



DISSENTER'S RIGHTS AND THE ISSUE OF ONE MEMBER, ONE VOTE

Background

From their inception, cooperatives were intended to represent a singularly unique form of business organization. Cooperative history and philosophy provide more than an adequate basis for this intentional differentiation. Patronage distribution practices and member voting rather than shareholder-voting are just two examples of cooperatives' unique characteristics.

To compete with their investor-owned corporate counterparts, patron-owned cooperatives have long sought improved operational efficiencies, often achieving that goal through mergers and consolidations with other cooperatives. Title 23B of the Washington State Code's General Business Corporation Law, Section 23B.13, includes reference to dissenting shareholder rights. Under a now-repealed statute (Title 24.32), cooperatives organized under that statute were subject to Title 23B, as described above. However, despite heavy merger/consolidation activity among cooperatives during the period of 1970-1989, there exists no record of any cooperative member choosing to exercise their dissenter's rights under the statute noted. Realistically, no barriers thereby existed which might have restricted or prohibited a cooperative from achieving enhanced operational efficiencies through merger or consolidation.

In 1989, RCW 23.86 was approved as the sole surviving statute under which

cooperative operations are governed. At that point a dissenting member's vote cast (in a minority position) in a pending cooperative merger/consolidation election conveyed to that member the right to receive fair market value for their investment in the cooperative corporation. In essence, the cooperative member was presumed to be entitled to receive their membership fee, and 100 percent of their equity in the cooperative, and (under certain conditions) some portion of the appreciated value of the cooperative.

Most Washington cooperatives are financed through member per-unit returns and/or retained patronage earnings. These are subsequently redeemed over a period of years generally referred to as the "equity revolve period." Should a cooperative seeking to merge/consolidate be faced with the need to redeem -- at fair market value -- the equity of its dissenting members, those firms could confront serious financial consequences. As a result, some cooperatives exploring the economic prospects of a merger/consolidation chose to terminate such analyses rather than face a financially uncertain consequence.

Why Dissenter's Rights?

Statutory reference to dissenter's rights is well-founded and reference to such can be found in the corporate statutes of most states. Underlying the stipulation of such rights lies the prevailing philosophy that corporations may not use funds provided by an investing public for purposes, which those investors (individually or collectively) find unacceptable. The corporate investor places their funds, voluntarily, with a corporation based on a

prospective and a speculative expectation of a return on that investment. If, following that act of investing, the corporation elects to undertake a major act such as a merger/consolidation, and the investor votes his/her shares in opposition to that act, the investor is afforded the right to be cashed out. The underlying premise is that corporate investors, particularly those voting in the minority, should not be forced by the majority shareholders to have their equity position utilized in ways the dissenting investor disapproves. Dissenter's rights statutes generally provide dissenting shareholders with cash-out privileges at fair market value for the shares held by the dissenters. It may be necessary that the corporation be appraised to ascertain this fair value. If the two fail to reach an accord on a fair value, the dispute may be subject to court ruling. In most cases, when such rights are exercised, a public market for the corporate stock is viable and fair values are, thereby, easily attainable without a costly dispute. In publicly held business entities herein described, dissenter's rights are easily afforded and do not represent a major problem for investors or investor-owned corporations.

The Cooperative Problem

While dissenter's rights enjoy a sound philosophical basis as they relate to investor-owned corporations, they are both inappropriate and unjust in their impact on patron-owned cooperative corporations.

First of all, dissenter's rights are linked to shareholders in, not patron-members of, a business. Investor-owned corporate interests can be and are controlled by shareholders based on a one-share, one-vote, basis. Patron-owned cooperatives are conversely, generally controlled by patrons based on a one-member, one-vote basis. A corporate shareholder, therefore, can enhance his/her voting influence through the acquisition of the simple majority of shares outstanding. Corporate actions, thereby undertaken, can be initiated against the wishes or welfare of minority shareholders. Dissenter's rights

restrict such actions and protect minority shareholders. A patron-owned cooperative, however, is governed differently. No single member-patron is afforded voting influence beyond their single vote. Additional equity held by that member as a result of a voluntary investment (preferred stock) or held in the form of certificates of equity (retained earnings) does not accrue a governance privilege beyond the single vote. Cooperative control, therefore, reflects a "true democracy" in the sense that shareholder influence is restricted to a single vote cast to reflect the member's interest in a single share of membership common (voting) stock. Those voting in the "minority," therefore, are not subject to the actions imposed on them by large volume investors or equity holders.

Second, as applied to cooperatives, dissenter's rights would permit one or more members voting in the minority to cash out or liquidate their equity positions "early," to the potential detriment of all other cooperative members. Since most cooperative equity is held in the form of issue-dated certificates of equity, that equity is redeemed (under an equity capital resolve program) on a first retained, first redeemed basis. Dissenter's rights, subsequent to the 1989 law, provided dissenting members with full redemption privileges in advance of all other members. Not only did this destroy the credibility of the equity capital program, it potentially reduced capital reserves to the point where the financial welfare of remaining members was seriously threatened.

Dissenter's Sequence of Actions

Chapter 23B.13 describes dissenter's rights and prescribes the sequential process by which claims are to be handled. In general, that process is as follows:

- (1) The chapter first describes the corporate "shareholders" as the person in whose name shares are registered in the records of the corporation. The "fair value" of the dissenter's claim is defined as the

value of the shares immediately before the effective date of the corporate action to which the dissenter objects.

- (2) The events giving rise to dissenter's rights are next defined. Dissenter's rights are activated when a corporation acts to consummate a plan of merger; a plan of share exchange to which the corporation is a party as the corporations whose shares will be acquired; or the sale or exchange of all, or substantially all, of the property of the corporation other than in the usual and regular course of business.
- (3) When the above actions are submitted to a vote at a shareholder's meeting, the meeting notice must state that shareholders are or may be entitled to assert dissenter's rights under 23B.13 and a copy of this chapter must accompany this notice.
- (4) Votes regarding the proposed corporate action must be taken.
- (5) Following the vote, those shareholders voting in the minority must receive notice within 10 days after the effective date of the corporate action, stating where payment demand must be sent and certificate deposited and setting a due date (30-60 days) for receipt of the demand.
- (6) Next, the dissenters must demand payment and certify whether the shareholder acquired beneficial ownership of the shares before the required date.
- (7) The affected corporation must then pay the dissenter the fair value within 30 days of the later of the effective date or receipt of the payment demand. Such payment

must be accompanied by a copy of the corporation's balance sheet, an explanation of how the corporation estimated the fair value of the shares, and an explanation of how the interest was calculated.

- (8) If the dissenting shareholders are dissatisfied with the corporation's payment or offer, they have 30 days within which to notify the corporation that additional payments are due.
- (9) The affected corporation then has 60 days following the added payments demand to petition the court to determine the fair value of the dissenting shares.
- (10) Finally, the court will enter a judgment as to the fair value. The corporation is responsible for the costs of corporate appraisal unless it can be shown that the dissenter acted vexatiously, arbitrarily, or not in good faith. The corporation may also be responsible for legal fees if it did not substantially comply with the terms of 23B.13.

As described above, the prescribed process for addressing dissenter's rights can be long, complex, and costly. An agribusiness firm would be foolish to discount the consequences of noncompliance. Reference to the appraisal process is particularly bothersome for a cooperative insofar as a cooperative member typically does not share in the appreciation in value of the organization until the eventual liquidation of the firm. Even then, their claim is not in proportion to their ownership, but rather in proportion to their patronage in the cooperative (as reflected by the amount of equity they hold). To address this problem, the Washington State legislation included a provision in the law whereby cooperative Articles of Incorporation can stipulate the limiting of fair value to a member's equity in the cooperative (but in no event may this be less than the consideration originally paid or

retained, or the fair value, whichever is less). While this limits the payment of appreciated values over time, problems related to cashing out the equity held by dissenters remain evident and often substantial.

The issue of dissenter's rights for cooperative members is not unique to the Pacific Northwest. Of 20 states surveyed by Don Franklin for the Washington State Council of Farmer Cooperatives (September, 1993), six states treated cooperative dissenters in the same manner as for profit corporations in those states, i.e., fair value was to be paid, including some appreciation in value over book value. Five states made no mention whatsoever, to dissenter's rights within their cooperative corporation statutes. Seven states afforded their cooperatives more protection (than Washington cooperatives) by stating that no dissenter's rights exist or that payment of claimed equities are to be paid over a prescribed period of years. Two states maintain more rigid statutes requiring payment of fair value within 30 days.

Solution Options

As Washington-based agribusiness cooperatives confronted the problem of dissenter's rights, several alternative solutions were considered, discussed, and explored. They included the following:

- (1) Status quo/do nothing. Learn to live with the statutory requirements and hope that mergers/consolidations are not threatened by costly dissenter's rights litigation.
- (2) Eliminate the right. Follow Idaho's lead by seeking statutory relief through the specific elimination of dissenter's rights for cooperative corporations.
- (3) Treat dissenters as terminated members. Use a model followed in California wherein the dissenting member is allowed to resign from his/her cooperative and afforded the

same rights as would have existed had this member not terminated, i.e., equity paid out in the normal course of the revolving program then followed by the cooperative.

- (4) Limit the fair value. Seek statutory specification, which would specifically prescribe the limits within which fair value could be determined, presumably removing the appreciated value question.
- (5) Apply discounted present value. Add legislative authority for the use of a discounted present value formula in computing the amounts paid to a dissenter the discount period to match the length of the current revolve period, discounted at current market rates for similar non-interest bearing securities.
- (6) Prescribed period of repayment. Authorize cooperatives to pay the claims of dissenters in equal annual amounts over a prescribed number of years.
- (7) Litigate for a precedent. Argue that dissenter's rights, as impacting shareholder corporations, should be applied only to the value of those "voting" shares held by the cooperative member. The basis here is that share values attach only to voting stock insofar as it is that vote, alone, which was cast in a minority position, thereby giving rise to a dissenter's right. Since cooperative members generally retain only a single share of voting stock, the dissenter's claim would apply only to this share and its modest value (see later discussion).

Solution Implemented

Each of the above options were discussed with the Washington State Council and their individual strengths/weaknesses considered.

Option 1 was not found to be very appealing insofar as the mere threat of dissenting members' actions represented a consequence of unknown magnitude. Option 2 was discarded in light of industry opinions that it would serve only to wave a "red flag" to those presuming that cooperatives were asking for "special treatment" under existing codes. Options 4, 5, and 6 raised a series of ambiguous questions regarding appropriate limits, correct discount rate and term, and an arbitrarily selected period for repayment. Option 3 was selected and heavily supported by the membership of the Washington State Council of Farmer Cooperatives.

As a result, SB 6492 was drafted and submitted for legislative consideration in late 1993. SB 6492 proposed to modify dissenter's rights in agricultural cooperatives and preserve cooperative principles essential to continued advancement of the cooperative way of doing business. In particular, SB 6492 maintained cooperative control among active members and disallowed attempts by retired or former members to interfere with the operation of the cooperative. It maintained equal treatment of members and prevented dissenters from disrupting the planned or normal sequence of cooperative equity repayment. It was prospective legislation insofar as it did not impact any pending merger/consolidation considerations. Neither did SB 6492 reduce equities due dissenters in any form, i.e., it simply required that they be repaid, in the order of issuance, with all other members. The critical section of SB 6492, as adopted by the senate 46 to 0 and later signed by the governor, prescribed that, "Any member of an agricultural association who exercises the right to dissent from an association action described in RCW 23.86.135 shall be entitled to payment of the member's equity interest on the same time schedule that would have applied if membership in the association had been terminated."

Postscript

Option 7 was not pursued due to its potential cost and lack of legal precedent. Ex post facto we can now look back to a recent court ruling described in "Legal Corner," *Farmer Cooperatives*, April 1994, pp. 17-18. This case involves the Indiana Farm Bureau Cooperative Association (IFBCA). The cooperative sought a declaratory judgment that the dissenter's rights, if they existed at all, applied only to its one share of voting common stock. In this case, the trial court granted summary judgment in favor of the member-dissenter and the results were appealed to the Indiana Court of Appeals. The Appeals Court reversed the lower court decision, holding that the members' dissenter's rights extended only to its one share of common voting stock. The court noted the emphasis in the Cooperative Act merger provision on one's status as a "member" instead of one's position as a "shareholder" for purposes of determining one's voting and other rights at the time of the merger.

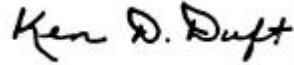
The member raised an interesting point that the court is allowing cooperatives to concentrate the member's equity value in non-voting shares so that it then has to pay only a nominal amount to a dissenting member. On its face, this perspective has some basis. But, the court held that this perspective fails to account for cooperative decision-making based on the democratic, one-person, one-vote principle rather than the amount of one's equity investment in the cooperative.

The dissenting member has now appealed this decision to the Indiana Supreme Court. Should the Appeals Court decision be upheld, a legal precedent will have been set such that Option 7 would have been afforded more favorable treatment.

SUMMARY

Dissenter's rights are not an issue, which has long plagued agricultural cooperatives. In those states, however, where such rights do apply, they represent a barrier to cooperative mergers/consolidation of significant magnitude. In Washington State, alone, several opportunistic mergers were sidetracked as the industry sought a solution to the mandatory "cash out" provisions associated with dissenter's rights. Washington State's solution was to seek statutory authority to treat dissenter's equity in a manner analogous to retired or ex-cooperative members. The solution is

consistent with the long-standing cooperative philosophy of equitable treatment for all cooperative patrons past and present. Subsequent litigation relating to an Indiana Supreme Court ruling may further clarify the issue insofar as the cooperative practice of one-member, one-vote serves to differentiate the cooperative from its one-shareholder, one-vote corporate counterpart.



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