

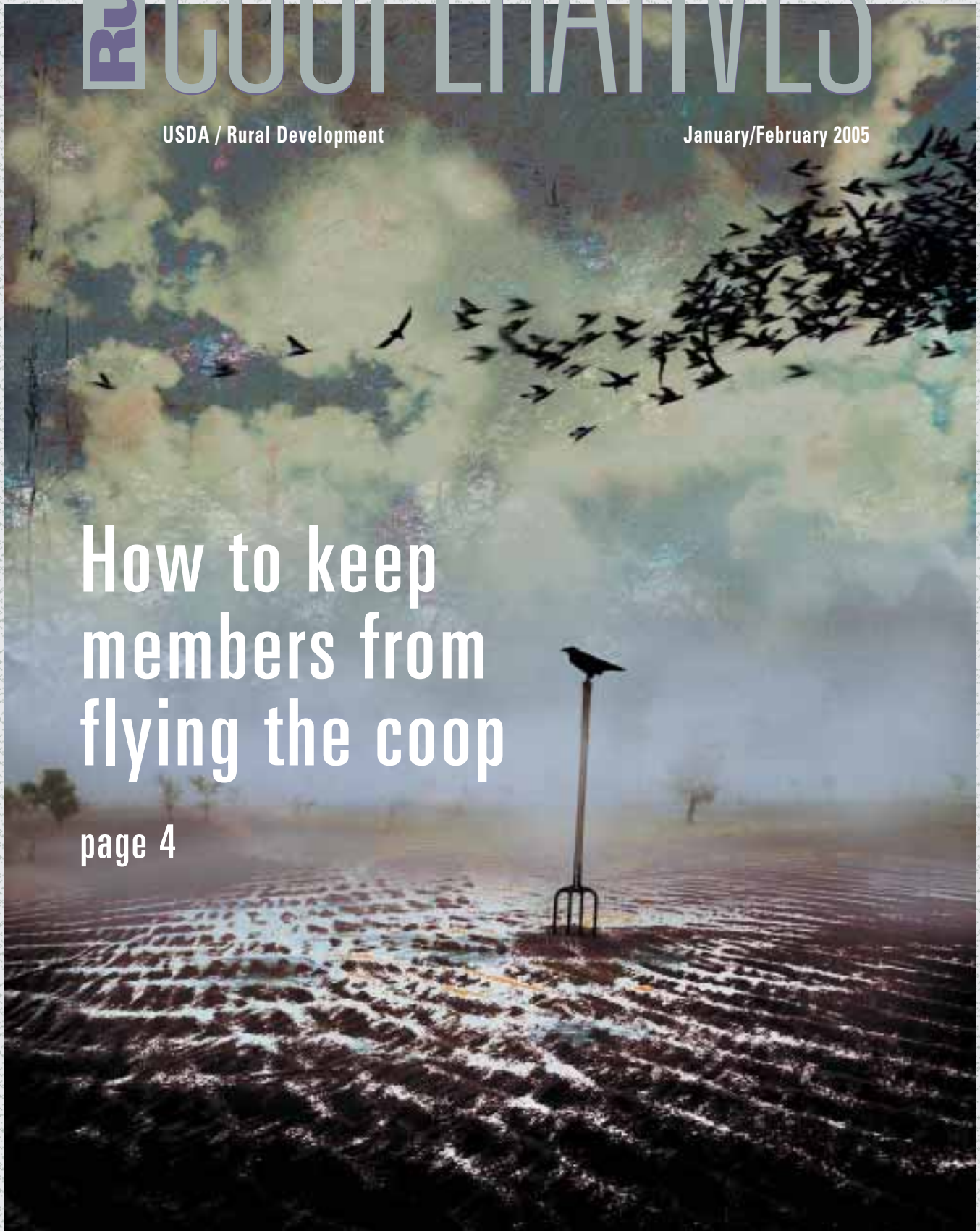
Rural COOPERATIVES

USDA / Rural Development

January/February 2005

How to keep
members from
flying the coop

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Rural America's role in the energy economy

As the second term of the Bush administration begins, I want to express USDA Rural Development's continued commitment to the positive agenda the President has outlined for rural America. A major component of the administration's domestic agenda continues to be forming a new energy policy with the development of renewable energy technology playing a key role. This ties into our bio-based and bio-energy programs. Both the nation's farmer and utility cooperatives are playing a major role in this effort, and that role will certainly grow in the years ahead.

This effort includes the Renewable Energy Systems and Energy Efficiency Improvements Grant Program (9006) from the 2002 Farm Bill. This initiative makes it possible to finance the purchase of renewable energy systems and to make energy improvements for agricultural producers and rural small businesses through grants offered through our business programs. Other efforts include USDA Rural Development electric loans that encourage the inclusion of renewable energy sources to help power America's rural electric grid.

To help achieve this goal, USDA Rural Development has forged a partnership with the Environmental Protection Agency to promote development of new, agricultural-based renewable energy projects (see Newline, page 40). This pro-

President Bush has said America must have an energy policy that plans for the future, but meets the needs of today.

gram will benefit the environment, will help reduce our dependence on foreign oil and will boost revenues for farmers and their co-ops, which in turn bolsters the entire rural economy.

President Bush has said America must have an energy policy that plans for the future, but meets the needs of today. This will be our goal as we finance new technologies needed to convert bio-mass into bio-based products and bio-energy in a manner which is cost-competitive in large national and international markets. U.S. production of ethanol from corn was 60 million gallons in the mid-1970s; in 2004, the U.S. produced an estimated 3.4 billion gallons.

USDA has also made great progress in the implementation of the President's management agenda, including the e-Government Initiative; our services are now available on the World Wide Web. As a result, our programs are more

user-friendly to consumers and producers.

In the 1890 Land Grant Colleges and Universities Initiative, we added 30 new 1890 scholars in December. Our goal is to hire some of these 1890 scholars for exceptional careers here at USDA.

One of the more competitive programs available through USDA Rural Development's Cooperative Programs is the Value-Added Producer Grants (VAPG). These grants consist of planning or using working capital to establish a value-added agricultural marketing venture, many of which are owned by cooperatives. For an example, see the Value-Added Corner on page 15 of this issue for a look at Golden Ridge Cheese Cooperative in Iowa and the article about Crooked Bow beef strips on page 7. Last year, approximately \$13.2 million in grants were available for up-and-coming cooperatives in rural America.

As you can see, our USDA Rural Development team is committed to providing strong leadership to increase economic opportunities and improve the quality of life for citizens living in America's rural communities. We look forward to working with you to bring such opportunities to you and your community. ■

— **Peter J. Thomas**,
Administrator,
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On the Cover:

Our cover story discusses strategy for preventing members from "flying the coop." Greg Spalenka's art has also been featured in Time, Newsweek, The Wall Street Journal, New York and Los Angeles Times and many other publications and books. To see more, visit: www.spalenka.com.



Flying the coop

Why members leave a co-op and ways to help prevent it

By Catherine Merlo

Editor's note: Merlo is a freelance writer and former co-op communications director based in Bakersfield, Calif., who specializes in issues pertaining to cooperatives.

In August 2002, grower Greg Palla rose before the board of directors of a major regional marketing cooperative and made a startling announcement.

Standing before the group during executive session, Palla announced he was resigning from the 50-member board after nearly 10 years as one of its directors.

"They were shocked," Palla remembers.

But they shouldn't have been, says the 49-year-old, whose family had been with the farmer-owned co-op since the 1930s. Palla himself had been a member for more than 20 years.

"For months, I had been urging the co-op to reconsider its process for selecting a new chief executive officer (CEO)," he says. "It was faulty. Also, the co-op had exhibited poor performance. I felt the board did not have proper oversight on the co-op's policy or management."

The co-op, accustomed to annual sales of \$500 million and higher, had come through a rough marketing season the year before. For the first time in decades, it had been forced to ask for a return on payment advances made to members. That had caused widespread

consternation. Coincidentally, the co-op's long-time CEO was preparing to retire, and the search had begun for new management.

Palla had expressed his views about the board's "inherent deficiency in its oversight of management." He had recommended more emphasis on strategic planning. He had even suggested the board consider adding an outside director to offer a different perspective. He had been met with what he calls "cross looks."

"The board was not inclined to hear my message," says Palla.

Changes weren't made. Six months after his resignation from the board, Palla ended his connection with the association during the co-op's annual membership sign-out period.

Lack of response prompts co-op members to quit

Palla wasn't alone in his departure. Three more long-time directors soon resigned from the co-op's board and membership. Numerous members also withdrew, angry and disappointed over having to pay back the advances the co-op had overpaid on its marketing pools.

The co-op's management troubles deepened. Nine months after hiring him, the board fired the new CEO.

The experience hasn't soured Palla on co-ops. He remains a member of two other co-ops and serves as board chairman for one of them.

"I still believe in growers banding together to enjoy economies of scale and have ownership in their particular activity," he says. "But what happened made me aware there are inherent concerns at co-ops."

Today, the co-op Palla left has rebounded with a new CEO, a return of many previously departed members and successful results. But both Palla and the co-op have learned hard lessons from the experience.

Reality of member departures

The case illustrates the reality that few cooperatives publicly like to talk about: members do grow unhappy and withdraw from their cooperatives. Certainly, not all member withdrawals stem from frustration. A co-op can lose members when they die, retire or leave the business.

But co-ops also lose members for more sharp-edged reasons, such as poor performance by the association, questions about its credibility or leadership, or inadequate products and services. In an era of fewer farmers and farmer-owned co-ops, membership loss can pose serious problems for a co-op.

According to USDA's Farmer Cooperative Statistics for 2002, U.S. farmer cooperatives number 3,140, down 89 from 2001. This includes losses from mergers, closures and conversions. Between 1993 and 2002, memberships in U.S. farmer cooperatives dropped from 4 million to 2.8

million. This decline reflects the decreasing number of farms, farmers and ranchers in the United States. But these numbers also drive home the importance of sustaining cooperative membership when the overall pie shrinks — at a time when volume matters and markets have become more competitive.

Co-ops that have strayed too far from their original purpose or aren't in touch with member needs "are often the co-ops with the most problems and least loyal membership."

—Joe Huffine

Performance first

A co-op's performance is paramount in retaining members, says Dan Vincent, president of Pacific Coast Producers (PCP), a 176-member fruit and vegetable processing and marketing cooperative based in Lodi, Calif.

Vincent, who became PCP president in June 2004, says, "The best advice I've had came from our previous president: Run the co-op like a business. In today's market, members are investing in us and expecting a decent return. If they're not getting it, they'll take their business somewhere else."

Palla agrees. "A co-op can buy ads and give out hats and toys, but perfor-

mance speaks much more loudly," he says.

Problems can develop when members perceive their co-op isn't doing as well as a competitor or the open market, or if its performance has lagged behind the industry average for three or four years.

"A co-op can lose members when there's no real or perceived value in the co-op," says Joe Huffine, manager of member services for Tennessee Farmers Cooperative, a federated farm supply co-op with 64 members representing 70,000 farmers.

"It's very important to evaluate the services offered to determine if they're being utilized or meeting current needs," Huffine says.

Not meeting members' needs can create indifference to the co-op, adds Huffine. Members can also drift away when they perceive the co-op is not focused on profitability or future growth and needs.

"When you're not returning patronage, when they see little or no value or your co-op's services are not compatible with their needs, members can become disenchanted," Huffine says. "Then the co-op becomes like any other business and members may seek out someone else. Perceived indifference to members can create a wall of obstruction for any business, especially a cooperative."

Co-ops that have strayed too far from their original purpose or aren't in touch with member needs, Huffine adds, "are often the co-ops with the most problems and least loyal membership."

Contending with competition

Co-ops also may lose members to competing businesses or even other farmer-owned organizations.

"Competition is legitimate and can be healthy for business," Huffine says. "But it can also be a death sentence for co-ops not willing to adapt to current membership and market demands."

He points out that many co-ops no longer have just local competitors to contend with. With the advent of

national companies through attrition and consolidation, competition has widened to a national scope. Farmers and ranchers can even turn to the Internet for products and services. All that's created an atmosphere of "survival of the fittest," Huffine says.

Competitors looking to boost their market share can do more than offer promises of better prices, products or services. They can sabotage a co-op's efforts, undermine its relationship with members or deliberately attempt to woo them away.

Dr. Shermain Hardesty, Extension economist for cooperatives and marketing at the University of California at Davis, has seen that happen between co-ops.

"There were two rival co-ops in California," Hardesty says. "One co-op had been struggling, and the other said all kinds of negative things about it. This just added fuel to the fire."

The negative campaign created more doubt in the minds of members at the struggling co-op. As a result, Hardesty says, many members left the troubled co-op, further weakening it. In time, it closed its doors for good.

The role of the board

A co-op's board plays an important role in member retention. In fact, "the board can make or break a co-op," Huffine says.

"A board member plays a significant role because he or she represents members," Hardesty agrees. "It's his or her duty to be in touch with them."

"If board members are fulfilling their responsibilities so that a co-op achieves its performance objectives, why would a member go anywhere else?" asks Palla.

But too often, board members fail in their responsibilities.

"The majority of board members are often there for the ride," says Palla. "Too many directors view their role more as an honor rather than performing a fiduciary responsibility representing the membership. It becomes a social club."

That happens frequently because

farming communities, where directors usually live, are small and close-knit, Palla says. Farms are so often steeped in family tradition that it can be hard to separate the family farm from the co-op.

Palla recalls hearing one long-time director emphatically state that the co-op's board had only to hire a CEO, not question his or her management decisions.

"That doesn't sit right with me," Palla says. "If a board member is not questioning management, he's not fulfilling his fiduciary responsibility."

Further, he says, "I maintain that the board needs to review its strategic plan and the performance of its CEO on an annual basis. That is the minimal fulfillment of a director's fiduciary responsibility."

Communications are essential

Whether it's between directors and members, or directors and management, or management and members,

communications are essential to solid member relations. Forthright and straightforward communications are the best way to earn members' trust and support, says Palla.

"Make sure the membership understands how the co-op is attaining its level of performance," says Palla. "If the performance is less than targeted, explain why — not with excuses, but with reasonable, plausible explanations. That's the best way."

The small service co-op where Palla serves as board chairman is doing a "great job" of member retention, he says, despite fewer producers as a result of retirements and consolidation of farming operations. Its success is partly due to a board that "sets aside its own personal objectives in favor of the co-op's objective."

The co-op also does a good job communicating its performance status to members. "The books are open to them," Palla says. "We go through all financial statements in detail at least

Actions that help retain members

In addition to delivering a strong financial performance, co-ops can help retain their members in other ways, such as:

- **Listening.** Board members and management should listen to members to be aware of what they want and need. Create opportunities by holding meetings or roundtable discussions or simply visiting with members.
- **Educating.** Whether it's through face-to-face meetings or a regular newsletter, keep members informed about performance, policy decisions, co-op procedures or industry development. "Many co-ops today have members who are third and fourth generation owners," says Joe Huffine of Tennessee Farmers Cooperative. "The younger generation has no sweat equity in the co-op. It's always had the co-op in the community. It's imperative for a co-op to educate the next generation of members and employees."
- **Being involved in the community.** "If you're an integral part of the community, people will support you better," says Huffine. "Publicize the good you do for your community." Those efforts might include scholarships, support of youth organizations like FFA or 4-H, or volunteering activities by co-op employees.
- **Taking a fresh look.** A co-op may need a face lift in its mission, strategy or marketing efforts. Maybe it's time to reintroduce your co-op to its community with a name recognition campaign. Annual meetings may also need some revising. "Co-ops need to take a close look at their annual meetings," says Huffine. "Are you getting enough bang for your buck at them? Are you happy or satisfied with them?" He suggests co-ops may want to plan annual meetings with more member education on the agenda. ■

once a year with members.”

Whether a co-op is large or small, it needs the support of its members to survive. Member retention takes work, commitment and a willingness to adapt to the needs of your members, Huffine says.

“If you’re losing members, if you’re not getting growth or your margins are

eroding, it’s time to reevaluate the benefit of your co-op to members today,” he says. “Maybe you need a third party to analyze your co-op. Problems may be invisible to us but obvious to others. It may be time to adopt a new business or marketing strategy.”

As for Palla, he remains confident of his decision to leave the co-op. “I

have no regrets whatsoever,” he says, “except that I wasn’t able to be more effective in getting the board to recognize the problems I saw. The rank-and-file member who’s not inside the leadership is dependent on those leaders to lead. Having seen it from the inside, I can say it’s often not adequate at all.” ■

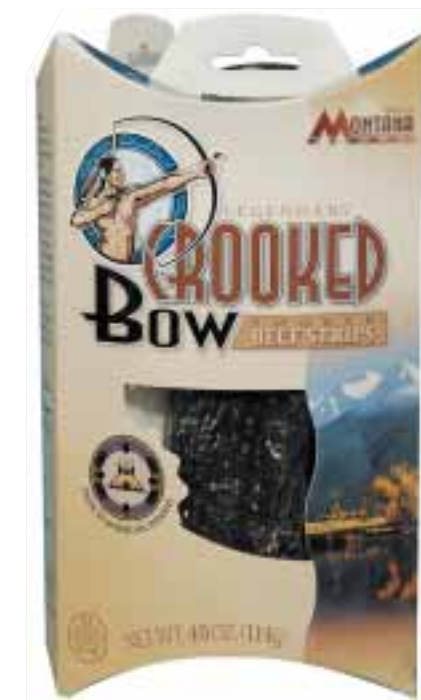
USDA, MSU Extension help Crooked Bow beef take a bow

The newest addition to the made-in-Montana pantry, Crooked Bow smoked beef strips, had an impressive debut in

September when it was sold at the Smithsonian Institution’s new National Museum of the American Indian in Washington, D.C. The museum gift shop’s first consignment of 200 packages sold out almost immediately. Crooked Bow’s beef strips — a very old recipe in a brand new package — are made of grass-fed beef raised by Salish, Kootenai and Pend O’Reille tribal members of the Flathead Native Agricultural Cooperative. The beef is hand-stripped and seasoned with locally grown huckleberries and chokecherries, a touch of apple cider vinegar and honey, then smoked over alder.

Helping in the development of the product was a \$100,000 Value Added Producer Grant awarded in 2002 for working capital for the project by USDA Rural Development.

The agricultural cooperative is a result of work done by Joel Clairmont of the Salish tribe, who is the Montana State University Extension agent on



Very old recipe, brand new package: the just-introduced Crooked Bow brand smoked beef strips. MSU photo by Erin Raley.

the Flathead Reservation. Clairmont was “the key player” in pulling together the cooperative, according to Jan Tusick, a manager with the Mission Mountain Market Cooperative Development Center in Ronan. Five years ago, Clairmont began talking with the ranchers about ways they might combine forces and develop

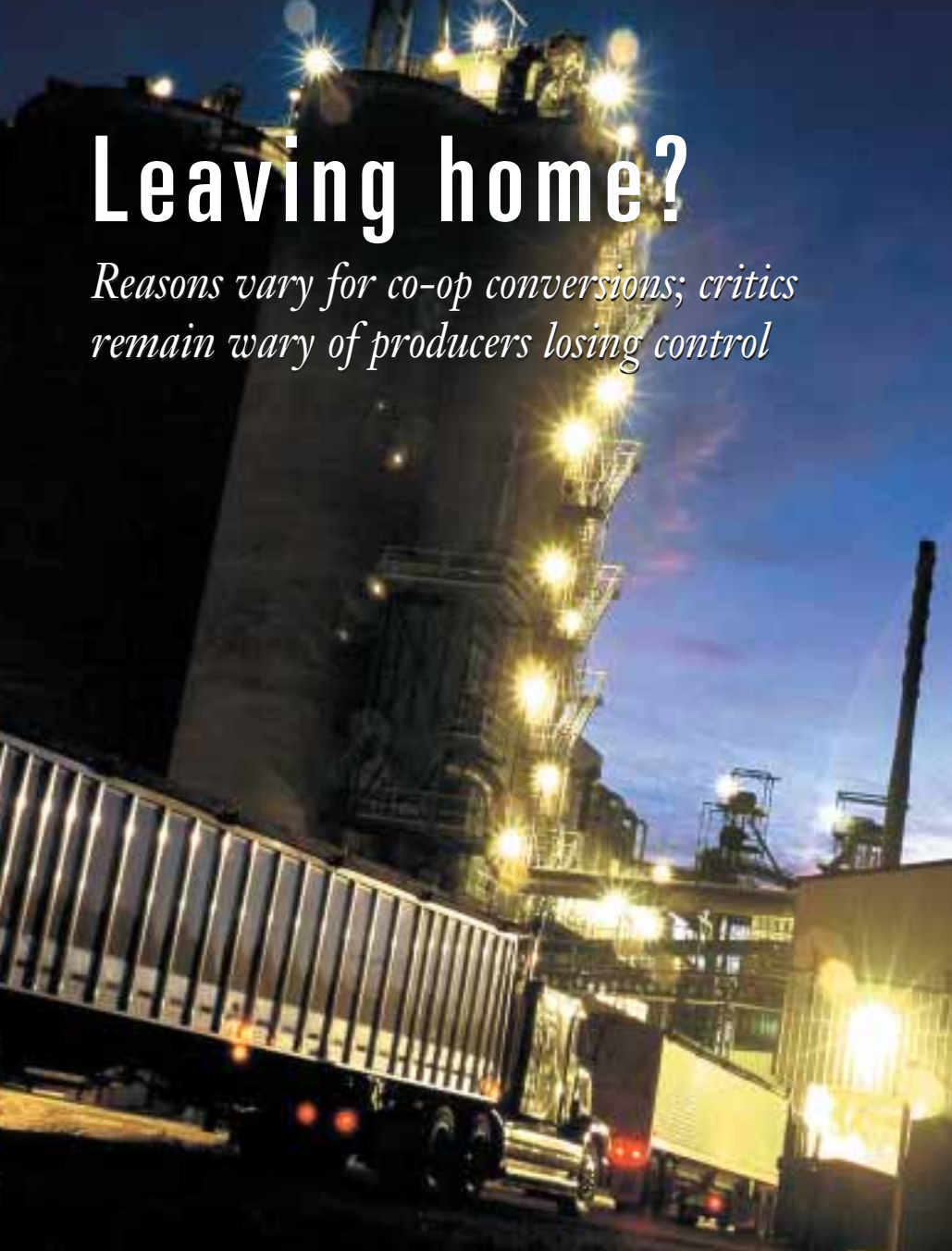
value-added products from what they produce.

The co-op now has six members, owns the Crooked Bow brand and its members raise the beef that is smoked and turned into strips. Other Flathead Reservation producers have shown an interest in joining. The beef strips are prepared and packaged in Mission Mountain Market’s licensed commercial kitchen and certified organic food processing center. The facility was created to help area entrepreneurs test, develop, refine and prepare and market value-added food products of all kinds.

A nonprofit entity, the market is also a business incubator that provides expertise on food-related regulatory issues and business and cooperative development, including possibilities for capitalization. Other MSU faculty helped develop the product, adapt the original recipe for commercial production, and train the people who prepare the strips in food handling and food safety. The Crooked Bow product line is to be enlarged soon with the addition of a beef stick product. For more information, contact the Flathead Native Agricultural Co-op, (406) 745-7500, ext. 2202. ■

Leaving home?

Reasons vary for co-op conversions; critics remain wary of producers losing control



A load of soybeans arrives at the South Dakota Soybean Processors (SDSP) plant in Volga, S.D. Photo courtesy SDSP

By Nancy Jorgensen

Editor's Note: Jorgensen worked for CoBank in Denver for 13 years before establishing her own communications and marketing consulting business in Pomerene, Ariz., which specializes in cooperatives.



Co-op conversions aren't exactly sweeping the nation — only a handful have converted to limited liability companies (LLCs)

or other business forms in recent years. And of these, most proudly say that they are still producer controlled.

Regardless, co-op conversions concern some co-op leaders, who say the risk is great that converted co-ops will eventually wind up under the control of outside investors.

Promoters of the concept counter that co-op conversions give producers another avenue for raising capital needed to become players in value-added agriculture markets and can help them gain other operating efficiencies.

The debate involves many of the same principles and issues that arise in the sale of co-ops to non-cooperative businesses, recent examples being the sale of Minnesota Corn Processors and the now-scuttled sale of FCSAmerica (see Nov-Dec. issue of this magazine). Are producers sacrificing their long-term good and that of producers who follow them for short-term gains? Is the conversion being undertaken primarily for the benefit of management staff or a select few members with large amounts of stock, rather than the overall membership? Or will the conversion open the door to greater marketing clout for producers? Should the definition of “cooperative” be expanded to include producer-owned LLCs as a new type of co-op, and should they receive Capper-Volstead protection?

These are just examples of the questions raised by some co-op conversions. This article does not examine all of these questions, but it will focus on why several co-ops have recently converted to LLCs or other corporate structures, and how some co-op leaders view co-op conversions.

Why some co-ops convert

Attorney Mark Hanson is viewed by some as an “evangelist” in the cause of co-op conversions, having been the architect of several. “We’re supportive of co-ops,” says Hanson, an attorney with Lindquist and Vennum, a Minneapolis-based firm with 13 attorneys devoted to co-op law. “We still help form more new co-ops than we convert. But some successful co-ops have outgrown the form.”

Hanson says co-ops convert for three major reasons: “To gain capital, to gain liquidity or to access enterprise value — the value of the business as a going entity. In successful co-ops, the value of the farmers’ commodities is small compared to the co-op’s enterprise value.”

Hanson estimates that only a dozen co-ops have converted to LLCs or other business forms in recent years. This doesn’t include conversions of co-ops which have all their members residing in only one state. These are harder to track because they aren’t regulated by the federal Securities and Exchange Commission. However, the number of such “one-state” co-op conversions is thought to be very small.

On the other side of the “conversion aisle” is E.G. Nadeau, director of research, planning and development for Cooperative Development Services in Madison, Wis. Nadeau is a defender of the traditional co-op model who sees serious problems ahead if the small number of co-op conversions and demutualizations becomes a trend.

In a report on demutualization (the term commonly used for conversion of consumer co-ops — such as housing, utility, insurance, food and credit co-ops — to investor-owned business) which he co-authored for the National Cooperative Business Association, Nadeau noted that Australia once had a large co-op business sector, but experienced “massive privatization” in recent years.

While such occurrences are still rare in the United States, “growing economic pressures to demutualize requires a coordinated response if widespread loss of member choice and control is to be avoided,” he wrote. Lack of capital is often used to justify co-op conversions, he adds, saying this underscores the need to find new ways to help co-ops gain access to capital.

The four co-ops discussed below each started out as new-generation, value-added co-ops. Adding value to farm commodities usually requires building capital-intensive processing plants, and that means sizable invest-

ments by producers. In these four cases, the minimum investment required for membership ranged from \$1,500 to \$20,000.

Farmer-members of all four co-ops voted to adopt new structures that allow for non-farmer investment. In each case, more than 80 percent voted for the conversion. It is important to note that all but one of the companies remains 100 percent farmer-owned and controlled. Dakota Growers raised outside capital, but farmers still own more than 90 percent of the shares.



Dakota Growers Pasta Co. in Carrington, N.D., is now the nation's third largest producer of dry pasta products. Photo courtesy Dakota Growers Pasta

Golden Oval Eggs LLC; Renville, Minn.

One of the top 10 producers of liquid eggs in the nation, Golden Oval Eggs owns more than 5 million laying hens and had sales of \$80 million in its last fiscal year. In 1994, when Golden Oval formed, the co-op required its 700 farmer-owners to deliver a minimum of 2,000 bushels each of feed corn annually, and to invest \$3.50 per bushel, with each bushel representing a share.

The desire for greater transferability of co-op stock was the major reason it converted to an LLC.

“A lot of our shareholders are retirement age,” says Marie Staley, vice president and chief administrative officer for Golden Oval. “They’d like the

company to remain farmer-owned, but they want to pass shares down to their children, even if the children aren’t farmers.”

The new LLC structure brings shareholders more liquidity, since they can sell shares to non-farmers. Shares recently traded for \$6.

“Farmers are proud to own the business, but at the end of the day, they want to make money,” says Staley. “Even if that means a different [business] structure.”

Staley adds that under the LLC structure, farmer-owners continue to benefit from the market the company created for grain, but they are no longer obligated to deliver grain to the company. This benefits those who no longer farm, or who can’t meet their obligation in times of poor production.

U.S. Premium Beef, Ltd., (an LLC); Kansas City, Mo.

Steve Hunt, CEO of U.S. Premium Beef (USPB), says liquidity of member investments ranks as the top reason for USPB’s conversion. “The LLC structure increases liquidity and flexibility for our members,” says Hunt. “As their businesses change, they may want to slow down, divest or expand.”

USPB’s 1,900 members include ranchers and feedlot owners in 36 states. At its initial stock offering in 1996, owners purchased a minimum of 100 shares at \$55 per share, with each share representing the right and obligation to deliver one finished animal to USPB’s processing company.

Today, the company owns the nation’s fourth largest beef processor, National Beef Packing Co. It had been partners with Farmland Industries in the company before buying out Farmland when the latter filed for bankruptcy.

Since converting in late 2004, USPB has offered two classes of stock, of which only Class A stock owners are obligated to deliver cattle. A member who owned 100 shares before the conversion now owns 100 Class A units and 100 Class B units, which combined now trade for \$170.

Owners of Class A units also benefit from receiving a dividend based on the profitability of the company, and additional premiums based on the quality of beef they deliver. Class A units receive 33 percent of dividends, while Class B units earn 66 percent.

"A rancher nearing retirement could sell Class A units to a niece who raises cattle, for example, and hold on to his Class B units," Hunt says,

USPB, which had \$800 million in net sales for 2003, continues to see major benefits in remaining a producer-owned business. "Surveys of USPB customers show that consumers trust a product that's directly tied to the producer," Hunt says. "They trust how we treat our animals and the environment, our animal health practices, and the quality of our beef."

South Dakota Soybean Processors LLC; Volga, S.D.

Rodney Christianson, CEO of South Dakota Soybean Processors (SDSP), cites taxes as the No. 1 reason his co-op's 2,100 members voted to become an LLC in 2002.

A co-op may pass tax liabilities on to its members based on business done with each member — based on patronage. However, the South Dakota company expects to handle more non-patronage business in the future, and co-op members would be double-taxed on that business — both at company and individual levels.

In an LLC, Christianson says "All profits and tax liabilities are passed on to the member or partner." He says the LLC structure better meshes with SDSP's goal to maximize member profits. Christianson estimates 2004 sales at \$240 million.

Based on members delivering 28 million bushels of soybeans per year, the company produces 620,000 tons of soybean meal, 50,000 tons of hulls and 310 million pounds of oil. "What if SDSP develops a market for 40 million more pounds of oil?" Christianson asks. "It would be difficult to develop a

patronage relationship with our members for the added soybeans we would need."

Christianson says members have seen their original minimum investment of \$5,000 increase two to three times. "Our goals remain steadfast: adding value and returning that value to our members. The direction is in the hands of our members and the board of directors. The organization builds and keeps loyalty only if it adds value to its membership." SDSP's governance has retained many co-op features, such as one-member, one-vote.



USPB owners also responded to tax concerns. "As a co-op, anything deemed non-patronage income was double-taxed," says Hunt. "As an LLC, we can pass through all taxes to the producer." Non-patronage revenues in USPB's future might come from applying food safety additives to the carcass in the processing plant, he adds.

Dakota Growers Pasta Co. Inc., (a C-corporation); Carrington, N.D.

Durum growers in North Dakota and Minnesota formed Dakota Growers Pasta in 1991, before the term "new generation co-op" had even been coined. About 1,000 producers agreed to purchase a minimum of 1,500 shares in the new co-op for

\$3.85 each, and to deliver 1,500 bushels of durum each annually to the co-op.

Back then, the Durum Triangle of north-central North Dakota produced most of the nation's durum, a wheat used to make pasta. But years of heavy rains in the area following the formation of the co-op caused the spread of a plant blight known as scab. As a result, durum production declined in the co-op's primary membership area, so production moved west to other parts of North Dakota and Montana.

"Mother Nature wasn't kind to the farmers who originally put up the money," says Timothy Dodd, CEO of Dakota Growers. "Our members no longer had the ability to deliver high-quality durum." Members tried to swap grain with the new producers. "Still, we ran the risk of being called on the carpet [for failing to source the majority of their crop from members] with no source of durum."

Despite this challenge, ownership in Dakota Growers proved profitable. "We paid back farmers' original investment long ago through dividends and stock splits," Dodd says.

Since the conversion in 2002, investors have owned two types of stock: common stock, which can be sold to anyone, and Series D stock, a preferred stock conveyed exclusively to co-op members before the conversion. Series D stockholders own a first-come, first-served privilege to deliver durum. They can transfer D stock to other producers, subject to board approval.

Dakota Growers, the third-largest manufacturer of dry pasta products in North America, generated net revenues of \$145 million in 2003, despite more consumers trending toward low-carbohydrate diets. Through a partnership with another firm, Dakota Growers has responded with a new product offering that reduces the number of digestible carbs found in tradi-

tional pasta. This pasta will be marketed under the Dreamfields brand.

Meanwhile, Dakota Growers refuses to give up on a production revival in the Durum Triangle. “We created an agronomy department, and worked with breeders to develop a variety that’s resistant to blight,” Dodd says.

While the other three co-ops converted to LLCs, Dakota Growers became a C-corporation. “The company took this route because it could reorganize on a tax-free basis, compared to the LLC option,” says Ed Irion, the pasta company’s vice president for finance. “It also provides greater opportunities for liquidity and access to capital.”

Lindquist and Vennum’s Hanson — who represented three of the four co-ops (all but SDSP) — weighs in on the tax issue: “LLCs are tax-efficient for distributing income over time, while C-corporations increase public investment and liquidity,” he says. C-corporation status is preferable if leaders foresee the business becoming a publicly traded company. A co-op should become an LLC if generating income takes precedence over growth, and if it wants to broaden access to capital.

New investors bring added capital

Of the four co-ops discussed above, only Dakota Growers has sought out-

side capital since its conversion. In 2004, MVC Capital provided \$5 million in equity financing to the pasta company.

“We expect to use the funds to capitalize on what we feel are excellent opportunities to promote a healthy lifestyle using the new Dreamfields [low-carb] technology and to bolster our position in the traditional pasta market,” Dodd says.

“We missed out on some very appealing opportunities, especially when Borden Foods exited the pasta business,” said Dakota Growers Chairman Jack Dalrymple in 2002 when the co-op converted. “We’re

continued on page 36

Study: co-op conversions rarely member-driven

According to a study commissioned by the National Cooperative Business Association, co-op conversions are rarely driven by members or by perceived benefits to members. Rather, conversion is more often driven “by co-op staff, leadership or outside consultants” who stand to gain from a switch, according to the report, *Strengthening Cooperative Business Structures: Lessons Learned from Demutualization and Cooperative Conversions*.

Cooperatives that have high voting thresholds, that engage their members in their activities, and that stay connected to the community are less likely to fall prey to even the most aggressive conversion tactics, the study says. The report, issued last year, was commissioned by a coalition of organizations including the Consumer Federation of America, Credit Union National Association, CUNA Mutual Group, National Cooperative Bank, National Cooperative Business Association, and the National Rural Electric Cooperative Association.

It was co-authored by E.G. Nadeau, a director with Cooperative Development Services in Madison, Wis., and Rod Nilsestuen, long-time president of the Wisconsin Federation of Cooperatives and now Wisconsin Secretary of Agriculture, Trade and Consumer Protection.

“The best way to avoid demutualization is to have active members engaged in the cooperative who recognize the role of the co-op in their economic well-being,” says NCBA President Paul Hazen.

Even though conversions are relatively rare, the report said they merit attention because of their impact on their consumer-members. “The economic disadvan-

tages of co-op conversion for consumer-members are obvious,” it says. “When the business is motivated by profit, rather than by member service, most members will pay more for the services or products they buy.” To slow the conversion trend, the study recommends a cross-sector campaign to communicate the benefits of member-owned businesses and state and federal legislative or regulatory changes to prevent co-op leaderships from gaining financially from conversions.

The study says rural electric cooperatives and retail food co-ops have a near total immunity to conversion, while mutual insurance companies, particularly those that offer life insurance, have the highest susceptibility to conversion. Credit unions and housing cooperatives, constrained by outdated laws and regulations from dealing with increasing economic pressures, are becoming conversion targets more often, the study added.

Among the study’s sector-specific findings was that lack of liquidity, financial difficulties and financial incentives to management and directors have fed the pressure on farmer-owned co-ops to convert. Members of a converting farm co-op may enjoy short-term financial gains, but they face longer term losses as they lose control over the price they are paid for their products. As a result, the market imbalance that led to creation of the cooperative in the first place may reemerge.

Strengthening Cooperative Business Structures: Lessons Learned from Demutualization and Cooperative Conversions is available from NCBA, 1401 New York Ave., NW, Suite 1100, Washington, DC 20005. Contact Art Jaeger, (202) 383-5462 for more information. ■

Co-op stock exchange

Why choice of trading rules matters for new-generation co-op stockholders

By Steven J. Holland
Macalester College
Robert P. King,
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Editor's note: Holland is policy associate, Macalester College. King is professor and head of the Department of Applied Economics, University of Minnesota. Please e-mail questions to: Rking@apec.umn.edu

The new-generation cooperative (NGC) is an institutional innovation that has helped many farmers establish value-added processing operations that would have been impossible to capitalize with a traditional cooperative. NGCs — with well-defined delivery rights/obligations and tradable shares — were a driving force in the sharp increase in the number of cooperatives formed during the 1990s. More recently, though, concerns have begun to emerge about the long-run viability of NGCs.

In 2002, for example, members of Minnesota Corn Processors approved the sale of their cooperative ethanol and corn sweetener business to Archer-Daniels-Midland, and members of Dakota Growers Pasta Co. approved conversion of their cooperative to an investor-owned corporation (see page 8). Should these and other takeovers and conversions be considered aberrations, or do they reveal an inherent vulnerability of the NGC organizational form?

Each takeover or conversion case is unique, with a sequence of events and



The diversification of stock benefits is one reason so many ethanol cooperatives are being organized on the new-generation co-op model.

decisions that led to organizational change. In order to explore the question of whether there are fundamental forces common to all situations, we developed a simulation model of cooperative formation and the market for cooperative stock.

Our model is “populated” by farmers who produce a crop that can be the raw product for a value-added processing facility. These farmers differ in the amount of land they farm, location and risk attitudes, but all manage their resources and make investment deci-

sions in a way that maximizes their long-run welfare.

The model also includes a non-cooperative firm that is not involved in farming but can build a processing plant or purchase a cooperatively owned plant. The farmers in the model can join together to create a cooperatively owned value-added processing plant, and the procedures for trading cooperative stock can be modified in the model in order to explore the implications of these organizational design decisions.

- We use our model to investigate three questions:
- Why do cooperatives often lead in the development of new types of value-added processing?
- When is an NGC most likely to be vulnerable to takeover by a non-cooperative firm?
- How do rules and procedures for trading NGC stock affect cooperative formation and vulnerability to takeover?

Our findings help explain NGC takeovers and conversions. They also point to some practical steps cooperative boards can take to make an NGC more attractive to new farmer investors and more robust when faced with takeover threats.

Why do co-ops often lead in the development of new types of value-added processing?

A significant, but rarely mentioned, advantage of farmer investment in an NGC value-added processing facility is the benefit of diversification. Consider the case of corn producers who have

an opportunity to invest in an ethanol plant. These farmers always face the risk of large downward swings in the price of corn.

However, low corn prices increase the operating margin for an ethanol NGC, yielding higher patronage refunds. While investment in an ethanol plant carries its own risks, it can also result in a moderation of a member's overall exposure to uncertainty by blunting the impact of downward corn price fluctuations. In short, the NGC provides benefits to members beyond the ability to share in the enterprise's profits.

The opportunity to diversify helps members, but it also helps the cooperative. If cooperative investors benefit from the diversification offered by shares of an NGC, then they should be — and they apparently are — willing to invest in an NGC processing plant that is slightly less profitable than would otherwise be necessary to attract investment. The practical implication is that it is easier for the cooperative to sell shares when the benefits of diversification are known to potential investors.

The diversification benefits of NGC stock ownership may help explain why so many ethanol plants are NGCs. For example, according to the Minnesota Department of Agriculture, 11 of Minnesota's 14 ethanol plants are NGCs — accounting for over 85 percent of total ethanol production in the state.

As a general rule, investor-owned firms (IOFs) invest in ethanol production because it promises to be profitable — not because it helps to diversify their portfolios. Consequently, they will build an ethanol plant only when it promises a level of profitability sufficient to fully recoup the cost of their investment. New-generation cooperatives, on the other hand, can tolerate lower profitability because they offer the added benefit of diversification to their members. It follows that NGCs can raise the money to build processing plants under conditions where IOFs would shy away.

Figure 1: Investment thresholds for an NGC and an IOF

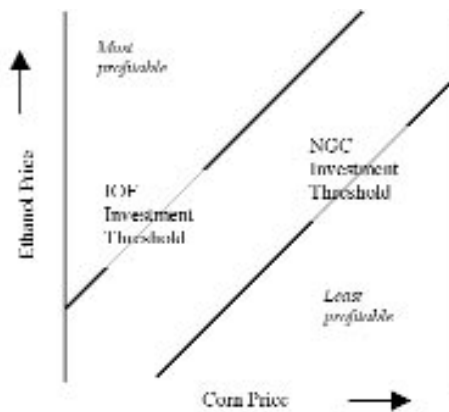


Figure 1 illustrates this point. An ethanol plant is highly profitable when the ethanol price is high and the corn price is low. This corresponds to the area in the upper left corner of the figure, which represents conditions under which investment is desirable for anyone. In the lower right corner, the ethanol price is low, the corn price is high, and the ethanol plant is likely to be losing money. Here, no one wants to own an interest in the plant. The “investment thresholds” in figure 1 represent the conditions under which an NGC and an IOF will first find investment in an ethanol plant desirable.

Because of the benefits of diversification, potential NGC members are willing to invest in value-added processing facilities under less favorable circumstances than IOF investors. As a result, there should be market conditions (those between the two investment thresholds) where NGC members would be willing to invest in a processing facility when IOF investors would not. This can give a start-up NGC the opportunity to form without interference from a competing IOF.

When is an NGC most likely to be vulnerable to takeover by a non-cooperative firm?

One of the reasons NGCs offer diversification benefits is because members can constantly adjust their exposure to risk by trading their NGC

shares. Of course, this argument fails when the member's shares cannot be easily traded. This is called the “thin market” problem.

In most cases, only a limited number of individuals are in a position to buy NGC stock because cooperative laws require that members produce the product being processed. Among those who can buy stock, even fewer actually will want to.

For example, many corn producers considering investment in an ethanol plant will be too far from the ethanol plant to make membership in the NGC a viable investment. Some simply will not be interested in investing.

The thin market problem is made worse by the fact that members tend to have the same general objectives. For example, when an ethanol plant is doing very well, there will be many potential investors but there might be a shortage of sellers. On the other hand, when an ethanol plant is not profitable, many members may be willing to sell but few will be willing buyers.

In either case, little NGC stock will be traded unless there are large increases or decreases in share prices, and investors will begin to fear that they will not be able to get out of the investment. In other words, a thin market can make the decision to invest irreversible.

This irreversibility can have two important effects on an NGC. First, potential investors may hesitate to buy shares if they anticipate the investment may be irreversible. This sort of thinking makes it much more difficult for the NGC to raise initial capital.

The second problem occurs when the NGC is able to form, but the market for NGC shares becomes thin later on. Our model suggests that this is a distinct possibility.

Generally, when an NGC makes its initial offering, there are interested investors who are not able to buy stock. Over the first few years after the NGC forms, both the volume of stock trading and the share price are propped up because producers who did

not invest initially are trying to buy into the NGC. Once most available investors have achieved a level of investment that fits their needs, though, fewer people want to buy and sell NGC stock and the thin market problem sets in.

Our analysis suggests the trading volume and share price of an NGC will remain relatively high as investors adjust their holdings of NGC stock. However, trading volume and share price will settle to much lower levels after this initial period of adjustment, and this may present an opportunity for an IOF looking to invest.

If the NGC share price drops far enough, the cost to an IOF of purchasing an existing processing plant will be lower than the cost of building a new one. This might be sufficient to pull the IOF into the market. At the same time, NGC members who have been frustrated about their inability to sell shares to other producers might see an offer from an IOF as too good to pass up. This response to the thin market problem may help explain why NGCs are sometimes taken over by IOFs or choose to convert to legal forms that allow investment by non-producers.

How do rules and procedures for trading NGC stock affect co-op formation and vulnerability to takeover?

The thin market problem reduces the demand for NGC shares, makes it more difficult for NGCs to raise capital, and increases the chances of takeover by an IOF. If NGCs are to fully realize their advantage over IOFs, they must find a way to alleviate the thin market problem. Here are three strategies that can help.

1) Choose trading procedures carefully.

NGCs use a variety of procedures to trade their stock. In some cases the cooperative acts as a clearinghouse that puts willing buyers in touch with willing sellers. Many other NGCs organize periodic stock auctions. When establishing rules for trading stock, few boards consider the effect on the coop-

erative's ability to raise money or survive a takeover attempt.

Economists often refer to a "perfect" market, with many buyers and many sellers shouting out the prices at which they are willing to buy or sell the good. If the quantity offered for sale at the prevailing price is less than the quantity demanded, buyers will bid up the price in an effort to buy the limited supply before their competition does so.

The same process brings the price down when supply exceeds demand. The immediate and accurate exchange of information makes this process happen quickly and results in an equilibrium "market price" at which supply equals demand. This is called a perfectly competitive market.

For a perfectly competitive market to exist in the real world there must be many buyers and sellers and free exchange of information. However, the pool of potential buyers and sellers for NGC stock is often small. Also, despite an NGC's best efforts, there may not be a free flow of information when information about members wishing to buy or sell shares is simply listed on a bulletin board or a Web site. This does not provide a mechanism for potential buyers and sellers to quickly adjust price or quantity to reflect market conditions.

Some NGCs have tried to overcome their inability to create a perfect, liquid market for their stock by holding frequent stock auctions. But the design of the auction format can have a significant effect on market liquidity. We used our model to evaluate two types of auctions.

The first is called a "discriminatory" auction. Potential sellers submit a reserve price and potential buyers submit a bid price. The cooperative then matches buyers who submit high bid prices with sellers who submit low reserve prices until no more matches are possible. Inevitably, some people submit bids or "asks" that are unsuccessful. The defining characteristic of a discriminatory auction is that successful buyers pay their bid price.

While a discriminatory auction is a convenient and easy way to match buyers and sellers, it may not be the best way to increase market liquidity. Buyers, knowing they will pay their bid price, have an incentive to submit a bid that is lower than the amount they are truly willing to pay. However, lower bid prices can mean that trades that could have taken place if bids had been "honest" will not take place. This increases market thinness.

An alternative to the discriminatory auction is a "competitive auction." Under a competitive auction mechanism, successful bidders do not pay their bid price. Instead, everyone trades at the same market clearing price — that is, the price at which the number of shares with bids at or above the market clearing price is equal to the number of shares with reserves at or below the market clearing price.

With this rule, successful bidders are guaranteed to pay an amount that is lower than or equal to their bid, so they have no incentive to bid below their true valuation of the stock. Higher bids imply more trading, and this increases market liquidity. Results from our modeling analysis indicate that the shift from a discriminatory to a competitive auction can significantly increase market liquidity and reduce the likelihood of takeover by an IOF.

2) Diversify the NGC membership.

Recall that a thin market can arise when investors all have the same general objectives. Another way, then, to improve liquidity in the NGC stock market is to increase diversity among members.

For instance, when the NGC is profitable, a young farmer may want to increase the level of his or her investment. Normally, he or she would have trouble finding a seller, but if the NGC has a number of members nearing retirement, some of them might take that opportunity to sell their shares. In this way, diverse ages can improve market liquidity.

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Iowa cheese co-op helps preserve a way of life

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Like the blue cheese it produces, the Golden Ridge Cheese Cooperative had to age a while before it was ready to go.

Founded five years ago by 40 Old Order Amish dairy farmers in northern Iowa and southern Minnesota, Golden Ridge was plagued by a series of production problems before the first blue cheese wheels were shipped from its 12,500-square-foot plant north of Cresco, Iowa, last January.

The Amish farmers invested more of their own capital into the plant, for a total of \$1 million, and brought in Neville McNaughton, a New Zealand native and cheese consultant who now lives in St. Louis. Like the blue mold that turns the Amish milk into cheese, McNaughton's addition as general manager has turned the Golden Ridge co-op into a going operation.

The co-op got a big boost in July when its Schwarz und Weiss natural rind blue cheese tied for first place in the blue cheese category of the

American Cheese Society's annual contest held in Milwaukee.

The competition is "considered one of the world's most influential and prestigious competitions in recognizing the art of specialty cheesemaking," according to the American Cheese Society's Web site. Since the announcement of the award, McNaughton said, "Cheese is now flying out of here. People are calling us." Prospects at the co-op weren't so rosy when McNaughton first showed up at the Golden Ridge plant.

"This was a stalled project," he said.



Cream of the crop: Neville McNaughton and Sara Bahgat pull stainless steel knives through a 7,000-pound batch of natural blue cheese at Golden Ridge Cooperative. Photo by Harry Baumert. Copyright 2004, Des Moines Register and Tribune Co. Reprinted with permission.

“They couldn’t decide how to get this up and running.”

McNaughton did a three-day assessment of the operation and re-wrote the co-op’s business plan. The co-op had been focused on making what McNaughton called commodity blue cheese. “We refocused the plant on making a quality product that plays to the strength of the milk,” he said.

A \$2 million loan guarantee was obtained from the U.S. Department of Agriculture’s rural development agency [USDA Rural Development]. That loan guarantee allowed the co-op’s bank to advance it more money to reconfigure the plant.

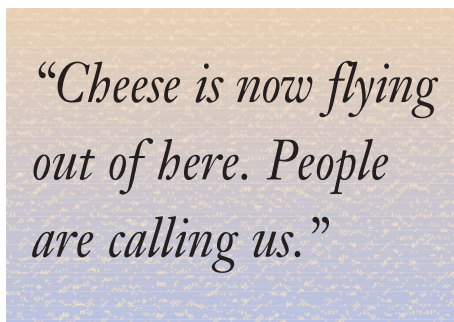
Dan Gingerich, an Old Order Amish dairy producer from Lanesboro, Minn., said the co-op members “didn’t realize what we were getting into” when they decided to form the co-op and make cheese. The dairy producers milk their small herds by hand and sell the milk in stainless steel cans weighing 80 pounds that hold just under 10 gallons of milk. The number of dairy processors willing to handle their milk cans had dropped from five to one, Gingerich said, narrowing their marketing options considerably.

“I’m trying to hang on to the dairy,” he said. “It got tougher to make a living on the farm than 20 years ago.”

Forming a cooperative to produce cheese in a modern plant needed to be examined by leaders of the Old Order Amish, Gingerich said. For religious reasons, Old Order Amish do not use many kinds of modern machinery. Their lifestyle is best known for the horse-and-buggy transportation on which the Amish rely. “Our elders thought that in order to keep the family farms going, we needed to change,” Gingerich said.

“We needed something like this so our children won’t have to live on one or two acres and become factory workers. On the one hand, it might be a modern concept, but on the other hand, we needed to have something like the cheese plant to keep our way of life going.”

With McNaughton on board and the American Cheese Society award, Gingerich said he thinks Golden Ridge has turned the corner. Golden Ridge makes three cheese products: Schwarz und Weiss, which means “black and white” in German; Harmony Blue, which has extra cream added, and Ultimate 50, which is half Amish cow milk and half goat milk supplied by Joy



Peckham, whose Peckview Dairy Goats operation is near the plant.

Peckham sells the Golden Ridge cheese and her other dairy goat products at the Metro Market in Des Moines and the Des Moines Farmers Market.

“Last weekend, I sold everything I brought in from Golden Ridge in the first hour,” Peckham said. “I wish I had brought more.” Peckham said she hopes the Ultimate 50 cheese takes off so she can eventually sell to Golden Ridge all of the 500,000 pounds of goat milk produced annually by her goats. Now, she sells almost all of her goat milk to a plant in Illinois.

Steve Logsdon, owner of the Basil Properi Bakery in Des Moines, said Schwarz und Weiss is selling well out of his dairy case.

“We carry European blue cheeses and Australian blue cheeses, and we’ve had a really good response to the Golden Ridge cheese,” Logsdon said. “People like the fact that it’s from Iowa and that they are using their own milk.” The Golden Ridge cheese also is priced competitively, he said, with a half-pound selling for \$7 to \$8, about the same as the nationally known Maytag blue cheese, the only other blue cheese made in Iowa.

Swiss Valley Farms, a farmer-owned cooperative with operations in Iowa,

makes blue cheese at its plant in Mindoro, Wis. Myrna Ver Ploeg, president of Maytag Dairy Farms, said she did not think the Golden Ridge and Maytag blue cheeses can be compared. “Ours is so different because it is made by hand,” Ver Ploeg said. “They are very different cheeses, and they satisfy different markets.”

The Maytag Dairy Farm, which was founded by Maytag appliance family members in 1941, no longer is connected with the company. The dairy is privately owned by 12 Maytag family members. The dairy does not release its sales numbers, Ver Ploeg said, but it makes 1 million pounds of blue cheese a year and buys 27,000 gallons of milk a day from small dairy farms within 15 miles of Newton. The Maytag dairy is expanding its aging calves to allow production to increase, Ver Ploeg said.

“We don’t make enough cheese to meet the demand,” she said. “We don’t want to be a big cheese company. We just want to be a good one.”

Gingerich, chairman of Golden Ridge, said the same thing about the Amish co-op. “We want to keep it small,” he said.

McNaughton said Golden Ridge now buys about 20,000 pounds of milk a day from its Amish producers. But only about 5,000 pounds of the milk bought by Golden Ridge is processed into cheese, McNaughton said. The rest is sold to AMPI, a large regional dairy processor [and also a farmer-owned cooperative]. The co-op’s goal, Gingerich said, is to make all the Amish milk into cheese.

Editor’s note: this article is reprinted courtesy the Des Moines Register. In addition to the \$2 million USDA Business and Industry (B&I) Guaranteed loan mentioned above, Golden Ridge Cheese Cooperative also received a \$500,000 Value Added Producer Grant (VAPG) from USDA Rural Development. To learn more about both programs, visit: www.rurdev.usda.gov, and follow the links for business programs. Or call (202) 720-4323, and press “1” to be connected to your USDA Rural Development state office. ■

Of necessity & invention

*Conference shows diversity of responses
by co-ops to changing market conditions*

**By Kimberly Zeuli,
Assistant Professor
University of Wisconsin-Madison**

Editor's note: More highlights of the 2004 Farmer Cooperative Conference will be included in the March-April issue of Rural Cooperatives.

“Innovation is rarely rocket science...in the past few decades, most of the companies that have created truly extraordinary amounts of wealth have done so by inventing great processes, not great products.”

(The Economist, April 24, 2004)

Business innovation can be defined as any new activity related to firm structure, production and output. Today, many cooperatives are at the forefront of agribusiness innovation. Cooperatives are being created in new sectors, such as renewable energy, to help farmers capture the full rewards of technological innovation. Established cooperatives are modifying their financial and ownership structures to seek strategic advantage in today's global marketplace while continuing to meet the needs of their diverse memberships. Recent changes in state laws allow unprecedented prospects for the evolution of the cooperative model.

The seventh annual Farmer Coop-

eratives Conference — *Cooperative Innovation* — highlighted some unique and successful examples of innovative agricultural cooperatives. The annual conference, most recently held Nov. 1-2 in Kansas City, was established by the University of Wisconsin Center for Cooperatives (UWCC) in 1998, with financial support from the Farm Foundation, to provide an open forum

Processors LLC, provided insight into how farmers can successfully secure the returns ethanol promises.

They both agreed that farmers need to commit to success and be willing to sacrifice much for achievement. As legendary football coach Vince Lombardi once said, “winning is everything.” Success also requires patience. Ten years of planning went into the



for critical thinking about the major trends and issues affecting agricultural cooperatives.

New energy for co-ops

It seems that everyone is talking about ethanol these days, spurring great expectations for corn and grain producers. According to the July/August 2004 issue of USDA's *Rural Cooperatives* magazine, 75 ethanol plants operate in the Midwest and Great Plains, with another dozen or more under construction. Most of these ethanol plants are farmer owned. Raymond Defenbaugh, president and CEO of Big River Resources Ethanol plant, and John Eggleston, board president of Northeast Missouri Grain

Northeast Missouri ethanol plant.

Defenbaugh suggested that farmers and co-ops might not be attacking the right enemy: “The enemy in agriculture is not other farmers and not other companies. It is poor prices. Farmers need to work together to combat this enemy.”

The statement that agricultural co-ops needed to work together to succeed was reiterated throughout the conference. As Benjamin Franklin said, “We must all hang together...or assuredly we shall all hang separately!”

Practicing what they preach, Big River Resources Ethanol members are willing to share the lessons they learned with other farmers interested in starting an ethanol plant. As Defenbaugh noted, his co-op has also certainly ben-

efited from the experiences of others along the way. He also stressed the importance of partnerships. Big River has pursued several joint-venture opportunities, with very positive results. “Most people want to work together, so don’t hesitate to look into joint-venture options.”

Defenbaugh and Eggleston also issued a perennial warning to all new co-ops: make sure you raise sufficient capital — the “life blood” of any organization. If co-ops are not adequately capitalized, they are not managing risk well. However, those interested in starting an ethanol co-op can’t assume capital will flow to the co-op, even with a good business idea.

With all the interest in ethanol, is there a risk of producing excess supply? Defenbaugh believes that this is a possibility, but legislation and the increasing popularity of ethanol fuel will balance supply and demand. He compared ethanol to the computer, which was ahead of its time at first, but today is used by most of the population.

Necessity: the mother of cooperative innovation

“If necessity is the mother of invention, then resourcefulness is the father.”

— Beulah L. Henry (*The inventor of a type of umbrella.*)

CHS Inc. provides compelling evidence that cooperatives can innovate when it comes to changing traditional structure. John McEnroe, vice president of Country Operations for CHS, provided one specific example of this with his presentation on the CHS “regionalization” concept.

Regionalization refers to the situation when a local co-op is essentially consolidated with CHS (the local becomes a CHS business division), but it may maintain its own name and retains its local producer board and considerable local control.

The CHS regionalization concept, under which it has consolidated with 27 local co-ops, was born in 1993 in North Dakota. At that time, a local co-op there in CHS’ trade territory was struggling, but the board didn’t want

to sell the co-op or invest in new assets because of the risk posed to its patron equity. Eventually, it agreed to merge with CHS to gain CHS’ oversight on strategic management decisions at the local co-op level.

In addition to its fully autonomous member co-ops, CHS currently includes 27 “regionalized” local co-ops (business units). All 27 pool their patronage with CHS. The patronage refunds are then distributed back to the locals, based on local use. CHS works closely with these units in terms of major decision-making and marketing.

For example, the CHS board decides the percentage of cash patronage refunds and the level of equity redemption. The local co-op’s employees become CHS employees, although the local co-op retains daily authority. One of five regional directors for CHS attends the local board meetings.

McEnroe acknowledged that there are pros and cons to this concept. On the positive side, it brings financial stability to the local co-ops, which are afforded timely equity redemption and protection. The local co-op still maintains significant control and direction at the local level, while also achieving economies of scale as part of CHS. On the downside, members may perceive that the co-op is “selling out,” although in actuality members retain considerable local control, as well as the ongoing economic benefits of being part of a co-op.

Authority for a few decision-making abilities — such as how equity is paid out, which is decided by the CHS Board — is also lost and, ultimately, the local co-op’s fortunes are tied to those of CHS.

In contrast, as CHS would be the first to acknowledge, many local co-ops are doing just fine on their own, implementing their own innovative strategies.

Jeff Nielsen, general manager of United Farmers Cooperative (UFC), presented such a case. UFC is a highly diversified local cooperative. Risk management and the desire to provide “customer-driven solutions” guided its pioneering effort to create a member-owned alternative insurance company: Parthenon Risk Partners. According to Nielsen, “the cost of insuring our people, property and assets had become almost unbearable.”

Parthenon is a captive insurance company; this means it is owned and



All 27 of CHS’ “regionalized” local co-ops retain daily operational authority, but the CHS board decides the percentage of cash patronage refunds and the level of equity redemption. Above, grain loading at the Corson Co-op in southeastern South Dakota. Photo courtesy CHS.

controlled by the insured parties. It is similar in design and operations to a cooperative business. In 2002, there were over 4,500 captive insurance companies operating in the United States. This new insurance program has helped UFC lower insurance premiums and increase coverage for its employees.

Nielsen believes that: (1) a pro-active and engaged membership and (2) a pro-active and visionary board are the two essential components for

cooperative innovation. “When making a commitment to find a solution, you need to decide whether to create a quick fix or the correct fix.”

Market stress leads to cooperative formation

In 1972, the Michigan factory that local cherry farmers sold their crops to was closed. One of those farmers was Don Nugent, who — along with other cherry growers — responded to the closure by forming Graceland Fruit Cooperative, which purchased the factory.

The dual problems of oversupply and the short, 12-hour shelf life of ripe cherries provided the momentum to create an innovative food product: infused dried cherries. Nugent, now president and CFO of Graceland Fruit, overcame food poisoning and a car accident to close a marketing deal for this product with Ocean Spray, vividly illustrating the principle that persistence pays off.

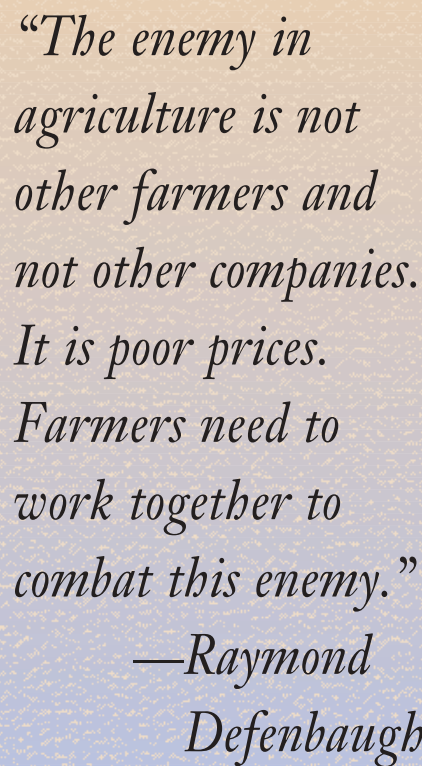
In 1998, the IRS ruled that Graceland no longer qualified as a co-op because of its level of non-member business, so it converted to a C-corporation. The cherry growers created a new co-op (still using the old name, Graceland Fruit Cooperative), which supplies all of the cherries to Graceland. Nugent believes that growing an innovative co-op depends upon a good strategic plan, a solid management team that can implement marketing strategies, as well as alliances for inputs, manufacturing and sales.

As the instigator of a new Wyoming cooperative state law, the Mountain States Lamb Cooperative (MSLC) is often featured in co-op news. MSLC is a Wyoming-based, vertically integrated marketing cooperative for lamb and wool. It has 125 members in 10 western states.

By the turn of the last century, lamb producers had suffered through 20 years of dismal prices. A core group of producers decided to form a vertically integrated marketing and processing operation, but were confronted a major road block: lack of capital. Non-

producers who considered agriculture vital to their rural communities wanted to invest in such a venture, but they could not if it was organized as a cooperative. Some members also wanted to invest more but did not want to have to supply a proportionate amount of product.

Brad Boner, board chairman of MSLC, said the cooperative created a separate co-op in 2001, the Mountain States Lamb & Wool Cooperative (MSL&W), which is organized under the new Wyoming co-op statute. MSLC is the sole member of MSL&W. The



“The enemy in agriculture is not other farmers and not other companies. It is poor prices. Farmers need to work together to combat this enemy.”
—Raymond Defenbaugh

latter was formed to provide marketing, processing and other services to both patron and possibly non-patron members.

This co-op’s structure (referred to as “the Wyoming model” or the “Patron Investor Cooperative”) is similar to an LLC in that it allows outside investment without a delivery requirement, but the business also receives the benefit of co-op tax laws while being able to provide a return greater than the standard co-op limit of 8 percent on contributed capital. MSL&W now sells its products on both coasts and

has a joint venture with a New York lamb wholesaler. A cross-country supply ensures year-round, consistent-quality products.

According to Mark Hanson, Attorney & Partner at Lindquist & Vennum PLLP and the primary architect of the new Wyoming cooperative statute, “The changing demographics of producers in the United States and elsewhere and the consolidations in the food industry generally will provide opportunities, nudge and even force changes in business structure.” From his perspective, the traditional co-op model was designed to enhance farmer-member income, not provide increased returns to investment. Therefore, a modified structure is necessary for today’s value-added cooperatives.

Co-op conversion — is it worth it?

Gene Carbone, former CFO for Calavo Growers, spoke previously at the Farmer Cooperatives Conference in 2000, when his California-based avocado-growers’ co-op was in the midst of converting to a C-Corporation. With hindsight, has his perspective on the conversion changed?

Carbone said he believes it was a success, in the sense that it provided much needed liquidity to members and provided a market-driven firm valuation. After conversion, shares were initially offered at \$5. Shares are currently trading at \$10.80 and there is a healthy turnover rate.

“Today, Calavo members are driving Lexuses and Mercedes,” he said. “The shareholders are very happy.” Original members have probably been selling some of their stock to new investors, but former members are also returning to the company. This suggests that the capitalization issue was an important impediment to Calavo members.

Under the current corporate structure, the company no longer has to treat all growers equally. Carbone feels this flexibility is another positive outcome from the conversion. However, Calavo has to offer competitive returns for the fruit producers (dividends per

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New tax law includes several cooperative provisions

By Donald A. Frederick,
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Editor's note: this article does not represent official policy of USDA, the Internal Revenue Service, the U.S. Department of the Treasury or any other government agency. It is presented only to provide information to persons interested in the tax treatment of cooperatives.

On Oct. 22, President Bush signed into law the American Jobs Creation Act of 2004. The primary impetus for the new law was a World Trade Organization (WTO) ruling that certain export tax benefits in our existing tax code violated international trade agreements we had signed. The WTO authorized European countries to collect special tariffs on American products they imported, until we repealed those export tax benefits.

While the original purpose of the legislation was to repeal the export incentives in question, numerous other changes to the tax code were added during the legislative process. The end result is a long, complex statute that includes several provisions important to cooperatives.

Extraterritorial Income Exclusion repeal

The offending export incentive, called the extraterritorial income (ETI)

exclusion, is repealed for transactions after Dec. 31, 2004. This includes the language allowing agricultural and horticultural marketing cooperatives to pass ETI benefits through to their patrons. Transition rules provide cooperatives and other taxpayers with 80 percent of their otherwise-available ETI benefits for transactions during 2005 and 60 percent of their otherwise-available ETI benefits for transactions during 2006.

Transition relief is also available for income realized under certain contracts in effect on September 17, 2003.

U.S. Production Deduction enacted

To encourage United States domestic economic growth, the law provides a new, phased-in deduction from taxable income for a portion of "qualified production activities income" (QPAI) generated by businesses, including cooperatives. The new deduction can be as much as 3 percent of QPAI for tax years beginning in 2005-2006, 6 percent for 2007-2009, and 9 percent for 2010 and later.

The range of income that can qualify is broad, including most taxable income realized on manufacturing, producing, growing and extracting goods in the United States. Special rules of interest to cooperatives provide that:

- Income from food processing (but not retail operations) is included,
- Income from storing and handling (but not transporting) agricultural products that are used in manufacturing, producing or growing other

goods is included, and

- Income from the production (but not the transmission or distribution) of electricity, natural gas and potable water is included.

Two limitations apply to this deduction. First, the deduction that may be claimed is the lesser of QPAI or taxable income for the year. So, if a cooperative or other taxpayer loses money on other activities, that could reduce or eliminate this deduction. A special provision in the law says *cooperatives that allocate the deduction to their patrons can compute "taxable income" for this purpose without taking into account their deductions for qualified patronage refund and per-unit retain allocations and the redemption of non-qualifieds*. The allocation rules are discussed later in this article.

Second, the QPAI deduction may not exceed 50 percent of the W-2 wages paid by the taxpayer for the year.

Cooperative Pass-through Provision

The report of the conferees who drafted the final version of the law makes it clear that income derived from manufacturing, production, growth or extraction of any agricultural or horticultural product by a cooperative, or from marketing agricultural or horticultural products by a cooperative, may be included in the cooperative's QPAI. A note to that report states that the term "agricultural or horticultural product" includes "fertilizer, diesel fuel and other supplies used in agricultural or horticultural production that are manufactured, produced,

grown or extracted by the cooperative.”

The law provides that *patrons of agricultural and horticultural cooperatives* can take a deduction on their tax returns for QPAI allocated to them as part of a *qualified* patronage refund or *qualified* per-unit retain. The amount each patron can deduct must be computed by the cooperative and a written notice must be provided each patron explaining the computation.

A special rule says a cooperative may not take a patronage refund deduction for amounts passed through to patrons that can be deducted by those patrons. As this amount is already eligible for the QPAI deduction at the cooperative level, this language merely makes it clear cooperatives can't deduct the same amount twice.

Example case

This example illustrates how the deduction and the pass-through might work at a typical agricultural or horticultural cooperative. Assume Co-op C has \$100,000 of QPAI. Also assume it is a tax year beginning in 2005 or 2006, so the available deduction is 3 percent of QPAI, or \$3,000.

Co-op C allocates the \$100,000 to its member-patrons as a qualified patronage refund. It is allowed to deduct the \$3,000 in QPAI under the new law and the remaining \$97,000 as a traditional patronage refund. Thus, the result is the same for the cooperative as it was before the new law was enacted, the entire \$100,000 is deductible.

Now, assume Patron P does 10 percent of the business with Co-op C in the tax year. Patron P receives a patronage refund of \$10,000 in QPAI, all of which is taxable income to Patron P. However, under the new law Patron P can deduct the applicable percentage of QPAI (3 percent in 2005 and 2006), or \$300. The value of this benefit will increase significantly when the QPAI deduction increases to 6 percent in 2007 and again to 9 percent in 2010.

Another provision states that any qualifying activity of patrons who mar-

ket agricultural or horticultural marketing through a cooperative may be attributed to that cooperative for purposes of computing its QPAI deduction.

Planning suggestions

Here are some points to remember in planning how best to use this new deduction. First, the legislative language is not always entirely clear. Tax experts have many unanswered questions about determining what income is eligible for the deduction. So, all cooperatives will want to work with their tax adviser to keep abreast of Internal Revenue Service rulings and other interpretations of this program.

Second, the deduction is first available for tax years beginning on, or after, Jan. 1, 2005. Many cooperatives on a tax year that begins sometime in the summer or fall will thus have nearly two years to become familiar with the intricacies of computing and allocating it.

Third, it is a deduction, not a credit. Tax credits, such as the energy-related credits discussed later in this article, can be used dollar-for-dollar to offset taxes due. Deductions can only be used to reduce taxable income, so their value depends on each taxpayer's tax bracket.

Dividend Allocation Rule repeal

The dividend allocation rule was an Internal Revenue Service (IRS) interpretation of the tax code requiring cooperatives that paid dividends on their equity investments to allocate those dividends on a pro rata basis between their patronage and non-patronage income. Under the new law, cooperatives can pay dividends on stock entirely out of non-patronage income. This allows cooperatives to reduce the tax cost of paying dividends on their equity investments and, at the same time, return more of their margins to patrons as patronage refunds.

To take advantage of this change, the new law requires cooperatives to have appropriate language authorizing them to pay stock dividends out of non-patronage income in their articles

of incorporation, bylaws or marketing contracts with their members and other patrons. Many cooperatives will want to amend one or more of these organizational documents to include such a provision.

Declaratory Judgment relief

Farmer cooperatives that want access to the special tax deductions permitted under Internal Revenue Code section 521 and other benefits that come with section 521 status, must apply for, and receive, approval from IRS. In the past, the only ways a cooperative could get a court to review a rejection of its application was claim a deduction IRS said they weren't entitled to, or pay some tax they didn't think they owed and then sue for a refund. This provision enables a farmer cooperative to seek judicial review of the denial without first creating a tax controversy or being subject to immediate tax liability.

Marketing includes value-added processing involving animals

One of the activities that allows a farmer cooperative to qualify for section 521 tax status is to engage in "...marketing the products of members or other producers." IRS interpreted this language to include value-added processing involving a mechanical process (converting corn to ethanol) but not a biological process (feeding corn to hens and selling eggs and chickens).

The new law makes it clear that under both section 521 and regular cooperative tax rules, marketing products of members and other producers includes feeding products of members and other producer to cattle, hogs, fish, chickens or other animals and selling the resulting animals or animal products.

Small ethanol producer credit, co-op pass-through

Current law provides a 10-cents-per-gallon tax credit for each gallon of ethanol produced and sold by so-called

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Charley's Angels

Utility co-ops show true colors sending aid to Hurricane Charley-ravaged Southern states

**By Stephen Thompson,
Assistant Editor**

For people in the area around Wauchula, Fla., located on the state's mid-Gulf Coast, 2004 was not the best of years.

On Aug. 13, Hurricane Charley roared in from the Gulf of Mexico, bringing winds of 140 miles per hour and spawning tornadoes. The storm knocked down trees, power lines and poles in the Peace River Electric Cooperative subscriber area.


Damage was huge, according to Brad Kimbro, Peace River's vice presi-

dent of marketing and member services: "Two-thirds of our system suffered significant damage; and one-third of that was simply gone."

That wasn't all. Two weeks later, just as soon as Charley's damage had been repaired, Hurricane Frances marched through with huge amounts of rain and extensive flooding. Mercifully, it did less damage than Charley, but still knocked out power to a significant number of customers. And Frances was followed three short weeks later by Hurricane Jeanne, whose high winds pummeled the area with a vengeance, toppling power poles like bowling pins.

\$42 billion in damage

While Peace River was the hardest hit, power co-ops in Georgia, Florida, Alabama and Mississippi all suffered varying amounts of damage in the 2004 hurricane season from four major storms in rapid succession: Charley, Frances, Ivan (which missed Peace River) and Jeanne. The 2004 hurricane season, which totaled nine hurricanes altogether, caused more than \$42 billion worth of damage — the most costly hurricane season in history. Damage was even greater than in 1992, when Hurricane Andrew devastated southern Florida, causing \$35 billion in damage.



A lineman from Cuivre River Electric Cooperative of Troy, Mo., unreels replacement cable while repairing lines in Florida. Electric co-ops from 15 states sent employees to help reconstruct power distribution systems in hurricane-damaged areas. Photos by Jeff Joiner, courtesy Association of Missouri Electric Cooperatives

Despite widespread damage to power distribution systems, electric co-op customers had their power restored in surprisingly quick time in all cases, an outcome that was made possible by the dedication of their maintenance personnel and the help of fellow co-ops around the country. More than 100 co-ops from 15 states sent hundreds of linemen and other workers with equipment to rebuild distribution



Clouds of bugs bothered linemen working to restore power on the Gulf Coast, including this one from White River Valley Electric Co-op.

infrastructure. And while the scope and severity of the damage were much greater than anyone was used to, the way it was handled was in many ways routine.

As the path of Hurricane Charley began to develop, a call for help went out from state electric cooperative associations in the threatened areas. Rob Land, the director of risk management for the Association of Missouri Electric Cooperatives, was attending a conference in Savannah, Ga., with Doug Drake, the association's field training director, when Charley hit. Both put in long hours on their cell phones in their hotel rooms, keeping notes on scraps of paper as they gathered information about available

resources from member co-ops, matched it up with assistance requirements, and put together a workable deployment plan. "One problem was that we only had one cell-phone charger between us," chuckles Drake.

Quick assessment crucial

Drake points out that if the affected co-ops do damage assessments as quickly as possible, it helps the assisting co-ops allocate the resources at hand most effectively.

As the co-op managers were notified, they in turn asked their employees for volunteers to pack up and move their equipment to the affected areas. "We never have a problem getting help for this kind of thing," says Drake. "Most of the people are anxious to go." This is despite the fact that workers know they will be facing long hours of hard work in difficult conditions —



Employees from Poplar Bluff, Missouri's Ozark Border Electric Cooperative and other out-of-state co-ops had to adapt to working in Florida's high humidity, soft sandy soil and marshes.

up to 18 days, in this case — and that they may have to put up with less-than-ideal sleeping and bathing arrangements.

The biggest problem, he says, is not in getting people to go, but in deciding who is going to stay behind. "When

we're dedicating resources, we have to remember that something could happen at home while we're away."

Regardless of the irregular conditions under which Land and Drake were working, they managed to put together an expedition to the south that arrived in Mississippi just in time to start putting things back together in Charley's wake.

"We'd never worked in that kind of environment before," Drake says. "The damage was similar to that we've seen with tornadoes, but it was much more widespread. And the working environment was different, too, with lots of sand and marshland. Our guys had to learn how to get their trucks around in the sand by lowering their tire pressures."

Being from the Show-Me State did have its advantages, though, as a local line crew found out when they were faced with the job of digging a hole in a concrete slab. "They didn't know what to do, because they weren't equipped for it," says Drake. "But our guys have to dig through rock all the time, so our augurs have tungsten-carbide teeth on them." It was one case of people from Missouri showing someone else. "They drilled through that concrete with no trouble at all."

Co-op aid from near and far

Among other states that sent help to hurricane-affected areas were Oklahoma, Illinois, New Jersey and Pennsylvania. Kentucky alone sent almost 100 workers and 60 trucks from 12 rural electric cooperatives. Many who stayed home also put in long hours: the Kentucky Association of Electric Cooperative's transformer manufacturing plant and the United Utility Supply Cooperative, also headquartered in Kentucky, put in long hours of overtime, including weekends, to make rewiring supplies and replacements for damaged distribution equipment.

Bill Davis, Service Manager of White River Valley Electric Cooperative in Branson, Mo., agrees with Drake that getting linemen to

volunteer for the trip wasn't hard. "The guys knew there'd be problems, that they might have to sleep in the trucks," he says. "Even when we have storms at home it's not easy — they have to work 15 or 16 hours a day. They knew we had a job to do, and so they just went and did it!"

Davis says that it took the trucks almost two days to travel the 750 miles to the storm area because of government commercial driving regulations. "They waived the rules in Alabama and Mississippi, so we were able to drive straight through," he says.

Their first stop was Singing River Electric Cooperative, headquartered in Gautier, Miss. Singing River was damaged relatively lightly by Charley, so after a couple of days of work, crews headed east into Alabama, where they spent 12 days repairing damage to Clarke-Washington Electric Membership Corporation, headquartered in Jackson.

John Davis of Ozark Electric Cooperative in Mount Vernon, Missouri, says that the first lodgings offered his linemen in Singing River

Co-op's subscriber area were "pretty bad." It wasn't the fault of the local co-op, he says. The problem was that so many people had been forced out of their homes, the only rooms left were in an old motel that had recently reopened after being closed for a long period. But the reactions of the local people to the appearance of the out-of-state crews helped make up for the grubby conditions: "They were real happy to see us."

Small, 4WD trucks prove value

When it came to choosing which equipment to take south, White River went against the grain. While most of

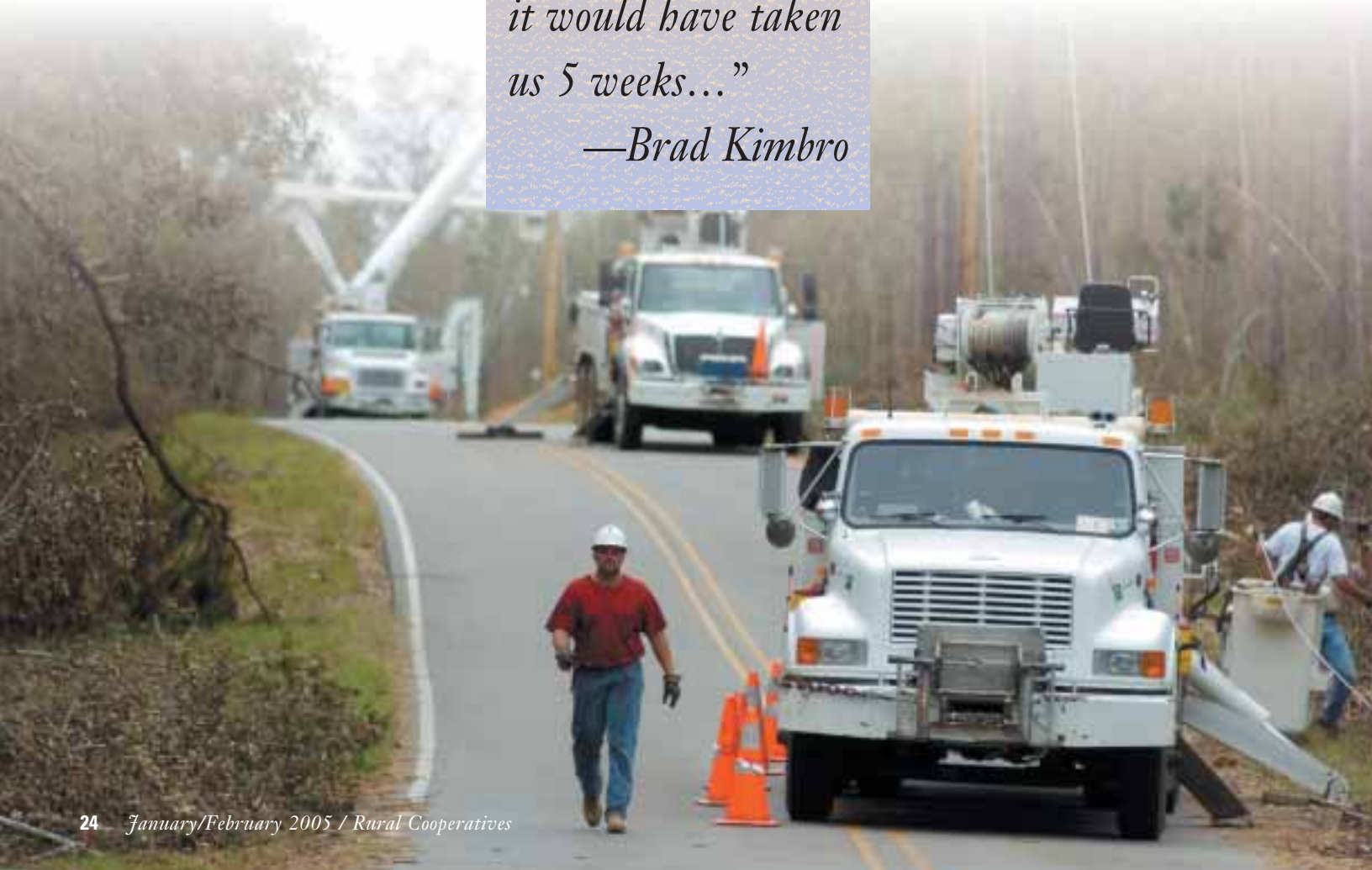
the assisting co-ops brought large "line bucket" trucks and other heavy equipment, Bill Davis's crew brought small "service" buckets mounted on four-wheel-drive vehicles, which allowed them to reach downed lines in areas the heavier trucks couldn't reach.

Meanwhile, back in Peace River's subscriber area, power was almost completely knocked out. So it was with relief, tinged with amazement, that residents watched help arrive in the form of a parade of almost 100 bucket trucks, augurs, pole setters and other equipment. In all, about 700 co-op men and women from 15 states descended on Wauchula to help clean up after Charley.

With almost all power knocked out, Peace River had figured it would take months to get all its subscribers back on line. But with the help of their fellow co-ops, power was back on for everyone in only two weeks. Unfortunately, nobody had much of a chance to enjoy it.

"Just as soon as we got cleaned up, Frances came in," says Kimbro. Compared to Charley, which had

"They finished the job in 5 hours. If we'd done that stretch by ourselves, it would have taken us 5 weeks..."
—Brad Kimbro





brought mostly high winds and tornadoes, Frances was less powerful, but moved much more slowly. As a result, it dumped a terrific amount of water on the area, causing extensive flooding and, again, many downed lines.

This time the help wasn't as plentiful, because Frances cut a much wider swath, covering most of Florida, and co-ops all over the state needed help. Nevertheless, as many as 200 outside co-op personnel showed up again to help put things right.

Ivan followed soon after. Projected to take the path of Charley, it swung to the west instead, sparing Peace River but hammering Alabama and the Florida panhandle before moving north and east over land toward Virginia. Later, it moved out to the Atlantic, looped south and west to cross Florida, and finally expired in Texas.

Spared by Ivan, and with things up and running for the second time, Peace River sent some of its crews to the panhandle to help out there. Unfortunately, however, Mother Nature was far from finished with them.

Hurricane Jeanne pounced from a different direction than the others —

the east. Its winds, while not quite as strong as Charley's, were still strong enough at 120 miles-per-hour to do extensive damage to an area still recovering from the previous two storms. "We had a four-mile stretch of highway where every single pole was down," says Kimbro. About 140 three-phase distribution poles on that highway alone had to be replaced or reset.

Again, outside co-ops came to the rescue, with about 250 linemen and other workers. "We had 75 trucks working to restore those lines. They finished the job in 5 hours. If we'd done that stretch by ourselves, it would have taken us 5 weeks," Kimbro says.

Co-op staff also hard hit

While the volunteers made sacrifices, the employees of the affected co-ops were hit hard — working long hours, in some cases, for weeks on end, as in Peace River. On top of the extra work, Peace River employees had to deal with the effects of the storms on their own lives and those of their families.

The co-op had over 70 employees who suffered losses from the storms — and 13 of them lost everything. "Our

communications manager was one of those," says Kimbro. "She noted in a TV interview that Peace River employees had suffered losses, and never hinted about her own." Kimbro thinks that the shared ordeal has strengthened the employees' relationships with each other and the co-op as a whole.

Kimbro also remembers with gratitude the support Peace River received from co-op personnel who were unable to be on the scene. "Central EMC in North Carolina couldn't spare personnel, but they sent a big care package with soap, sunscreen, deodorant and so on," he says. Other co-ops donated clothing, and the National Rural Electric Cooperative Association sent \$4,500 for Peace River employees who suffered damage. "I was really impressed when I found that the money was from NRECA employees."

Brad Kimbro says he is "really humbled" by the effort made by his own co-op's employees and by hundreds of employees of fellow co-ops to get Peace River's subscribers back on-line. "I hope they never need help like we did," he says, "But if they do, we'll respond." ■

Retail co-ops advised to foster member identification, not force conformity

By Janet Ciccone,
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Retail cooperatives wanting to retain members and encourage their participation in programs would do best to foster feelings of identification within the group to increase interactions, rather than force conformity to group goals.

This is according to a study by Leslie M. Stoel, assistant professor of merchandising management at The Ohio State University, College of Human Ecology. The results of her study, which appeared in the *Journal of Small Business Management*, apply to retail cooperatives in other industries and to many types of franchises, even though data were collected from the hardware industry.

U.S. retail hardware cooperative groups have increased their membership in the last decade, some as much as doubling. This is in part due to co-op mergers, and in part due to independent retailers joining cooperatives to work toward results that they cannot achieve individually.

Cooperatives offer a variety of programs that, in the past, were all voluntary. Today, however, co-ops increasingly rely on prescribed programs.

“From our study, we found that strength of identification by the co-op

member with the co-op influences the likelihood that members will participate in the voluntary co-op programs,” Stoel says. “Specifically, if they identified strongly with the co-op, if they considered their role as co-op members more important than their role as a store owner, they were

more likely to adhere to the norms of the group, such as adopting a new sign program or a new computer program.”

At the same time, however, Stoel notes that identification with the co-op should not be confused with conformity. “High levels of forced conformity to group goals can be divisive,” Stoel says. “Care should be taken in ordering conformity, because it may lead to within-group conflict, ultimately splitting the group.”

Hardware stores surveyed

Stoel surveyed 147 retail hardware store owners that had five or fewer employees and less than 10,000 square feet of retail space. Half of the stores had a sales volume of under \$1 million.

The stores answered a series of questions about being a member of the co-op group and about their competitive situation. Each store was located in a geographic area where it competed with a hardware store that belonged



Some 20,000 U.S. hardware stores belong to a cooperative, with Ace and Tru Value being two of the largest. Photo courtesy Ace Hardware

to another hardware cooperative.

Stoel also looked at how belonging to the co-op affected members' perceptions of rivalry toward stores in their geographic area belonging to a different co-op. She asked: If Ed's TruValue Hardware is competing for customers against Fred's Ace Hardware, to what extent will belonging to the TruValue cooperative influence Ed's perceptions about Fred as a rival for local customers?

Stoel found that the importance a co-op member attaches to being a member of the group influences his/her perception of conflict with a rival party and beliefs about what behavior was appropriate in response.

“The majority of respondents considered their primary competitive rival as being the Big Box stores (e.g., Home Depot, Lowe's), despite the proximity of the store belonging to the rival co-op,” Stoel said. “Another small fraction

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Paper or plastic?

For single-serve milk market, there is no debate as plastic sales soar, bringing smiles at dairy conclave

By Dan Campbell, editor

Ronald McDonald wasn't officially registered as a guest or a speaker, but his presence was certainly felt during the joint annual meeting of the National Milk Producers Federation (NMPF) and Dairy Management Inc. (DMI), the planning and management organization formed by the National Dairy Promotion and Research Board (NDB) and United Dairy Industry Association (UDIA). The meeting, held in Reno, Nev., was filled with good news for dairy producers and their co-ops. Some of the best reports concerned the rapidly increasing sales of single-serve milk containers at two

of the nation's largest fast food restaurant chains: McDonalds and Wendy's.

Wendy's led the way by offering single-serve milk in plastic bottles as a substitute for soda in its kid-meal packs. Within a year of introducing the new milk packaging, sales shot up from about 65,000 milk cartons to more than 1 million plastic bottles of milk per week, according to DMI CEO Thomas Gallagher. McDonalds soon followed suite, and saw its milk sales rocket from 600,000 cartons to 4.2 million bottles weekly.

Other fast food chains are expected to join the party as production capacity is ramped up to meet the surge in demand, producers were told at the meeting, held in late October.



The exhibit hall at the dairy conference featured samples of a wide array of new dairy foods, many of which are being developed with help from the Dairy Checkoff Program. USDA photos by Dan Campbell

Many reasons to cheer

There were plenty of other reasons for good cheer at the conference, including big wins on the legislative front, higher on-farm milk prices thanks to the industry's supply-balancing actions, and an increasing number of school districts getting back on the milk bandwagon.

Another cause for optimism was the way the entire industry — producers and their co-ops, food processors, retailers and nutrition and health experts — are uniting behind the “3-A-Day” promotional campaign. That effort builds on



the newest version of the USDA food pyramid, which has bumped up the number of recommended daily servings of dairy products from two to three per day. New dietary studies are also showing that milk can play a part in fighting the obesity epidemic.

The 3-A-Day campaign shows that producers can look at food manufacturers “not as the enemy, but as powerful partners,” Gallagher said. And to those who think food pyramid placement doesn't mean much, he pointed out that it helps to trigger government food purchases for use in feeding programs and the menu choic-

es made by school districts and health professionals. Last year alone, school lunch and Women, Infants and Children (WIC) feeding programs made about \$16 billion in purchases.

DMI Chairman Paul Rovey said the industry has traditionally been slow to respond to changes in the fluid milk market and has not been active enough in meeting the challenge as “others hedged-in on dairy's calcium advantage.” But the dairy industry has become more flexible and proactive, as the marketing gains of the past year show, said Rovey, an Arizona dairyman.

Now the industry needs to capitalize on the finding that dairy calcium is a useful tool in fighting obesity, which may prove to be “the most powerful

CoBank CEO: Gear co-ops to consumer demand

Doug Sims, CEO of Denver-based CoBank, told national dairy conference attendees that consumer-driven co-ops will be the winners in the years ahead because “the consumer is driving the bus that all of agriculture is riding on.” For many, the ability to capitalize on market niches will also be crucial as is their capability to work together to strengthen the market position of co-ops. Co-ops must further show how they are different and what makes them unique — to demonstrate that they add value for members, customers and employees, said Sims, who grew up on a dairy farm.

CoBank and its affiliated agricultural credit associations in the U.S. Farm Credit System support the dairy industry with more than \$2 billion in loans outstanding to agricultural cooperatives, dairy processors and dairy farm operators.

Sims told attendees at the annual meeting of the National Milk Producers Federation, United Dairy Association and National Dairy Promotion and Research Board that the dairy industry today has “more

influence than any other livestock industry because you are working together.” For example, Sims pointed to the milk supply/demand balancing program of Cooperatives Working Together (CWT) as “a real success that shows the industry is united.”

He encouraged continued cooperation, noting that co-ops need to collaborate to fund research and development — as the dairy industry is — and should even try working with competitors.

At a time when only a handful of retail chains control approximately 40 percent of food sales in the U.S., Sims said through cooperation, co-ops can and must create market power. The rate of concentration in food retail markets is likely to accelerate rapidly, he predicted, and co-ops must establish market position with these top food retailers.

“Investing in new ways to collaborate, investing in new products, new markets and new ways of thinking about your value proposition are criti-

cal success factors,” Sims said.

Sims added that the dairy industry's willingness to fund new, innovative products is paying off. He pointed to the



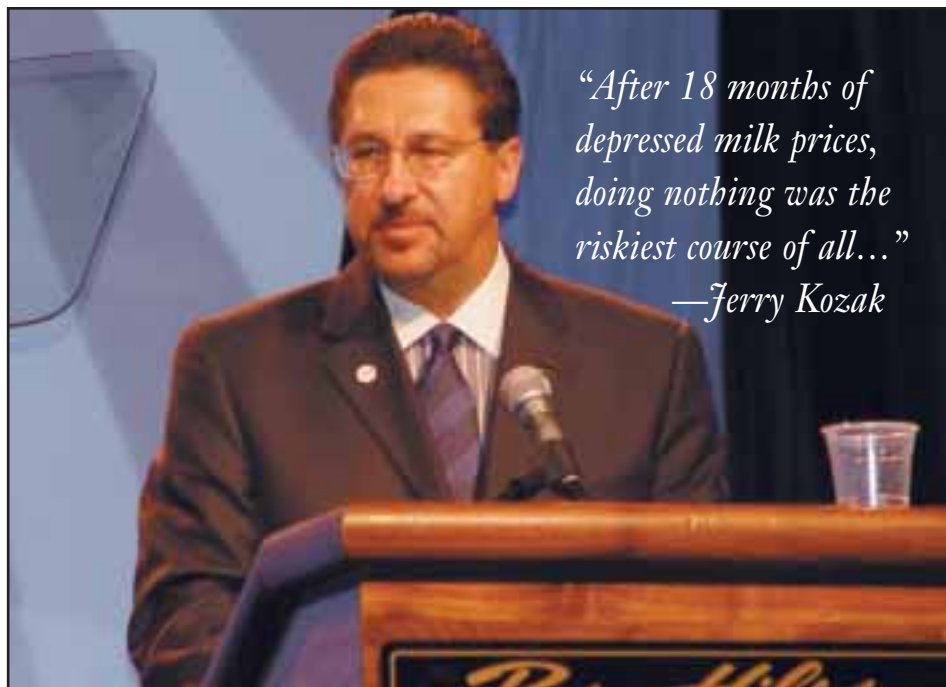
dairy nutrition message ever,” Rovey said.

“Five years ago, we saw that obesity would be ballooning as a health issue, and we wanted to make sure dairy was part of the solution, not the problem,” Gallagher said.

The point hammered home throughout the conference was that most of these marketing successes can be traced back to work funded by the Dairy Checkoff program, under which producers pay 15 cents per hundred-weight to fund promotion and research.

CWT helps balance supply

Under the NMPF banner, dairy producers helped to boost on-farm milk prices this past year by using the



industry's success in introducing "low-carb" products to satisfy changing consumer preferences as one example. Citing research from Productscan Online, Sims noted that in the first five months of the past year, dairy processors introduced 62 "low-carb" ice creams. In contrast, there were only 19 "low-carb" ice creams in 2003 and in 2000 there were none.

"Consumer-driven co-ops will be the global winners," he said. "The consumer by far is the key driver in the food system. In the U.S., the consumer is "king and queen."

Sims also acknowledged the changing global marketplace, noting that governments are reducing barriers to entry and providing access to U.S. markets. Specifically with regard to the Farm Credit System, Sims said that FCS owes thanks to the dairy industry for supporting efforts to oppose the sale of a key Farm Credit System lender to Dutch banking giant Rabobank this past year. He stressed the importance of farmers having a locally owned and controlled cooperative lender.

Another key factor to watch in today's business environment, according to Sims, is the effect of recent scandals on the image of corporate America. Good governance practices by co-ops will help avoid such scandals, he advised. He posed a series of questions to encourage co-op attendees to engage in critical self-examination of their business practices, governance policies and business focus. "What do you offer members that they value? Why should retailers take your products? Why do employees want to work for you? What is the difference between your co-op and the business down the road? What training do you provide your directors?"

If patronage returns are the only way a co-op returns value to members, it will ultimately prove to be a losing

proposition, Sims continued. Co-ops must also deliver superior service and convenience, and provide access to domestic and global markets at a competitive price.

He further urged co-op leaders at the meeting to determine whether their capital plan will meet demands of equity retirements, business growth, product research and development and other needs. If outside capital is being raised, how will it affect the governance of the co-op? "And does your co-op have the right skills on the board? Do directors understand the co-op's strategic plan? How is the co-op measuring progress?"

If directors lack skills, get training for them, he stressed, and remember that every meeting is a director-training opportunity. Sims said he is a proponent for using outside (non-member) directors to bring valuable expertise to the board, which can range from help with product development to greater financial acumen.

The most important function of a co-op board is hiring the CEO or manager, Sims continued. To do it right, and to monitor his or her performance, directors must be able to ask the right questions.

"The keys to success today and in the future is all about investing in the right things — people, strategy and business execution," he emphasized. "Co-ops need to critically examine the combination of expertise reflected in their boards and management teams, re-evaluate their business focus in light of changing markets and challenges, and collaborate in efforts to deliver innovative products quickly and efficiently.

"Working together, co-ops can invest in a better future, and continue to make a definitive difference in the marketplace," he concluded. ■ — By Dan Campbell

CWT program to better balance milk supply with demand. CWT is an industry-funded, self-help program under which some producers contribute to a special fund that helps reduce excess milk production capacity by paying some producers to retire from the industry and by providing export assistance for selected dairy products.

"To some, CWT was a crazy, bet-the-farm wager," said Jerry Kozak, NMPF president and CEO. "But others were confident that it was a sound investment for the dairy industry, and they were proved right." Indeed, the program was renewed on July 1 for another year.

"After 18 months of depressed milk prices, doing nothing was the riskiest course of all," Kozak said. No one is claiming CWT was entirely responsible for higher on-farm milk prices last year, but it was definitely a "tailwind" that can probably take credit for a price increase of 60 cents per hundredweight, he noted.

"CWT needs to be part of the industry's long-term portfolio," Kozak stressed.

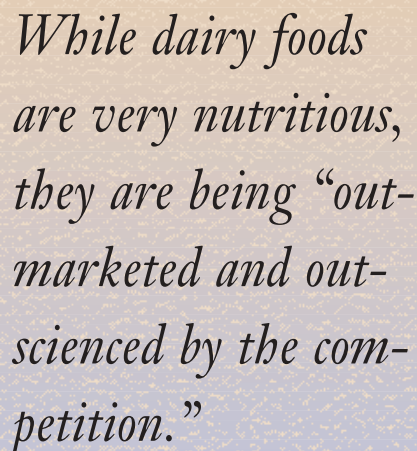
There were also key successes on the legislative front, including a full-court-press lobbying effort that resulted in no major increase in dairy product imports from "down under" as a result of the Australia Free Trade Agreement. NMPF Chairman Charles Beckendorf said that trade deal would have been "anything but free for our dairy producers."

NMPF staff and co-op representatives spent "countless hours" knocking on doors on Capitol Hill to carry the dairy producer's message to Congress and the Bush administration. They even bought a full-page ad in the *Washington Times* to run an open letter to President Bush, telling him how crucial trade and other legislative issues are to dairy producers.

Beckendorf said that there will still likely be a slight rise in dairy imports into the United States in coming years, but that it will be "a drop in the bucket compared to what it could have been."

Politics and government policy will

always be a big part of the dairy industry, Kozak said, quoting Charles DeGaulle's comment that "politics is too serious to leave to politicians." Campaign finance reform has not removed the need for political action committees, he added. "Federal officials want to know what people are thinking, and you must stand out from the crowd to be counted."



While dairy foods are very nutritious, they are being "out-marketed and out-scienced by the competition."

—Kevin Toland

Working in partnership with IDFA (International Dairy Foods Assoc., a food processors' trade group) was "a risky gamble," given that the organization "has so often been at odds with us," Kozak said. But successes in school lunch lobbying and other areas has proven it to be a good business move, he added.

School sales gaining

The dairy industry successfully supported legislation passed by Congress earlier this year that requires school districts to offer students at least two types of milk and would forbid schools from entering into exclusive contracts with soft drink companies that restrict the sale of milk products at school functions.

Beckendorf said the industry's ability to work with schools is vital, because improved milk products must be placed in front of the nation's youth at a time when they are forming lifelong

dietary habits. As one speaker said, "if they drink milk at 16, odds are they will still be drinking it at 86."

Test marketing showed that in-school milk sales would jump 30 percent when the switch was made to re-sealable plastic bottles. But last year's results were even better, up 34 percent in schools where the change was made, Gallagher said. And this year the number of schools offering the improved packaging will jump from 1,200 to 3,000, meaning the industry needs "more processors to step forward" with the product, he added.

Mad Cow response

The discovery of mad cow disease (BSE) in a single animal in Moses Lake, Wash., in December 2003 could have been a disaster for the dairy industry, but a crisis communications plan was in place for that eventuality, leading to the flow of the type of prompt, reliable information needed to reassure the public and media about the safety of the nation's dairy foods and herds.

Beckendorf said the biggest outcome of the BSE discovery will be the eventual creation of a national animal identification program that will enable any disease problem to be traced back to the exact source so that it can be nipped in the bud.

With a lean staff of only 17, Beckendorf said he knows of no other ag commodity organization that does as much for its members as does NMPF.

New direction for promotion

William Siebenborn, a Missouri dairyman and UDIA chairman, said forging a single dairy marketing plan and vision will help boost worldwide demand for U.S. dairy products. Under this effort, what had been primarily an advertising and classroom-based dairy promotional program has transitioned to one that leverages partnerships with the industry. It was not a quick or easy transformation to complete, he said, adding that the effort starts with local dairy promotion boards.

"Kids don't read or study the food pyramid," he said, so product presenta-

tion to them is all important. "Milk won't be cool just by saying it is in ads," he continued. "We need the right products in the right places — availability is the key." So emphasis has switched from running health-oriented ads to creating milk products with more pizzazz.

"Now the concept is to work within marketing chains to get improved products into more outlets," Gallagher said. He cited Yoplait Yogurt as an example, noting that it will print the 3-A-Day logo on all of its yogurt lids. "That's 2 billion packages annually that moms all across the country will be seeing," he said.

William Ahlem, Jr., a Hilmar, Calif., dairyman and NDB chairman, said it takes an enormous logistical effort to get new dairy products into stores and fast food restaurants. The industry has felt "tremendous frustration" for many years with school districts for not being more willing to include more milk and dairy products on their menus.

A door of opportunity was thrown open to the dairy industry when the Surgeon General issued a warning that the nation is facing a calcium-deficiency crisis, Ahlem continued. The report said 7 of 10 boys and 9 of 10 girls are deficient in calcium. Other reports indicate that the nation's epidemic of

obesity is increasingly spreading to our children. Dairy Checkoff-funded research shows that calcium helps burn body fat, Ahlem noted.

Low-carb milk?

About 7 percent of the U.S. population is now on a low-carb diet, and 24 percent say they are watching their carbs, it was noted.

John Kaneb, CEO and chairman of HP Hood, a New England dairy company with seven national dairy brands and \$2.3 billion in annual sales, said Hood spent \$25 million in 2004 to develop a new low-carb milk, called Carb Countdown. That effort was

Livingston gives producers legislative tips

Former Louisiana Rep. Bob Livingston, who chaired the House Appropriations Committee during his tenure, told producers they must continue to find effective ways to make their needs known to their elected officials. "You may be convinced in the righteousness of your position, but there is always someone just as fervent on the other side," said Livingston, who retired from Congress in 1999 and now operates a lobbying firm.

"You need to frame and condense your message so that they listen to you, rather than the other guy. That's why we band together in trade associations and hire lobbyists and attorneys — to study, advocate and lobby."

Congressional representatives are incredibly busy, he said, so you can't waste their time. "You must be ready to make your case in 15 to 30 minutes." He advised letting elected officials know that a large number of their constituents favor the position you espouse, and hammer that point home by having constituents contact the official prior to, or immediately following, your meeting. "It is incredibly important to have grassroots activity back home support your position," Livingston said.

He advised producer groups to find out when one of their elected officials will be back home, and then volunteer to

host a fact-finding session for them. These can take the form of a town hall-type meeting with constituents, a tour of farms, etc. Having your political action committee hold a fund-raising barbecue on a member's farm is also a good idea. Such an event can be 90 percent fun, but the critical time "is the half-hour you spend discussing your key concern."

Members can also become activists in campaigns, he noted.

"Tighter budget caps are coming for farm programs, which means you must make your voice even louder,"

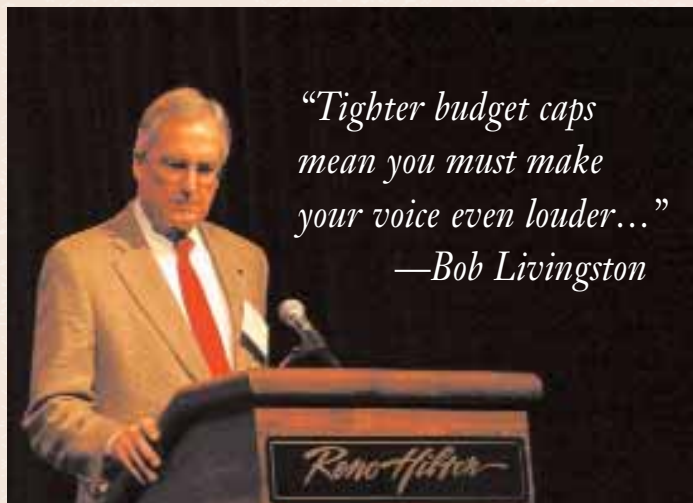
Livingston said.

He noted that the dairy industry failed last year to close a loophole that is allowing imported casein-protein to enter the United States, which means the industry needs to work harder next year to close the loophole.

"Continue to work to make sure free trade means fair trade, and work to hold your seat at the table so you don't wind up as the main course," Livingston advised. "Oppose unilateral disarmament [in

trade talks]. Keep pressure on your elected officials all year long."

Congressional oversight of agriculture is critical, but over-regulation is not, he said. "If government does not provide sufficient oversight, you get monopolies and lack of competition." But too much regulation will stifle the industries it is supposed to help. ■



launched following a request from Wal-Mart in 2003 for such a product. Kaneb, whose family purchased Hood in 1995, said even a company of Hood's size can't go on putting that kind of money into new product development indefinitely.

Hood would like to find ways it can work with dairy co-ops and NMPF to get more help in the early stages of product development, he said. "Dairy's competitors have many advantages. They either control raw materials, or the raw materials are so cheap — as in the case of soda — that they don't need to control them," he said.

Kaneb indicated that help from dairy producers might come in the form of allowing processors to avoid

having to pay Class I prices for milk being purchased for use in some of these promising new products.

Hood also makes Lactaid, a best-selling, lactose-free milk. It too is expensive to process and package, as it must be processed with enzymes. Hood has to buy five gallons of milk to make four gallons of Lactaid, Kaneb said, "so producers should love it."

Other meeting highlights:

- U.S. Agriculture Trade Ambassador Allen Johnson said the goal in ongoing trade talks is to establish the level playing field that farmers demand. He said President Bush has made agriculture a priority, and that "without agriculture, there is no trade agen-

da." He urged farmers to continue to make their voices heard, noting that their coffee shop discussions funnel up to farm and co-op meetings that eventually help set trade policy. He noted that the EU and some other competitors far out-spend the United States on export subsidies and trade-distorting domestic supports, and they erect far more tariff and non-tariff barriers.

- Emphasis is being placed on development of new cheese snacks, which is important because a slowdown is expected in the growth in demand for cheese from pizza makers.
- Almost all consumption gains in the beverage category are being achieved by health beverages, led by bottled

Retail co-ops advised to foster member identification, not force conformity *continued from page 26*

didn't seem to perceive a rivalry at all, instead focusing on their customers."

However, 28 percent of the respondents perceived that their No. 1 competitor was the other hardware store that belonged to a rival cooperative. With 20,000 hardware stores belonging to cooperatives in 1996, this number is noteworthy. For these members, feelings of identification with the cooperative group resulted in increased perceptions of conflict with the member of the competing cooperative. These feelings influenced their beliefs about the importance of competitive behaviors relative to that rival.

"It is critical that we understand how belonging to the group can influence perceptions and behavior," Stoel said. "Hardware retailers must compete on two fronts — against "category killers" and group-affiliated retailers. They will want to make careful choices, especially since research shows that intense rivalry is associated with poor performance."

Strategies for retail co-ops

To help cooperatives operate to maximum advantage, Stoel recom-

mends that they focus on helping members develop a sense of belonging and appreciation for their membership. She suggests that co-ops could consider the following:

- Offer programs that accommodate members in diverse competitive situations, i.e., allow variations in programs to keep them relevant to different situations. Examples of variations for different competitive situations are as follows:
 - a. An advertising/promotion program (or store interior and signage program) for stores that compete heavily with Big Box stores, another program for stores that compete mostly with another coop store, and perhaps another for those that compete mostly with Wal-Mart or other general merchandise discounter.
 - b. Merchandise/inventory assortment programs for rural stores, urban stores and suburban stores, or programs targeted by region (e.g., southern vs. midwestern or northern, due to climate differences, housing differences, etc.).
 - c. Human resource development/

training programs based on education level/workforce readiness of potential workers (e.g., program needs for rural and urban stores may differ in some cases from suburban needs).

- Educate members about benefits of conforming to co-op programs, especially in terms of customer appeal (e.g., answer the question: how will this program improve customer perceptions and responses?). One method of education would be to obtain and publicize customer response to pilot tests of new programs.
- Provide opportunities for co-op members in similar competitive situations to network with other members and with co-op management (e.g., using online bulletin boards or discussion boards).

Stoel's recommendations about rivalry are to be aware of it in order to stay sharp but focus on your customers. What can you do, with the help of your co-op, that your rival can't do? Or what you can do better than your rival, with the assistance of your co-op? ■

water, which has doubled its sales since 1998. Low-carb drinks are up 67 percent, while milk is up only about 1 percent since 1998. Drinkable yogurts have been a bright spot for dairy, with sales quadrupling since 1999.

- Soy beverages “tried to grab a bigger piece of the action” from real milk in 2004, which the dairy industry is countering with efforts to keep the soy drinks from being labeled as “milk.”
- Some soda-pop companies, including Coke and Schweppes, are experimenting with dairy soft drinks containing about half milk. This is largely seen as negative for dairy producers, in that these drinks would be marketed as a milk replacement (and would thus cannibalize existing milk sales).

On the plus side, these companies have the ability to get the drinks into convenience stores and vending machines, where dairy struggles for a bigger presence. One speaker said soft drink companies may have designed these products simply as “place holders” to fulfill school contracts requiring that dairy beverages be offered to students. Both companies have currently pulled their dairy soft drinks off the market, but others are likely coming.

- Kevin Toland, executive director with Irish dairy co-op Glanbia PLC, reported on a major new cheese plant being built in New Mexico as a joint venture with DFA. The new factory will be one of the largest and most

efficient cheese plants in the world, processing over 2.4 billion pounds of milk and producing in excess of 250 million pounds of cheese and 16.5 million pounds of high-value-added whey proteins annually. Variety, convenience and healthful nutrition factors are driving consumer choices, he said, calling nutrition a “worldwide mega-trend.” While dairy foods are very nutritious, they are being “out-marketed and out-scienced by the competition,” he said. “Even on calcium, we are being beaten by raw-calcium supplements.” He said using more dairy products, such as whey, as food ingredients and nutritional supplements, looks very promising, and he gave a detailed overview of the potential market. ■

Co-op stock exchange *continued from page 14*

Greater stock market liquidity can also be gained by making sure the NGC membership has a balance of large and small farmers as well as farmers from a wide geographic range. If members are affected differently by weather conditions, local prices and changes in production costs, then it is more likely that at any point in time some will want to buy shares and some will want to sell shares. This kind of diversity helps keep the NGC stock market healthy.

3) *Grow the pool of potential investors.*

Internet auction Web sites, such as eBay, put sellers of myriad products in touch with a large audience of potential buyers, greatly increasing the chances of finding someone with whom to trade. Analogously, the market for NGC stock can be made more liquid if steps are taken to expand the pool of potential NGC investors.

The Internet can create opportunities for the inexpensive and timely exchange of information between farmers who have never met each other and live hundreds of miles apart.

It can also allow potential traders to quickly and easily adjust their prices and quantities to reflect market conditions. While an NGC might never be able to replicate the trading pit model of exchange, prudent use of technology might allow it to get closer to that model than it ever could before.

Two key constraints that limit the number of potential NGC investors are: legal rules that prevent non-producers from investing in an NGC and the cost of delivering a crop from a distant farm to the NGC. NGCs can do little to change the legal rules, but they can often circumvent these restrictions. The most common method of expanding the pool of potential investors is for the NGC to enter into a joint venture or partnership with non-producers.

In fact, many ethanol plants are LLCs or LLPs that are partially owned by the NGC and partially owned by outside investors. Some NGCs have gone a step further and chosen to convert to a non-cooperative business form.

Other NGCs are uncomfortable with partnerships with non-producers

because it is feared that the organization can stray from its cooperative nature. Another possibility that does not require outside investment is to allow distant farmers to arrange for delivery of corn through the exchange of warehouse receipts at cooperating grain elevators. This practice is currently used by some NGCs to expand the area from which they find raw product and has the added benefit of increasing the number of stock market participants.

Conclusions

The NGC model makes it easier for farmers to invest in value-added processing facilities, creating new opportunities for profit-making and diversification. But thin markets for NGC stock can limit farmers' ability to adjust their holdings and can leave a cooperative vulnerable to takeover by an IOF. The thin market problem cannot be eliminated, but it can be alleviated through careful design of stock trading procedures, diversification of membership and expansion of the pool of potential investors. ■



TFC's \$447-million sales year sets record; income also climbs

A good year for Tennessee farmers, bolstered by excellent growing conditions, translated into record sales for Tennessee Farmers Cooperative (TFC), a regional farm supply and service organization owned by 64 local co-ops across the state. TFC's sales topped \$447 million for the fiscal year ending July 31, 2004. That's a gain of \$35 million from 2003. Net income before taxes and member programs was nearly \$11 million, an increase of more than \$2.7 million since 2003.

TFC, following a five-year plan enacted in August 2002, also strengthened its financial standing by increasing working capital to \$17.1 million — a \$3.6 million increase over 2003 and up \$10.7 million in two years. TFC also returned more than \$6.5 million



TFC's member store construction projects have continued at a record pace. Henderson Chester Farmers Cooperative was rebuilt after a tornado destroyed the old one in 2003. Photo courtesy TFC

in cash to member co-ops through its member marketing allowance, performance and patronage programs.

Both Board Chairman Larry Paul Harris and CEO Vernon Glover praised the efforts of management and employees in a banner year for the co-op as they reported the results at TFC's annual meeting Nov. 29 in Nashville, attended by nearly 1,000. In addition to outstanding crop yields,

farmers statewide also received good prices for crops and livestock.

Glover said fertilizer volume was 462,000 tons, while feed sales were up \$860,000, with increases in minerals and beef, horse, goat and sheep feeds. The Home, Lawn, Specialty Department recorded the most profitable year since 1997. All of the Ag Distributors Inc., (ADI) subsidiary operations were profitable and had sales increases. Sales of FFR seed increased, as did sales of crop protec-

tion, hardware, TBA (tires, batteries, accessories) and animal health products. "As we have grown our business, we have also emphasized expense control, inventory management and the reduction of long-term debt."

Harris challenged management and the membership to work together to maintain the momentum as they address the issues of a "changing agricultural climate that holds a lot of

New tax law includes several cooperative provisions *continued from page 21*

small ethanol producers, including cooperatives. These are companies with production capacity that does not exceed 30 million gallons of ethanol per year. The credit can be claimed on production of up to 15 million gallons of ethanol per year.

The new law allows cooperatives to choose to pass some or all of the small ethanol producer credit through to their patrons. The credit is to be apportioned among patrons on the basis of the quantity or value of business done with, or for, such patrons during the tax year. Any credit not passed through to patrons is treated as a general business credit by the cooperative.

Small, low-sulfur diesel fuel producer credit, co-op pass-through

The act creates a new, 5-cents-per-gallon tax credit to small petroleum refiners who must incur capital costs complying with the Environmental Protection Agency's rules limiting the sulfur content of diesel fuel. Eligible refiners may claim the credit until they have recovered 25 percent of such costs. For these purposes, a small refiner is one that employs not more than 1,500 persons directly in refining and has less than 205,000 barrels per day (average) of total refining capacity. The credit is reduced for refiners with a capacity

between 155,000 and 205,000 barrels per day. The conferees' report states that when capacity "differs substantially" from average daily output of refined product, capacity should be measured by reference to average daily output.

Cooperatives may also choose to pass some or all of this credit through to their patrons. As with the small ethanol producer credit, any pass-through is to be apportioned among patrons on the basis of patronage and any credit not passed through to patrons is treated as a general business credit by the cooperative. ■

uncertainty.” He noted that the 2002 Farm Census shows that the number of Tennessee farms has climbed from 75,067 in 1992 to 87,595, but the average size decreased from 149 to 133 acres. Just 11 percent of the farms produced 86 percent of the state’s agriculture in 2002. Some 78 percent of the state’s agricultural operations had less than \$10,000 in annual sales of agricultural products.

“More and more, we’re providing products and services to the row-crop farmer growing hundreds or even thousands of acres of corn, soybeans and cotton,” Harris said. “And, at the same time, we’re finding ways to help a

growing number of goat producers and selling pet and horse feeds to those farmers’ neighbors. We’ll always be here for our farmer owners — that’s our focus — but we must continue to meet the needs of all those involved in Tennessee agriculture.”

Humboldt Creamery acquires WestFarm’s ice cream division

Humboldt Creamery Association, a Fortuna, Calif.-based dairy co-op, has completed acquisitions that make it one of the nation’s largest ice cream manufacturers and have nearly doubled its size. Rich Ghilarducci, Humboldt’s president and CEO, says the co-op has

chosen to remain independent by securing its future through acquisitions and consolidating all of its operations in California.

Recent acquisitions include: The Aug. 1 purchase of a 40,000-square-foot distribution facility and nine acres in Stockton, Calif., from P&O Cold Logistics; The Nov. 1 acquisition of the ice cream division of WestFarm Foods, which has facilities in Seattle, San Jose and Los Angeles, and a license of the WestFarm Foods/Darigold brand of ice cream, and the Nov. 1 acquisition of Arctic Ice Cream in Seattle, including its Arctic and Vitarich Ice Cream brands.

Of necessity & invention *continued from page 19*

pound), otherwise it risks losing supplies. This is a source of tension between shareholders, who receive dividends per share, and growers.

Carbone cautioned that converting a company does not happen overnight. The three-stage conversion process was, in his words, “a long and painful process.” It took almost nine-months to complete. There are also downsides to the process. At the top of his list was the loss of heritage, or co-op culture. A potential change in directors and, therefore, company vision, was another risk. Further, the registration requirements for a public company can be onerous and costly.

Sale means veggie growers no longer control own destiny

William Harris, a long-time Pro-Fac Cooperative member and investor in Birds Eye Foods, provided a growers’ assessment of his co-op’s sale of the majority of Birds Eye stock. Over 70 percent of Harris’ gross farm income depends on his sales to the cooperative. Pro-Fac has always been innovative, he noted. Like the cherry growers in Michigan, the vegetable growers established a “new age” co-op in 1961 to buy failing processing companies in the region.

In this case, however, a private company — Curtice-Burns (which eventually became Birds Eye Foods) — leased and operated the processing facilities and marketed the finished product for the co-op. According to Harris, the profit and losses were shared equally between Pro-Fac and Curtice-Burns through a series of agreements. “The business model worked extremely well and through acquisitions the company grew.”

Perhaps it grew too quickly, or too large. In 1994, Pro-Fac purchased Curtice Burns. By 1999, Pro-Fac was highly leveraged and poorly positioned to take advantage of future growth opportunities. In hindsight, Harris acknowledged, Pro-Fac did not retain enough of its earnings. It also had issued a lot of preferred stock, which led to a cumulative dividend issue.

Even with “their backs against the wall,” Harris said that the decision in 2002 to sell approximately 60 percent of its processing company and brand, Birds Eye, to Vestar Equity Investment was only made “after a lot of soul searching.”

Was it the right decision? Birds Eye Foods is certainly more financially viable today than it was in 1999, mean-

ing that Pro-Fac is also more stable financially. However, as Harris somewhat wistfully noted, Pro-Fac no longer controls its own destiny.

If Vestar wants to sell Birds Eye, the co-op can’t stop it. Grower-members have limited input into the company’s decisions. They now have a legal, contractual relationship with their processor. Pro-Fac members are left out of the loop at the corporate level and decisions are not as transparent as in the past due to stronger confidentiality conditions. As a result, Harris feels that “what would have been small disputes between growers and Birds Eye have now become protracted disagreements.”

Dave Swanson, Partner at Dorsey & Whitney LLP, counseled cooperatives to exhaust other options before committing to a business conversion. “Identify your goals and examine the options. Can you get additional capital from your members or through joint ventures?” Alternative options include sale of preferred stock, joint ventures and consolidation. Each co-op’s situation is unique. The potential pitfalls and benefits of alternative capitalization methods need to be kept in mind in order to preserve the political and social aspects of the co-op involved. ■

“Humboldt Creamery will become a full-service frozen dessert supplier to the retail grocery industry and one of the largest ice cream manufacturers in the United States,” said Ghilarducci. “This company expansion will allow us to preserve our members’ pasture-based family dairies and protect green space in Northern California for generations to come.”

In conjunction with the expansion announcements, Ghilarducci also announced the national launch of a new Humboldt Creamery brand of organic super-premium ice cream. The product is expected to begin retail dis-



Photo courtesy Humboldt Creamery

tribution in the first quarter of 2005. Humboldt Creamery is a co-op association owned by 62 Northern California dairy families and is the oldest active dairy cooperative in the state. The company, which celebrated its 75th anniversary in October, produces a full line of dairy products, including fluid milk, powdered milk, ice cream and frozen novelties, both conventional and organic.

Record crop returns for Blue Diamond members

Almond growers who deliver to Blue Diamond received 2003 crop

Leaving home? *continued from page 11*

now in a position to attract new investors and additional capital,” adds Dalrymple, who is lieutenant governor of North Dakota.

Neither SDSP, USPB nor Golden Oval plans to raise outside capital now, but their new structures allow for the possibility. Says Golden Oval’s Staley: “Farmers make up less than 2 percent of the population. We can’t continue to go to farmers for equity in order to grow or keep strong.”

“It puts us in a position to protect ourselves from difficult times when prices might go down,” adds USPB’s Hunt.

Of the four co-ops examined above, only USPB requires farmer control. At USPB, owners of delivery rights hold a majority of the seats on the board of directors. “The premise of a producer-owned entity remains intact,” says Hunt.

Neither Golden Oval nor SDSP requires farmer control.

At Dakota Growers, the 10-member board must include five North Dakota residents and three agricultural producers. Currently, nine board members farm, while an MVC representative holds the tenth seat.

“We’re still a farmer-owned business, just not a farmer co-op,” Dodd says.

Caution urged

Many co-op advocates take a dim view of co-op conversions, especially those that don’t require a majority of farmers to control the business.

The National Cooperative Business Association (NCBA) in Washington, D.C., opposes conversions even when members retain control.

“We think the co-op form of business remains the best model for producers and consumers,” says Paul Hazen, NCBA president and CEO. NCBA represents all types of co-ops, including farmer, food, housing and insurance co-ops as well as credit unions. “When any non-member has ownership, that’s not a co-op.”

James Baarda shares that view. “My overall concern is when farmers start to think of their own organization as an investment,” says Baarda, an agricultural economist with the Cooperative Services branch of USDA Rural Development in Washington, D.C.

In cases where the business has outside investors, it is those investors who get paid first, he notes. “Farmers get whatever’s left. That’s why farmers formed co-ops in the first place [to ensure that producers come first]!”

Baarda says co-ops on both sides of the “success spectrum” can wind up as candidates for conversion. If the busi-

ness is unsuccessful, leaders may be desperately looking for some way to save the business. If a co-op is successful, farmers may not be able to capture the co-op’s value, and can seek another business form that would allow them to tap into the value.

“Some successful co-ops, rather than generating equity to farmers, put their dollars into unallocated reserves,” he says. “How does a farmer cash out their value if they can’t get their hands on it?”

Hanson points to GoldKist Inc., the nation’s largest integrated chicken company, as an example of a traditional co-op that converted so that members could access enterprise value growth and public market liquidity. After the conversion, he says, the 2,300 former farmer-members converted \$360 million of patronage equities to stock, plus added cash and stock of \$140 million. GoldKist issued publicly traded stock as part of the conversion, and farmer-held stock will be publicly tradable as well after a holding period.

E.G. Nadeau expresses disappointment in co-op conversions, including all the examples cited above. “But I understand some of the motivations,” says Nadeau. “Some co-ops have converted for the wrong reasons: based more on financial benefits to management and

returns that were 35 percent higher, on a per-pound basis, than in 2002. The co-op's average payment of \$2,900 per acre shattered the old record of \$2,500 per acre, set in 1997. The co-op reported near-record net sales of \$541.9 million

"This new revenue record is a remarkable performance because the 2003 crop was the second largest crop in the industry's history and the second billion-pound crop in a row," Blue Diamond President and CEO Doug Youngdahl told owner-members at their 94th annual meeting in Fresno, Calif. "As a result, global consumption reached new levels and industry shipments exceeded one billion pounds for the first time in history — the fifth consecutive year of record shipments,"

Youngdahl said.

"The days of looking at large crops with trepidation are over," added Youngdahl. "Ever-larger crops will be needed in the future to support global consumption growth." The co-op had 43 percent growth in retail brand sales in 2003 and has achieved more than \$9 million in annual savings since 2001 from new technology and process enhancements.

Youngdahl said almond tree plantings are projected to exceed 50,000 net new acres per year through 2010, resulting in a dramatic increase in almond supplies beginning in 2007 and 2008. Additional tonnage delivered to Blue Diamond will support "new products markets and additional consumption and will keep your busi-

nesses profitable" in years ahead, he noted.

USDA awards \$8.8 million in rural broadband grants

USDA has announced that \$8.8 million in broadband community connect grants will be awarded to 16 communities in 10 states to connect essential community facilities in rural towns and communities where no broadband service exists. USDA believes that technology is key to the ability of rural businesses and rural economies to compete in the global marketplace. Extending broadband technology to allow more families and communities to access business, education, public safety and health services is part of the Bush administration's effort to expand

board members than on benefits to members," he says. He notes that some former members of Minnesota Corn Processors are suing the former manager, alleging that he "walked away with more than \$1 million as a result of his support for the merger."

In its Nov. 7 issue, the *Chicago Tribune* ran a detailed account of how MCP's then-CEO began secretly meeting with its chief rival — Archer Daniel Midland Co. — to lay the groundwork for the sale of the co-op to ADM, and that he agreed at these meetings to try to convince farmers to accept a lower price than most thought the co-op was worth, while focusing on how much he would receive from ADM. "The case has fed long-standing resentments among independent-minded farmers against the consolidation of agriculture into the hands of a few global titans, such as ADM," the article says. [Editor's note: this was an outright acquisition, not a co-op conversion, but many of the same issues arise in each type of transaction.]

Nadeau likes new co-op laws passed in Minnesota and similar laws being developed in other states that allow for non-member investors but preserve majority member control. These laws

apply to the formation of new cooperatives and do not affect existing co-ops. They require that patrons retain at least 50 percent of decision-making power.

"These laws retain the important co-op provision of democratic member control," Nadeau says. "Attempts to form co-op-like entities, such as C-corporations or LLCs, don't share this basic statutory protection and thus can more easily be converted to investor-controlled businesses."

Not a black & white issue

Terry Barr, an agricultural economist with the National Council of Farmer Cooperatives (NCFC) in Washington, D.C., thinks critics should avoid viewing co-op conversions as a black or white issue, considering the complex challenges facing farmer co-ops.

"NCFC supports all farmer-owned organizations that seek to enhance farmer returns," says Barr. "We should worry less about what we call the form, and more about whether members understand the implications of the change and whether it truly serves the interest of the farmers in both the short and the long term."

Other business forms continue to change as well, he says. "The corporate business form arose in the early 1800s because of the lack of venture capital," he says. "Today, there is no shortage [of venture capital], and there's an active equity market. At the same time, the cost of regulatory burdens, spurred by corporate scandals such as Enron, have increased dramatically. In this environment, many corporations are evaluating conversion."

Barr adds that most traditional ag co-ops already modified their structures or capital plans to deal with a changing global marketplace. "Many farmer-owned co-ops are building relationships with companies throughout the food chain," he says. "Most are involved in joint ventures. Most have subsidiary LLCs. None are the same."

Barr agrees with co-op attorney Hanson that the changing structure of food and agriculture presents a transitional challenge for most co-ops. "When co-ops were formed, the idea was that current patrons would replace the capital of prior patrons," Hanson says. "But co-ops have fewer patrons today. Without outside capital, that points to a train wreck in the future."

economic opportunity and improve the quality of life in rural America.

One grant was awarded to the Havasupai Tribal Council to provide wireless broadband internet service to the community of Supai, Havasupai Reservation in Arizona. Located in the southwest corner of Grand Canyon National Park, the Supai community will connect all critical facilities, including public safety and health service, public schools and homes in the community that has a population of 503. Other grants range from the North Slope Borough of Nuiqsut, Ala., to Benoit, Miss.

Communities selected for the Broadband Community Connect program (the complete list is available at www.rurdev.usda.gov) do not have access to broadband connectivity for the essential services of police and fire protection, hospitals, local government, libraries and schools. The program is in its third year and, including today's announcement, has invested \$30.1 million in grant funds.

Ninety rural communities have now been connected to high-speed telecommunications through this program. In return, the communities will make at least 10 computers available to the public with set hours and instruction available for use on the Internet. The grant program supplements USDA Rural Development's standard high-speed telecommunications loan program.

AMPI butter plant hit by fire

Cleanup was underway in early January at the scene of a fire that damaged the Associated Milk Producers Inc. (AMPI) butter manufacturing and packaging plant in New Ulm, Minn. Workers began clearing rubble from the exterior of the manufacturing plant as fire and insurance investigators continued their assessment. While the full extent of the damage caused by the fire was still being determined, the cooper-

ative was working to provide uninterrupted service to its butter customers. "Other butter makers from throughout the country are generously helping AMPI fill its orders," said AMPI General Manager Mark Furth.

Alert employees reported the fire shortly after 6 p.m. on Dec. 1. Following safety protocol, all 30 employees on duty in the plant were immediately evacuated and no injuries were reported. Fire officials commended AMPI employees for their quick action and assistance in controlling the blaze. "AMPI did an excellent job with

its evacuation plan," said New Ulm Fire Chief



Debris is cleared following a fire at AMPI's butter plant in New Ulm, Minn. Above, Minnesota Governor Tim Pawlenty (left) and AMPI General Manager Mark Furth survey the damaged plant, which will be rebuilt in New Ulm this spring. Photos courtesy AMPI

Curt Curry. "Their participation in the process was outstanding. There were employees on the ground helping with the plant layout and location of hazardous materials."

Service to the dairy producers who ship their milk to the plant was not interrupted. The butter plant's milk receiving facility, which is housed in a separate building, did not sustain any damage. Milk delivered to the facility is routinely processed at one of AMPI's 12 other manufacturing plants that are located throughout the upper Midwest.

The butter plant primarily churns cream and packages butter.

CHS 2004 earnings a record \$221 million

CHS Inc. reported record net income of \$221.3 million for its fiscal year ending Aug. 31, 2004. The record net earnings represent the highest ever recorded by a U.S. regional agricultural cooperative. The 2004 results compared with net income of \$123.8 million for the period Sept. 1, 2002 - Aug. 31, 2003. Net income for 2004 exceeded a previous company record of \$178.6 million set in fiscal 2001. Net sales for fiscal 2004 also set a record at \$10.9 billion, compared with \$9.3 billion for fiscal 2003, largely attributed to increased prices for energy products and grain.

Strong refining margins, combined with improved performance by CHS lubricants and propane, contributed to the highest energy earnings in the co-op's history. Agronomy operations, represented by CHS 50 percent ownership in Agrilience, LLC, reported earnings double those of fiscal 2003.

CHS "outputs" businesses, consisting of local operations, business services, grain marketing, processing and foods, reported

improved performance across the board. Country Operations and Services, which includes CHS local operations, animal nutrition and sunflower businesses, turned in its fourth consecutive year of strong performance. Grain marketing operations overcame challenges in Chinese soybean markets to complete fiscal 2004 with its best earnings in five years.

Earnings for 2004 were up significantly over the previous year within the processed grains and foods segment, which consists of oilseed pro-

cessing, Mexican foods, CHS ownership in Horizon Milling LLC (a flour-milling venture), and Ventura Foods LLC (a vegetable oil-based food manufacturer and packager).

CHS has realigned its business organization and leadership responsibilities to position the company for growth in current and future businesses. Under the realignment, CHS will consist of four operating divisions: Processing, Ag Business, Energy and Business Solutions. There will also be two supporting divisions: Finance and Shared Services. Each of the six divisions will be led by an executive vice president. The changes took effect Jan. 1. "As CHS focuses on continuing to add value for all of its stakeholders, it's essential that our structure reflects our strategic direction and efforts to grow in our core business areas," said John Johnson, president and chief executive officer.

CHS also recently announced that it is entering the wholesale propane business in the Indiana, Ohio and Michigan marketplace previously served by Countrymark Co-op.

Bison co-op optimistic about emerging from Chapter 11

The North American Bison Cooperative of New Rockford, N.D., filed for Chapter 11 (reorganization) bankruptcy in Fargo, N.D., in November, but says it is in better shape than a year ago and expects to emerge from bankruptcy within a year. Meanwhile, the 330-member co-op is fighting back with a new retail brand name, *TenderBison*, and will be improving the efficiency of its processing plant by doing custom bison slaughtering. The co-op currently handles 250 to 600 head a month at its plant, but has the capacity to process more than 1,000 bison or cattle each month.

Co-op CEO Dieter Pape said \$600,000 will be spent on capital improvements this year, according to *AgWeek*. "I think the changes we have implemented will allow us to emerge fairly quickly from Chapter 11 and continue to be a profitable and ongoing

concern that has capacity to start repaying members from profits to help liquidate their deferred accounts, which will be turned into equity," Pape said.

UW co-op reference book newly revised

Cooperatives: Principles and Practices in the Twenty-First Century, a cooperative reference book last published in 1980, has undergone an extensive revision by Kimberly Zeuli, assistant professor, and Bob Cropp, professor emeritus, at the University of Wisconsin Department of Agricultural and Applied Economics. The book's chapters on organization, structure, financing and management of cooperatives are as relevant today as ever. Books can be ordered (there is a charge) at: <http://cecommerce.uwex.edu/showcat.asp?id=107>. A PDF version can be downloaded for free at: <http://cecommerce.uwex.edu/pdfs/A1457.PDF>.

Specialty grain industry education network expands

The Midwest Shippers' Association (MSA) co-op will be able to strengthen its Midwest Specialty Grain Industry and Education Network through a grant from The Cooperative Foundation. "The Network provides valuable education to producers on existing and emerging opportunities in the identity-preserved specialty grains industry," says William J. Nelson, Cooperative Foundation president. "It also provides producers with a network of processors, traders, as well as domestic and international buyers and end users in the specialty grains industry."

As a networking project, the contribution will help support a promotional DVD for the 2005 Midwest Specialty Grains Conference and Trade Show. The Network also includes weekly news and information releases relating to foreign trade leads and market intelligence.

MSA is a nonprofit, agricultural cooperative that helps producers, producer groups and small agribusinesses in Minnesota, North Dakota, South

Dakota, Iowa and Wisconsin efficiently produce and export specialty grains. More information is available at: www.mnshippers.org. As a private foundation, The Cooperative Foundation has supported cooperative business development, education and research projects in the Upper Midwest for more than 50 years. For more information, visit: www.coopfoundation.org.

Cropp interim director of UW Center for Co-ops

Bob Cropp, professor emeritus of agricultural economics, will serve as interim director of the Center for Cooperatives at University of Wisconsin-Madison. Cropp was director of the center from 1990 to 2003. Anne Reynolds, who had been serving as interim director, will remain at the center as assistant director. The change relieves her of administrative responsibilities so she can focus on developing and delivering extension and outreach programs and applied research.

"The center has increasing demands for work to address critical extension and outreach needs," said Dean Elton Aberle. "I commend Anne Reynolds for her leadership as interim director while also carrying major responsibilities for extension, outreach and grant projects." Founded in 1962 as the International Cooperative Training Center, the UWCC provides programs for international and domestic cooperatives.

DotCoop launches directory; Paul Hazen to head OCDC

A directory of all active .coop Web sites is now available from DotCooperation LLC, the sponsor of the cooperative-only .coop domain. Launched in November, the directory allows searches for co-ops by name, location and domain name. The directory of nearly 4,300 addresses can be found at www.directory.coop or through a link from the dotCoop site at www.coop. The directory displays each domain name; clicking on the domain name takes you directly to the site.

"When you find co-ops on our directory," says NCBA CEO Paul Hazen, "you know they are co-ops that truly identify themselves as co-ops and promote the co-operative principles through their Internet identity." The .coop domain, approved by ICANN in 2000 and launched in early 2002, now has more than 8,000 domain names registered.

In other NCBA-related news, Hazen, who has served on the Overseas Cooperative Development Council (OCDC) board for six years, has been elected chair by the board. OCDC is an association of eight international cooperative development organizations. As board chair, Hazen said his top priorities will be to guide OCDC through the transition expected with the retirement of long-time Executive Director Ted Weihe and to refocus on expanding funding for OCDC members' international development work.

"We need to reverse the trend toward a declining federal commitment to overseas cooperative development and renew policy makers' support for cooperatives as a tool to build wealth and opportunity in some of the world's poorest countries," Hazen said. "I'll be working to ensure that OCDC resources are focused on that core goal."

New funding source for rural economic development

The U.S. Department of Agriculture has announced the creation of a new rural development program that will provide a long-term funding mechanism for loans and grants to rural America. This new source of capital for rural economic development will bring new jobs to some of the most isolated and rural areas of the country.

USDA Rural Development's Rural Economic Development Loan and Grant Program (REDLG) manages these projects. New regulations enable USDA to guarantee up to \$3 billion in bonds or notes of nonprofit lenders, for up to 20 years, if the proceeds are

used for electric and telecommunications loans. The lender, whose notes the government will guarantee, will be required to pay an annual fee of 30 basis points over the term of the unpaid debt. Most of the 30 basis points will be deposited into the REDLG program.

The program was authorized by Section 6101 of the 2002 Farm Bill. Like other USDA Rural Development programs, local leaders will make the decisions on what projects are needed in their communities. The REDLG program provides zero-interest loans and grants for all types of community and economic development projects. Past projects have included fire trucks, libraries, health facilities and industrial parks.

From the beginning of this program in 1989, USDA Rural Development has invested approximately \$250 million in more than 1,000 projects across the country, leveraging an additional \$1.4 billion in private sector funds and creating an estimated 28,000 jobs. During the Bush administration, approximately \$90 million has been invested, creating or saving almost 15,000 jobs.

Hanson gets co-op leadership honor

Mark J. Hanson, chairman of Lindquist & Vennum PLLP's Agribusiness and Cooperative Practice Group, received the Minnesota Cooperative Leadership Award during the joint annual meeting of the Minnesota and Wisconsin state co-op associations. Hanson is the youngest recipient of the award and the only attorney to be so honored.

He is responsible for developing a new form of business organization: a cooperative taxed on a partnership basis. His efforts in analyzing trends related to the future viability of cooperatives led to Minnesota Chapter 308B, a 2003 law intended to help spur significant Minnesota cooperative development. He is working with similar legislation in Wisconsin and Iowa as well as working with federal

officials to change federal law and make the cooperative legal structure more attractive. Hanson also organized some of the first ethanol, egg and beef-processing cooperatives using marketing agreement pledges



Mark J. Hanson

and stock investment for capitalizing these sophisticated businesses.

The Leadership Award is sponsored and administered by the Minnesota Association of Cooperatives to

honor distinguished individuals for their contributions to cooperative business. Nominees are selected for their leadership, vision, personal commitment, innovation and statesmanship.

Dakota local co-ops merge

The Farmers Union Co-op Association of Redfield-Doland has merged with the 4 Seasons Cooperative of Britton, both in South Dakota, effective Feb. 1, 2005. The merger was approved Dec. 6 at the 4 Seasons Co-op's annual meeting. Patrons of Redfield-Doland voted unanimously on Nov. 22 to merge with 4 Seasons, while there were only two dissenting votes at the later co-op, for a 98 percent favorable vote. The merged co-op will be operated initially by a 16-member board. Plans call for three directors to go off the board each year at the first two annual meetings, reducing the board to nine directors.

4 Seasons Co-op's year ending Aug. 31 was the second most profitable year for the co-op since 1986. It had a margin before taxes of \$837,695. The grain division showed a profit of \$102,000.

Lamb Checkoff faces vote

Sheep producers, feeders and first-handlers are voting to decide whether to continue the American Lamb Checkoff program, which promotes year-round consumption of American lamb and works to minimize the

volatility of seasonal lamb sales. The four-week voting period begins Jan 31 and ends Feb. 28. The referendum is being conducted at local county USDA Farm Service Agency (FSA) offices. To find your closest office, visit FSA's Web site: www.fsa.usda.gov/pas/default.asp.

Collections under the Lamb Checkoff program began in July 2002, and raise a budget for the American Lamb Board of about \$2.3 million annually. Administrative expenses are limited to 10 percent of budget. The 13-member board is appointed by the Secretary of Agriculture, and the board office is in Denver.

Record beet payments for Minn-Dak members

Minn-Dak Farmers Cooperative harvested net revenues of \$198.9 million for the excellent 2003 crop, resulting in the highest gross beet payment in co-op history for member-shareholders. Addressing members at the co-op's annual meeting in Fargo, N.D., in early December, Minn-Dak Executive Vice-President Steve Caspers said sugar content of the 2003 crop was "an excellent 18.7 percent -- well above the five-year average," and beet purity was also good.

The co-op sliced 2.1 million tons of beets, the second largest volume ever processed by Minn-Dak. About 2.26 million tons of beets were harvested from 112,800 acres in 2003, with an average yield of 20 tons per acre.

The high-quality crop also resulted in a good year for Minn-Dak's marketing subsidiaries. John Doxie, president of United Sugars Corporation, a joint venture which markets sugar for Minn-Dak and two other sugarbeet co-ops, said sales volume was up 23 percent in 2004. Midwest Agri-Commodities Co. of San Rafael, Calif., marketer of Minn-Dak's molasses and beet pulp, also had record sales volume and made record returns to members. Minn-Dak Yeast Co., owned by Minn-

Dak and Sensient Technologies of Milwaukee, Wis., recorded sales of \$7.3 million.

Minn-Dak President and CEO David Roche said he foresees challenges looming large on the horizon for the co-op, including falling sugar prices, the need for more industry promotion, higher production costs and trade agreements which could result in more sugar imports. Stagnant, if not declining, prices have been the norm at Minn-Dak the past several years, and the co-op has continually taken steps to increase productivity and efficiency to counteract the price declines in order to cushion the impact on



Sugar samples are tested in Minn-Dak's lab. Members received the highest gross beet payments in the co-op's history for the 2003 crop. Photo courtesy Minn-Dak

shareholders, he noted. In addition, the entire sugar industry has had to come to terms with lower consumption by consumers, which has prompted sugar producers to consider new ways to promote sugar.

Despite these hurdles, Roche said he sees a bright future for the co-op. "The intensity of our owners has created a 'can do' culture at Minn-Dak," he said.

Victor Krabbenhoft, delivering his last speech before retiring as Minn-Dak board chairman, compared the history of the co-op to a marathon. "It's a long run, complete with obstacles, and those with a strong will continue on. It's important that we don't back down from these challenges, but rather meet them head on."

The 2004 crop sugar content is down to 16.7 percent, due to large amounts of rain in the fall.

USDA Ag Outlook Forum provides insight on "front-burner" ag issues

USDA's annual Ag Outlook Forum will be held Feb. 24-25 in the Washington, D.C. suburb of Arlington, Va. Leading commodity analysts will be on hand to discuss planting, trade and price prospects for farm commodities for the year ahead. The program will focus on the impact of science on farming, farm policy and agricultural markets. Speakers will also discuss issues such as Mad Cow disease (BSE) and beef trade, prospects for energy prices and ethanol, international trade talks, market integration in North America, early debate on the next Farm Bill and new dietary guidelines.

There will be ample time for networking at this popular event, which attracted 1,400 people last year. Attendees will receive a set of new USDA long-term commodity projections to 2014. The conference will be held at Crystal Gateway Marriott Hotel. For program details, registration and hotel information, visit the conference

Web site:<http://www.usda.gov/occe/forum>, or call (877) 744-3083.

Crop-based biofuels could add \$5 billion to farm profits by 2025

A new report provides further weight to the potential benefit of ethanol and other biofuels in reducing America's dependence on imported oil, while adding \$5 billion annually to farm profits by 2025 if production commitments are made now. "These fuels are derived from cellulosic biomass such as corn stover, grain straw, straw and sugarcane waste rather than just from grains, thus providing a further benefit of harvesting two crops from every field," says Brent Erickson, a vice president of the

Biotechnology Industry Organization (www.bio.org).

At \$40 per dry ton, the \$5 billion added profit is based on 200 million tons of biomass, which is less than one-sixth the total amount of biomass farmers could produce by 2050, according to the report "Growing Energy: How Biofuels Can Help End America's Oil Dependence," issued by the nonprofit National Resources Defense Council (NRDC). The result of a two-year study by agricultural, engineering and environmental experts, it is the first to focus on what bioenergy technologies can do when commercially mature and operating on a large scale. In addition to adding to farm profits, biofuels have the potential of being cheaper than gasoline and diesel, saving about \$20 billion per year on fuel costs by 2050, according to the report. Moreover, biofuels could reduce greenhouse gas emissions by 1.7 billion tons per year.

"This report also addresses some of the concerns raised when using biomass for energy independence," Erickson said. "For example, biofuels can be competitive with gasoline and diesel, with a price of between 59 cents and 91 cents per gallon for the former and 86 cents per gallon for diesel. This is the equivalent of saving \$20 billion per year in fuel costs by 2050. Enough land is available for biofuels to make a big contribution, and emission concerns over low-percentage blends of ethanol in the existing fleet can be addressed."

For a copy of the 96-page report and executive summary *Growing Energy: How Biofuels Can Help End America's Oil Dependence*, log onto: <http://www.bio.org/ind/GrowingEnergy.pdf>

USDA-EPA partnership promotes renewable energy

USDA Rural Development and the Environmental Protection Agency

(EPA) recently announced a new inter-agency partnership to support agricultural and business based renewable energy systems. This agreement is part of the Bush administration's effort to increase teamwork in delivering services to rural America.

"This agreement is a triple play," said Agriculture Acting Under Secretary for Rural Development Gilbert Gonzalez. "It's good for the environment. It helps exploit a new energy source — one with high growth potential — of clean, renewable fuel to reduce our oil imports. And it's good



USDA's Gilbert Gonzalez (right) and the Environmental Protection Agency's Jeff Holmstead sign an agreement setting up a new partnership to support agricultural- and business-based renewable energy systems.

for the bottom-line of farmers, ranchers and small businesses."

The agreement provides for EPA technical support of USDA in reviewing systems for methane gas recovery via anaerobic digestion of animal waste. EPA will also consult on technical guidelines for USDA Rural Development initiatives encouraging more state-of-the-art digester technologies. USDA and EPA are also investigating expanding support to other areas. The partnership will promote use of anaerobic digestion technology in a way that enhances rural agricultural development, provides environmental benefits and increases farm revenues through the generation of renewable energy.

"Energy production is an exciting growth sector for U.S. agriculture," said Gonzalez, "and a strong rural economy, more jobs in rural areas, renewable energy production and a cleaner environment are all key elements of President Bush's agenda. USDA Rural Development is committed to aggressive leadership on these initiatives.

The 2002 Farm Bill directs USDA to encourage the development of renewable energy. In 2003-04, USDA Rural Development invested \$16.9 million in 67 anaerobic digester projects.

With leveraging, the total investment exceeds \$80 million. These projects serve 11,300 rural households, generate 127 GWh, and create 120 jobs.

Another \$3 million going back to Walton EMC members

For the second year in a row, most Walton Electric Membership Corporation customer-owners will be taking part in a \$3 million refund. That means \$22 million has been returned to co-op members over the past 17 years. Most of the refunds will appear as a credit on electric bills, with

the average being \$27. This saves more than \$30,000 in check production and mailing costs. Refunds are based on the amount of the customer's annual power bills.

Some margins are held for reserve funds so that Walton EMC is prepared for emergencies. Margins are also used to help pay down debt and to make major purchases. "But when those margin reserves grow to more than what's needed for a safe financial cushion, Walton EMC returns the extra," explains CEO Ronnie Lee. More than 92,000 customers will get money back. Walton EMC is a customer-owned electric company and serves 107,000 electric accounts in ten Northeast Georgia counties. ■



Science, Policy, Markets— What's Ahead?

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See program details and register at www.usda.gov/oce/forum.

For program updates, send your contact information to agforum@oce.usda.gov.

Vital Info for Co-op Boards

Co-op board members owe it to themselves and their members to be familiar with the issues detailed in these USDA Rural Development publications.

All Publications Free

NEW Nominating, Electing, and Compensating Co-op Directors: CIR 63 – Originally published in *Rural Cooperatives* magazine, these three articles use examples from successful co-ops to provide suggestions for selecting members of a cooperative board of directors and maintaining a competent and effective board.

Cooperative Business Management Functions: CIR 45, Sec. 11 – Basic information about the responsibilities and functions of co-op business managers and the boards of directors who hire them.

Who Runs the Cooperative Business? Board of Directors: CIR 45, Sec. 5 – How a co-op board of directors oversees the management of the business.

Cooperative Directors: Asking Necessary Questions: CIR 62 – This report guides directors in asking the right questions to invoke informative responses from managers, staff, auditors, other directors, etc. An invaluable resource for directors with limited business experience.

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