While formulations differ widely, a list of seven characteristics describes most corporations. (Cox Hazen and O'Neal, p. 6).

1. Stockholders are not personally liable for the corporation's obligations except to the extent they can lose the value of the equity owned.
2. The corporate entity has perpetual existence that does not depend on changes in the makeup of its stockholders.
3. Corporations have centralized management implemented through the authority and actions of the board of directors.
4. Shares of stock or other interests in the corporation are generally freely transferable. This applies to publically held corporation but less so to close

⁵ The term "stakeholder" includes individuals and entities who have some interest in the firm's performance and behavior. The range of those who should be identified as stakeholders is debated, particularly where stakeholder status is assigned a degree of right to influence firm behavior, with corresponding firm obligations to such stakeholders. In this paper, rights and obligations will be restricted to those who have contractual or statutorily mandated relationships directly relevant to a voluntary, bargained agreement. Stakeholder definition is important for public policy considerations.

corporations. Close corporations restrict ownership and transferability for a number of reasons primarily through contractual agreements.

5. The corporate business has access to debt and equity capital in a great variety of forms and in many markets. This ability to garner financing from many sources is one of the main advantages of the corporate business form and accounts for the growth of corporations, particularly in the latter part of the 19th century as business enterprise size and financial needs outstripped the capacity of individuals, families, or small consortia to supply adequate financial resources.
6. The corporate entity has most of the legal rights of an individual. It acts as a single unit to hold property, to contract, and to resort to the legal system to enforce its rights.
7. Many of the relationships among stakeholders are standardized by operation of corporate statutes giving stability and predictability to corporations, stakeholders, and those dealing with corporations. This standardization includes institutional stockholder and creditor protections.

As in the case of cooperative principles, several formulations of corporate characteristics are offered as summary descriptions of the corporate entity. For example, a list of four (Solomon *et al.*, p.1) may include:

1. A corporation is a separate entity with perpetual existence. It exists apart from those who provide risk capital or who manage its business.
2. Liability for corporate debts is limited to the assets the corporation owns and does not extend to owners' assets.
3. The power to manage the corporation's business is centralized by delegation to the board of directors.
4. Stockholders can transfer their ownership interests to others without terminating the corporation's existence.

The above principles reflect the character of organizations in which a farmer producer could participate as a direct stakeholder if so desired, in addition to being a party to a production contract with that firm. The producer would have a significant number of rights and obligations sets from which to choose. The producer could contract to market product to the firm and hold stock in the firm, contract to market product to the firm and be a director, or contract to market to the firm and be a voting stockholder, among others, or some combination thereof. Participation in the firm would have little necessary and direct effect on the production agreement itself. With respect to the production and marketing of a farm product, the producer would still "participate" in the supply chain primarily through the rights and obligations established by the production

contract, not through the status of a stakeholder in the business firm that itself participates in the supply chain as an independent business entity. Generally, a production contract thus defines the timing, extent, and character of producer participation in the supply chain.

The Cooperative Corporate Entity

The situation is very different for farmer cooperative members. Cooperative members are drawn into the supply chain with multiple interrelated rights and obligations, all of which have a direct and integral role in defining farmers' relationships to the supply chain as a whole. Members are exposed to a myriad of market forces not inherent in a mere production contract. The reason for this difference is found in cooperative principles that overlay corporate principles. Some corporate principles are directly applicable to cooperatives but others are modified or eliminated by cooperative principles.

A summary definition of a cooperative enterprise incorporates all essential principles. As defined in the 1967 USDA publication *Cooperative Criteria* (Savage and Volkin):

A cooperative is a voluntary contractual organization of persons having a mutual ownership interest in providing themselves needed service(s) on a nonprofit basis. It is usually organized as a legal entity to accomplish an economic objective through joint participation of its members. In a cooperative the investment and operational risks, benefits gained, or losses incurred are shared equitably by its members in proportion to their use of the cooperative's services. A cooperative is democratically controlled by its members on the basis of their status as member-users and not as investors in the capital structure of the cooperative.

Combining summary statements of principles with the descriptive formulation of USDA's Agricultural Cooperative Service gives four principles for modern farmer cooperatives (Baarda (1986)):

1. Cooperatives are owned and democratically controlled by those who use their services.
2. Net margins are distributed to users in proportion to their use of the cooperative.
3. Returns on investment are limited.
4. Cooperatives are financed substantially by those who use their services.

The first three principles are common factors in statement of principles, whether the lists are condensed to only three (Nourse, Fetrow) or expanded to several. (Bakken and Schaars, Bakken, Schaars, Packel). The fourth principle is a reemphasis of the ownership feature of the first principle.

The most definitive set of principles has been developed by the U.S. Department of Agriculture. (Dunn). Modern principles are:

1. *The User-Owner Principle:* Those who own and finance the cooperative are those who use the cooperative.
2. *The User-Control Principle:* Those who control the cooperative are those who use the cooperative.
3. *The User-Benefits Principle:* The cooperative's sole purpose is to provide and distribute benefits to its users on the basis of their use.

A farmer who becomes a member of a cooperative (or who may have created the cooperative in the first instance) incurs a totality of rights and obligations that combine those described in corporate principles and those described in cooperative principles. Mere principles, of course, do not make a contractual arrangement. That event comes when principles are combined with corporate and cooperative incorporation statutes to create legal organization. Specific rights and obligations of all relevant parties are defined in the corporate charter, in the form of articles of incorporation, and in bylaws. Other additional contractual arrangements are established either within the community of member patrons or between the corporate entity (whether cooperative or not) and other business entities representing the remainder of the relevant parts of the supply chain.

Contracts, Cooperatives, and Firm Theory

Explicit Contractual Rights and Obligations

Relationships of various stakeholders in a corporation, including a cooperative corporation, are frequently established and regulated by fundamentally contractual relationships though they may not be identified as separate contracts among parties. Such contractually based relationships may be found, for example, in articles of incorporation and the entity's bylaws.

Articles of incorporation, the document that establishes the corporation's basic structure, combine with the statute under which incorporation takes place to form the corporate "charter" although that term is not always applied. The articles of incorporation constitute "a contract between the corporation and the individuals who become shareholders or members of the corporation." (Cox Hazen and O'Neal, p. 56). Most incorporation statutes are "enabling," thus the terms of the articles of incorporation can be designed to meet the specific objectives of the organizers and corporation within the parameters set by incorporate statutes. Such is the case for

cooperative corporations as well.⁶ (Baarda (1982) and Baarda (1986)).

A second document with legal import found in all corporate entities is the set of bylaws. (See, e.g., *Legal Phases of Farmer Cooperatives*). Bylaws are more detailed in their description of internal matters though they cannot contravene either the articles of incorporation or the incorporation statutes. Bylaws are contractual in that they establish rights and obligations among the members that will be recognized and enforced in law. Rights and obligations are established either by direct assignment of rights and obligations or by descriptions of internal operations and structures that derivatively impose rights and obligations on selected parties.⁷

Certain peculiarities of bylaws as contracts should be noted to avoid overstating the case.⁸ Contracts are by their nature voluntary agreements between parties that bind the parties until terms of the contract are satisfied or unless they agree to terminate or modify the original agreement. Other individuals have no right to make unwanted changes. Bylaws, however, may be changed over the objection of some stockholders and such changes will be enforceable even against the objecting parties. The rights to change bylaws are limited where certain detrimental effects will be imposed on others as a result.⁹

Much emphasis in corporate law is given to the relationship between stockholders and the corporation as would be expected. This relationship is described in contractual terms. “A share of stock is primarily a profit-sharing contract, a unit of interest in the corporation based on a contribution to the corporate capital.” (Cox Hazen and O’Neal, p. 306). The contractual

⁶ Only corporate entities are discussed in this paper. Similar concepts are found in partnerships in the form of statutes and partnership agreements and in limited liability companies in statutes and operating agreements, all of which define in some detail the relative rights and obligations of participants. Each can be used to some degree to establish organizations that adhere to the basic cooperative principles described above.

⁷ A cooperative’s marketing agreement may reemphasize the contractual nature of other documents. Sample Legal Documents (Frederick) notes a contract provision that states:

It is agreed that the articles of incorporation and the bylaws of the Association, now or hereafter in effect, and this marketing agreement constitute the entire agreement between the Association and the producer.

⁸ It should also be recognized that the extent of stakeholders’ ability to make arrangements by private contract that contravene or override statutory formulas applicable to corporations is at the heart of scholarly disagreement about the nexus-of-contract theory of corporations, noted further below.

⁹ Some examples of such constraints are noted for cooperatives in *Legal Phases of Farmer Cooperatives*, pp. 57 - 67.

arrangement gives stockholders rights that are “in essence contract rights ... determined by the terms of the shares as described in the articles of incorporation in conjunction with provisions of the general corporation law.” (Cox Hazen and O’Neal, p. 306, fn. 2). Stockholders may create additional contractual rights and obligations in the form of shareholder agreements, typically used to further refine the wishes of those who participate in close corporations.

The three previous examples of contractual relationships are essentially “internal” to the corporate entity. The corporation is also expected to have a multitude of contractual relationships with others such as lenders, suppliers, customers, and management. For the most part, transactions within the corporate entity are isolated from “outside” arrangements by several corporate principles including the entity concept of a corporation, the limited liability rule typically applied to corporate entities, and business judgment rules. As is evident from further consideration of cooperatives and their members, producers who are members and patrons of a cooperative are subjected to numerous external forces not otherwise found in a corporate entity.

The “Corporate Contract”

Consideration of rights and obligations that describe a corporate entity are broadened in scholarly analyses of corporations. It extends to relationships beyond the specific contract-based relationship described above. (Butler). Easterbrook and Fischel title the first chapter of a classic work on corporations “The Corporate Contract” to set the stage for their economic analysis of corporate structure. This concept brings to full circle the place of corporate stakeholders in the market as well as among themselves, a position of critical importance to farmers who choose to be members of a cooperative corporate entity and who deliver product to the cooperative. The following sections briefly summarize the basis for the broader concept of a corporation as a set of contracts whether “real or unreal” (Easterbrook and Fischel) and whether unrestrained or bounded. (Easterbrook and Fischel, Baarda (2002)).

The Firm As a Transaction Set

Contracts are fundamentally transaction based. Transition from independent producers who participate in the supply chain only by contracting with buyers to producers who are part of a marketing business firm is reflected in several aspects of firm theory. Generally, private ownership of factors of production means that each input owner can produce and market goods, sell the input outright, or enter into contractual arrangements and surrender the use of the input to an agent in exchange for an income. (Cheung). An entrepreneur or agent with a limited set of rights can, by contract, direct production without a specific reference to the price of each activity as if it were a market. Contracts are based on transactions, without which the concept of a set of rights and obligations regarding an event would be relatively meaningless. A prerequisite for a reasonable application of contract to a business firm is that the firm be dissectable into transactions to which the concept of a contract is relevant.

John R. Commons introduced a view of the firm in 1934 that focused on transactions rather than on a purely formalistic structural view of the firm as a homogeneous whole.

(Commons). This concept opened a new analytical window into the firm. Soon thereafter, Coase (1937) published his seminal article on the nature of the firm that has led to a long history of discussion and productive analysis based on transactions cost that continues to this day.¹⁰ An offshoot of this view of the firm and the desire to further investigate the firm and its boundaries led to theories of the firm that depend on treating the internal relationships in a firm as sets of transactions subject to contract.

Corporate Firm as a “Nexus-of-Contracts”

A corporation is a legal entity and at the same time a legal fiction. The proposition that a corporation is a legal fiction has led legal scholars to explore theoretical bases that explain the multidimensional set of rights, obligations, and objectives. One school of thought emphasizes that the corporation is primarily a set of relationships that either is, or could be, explained as a set of contractual obligations among individuals that together make the corporate firm.¹¹ Corporations “are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals.” (Jensen and Meckling). All of the relationships among all of the individuals related to a corporation could be and are viewed as simply a rather elaborate set of contracts establishing the rights and obligations of all parties associated with the fictional corporation. The question whether these are actual contracts or relationships established as if they are contracts is a subject of contention.

The nexus-of-contracts theory has gathered a substantial following and is influential in many important discussions about the corporate form of business. The more committed proponents of the nexus-of-contracts theory, the true “contractarians” in academic parlance, propose that the contracts making up the nexus are simply contracts, nothing more and nothing less. As such, they are voluntary agreements among individuals. Some believe that this view of the relationship among individuals obviates the necessity, importance, or even the possibility of distinguishing between contracts representing transactions within the firm and those outside the firm. (Jensen and Meckling, Alchian and Demsetz, Cheung, Klein, Hart, and Schwab). In this view, Coase’s distinction between transactions internal to the firm and those subject to market forces is not critical because whether a firm or corporation exists is not important.

Others adhering to the nexus-of-contracts view of corporations believe that the intra-, inter-firm distinction is significant regardless of the view of a corporate entity. (Spence). Contracts may still be defined as intra- or inter-firm transactions. (Easterbrook and Fischel). As with the distinction for transactions, and in addition to such considerations, contractual characteristics have been suggested to distinguish between internal agreements and cross-boundary agreements.

¹⁰ Contributions include those of Coase (1937), Williamson, Cheung, Coase (1988), and Demsetz.

¹¹ This section is based on Baarda (2003).

The market-driven versus corporate hierarchy distinction is one such approach. Others note the degree of specialization of a contract or the length of time of association among the parties as a guide. Within the corporation, the decision process is comprised of steps such as initiation of proposals for resource use, ratification of the choice of decisions, executing the decisions, and monitoring performance and allocating rewards. (Fama and Jensen). The degree of conscious direction that is employed to guide the uses to which resources are applied relates to the identity of the firm and the contracting nexus. (Demsetz). A contractual paradigm for the corporation implies further that the general rules of contracts will be applied to establish and allocate rights and obligations within the firm, including supplementation with contract law principles. (Cheung, Baarda (2002)).

Recent commentary has refined and modified the generally understood nexus-of-contracts approach to corporate structure. Suggestions further identify the nexus within the corporation itself. In one modification, Bainbridge identifies the board of directors as the nexus-of-contracts, a concept of considerable interest to cooperatives because of their dependence on active boards of directors. This flows from his argument that shareholder primacy is found not through the position of shareholders as owners but through the board of directors as the nexus-of-contracts bringing all interests together, including the special interests of the shareholders. A second modification of the contracts analysis argues that a corporation is not even a nexus-of-contracts. (Gulati Klein and Zolt). Rather, a “connected contracts” model denies that a firm has any boundaries and that because almost everything that makes up a firm is contracted, the contracts run directly among all the parties rather than through the mechanism of a firm.

The nexus-of-contract view of corporations is, needless to say, not universally accepted, certainly not if it is promoted to explain all relationships within a corporate firm.¹² However, the essentials are useful to assess a producer’s role in the supply chain where the producer becomes a stakeholder in such a corporate organization.

New Dimensions of Cooperative Participation

Explicit terms of a contract define one aspect of the set of relationships that parties impose on themselves when a contract is formed. Another view of a contract summarizes the range of parties to the contract, the activities covered by contract terms, and events that are included in the contractual arrangement. While some actions are prescribed or circumscribed by a contract and by the contracting parties who participate in the supply chain system using contractual arrangements, other activities and market system features are excluded. These limitations set bounds on the rights and obligations applicable to contracting parties – a contract’s dimensions.

¹² Alternatives to the pure nexus-of-contracts corporate theory also ring true for cooperatives. Some, indeed, reflect deeper distinctions between the corporate form of business and a cooperative approach to economic organization.

The Dimensions of a Contract

The extent to which contracting parties participate in the market system as a whole is defined by four dimensions. It is the expansion of these dimensions in the case of farmers who market through their cooperative that greatly changes the supply chain status of contracting farmers. These are the “new contractual dimensions” of farmer cooperatives noted in the paper’s title.

This expansion is demonstrated by comparing the extent of market participation by a farmer producing under contract and that for a farmer who markets through a cooperative. A simple production contract is described as an example. Considerable research and discussion has addressed contracts in fully integrated production systems. However, for purposes of comparison, integrated systems are not explicitly discussed here. The analytical techniques and principles suggested in this paper can be applied to such contracts for comparisons with cooperative actions on the part of producers.

An example cooperative is described for purposes of comparison. Modern cooperatives demonstrate an enormous range of structures, operating methods, and market participation. The example cooperative captures the basic principles of an effective cooperative that markets products delivered to it by its members and further adds value that will be returned to the farmer members. As with contracts, the principles outlined using the example cooperative can be extended to other kinds of cooperatives.

Example Contract

The example contract is an agreement with the following characteristics:¹³

1. The parties are a farmer and a firm that purchases the relevant farm product. The farmer agrees to produce the product and the firm agrees to purchase it.
2. The product is identified, the quantity and quality of product is described, and the origin of the product is likewise specified.
3. The price is either set at the time the contract is made or a formula is devised based on market prices at the time the product is delivered to the firm.
4. Delivery times and methods are specified.

¹³ Basic characteristics of a production contract are noted in somewhat more detail in Table 1.

5. Risk is allocated either explicitly or implicitly. The producer bears all risk of production and losses to the point of delivery under terms of the contract. The buying firm bears no risk until delivery and the farmer bears no risk after delivery conditions have been satisfied.

6. Title to the product remains with the farmer until delivery at which time it is transferred to the purchasing firm.

7. Criteria and measurement of performance are contained in the contract. Enforcement terms include damages to be paid in the case of non-performance by either party. Dispute resolution methods are identified. No contractual rights or obligations remain following performance of the contract at delivery by the farmer and payment by the firm.

Example Cooperative

The issues addressed in this paper can be demonstrated with a cooperative that has characteristics found in many farmer cooperatives. A simple example is chosen but the analytical methods suggested by a contracts approach to the cooperative corporate entity are applicable to many forms of cooperatives.

Marketing Agreement

The cooperative has a marketing agreement with its members in which the member agrees to market an identified commodity through the cooperative.¹⁴ The characteristics of the marketing agreement in the example cooperative are almost identical to those for the example production contract. Therefore, the example marketing agreement itself does not change any essential dimensions of the example contract. The focus of new dimensions is on the consequences of cooperative membership.

The Cooperative

The example cooperative is a relatively simple marketing cooperative that purchases a commodity from its member patrons, processes the commodity into a different form, and markets the new product. Value is added by the change in form by marketing techniques such as branding and packaging, and by sale of the new product into a higher end market.

The cooperative has the following characteristics:

¹⁴ The bulk of the analysis does not depend on the use of a marketing agreement. In many cooperatives, no such agreements exist. In such cases the farmer may or may not deliver product to the cooperative in any year. However, effective cooperatives rely more heavily on marketing agreements.

1. It is incorporated as a cooperative corporation under an appropriate statute, has articles of incorporation and bylaws that reflect and describe its essential characteristics, and is properly managed.

2. As a corporate entity, the principles listed in the Cox Hazen and O'Neal formulation noted above describe the cooperative with the exceptions of principles four and five which apply only to a limited extent. The first three principles of the Solomon formulation apply.

3. All three of the modern formulation of cooperative principles apply –

The User-Owner Principle: Farmer-members who deliver product to the cooperative are the same farmer-members who own and finance the cooperative.

The User-Control Principle: Farmer-members who deliver product to the cooperative also control the cooperative.

The User-Benefits Principle: The cooperative's sole purpose is to provide and distribute benefits to the farmer-members on the basis of their use of the cooperative, in this case marketing their commodity through the cooperative.

4. Each producer's membership is evidenced by a share of membership stock that carries the right to vote and otherwise participate in the cooperative but carries no rights to dividends on capital stock or other methods of distributing cooperative net margins.

5. The cooperative's financial structure consists primarily of equity capital contributed by its members and borrowed capital obtained from outside sources.

6. The cooperative entity owns all assets needed for its processing and marketing functions.

7. Equity capital is obtained from farmer members through a retained patronage refund system by which the cooperative pays a portion of patronage refunds in cash and a portion in equity certificates evidencing investment in the cooperative by each farmer member.

8. A revolving fund system is used in which equity contributed by each farmer member is redeemed at some future date as the old equity is replaced by incoming equity, all based on the needs of the cooperative as determined by the cooperative's own board of directors.

9. Each member has a right to vote in the affairs of the cooperative and select the board of directors on a one-member, one-vote basis.

10. Members of the board of directors are cooperative farmer-members.

11. Upon delivery, the cooperative pays each member a current market price for the product as determined by market conditions.

12. The cooperative incurs all expenses of processing and marketing after it receives the members' product.

13. Net margins are calculated by subtracting from the total income generated by final sales all expenses, including cost of goods sold based on amounts paid members at delivery.

14. Net margins each year are allocated to individual members in proportion to the value of commodity they delivered to the cooperative during the fiscal year.

15. Allocated net margins are paid to members after the end of the cooperative's fiscal year but within eight and one-half months of the end of the fiscal year.

16. Cooperative losses are allocated to each member-patron in the same proportion as net margins are allocated.

Analysis of changes in the following four dimension brought about by cooperative participation is based on application of:

1. Corporate principles;
2. Cooperative principles;
3. Contractual characteristics of cooperative arrangements; and
4. Contractual characteristics of the cooperative as a corporate entity as conceived in the nexus-of-contracts theory.

Vertical Dimensions

A contract's "vertical" dimension determines the initial and terminal stages in the supply chain at which the rights and obligations of a contract are imposed on a farmer producer and on the buyer. A contract that only calls for delivery of a product under times, prices, and conditions established in the contract leaves the producer free to engage in any kinds of activities necessary to meet the terms of the contract. Nothing in the contract touches the farmer's participation in the supply chain, at this stage primarily the production process, before the product specified by contract is delivered. Contract vertical dimensions may, of course, reach further upstream in the process when, as an example, the contract requires a particular production process, specified genetics, or limits production to identified land.

The vertical dimension at the other end of the supply chain may similarly vary. If the contract requires only delivery and if payment is complete at the transaction's end, the farmer has no further involvement in the supply chain. Nothing that happens in the supply chain beyond that point is relevant to the contracting producer by terms of the contract. This dimension, too, can be modified to extend the contracting producer's reach further downstream. An example

would be a contract that adjusts the final price paid to the farmer depending on final market conditions or that requires the buyer to process the product in a particular way or otherwise provide described inputs.

For the example used in this paper, vertical dimension is concerned primarily with downstream activities in which the farmer's commodity is further processed and marketed.

Contract Only

The vertical dimension of the example contract ends when the farmer delivers the commodity to the buying firm. The farmer has no further obligations regardless of what the buying firm does with the product and has no rights to any income or profit generated by the buying firm regardless of the profitability of further processing or marketing. The farmer has no contractual relationships with other parties following delivery. The farmer is not subject to any market forces beyond the delivery point and satisfaction of specific contract terms. In short, the farmer's participation in the market system through the supply chain terminates completely.

Example Cooperative

Delivery to the example cooperative does not terminate the farmer's vertical participation in the supply chain. Given the treatment of the cooperative-member relationship as a part of the internal contractual relationships in a cooperative firm, the member's vertical contract dimension is extended with the following characteristics:

1. The farmer obtains an interest in the economic and business consequences of further processing and marketing. This includes the income received from marketing the new product by the cooperative as well as the expenses of processing and marketing.
2. The market forces for this segment of the supply chain are separate from and in addition to those that are inherent in the example production contract. Market forces which are a part of the farmer's new position in the supply chain now include all those affecting the final product, not only the commodity delivered. These forces have a direct impact on the farmer-producer.
3. The farmer's right to share in the net margins generated in the supply chain extends beyond commodity delivery to the cooperative. It now includes the income produced in commodity processing and final product marketing.
4. Farmer-members also take on obligations to meet whatever requirements may exist for further processing and marketing, including risks in the processing operations and risks of the market in which the final product is sold.

Horizontal Dimensions

A contract's "horizontal" dimension defines to what extent, if any, the performance of one contract is dependent on the performance by another of a separate contract. Satisfaction of the terms of a contract are determined only by the behavior of each party to the contract. Most production contracts are "stovepipe" in structure. That is, they are contracts binding only two parties. A buyer may have a multitude of such contracts with producers, but the rights and obligations of the contract flow only between the producer party and the buyer party. Exceptions, of course, exist to this general practice. The starkest exception is the much discussed and disputed tournament pricing system for some products, particularly in an integrated system. The price ultimately paid to a producer under such situations depends to some degree on the performance of competing producers. For the most part, however, the contractual rights and obligations of parties to a single contract are bounded only by the contract and not by the behavior of others.

Example Contract

A producer who is a party to the example contract is obligated only to adhere to the contract between that producer and the buying entity, has no obligations to any other party, and has no rights to mandate performance by any other party. The contracting producer is not affected by the performance of any other producer. Similarly, another producer's failure to meet the terms of the other producer's contract will not have an impact on the rights and obligations of the contracting producer. There is no horizontal relationship in the example contract.

Example Cooperative

Cooperative member rights and obligations are shared among producers (horizontally) in at least two ways. At the first level, the producer's interest in the cooperative is directly affected by another producer's failure to meet the terms of the contract. This occurs because the performance of the cooperative entity is thereby affected and thus the value of the cooperative to the farmer. This horizontal relationship is found in contractually-based rights and obligations sometimes described by statute. A typical cooperative incorporation statute provides:

(a) The by-laws or the marketing contract may fix, as liquidated damages, specific sums to be paid by the member or stockholder to the association upon the breach by him of any provision of the marketing contract regarding the sale or delivery or withholding of products; and may further provide that the member will pay all costs, premiums for bonds, expenses and fees, in case any action is brought upon the contract by the association; and any such provision shall be valid and enforceable in the courts of this State; and such clauses providing for liquidated damages shall be enforceable as such and shall not be regarded as penalties.

(b) In the event of any such breach or threatened breach of such marketing contract by a member, the association shall be entitled to an injunction to prevent the further breach of the contract and to a decree of specific performance thereof. Pending the adjudication of such an action and upon filing a verified complaint

showing the breach or threatened breach, and upon filing a sufficient bond, the association shall be entitled to a temporary restraining order and preliminary injunction against the member.

More generally applicable horizontal relationships are found among producers who are members of a cooperative, in contrast to those who are not, are found at the cooperative level. Once the commodity enters the cooperative the new characteristics of processing, value-adding, and marketing take over. The vicissitudes of the processing and marketing described for the example cooperative are shared among all cooperative members. Members have a right to the net margin, or obligations for net loss, generated by the cooperative. Operations leading to such net margins or losses are homogeneous and not identified with any particular producer or producer contract. The producer does not trace the progress of the delivered commodity beyond delivery and cannot isolate expenses and income attributed to that commodity. Without such tracing, “stovepipe” rights and obligations do not exist. Rights and obligations related to net margins or losses are based on the contractual relationships between the cooperative and the members delivering product to the cooperative. The net margins or losses are aggregate margins or losses for the cooperative organization as a whole and are thus shared among all members.

Viewed as contractually-based, the arrangements inherent in cooperative membership and patronage provide that margins and losses are shared among all members based on business done with the cooperative. The dimensions of contract extend horizontally.

Temporal Dimensions

Contracts take effect – begin in time – when the parties become bound by the rights and obligations that define the agreement. Similarly, contracts terminate when the parties have satisfied their obligations. Though easily stated, this “temporal” dimension occasionally becomes embroiled in issues of whether the contract has been completed. For our purposes, the important principle in the temporal dimension of a contract is the length of time the parties, whether producers or buyers, are in some way affected by lingering terms of the contract.

Example Contract

The producer’s contractually-based rights and obligations begin when the contract is executed and terminate when the contractual terms are satisfied. In our example, that event occurs when the commodity is delivered to the buying entity and the buyer makes payment as required by production contract.

Example Cooperative

Contractual rights and obligations commonly inherent in cooperative membership extend the time during which the contractual terms affect the producer well beyond the point at which delivery is made. Two cooperative characteristics determine the time during which a producer

has rights and obligations with respect to the cooperative. This is the case even where a marketing agreement has termination provisions identical to the example contract.

Cooperative members often have an ongoing relationship with the cooperative because they are continuing members. Membership itself may convey either a requirement that the member market through the cooperative or at least give the right to market through the cooperative to the extent chosen by the farmer. No specific beginning point in time at which contractual rights and obligations take full effect is clearly identified. To the extent that the temporal initiation boundary is not defined, contractually based rights and obligations may exist in some form before an explicit contract would normally be recognized under general principles of contract law. Indeed, continuing cooperative membership may be viewed as a kind of contract in itself.¹⁵

The most immediate of the downstream contractual sources of extension is the patronage refund process. Following delivery and initial payment, producers still do not know what their final compensation will be. The producer has rights to future payments and the cooperative has an obligation to make those payments. The cooperative determines net margins to be allocated to patrons based on the year's operations. Those net margins can only then be distributed to members. Distributions are typically made months after the date at which the farmer delivers to the cooperative and the time the relationship would be terminated in the case of the example contract. In pooling arrangements, the final compensation may be determined even later upon pool closing.¹⁶

The example cooperative includes rights and obligations that extend substantially longer into the future. The cooperative's financial structure is integrally tied to the patronage relationship. In the revolving fund system described above, the investment made in the cooperative by the farmer member will be revolved out – redeemed – some time in the future. The farmer's rights and obligations do not end until the farmer has received all investment back and the cooperative has no more obligation to the member for retained equities. The period from investment to redemption, called the "redemption period," may extend for many years. (Cobia, *et al.*). Thus, the farmer's contractual relationships in the supply chain do not end until years following the initial contract, membership, and delivery to the cooperative.

The two latter temporal dimension extensions are interrelated. Typically, the redemption period depends on both the cooperative's capital needs and the rapidity with which the cooperative can replace old equity with new, which in turn depends on the equity acquisition

¹⁵ Contract theory has developed for what are termed relational contracts. The thought is that contracts existing in the context of ongoing, repeated relationships may have significantly different characteristics from one-time contracts. (Macneil (1978), Macneil (1985), and Barnett).

¹⁶ Buccola, Cobia, and Jermolowicz summarize differing perspectives of cooperative pooling.

systems. For example, some cooperative members may wish to have patronage refunds paid in a high proportion of cash. This yields less addition to capital to replace existing capital. Thus, the balance of cash and equity investment affects all cooperative members and represents another example of expanded horizontal as well as temporal contract dimension.

Boundaries of the Firm

Contract dimensions defined by “boundaries of the firm” determine how “involved” each contract party is in the business affairs of the other. The internal workings of a firm include a large collection of relationships such as those that relate to financing, investment, property ownership, control, planning, execution, generation of firm income, incurrence of firm expenses, marketing, purchasing, determination of profit or loss, tax obligations, and allocation of profit or loss, among others. Corporate principles summarize characteristics of the entity. All of these exist in a corporate buyer of farm products. The question is to what extent, if any, does a producer become party to those relationships merely by becoming a party to a production contract.

Example Contract

The example contract by which a producer agrees to sell to a buyer has nothing to do with any of the above noted relationships. The boundary of the firm is established. In a typical production contractual arrangement the contract does not bring the farmer producer into contact with any of the firm’s internal structure or workings. Thus the producer contractor is isolated and effectively insulated from the firm’s fortunes, whether good or ill, and owes nothing to the firm other than what the contract requires.¹⁷

Example Cooperative

This dimension of typical contracts is dramatically expanded when the corporate buyer is a cooperative in which the producer actively participates as member patron.¹⁸ All of the rights and obligations inherent in both corporate principles and cooperative principles are part of the cooperative member producer’s involvement in the supply chain. These include, in summary terms, rights and obligations relating to the following corporate (cooperative) characteristics, none of which are present in those of the example contract:

1. Direct participation in control of a processing and marketing firm;

¹⁷ This statement must be modified, of course, if the firm’s condition affected its ability to meet its contractual obligation or if future relationships are considered.

¹⁸ Some aspects of cooperative boundaries are discussed in Baarda (2003).

2. Oversight of management in a processing and marketing firm, including employment of professional management;
3. Participation in capital markets, normally but not exclusively credit markets;
4. Investment of equity in a processing and marketing firm;
5. Sharing profits and losses in a processing and marketing firm;
6. Risks of a business operating in a volatile and highly competitive market;
7. Agreements in suppliers, buyers, and service providers at all levels of the organization;
8. Extended business rights and obligations based on the cooperative's acquisition and ownership of assets.

A brief note on development in cooperative theory further demonstrates the special interest in the boundaries of the cooperative firm as compared to those of other types of businesses. Of course, from a strictly legal perspective a cooperative is just as much an entity as a corporation. That is only a technical issue and does not address the full implications of firm and contract principles the subject of this paper.

We have made the assumption to this point that the cooperatives is indeed an entity with the assigned characteristics of a corporation, modified with cooperative principles. This is a realistic and practical assumption. If, however, no entity in fact existed in the case of a cooperative, all rights and obligations binding the producer to the supply chain would be purely contractual. They would fall directly into the framework suggested in this paper without the need to hypothesize contract rights and obligations in a nexus-of-contracts or related approach.

Early cooperative theory took this very approach.¹⁹ Emelianoff opened the discussions of cooperative theory with a view that a cooperative is not really a "firm" at all. It operates only at cost and generates neither profit or loss. Its objective is not to accumulate capital for the benefit of its owners. The basic characteristics of a business entity are not recognized by the cooperative itself but only by its members. In this view, a cooperative is only a mechanism by which farmers can participate directly, though collectively, in the supply chain as a form of vertical integration.

Robotka and Phillips accepted Emelianoff's general assumptions and refined the concepts by couching the principles in economic terms. Phillips in particular viewed farmer producers as independent firms while the cooperative took the role of a jointly owned plant. "When a group

¹⁹ Several overview articles summarize cooperative theory development from an economics perspective. They include Vitaliano, Staatz (1987), Royer (1978), and Torgerson.

of individual firms forms a cooperative association, they agree mutually to set up a plant and operate it jointly as an integral part of each of their individual firms (or households in the case of a consumer cooperative). The cooperative has no more economic life or purpose apart from that of the participating economic units than one of the individual plants of a large multi-plant firm. ... It is technically correct to speak of the cooperative plant and of cooperating firms, but not of the cooperative firm.”

The Emelianoff-Phillips de-emphasis of the firm characteristics of a cooperative was expectedly challenged.²⁰ Several themes of cooperative theory continue to emphasize the economic firm nature of a cooperative. At the same time, the heterogeneity of membership and the unique methods of decision-making in a cooperative were early recognized in parallel streams of thought. A coalition approach focused on characteristics of the cooperative-membership relationship familiar to those in contracting situations in which conflicts are identified, solutions reached through bargaining processes, and decisions implemented through binding arrangements between the cooperative and its members as well as among members. This view of cooperatives remains a useful means by which to describe individual farmer participation in the supply chain through cooperative membership.

A substantial amount of more recent cooperative theory incorporates contract theory directly to investigate the nature of a cooperative. Staatz (1987, p. 85) noted:

What is crucial is not how we label the cooperative, but the nature of the contractual relationship among various participants in the organization (farmer-members, managers, other employees, board members, etc.). It is the nature of these implicit and explicit contracts that determines the degree of member or managerial control, the degree to which the cooperative achieves goals similar to those of a vertically integrated firm, and so on.

It is also this contract-based analysis that determines the level, kind, and complexity of a producer’s participation in the supply chain when viewed from the farmer-member’s perspective. Contract-based theories applicable to firms and cooperatives clearly but implicitly address contractual dimensions of farmer participation in the supply chain. Agency theory, the nature of residual claims, transactions costs, governance structure, neoclassical and relational contracting, trust in transactions, indeterminacy, and game theory are only some examples of analyses that can investigate membership in a cooperative from the cooperative’s perspective.²¹ The rights and obligations established by farmers can be elucidated when the boundaries of the cooperative are

²⁰ Royer (1994) summarized the reactions in his retrospective of Phillips’ classic article and its role in cooperative theory. Staatz (1994) likewise noted the limitations in a narrow view of the cooperative firm.

²¹ These are summarized by Staatz (1987).

carefully considered as can the implications of new contractual dimensions resulting from cooperative membership.

Contractual Significance of New Dimensions

New dimensions of contract as described above can be further analyzed by comparing itemized substantive contractual terms inherent in the dimensional definitions. Contracts can be analyzed by taking separative provisions that establish rights and obligations with respect to each topic in the overall document creating the contract.

Substantive Elements of a Contract

The terms in contracts that define the rights and obligations of the parties are peculiar to each contract.²² They are tailored to the subject matter, the wishes of all the parties, the requirements and prohibitions of law, and the economic forces prevalent in the industry. Nevertheless, it is useful to outline the issues that will be addressed explicitly or implicitly in almost all production contracts. These are the “elements” of the contractual relationship for our purposes. The contrast between simple production contracts and cooperative participation can be compared directly term-by-term using the contractual formulation for each.

The main contractually-conceived distinctions between production contracts and cooperative membership as discussed in this paper are listed in Table 1. In keeping with the paper’s objective to describe producer participation in a cooperative in terms of contracts, the right-hand column includes the essentials of cooperative-member patron relationships described as contractual arrangements. Each entry in the table summarizes the rights and obligations set applicable to the substantive contract element.

Conclusions

Describing a producer’s participation in the supply chain by investigating the rights and obligations the producer takes on by choice appears to be a useful endeavor. Further, applying rights and obligations in a contractual framework reflects the real world of the agricultural marketing system in terms entrepreneurs appreciate.

When farmer producers decide to participate actively “beyond the farm gate” through value-added cooperatives, they incur new sets of rights and obligations. While various rights and

²² Contracts do not stand in isolation either at their initiation or during their effective period and performance. Contracts are influenced by matters beyond the substantive elements actually incorporated in the contract by the parties. These may be called “ancillary” elements and are not included in the present discussion though they may be important to understand the totality of the contractual rights and obligations for relevant situations. Only in the context of ancillary elements are contracts actually made and executed.

obligations are usually summarized as cooperative membership, contract principles can be used for analysis with only a small adjustment from production contracts, to actual contractual relationships as cooperative members, to full blown treatment of all such relationships as fundamentally contractual in character. The cooperative and its relationship to members is no longer a homogeneous aggregate but becomes, as in corporate theory, a set of transactions described by a “nexus-of-contracts.” These transactions and the associated contracts are amenable to a broad tool set from legal and economic analysis.

The contractual analysis of a producer’s participation in the supply chain when a producer uses a cooperative to do so yields seven benefits for analysis.

1. The producer’s relationships with the cooperative, at least the relationships that bear the force of enforceable agreements, can be broken down with this analysis. In this way particular rights and obligations can be separated, analyzed, and compared. A producer’s new roles in the supply chain can be identified and explained with greater clarity.

2. Casting the timing, extent, and manner in which farmer producers participate in the supply chain in terms of contracts opens many problems to analysis using principles that have been developed for contracts, a substantial body of research indeed. New approaches to investigating cooperatives, cooperative principles, and cooperative economics becomes available to the researcher and to cooperative participants alike.

3. Cooperatives can be designed to offer producers their most desired participation in the supply chain if a contractual analysis is applied carefully. Member-cooperative agreements can be supplemented by additional terms in articles of incorporation, bylaws, and ancillary agreements with the implications of each subject to scrutiny. Each aspect of the relationship becomes visible as a separate subject for consideration and analysis.

4. The very definition of a cooperative – a current issue of substantial importance – lends itself to the contractual approach when viewed from the producer’s perspective.²³ The panoply of

²³ Some state incorporation statutes have been modified significantly to allow relationships not traditionally considered “cooperative.” In Minnesota, the law is CHAPTER 105-H.F.No. 984; An act relating to cooperatives; authorizing businesses to organize as cooperative associations; providing penalties; amending Minnesota Statutes 2002, sections 80A.14, subdivision 17; 80A.15, subdivision 2; 322B.70, subdivision 1; proposing coding for new law in Minnesota Statutes, chapter 322B; proposing coding for new law as Minnesota Statutes, chapter 308B. Wyoming was the first to enact such a statute. The National Conference of Commissioners on Uniform State Laws has created a Study Committee on a Business Cooperative Act to address the possibility of developing a new cooperative law for State consideration. Drafts are being prepared for consideration. Wisconsin is also considering a similar statute.

rights and obligations yielding results envisioned by cooperative principles can be organized around the position of a producer who is a cooperative member. When the nexus of various applicable contracts leads the producer into a position conforming to that describes by principles of cooperation, the producer may feel comfortable that participation in the supply chain has been well-designed.

5. Producers make decisions about the timing, extent, and manner in which they wish to participate in the supply chain. Production contracts of many kinds are one option. Cooperative membership may be another. By focusing on the contractually based rights and obligations to which a producer agrees when becoming a cooperative member, producers can make informed decisions about the method they wish to utilize as they engage first in farming and then in marketing their product.

6. The contract approach to supply chain participation through cooperatives also facilitates a focus on the producer's relationship to the market system rather than as an investor in a corporate entity. This clarifies a producer's understanding of what cooperative membership means. It helps explain the value of the cooperative as a means to increase farm income rather than enhance invested funds. It identifies consequences of decisions that may seem at first glance to relate only to the cooperative as a corporate entity but in reality are a nexus of contracts binding the producer to market forces.

7. Cooperation among farmers is not by any means limited to a formal cooperative that exhibits all of the principles discussed in this paper. Farmers have an almost unlimited range of alternatives to cooperate to whatever degree they desire. Each method will result in a set of rights and obligations for all parties involved. The contractual approach as outlined in this paper offers a method by which to determine which forms of cooperation will best meet the needs of each producer individually and of all producers collectively.

In summary, if the contractual view of cooperative membership and patronage is realistic and pragmatic, it offers two benefits. First, it provides a new way to look at farmer cooperation and farmer's participation in the supply chain. The result is a greater degree of flexibility that reflects the greatly expanded collection of arrangements farmers have available to them. Second, it brings to the table new analytical tools that have been developed in heretofore unrelated subdisciplines of law and economics.

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Table 1 – SUBSTANTIVE CONTRACTUAL CHARACTERISTICS COMPARED

Terms in Example Production Contract

Terms in Cooperative Contractual System

1. The Parties – Identification

Only the farmer producer and the buyer are parties to a single contract

The farmer producer and the cooperative are parties to a marketing agreement, if one exists

Producers are parties among themselves as joint contractors

Producers are parties among themselves through articles of incorporation, bylaws, other agreements internal to the cooperative

Producers are parties among themselves as participants in statutory cooperative corporation in which they share rights and obligations as stakeholders

Producers are parties indirectly between themselves and other entities in the supply chain, common to the market system

The Parties – Relationship

Relationship is only as parties to a contract
 Rights and obligations are based on contractual “good faith” performance required by ordinary contract law
 One-time contract, with following contracts to be renegotiated

Relationship is that of parties to a contract between producer and cooperative

Relationship is defined as substantially contractual in character through articles of incorporation and bylaws, though with modifications

Relationship is that of contractual parties to internal contracts as conceived in the nexus-of-contracts view of the corporate entity

Some relationships involve rights and obligations that carry fiduciary duties found in corporate entities but not found in mere contracts

Contracts are more relational with expectations of further transactions that are integrally tied with current transaction

2. Product – Identification.

Product is identified in the contract to be delivered to the buyer by terms of the contract

Product is identified in the contract to be delivered to the cooperative
Total system of contracts within the cooperative includes intermediate and final product to be marketed by the cooperative, benefits of which are shared with members as patrons, though commodity identification ends at producer delivery

Product – Quantity

Contract specifies amount required from producer, with possible ranges

Amount required from producer, with possible ranges, is specified by agreement or by general authority granted to the cooperative

Cooperative may also establish quantities based on specific needs apportioned among all producer members based on cooperative processing and marketing capacities

Product – Quality

Quality is specified in production contract

Quality is specified in marketing agreement or bylaw provisions

Product – Origin

May or may not be contracted

May or may not be contracted

3. Price – Set

Price to be paid producer at delivery is set in contract

Initial price or advance paid to producer is set by marketing agreement or other agreement

Final price paid will be modified by payment of subsequent patronage refunds payments dependent on net margins available for allocation and distribution

Price – Market-determined

Product to be priced at commodity market rate upon delivery

Product to be priced at commodity market rate upon delivery
Final price will depend on a different market – that of the final product sold by the cooperative after processing

Contract terms specifying this result may be found in marketing agreement, bylaws, or to some degree statutes

Price – Formula

Price is determined by exogenous factors by a formula agreed to in the contract

Price is determined by identified factors, some of which would be exogenous in the case of the non-cooperative example contract but that are endogenous in the case of a cooperative
Because product changes form during processing, transfer pricing may be used to allocate income and expenses

4. Delivery Conditions – Time

Time is specified in contract

Time is specified in contract or by direction of cooperative under additional terms of bylaws
Scheduling may be adjusted to assure member equity in cases of conflict among producers given limitations on receiving or processing capacities

Delivery Conditions – Method

Methods are specified

Methods are specified

5. Risk – Sources

Source of risk is producer non-performance of the contract, intentionally or because of production failure

Source of risk is producer nonperformance of contract, intentionally or by production failure

Source of risk is non-performance by buyer

Source of risk is added for cooperative members related to general performance of cooperative and net losses

Risks associated with market into which final product is sold

Risk – Scope

Limited to terms of production contract and application of contract law principles

Delivery risks limited to terms of marketing agreement, bylaw provisions, special statutory rules applicable to cooperative agreements

Limited to risks associated with contract performance

Risk of loss related to degree of monetary loss by cooperative, to be recovered from producer by terms of articles, bylaws, other internal contractual rights and obligations

Limited liability for members of cooperatives with applicable corporate limited liability laws – loss is limited to amount of investment in the cooperative

Risk – Allocation

Allocated by agreement of parties as stated in contract, on the basis of title, application of contract law principles

Risk associated with specific marketing agreement is specified in the agreement, statutes, bylaw provisions

Each producer bears entire risk of contract and shares no risk of another's non-performance

Risk of loss at cooperative level is allocated to producers primarily on patronage basis

Ability to allocate risk to the cooperative rather than to patrons is limited because members ultimately absorb cooperative losses, with some avoidance techniques based on allocating cooperative risk to others
Producer risk may be reduced by the sharing process peculiar to cooperatives, pooling and other pricing mechanisms as defined in the bylaws

6. Ownership – Title

Transfer of title by terms of contract

Transfer of title by terms of contract, bylaw provisions.
Producer may maintain title until product to some point during or after point at which processing occurs
Producer obtains no title to transformed commodity, cooperative owns final product to be sold

Title – Rights and Obligations

Title transfer normally terminates producer interests

Transfer of title does not terminate producer interests in what happens to product
Farmer producer does not hold title to final product but compensation under terms of the marketing agreement and other internal contractual relationships depend on disposition of final product

7. Performance – Measurement and Standards

Established by terms of contract and application of contract law

Established by terms of marketing agreement, bylaw provisions, contract law

Performance – Consequences of Breach

Primarily based on contract law, with some authority to specify consequences in contract
Normally limited to monetary damages

Based on contract law with more options given to cooperatives by some cooperative statutes, possibly including liquidated damages and injunctions
Cooperative may impose additional detriments such as expulsion of member from cooperative
Producer may be subject to other cooperative techniques to reduce or cover losses such as liens on producer equity

Performance – Enforcement

Contract may require arbitration, otherwise legal action is available

Contract may require arbitration, otherwise legal action is available
