

THE APPLICATION OF SECURITIES LAWS TO COOPERATIVES: A CALL FOR EQUAL TREATMENT FOR NONAGRICULTURAL COOPERATIVES

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I. INTRODUCTION

In 1990, the United States Supreme Court decided *Reves v. Ernst & Young*.¹ Whether promissory notes that were issued by an Arkansas cooperative constituted securities was at issue in *Reves*.² The cooperative had marketed the loans as an investment in the cooperative, had issued the notes to nonmembers as well as members, and had paid a floating rate of interest that was higher than that offered by local banks.³ The notes issued were demand notes—payable upon the demand of the lender.⁴ The issues decided by the Court were: (1) whether demand notes were exempted from coverage by the securities laws under an exemption for notes issued for nine months or less; and (2) the criteria for determining whether notes with a maturity date in excess of nine months were within the purview of the securities laws; that is, whether the notes were an investment or a commercial venture.⁵ With regard to the first issue, the Court found that demand notes were securities.⁶ On the second issue, the Court found that these notes were investments and

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1. *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

2. *Id.* at 58.

3. *Id.* at 58-59.

4. *Id.* at 58.

5. *Id.* at 60, 67.

6. *Id.* at 73.

enunciated a test for making this determination in the future.⁷ The Court's holding with regard to the first issue invoked the application of the securities laws. The failure to register the securities and provide truthful information when they were issued gave rise to a private right of action by the lenders, which resulted in a significant damage award.⁸ Given the facts of the case, the Court's decision was not startling.⁹ What was startling, however, was the fact that the cooperative status of the issuer was not mentioned in the opinion, nor that it did not appear to be a factor in the decision.¹⁰

Failure to raise the issue of the cooperative status of the notes' issuer was noteworthy because the United States Supreme Court had previously decided in *United Housing Foundation, Inc. v. Forman*,¹¹ that stock issued by a housing cooperative was not a security,¹² and the federal securities laws provide certain exemptions for securities issued by certain agricultural cooperatives.¹³ Thus, many cooperatives were led to assume that the stock and notes they issued were not securities within the definitions contained in federal and state laws.

The purpose of this Article is to review the application of federal and state securities laws to cooperative stock, notes, and other investments in cooperatives—whether equity or debt—as it has evolved since the *Reves* decision. The following analysis will show that many unresolved questions exist regarding the application of the securities laws to stock and notes in general and to cooperatives in particular. In addition, the various exemptions for cooperative securities will be reviewed and analyzed for their continued viability.

II. COOPERATIVE DEFINED

While cooperative enterprises have existed since time immemorial,¹⁴ the form of cooperative business that is widely used and regulated today first

7. *Id.* at 65-67.

8. *Id.* at 69-71.

9. In *Reves*, a cooperative filed for bankruptcy after issuing over \$10 million in notes to over 1600 members and nonmembers of the cooperative. *Id.* at 59. These notes were uncollateralized and uninsured. *Id.* at 69. The note holders sued the accounting firm responsible for auditing the financial statements of the cooperative, alleging that the firm failed to use generally accepted accounting principles in auditing the cooperative and that the firm had committed a violation of the 1934 Securities Exchange Act's antifraud provisions. *Id.* at 59.

10. It may be that because the notes were offered and issued to members and nonmembers alike an argument based on the cooperative status of the business was obviated.

11. *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975).

12. *Id.* at 847.

13. 15 U.S.C. § 77c(a)(5)(B) (1994).

14. In 1735, Ben Franklin opened what is considered the first American cooperative enterprise, a mutual fire fighting company. JOSEPH G. KNAPP, *THE RISE OF AMERICAN COOPERATIVE ENTERPRISE: 1620-1920*, at 7 (1969). Joint efforts in home construction were also found in New England. *Id.* at 5.

came into use in the mid-nineteenth century.¹⁵ The first state to adopt a cooperative incorporation statute was Michigan in 1865.¹⁶ Economic democracy was the guiding principle behind the cooperatives and remains so today.¹⁷ From this principle came the characteristics, also called cooperative principles, that are accepted as distinguishing cooperatives from other forms of business organization.¹⁸ These characteristics are member-user ownership of the cooperative, democratic control (usually meaning one vote per member regardless of how many shares or how much equity owned), payment of patronage dividends based on usage of the cooperative, and limited return on capital, which is usually no more than eight percent.¹⁹ While not generally considered cooperative principles, other common characteristics of cooperatives include the limited or nontransferability of stock and the inability of its stock to appreciate in value.²⁰

The three most common forms of cooperatives are consumer, agriculture (producer), and worker (production) cooperatives.²¹ Consumers have formed food, housing,²² childcare cooperatives,²³ electric and telephone cooperatives,²⁴ and other similarly oriented cooperatives.²⁵ Patronage in these cooperatives is determined by the amount of goods or services purchased or

15. *Id.* at 39. The first modern cooperative society using what today are recognized as cooperative principles is credited with being formed by a group of workers in Rochdale, England, in 1844. *Id.* at 30.

16. *Id.* at 32. Massachusetts followed suit in 1866, Pennsylvania in 1868, and Minnesota in 1870. *Id.* Seven other states passed laws by 1895. EDWIN G. NOURSE, *THE LEGAL STATUS OF AGRICULTURAL CO-OPERATION* 39-44 (1928).

17. NOURSE, *supra* note 16, at 29-30.

18. *Id.* at 14-20.

19. *Id.* Other noneconomic principles generally accepted for cooperatives are cooperation among cooperatives and political neutrality. *Id.* at 21-23; see also JERRY VOORHIS, *COOPERATIVE ENTERPRISE: THE LITTLE PEOPLE'S CHANCE IN A WORLD OF BIGNESS* 19 (1975) ("Cooperatives exist to meet the needs of the people who form them rather than to provide a high return on invested capital.").

20. *COOPERATIVE/CREDIT UNION DICTIONARY AND REFERENCE* 56 (Jack McLanahan & McLanahan eds., 1990) [hereinafter *COOPERATIVE DICTIONARY*]. See, e.g., HAW. REV. STAT. ANN. § 421H-1 (Michie 1993 & Supp. 1996) (defining limited-equity housing cooperative in terms of transferability of stock); IOWA CODE § 499.17 (1997) (providing that generally common stock in cooperatives is not transferable); WIS. STAT. ANN. § 185.21(6) (West 1995) (defining general rights of cooperative stock holders).

21. VOORHIS, *supra* note 19, 187-91 (1975); see also *The Co-Op Home Page—Co-Op Primer* (visited Feb. 21, 1998) <<http://www.cooperative.org/coop.htm>>. Credit unions are a form of financial cooperative, but because they are regulated differently, they will not be considered in this Article.

22. VOORHIS, *supra* note 19, at 163-64.

23. *COOPERATIVE DICTIONARY*, *supra* note 20, at 51 (defining child care cooperatives).

24. Electric and telephone cooperatives are regulated by federal and state laws and therefore, are not considered in this article.

25. See VOORHIS, *supra* note 19, at 163-64.

used by the member.²⁶ Workers have formed worker or production cooperatives.²⁷ These cooperatives may be retail or wholesale operations that sell goods or services to the public, or engage in the production of goods sold to the public.²⁸ Patronage in these cooperatives is based on hours worked or salary paid.²⁹ Farmers, among others producers,³⁰ have formed marketing or agricultural cooperatives³¹ to market their products.³² Patronage in these cooperatives is based on the amount of goods marketed through the cooperative by the member.³³ While the focus of each of these forms of cooperatives is somewhat different, they do share a similar commitment to cooperative principles and a desire to improve the individual's economic situation by banding with other individuals that have similar economic interests in a democratic and fair manner. There currently exist many more consumer cooperatives than agricultural cooperatives and worker cooperatives.³⁴

Because of the limited return on investment and the one member-one vote requirements, it is extremely difficult for cooperatives to obtain equity capital from anyone other than its members.³⁵ The resulting lack of investment capital can have a negative impact on the cooperative's ability to initially form (or once formed, to expand) and compete competitively.³⁶ A

26. See COOPERATIVE DICTIONARY, *supra* note 20, at 56. While not a true consumer cooperative, groups of pharmacists or grocers have come together to form cooperative buying associations to obtain more favorable discounts. *Id.* at 48. Patronage dividends would be based on purchases just like in a consumer cooperative. *Id.* at 56.

27. *Id.* at 104.

28. *Id.* at 56; see also VOORHIS, *supra* note 19, at 17.

29. COOPERATIVE DICTIONARY, *supra* note 20, at 56.

30. Artisans and wild rice harvesters have also formed cooperatives to market their products.

31. In addition, to marketing their products, many agricultural cooperatives also sell farm supplies to their members. *Id.*

32. *Id.* at 88.

33. *Id.* at 20.

34. Of the 42,000 to 47,000 cooperatives, approximately 4100 are agricultural cooperatives. See Interview with Olivier Kpognon, National Cooperative Bank (Feb. 24, 1997) (on file with author) (stating that there were 38,000 nonagricultural cooperatives); *The Co-Op Home Page—Agriculture* (visited Apr. 20, 1997) <<http://www.cooperative.org/agri.htm>> (stating that there were 4100 agricultural cooperatives); *Co-Op Facts* (visited Apr. 20, 1997) <<http://www.access.digex.net/~ncfc/members/cf.html>> (stating that there were over 4000 agricultural cooperatives). A 1994 article on the University of Wisconsin's Center for Cooperatives Web site listed the number of cooperatives at approximately 47,000. Viva Rochdale, 1994 *Is Declared Cooperative Year* (visited Feb. 24, 1997) <gopher://wiscinfo.wisc.edu:70/00/.info-source/coop/def-history/1994>.

35. VOORHIS, *supra* note 19, at 19; see also Lewis D. Soloman & Melissa B. Kirgis, *Business Cooperatives: A Primer*, 6 DE PAUL BUS. L.J. 233, 251 (1994).

36. Soloman & Kirgis, *supra* note 35, at 251. Imposing the burdens of the securities laws, as will be discussed below, is another impediment to cooperative formation due to the

cooperative's only source of capital is from its members.³⁷ A member provides capital to the cooperative in many ways.³⁸

Cooperatives usually require some initial investment to become a member.³⁹ These requirements include the purchase of one or more shares of stock or the payment of a membership fee or both.⁴⁰ This initial membership investment is one way that members provide equity capital to the cooperative.

Retained patronage dividends are a second form of economic interest that members often have in their cooperative.⁴¹ Cooperatives are required by federal tax laws and state incorporation laws to pay patronage dividends each year to their members.⁴² Cooperatives, however, are not required to pay the entire dividend in cash.⁴³ Instead, the amount not paid in cash is retained by the cooperative and credited to the member in one of several ways. For example, a member may receive stock, credit on a capital account, an equity certificate, or some other evidence of his or her retained patronage in the cooperative.⁴⁴ Retained patronage dividends thus provide another way for members to contribute equity capital to the cooperative.⁴⁵

A third and less common form of supplying capital to a cooperative is the purchase of additional nonvoting or preferred stock beyond the initial membership requirements. A cooperative might prefer this form to obtaining a loan, whether from members or a commercial source, because it creates a better looking balance sheet and limits the return on the investment.⁴⁶ Most cooperative incorporation statutes limit the dividends that may be paid on capital stock and no such limit exists on interest paid by cooperatives.⁴⁷

expense. See *infra* Part IV. Therefore, policy considerations should favor relaxed security regulation of cooperatives to encourage their formation.

37. See Soloman & Kirgis, *supra* note 35, at 250-51.

38. *Id.* at 251-57 (discussing the use of equity and debt finance for capitalization of cooperatives as well as lease agreements to acquire needed assets).

39. *Id.* at 242.

40. *Id.* at 239-45. Cooperatives may be formed on a stock or nonstock basis. The implications of using the nonstock form will be discussed below.

41. ISRAEL PACKEL, *THE ORGANIZATION AND OPERATION OF COOPERATIVES* § 51, at 186 (4th ed. 1970). Patronage dividends are based on a member's patronage, each member receiving a share of the cooperative's surplus (or profit) based on their percentage of patronage in the cooperative. *Id.* Many agricultural cooperatives simply retain a portion of the members' payment for their product on a per unit basis. *Id.* § 62, at 252-53. The per unit retention represents the members investment in their cooperative. *Id.*

42. See, e.g., I.R.C. § 1388 (1994); IOWA CODE § 498.23 (1997).

43. The federal tax law requires at least 20% be paid in money or by qualified check in order for the entire patronage dividend to be a deductible expense for the cooperative. I.R.C. § 1388(c)(1).

44. See Terence J. Centner, *Retained Equities of Agricultural Cooperatives and the Federal Securities Acts*, 31 U. KAN. L. REV. 245, 246 (1983).

45. *Id.* at 247.

46. Stock is equity and an asset on the balance sheet while a loan is a liability.

47. JAMES R. BAARDA, U.S. DEP'T OF AGRIC. COOPERATIVE INFORMATION REPORT 30: STATE INCORPORATION STATUTES FOR FARMER COOPERATIVES 112-13 (1982). See, e.g., Minn.

The fourth form of economic investment that members may make in their cooperative is to make a loan to the cooperative. This may take the form of advance payments for supplies to be purchased later or outright cash loans evidenced by promissory notes. Because cooperatives often are able to secure loans from members below market rates, which for members are above-market returns on their cash, it is a win-win situation for both cooperative and member. Loans are not generally considered equity capital but rather debt.

It is, in theory, possible for nonmembers to make loans or own nonvoting stock in a cooperative, but it is not a widespread practice, the *Reves* case notwithstanding.⁴⁸ The limited rate of return on stock and the restrictions on the transfer of stock make nonmember investment in a cooperative rare. It has been common for ex-members to have nonvoting stock or some other economic interest in a cooperative after their membership in the cooperative is terminated.⁴⁹

These four types of economic interest in a cooperative may or may not come under regulation by the securities laws. A discussion of the current state of affairs is discussed below.

III. SECURITIES LAW INTRODUCTION

Regulation of investment practices and markets began in the 1930s in response to the perception that security sale abuses were in part responsible for the stock market crash in 1929 and the resulting depression of the 1930s.⁵⁰ In order to prevent fraudulent practices regarding the sale or resale of securities, and to regulate the sale and resale of securities, Congress passed two laws—the Securities Act of 1933 and the Securities Exchange Act of 1934.⁵¹ The Securities Act of 1933 regulates the initial sale of securities.⁵² The Securities Exchange Act of 1934 controls the market for securities by

Stat. Ann. § 308A.131(1)(a)(10) (West 1996) (limiting dividends to 8% annually). There are no limits to interest paid on loans other than state usury laws.

48. See *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

49. Equity redemption raises certain issues for cooperatives. On the one hand, the difficulty of replacing the capital makes cooperatives unwilling to redeem the equity of departing members. On the other hand, members impatiently wait for their equity, claiming that current patrons should provide capital. Efforts to force cooperatives to redeem equity in the past have failed. Cooperatives are not required to redeem stock of members upon termination of membership; thus, leaving many ex-members with equity in the cooperative. Many cooperatives have adopted a revolving fund to redeem equity over a period of years. See L. HULBERT & M. NEELY, U.S. DEP'T OF AGRIC., *LEGAL PHASES OF FARMERS COOPERATIVES* 480-88 (4th ed. 1976).

50. THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* § 1.2 (1996).

51. Securities Act of 1933, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aa (1994)); Securities Exchange Act of 1934, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78ll (1994)).

52. See 15 U.S.C. § 77e (1994).

regulating brokers and dealers of securities and the exchanges where securities are bought and sold.⁵³

Both the Securities Act and the Exchange Act define the term "security," albeit in a slightly different way.⁵⁴ The definition of security is important because only those investment instruments contained in the definition are covered by the respective acts.⁵⁵

Briefly stated, the Securities Act operates generally to regulate the initial offering of securities to the public and prohibits the sale or delivery after sale of unregistered securities in interstate commerce.⁵⁶ The Securities Act defines

53. See *id.* § 78b. "Exchange" is defined very broadly to include the bringing together of sellers and buyers of securities. *Id.* § 78c(a)(1).

54. The Securities Act states:

The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Id. § 77b(1). The Exchange Act states:

The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a security; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Id. § 78c(a)(10).

55. This crucial issue will be discussed more fully *infra* Part III.A.

56. See 15 U.S.C. § 77e. The Securities Act does not apply, therefore, to securities sold only within one state, although individual state securities laws may well apply. *Id.* § 77c(a)(11).

the securities,⁵⁷ then lists exempted securities⁵⁸ and exempted transactions.⁵⁹ If the investment meets the definition of a security and there is no exemption

57. 15 U.S.C. § 77b(1); *see also infra* notes 82-84 and accompanying text.

58. 15 U.S.C. § 77c.

59. *Id.* § 77d. The Securities Act states:

The provisions of section 77e of this title shall not apply to—

- (1) transactions by any person other than an issuer, underwriter, or dealer.
- (2) transactions by an issuer not involving any public offering.
- (3) transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except—
 - (A) transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter,
 - (B) transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 77h of this title is in effect as to the security), or such shorter period as the Commission may specify by rules and regulations or order, and
 - (C) transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter.

With respect to transactions referred to in clause (B), if securities of the issuer have not previously been sold pursuant to an earlier effective registration statement the applicable period, instead of forty days, shall be ninety days, or such shorter period as the Commission may specify by rules and regulations or order.

- (4) brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders.
- (5) (A) Transactions involving offers or sales of one or more promissory notes directly secured by a first lien on a single parcel of real estate upon which is located a dwelling or other residential or commercial structure, and participation interests in such notes—
 - (i) where such securities are originated by a savings and loan association, savings bank, commercial bank, or similar banking institution which is supervised and examined by a Federal or State authority, and are offered and sold subject to the following conditions:
 - (a) the minimum aggregate sales price per purchaser shall not be less than \$250,000;

from registration contained in the Securities Act, it must be registered with the Securities Exchange Commission.⁶⁰ If the investment is a security and an exemption from registration exists, the security is exempt only from the registration provisions of the Securities Act and *not* the other provisions of the Securities Act, such as the antifraud requirements.⁶¹ If registration is required, a registration statement must be prepared with detailed information about the

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- (b) the purchaser shall pay cash either at the time of the sale or within sixty days thereof; and
 - (c) each purchaser shall buy for his own account only; or
 - (ii) where such securities are originated by a mortgagee approved by the Secretary of Housing and Urban Development pursuant to sections 1709 and 1715b of Title 12 and are offered or sold subject to the three conditions specified in subparagraph (A)(i) to any institution described in such subparagraph or to any insurance company subject to the supervision of the insurance commissioner, or any agency or officer performing like function, of any State or territory of the United States or the District of Columbia, or the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, or the Government National Mortgage Association.
- (B) Transactions between any of the entities described in subparagraph (A)(i) or (A)(ii) involving non-assignable contracts to buy or sell the foregoing securities which are to be completed within two years, where the seller of the foregoing securities pursuant to any such contract is one of the parties described in subparagraph (A)(i) or (A)(ii) who may originate such securities and the purchaser of such securities pursuant to any such contract is any institution described in subparagraph (A)(i) or any insurance company described in subparagraph (A)(ii), the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, or the Government National Mortgage Association and where the foregoing securities are subject to the three conditions for sale set forth in subparagraphs (A)(i)(a) through (c).
- (C) The exemption provided by subparagraphs (A) and (B) shall not apply to resales of the securities acquired pursuant thereto, unless each of the conditions for sale contained in subparagraphs (A)(i)(a) through (c) are satisfied.
- (6) transactions involving offers or sales by an issuer solely to one or more accredited investors, if the aggregate offering price of an issue of securities offered in reliance on this paragraph does not exceed the amount allowed under section 77c(b) of this title, if there is no advertising or public solicitation in connection with the transaction by the issuer or anyone acting on the issuer's behalf, and if the issuer files such notice with the Commission as the Commission shall prescribe.

Id.

60. *Id.* § 77f.

61. *See id.* § 77d.

investment.⁶² In addition, a prospectus is required to be given to all prospective investors.⁶³ The requirements for the registration form and prospectus are contained in the Securities Act.⁶⁴ Whether or not a security must be registered, the Securities Act provides for civil and criminal liability for untrue statements or omissions of material fact, such as fraud in the distribution of securities as that term is defined in the Securities Act.⁶⁵

The Exchange Act more generally regulates all aspects of securities trading. Registration and reporting requirements are imposed upon most

62. *Id.* § 77f(a).

63. *Id.* § 77e(b).

64. *Id.* §§ 77e-77f, 77j.

65. Civil liabilities arising in connection with prospectuses and communications.

(a) In general

Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable, subject to subsection (b) of this section, to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

(b) Loss causation.

In an action described in subsection (a)(2) of this section, if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) of this section represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.

Id. § 77l.

issuers of securities, securities dealers, and security exchanges.⁶⁶ It is unlawful for any broker or dealer to perform any security transaction on a national exchange unless the security has been registered.⁶⁷ In addition, certain over-the-counter equity securities must be registered.⁶⁸ Exemptions from registration for over-the-counter equity securities are contained in the Exchange Act.⁶⁹ Registration under the Exchange Act triggers the application of the rest of the Exchange Act provisions.⁷⁰ These include regular reporting requirements concerning all proxy statements, tender offers, purchases of more than five percent of any class of a corporation's equity securities, and purchases or sales by corporate officers, directors or beneficial owners.⁷¹ Price manipulation and other manipulative and deceptive practices are prohibited.⁷² Procedures for investigation by the SEC and civil penalties for violations of the law are contained in the Securities Exchange Act.⁷³ Investors that are injured by false information contained in the filings may bring civil suits.⁷⁴

Congress may regulate only interstate commerce; therefore, the Acts generally do not apply to securities sold only within one state.⁷⁵ All states, therefore, have some form of securities legislation to regulate the sale and exchange of securities within the state.⁷⁶ Many states have adopted a version of the Practising Law Institute's Uniform Securities Act.⁷⁷ The state schemes are similar to that of the federal laws because registration of securities issued or sold within a state is required unless the instrument is not defined as a security, the security is exempt, or the transaction is exempt.⁷⁸ Some states go beyond mere registration and disclosure requirements, however, and review the merits of the investment before it can be offered in the state.⁷⁹ Most states also regulate broker-dealers within the state.⁸⁰ State laws provide various remedies for violations of the laws, including private right of actions and

66. 15 U.S.C. § 78l.

67. 15 U.S.C. § 78l(a).

68. *See id.* § 78l(g)(1). Over-the-counter debt securities are not directly covered by the Act, except the section 15(d) requirement that those that issue securities using a registration statement pursuant to the 1933 Act have to file reports as required by section 12 of the Exchange Act. HAZEN, *supra* note 50, § 9.2, at 411.

69. 15 U.S.C. § 78l(g)(2).

70. HAZEN, *supra* note 50, § 9.2, at 411.

71. *Id.*

72. 15 U.S.C. §§ 78i, 78j, 78r.

73. *Id.* §§ 78o, 78o-3, 78o-4, 78o-5.

74. *Id.* § 78r.

75. *Id.* § 78a.

76. HAZEN, *supra* note 50, § 8.1, at 388.

77. *Id.* § 8.1, at 389.

78. *Id.* §§ 8.3-.5. If the instrument is not a security, the state security laws would not apply. Definitions of what constitutes a security, however, may be different under state law. *Id.* § 8.3, at 398.

79. *Id.* § 8.1, at 389.

80. *Id.* § 8.1, at 390.

rescission of the transactions that violated the law.⁸¹ A review of the legislation of each state is beyond the purview of this Article; however, a general discussion of various state regulation of cooperative securities will be found below.

A. What Are Securities? The Statutory Framework

Both Acts contain definitions of the term "security." As previously mentioned, these definitions and their application to investment activities are important because they trigger the operation of the Acts. Both Acts include the terms "note" and "stock" in their definitions of securities.⁸² The Securities Act also includes the terms "evidence of indebtedness," "certificate of interest or participation in any profit-sharing agreement," and "any interest or instrument commonly known as a 'security'" in its definition of security.⁸³ The Exchange Act includes the terms "certificate of interest or participation in any profit sharing agreement" and "any instrument commonly known as a 'security'" in its definition of security.⁸⁴

Each of the Acts also contain exemptions from registration for certain securities or certain transactions. With regard to the Securities Act, the main exemptions are for government securities, securities issued by certain nonprofit organizations, securities issued by farmers' cooperatives exempt from tax under Internal Revenue Code section 521, securities issued by savings and loan associations, securities arising out of a current transaction having a maturity date of less than nine months, securities issued by banks, insurance companies and qualified pension plans, securities issued by common carriers, insurance policies and annuity contracts, securities issued by bankruptcy trustees or judicial or administratively approved reorganizations, and securities exchanged for securities of the same business to the same holders where no commission is paid.⁸⁵ Small offerings of securities, less than \$5 million are also subject to an exemption that usually takes the form of an easier registration process.⁸⁶ In addition, certain transactions are exempt under the Securities Act. Nonpublic offerings, transactions by persons other than issuers, underwriters and dealers, certain mortgage note transactions, and sales to accredited investors are exempt.⁸⁷

81. *Id.* § 8.1, at 392-93 (citing CAL. CORP. CODE § 2550 (West 1989); DEL. CODE ANN., tit. 10, § 7323 (1975); FLA. STAT. ANN. § 517.211 (West 1997); 815 ILL. COMP. STAT. ANN. 5/13 (West 1993); KAN. STAT. ANN. § 17-1268 (1995); MINN. STAT. ANN. § 80A.23 (West 1990 & Supp. 1997); MO. ANN. STAT. § 409.411 (West 1997); N.J. STAT. ANN. § 421-B:25 (West 1986 & Supp. 1997); N.M. STAT. ANN. § 58-138-40 (Michie 1978); N.C. GEN. STAT. § 78A-56 (1997)).

82. 15 U.S.C. §§ 77b(1), 78c(a)(10).

83. *Id.* § 77b(1).

84. *Id.* § 78c(a)(10).

85. *Id.* § 78c(i); see also *supra* note 54 and accompanying text.

86. *Id.* § 77c(b).

87. *Id.* § 77d; see also *supra* note 59 and accompanying text.

The Exchange Act contains exemptions from registration for government and municipal securities and common trust funds.⁸⁸ In addition, certain equity securities need not be registered to be sold by brokers or dealers over the counter.⁸⁹ These include securities of issuers registered under the Investment Company Act,⁹⁰ securities of savings and loan associations, securities issued by agricultural cooperatives, securities issued by nonprofit organizations, certain securities issued by mutual or cooperative associations, certain insurance company securities, and employee stock or pension plans.⁹¹ Additional exemptions may be available by administrative rule.⁹²

B. *Federal Exemptions for Cooperative Securities:
History and Policy Considerations*

Securities regulation in the 1930s embraced a number of objectives, including requiring adequate disclosure by issuers of securities.⁹³ A second important objective was to restrain the rampant speculation in securities that had characterized the securities market in the 1920s.⁹⁴ As a result of the securities regulation in the 1930s, the government obligated every issuer of new securities to be sold in interstate commerce, to provide full publicity and information; thus, the government assumed the obligation to ensure that no essential elements alluding the issue would be concealed from the public.⁹⁵ The Securities Act was carefully shepherded through the House of Representatives by Representative Sam Rayburn with only five hours allowed for debate.⁹⁶ No mention of cooperatives appear in the House version of the Securities Act. During the debate, however, Representative Arens of Minnesota brought up the subject of an exemption for farmers' cooperatives.⁹⁷ Representative Bulwinkle stated that the Commerce Committee had not considered farmers' cooperatives in their formation of the Securities Act.⁹⁸ There was some discussion, in this latter debate, about whether the Securities Act already implied an exemption for securities issued by farmers' cooperatives.⁹⁹ While the idea of an exemption was favorably commented upon by Representative Rayburn, the House passed the bill

88. *Id.* § 78c(a)(12)(A)(i)-(iii).

89. *Id.* § 78l(g)(2).

90. Investment Company Act of 1940, 15 U.S.C. § 80a-8.

91. *Id.* § 78l(g)(2)(B)-(H).

92. *Id.* § 78l(h).

93. See 4 THE ECONOMIC REGULATION OF BUSINESS AND INDUSTRY: A LEGISLATIVE HISTORY OF U.S. REGULATORY AGENCIES 2549 (Bernard Schwartz ed., 1973) [hereinafter LEGISLATIVE HISTORY].

94. Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 409 (1990).

95. *Id.*

96. *Id.* at 442-49.

97. 77 CONG. REC. 2924 (1933); see also LEGISLATIVE HISTORY, *supra* note 93, at 2633.

98. 77 CONG. REC. 2634, 2924 (referring specifically to farmers' cooperatives that do not "sell stock as an issuer or a dealer or underwriter").

99. *Id.*

without specific mention of an exemption for securities issued by a farmers' cooperative.¹⁰⁰

The United States Senate substituted its version for the House bill, and its version of the Securities Act contained a provision that provided an exemption for farmers' cooperatives.¹⁰¹ This exemption was very similar to that contained in the final version of the bill that was adopted by both houses of Congress.

The Exchange Act did not mention cooperatives until the Securities Acts Amendments of 1964.¹⁰² Prior to that time, it does not appear that the SEC had applied the provisions of the Exchange Act to farmers' cooperatives.¹⁰³ Upon being told by the SEC that it proposed to exempt farmers' cooperatives by rule, Congress decided to make the exemption statutory.¹⁰⁴

The reasons for the farmers' cooperatives exemption can be traced to political pressure exerted by these cooperatives.¹⁰⁵ It is unlikely, however, that this pressure would have been successful had the cooperatives not been seen as an alternative to regular business corporations. The same potential for abuse did not exist where the motives for joining the cooperative were not the same as those for investing in a regular business corporation. The existence of statutes limiting the rate of return on cooperative stock and the inability of cooperative stock to appreciate in value made it unlikely that the form of business organization would be used to entice unwary investors. Thus, the abuses and speculation that the Acts were intended to curb were not present in cooperative investments, nor were the motives of the members that provided capital for a cooperative the same as investors in other businesses.

The failure to mention other forms of cooperatives in the Acts can be attributed, in part, to their smaller size and lower profile at that time. Given the fact that today there are many more consumer cooperatives than agricultural cooperatives, their continued omission is unfortunate and leads to uncertainty among cooperatives and their counsel. Fortunately, court decisions and SEC policy has resulted, for the most part, in consumer cooperative securities being treated the same as those of farmer cooperatives even without explicit statutory exemption.¹⁰⁶ A strong argument can be made, however,

100. *See id.* at 2925.

101. S. 875, 73d Cong. (1993).

102. Securities Acts Amendments of 1964, Pub. L. No. 88-467, 78 Stat. 565, 568 (codified as amended at 15 U.S.C. § 78j(g)(2)(E)-(F) (1994)).

103. LEGISLATIVE HISTORY, *supra* note 93, at 2692.

104. *See* H.R. Rep. No. 88-1418, pt. 2 (1964), *reprinted in* 1964 U.S.C.C.A.N. 3013, 3047.

105. *See* 77 Cong. Rec. 2634 (1993) (statements of Rep. Arens and Rep. Bulwinkle); *see also infra* 184 and accompanying text.

106. *See, e.g.,* United Hous. Found., Inc. v. Foreman, 421 U.S. 837 (1975); Greenbelt Consumer Servs., SEC No-Action Letter (Apr. 30, 1979), *available in* Westlaw, 1979 WL 11423; Yellow Cab Coop. Ass'n, SEC No-Action Letter (Apr. 25, 1984), *available in* Westlaw, 1984 WL 45206; Yellow Cab Coop. Ass'n, SEC No-Action Letter (Apr. 6, 1979), *available in* Westlaw, 1979 WL 13528; United Suppliers, Inc., SEC No-Action Letter (Apr. 13, 1977), *available in* Westlaw, 1977 WL 15043.

that the omission of nonagricultural cooperatives in the Acts should be rectified. There is no policy reason to treat them differently, and the SEC has by its nonaction, in effect, created an exemption. Many states treat all cooperatives the same in their securities law as discussed below.

C. What Is a Security? The Case Law

The Acts themselves do not fully or completely define all the terms contained in their respective definitions. That job has been left to the regulatory bodies and the courts. In deciding whether an instrument or investment is a security covered by one or both of the Acts, courts have often looked beyond the transaction to see if Congress intended to protect it.¹⁰⁷ While this approach is logical, the reliance on individual facts and situations to determine the coverage of the securities laws cannot guarantee a particular holding to businesses and their advisers. A brief review of relevant case law and the tests that have evolved from those decisions will clarify this situation.

Since the United States Supreme Court decided *SEC v. C.M. Joiner Leasing Corp.*¹⁰⁸ and *SEC v. W.J. Howey Co.*,¹⁰⁹ judicial review of equity investments have focused on the economic realities of the investment.¹¹⁰ Both cases were concerned with the definition of an "investment contract."¹¹¹ The test used by the Supreme Court in *C.M. Joiner Leasing* and *Howey* has come to be called the "economic reality test."¹¹²

In order to determine if the investment contract was a security, the *Joiner* Court looked at the terms of the offer, the plan of distribution, and the economic inducements that were held out to the prospective investor.¹¹³ In *Howey*, the Court refined its analysis further and stated that a security will be found if a person invests his or her money in a common enterprise and expects profits solely¹¹⁴ or primarily from the efforts of the promoter or other third person.¹¹⁵

107. See, e.g., *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946).

108. *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943).

109. *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

110. See, e.g., *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 691 (1985) ("[The] *Howey* reality test was designed to determine whether a particular instrument is an 'investment contract' not whether it fits within any of the examples listed in the statutory definition of 'security.'").

111. *SEC v. W.J. Howey Co.*, 328 U.S. at 298; *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. at 351.

112. See, e.g., *Landreth Timber Co. v. Landreth*, 471 U.S. at 691 (referring to the "Howey economic reality test").

113. *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. at 352-53.

114. In *United Housing Foundation, Inc. v. Forman*, the Supreme Court noted that the Ninth Circuit Court of Appeals had held that the word "solely" should not be interpreted literally, but rather should be given an interpretation that would be realistic, and therefore, catch cases in which an item was in substance, but not in form, a security. *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 852 n.16 (1975) (citing *SEC v. Glenn W. Turner Enter., Inc.*, 474

Because both *Joiner* and *Howey* were attempts to define an investment contract, an ambiguous term, it was not clear whether the economic reality test formed in the *Joiner* and *Howey* cases would be applicable to other forms of equity investments, including stocks. Over the years, the Supreme Court answered that question in the affirmative, applying the test to lease agreements,¹¹⁶ variable annuities,¹¹⁷ and flexible fund annuities,¹¹⁸ to find that the provisions of the Securities Act did apply. In addition, the economic reality test was used to find that a mandatory, noncontributory, compulsory pension plan was not a security,¹¹⁹ and that in certain circumstances, even the sale of stocks was not a security.¹²⁰

The *United Housing Foundation, Inc. v. Forman*¹²¹ decision involved the purchase of housing cooperative stock.¹²² Members that wished to live in the cooperative apartments were required to purchase a certain amount of stock.¹²³ The stock paid no dividends, was only transferable back to the cooperative or a prospective tenant that was eligible to be a member, and could not appreciate in value.¹²⁴

F.2d 476, 482 (9th Cir. 1973)). The Court noted that it expressed no view on the lower court's holding. *Id.* at 852.

115. *SEC v. W.J. Howey Co.*, 328 U.S. at 301 (involving the sale of units in a Florida citrus grove development).

116. *Kolibash v. Sagittarius Recording Co.*, 626 F. Supp. 1173, 1176 (S.D. Ohio 1986).

117. *See, e.g., SEC v. Variable Annuity Life Ins. Co. of Am.*, 359 U.S. 65 (1959).

118. *See, e.g., SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967).

119. *See, e.g., International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 570 (1979).

120. The *Forman* and *Landreth* cases discussed *infra* came to different conclusions. *Compare* *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 848 (1975) (holding that shares of stock in an apartment cooperative was not a security because the commodity was purchased for personal consumption), *with* *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985) (holding that sale of outstanding stock in lumber yard was subject to securities laws despite owner's intent to operate the business).

121. *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975).

122. *Id.* at 841.

123. *Id.* at 842.

124. *Id.* at 842-43. The housing and shares that were the subject of this litigation were authorized under the Mitchell-Lama Act, which was designed to allow the building of low-cost cooperative housing. *Id.* at 840 (citing N.Y. PRIV. HOUS. FIN. LAW §§ 11-37 (1962 and Supp. 1974-75)). These housing cooperatives had to be nonprofit. *Id.* at 841. In addition, the housing could be leased only to families whose income was low enough to meet state guidelines. *Id.* at 841 n.1. In addition, cooperatives were required to give preference to veterans, the elderly, and the handicapped. *Id.* Cooperatives owned the land and buildings. *Id.* at 841. They issued stock that purchasers bought. *Id.* Each room cost 18 shares of stock. *Id.* at 842. Shares were linked with the apartment and could not be transferred to nontenants. *Id.* Neither could shares be pledged or encumbered in any way. *Id.* Voting rights did not attach to the shares directly; despite the number of shares a tenant possessed, the tenant was entitled to only one vote in the cooperative. *Id.*

Even though stock was issued by the housing cooperative, the Court refused to find that calling the instruments stock resulted in the automatic application of the securities laws without further analysis.¹²⁵ Applying the economic reality test to the facts of the case, the Supreme Court found that the stock in question was not a security because it did not have any of the usual characteristics that stock possess.¹²⁶ The five common characteristics of stock that the Court specifically mentioned were as follows: the right to receive dividends contingent upon an apportionment of profits, negotiability, the ability of the shareholder to pledge or hypothecate the stock, voting rights in proportion to the number of shares owned, and the capacity to appreciate in value.¹²⁷ In *Forman*, there was no right to receive dividends, the shares were not negotiable, they conferred no voting rights in proportion to the number of shares owned, and they could not appreciate in value.¹²⁸ The Court further found that a member did not have an investment motive in purchasing the housing cooperative stock—the member was not anticipating a profit on the investment due to the efforts of the promoter.¹²⁹ Thus, the Securities Act's registration requirement was not applicable and no private cause of action existed for damages.¹³⁰

The Supreme Court found in *Landreth Timber Co. v. Landreth*,¹³¹ that the securities laws apply when stock is sold to transfer ownership.¹³² Thus, the sale of all or substantially all of a business's stock that results in the transfer of business ownership is a transaction covered by the Acts.¹³³

Finally, there have been several court cases involving the sale of commodities or managed accounts that have resulted in a modification of the economic reality test.¹³⁴ At issue is the requirement of a commonality of interest in the venture. Vertical versus horizontal commonality has become important, and in some instances the requirement of commonality has been

125. *Id.* at 848.

126. *Id.* at 858-59.

127. *Id.* at 850-51.

128. In *Forman*, the SEC filed an amicus curiae brief advocating that the Court hold securities laws applicable in this type of case. *United Hous. Found., Inc. v. Forman*, 421 U.S. at 840. The *Forman* Court, however, noted that this application contradicted Release No. 33-5347, 38 Fed. Reg. 1735 (Jan. 18, 1973), regarding real estate developments. *Id.* at 858 n.25. The current SEC position is that type of share would not require registration. See *Kentucky Pharmacy Servs. Corp.*, SEC No-Action Letter (June 6, 1991), available in Westlaw, 1991 WL 176913.

129. *United Hous. Found., Inc. v. Forman*, 421 U.S. at 858.

130. *Id.* at 856. Arguably, the exemption for cooperatives under the Exchange Act would apply. See *infra* notes 170-73 and accompanying text.

131. *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985).

132. *Id.* at 686-87; see also *Gould v. Rufenacht*, 471 U.S. 701, 704 (1985).

133. *Landreth Timber Co. v. Landreth*, 471 U.S. at 686-87.

134. See, e.g., *Revak v. SEC Realty Corp.*, 18 F.3d 81, 88 (2d Cir. 1994); *Mechigan v. Art Capital Corp.*, 612 F. Supp. 1421, 1427 (S.D.N.Y. 1985).

dispensed with entirely.¹³⁵ The new test advanced, the risk capital test, dispenses with the requirement of a common enterprise and focuses instead on the dependency upon others for the success of the venture.¹³⁶

These recent developments call into question the continuing usefulness of the *Howey* and *Forman* cases in analyzing other forms of capital investments.¹³⁷ Each case may be limited in the future to its facts. Because the focus of this Article is on cooperative securities, *Forman* is relevant to the analysis below.

The question of whether a loan agreement constitutes a security has been frequently litigated in the past few years. Because the term "note" is contained in the definition of security in both Acts, and because short-term commercial notes—notes with a due date of nine months or less—are exempt from the coverage of both Acts,¹³⁸ there has been much room for disagreement. The circuits have developed several tests to decide the matter, including the commercial-investment dichotomy, the *Howey* test, the risk capital test, and the family resemblance test.¹³⁹ The *Reves* case¹⁴⁰ was the first time the Supreme Court enunciated its approach to deciding which notes are securities.

135. HAZEN, *supra* note 50, § 1.5, at 53; see also *Silver Hills Country Club v. Sobieski*, 361 P.2d 906, 908-09 (Cal. 1961) (deciding whether the sale of country club memberships was a security); *Tanenbaum v. Agri-Capital, Inc.*, 885 F.2d 464, 467-68 (8th Cir. 1989) (applying Arkansas law to the question of whether the purchase of purebred cattle embryos was a security).

136. HAZEN, *supra* note 50, § 1.5, at 53.

137. See *Matek v. Murat*, 862 F.2d 720, 725-26 (9th Cir. 1988) (discussing the re-examination by courts of the *Howey* test).

138. 15 U.S.C. § 77c(a)(3), 78c(a)(10) (1994).

139. The Seventh Circuit has developed the commercial-investment dichotomy. See *C.N.S. Enters., Inc. v. G. & G. Enters., Inc.*, 508 F.2d 1354, 1360-63 (7th Cir. 1975). The commercial-investment dichotomy is used to exclude certain notes from coverage by the Securities Act when those notes involve an underlying transaction between a payor and payee that is not in the nature of an investment, but is a commercial transaction. *Id.* It is often used to differentiate between a loan to a party versus an investment. *Id.*

An investment contract is "a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946).

The risk capital test looks at whether the party giving the funds has contributed "risk capital" to a venture that will be subject to managerial or entrepreneurial efforts by others. *Underhill v. Royal*, 769 F.2d 1426, 1431 (9th Cir. 1976). Six factors, that may be used to determine whether risk capital was involved in the transaction are: "(1) time; (2) collateralization; (3) form of the obligation; (4) circumstances of issuance; (5) relationship between the amount borrowed and the size of the borrower's business; and (6) the contemplated use of the funds." *Id.* Other factors may also be applied. *Id.*

The family resemblance test begins with a rebuttable presumption that a note is a security. *Reves v. Ernst & Young*, 494 U.S. 56, 65 (1990). If a note is used to secure a mortgage on a home given in consumer financing, a short-term note secured by a lien on a

The applicability of the securities laws to promissory notes has proven difficult to ascertain. Underlying all of the various tests is the attempt to differentiate between investment vehicles, which are covered by the securities laws, and commercial activities, which are exempt. In *Reves* the Court adopted a version of the so-called family resemblance test. The family resemblance test had first been enunciated by the Second Circuit in *Exchange National Bank v. Touche Ross & Co.*¹⁴¹ The Supreme Court, following the Second Circuit, held that a note was presumed to be a security unless it bore a strong family resemblance to one of the following categories of instruments: consumer notes, mortgage notes, or short term notes secured by a lien on a business or part of the business's assets.¹⁴² To determine if a strong resemblance exists and whether the list should be expanded, the Court suggested that four factors be reviewed: the motivations of the seller and buyer entering into the transaction, the plan of distribution, reasonable expectations of the investing public, and the existence of another factor that would reduce the risk of the instrument—another regulatory scheme.¹⁴³ These factors are the same or exceedingly similar to the *Howey* economic reality test. But, the Supreme Court specifically rejected the *Howey* test,¹⁴⁴ leaving some wondering what it had meant.¹⁴⁵

D. Lower Court and SEC Decisions Affecting Cooperatives

As indicated, there are two Supreme Court securities law cases involving cooperatives, the *Forman* case where the existence of the cooperative was the deciding factor and the *Reves* case where it seemingly had no impact.¹⁴⁶ In

small business or its assets, a character loan in the form of a note to a bank's customer, a short-term note secured by accounts receivable, or a note that formalizes open-account debts from the ordinary course of business, then it is not a security. *Id.* If a note is not listed, the Supreme Court looks at four factors to determine whether another exception should be implied. *Id.* at 66. These factors are: (1) the motivations of reasonable buyers and sellers entering into the transaction; (2) how the note was distributed or offered; (3) the reasonable expectations of the public with respect to buying the offering; and (4) if there is any outside factor, such as another regulatory scheme, it covers the note and thus would reduce the risk to the buyers of the note. *Id.* at 66-67; see also *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1137-38 (2d Cir. 1976) (setting forth the family resemblance test).

140. *Reves v. Ernst & Young*, 494 U.S. at 58.

141. See *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976).

142. *Reves v. Ernst & Young*, 494 U.S. at 56-57; see also *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 937 (2d Cir. 1984) (expanding the list to include note endorsements) (citing *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d at 1137-38).

143. *Reves v. Ernst & Young*, 494 U.S. at 57.

144. *Id.* at 64.

145. The notes in *Reves* were demand notes and thus, arguably payable within nine months of issue. The Supreme Court found that the nine months exemption did not apply because the notes did not fall within the "plain words" of the statute. *Id.* at 70-71.

146. See *id.* at 73 (holding that demand promissory notes in a farmer's cooperative were securities after analyzing the form under the family resemblance test); *United Hous. Found.*,

addition, there have been several lower federal and state court decisions applying the *Forman* decision to cooperative stock offerings. Finally, the SEC has issued no-action or denied no-action letters on several cooperative offerings.

In general, post-*Forman* cases have found that stock issued by a cooperative to evidence membership or patronage dividends is not a security. For example, after *Forman*, the Second Circuit reversed itself and found that stock in a privately owned housing cooperative where the value of the apartments could appreciate was not a security.¹⁴⁷ In another case, *Rosenberg & Sons, Inc. v. St. James Sugar Cooperative, Inc.*,¹⁴⁸ the court found that membership stock in a farmers' marketing cooperative was not a security.¹⁴⁹

In *Great Rivers Cooperative v. Farmland Industries*,¹⁵⁰ the plaintiffs alleged that a cooperative had violated federal securities laws, RICO provisions, and various state laws in compelling the plaintiffs, who were not members of the cooperative, to accept patronage refunds in the form of capital credits from the cooperative.¹⁵¹ Despite the fact that the cooperative had registered its capital credits with the SEC as a security, the court found that the agricultural cooperative's capital credits were not securities.¹⁵²

Additionally, the SEC has consistently issued no-action letters when the stock of a cooperative evidences membership, is not transferable, pays no dividends, and cannot appreciate in value.¹⁵³ Similarly, the SEC has issued no-action letters involving the issuance of equity instruments evidencing patronage rebates or dividends even where these instruments pay interest or dividends.¹⁵⁴

Inc. v. Forman, 421 U.S. 837, 858 (1975) (holding that shares of stock in a housing cooperative were not a security).

147. Grenader v. Spitz, 537 F.2d 612, 613 (2d Cir. 1976) (overruling 1050 Tenants Corp. v. Jakobson, 503 F.2d 1375 (2d Cir. 1974)); see also AMR Realty Co. v. Bureau of Sec., 373 A.2d 1002 (N.J. Super. Ct. App. Div. 1977).

148. Rosenberg & Sons, Inc. v. St. James Sugar Coop., Inc., 447 F. Supp. 1 (E.D. La. 1976), *aff'd*, 565 F.2d 1213 (5th Cir. 1977).

149. *Id.* at 3. Louisiana cooperative marketing association issued shares that provided no dividends, were nonnegotiable, could only be transferred with the approval of the cooperative's board, and whose patronage dividends were based on patronage to members and nonmembers alike. *Id.*

150. Great Rivers Coop. v. Farmland Indus., No. 4-95-70529 (S.D. Iowa May 5, 1997).

151. *Id.*, slip op. at 1.

152. *Id.*, slip op. at 24. The court applied both the economic realities test and the family resemblance test, citing *Reves*, *Forman*, and *Howey*, in determining that the cooperatives capital credits were not securities. *Id.*, slip op. at 21-29 (citing *Reves v. Ernst & Young*, 494 U.S. 56 (1990); *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946)).

153. Steve F. Brault, *Equity Financing of Cooperatives: Advantageous Federal Securities Law and Tax Treatment*, 21 WILLAMETTE L. REV. 225, 243-45 (1985).

154. See, e.g., Associated Grocers, Inc., SEC No-Action Letter, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79, 415, at 77,171 (Oct. 5, 1989); Affiliated of Florida, Inc., SEC No-Action Letter (Sept. 25, 1987), available in Westlaw, 1987 WL 108467; Certified Grocers,

The SEC has been concerned with income derived from nonmember activities.¹⁵⁵ Generally, if the income derived from nonmember activities is insubstantial, then member stock and patronage dividend stock or equity certificates will not be considered securities.¹⁵⁶ While it is arguable that the SEC requirements are stricter than those enunciated in *Forman*¹⁵⁷ or the Acts,¹⁵⁸ they do provide a safe harbor for cooperatives that are able to comply with the requirements. In SEC no-action letters, the *Reves* test is now invoked in determining whether an SEC will issue a no-action letter.¹⁵⁹

E. State Regulatory Schemes Affecting Cooperatives

As mentioned, all states regulate the sales of securities within their borders.¹⁶⁰ Many states have adopted the Uniform Securities Act in some form.¹⁶¹ That Uniform Securities Act has an optional provision exempting cooperative securities.¹⁶² The exemption applies to all cooperative membership or equity interests.¹⁶³ Some states have modified the exemption to apply only to agricultural cooperatives.¹⁶⁴ Other states have gone in the opposite

Inc., SEC No-Action Letter (June 22, 1984), available in Westlaw, 1984 WL 45381; Seafood Producers Cooperative, SEC No-Action Letter, [1981 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,804, at 77,236 (Dec. 18, 1980).

155. The IRS, mirroring the SEC's concern, previously took the position that a cooperative had to do more than 50% of its business with its own members. The IRS position was not upheld by courts, thus calling into question the continuing validity of the SEC's concern. See *Conway County Farmers Ass'n v. United States*, 588 F.2d 592, 600 (8th Cir. 1978) (holding that an organization would maintain its cooperative designation even if more than 50% of its business was comprised of noncooperative members); *Columbus Fruit & Vegetable Coop. Ass'n v. United States*, 7 Cl. Ct. 561, 565 (1985) (holding that an agricultural cooperative deriving 24% of its income from the sale of member's merchandise was entitled to a refund of federal income tax paid on patronage dividends).

156. Brault, *supra* note 153, at 244-45 n.95 (commenting on Atlantic Breeders Coop., SEC No-Action Letter, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,386, at 76,608 (Mar. 31, 1980)).

157. See *id.* at 245.

158. Eight percent dividends are allowed by I.R.C. § 521 (1994) and the Agricultural Marketing Act, 12 U.S.C. § 1141j(a) (1994).

159. See, e.g., Peer Marketing Assocs., SEC No-Action Letter (Feb. 3, 1993), available in Westlaw, 1993 WL 28727; Kentucky Pharmacy Servs. Corp., SEC No-Action Letter (June 6, 1991), available in Westlaw, 1991 WL 176913.

160. See John D. Reilly, *Recent Changes to the State Securities Law Exemption for Cooperatives*, THE COOPERATIVE ACCT., Spring 1996, at 3.

161. See HAZEN *supra* note 50, § 8.1, at 389.

162. See UNIF. SECURITIES ACT § 401(b)(13) (1988).

163. The exemption states that "a membership or equity interest in, or a retention certificate or like security given in lieu of a cash patronage dividend issued by, a cooperative organized and operated as a nonprofit membership cooperative under the cooperative laws of any state if not traded to the public" can be made exempt by this optional provision. *Id.*

164. ARK. CODE ANN. § 23-42-503(c) (Michie Supp. 1995); CAL. CORP. CODE § 25100 (West 1977); DEL. CODE ANN. tit. 6 § 7309(12) (1993); IND. CODE ANN. § 23-2-1-2(8) (Michie

direction, broadening exemptions so that they apply to a broad variety of cooperative organizations and securities.¹⁶⁵ A table is provided below.¹⁶⁶

IV. ANALYSIS OF APPLICATION OF SECURITIES LAW TO COOPERATIVES

Congress, state legislators, and the courts have, to different degrees, recognized that certain types of member investments in cooperatives ought to be treated differently than investments in traditional business ventures.¹⁶⁷ The Securities Act of 1933 contain exemptions for any security issued by a farmer's cooperative exempt from tax under section 521 of the Internal Revenue Code.¹⁶⁸ Because there are very few farmer's cooperatives today that are able to qualify for tax exemption under section 521,¹⁶⁹ this Securities Act exemption for farmer's cooperatives based on section 521 qualification has limited practical application for agricultural cooperatives and is of no use to other forms of cooperatives.

The Securities Exchange Act of 1934 has an exemption covering cooperatives who qualify under the Agricultural Marketing Act.¹⁷⁰ It also contains an exemption for cooperatives that supply commodities or services primarily for the benefit of members where the security is issued to patrons of the cooperative, no dividend is paid on the security, and the security is transferable only to a successor in interest or occupancy of the premises served.¹⁷¹ The legislative history to the Securities Exchange Act indicates that Congress decided to exempt this type of cooperative securities from the Securities Exchange Act because the SEC planned to do so by rule in any event.¹⁷² It is clear from the legislative history that Congress had agricultural marketing

Supp. 1997); MO. ANN. STAT. § 409.402 (West 1989); N.J. STAT. ANN. § 49:3-50 (West 1991); UTAH CODE ANN. § 61-1-14 (1997); W. VA. CODE § 32-4-402 (1995).

165. COLO. REV. STAT. ANN. § 7-55-115 (Supp. 1996); CONN. GEN. STAT. ANN. § 36b-21 (West 1996); FLA. STAT. ANN. § 517.051 (West 1997); MASS. GEN. LAWS ch. 110A § 414 (1990); MISS. CODE ANN. § 75-71-201 (1991); N.C. GEN. STAT. § 78A-16 (1994); N.D. LAWS 10-04-05 (Michie 1995); S.C. CODE ANN. 35-1-310 (Law. Co-op. 1987); S.D. CODIFIED LAWS § 47-31A-402 (Michie 1991); VT. STAT. ANN. tit. 9 § 4203 (1981); VA. CODE ANN. § 13.1-514 (Michie 1993); WIS. STAT. § 551.22 (West 1988).

166. See Appendix.

167. Nonprofits also have been accorded treatment similar to that afforded cooperatives. See 15 U.S.C. § 77c(a)(4) (1994); see also HAZEN, *supra* note 50, § 4.5, at 172 (discussing the 1933 Securities Act's exemption of eleemosynary organizations).

168. 15 U.S.C. § 77c(5)(B)(i).

169. While there is no established number of how many farmers cooperatives qualify for tax exemption under section 521, a survey of the approximately 4100 agricultural cooperatives, in which 1200 cooperatives responded, indicated that 22% of the responding cooperatives were exempt. Interview with Don Frederick, Program Leader for Law, Policy and Governance with the USDA Cooperative Services Unit (Feb. 24, 1997) (on file with author).

170. 15 U.S.C. § 78l(g)(2)(E) (referring to the Agricultural Marketing Act, 12 U.S.C. § 1141).

171. *Id.*

172. H.R. REP. NO. 1418 (1964), reprinted in 1964 U.S.C.C.A.N. 3013, 3023.

cooperatives and rural electric cooperatives in mind when it passed these exemptions.¹⁷³

The language, however, in section 12(b)(6) is broad enough to cover some consumer cooperatives. Because consumer cooperatives generally provide a commodity or service to their members, the exemption arguably covers them. The only language that possibly could be used to deny the exemption to consumer cooperatives is contained in the limitation providing that the security is transferable only to a "successor in interest or occupancy of premises serviced or to be served by the issuer."¹⁷⁴ Because the language contains the connector "or," it appears that transferability only to a successor in interest is sufficient, which would arguably qualify consumer cooperatives. The requirement that the cooperative provide services or commodities primarily to members could be troublesome for some consumer cooperatives that do not do more than half of their sales volume with their members. The limitation that the cooperative provide a service or commodity to its members would seemingly exclude worker or production cooperatives and agricultural or other marketing cooperatives that do not qualify under the Agricultural Marketing Act.

The Supreme Court has made it clear that stock issued by what are commonly known as limited equity housing cooperatives¹⁷⁵ is not within the purview of the Securities Act.¹⁷⁶ Lower courts have extended the Supreme Court's decision to cover other forms of housing cooperatives.¹⁷⁷ The SEC has followed the Supreme Court and issued no-action letters for cooperative membership and patronage dividend "stock" if the stock was nontransferable and did not pay dividends, no matter what type of cooperative issued the stock.¹⁷⁸ Thus, stock issued by a cooperative to evidence membership in the

173. *Id.*

174. 15 U.S.C. § 78I(g)(2)(F).

175. A limited equity housing cooperative is defined as:

[A] housing corporation in which a person is entitled to occupy a dwelling unit by virtue of such person's ownership of stock in the cooperative and, among other things, the consideration paid for stock held by any stockholder entitled to occupy a dwelling unit does not exceed the sum of the amount paid for such stock by the first stockholder, as increased by a cost-of-living adjustment, and as further increased by payments made by any stockholder for improvements to the stockholder's residence and payments attributable to the stockholder to amortize the cooperative's indebtedness arising from the acquisition and development of real property.

Carlie B. Sorensen & Clifford M. Gerber, *Housing Bonds, Qualified 501(c)(3) Bonds and Change in Use of Facilities Financed with Tax-Exempt Private Activity Bonds, After the Tax Reform Act of 1986*, in TAX EXEMPT FINANCING UNDER THE TAX REFORM ACT, at 59, 68 (PLI Tax Law & Estate Planning Course Handbook Series No. 245, 1986).

176. *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 847 (1975).

177. *See, e.g., Grenader v. Spitz*, 537 F.2d 612, 613 (2d Cir. 1976) (holding a privately owned and operated apartment cooperative was not a security under the Securities Act).

178. *Soloman & Kirgis, supra* note 35, at 253 n.115; *see also Brault, supra* note 153, at 243-44.

cooperative where the stock is not transferable and pays no dividends does not fall within the purview of the Acts.¹⁷⁹ This analysis should also apply to membership fees or membership certificates where stock is not issued. Similarly, patronage dividends issued to cooperative patrons in the form of stock or other equity certificates are also not securities within the meanings of the Act.¹⁸⁰ The patron that receives the stock or equity credit in lieu of a cash patronage dividend is not making an investment in the way that term is usually understood and as has been interpreted by the Supreme Court.

While the laws and court decisions have provided a safe harbor for certain forms of cooperatives, such as agricultural cooperatives, and for certain forms of cooperative securities, such as membership and patronage dividend stock or equity, other problem areas remain. Some problem areas that remain are transferable stock, stock that pays dividends, stock not issued to evidence membership or patronage rebates, and notes issued by a cooperative.

If dividends are paid on the membership stock, patronage dividend stock, or equity credit, then closer scrutiny is necessary. If the cooperative fits within the definition of the Agricultural Marketing Act, then it is allowed to pay dividends of up to eight percent on its capital stock.¹⁸¹ Clearly, an agricultural cooperative such as this may pay dividends and still qualify for the Securities Exchange Act exemption. Similarly, farmers' cooperatives that are eligible for section 521 tax treatment may also pay dividends of up to eight percent and are also exempt under the Securities Act.¹⁸² There seems to be no policy argument that explains why other types of cooperatives should not be allowed similar treatment.¹⁸³ Similarly, the payment of capital dividends by cooperatives is almost always regulated by state law and thus not likely to be abused.¹⁸⁴ Therefore, an argument may be made that payment of dividends should not disqualify a cooperative from the Acts' exemptions even if they are not eligible for section 521 treatment or are not an eligible cooperative under the Agricultural Marketing Act. This position has been accepted by the SEC in situations where no substantial income is generated from nonmember business,¹⁸⁵ and it is clearly in line with legislative intent and cooperative principles.

179. Soloman & Kirgis, *supra* note 35, at 242-43.

180. *Id.* at 253 (providing that the stock or equity credit falls under an exemption to the Securities Act).

181. 12 U.S.C. § 1141j(a) (1994).

182. I.R.C. § 521(b)(2) (1994).

183. Agricultural cooperatives are better organized politically, are larger entities and represent "family farmers," that are seen in need of protection (and incentives) to service. *See, e.g.,* VOORHIS, *supra* note 19, at 84 ("The largest, most important, and most disadvantaged group of small business [people] who suffer from monopolistic controls in our economy is the farmers."). None of these reasons makes them more worthy of security law exemptions.

184. Soloman & Kirgis, *supra* note 35, at 257-59.

185. Brault, *supra* note 153, at 244-45 n.95 (commenting on Atlantic Breeders Coop., SEC No-Action Letter, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,386, at 76,608 (Mar. 31, 1980)).

The payment of dividends on capital by cooperatives is somewhat rare.¹⁸⁶ Payment of limited return on capital is seen as fair, like the payment of rent for the use of land.¹⁸⁷ It provides a fair return on the investment to the owner. Because the payment of dividends on membership stock or patronage dividend stock is limited, regulated by cooperative incorporation statutes, and fair to members, it should not be used to deny a securities law exemption.¹⁸⁸ This would apply not only to agricultural cooperatives but to other types of cooperatives as well. There is no policy reason to treat consumer and agricultural cooperatives differently.

Stock or equity credits held by ex-members for a reasonable period of time should not create a problem for cooperatives that otherwise qualify for the exempt status. The requirement that the cooperative have a policy of regularly redeeming such equity could be imposed as a condition of receiving exemption.¹⁸⁹ This would solve a recurring complaint of ex-members and provide cooperatives with a valuable exemption from the securities laws.

The Supreme Court, as previously indicated, has held that promissory notes issued by a cooperative may be securities in certain circumstances.¹⁹⁰ The offering of notes by a cooperative to nonmembers at market or above-market interest rates clearly is a security based on *Reves*.¹⁹¹ If a cooperative solicits loans only from current members at interest rates that are at or below market, however, a strong argument can be made that these notes are not securities. A member making such a loan to his or her cooperative clearly is not motivated to do so by profit, is not making the loan for investment purposes, and has no reasonable expectation that a profit will be derived as a result of the activities of others. One could argue that a member's involvement in the cooperative through voting rights, election of the board of directors, and attendance at annual meetings where financial information is provided are factors that reduce the risk of the loan. While there is no public market for the notes nor other regulatory scheme, this factor should not be determinative. Stock or equity credits sold to nonmembers should be treated as any other security would be—coverage of the Acts would apply unless some other exemption applies.¹⁹² There are no policy reasons that would compel other treatment.

Stock or equity investments by members other than membership shares or retained patronage dividends are somewhat more problematic. The SEC position is that this is a security.¹⁹³ A strong argument can be made that these

186. Soloman & Kirgis, *supra* note 35, at 251.

187. *Id.* at 251-54.

188. *Id.*

189. This requirement would provide an incentive for cooperatives to have a regular redemption program.

190. *Reves v. Ernst & Young*, 494 U.S. 56, 58 (1990).

191. *See id.* at 65-69.

192. This treatment would then be analogous to tax treatment of nonmember income under the Internal Revenue Code.

193. *See* Garden State Coop. Group, Inc., SEC No-Action Letter (Jan. 17, 1983), available in Westlaw, 1983 WL 29262; Mutual Service Coop., SEC No-Action Letter (July 27,

types of securities should also be exempt. First, dividends paid on such equity is usually regulated and limited by the cooperative incorporation statutes. Second, members that provide the equity to the cooperative have access to the financial records of the cooperative and participate in the democratic management of the cooperative. They are, thus, less likely to need of the protective mechanisms of the Acts. Third, the member's motives in making the additional investment in the cooperative are mixed. While it is fair to say that a return on their investment is expected, that is not the only purpose and may not even be the main purpose for making the additional investment. The success of the cooperative is important to the member so that he or she may continue to participate in the economic benefits of the cooperative. The economic reality test, if applied to these members, would result in a finding that "the" "no investment," as that term is usually understood, is being made. Finally, there are policy reasons to encourage the formation of cooperatives. To do so, the cooperative needs capital and the member is the only source of equity capital for a cooperative. Thus, to encourage the formation of cooperatives, this form of member "investment" should be encouraged and not regulated. Thus, as long as the cooperative is truthful with its members, there would be no reason to invoke the Acts to protect the members.

V. CONCLUSION

Current federal law provides favorable treatment for securities issued by agricultural cooperatives to their members. Similar treatment should be afforded to other forms of cooperatives, either through the expansion of the definition of cooperative contained in the law or agency rule. This would bring federal law into conformity with most state securities laws—offering the same treatment for the securities of all cooperatives. There is no policy reason to treat agricultural cooperatives differently from other types of cooperatives.

The courts and the SEC have for the most part faithfully followed the intent of Congress to exempt cooperatives from regulation, recognizing the differences between a cooperative and other business corporations. Consideration should be given by the courts and SEC to limiting the *Reves* decision to its facts. Loans made by nonmembers to a cooperative at market or above market rates should be regulated; however, strong arguments exist to exempt loans made by members to their cooperatives. Because obtaining capital is difficult for cooperatives, exempting member loans would facilitate the creation and continued existence of cooperatives. Public policy supports this action.

Similarly, other equity "investments" made by members in the cooperative should be exempt from securities regulation. Federal and state laws limit the rate of return on the "investment" and many state statutes also limit the appreciation of cooperative stock. Additionally, the motivation

1981), available in Westlaw, 1981 WL 25127; Wheatbelt Merchandising Group, Inc., SEC No-Action Letter (June 30, 1980).

behind these "investments" is not the typical investment for profit motivation, thus rendering the protections of the various laws unnecessary.

To provide certainty to cooperatives and their advisors, either Congress or SEC should codify the application or nonapplication of the securities laws to cooperatives. The exemptions, given to agricultural cooperatives sixty-five years ago, need to be updated and brought in line with today's economic reality.

APPENDIX

STATE	CITATION	EFFECT
Alabama	ALA. STAT. § 37-6-29 (1992).	The securities law does not apply to any evidence of indebtedness to federal agencies by electric cooperatives (or to the issuance of membership certificates by any cooperative).
Alaska		No exemption
Arizona	ARIZ. REV. STAT. ANN. § 10-2025 (West 1996). (Exempt securities)	Exempts membership certificates or other types of member interest equity or contribution by cooperative marketing associations from the state's securities laws.
Arkansas	ARK. STAT. ANN. § 23-42-503(c) (Michie Supp. 1995).	Exempts securities of farm cooperatives and corporations operated as a farm cooperative.
California	CAL. FOOD & AGRIC. CODE § 54201 (West 1986).	Agricultural cooperative securities are exempt from securities law.
Colorado	COLO. REV. STAT. ANN. § 7-55-115 (Supp. 1996).	"Any security, patronage refund, per unit retain certificate, or evidence of membership issued or sold by a cooperative association as an investment in its stock or capital to the members of a cooperative association organized under this article or a similar law of any other state and qualified to do business in this state is exempt from securities laws as contained in article 51 of title 11, C.R.S."
	COLO. REV. STAT. ANN. § 7-56-509 (Supp. 1996). (Exempt securities)	Exempts cooperative securities for cooperatives organized under article 56 of COLO. REV. STAT. from Colorado securities law (Article 51 of title 11, C.R.S.).
	COLO. REV. STAT. ANN. § 38-33.5-106 (1986).	Housing cooperative securities exempt.
	COLO. REV. STAT. ANN. 11-51-307 (Supp. 1996). (Exempt securities)	Exemption for securities of electric cooperatives. Exemption for cooperatives described in article 55 of title 7, C.R.S.

Connecticut	CONN. GEN. STAT. ANN. § 36b-21(a)(12) (West 1996). (Exempt securities and transactions)	Exempts securities of apartment cooperatives from registration, and from having to file material intended for distribution to prospective investors.
	CONN. GEN. STAT. ANN. § 36b-21(a)(15) (West 1996).	Exempts section 521 farmer's cooperative securities from registration as defined by the Internal Revenue Code of 1986, and from having to file material intended for distribution to prospective investors.
	CONN. GEN. STAT. ANN. § 36b-21(a)(16) (West 1996).	Exempts chapter 595 cooperatives associations from registration, and from having to file material intended for distribution to prospective investors.
	CONN. GEN. STAT. ANN. § 36b-21(a)(20) (West 1996).	Exempts worker's cooperatives from registration, and from having to file material intended for distribution to prospective investors.
Delaware	DEL. CODE ANN. tit. 6, § 7309(12) (1993). (Exempt securities)	Agricultural cooperatives securities exempt.
Florida	FLA. STAT. ANN. § 517.051(7) (West 1997). (Exempt securities)	Agricultural cooperative securities exempt.
	FLA. STAT. ANN. § 425.29 (West 1993).	Rural electric cooperatives are not subject to the provisions of state securities law.
	FLA. STAT. ANN. § 517.061(14) (West 1997). (Exempt transactions)	Offer or sale of shares in a housing cooperative are exempt transactions.

Georgia	GA. CODE ANN. § 10-5-8(5) (Harrison 1994). (Exempt securities)	Farmer's section 521 cooperative securities are exempt.
	GA. CODE ANN. § 46-3-176 (Harrison 1994).	Obligations of electric cooperatives issued to secure payment of money borrowed from any federal agency are not subject to 6A securities laws.
Hawaii	HAW. REV. STAT. § 485-4(14) (1993). (Exempt securities) HAW. REV. STAT. § 421C-36 (1993).	Membership stock or certificates and shares or membership capital of any cooperative are exempt from registration and framed provisions of the securities law.
Illinois	815 ILL. COMP. STAT. ANN. 5/3(S) (West 1993). (Exempt securities)	Agricultural cooperative securities are exempt.
	815 ILL. COMP. STAT. ANN. 5/4(K) (West 1993). (Exempt transactions)	Exempts transactions in securities for patronage, patronage refunds in connection with marketing agreements, and the sale of stock or subscriptions for stock for agricultural, producer, marketing, purchasing, or consumer cooperatives if any person does not own beneficially more than 5% of the aggregate amount of the issued and outstanding capital stock of the cooperative association.
Indiana	IND. CODE ANN. § 23-2-1-2(a)(8) (Michie 1995).	Agricultural cooperative securities are exempt.
Iowa	IOWA CODE § 502.202(12)(a)-(b) (1997). (Exempt securities)	A stock or similar security, including a patronage refund certificate issued by cooperative housing associations and mutual or cooperative organizations are exempt.
	IOWA CODE § 502.202(13) (1997). (Exempt securities)	Agricultural cooperative securities are exempt.

Kansas	<p>KAN. STAT. ANN. § 17-1261(k)-(1) (Supp. 1996). (Exempt securities)</p> <p>KAN. STAT. ANN. § 17-4632 (1995).</p>	<p>Securities issued by an agricultural cooperatives are exempt.</p> <p>Notes, bond, or other evidence of indebtedness issued to the U.S. government, any agency or instrumentality of the U.S. government, or to any mortgage, deed of trust, or other instrument executed to secure such indebtedness are exempt. The securities act does not apply to the issuance of membership certificates by any cooperative.</p>
Kentucky	<p>KY. REV. STAT. ANN. § 292.400(12) (Michie Supp. 1996). (Exempt securities)</p> <p>KY. REV. STAT. ANN. § 292.400(15) (Michie Supp. 1996). (Exempt securities)</p>	<p>Securities and patronage refunds that represent distributions of an agricultural cooperative's distributable earnings or savings and are issued in the form of stock, book equities, letters of credit, or letters of advice are exempt.</p> <p>Membership and voting stock, and patronage refunds of cooperative corporations, that conform to sections 272.020 to 272.050 (Cooperative Corps. and Ass'ns) are exempt.</p>
Louisiana	<p>LA. REV. STAT. ANN. § 51:708(5) (West 1987). (Exempt securities)</p> <p>LA. REV. STAT. ANN. § 12:427 (West 1994). (Exempt securities)</p>	<p>Agricultural cooperative securities are exempt.</p> <p>Securities law does not apply to any note, bond, or other evidence of indebtedness issued by an electric cooperative to the U.S. government, any agency of such, or other indebtedness to secure the same. Securities law shall not apply to the issuance of membership certificates by any cooperative.</p>
Maine	<p>32 ME. REV. STAT. ANN. tit. 32, § 10502(1)(m) (West 1988).</p>	<p>Membership, equity interests in retention certificates, or like securities given in place of a cash patronage dividend are exempt when issued by</p>

Maine (cont.)	(Exempt securities)	a nonprofit membership cooperative that is organized and operated under any states' laws as such, when not traded to the public.
Maryland	MD. CODE ANN., CORPS. & ASS'NS § 5-5A-28 (1993).	Cooperative stock, membership interest, or other evidence of membership capital are exempt.
	MD. CODE ANN., CORPS. & ASS'NS § 5-6B-13(a) (1993).	A cooperative interest in a housing cooperative is not a security.
Massachusetts	MASS. GEN. LAWS ANN. ch. 110A, § 402(a)(12) (West 1990). (Exemptions)	Any security issued by a cooperative corporation is exempt if the capital stock is no more than \$50,000 and no expenditure is made by or on its behalf in connection with the issuance or sale of its securities other than certain listed expenses.
Michigan	MICH. COMP. LAWS ANN. § 451.802(b)(16) (West 1989). (Exempt transactions)	Distribution by a cooperative of its securities to its patrons as patronage refunds or returns distributed on a patronage basis are exempt.
Minnesota	MINN. STAT. ANN. § 80A.15(2)(j) (West 1986 & Supp. 1997). (Exempt transactions)	An offer and sale by a cooperative of securities when they are offered only to members, or incidental to establishing membership, or when they are issued as patronage dividends are exempt. Foreign corporations must also comply with minor filing requirements to get this exemption.
	MINN. STAT. ANN. § 308A.505 (West 1996).	"Cooperatives are subject to the provisions of chapter 80A, except as specifically provided in section 80A.15."
Mississippi	MISS. CODE ANN. § 75-71-201(12) (1991). (Exempt securities)	All cooperatives organized under the Mississippi law, operating wholly within the state, where all stockholders are bona fide legal residents of

Mississippi (cont.)		Mississippi, and the cooperative has no nonresident promoter interested therein are exempt. IRC section 521 cooperative members do not need to be "bona fide legal residents of Mississippi."
Missouri	<p>MO. ANN. STAT. § 409.402(a)(5) (West 1990). (Exemptions)</p> <p>MO. ANN. STAT. § 409.402(b)(16) (West 1990). (Exempt transactions)</p>	<p>Any security issued by an agricultural cooperative corporation organized under the laws of this state and operated as an agricultural "cooperative association" is exempt if the commissioner is notified in writing thirty days, or such shorter period of time as the commissioner may by rule or order specify, before any such security is sold or offered for sale other than in transactions exempted under subsection (b) hereof, which notification shall contain the form of prospectus or other sales literature intended to be used in connection with the offering of such security together with financial statements.</p> <p>Any agricultural cooperative's patronage distribution is exempt.</p>
Montana		No exemptions
Nebraska	<p>NEB. REV. STAT. ANN. § 8-1111(15) (Michie 1995). (Exempt transactions)</p> <p>NEB. REV. STAT. ANN. § 70-734 (Michie 1995).</p>	<p>Any transaction involving an issuance for cash of any evidence of ownership interest or indebtedness by any agricultural cooperative formed as a corporation under Nebraska Statute sections 21-1301 or 21-1401 is exempt as long as certain notice procedures are followed.</p> <p>Obligations issued by an electric cooperative to secure obligations to an agency of the U.S. government are exempt.</p>

Nevada	NEV. REV. STAT. § 90.520(1)(m) (1995). (Exempt securities)	Membership, equity interests in, or retention certificates or like security given in place of cash patronage dividend by a cooperative organized and operated as a nonprofit membership cooperative under the cooperative laws of any state are exempt, if not traded to the public.
New Hampshire	N.H. REV. STAT. ANN. § 421-B:17 II (Michie Supp. 1996). (Exemptions)	The offer and sale of securities needed to establish membership in a cooperative, or when such securities are issued as patronage dividends are exempt if the cooperative is organized under N.H. law and such securities are offered and sold only to cooperative members.
New Jersey	N.J. STAT. ANN. § 4:13-2.1 (West 1991).	Agricultural cooperatives are exempt.
New Mexico	N.M. STAT. ANN. § 62:15-30 (Michie 1993). (Exempt securities)	The Securities Act does not apply to any evidence of indebtedness to a federal agency or to membership certificates issued by any cooperative.
	N.M. STAT. ANN. § 58-13B-26(L) (Michie 1997). (Exempt securities)	Membership, equity interests in, or retention certificates, or like security given in place of cash patronage dividend by a cooperative organized and operated as a nonprofit membership cooperative, under any state's laws are exempt, if said securities are not traded to the public.
New York	N.Y. RURAL ELEC. COOP. LAW § 68 (McKinney 1948). (Exempt securities)	Obligations issued by an electric cooperative to the U.S. government, or its agencies, or an obligation to secure such obligations are exempt. Membership certificates of electric cooperatives are also exempt.
North Carolina	N.C. GEN. STAT. § 78A-16(14) (1994). (Exempt securities)	Securities issued by a mutual association, agricultural marketing association (cooperative), or electric or telephone cooperative are exempt.
North Dakota	N.D. CENT. CODE § 10-04-05(9) (1995). (Exempt securities)	Securities issued by any cooperative formed under the North Dakota statutes are exempt.

North Dakota (cont.)	N.D. CENT. CODE § 10-13-08 (1998).	The securities laws do not apply to membership certificates in electric cooperatives, nor to obligations issued by such cooperatives to secure moneys borrowed by the cooperative from a federal agency.
Ohio	OHIO REV. CODE ANN. § 1707.02(I) (Anderson 1992). (Exempt securities)	Any security, other than notes, bonds, debentures, or other evidences of indebtedness or of promises or agreements to pay money, which is issued by a not for profit association organized exclusively for conducting cooperative marketing, is exempt, if no part of the net earnings of the cooperative inures to the benefit of any shareholder or member of such issuer or to any individual, and if the total commission, remuneration, expense, or discount in connection with the sale of such securities does not exceed 2% of the total sale price thereof plus \$500.
Oklahoma	OKLA. STAT. ANN. tit. 71, § 401(a)(4) (West Supp. 1998). (Exemptions) OKLA. STAT. ANN. tit. 18, § 437.27 (West 1986).	Membership, equity interests in, or any retention certificates or like security given in place of a cash patronage dividend issued by a cooperative, operated as a not-for-profit membership cooperative under the laws of any state, are exempt if they are not traded to the public. Notes, bonds, or other evidence of indebtedness issued to the U.S. government agency or instrumentality of it, or to any mortgage, deed of trust, or other instrument executed to secure such indebtedness are exempt. The Securities Act does not apply to the issuance of membership certificates by any electric cooperative.
Oregon	OR. REV. STAT. § 59.025(9) (1995). (Exempt securities)	Stock or membership certificates issued by an agricultural cooperative, corporation, or irrigation association are exempt if stock is issued to show membership in the cooperative or association. Patronage dividends and

Oregon (cont.)	OR. REV. STAT. § 59.025(10) (1995). (Exempt securities)	certificates issued to members or patrons by such a cooperative or association to show their respective interests in reserves or as patronage dividends are exempt. Exemption does not apply to cooperatives that produce, process, or market forest products.
	OR. REV. STAT. § 59.025(11) (1995). (Exempt securities)	Stock or membership certificates issued by a fishing cooperative corporation, when stock or certificates are for purpose of showing membership in the cooperative or for showing interests in reserves or patronage dividends are exempt.
		Stock or membership certificates issued by a consumer cooperative when the stock or certificates are issued to members either for the purpose of showing membership in the association or for the purpose of showing their interests in patronage dividends or reserves are exempt. Some limitations apply.
Pennsylvania	68 PA. CONS. STAT. ANN. § 4407 (West 1994).	An interest in a cooperative is not a security and is exempt from Pennsylvania's Securities Act.
	15 PA. CONS. STAT. ANN. § 7335 (West 1994).	The Securities Act does not apply to obligations issued to secure payment of money borrowed from a federal agency.
Rhode Island	R.I. GEN. LAWS § 7-8-31 (1992).	The securities law does not apply to stock or memberships in any consumer cooperative.
	R.I. GEN. LAWS § 7-11-401(13) (1992). (Exempt securities)	A membership or equity interest, or retention certificate or like security given in place of a cash patronage dividend issued by a cooperative organized and operated as a nonprofit membership cooperative under any state's cooperative laws is exempt, if not traded to the public.

South Carolina	<p>S.C. CODE ANN. § 35-1-310(11) (Law. Co-op. 1987). (Exempt securities)</p> <p>S.C. CODE ANN. § 33-49-60 (Law. Co-op. 1990). (Exempt securities)</p>	<p>Any security issued by a cooperative association organized under the laws of South Carolina is exempt.</p> <p>Notes, bonds, or other evidence of indebtedness issued by any rural electric cooperative transacting business in South Carolina, to U.S. government or any agency or instrumentality thereof, or any mortgage, or deed of trust executed to secure such debt are exempt. Membership certificates issued by any such cooperative are also exempt.</p>
South Dakota	<p>S.D. CODIFIED LAWS § 47-31A-402(a)(12) (Michie 1991). (Exempt securities)</p>	<p>Any securities of an agricultural cooperative, rural telephone, or rural development project cooperative sold only to members for the purpose of conducting the cooperative's business are exempt.</p>
Tennessee	<p>TENN. CODE ANN. § 48-2-103(a)(12) (1995). (Exempt securities)</p> <p>TENN. CODE ANN. § 65-25-224 (1993). (Exempt securities)</p>	<p>Securities, stocks, and bonds of an agricultural cooperative are exempt.</p> <p>Indebtedness to a federal agency, or securities to secure such debt, and membership certificates of electric and telephone cooperatives are exempt.</p>
Texas	<p>TEX. REV. CIV. STAT. ANN. art. 1528b, § 31 (West 1997). (Exempt securities)</p> <p>TEX. REV. CIV. STAT. ANN. art. 581-5(N) (West Supp. 1997). (Exempt transactions)</p>	<p>Obligations issued by electric cooperatives to secure the payment of money borrowed from federal agencies shall be exempt from the provisions of the Texas Securities Act. Membership certificates to electric cooperatives are also exempt.</p> <p>Sale and issuance of any securities by a farmers cooperative organized under the Cooperative Association Act are exempt when offered only to members and no commission is paid on such sale.</p>

Utah	UTAH CODE ANN. § 61-1-14(1)(h)(ii) (1997). (Exempt securities)	Agricultural cooperative securities are exempt.
Vermont	VT. STAT. ANN. tit. 9, § 4204a(a)(10) (1993). (Exempt securities) VT. STAT. ANN. tit. 9, § 4203a (1993). (Exempt securities)	"Any security issued by a cooperative organized pursuant to chapter 7, 8, or 14 of Title 11" or issued by a cooperative "organized under the laws of another state that has been duly qualified to do business" in Vermont are exempt, if the securities are offered only to members, or if purchase of the securities is needed to establish membership in the cooperative, or if "such securities are issued as patronage dividends." Evidence of indebtedness to a U.S. government agency or other instrument to secure such indebtedness, and issuance of membership certificates by an electric cooperative are exempt from the securities law.
Virginia	VA. CODE ANN. § 13.1-514(A)(11) (Michie 1993). (Exempt securities)	Any security issued by cooperative organized as a corporation under the laws of Virginia is exempt.
Washington	WASH. REV. CODE ANN. § 21.20.320(16) (West 1989 & Supp. 1997). (Exempt transactions)	A transaction by a mutual or cooperative association is exempt if: the transaction does not involve advertising or public solicitation; and the association first files a notice of claim of exemption and the exemption is not denied within the next ten full business days; or the association is an employee cooperative and identifies itself as such in advertising or public solicitation and the transaction involves an instrument or interest that qualifies its holder to be a member or patron of the association; or represents a contribution of capital to the association by a person who is or intends to become a member or patron of the association or represents a patronage dividend or other

Washington (cont.)		patronage allocation; or it represents the terms or conditions by which a member or patron purchases, sells, or markets products, commodities, or services from, to, or through the association; and if it is nontransferable except in the case of death, operation of law, bona fide transfer for security purposes only to the association, a bank, or other financial institution, intrafamily transfer, or transfer to an existing member or person who will become a member and, in the case of an instrument, so states conspicuously on its face.
West Virginia	W. VA. CODE § 32-4-402(a)(12) (Supp. 1997)	Agricultural cooperatives are exempt.
Wisconsin	WIS. STAT. ANN § 551.22(12) (West Supp. 1997) (Exempt securities)	Securities of a cooperative corporation organized under Wis. STAT. § 185 are exempt.
Wyoming	WYO. STAT. ANN. § 17-20-104 (Michie 1996) (Exempt securities)	Notes, bonds, or other evidence of indebtedness issued by a utility to the United States government or its agencies or instrumentalities, or a mortgage or deed of trust executed to secure such indebtedness, are exempt. Issuance of membership certificates or proxies by a cooperative utility is also exempt.

