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NCFC
Legal, Tax and Accounting
Subcommittee Reports

NCFC
National Council of
Farmer Cooperatives

NCFC®
National Council of Farmer Cooperatives

Tel: 202-626-8700
Fax: 202-626-8722
50 F Street, NW Suite 900
Washington, DC 20001
www.ncfc.org

INTRODUCTION

The LTA subcommittee reports are prepared annually through the efforts of individuals who serve on NCFC's Legal, Tax and Accounting Committee. NCFC is grateful for the dedication and generosity of these volunteers, many of whom are national experts in their respective areas of practice.

The purpose of the reports is to interpret and highlight the legal, tax and accounting events of the past year, and to discuss in detail many of the issues faced by cooperatives. Please note that the following reports do not constitute specific advice and may fail to address aspects of an issue or development relevant to the reader. Readers should be particularly aware of the importance of checking for subsequent developments.

If you have questions or need materials referred to in the reports, please contact me at mcarson@ncfc.org or 202-879-0825.

Sincerely,

Marlis L. Carson

Marlis Carson
Senior Vice President & General Counsel

TABLE OF CONTENTS

Financial Reporting and Audit Issues of Agricultural Cooperatives

Workforce of the future
- Internal controls in remote work environments

With the onset of COVID-19 in the United States in early 2020 and numerous states enacting stay-at-home orders, employers sent their non-essential workers home and were forced to immediately implement remote work practices. The sudden and swift shift of millions of workers from on-site to remote work environments challenged organizations as never before. A couple of the more pressing areas that CFOs and management executive teams needed to immediately address were remote connectivity and maintaining strong internal controls in a remote work environment.

Technology and security considerations in a remote work environment:

During the early weeks of the crisis, organizations were mostly focused on remote connectivity and ensuring that they had the capacity to meet the needs of their customers and employees for virtual meetings, live streaming, online education, customer assistance and more. For organizations that had a large-capacity virtual private network (VPN) and laptops for all its employees, the transition was more seamless. However, for organizations that had a limited bandwidth VPN and where employees worked on desktop machines, the transition was much more challenging. Many organizations had to expand remote connectivity and some may have taken short-cuts to get there. For those organizations, it may make sense to conduct an assessment that reviews access, the current controls in place and the threats remote workers may inadvertently be creating. In a recent PwC CFO Pulse Survey, more than two-thirds of the organizations responding to the survey are investing in cybersecurity tools and training. This includes updating algorithms and analytics solutions to help detect anomalous behavior and taking a holistic approach to identity management. They are also considering robust risk analysis and scenario planning to account for possible disruptions. Even with these investments being made, cybersecurity remains a top concern, and more than one-third of CFOs in that survey say not having effective cybersecurity measures in place is a challenge to a successful hybrid work model.
Below are some comment best practices related to IT security in a remote work environment:

- Whenever possible use a company-owned computer, NOT your personal computer, to work from home. The company computer should have the necessary anti-virus and encryption software to ensure the data is protected. Also, company I.T. staff will be familiar with company devices and therefore be better able to help answer questions and resolve issues.

- If you have WiFi in your home, make sure that you have encryption turned ON (this will require you to enter a password before you connect) and that the password is long (24 characters) and not easy to guess. This will help prevent neighbors or others accessing your network and intercepting work-related information.

- DO NOT let your children or other family members play with or use your company computer for any reason. Restrict YOUR use of the computer to business purposes only. This will reduce the possibility of downloading something malicious onto the computer.

- If you have limited Internet bandwidth in your home, you may experience slow computer response, or some functions may not work correctly. Limit the bandwidth used by other devices during working hours (TV, audio steaming, etc.) and if you are meeting with others via Skype, Zoom, GoToMeeting, etc. limit the meeting to AUDIO only, as video webcams use more bandwidth.

- Use a Virtual Private Network (VPN) to connect to the office. A VPN connection allows someone outside the company's network to connect to it and access resources. Enabling Multi-Factor Authentication (MFA) will require employees to enter another randomly generated code that is sent by text message or is available on an authenticator app, which only the employee has access to.

- DO NOT save files or documents on your local computer, put them where they belong on the home network (Shared disk, etc.) Otherwise, working remotely could end up meaning files are scattered and inaccessible to others. If users do not have a way to connect back to the company network, or independently determine it is too difficult, they may look to a file sharing program available online to help them store and transfer files. Programs like Google Drive, Dropbox, etc. could be used. The problem is that this allows company documents and information to be stored outside of the company network. Once documents are stored in these locations they are no longer under the control of the company, possibly without the knowledge of IT or leadership within the company. Company data can easily be breached without the knowledge of the company. Use of these applications should be limited by both policy and technology constraints to help ensure data is not compromised.

- Remote employees' computers will not be protected by the company's firewall. This is true regardless of what computer is being used. Hopefully they have an adequate endpoint protection (that includes more features than just anti-virus), but that does not replace the protection of a hardware firewall. Firewalls have features like content filtering, geo-filtering, Intrusion Protection System (IPS), etc. Employees will have to be extra cautious when browsing the web and when reviewing emails. A simple mis-click can lead them to a site that would have otherwise been blocked inside the protection of the company network.

- It is important to continually train employees due to this change. Employees who sit through a one-time training may not effectively learn everything; it is a lot to take in all at once. Then, what they did learn may not be relevant after a couple years, or even months. A recurring training and testing program will allow employees to learn pieces at a time, reinforce what they learned at a later date, and then be updated on new technology, terms, and recommendations. How many employees in your organization would be able to recognize an email that is a phishing attempt, trying to get them to click a link that would compromise your entire system? Some other examples are password best practices, working from home, public Wi-Fi security, etc. There is an ever growing and changing list of what employees need to be knowledgeable about in the IT and cybersecurity world.

As a reminder, there are some best-in-class industry resources that can be utilized in a cost-efficient manner to help protect your business. For example, COSO has published a Fraud Risk Management Guide to assist businesses in managing fraud risks, including those fraud risks prevalent in a remote working environment. The guide includes best-practices on the following topics: 1) Establishing fraud risk governance policies; 2) Performing a fraud risk assessment; 3) Designing and deploying fraud preventative and detective control activities; 4) Conducting investigations; and 5) Monitoring and evaluating the total fraud risk management program.

Not only is technology a key component to a successful hybrid work model and maintaining a strong internal control environment, but people collaborating and working together are integral to strong internal controls as well. A big concern around making a hybrid work model successful centers on what gets lost when people aren't physically working together. Coordination among teams is a key for success to avoid dropped hand-offs between functions. Another key to success is maintaining the corporate culture of a disciplined internal control framework, which can be challenging in a remote work environment. Organizations' control environments likely changed over the course of the pandemic given the move to remote work and changes in business conditions and work volume. So it's important to revisit and evaluate internal controls and processes in an environment that combines both remote and on-site work. It's also a good time to leverage technology in the move toward virtual processes and to use digital tools to automate manual processes where possible.

Actions taken and planned to be taken at CoBank:

At CoBank we were fortunate that at the onset of the pandemic all employees had laptop computers and access to a large-capacity VPN, which facilitated a relatively smooth transition to remote work. We evaluated our internal controls in a remote work environment and considered changes that would be needed to maintain a clean integrated audit opinion and Service Organization Control 1 (SOC1) report. We make an assertion as to the effectiveness of our internal controls over financial reporting (ICFR) and receive an audit opinion on such. We also issue a SOC1 report to offer assurance on certain of our service controls. We determined that only minor changes in controls were necessary as a result of most employees working from home. However, we are now being responsive to the longer-term and evolving risks presented with a remote work environment, including cyber considerations, electronic workflow and communications, human capital, etc. The following are some of the actions we took to ensure strong internal controls in a remote work environment.

- Replaced manual, wet signatures with electronic signatures via PDF or scanned copies to evidence many review and approval controls.

- Adjusted our quarterly management certifications of internal controls supporting ICFR to include COVID-19 considerations (changes in internal controls, evidence of effectiveness, etc.).

- Collaborated closely with areas across the bank to understand any issues and changes in internal controls and processes.

- Established ongoing and regular communication with Internal Audit to gain alignment on any control changes required.

- Engaged in frequent communication with our independent auditors to understand their remote work arrangements and to effectively execute interim and year-end procedures for financial reports, ICFR reviews and testing.

- Revisited our hiring and onboarding process to ensure the approach is well-designed to support new employees successfully joining the bank while working remotely.

- Provided a stipend to all employees early in the pandemic to ensure they had the right equipment and office set-up to work effectively from home.

- Balanced out the workload to avoid overloading some employees with tasks while others have time to take on more.

- Maintained a detailed closing and financial reporting checklist with clear owners and dates.

- Stayed in touch with our employees through virtual meetings ranging from small group social events to "skip-level" manager meetings to Finance division meetings to all-employee meetings hosted by our CEO.

The following are actions CoBank is planning to take in the future:

i. Identify and document significant manual processes and controls in Finance, as well as individuals involved. Evaluate readily available digital tools to help automate manual processes.

ii. Upskill Finance resources with knowledge of essential tools, digital acumen and new ways of working. Have employees use their new skills to develop tools and bots to automate manual processes and make it easier to do work virtually.

iii. Continue to focus on frequently touching base with employees and personalizing messages for them as well as meeting people's individual needs. Open and frequent communication from leaders makes employees feel more engaged and confident in their ability to do their jobs, which further strengthens the internal control environment.

iv. Adopt flexible, hybrid job classifications allowing employees to take care of themselves and their families while maintaining a strong commitment to meet their working requirements.

For remote work environments, organizations must ensure that they have the right policies, procedures and controls in place for safe, healthy and productive employees and for a strong internal control environment that customers, employees and business partners can trust.

Automation in the Accounting Function

The COVID-19 pandemic has accelerated the pace in which cooperatives need to re-imagine their accounting departments. As it becomes increasingly more difficult for all organizations to attract and retain accounting and finance talent, automation of certain elements within the accounting function may allow organizations to leverage transactional tasks, allowing its accounting and finance team to focus on performing high-value, high-impact tasks.

There are several different technologies that enable cooperatives to automate accounting functions. Robotic Process Automation (RPA) is a software solution that works like a virtual employee. RPA performs repetitive tasks which emulate human execution, often within the existing IT landscape. Many organizations experience reduction in data entry costs (by up to 70%) and reduction of error rates. Moving further down the automation journey, some organizations have added Artificial Intelligence (AI) technology. AI mimics human judgment and behavior to solve certain problems. Such activities could include reconciling accounts, inputting and matching data from scanned documents, comparing employee expense reports against company policies, or tracking vendor price changes. Further down the AI maturity model is Machine Learning (ML), which allows the machine to learn from its experience to more accurately handle automated activities.

The journey to automate accounting processes can be daunting. However, taking the time to conduct an objective assessment of the current accounting and finance infrastructure is the first step in the journey. Questions to consider:

- What are the roles and responsibilities of the individuals on the team?
- How much time are they spending entering data or operating in excel data files?
- Which processes would be nice to automate and which are critical to automate?
- Which systems utilized by the organization do not integrate, and how much “dual entry” is occurring between systems?

Cloud Computing

Cooperatives have been hearing about the trend towards more technology and automation for years. The abrupt need to shift to a remote working environment escalated during the COVID-19 pandemic. Cooperatives that were slow to adapt to cloud technologies suffered a decline in back-office efficiency, timeliness of reporting and ultimately negative impacts to the cooperative’s bottom line.

Cloud computing can be key as cooperatives evaluate their digital transformation plans. Cooperatives that operate in a cloud computing environment often see benefits, such as managing costs associated with an in-house IT infrastructure. Also, many see the benefit of increased speed and processing time, while scaling storage capacity.

There are many misconceptions about modern cloud technology, specifically surrounding difficulty in implementing and security compared to on premise systems. While implementing any system can be overwhelming, there continues to be a surge in cloud technologies that allow organizations, from small to middle market to large, to choose systems that work for them. The word "implementation" no longer necessarily means a robust team working on the project for 12 to 24 months. Regarding security, on premise systems can be secure if you have the right controls in place and have a strong internal IT team. However, sharing data security responsibilities with one of the reputable cloud technology providers is often just as effective from a risk management standpoint. Many of these providers have robust security controls and go through extensive third-party IT audits.

Cooperatives that are considering moving systems to the cloud should evaluate the impact on their internal control environment, including their Enterprise Risk Management (ERM) strategy. This includes having an understanding of cybersecurity, who is accessing company data and why, and what the cooperative's enterprise-wide cloud activities consist of.

Treasury Management

Banks have provided traditional treasury management services to their cooperative clients for years. Just as cooperatives and other businesses are using technology and increased automation to achieve efficiencies, many banks have upgraded their treasury management services to include advanced technology tools that cooperative finance teams may use right at their desk. Just one example of these tools is integrated payables.

First, what are integrated payables? It is a service whereby numerous vendor payments are consolidated into a single file and transmitted to the cooperative's bank (that provides such service) for processing. The bank then processes the payments pursuant to the cooperative's instructions. Depending on the preference of the cooperative, vendor and the bank's capabilities, payments may be sent via mail, electronically, by virtual card, ACH or wire.

The benefits of integrated payables are many. The cooperative consolidates its payment processing function into a single step, rather than entering each vendor transaction separately. Using integrated payables improves efficiencies by reducing the cooperative's costs in processing each payment and allowing the cooperative's bank to absorb such costs. Many banks that provide this service will also survey the cooperative's vendors, analyze the vendors' preferred methods of payment and incorporate those payment methods in their process. Additionally, by scheduling payments on their due date or sooner to take advantage of potential discounts, a cooperative may better manage its cash flow and accounts payable. Finally, many banks include fraud protection tools in their integrated payables processes, including dual control for file processing and transaction approval, matching checks issued against checks presented for payment and debit protection for ACH payments.

Of course, there may be initial challenges in setting up an integrated payables platform. Some banks require specific file formats that may or may not be compatible with existing IT systems. Also, depending upon the bank, not all of the services and tools discussed above may be available as part of a particular bank's process. And there will be some degree of education and training necessary to prepare the finance team to use an integrated payables system to the full extent of its capabilities. Notwithstanding these challenges, incorporating an integrated payables process into a cooperative's finance function allows the finance team to focus on what matters. Instead of spending an inordinate amount of time writing checks and processing vendor payments, the finance team can focus on strategic initiatives and growing the business.

Cybercrime - Protecting Your Organization from Online Hackers

While high profile breaches at Colonial Pipelines and Solar Winds dominate the headlines, breaches at small businesses fly under the radar. Yet these disruptions are often more devastating, even to the point of business failure.

Small businesses that never considered themselves targets are becoming victims of payment fraud, crippling ransomware attacks, and password theft. These crimes are often perpetrated from outside the country by attacking the online cash management features that banks provide their customers.

You can take steps to protect your entity, but before taking action, you must first understand and acknowledge this growing threat. The attacks fall into four main categories:

- Theft of personal financial information
- Online banking malware (so-called corporate account take-over)
- Ransomware
- Credential harvesting (theft of user ID and password)

Theft of Personal Financial Information

Organized crime groups (primarily in Russia, Eastern Europe, and China) have created a high demand for personal financial information, including name, address, social security number, driver's license number, bank account number, and credit card details. Hackers steal this information then sell it to criminals who use it to commit various form of identity theft. The more complete and associated to an individual, the more valuable the information is on a "wholesale" basis. Payroll databases, customer sales records, and supplier/accounts payable records are common targets for this type of attack.

Online Banking Malware

Online banking malware does not dominate the news the way it once did, but it still occurs with frequency. Once a network is infected with this type of malware the online banking credentials (user ID, password, challenge questions) are harvested by the attacker, who then logs into the online banking server and executes fraudulent wires or ACH transactions. More sophisticated malware can bypass multifactor authentication tokens. This type of attack is often called corporate account takeover.

Malware code is often delivered via email, either by a file attached directly to the message, or more commonly, by use of a link to a rogue web page. In the latter case, the malware returns with the web page and installs itself on the victim's computer. This type of attack has been dubbed "spear phishing" since often only one email is sent to the victim organization.

Spear phishing emails have improved significantly in their sophistication and effectiveness, and can be very difficult for users to identify as fraudulent. They often use carefully crafted scripts to entice the user to click the link. In some cases, the emails are even "spoofed," that is, they are crafted to appear to come from someone inside the victim organization (e.g., the company president). In other cases, the emails are designed so they appear to come from a legitimate business or organization, such as UPS, American Express, PayPal, or the IRS. These spoofing tactics are designed to increase the likelihood that the recipient will act quickly, clicking on the link without much thought.

Credential Harvesting

With the popularity of cloud adoption hackers are motivated to steal user ID/password combinations (credential harvesting) in order to access these potentially sensitive services. Credential harvesting is typically done be keystroke logging malware or by social engineering – tricking users into supplying internal network credentials on an external website.

Ransomware

Ransomware is not new but has become a very lucrative business model for attackers. It involves the delivery of malware that encrypts the devices on the network, then demands payment for the key to decrypt these devices. This can create a true business interruption event. Newer ransomware variants are capable of encrypting the backup media or exfiltrating key network data before encrypting the production network.

Protecting Your Business

Preventing these attacks is no small task. It requires a multilayered approach. Organizations should consider each of these tactics.

Properly Defend

- Keep current on technical defensive measures such as firewalls, intrusion detection systems, and spam filters.
- Keep up-to-date on the anti-virus software on each device and complete regular scans to keep them clean.
- Keep all network servers and PC workstations current with the latest security updates and patches.
- Limit administrator privileges. End users should not have administrator privilege on their laptop or workstations. In addition, system administrators should have a separate, non-privileged user account for browsing, email, and other user activities.
- Encrypt sensitive data, such as intellectual property and personal financial information.
- Limit the number of PCs used to conduct online cash management. If possible, isolate them from the rest of the company network.
- Deploy protection measures provided by your bank, including (but not limited to):
  - Multifactor authentication
  - ACH blocks and filters
  - Daily and individual transaction limits
  - Wire call-back features
  - Positive pay systems to reduce check fraud

- Make regular backups of key data and systems and store them in a secure, off-site location that is properly segmented (air-gapped) from the production network.

- Monitor activity and balance online accounts daily.

- Perform periodic vulnerability or penetration assessments to validate that controls believed to be in place are functioning as intended.

- Use multi-factor authentication (MFA) on all cloud apps and remote access (such as VPN)

Relationship, Communication, and Training

- Educate users to spot fake emails and to be wary of website links and file attachments.

- Read and thoroughly understand your agreements with your bank related to online activity.

- Identify the primary contact at your bank who will be your first call for help in the event of a breach.

- Develop an incident response plan so users know who to contact immediately if they suspect malicious activity on their computer.

- Establish a relationship with local law enforcement agencies that are familiar with online crimes.

Real World Experience

A cyber-attack may begin in any number of ways. Whether it is a strange email from an officer of the company requesting procedures be changed or ignored, an email containing a bizarre link or attachment or even a seemingly legitimate email from a vendor purportedly changing their bank information, it is imperative for a business to know how to respond.

If you suspect that your business has suffered a cyber-attack, the most important thing to do is report the incident immediately. This includes reporting to your bank, insurance carrier, any outside IT vendors and local law enforcement. Timely reporting is the number one thing you can do to increase your chances of recovery and/or limit exposure. To insure timely reporting, employee engagement is key. Management should make sure employees know that reporting a cyber-attack, even if it was the result of an employee opening a strange email or clicking on an attachment, will not result in an adverse employment action. Eliminating fear and creating a culture of cooperation will have a direct benefit to the business in its cyber strategy.

Additionally, every business should have a cyber incident response plan. This plan should clearly identify the different functional groups to involve, such as finance/accounting, information technology, risk management, and legal/compliance. Representatives from each of these groups should take part in preparing the plan and having a thorough understanding of their roles in its implementation and in any given response. Also, the business should identify outside professionals in advance to assist in responding to an event. This includes outside specialist in IT security and systems, legal counsel and possibly crisis management consultants. The need for both internal and external expertise is due to the breadth of the impact a cyber-attack may have on a business. Every stakeholder in a business from investors, employees, customers and vendors may be adversely impacted. Further, depending upon the type of attack, the business may have certain legal obligations to notify third parties that their information may have been accessed.

The time to prepare an incident response plan is before an incident occurs. It goes without saying, if you are trying to develop your plan and respond to an incident at the same time, it is too late.

Conclusion

The question of when a company will be the victim of a cyber-attack is not "if" but "when." Sophisticated bad actors targeting small businesses are highly motivated and determined to monetize anything of value. In a 2019 public service announcement, the FBI reported businesses lost $26 billion in email compromise schemes between 2016 and 2019. This statistic only accounts for reported incidences. Because many of these events go unreported for a variety of reasons, the true loss figure is certainly much higher. No amount of education, training or security can fully eliminate the risk of a successful attack. Unfortunately, there is no way to anticipate every possible scheme or scenario. Businesses and individual employees must accept shared responsibility to create a culture of vigilance, awareness, and skepticism. There is no way for an incident response plan, security tools or safeguards to take the place of critical thinking.

FASB Issues Accounting Relief for Reference Rate Reform

The Financial Accounting Standards Board (FASB) issued temporary accounting relief to help ease the burden of reference rate reform. The temporary accounting relief consists of optional expedients and exceptions for applying generally accepted accounting principles (GAAP) to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met.

The temporary accounting relief impacts entities that are required to modify existing contracts and hedging relationships due to the market-wide migration from interbank offered rates (IBORs) to alternative reference rates.

Effective Dates

The optional expedients and accounting relief in Topic 848 were effective for all entities upon issuance of ASU 2020-04 on March 12, 2020, and will remain effective until December 31, 2022.

This means the practical expedients can be applied to contract modifications and eligible hedging relationships that:

- Existed as of the beginning of the interim period that includes March 12, 2020
- Were entered into after March 12, 2020, and through December 31, 2022
- Entities must disclose the nature of and reason for electing the optional expedients and exceptions in each interim and annual financial statement period in the fiscal year of application.

Identifying Alternative Reference Rates

IBORs are an indicative measure of the average interest rate at which major global banks could borrow from one another and are widely used as benchmark or reference rates. The London Interbank Offered Rate (LIBOR) is the most commonly used reference rate in the global financial market. LIBOR is used as a benchmark in both commercial and financial contracts, including:

- Corporate and municipal bonds and loans
- Floating rate mortgages
- Asset-backed securities
- Consumer loans
- Lease agreements
- Derivative instruments, including those related to interest rates, foreign currency, and various commodities

It's expected, however, that many private-sector banks currently reporting information used to set LIBOR will stop doing so after 2021 when their current reporting commitment ends.

Concerns about the sustainability of LIBOR and other IBORs led to an effort to identify alternative reference rates. The FASB launched the reference rate reform project in 2018 to address accounting challenges expected to arise from the transition of LIBOR and other IBORs.

Topic 848 Accounting Relief

Amendments in ASU 2020-04 introduce Topic 848, Reference Rate Reform, a new topic that provides temporary optional expedients to ease accounting requirements related to transitioning from LIBOR—or other reference rates that are expected to be discontinued—to alternative reference rates.

If certain criteria are met, entities may elect not to apply certain aspects of contract modification accounting to modifications related to reference rate reform and to continue applying hedge accounting for hedging relationships that are modified due to reference rate reform.

Contracts That Qualify Under Topic 848

The effects of reference rate reform are expected to be temporary, so the accounting relief will generally only apply to contract modifications made, or hedging relationships entered into or evaluated subsequent to the beginning of the reporting period that includes March 12, 2020, and prior to December 31, 2022.

The optional expedients and exceptions only apply to contracts or hedging relationships that are affected by reference rate reform and that reference LIBOR or another reference rate expected to be discontinued due to reference rate reform.

Additionally, the relief is limited to changes being made to the terms of the contract that include:

- The direct replacement of a reference rate being discontinued
- Other modifications to terms that are considered related to the replacement of a reference rate

Discounting Transition

In connection with reference rate reform, certain interest rates used to determine variable cash flows, or for valuation purposes, are transitioning to alternative rates.

Rates that may transition to alternative rates include:

- Rates used to compute the cash flows for an interest rate swap’s variable leg
- Interest rates used to discount the future cash flows of a derivative instrument to determine its fair value
- Margin payments that must be exchanged on the basis of changes in the derivative instrument’s fair value
- Compensation or interest amounts earned on margin payments—referred to as contract price alignment

Changes in the interest rates used for margining, discounting, or contract price alignment for derivative instruments that are being implemented as part of the market-wide transition to new reference rates is commonly referred to as the discounting transition.

The amendments in ASU 2021-01 clarify the scope of Topic 848 includes derivative instruments that undergo a rate modification for one of the items noted above.

Contracts That Don't Qualify Under Topic 848

If a contract modification includes both a reference rate change and other substantive changes that are unrelated to reference rate reform, the contract won't qualify for the practical expedients or accounting relief provided for in the reference rate reform standard.

The optional expedients and accounting relief don't apply to modifications that occur in the ordinary course of business or for reasons unrelated to reference rate reform, such as borrowing base redeterminations, extensions, and covenant remedies.

Optional Expedients for Contract Modifications

Under current GAAP, contract modifications must be evaluated to determine whether modifications result in either:

- Establishment of a new contract
- Continuation of an existing contract

Topic 848 simplifies the accounting analysis for contract modifications affected by reference rate reform, including rates referenced in fallback provisions. It also simplifies the accounting for contemporaneous modifications of other contract terms related to the replacement of reference rate, including contact modifications to fallback provisions.

It does this by permitting the following optional expedients.

- **Receivables and debt**. Modifications within the scope of Topic 310, Receivables, and Topic 470, Debt, should be accounted for by prospectively adjusting the effective interest rate.
- **Leases**. Modifications within the scope of Topic 842, Leases, should be accounted for as a continuation of the existing contract with no reassessments or remeasurements of lease classification, discount rates, or lease payments.
- **Derivatives and hedging**. Modifications within the scope of Topic 815-15, Derivatives and Hedging—Embedded Derivatives, won't require a reassessment of whether or not an embedded derivative should be accounted for as a separate instrument.

  Lack of explicit guidance. Modifications for which explicit guidance isn't provided should be accounted for as a continuation of those contracts without having to reassess previous determinations.

The optional expedients must be applied consistently to all modified contracts and eligible transactions within the relevant codification topic or subtopic. If elected, they must also be applied to all modifications of an interest rate used for margining, discounting, or contract price alignment for derivative instruments.

This election, however, doesn't require the optional expedients to be applied to other modifications of derivative instruments.

When Optional Expedients Can't Be Applied

The optional expedients may not be applied to a modification made to a term that changes, or has the potential to change, the amount or timing of contractual cash flows is unrelated to the replacement of a reference rate—with the exception of a modification to the interest rate used for margining, discounting, or contract price alignment.

Optional Expedients for Hedging Relationships

Under current GAAP, changes in a reference rate could disallow the application of hedge accounting, and certain hedging relationships may no longer qualify as highly effective.

> If a contract modification includes both a reference rate change and other substantive changes that are unrelated to reference rate reform, the contract won't qualify for the practical expedients or accounting relief provided for in the reference rate reform standard.

Topic 848 provides exceptions to current guidance in Topic 815; the following changes won't result in the dedesignation of the hedging relationship if they're due to reference rate reform.

- **Critical terms**. Certain changes in the critical terms of a designated hedging instrument, a hedged item, or a forecasted transaction in a fair value, cash flow, or net investment hedge.

- **Adjustments**. A change to rebalance or adjust a fair value or cash flow hedge.

- **Assessment methods**. A change in the method used to assess hedge effectiveness for a cash flow hedge, when initially applying an optional expedient method and reverting back to current GAAP.

- **Additional terms**. A change to the terms as a result of the discounting transition.

Upon a change to the terms of a hedging relationship affected by reference rate reform, the amendments allow entities to change the systematic and rational method used to recognize in earnings the components excluded from the assessment of effectiveness. Additionally, if the change in terms impacts the fair value of the excluded component, the fair value adjustment may be recognized in current earnings.

The optional expedients are intended to make it easier for entities to continue to apply hedge accounting.

Fair Value Hedges

If certain criteria are met, Topic 848 also provides the following optional expedients for existing fair value hedging relationships affected by either reference rate reform or the discounting transition.

- Benchmark rates. Entities may change the designated benchmark rate documented at hedge inception to a different eligible benchmark rate without dedesignating the relationship.

- Perfect hedge effectiveness methods. Entities that applied the shortcut method, or another method that assumes perfect hedge effectiveness, can continue to apply it for the remainder of the hedging relationship—including the remainder of hedging relationships that end after December 31, 2022—even though certain requirements to apply this method would no longer be met as a result of reference rate reform.

These optional expedients should be applied on a hedge-by-hedge basis. The method used to change the designated benchmark interest rate should be applied consistently across similar fair value hedging relationships.

In some cases, the cumulative fair value hedge basis adjustment may be modified for the amount of cash compensation, using a reasonable method. This can occur if the shortcut method is applied to a fair value hedging instrument that is affected by a payment or receipt of a cash settlement intended to compensate for a modification of the interest rate used to margin, discount, or align the contract price for the derivative instrument related to reference rate reform.

Cash Flow Hedges

Topic 848 provides the following optional expedients for cash flow hedging relationships affected by reference rate reform if certain criteria are met.

- **Designated hedged risk**. Entities may disregard potential changes in the designated hedged risk due to reference rate reform when assessing if of the occurrence of the hedged forecasted transaction continues to be probable.

- **Interest rate risk changes**. Entities may continue hedge accounting when the hedged interest rate risk changes if the hedge is either highly effective or an optional expedient method is elected.

- **Shortcut method**. Entities that applied the shortcut method, or another method that assumes perfect hedge effectiveness, can continue to apply that method even though certain requirements to apply this method may no longer be met as a result of reference rate reform.

- **Disregarding mismatches**. Entities may adjust the methods used to initially and subsequently assess hedge effectiveness to disregard certain mismatches between the designated hedging instrument and the hedged item when either the hedging instrument or hedged forecasted transaction reference a rate that is expected to be affected by reference rate reform.

- **Qualitative method**. Entities may elect to subsequently assess hedge effectiveness using a qualitative method.

- **Forecasted transaction portfolios**. Entities may disregard the requirement for forecasted transaction portfolios that reference a rate expected to be affected by reference rate reform to share the same risk exposure for which they’re designated as being hedged.

The above optional expedients should be applied on a hedge-by-hedge basis. They must be discontinued as of either:

- Date the hedging instrument or hedged forecasted transaction ceases to reference a rate affected by reference rate reform

- After December 31, 2022

The amount recorded in accumulated other comprehensive income may be adjusted for the amount of cash compensation exchanged using a reasonable method. This is only true, however, if a cash flow hedging instrument is affected by a payment or receipt of a cash settlement intended to compensate for a modification of the interest rate used for margining, discounting, or contract price alignment for the derivative instrument related to reference rate reform.

Net Investment Hedges

Topic 848 allows a receive-variable rate, pay-variable rate cross-currency interest rate swap to be designated as the hedging instrument in a net investment hedge if the repricing terms of the swap's variable legs don't match because of reference rate reform.

Applicability of Optional Expedients for Hedge Accounting

Entities may only elect the following optional expedients for hedge accounting if the amendments in ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities

(https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176169282347&acceptedDisclaimer=true), haven't yet been adopted.

- **Critical terms**. Changes in critical terms of a hedging relationship.

- **Elected method**. Changing the method used to assess hedge effectiveness in a cash flow hedge if the optional expedient method elected is the simplified hedge accounting approach for initial hedge effectiveness or subsequent hedge effectiveness. This expedient only applies to eligible private companies.

- **Probable to occur**. Assuming the hedged forecasted transaction in a cash flow hedge is probable to occur.

- **Quantitative-basis measurement**. Assuming the reference rate won't be replaced for the remainder of the hedging relationships when the entity is using the quantitative basis to assess and measure hedge effectiveness in a cash flow hedge.

- **Simplified hedge accounting requirements**. Disregarding certain requirements of the simplified hedge accounting approach for initial or subsequent hedge effectiveness in a cash flow hedge. This expedient only applies to eligible private companies.

Selling or Transferring Debt Securities

Topic 848 allows entities to may make a one-time election to sell or transfer certain debt securities classified as held to maturity, without calling into question the entity's prior intent to hold those debt securities to maturity.

At the time of applying the one-time election, the entity may sell, transfer, or both sell and transfer, debt securities classified as held to maturity if they meet both of the following criteria:

- Reference a rate affected by reference rate reform

- Classified as held to maturity before January 1, 2020

Accounting Considerations for Paycheck Protection Program

The Paycheck Protection Program (PPP) provides small businesses and other eligible entities with funds in the form of low- interest loans that are guaranteed by the Small Business Administration (SBA).

To assist entities in accounting for loans received under the PPP, the American Institute of Certified Public Accountants (AICPA) issued Technical Question and Answer (TQA) 3200.18

(http://www.aicpa.org/InterestAreas/FRC/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx), Borrower Accounting for a Forgivable Loan Received Under the Small Business Administration Paycheck Protection Program

(https://www.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-sections/tqa-section-3200-18.pdf), on June 10, 2020.

The Governmental Accounting Standards Board (GASB) also issued proposed Technical Bulletin 2020-a, Accounting and Financial Reporting Issues Related to the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) of 2020 and Coronavirus Diseases on June 11, 2020.

Below we address accounting and reporting considerations for borrowers—both nongovernmental and governmental entities— that obtained PPP loans.

Background

The PPP was established by the Coronavirus Aid, Relief, and Economic Security (CARES) Act, through a significant expansion of the SBA 7(a) loan program. It was designed to provide a direct incentive for small businesses to keep their workers on the payroll.

The PPP allows for loans of up to $10 million to small businesses with less than 500 employees to assist with payroll costs, rent, mortgage interest, or utilities during the COVID-19 pandemic. Under Section 1106 of the CARES Act, entities could be eligible for forgiveness of the principal amount and accrued interest on PPP loans if certain criteria are met.

The question of how to appropriately interpret and apply the PPP loan forgiveness criteria has been an area of high interest since the enactment of the CARES Act. The PPP Flexibility Act (/articles/2020/06/paycheck-protection-program-flexibility-act) was signed into law on June 5, 2020, which generally improved borrowers' ability to qualify for forgiveness.

Additionally, the SBA continues to update its published Paycheck Protection Program Loans Frequently Asked Questions (https://www.sba.gov/document/support--faq-lenders-borrowers) to provide additional guidance to borrowers and lenders.

Nongovernmental Entities

Given the unique nature of the PPP, questions have arisen as to how a borrower should account for the loan in accordance with US Generally Accepted Accounting Principles (GAAP).

Although the legal form of the PPP loan is debt, some believe that the loan is, in substance, a government grant. There's no guidance in existing US GAAP that specifically contemplates the accounting for forgivable loans obtained from, or guaranteed by, a governmental entity.

TQA 3200.18 provides nonauthoritative guidance on how nongovernmental entities, including business entities and not-for-profit entities, should account for a forgivable loan received under the PPP. The AICPA staff consulted with the SEC and Financial Accounting Standards Board (FASB) staff, as well as various expert panels, to develop the TQA.

As indicated in the TQA, the staff of the Office of the Chief Accountant of the SEC have indicated they wouldn't object to an SEC registrant accounting for a PPP loan under FASB Accounting Standards Codification (ASC) 470, Debt, or as a government grant by analogy to International Accounting Standard (IAS) 20, Accounting for Government Grants and Disclosure of Government Assistance, provided certain conditions are met.

More details are provided below on the specific accounting considerations.

Debt

Regardless of whether a nongovernmental entity expects to repay the PPP loan or believes it represents an in-substance grant, the loan may always be accounted for as a financial liability in accordance with ASC 470, Debt, with interest accrued in accordance with the interest method under ASC 835-30, Imputation of Interest.

Following the guidance in ASC 470, a borrower would recognize the entire loan amount as a liability on the balance sheet, with interest accrued and expensed over the term of the loan. The entity wouldn't impute additional interest at a market rate because transactions where interest rates are prescribed by governmental agencies are excluded from the scope of ASC 835-30.

For purposes of derecognizing the liability, ASC 470 refers to the extinguishment guidance in ASC 405, Liabilities. Based on that guidance, the loan would remain recorded as a liability until either of the following criteria are met:

- The entity has been legally released from being the primary obligor under the liability.
- The entity pays the lender and is relieved of its obligation for the liability.

Because a borrower wouldn't be legally released from being the primary obligor of a PPP loan until forgiveness is actually granted, income from the extinguishment of the loan would only be recognized once the borrower's application for forgiveness is approved.

Any amount forgiven would be recognized in the income statement as a gain on extinguishment.

In-Substance Government Grants

Borrowers may also conclude that a PPP loan should be accounted for as an in-substance government grant based on its circumstances.

The TQA states that if a business entity expects to meet the PPP eligibility criteria and concludes that the loan represents, in substance, a grant that's expected to be forgiven, it may analogize to the guidance in IAS 20, Accounting for Government Grants and Disclosure of Government Assistance.

The AICPA staff observed that business entities may also analogize to not-for-profit entity (NFP) guidance in ASC 958-605, Revenue Recognition, or to ASC 450-30, Gain Contingencies, if the borrower expects to meet the PPP's eligibility criteria and expects the loan to be forgiven.

A NFP that chooses not to account for the loan under ASC 470 and expects to meet the PPP's eligibility requirements and concludes that the PPP loan represents, in substance, a grant that is expected to be forgiven, should account for the PPP loan in accordance with ASC 958-605 as a conditional contribution.

IAS 20

IAS 20 outlines an accounting model for different forms of government assistance, including forgivable loans. Under IAS 20, government assistance isn't recognized until there's reasonable assurance that:

- Any conditions attached to the assistance will be met.
- The assistance will be received.

The term reasonable assurance isn't defined in IAS 20, but is generally viewed as a similar threshold to probable in US GAAP.

If the entity is able to assert that it meets all qualifications for the PPP loan and that forgiveness is probable, the proceeds from the loan would initially be recognized as a deferred income liability. Subsequently, the entity would reduce the liability and recognize income on a systematic basis over the period in which the entity recognizes the related costs for which the PPP loan is intended to compensate, for example, payroll costs.

Under the IAS 20 model, PPP loan income would be presented on the income statement as either:

- A credit, in a separate line item or under a general heading such as other income
- A reduction of the related expenses

ASC 958-605

Although the scope of ASC 958-605 excludes business entities, the FASB staff has acknowledged that business entities aren't precluded from applying the guidance by analogy when appropriate.

The conditional contribution model is discussed in more detail below.

ASC 450-30

Under this model, income from a conditional grant is treated as a gain contingency.

A borrower applying this model would initially recognize PPP loan proceeds as a liability. The earnings impact of gain contingency is recognized when all the contingencies related to the assistance have been met and the gain is realized or realizable.

Conditional Contribution

In accordance with ASC 958-605, conditional contributions aren't recognized until the conditions are substantially met or explicitly waived. In cases where conditions are met over time or in stages, contributions should be recognized as qualifying expenses are incurred.

Under this model, the proceeds from a PPP loan would initially be recognized as a refundable advance—a liability—until the conditions for forgiveness are substantially met. The borrower would subsequently recognize contribution revenue as it incurs qualifying PPP expenses, assuming all other conditions are substantially met.

Disclosure

Nongovernmental entities should disclose their accounting policy for PPP loans and the related impact to the financial statements.

Governmental Entities

Proposed Technical Bulletin 2020-a would provide guidance on how governmental entities should account for a forgivable loan received under the PPP.

Among other items, the guidance in the proposed technical bulletin would clarify that an entity that reports in accordance with GASB standards should account for a PPP loan as a liability in accordance with Statement 70, Accounting and Financial Reporting for Nonexchange Financial Guarantees, until that entity is legally released from the debt.

During the period in which the entity is legally released from the debt, an inflow of resources should be reported.

Comments on the proposed technical bulletin are due by June 25, 2020, and the GASB is scheduled to review feedback and consider a final Technical Bulletin on June 30, 2020.

Overview of New Tax, Other Legislation and Implementation Issues Affecting Farmer Cooperatives (Report Pending)

Cooperative Structures: Mergers, Acquisitions, Joint Ventures and Subsidiaries

2021 FINAL REPORT

OF THE

LTA REPORTING SUBCOMMITTEE

ON COOPERATIVE STRUCTURES: MERGERS, ACQUISITIONS, JOINT VENTURES, AND SUBSIDIARIES

As of January 25, 2022

Prepared by:

David P. Swanson, Chair
Dorsey & Whitney LLP
Telephone: (612) 343-8275
E-mail: swanson.dave@dorsey.com

AND

William Covey, Vice Chair
GROWMARK, Inc.
Telephone: (309) 557-6292
E-mail: bcovey@growmark.com

AND

Danny Posch, Vice Chair
MKCOOP
Telephone: 620-345-6328
E-mail: dposch@mkcoop.com

INTRODUCTION

This year's subcommittee report for the Reporting Subcommittee on Cooperative Structures compiles the following three types of developments involving cooperatives: (i) sales or acquisitions of assets, (ii) mergers and consolidations, and (iii) miscellaneous transactions and news. Each section reflects the specified type of transaction or venture involving cooperatives as reported by the news media or other sources during 2020 and 2021.

I. Sales or Acquisition of Assets

1. Arizona Coop Considers Sale of Natural Gas Division

Graham County Electric Coop will move forward with the potential sale of its natural gas division upon the affirmative two-thirds vote of its members on October 17th. The division has not made any money since 1989, is projected to lose $291,000 this year, and is $2.625 million in debt. Southwest Gas has expressed an interest in purchasing the division.

Source: Coop Law Blog, *Arizona Coop Considers Sale of Natural Gas Division*, EVERSHEDS SUTHERLAND (Sept. 25, 2020), https://www.cooplawblog.com/2020/09/arizona-coop-considers-sale-of-natural-gas-division/.

2. Ubiquity Announces Acquisition of Dallas-Fort Worth Broadband Provider

Ubiquity Management, LP (Ubiquity), an investor in critical communications infrastructure throughout the United States, recently announced that it has completed the acquisition of Millennium Telcom, LLC d/b/a OneSource Communications, a provider of fiber-fed broadband services in the Dallas-Fort Worth metro area, from Tri-County Electric Cooperative. OneSource's fiber network is within 1,000 feet of approximately 72,000 homes and businesses, and with 6,100 existing customers, the company is positioned for significant growth. The growing residential and business population within the service territory is expected to provide both organic and expansion growth catalysts as well.

Source: Coop Law Blog, *Ubiquity Announces Acquisition of Dallas-Fort Worth Broadband Provider*, EVERSHEDS SUTHERLAND (Oct. 12, 2020), https://www.cooplawblog.com/2020/10/ubiquity-announces-acquisition-of-dallas-fort-worth-broadband-provider/.

3. Entities Consider Purchase of Coal Creek Plant, with Sustainable Enhancements

At least two entities are considering purchasing Great River Energy's 1,147-MW Coal Creek plant, which was slated for retirement in the second half of 2022. The purchasers are considering operating the plant with enhancements such as carbon capture and storage technologies and building energy storage and wind generation in the area.

Source: Coop Law Blog, *Entities Consider Purchase of Coal Creek Plant, with Sustainable Enhancements*, EVERSHEDS SUTHERLAND (Oct. 16, 2020), https://www.cooplawblog.com/2020/10/entities-consider-purchase-of-coal-creek-plant-with-sustainable-enhancements/.

4. Pedernales Electric Cooperative signs 100-MW PPA on Texas Wind Project

EDF Renewables North America and Pedernales Electric Cooperative, the largest distribution electric cooperative in the United States, signed a 15-year power purchase agreement (PPA) for a 100-MW share of King Creek 1 Wind Project. The project will consist of 47 wind turbine generators and construction is expected to start by the end of 2020. The project will create approximately 300 construction-related jobs during its peak and will benefit the local community over its operating life through land lease, tax and other payments.

Source: Coop Law Blog, *Pedernales Electric Cooperative Signs 100-MW PPA on Texas Wind Project*, EVERSHEDS SUTHERLAND (Nov. 2, 2020), https://www.cooplawblog.com/2020/11/pedernales-electric-cooperative-signs-100-mw-ppa-on-texas-wind-project/.

5. 4 Rivers Electric Cooperative to Develop Sun Farm

Twelve Kansas electric coops, including 4 Rivers Electric Cooperative, are partnering to develop 800 miles of sun farms across the state. All systems installed will be sized in the 1 MW range and contracted through a 25-year power purchase agreement.

Source: Coop Law Blog, *4 Rivers Electric Cooperative to Develop Sun Farm*, EVERSHEDS SUTHERLAND (Nov. 20, 2020), https://www.cooplawblog.com/2020/11/4-rivers-electric-cooperative-to-develop-sun-farm/.

6. Electric Coops Create New Electric Vehicle Charging Network

A group of 29 electric cooperatives, including Freeborn-Mower Cooperative Services, has created a regional electric vehicle charging network across Wisconsin, Illinois, Iowa and Minnesota. The network, named CHARGE EV LLC, will include over 30 Level 2 and Level 3 charging stations. Level 3 supercharging stations allow vehicles to be fully charged in less than an hour.

Source: Coop Law Blog, *Electric Coops Create New Electric Vehicle Charging Network*, EVERSHEDS SUTHERLAND (Dec. 29, 2020), https://www.cooplawblog.com/2020/12/electric-coops-create-new-electric-vehicle-charging-network/.

7. Northeastern REMC to Utilize Battery Storage System

In December, Northeastern REMC contracted with battery maker FlexGen for a total of 31 MW of lithium iron phosphate batteries to be fully operational by 2023. The 109-megawatt-hour battery energy storage system, one of the largest to be owned and operated by an electric coop, is expected to save coop members $35 million over the next two decades.

Source: Coop Law Blog, *Northeastern REMC to Utilize Battery Storage System*, EVERSHEDS SUTHERLAND (Jan. 15, 2021), https://www.cooplawblog.com/2021/01/northeastern-remc-to-utilize-battery-storage-system/.

8. Electric Cooperatives Create Electric Vehicle Charging Network

A coalition of 29 electric cooperatives has created an electric vehicle charging network across Wisconsin, Minnesota, Illinois and Iowa designed to encourage coop consumer-members to drive electric vehicles (EVs). The coalition invested over $100,000 in more than 40 Level 2 and Level 3 chargers provided by ZEF Energy Inc. to form the CHARGE EV network.

Source: Coop Law Blog, *Electric Cooperatives Create Electric Vehicle Charging Network*, EVERSHEDS SUTHERLAND (Jan. 19, 2021), https://www.cooplawblog.com/2021/01/electric-cooperatives-create-electric-vehicle-charging-network/.

9. Iowa Coop Receives REDLG Loan to Assist Local Business Expansion

Pella Cooperative Electric Association, an Iowa electric cooperative, and Co-Line Welding, Inc. successfully secured a $1 million loan through the United States Department of Agriculture (USDA) Rural Economic Development Loan and Grant (REDLG) program to assist with a $6,675,000 building expansion for Co-Line, a metal fabrication and manufacturing business and a member of Pella Cooperative Electric Association. The REDLG program provides zero-interest loans to rural utility providers, such as Pella Cooperative Electric, that in turn re-lend the money at zero interest to businesses within their communities.

Source: Coop Law Blog, *Iowa Coop Receives REDLG Loan to Assist Local Business Expansion*, EVERSHEDS SUTHERLAND (Jan. 29, 2021), https://www.cooplawblog.com/2021/01/iowa-coop-receives-redlg-loan-to-assist-local-business-expansion/.

10. Two More Georgia Cooperatives to Offer Broadband

Central Georgia Electric Membership Corp. and Southern Rivers Energy, two Georgia electric cooperatives, say they and partners will invest more than $200 million to extend broadband internet to more than 80,000 customers in 18 counties between Atlanta and Macon.

Source: Coop Law Blog, *Two More Georgia Cooperatives to Offer Broadband*, EVERSHEDS SUTHERLAND (Feb. 9, 2021), https://www.cooplawblog.com/2021/02/two-more-georgia-cooperatives-to-offer-broadband/.

11. Hoosier Energy and Capital Dynamics Sign 150 MW Solar Energy Power Purchase Agreement

Capital Dynamics CEI, the Clean Energy Infrastructure (CEI) business line of Capital Dynamics, an independent global private asset management firm, and Hoosier Energy recently announced the signing of a long-term Power Purchase Agreement (PPA). Under the terms of the PPA, Hoosier Energy will purchase 150 MW of the power generated by the Ratts 2 Solar Project, a CEI-owned greenfield solar project that is currently being developed in Knox County, Indiana.

Source: Coop Law Blog, *Hoosier Energy and Capital Dynamics Sign 150 MW Solar Energy Power Purchase Agreement*, EVERSHEDS SUTHERLAND (Feb. 22, 2021), https://www.cooplawblog.com/2021/02/hoosier-energy-and-capital-dynamics-sign-150-mw-solar-energy-power-purchase-agreement/.

12. Texas Coop to Strengthen Infrastructure

Upshur Rural Electric Cooperative is currently replacing and increasing the number of poles and lines in anticipation of "storm season" in East Texas. The coop believes the investment will save money down the road by avoiding repeated repairs.

Source: Coop Law Blog, *Texas Coop to Strengthen Infrastructure*, EVERSHEDS SUTHERLAND (Mar. 19, 2021), https://www.cooplawblog.com/2021/03/texas-coop-to-strengthen-infrastructure/.

13. Tennessee Valley Authority to Build Kentucky's Largest Solar Site

The Tennessee Valley Authority (TVA) announced plans last Thursday to build the largest solar-plus-storage project in its Kentucky service area. The new Logan County solar farm, part of the TVA's Green Invest program, will provide Facebook's regional data center operations with 145 megawatts of solar power and General Motors' Corvette Plant in Bowling Green with 28 megawatts of solar power. Facebook's investment helped enable the addition of 120 megawatt-hours of new battery storage technology which will increase the resilience of the power grid. TVA and Warren Rural Electric Cooperative Corporation are partnering with Nashville-based Silicon Ranch to develop the project.

Source: Coop Law Blog, *Tennessee Valley Authority to Build Kentucky's Largest Solar Site*, EVERSHEDS SUTHERLAND (Mar. 30, 2021), https://www.cooplawblog.com/2021/03/tennessee-valley-authority-to-build-kentuckys-largest-solar-site/.

14. New York Cooperative Enters into Purchase Agreement

Tri-County Rural Electric Cooperative (Tri-County) entered into an asset purchase agreement to acquire the Waverly, NY electric distribution assets of Pennsylvania Electric Co. (Penelec). Tri-County intends to add Penelec's customers in Waverly to its cooperative membership upon completion of the acquisition.

Source: Coop Law Blog, *New York Cooperative Enters into Purchase Agreement*, EVERSHEDS SUTHERLAND (Apr. 2, 2021), https://www.cooplawblog.com/2021/04/new-york-cooperative-enters-into-purchase-agreement/.

15. Iowa Cooperative Announces Plans for Solar Farm

Central Iowa Power Cooperative has announced plans for a huge solar farm in eastern Iowa. The project will deliver 100 megawatts of power starting in 2022.

Source: Coop Law Blog, *Iowa Cooperative Announces Plans for Solar Farm*, EVERSHEDS SUTHERLAND (Apr. 27, 2021), https://www.cooplawblog.com/2021/04/iowa-cooperative-announces-plans-for-solar-farm/.

16. SMECO Begins Extensive Electric Vehicle Charging Network

Southern Maryland Electric Cooperative (SMECO) is creating an electric vehicle charging network that will grow to 60 stations over the next four years as the coop works to help Maryland achieve its ambitious goal of having 300,000 electric vehicles (EVs) on the road by 2025. The coop's stations are at public locations that include regional parks, senior centers and libraries.

Source: Coop Law Blog, *SMECO Begins Extensive Electric Vehicle Charging Network*, EVERSHEDS SUTHERLAND (May 10, 2021), https://www.cooplawblog.com/2021/05/smeco-begins-extensive-electric-vehicle-charging-network/.

17. Cooperative Turns on Battery Storage Facility

The first large standalone battery storage facility in New Hampshire has been turned on by the New Hampshire Electric Cooperative alongside its solar farm. The 2.45-megawatt battery project, the largest in New Hampshire, was developed in partnership with Engie, the North American arm of a French energy firm.

Source: Coop Law Blog, *Cooperative Turns on Battery Storage Facility*, EVERSHEDS SUTHERLAND (May 18, 2021), https://www.cooplawblog.com/2021/05/cooperative-turns-on-battery-storage-facility/.

18. Great River Energy Finds Buyer for Coal Creek Station

The search for a new owner for Coal Creek Station is over, as a Bismarck-based company has reached a deal with operator Great River Energy to purchase the power plant. Affiliates of Rainbow Energy Marketing Corp. will acquire the McLean County, North Dakota plant and its transmission line for an undisclosed price.

Source: Coop Law Blog, *Great River Energy Finds Buyer for Coal Creek Station*, EVERSHEDS SUTHERLAND (July 6, 2021), https://www.cooplawblog.com/2021/07/great-river-energy-finds-buyer-for-coal-creek-station/.

19. Dean Foods Completes Sale of Assets to Dairy Farmers of America

Dean Foods Company announced that it has completed the previously announced sales of substantially of its assets, including the sale of the assets, rights, interests and properties relating to 44 of the Company's fluid and frozen facilities to subsidiaries of Dairy Farmers of America.

Source: News Release, *Dean Foods Completes Sale of Assets to Dairy Farmers of America* (May 1, 2020) https://www.Dean Foods Completes Sale of Assets to Dairy Farmers of America | Dean Foods

20. Post-Transaction Integration Efforts Of GROWMARK And Southern States Cooperative

On October 8, 2020, GROWMARK and Southern States Cooperative ("Southern States") closed on a transaction that aligned the organizations operationally to yield increased innovation, growth, and returns for the farmer-owners of both cooperative systems.

GROWMARK assumed the wholesale agronomy and energy (fuels and propane) assets of Southern States, along with several retail locations serving farmers in Delaware and Maryland. GROWMARK is providing crop inputs, fuels, propane, and a variety of customer support and marketing services to Southern States and its member cooperatives. They, in turn, are continuing to deliver customer solutions with access to GROWMARK's product-mix, distribution expertise, and drive for innovation.

Focus on… Integrating Southern States into the GROWMARK System

October 8, 2020 was a memorable day for the GROWMARK and Southern States Cooperative Systems. Just 10 months ago a new and unique model of doing business came to fruition. So much has been accomplished in the time since, with many hours and days spent by Southern States and GROWMARK teams, collaborating and diligently forging a wholesale Energy and Agronomy supply system. Integration occurred utilizing GROWMARK's vast supply chain footprint and vendor relationships unique to Southern States. Becoming the wholesale supplier for the newly formed FS – Southern States Members is a huge component of the transaction. But just as important was developing the Member relationships and partnerships that the FS System values and the agricultural industry respects.

It has been a pleasure and huge advantage to bring many of the prior Southern States wholesale team on board now as GROWMARK employees. The entire Southern States team has been instrumental in helping prepare GROWMARK team members with familiar areas and roles of servicing Members in a less familiar geography.

Our original plan called for a much earlier closing and transition date however COVID-19 threw us the most unexpected curve ball and created a slight delay. That delay caused some challenges in planning for supply, as many agricultural products require supply plans months in advance of busy seasons. Although this past year also created some supply headwinds both teams collaborated to cover supply needs and overcome these industry challenges.

As a cooperative System the services provided to members is a significant piece of the value proposition. This unique model provides members a shared services platform.

We are off to a great start, with sales and profitability reaching and exceeding plan. The business model and structure of the GROWMARK – Southern States transaction is unique and designed to keep engagement and commitment towards this new and expanded System working together. It is exciting, this new GROWMARK – Southern States System is executing now on opportunities that were viewed to be available much later in this journey.

The Southern States transition is continuing to reinforce the Mission of the GROWMARK System – to improve the long-term profitability of our Member owners.

-Shelly Kruse, Executive Director, Strategic Relationships

Sources: *Agricultural Cooperatives Growmark and Southern States Combine Efforts to Maximize Value for Farmer-Owners Across North America*, GROWMARK Press Release, August 7, 2020; and *Focus on ... Integrating Southern States into the GROWMARK System*, Internal GROWMARK Communication, August 2021.

21. GROWMARK Subsidiary Total Grain Marketing Acquires Grain Assets From The Andersons In Champaign, Illinois

Largest grain elevator in Illinois now part of the GROWMARK/FS System

Total Grain Marketing, a venture of GROWMARK, Inc., Illini FS, South Central FS, and Wabash Valley Service Company, announces the acquisition of grain assets from The Andersons, Inc. (Nasdaq: ANDE) in Champaign, Illinois.

"The Andersons facility and assets in Champaign complements Total Grain Marketing's existing portfolio," said GROWMARK Grain Division Executive Director Matt Lurkins. "Our goal is to deliver an unsurpassed customer experience through local grain market expertise along with merchandising flexibility to help deliver increased profitability for customers."

The site has more than 16 million bushels of storage capacity making it the largest grain elevator by upright storage in Illinois.

“We opened the grain elevator at Champaign in 1968 and grew a loyal customer base by concentrating on strong relationships and providing extraordinary service,” said Bill Krueger, president of The Andersons Trade and Processing. “We value the relationships that have been built and are pleased that these customers will continue to be served by Total Grain Marketing. This sale represents a step in optimizing our portfolio in support of our ongoing strategy to be the most nimble and innovative North American supply chain company in the ag industry.”

The Andersons will continue to own and operate the bulk fertilizer business in the Champaign complex.

“This new location is right in the heart of our territory,” said Illini FS General Manager Kory Kraus. “Total Grain Marketing will give great opportunities to the shareholders of Illini FS. This will be a welcome addition to our trade territory.”

The acquisition also opens a new rail market for Total Grain Marketing, expanding access to poultry markets throughout the United States.

About Total Grain Marketing:

Total Grain Marketing, also known as TGM, is a full-service grain company offering various grain marketing options to meet the grain demands of producers and consumers. Established in 2006 as a venture between Effingham-Clay Service Company (now South Central FS), GROWMARK, Inc., and Wabash Valley Service Company, TGM operates 41 elevators, nine of which are MID-CO Commodities branch offices with a total of 11 licensed brokers, to provide service and recommendations in the futures markets.

Eight of the 41 locations operate on the CN, CSX, WATCO, INRD, and UP railroads. Combined, these locations have the capability to hold 375 rail cars and load out over 1.3 million bushels per day. These facilities ship grain to the southern poultry market, Gulf region, and to states of Tennessee, South Carolina, Georgia, Florida, Alabama, Texas, Arkansas, and New York. TGM’s facilities have been buying grain since the mid-1940s. TGM is now one of the largest non-multi-national grain companies.

About GROWMARK:

GROWMARK is an agricultural cooperative serving almost 400,000 customers across North America, providing agronomy, energy, facility engineering and construction, and logistics products and services, as well as grain marketing and risk management services. Headquartered in Bloomington, Illinois, GROWMARK owns the FS trademark, which is used by member cooperatives. GROWMARK also owns and operates SEEDWAY, the largest full-line seed company in the United States. More information is available at growmark.com.

About The Andersons, Inc.:

Founded in the Maumee, Ohio, in 1947, The Andersons is a diversified company rooted in agriculture, conducting business across North America in the commodity trading, ethanol, and plant nutrient sectors. Through its Statement of Principles, The Andersons strives to provide extraordinary service to its customers, help its employees improve, support its communities, and increase the value of the company. For additional information, please visit www.andersonsinc.com.

Source: *Total Grain Marketing Acquires Grain Assets from The Andersons in Champaign*, GROWMARK Press Release, September 17, 2021.

22. GROWMARK's Insight FS Retail Division Acquires Draeger Oil

Insight FS, a division of GROWMARK based in Jefferson, Wisconsin, acquired the assets of Draeger Oil in Antigo, Wisconsin. The transaction closed on February 25, 2021.

Source: GROWMARK General Counsel's Division Monthly Operations Report, April 1, 2021.

23. GROWMARK's Insight FS Retail Division Acquires Real Estate For Potential Expansion

Insight FS, a division of GROWMARK, purchased real estate located in Ishpeming, Michigan from Ruusi-Vivian Oil Co. for potential expansion. The transaction successfully closed on July 15, 2021.

Source: GROWMARK General Counsel's Division Monthly Operations Report, August 5, 2021.

24. WESTERN GRAIN MARKETING, LLC Acquires Grain Assets

WESTERN GRAIN MARKETING, LLC ("WGM"), a grain joint venture owned by GROWMARK and several of its member cooperatives and based in Rushville, Illinois, purchased the assets of Prentice Farmer's Elevator Company ("Prentice Elevator"), which operated multiple grain facilities in west central Illinois. WGM took possession of the assets and began operating the grain elevators in September of 2020 under a lease for early possession. The closing on the real estate occurred on April 16, 2021.

Source: GROWMARK General Counsel's Division Monthly Operations Report, April 27, 2021.

25. TriCounty FS Acquires Customers of Jerseyville Gas Service

GROWMARK member cooperative TriCounty FS, based in Jerseyville, Illinois, purchased the customer base of Jerseyville Gas Service. The closing took place on August 28, 2021.

Source: GROWMARK General Counsel's Division Monthly Operations Report, September 8, 2021.

26. West Central FS Acquires Assets From Munson Hybrids, Inc.

GROWMARK member cooperative West Central FS, based in Galesburg, Illinois, purchased real estate and buildings from Munson Hybrids, Inc. The transaction closed on August 20, 2021.

Source: GROWMARK General Counsel's Division Monthly Operations Report, September 8, 2021.

27. M & M Service Company and Christian County Farmers Supply Company Acquire Grain Assets

GROWMARK member cooperatives M & M Service Company, based in Carlinville, Illinois, and Christian County Farmers Supply Company, based in Taylorville, Illinois, acquired grain facilities owned by Rt. 16 Grain and located in south central Illinois. The transaction closed on December 28, 2020.

Source: GROWMARK General Counsel's Division Monthly Operations Report, January 28, 2021.

28. St. Clair Service Company Acquires Belleville Seed House

Effective December 29, 2020, GROWMARK member cooperative St. Clair Service Company acquired the assets of the Belleville Seed House, a locally owned turf business based in Belleville, Illinois. The acquisition includes the Seed House's single location which provides a full range of products and services to support residential and commercial turf management to customers in the metro area.

"David Easter and the Seed House team have built tremendous business with a solid reputation in the Belleville area," said Brett Crawley, St. Clair General Manager. "We're excited to be able to combine the strengths of both companies to better serve our customers as well as introduce the Seed House customers to our lineup of GreenYard turf products."

The acquisition of the Belleville Seed House provides St. Clair Service Company with its sixth location. Across St. Clair County, Illinois, St. Clair Service Company has full-service agronomy and energy facilities, grain elevators, a fertilizer plant, and a unit storage facility.

Source: *St. Clair Service Company acquires Belleville Seed House*, St. Clair Service Company Press Release, January 15, 2021.

II. Mergers and Consolidations

1. Pee Dee Electric and Marlboro electric Announce Strategic Partnership

Pee Dee Electric Cooperative and Marlboro Electric Cooperative, neighboring cooperatives in South Carolina, have announced that they will enter into a management agreement, effective September 18, 2020.

Source: Coop Law Blog, *Pee Dee Electric and Marlboro Electric Announce Strategic Partnership*, EVERSHEDS SUTHERLAND (Sept. 17, 2020), https://www.cooplawblog.com/2020/09/pee-dee-electric-and-marlboro-electric-announce-strategic-partnership/.

2. Members Reject Proposed Merger of Kansas Electric Cooperatives

A proposed merger of two northeast Kansas electric cooperatives was recently rejected by coop members. The Boards of Trustees for Nemaha-Marshall Electric Cooperative Association in Axtell, Kansas and Doniphan Electric Cooperative Association in Troy, Kansas had unanimously approved taking the proposed consolidation to their members. Kansas law requires that each cooperative receive at least two-thirds approval by members.

Source: Coop Law Blog, *Members Reject Proposed Merger of Kansas Electric Cooperatives*, EVERSHEDS SUTHERLAND (Oct. 5, 2020), https://www.cooplawblog.com/2020/10/members-reject-proposed-merger-of-kansas-electric-cooperatives/.

3. Gas South Plans to Acquire Infinite Energy

Gas South, a Cobb County, Georgia-based natural gas marketer and a subsidiary of electric cooperative Cobb EMC, is planning to acquire Infinite Energy, based in Gainesville, Florida. The headquarters for Gas South will remain in Cobb County, where the business employs about 240 people, but the company said it would retain a presence in Gainesville, Florida, where most of Infinite's 300 employees are located.

Source: Coop Law Blog, *Gas South Plans to Acquire Infinite Energy*, EVERSHEDS SUTHERLAND (Oct. 26, 2020), https://www.cooplawblog.com/2020/10/gas-south-to-acquire-infinite-energy/.

4. Valley Wide and Ag Link Cooperatives Merge

Valley Wide Cooperative and Ag Link, Inc. announced that both co-op memberships voted in favor to allow the two co-ops to merge. Valley Wide Cooperative is an agronomy, energy, and farm supply company with locations across the Pacific Northwest. Ag Link, Inc. is an agronomy and energy company in northeastern Washington.

Source: News Release, *Valley Wide and Ag Link Cooperatives Merge*, THE SCOOP (July 12, 2021), https://www.thedailyscoop.com/news/retail-business/valley-wide-and-ag-link-cooperatives-merge?mkt_tok=ODQzLVlHQi03OTMAAAF-Pre23PU1PEZt4RY5A9WP7Las3pHQR3mZ1zi0XyWKonA0WQ51CwcQxpmWRpG65s7JsX1N8uF8Ui0qIRNQY5XUQv8kZREM78iK31BISmudZtRvZo05lw.

5. Landus Leading Optimization of Local Cooperative Model for Benefit of Farmer-Owners

Landus, a farmer-owned cooperative based in Iowa, is leading a strategy to implement an innovative alternative to traditional mergers and acquisitions for local agricultural cooperatives and independent businesses, optimizing overall performance. It is focused on improving service and competitiveness to drive more value for its collective membership and customers, while maintaining local influence and identity.

Source: News Release, *Landus Leading Optimization of Local Cooperative Model for Benefit of Farmer-Owners,* Landis Website (April 12, 2021) https://www.landuscooperative.com/news-events/blog/landus-leading-optimization-of-local-cooperative-model-for-benefit-of-farmer-owners

6. AMPI and First District Association Announce Formation of Common Marketing Agency

Associated Milk Producers, Inc. (AMPI) and First District Association (FDA) announced the formation of a jointly owned Common Marketing Agency (CMA) of the two Minnesota-based dairy cooperatives.

The CMA will optimize operational and supply chain efficiencies to benefit members and customers. This includes enhanced on-farm services, better utilizing manufacturing capacity and serving domestic and global customers with an expanded dairy product portfolio.

Source: News Release, *AMPI and First District Association announce formation of Common Marketing Agency,* AMPI website (February 24, 2021) AMPI News Releases

7. MaxYield Cooperative's Members Approve Merger with NEW Cooperative, Inc.

The members of MaxYield Cooperative, headquartered in West Bend, Iowa, have approved the merger proposal with Fort Dodge, Iowa-based NEW Cooperative, Inc. The merger will become effective August 1, 2021.

Source: News Release, *MaxYield Cooperative's Members Approve Merger with NEW Cooperative, Inc*. https://www.MaxYield Cooperative's Members Approve Merger with NEW Cooperative, Inc. - NEW Cooperative Inc.

8. Landmark Services, Countryside Merger Complete

Two Wisconsin-based cooperatives, Landmark Services Cooperative and Countryside Cooperative have officially merged. New cooperative will serve more than 26,000 members, employ over 800 people and generate annual sales in excess of $600 million.

Source: Feed and Grain (March 3, 2021) *Landmark Services, Countryside Merger Complete* https://www.feedandgrain.com/news/landmark-services-countryside-co-op-merger-complete

III. Miscellaneous Transactions and News

1. House Bill Would Give Coops Tax Credits to Help Pay Retirement Costs

NRECA is supporting a bipartisan House bill that would give electric cooperatives a temporary tax credit to help keep their retirement plans funded during the COVID-19 pandemic. The Preserving Employee Retirement Savings Act would provide a two-year tax credit for up to 20% of the retirement costs paid by coops and other small businesses experiencing hardships because of the pandemic. The credit would be refundable, so even a tax-exempt coop that pays no federal taxes would be eligible to receive as much as $100,000 in 2020 and 2021.

Source: Coop Law Blog, *House Bill Would Give Coops Tax Credits to Help Pay Retirement Costs*, EVERSHEDS SUTHERLAND (Sept. 1, 2020), https://www.cooplawblog.com/2020/09/house-bill-would-give-coops-tax-credits-to-help-pay-retirement-costs/.

2. Roanoke Electric Program Fights Systemic Discrimination Against African American Landowners

Roanoke Electric Cooperative's Sustainable Forestry and Land Retention Project provides education and access to technical assistance as well as capital and estate planning services to African American landowners in order to transform unprofitable family farms and forests into economic assets and keep valuable land within families. The program was created to combat discriminatory practices and decades of decline in African American farm ownership.

Source: Coop Law Blog, *Roanoke Electric Program Fights Systemic Discrimination Against African American Landowners*, EVERSHEDS SUTHERLAND (Sept. 7, 2020), https://www.cooplawblog.com/2020/09/roanoke-electric-program-fights-systemic-discrimination-against-african-american-landowners/.

3. FERC Affirms Jurisdiction over Tri-State Generation and Transmission Rates and Exit Charges

Last week, the Federal Energy Regulatory Commission (FERC) affirmed its exclusive jurisdiction over Tri-State Generation and Transmission Association's rates and member exit charges, and further reaffirmed that Tri-State's addition of new members was lawful under the Federal Power Act. The decision preempts Colorado Public Utilities Commission jurisdiction on these matters.

Source: Coop Law Blog, *FERC Affirms Exclusive Jurisdiction over Tri-State Generation and Transmission Rates and Exit Charges*, EVERSHEDS SUTHERLAND (Sept. 9, 2020), https://www.cooplawblog.com/2020/09/ferc-affirms-exclusive-jurisdiction-over-tri-state-generation-and-transmission-rates-and-exit-charges/.

4. Indiana Electric Cooperatives Receive $36 Million in Broadband Grants

Seven Indiana electric coops will receive just over $36 million in grants from the Next Level Connections Broadband Grant Program, which is designed to strengthen broadband infrastructure investment in unserved areas of the state. A recent report estimated a return of nearly $4 to the local economy for every dollar spent on the necessary broadband infrastructure.

Source: Coop Law Blog, *Indiana Electric Cooperatives Receive $36 Million in Broadband Grants*, EVERSHEDS SUTHERLAND (Sept. 11, 2020), https://www.cooplawblog.com/2020/09/indiana-electric-cooperatives-receive-36-million-in-broadband-grants/.

5. Oregon Wildfires Devastate Coop-Served Communities

Wildfires fueled by strong winds are ravaging western Oregon, destroying small towns served by electric cooperatives, forcing people to flee their homes, and spurring four coops to turn off power at night to avoid sparking new blazes. Ted Case, executive director of the Oregon Rural Electric Cooperative Association in Wilsonville said the wildfires have hit four of the state's 18 coops hardest: Consumers Power Inc. in Philomath, Lane Electric Cooperative in Eugene, Blachly-Lane Electric Cooperative in Junction City and West Oregon Electric Cooperative in Vernonia.

Source: Coop Law Blog, *Oregon Wildfires Devastate Coop-Served Communities*, EVERSHEDS SUTHERLAND (Sept. 15, 2020), https://www.cooplawblog.com/2020/09/oregon-wildfires-devastate-coop-served-communities/.

6. Central Iowa Power Cooperative Signs PPA for 54-MW Wind Project

Independent power producer RPM Access LLC has signed a power purchase agreement (PPA) to supply electricity from a 54-MW wind park in Iowa to Central Iowa Power Cooperative.

Source: Coop Law Blog, *Central Iowa Power Cooperative Signs PPA for 54-MW Wind Project*, EVERSHEDS SUTHERLAND (Sept. 16, 2020), https://www.cooplawblog.com/2020/09/central-iowa-power-cooperative-signs-ppa-for-54-mw-wind-project/.

7. USDA Investment to Upgrade Arkansas Power Grid

US Sen. John Boozman and US Rep. Bruce Westerman recently announced that US Department of Agriculture (USDA) funds will go toward modernizing a power grid by installing fiber-optic cable to supply a secure high-speed communications path to nearly 60,000 Arkansas Valley Electric Cooperative customers. Specifically, a $151 million investment through the Department's Electric Infrastructure Loan Program will help Arkansans in 10 counties: Crawford, Franklin, Johnson, Logan, Madison, Newton, Pope, Scott, Sebastian and Yell.

Source: Coop Law Blog, *USDA Investment to Upgrade Arkansas Power Grid*, EVERSHEDS SUTHERLAND (Sept. 21, 2020), https://www.cooplawblog.com/2020/09/usda-investment-to-upgrade-arkansas-power-grid/.

8. Pedernales Electric Cooperative Energizes New Battery Storage System

Pedernales Electric Cooperative (PEC) has installed and energized a new battery storage system, making it the first cooperative in Texas to utilize battery storage. The battery storage system can hold a total of 2.25 MWs of electricity for two hours and are charged by PEC's Johnson City solar installation.

Source: Coop Law Blog, Pedernales Electric Cooperative Energizes New Battery Storage System, EVERSHEDS SUTHERLAND (Sept. 23, 2020), https://www.cooplawblog.com/2020/09/pedernales-electric-cooperative-energizes-new-battery-storage-system/.

9. Indiana Awards Grants to Electric Coops to Build Broadband

Through the Next Level Connections Broadband Grant Program, Indiana is awarding $36 million in state broadband grants to eight electric cooperatives to connect unserved areas.

Source: Coop Law Blog, *Indiana Awards Grants to Electric Coops to Build Broadband*, EVERSHEDS SUTHERLAND (Sept. 23, 2020), https://www.cooplawblog.com/2020/09/indiana-awards-grants-to-electric-coops-to-build-broadband/.

10. Colorado Coop Helps Community Build Microgrid

Poudre Valley REA is working with the Red Feather Lakes community to install a microgrid, which will be a 140-kilowatt/448-kilowatt-hour battery with 3.2 hours of energy storage interconnected with generation resources.

Source: Coop Law Blog, *Colorado Coop Helps Community Build Microgrid*, EVERSHEDS SUTHERLAND (Sept. 23, 2020), https://www.cooplawblog.com/2020/09/colorado-coop-helps-community-build-microgrid/.

11. NRECA Earns $6 Million Grant from Department of Energy to Boost Cybersecurity

The Department of Energy recently awarded the National Rural Electric Cooperative Association a $6 million grant to expand ongoing research and development into electric coop cybersecurity tools. Specifically, the grant will enable a three-year project, known as Essence 2.0, which will provide NRECA's member cooperatives with a revolutionary cyber monitoring tool that enables machine-to-machine learning and is designed to quickly detect and share information about anomalies in utility network traffic. The Essence 2.0 project builds on NRECA's existing cyber readiness and prevention tools and will be deployed to electric cooperatives early next year.

Source: Coop Law Blog, *NRECA Earns $6 Million Grant from Department of Energy to Boost Cybersecurity*, EVERSHEDS SUTHERLAND (Sept. 28, 2020), https://www.cooplawblog.com/2020/09/nreca-earns-6-million-grant-from-department-of-energy-to-boost-cybersecurity/.

12. NRECA Receives DOE Funding to Strengthen Cybersecurity

The National Rural Electric Cooperative Association (NRECA) will use $6 million in Department of Energy (DOE) funding to develop and deliver its cybersecurity tool, Essence, to cooperatives nationwide. Essence continually monitors for cyber threats and enables the utility industry to share characteristics of an incident to help detect large, coordinated cyberattacks.

Source: Coop Law Blog, *NRECA Receives DOE Funding to Strengthen Cybersecurity*, EVERSHEDS SUTHERLAND (Oct. 2, 2020), https://www.cooplawblog.com/2020/10/nreca-receives-doe-funding-to-strengthen-cybersecurity/.

13. Missouri Rural Electric Coops to Receive $5.5 Million in Economic Development Support

The Trump Administration and Department of Agriculture Rural Development State Director for Missouri announced that eight rural electric cooperatives in Missouri will receive $5.5 million to create jobs and increase economic opportunities throughout the state. The funding will support infrastructure improvements, business development, housing and high-speed internet access in rural areas, amongst other things.

Source: Coop Law Blog, *Missouri Rural Electric Coops to Receive $5.5 Million in Economic Development Support*, EVERSHEDS SUTHERLAND (Oct. 9, 2020), https://www.cooplawblog.com/2020/10/missouri-rural-electric-coops-to-receive-5-5-million-in-economic-development-support/.

14. Several Cooperative Agricultural and Rural Infrastructure Banks Ranked World's Safest for 2020

Several cooperative agricultural and rural infrastructure banks, including CoBank, made the Global Finance World's 50 Safest Banks annual ranking for 2020. The rankings have long been recognized as a trusted standard for individuals and investors to gauge the financial safety of banks.

Source: Coop Law Blog, *Several Cooperative Agricultural and Rural Infrastructure Banks Ranked World's Safest for 2020*, EVERSHEDS SUTHERLAND (Oct. 23, 2020), https://www.cooplawblog.com/2020/10/several-cooperative-agricultural-and-rural-infrastructure-banks-ranked-worlds-safest-for-2020/.

15. The Georgia Solution: A Plan to Spur Broadband Deployment

The Georgia Solution, which was filed with the Georgia Public Service Commission as part of a rate case that involves fees that cable companies would pay to connect to the electric cooperatives' utility poles, is aimed at encouraging rural broadband deployments by cable companies and other providers. There are two key parts to the Georgia Solution — the One Buck Deal and the Georgia One-Touch-Make-Ready Program.

Source: Coop Law Blog, *The Georgia Solution: A Plan to Spur Broadband Deployment*, EVERSHEDS SUTHERLAND (Oct. 27, 2020), https://www.cooplawblog.com/2020/10/the-georgia-solution-a-plan-to-spur-broadband-deployment/.

16. 190 Electric Coops Qualify to Bid at FCC's $16 Billion Broadband Auction

About 190 electric cooperatives have qualified to compete for up to $16 billion in the Federal Communications Commission's (FCC) largest reverse auction to fund broadband internet for unserved areas across the country. Winning bidders will receive funds over a 10-year period to deploy broadband to unserved census blocks identified by the FCC.

Source: Coop Law Blog, *190 Electric Coops Qualify to Bid at FCC's $16 Billion Broadband Auction*, EVERSHEDS SUTHERLAND (Oct. 27, 2020), https://www.cooplawblog.com/2020/10/190-electric-coops-qualify-to-bid-at-fccs-16-billion-broadband-auction/.

17. Congressmen Introduce Bill to Support Electric Cooperatives

Congressman Neal Dunn, M.D. (Florida-02) and Congressman Darren Soto (Florida-09) introduced the FEMA Loan Interest Payment Relief Act (H.R. 8701) requiring the Federal Emergency Management Agency (FEMA) to reimburse local governments and electric cooperatives for interest incurred on loans used to restore essential functions after natural disasters. The interest paid on emergency loans is often a cost passed on to taxpayers and ratepayers alike.

Source: Coop Law Blog, *Congressmen Introduce Bill to Support Electric Cooperatives*, EVERSHEDS SUTHERLAND (Nov. 3, 2020), https://www.cooplawblog.com/2020/11/congressmen-introduce-bill-to-support-electric-cooperatives/.

18. USDA Approves $3.1 Billion in Loans to Coops

As part of its latest round of Electric Loan Program awards, the U.S. Department of Agriculture (USDA) has approved $3.1 billion in rural infrastructure loans for 45 electric cooperatives. The loans will go to projects in 25 states to upgrade or build transmission and distribution lines and to develop smart grid technology and digital communications to help detect and respond to outages.

Source: Coop Law Blog, *USDA Approves $3.1 Billion in Loans to Coops*, EVERSHEDS SUTHERLAND (Nov. 4, 2020), https://www.cooplawblog.com/2020/11/usda-approves-3-1-billion-in-loans-to-coops/.

19. Basin Electric Cooperative Sees Challenging Year in 2020; Load Returning

Paul Sukut, General Manager of Basin Electric Power Cooperative, said that while 2020 has been a challenging year, the pre-COVID-19 load is slowly returning. To further that growth, Basin is working on finding new sources of power that are low-carbon or no carbon emissions, including solar power and wind turbines.

Source: Coop Law Blog, *Basin Electric Cooperative Sees Challenging Year in 2020; Load Returning*, EVERSHEDS SUTHERLAND (Nov. 6, 2020), https://www.cooplawblog.com/2020/11/basin-electric-cooperative-sees-challenging-year-in-2020-load-returning/.

20. What Biden's Victory Means for Electric Cooperatives

Joe Biden's victory in the presidential race sets the stage for potentially sweeping environmental policy changes. However, his planned policy agenda would be muted by what now looks to be a divided Congress, with a Republican-led Senate and a diminished Democratic majority in the House. In the near term, Biden is expected to push for a broad economic stimulus plan shortly after he takes office in January, presenting opportunities for NRECA to secure more pandemic relief for coops and their consumer-members. Over the longer term, electric coops will work to shape a $2 trillion environmental plan Biden campaigned on that would eliminate carbon dioxide emissions from the electric power sector by 2035 and replace fossil fuels with zero-emission sources such as wind, solar, nuclear, hydropower and biomass.

Source: Coop Law Blog, *What Biden's Victory Means for Electric Cooperatives*, EVERSHEDS SUTHERLAND (Nov. 10, 2020), https://www.cooplawblog.com/2020/11/what-bidens-victory-means-for-electric-cooperatives/.

21. South Carolina Coop to Add Solar Energy to Resource Portfolio

Central Electric Power Cooperative, a South Carolina electric cooperative, recently announced intention to obtain as much as 363 MW of solar generating capacity through power purchase agreements with independent solar developers. Central Electric Power Cooperative is coordinating with Santee Cooper in a joint request for proposals to procure up to 500 MW of solar generation capacity, but it will be pursuing its own separate power purchase agreements with solar developers for its pro rata share of the procurement.

Source: Coop Law Blog, *South Carolina Coop to Add Solar Energy to Resource Portfolio*, EVERSHEDS SUTHERLAND (Nov. 12, 2020), https://www.cooplawblog.com/2020/11/south-carolina-coop-to-add-solar-energy-to-resource-portfolio/.

22. Southwest Pool Power Considering Westward Expansion

Regional transmission operator Southwest Pool Power (SPP) announced interest in a western state expansion after a recent study found the move would produce $49 million a year in savings. If membership is pursued, Basin Electric Power Cooperative, Deseret Power Electric Cooperative and Tri-State Generation and Transmission Association, amongst others, could become the first members to place facilities in the Western Interconnection under SPP's Open Access Transmission Tariff.

Source: Coop Law Blog, *Southwest Pool Power Considering Westward Expansion*, EVERSHEDS SUTHERLAND (Nov. 13, 2020), https://www.cooplawblog.com/2020/11/southwest-pool-power-considering-westward-expansion/.

23. North Carolina Coops Use Hog Waste to Power Microgrids

A new project by North Carolina's Electric Cooperatives is utilizing methane gas from hog waste to generate electricity. Microgrids using the waste have been able to produce enough electricity to power at least 28 homes for several hours.

Source: Coop Law Blog, *North Carolina Coops Use Hog Waste to Power Microgrids*, EVERSHEDS SUTHERLAND (Nov. 13, 2020), https://www.cooplawblog.com/2020/11/north-carolina-microgrids-use-hog-waste-to-power-microgrids/.

24. Colorado Governor Joins Tri-State to Announce Greenhouse Gas Reduction Goals

Tri-State Generation and Transmission Association (Tri-State) and Colorado Governor Jared Polis recently announced Tri-State will be submitting a "preferred scenario" to reduce emissions associated with its wholesale electricity sales in Colorado by 80% by 2030. With the support of its members and board of directors, Tri-State will put forward this preferred scenario in its Electric Resource Plan, which will be filed with the Colorado Public Utilities Commission on December 1, 2020.

Source: Coop Law Blog, *Colorado Governor Joins Tri-State to announce Greenhouse Gas Reduction Goals*, EVERSHEDS SUTHERLAND (Nov. 16, 2020), https://www.cooplawblog.com/2020/11/colorado-governor-joins-tri-state-to-announce-greenhouse-gas-reduction-goals/.

25. FERC Urged to Reject Objections to Small Utility Opt-in Mechanism

In September, the Federal Energy Regulatory Commission (FERC) approved Order No. 222, which enables distributed energy resource aggregators to participate alongside traditional resources in the regional organized wholesale markets through aggregations. The American Public Power Association and the National Rural Electric Cooperative Association are now urging FERC to reject objections to the small utility "opt-in" mechanism.

Source: Coop Law Blog, *FERC Urged to Reject Objections to Small Utility Opt-in Mechanism*, EVERSHEDS SUTHERLAND (Nov. 20, 2020), https://www.cooplawblog.com/2020/11/ferc-urged-to-reject-objections-to-small-utility-opt-in-mechanism/.

26. Wyoming Carbon Storage Project Advances to Next Phase

Basin Electric Power Cooperative's Dry Fork Station is inching closer to adding carbon dioxide storage to its advanced coal technology, an action that could help control emissions and eventually lead to commercial uses for the compound.

Source: Coop Law Blog, *Wyoming Carbon storage Project Advances to Next Phase*, EVERSHEDS SUTHERLAND (Dec. 2, 2020), https://www.cooplawblog.com/2020/12/wyoming-carbon-storage-project-advances-to-next-phase/.

27. Roanoke Electric Cooperative to Pilot Cutting-Edge Vehicle-to-Grid Technology

Roanoke Electric Cooperative is working with Fermata Energy to pilot the first electric vehicle (EV) charging system equipment to meet the North American standard for two-way current. Roanoke Electric is seeking to unlock the value of vehicle-to-grid integration with a Nissan Leaf, one of the most widely sold and affordable EVs in the market.

Source: Coop Law Blog, *Roanoke Electric Cooperative to Pilot Cutting-Edge Vehicle-to-Grid Technology*, EVERSHEDS SUTHERLAND (Dec. 2, 2020), https://www.cooplawblog.com/2020/12/roanoke-electric-cooperative-to-pilot-cutting-edge-vehicle-to-grid-technology/.

28. North Georgia Cooperative Helps Bring Broadband to Unserved Areas

Amicalola EMC (Amicalola) and Ellijay Telephone Company (ETC) have formed an innovative partnership to expand broadband in Cherokee, Dawson, Lumpkin and Pickens Counties. Amicalola will invest $6.5-7 million and add more than 250 miles of high-speed connectivity to ETC's network, providing broadband access to approximately 6,000 customers.

Source: Coop Law Blog, *North Georgia Cooperative Helps Bring Broadband to Unserved Areas*, EVERSHEDS SUTHERLAND (Dec. 4, 2020), https://www.cooplawblog.com/2020/12/north-georgia-cooperative-helps-bring-broadband-to-unserved-areas/.

29. FCC Doles Out $9.2 Billion in Phase I of Rural Digital Opportunity Fund Auction

The Federal Communications Commission (FCC) has allocated $9.2 billion to roll out broadband in 49 States and the Commonwealth of the Northern Mariana Islands through the Rural Digital Opportunity Fund Phase I auction. Auction results released December 7 show that bidders won funding to deploy high-speed broadband to over 5.2 million unserved homes and businesses. A broad range of providers successfully competed in the Phase I auction, including electric cooperatives.

Source: Coop Law Blog, *FCC Doles Out $9.2 Billion in Phase I of Rural Digital Opportunity Fund Action*, EVERSHEDS SUTHERLAND (Dec. 8, 2020), https://www.cooplawblog.com/2020/12/fcc-doles-out-9-2-billion-in-phase-i-of-rural-digital-opportunity-fund-auction/.

30. Coops Work Together to Restore Power in 2020

The tumultuous weather of 2020 saw coop line crews logging thousands of miles and long hours to restore power. Coops from more than two dozen states provided mutual aid on restoration projects in the hardest-hit areas this year.

Source: Coop Law Blog, *Coops Work Together to Restore Power in 2020*, EVERSHEDS SUTHERLAND (Dec. 11, 2020), https://www.cooplawblog.com/2020/12/coops-work-together-to-restore-power-in-2020/.

31. NRECA, Others, Warm FERC on Need for New NERC Standards

The American Public Power Association and the National Rural Electric Cooperative Association (NRECA), amongst others, are warning the Federal Energy Regulatory Commission (FERC) against directing the North American Electric Reliability Corporation (NERC) to develop new standards or requirements in an effort to mitigate security risks tied to equipment and services.

Source: Coop Law Blog, *NRECA, Others, Warn FERC on Need for New NERC Standards*, EVERSHEDS SUTHERLAND (Dec. 11, 2020), https://www.cooplawblog.com/2020/12/nreca-others-warn-ferc-on-need-for-new-nerc-standards/.

32. EKPC Announces First Sustainability Plan

Eastern Kentucky Power Cooperative (EKPC) announced its first sustainability plan on Wednesday. The plan includes targets for increasing use of renewable energy and reducing carbon emissions in the coming decades.

Source: Coop Law Blog, *EKPC Announces First Sustainability Plan*, EVERSHEDS SUTHERLAND (Dec. 18, 2020), https://www.cooplawblog.com/2020/12/ekpc-announces-first-sustainability-plan/.

33. Flathead Electric Cooperative Assists in Bird Conservation Efforts

Flathead Electric Cooperative assisted in the installation of an osprey nest adjacent to its Bigfork Dam. The nest will serve to keep the area's osprey population healthy and strong.

Source: Coop Law Blog, *Flathead Electric Cooperative Assists in Bird Conservation Efforts*, EVERSHEDS SUTHERLAND (Dec. 18, 2020), https://www.cooplawblog.com/2020/12/flathead-electric-cooperative-assists-in-bird-conservation-efforts/.

34. New Hampshire Electric Cooperative Expands Broadband Access

New Hampshire Electric Cooperative expanded broadband service to nearly 900 members in December. The expansion was supported by a $6.7 million grant from the state's Connecting New Hampshire Emergency Broadband Program.

Source: Coop Law Blog, *New Hampshire Electric Cooperative Expands Broadband Access*, EVERSHEDS SUTHERLAND (Dec. 18, 2020), https://www.cooplawblog.com/2020/12/new-hampshire-electric-cooperative-expands-broadband-access/.

35. Year-End Spending Package Excludes Key COVID Relief Provision

The National Rural Electric Cooperative Association expressed dismay at Congress failing to include a waiver of the pre-payment penalty for coops refinancing RUS debt in its year-end spending package. Despite this, the spending package does contain several key energy provision supported by electric coops.

Source: Coop Law Blog, *Year-End Spending Package Excludes Key COVID Relief Provision*, EVERSHEDS SUTHERLAND (Dec. 27, 2020), https://www.cooplawblog.com/2020/12/year-end-spending-package-excludes-key-covid-relief-provision/.

36. Electric Cooperatives Form New Broadband Association

Five electric cooperatives in Virginia and Maryland have formed a broadband cooperative association aimed at encouraging the expansion of high-speed internet service in underserved rural areas. The new Virginia, Maryland & Delaware Association of Broadband Cooperatives (VMDABC) includes Millboro-based BARC Electric Cooperative and its BARC Connects subsidiary, Arrington-based Central Virginia Electric Cooperative and its Firefly Fiber Broadband subsidiary, Waverly-based Prince George Electric Cooperative and its Ruralband subsidiary, Chase City-based Mecklenburg Electric Cooperative and its Empower Broadband subsidiary, and Denton, Maryland-based Choptank Electric Cooperative and its Choptank Fiber LLC subsidiary. With internet connectivity issues growing in importance during the COVID-19 pandemic, the VMDABC association hopes to bring underserved areas into the digital age with reliable broadband service.

Source: Coop Law Blog, *Electric Cooperatives Form New Broadband Association*, EVERSHEDS SUTHERLAND (Jan. 5, 2021), https://www.cooplawblog.com/2021/01/electric-cooperatives-form-new-broadband-association/.

37. Microgrid Being Planned Near Aspen, Colorado

Electric cooperative Holy Cross Energy, the Roaring Fork Transportation Authority, and Pitkin County representatives are conducting a feasibility study for a local, renewable energy microgrid. The proposed microgrid would connect the Aspen-Pitkin County Airport with neighboring public facilities and would be incorporated into the existing infrastructure of Holy Cross Energy.

Source: Coop Law Blog, *Microgrid Being Planned Near Aspen, Colorado*, EVERSHEDS SUTHERLAND (Jan. 7, 2021), https://www.cooplawblog.com/2021/01/microgrid-being-planned-near-aspen-colorado/.

38. NRECA to Press Congress to Approve Repricing of RUS Loans

The National Rural Electric Cooperative Association (NRECA) is planning to urge Congress and the incoming Biden administration to support legislation to reprice Rural Utilities Service (RUS) loans at current low interest rates. The proposed legislation would allow coops to request rate adjustments on existing RUS loans within 180 days of the bill's enactment and waive any prepayment penalties normally associated with RUS refinancing.

Source: Coop Law Blog, *NRECA to Press Congress to Approve Repricing of RUS Loans*, EVERSHEDS SUTHERLAND (Jan. 8, 2021), https://www.cooplawblog.com/2021/01/nreca-to-press-congress-to-approve-repricing-of-rus-loans/.

39. Maryland Electric Cooperative Awards $30 Million Energy Efficiency Contract

Southern Maryland Electric Cooperative awarded global consulting and digital services provider ICF with a three-year, $30 million contract to implement its residential and commercial energy portfolios. Services are to include marketing, customer participation, and program management as well as energy efficiency pilot programs in schools.

Source: Coop Law Blog, *Maryland Electric Cooperative Awards $30 Million Energy Efficiency Contract*, EVERSHEDS SUTHERLAND (Jan. 8, 2021), https://www.cooplawblog.com/2021/01/maryland-electric-cooperative-awards-30-million-energy-efficiency-contract/.

40. York Electric Cooperative and Comporium Latest in Telco Electric Broadband Partnership

York Electric Cooperative and Comporium plan to make gigabit fiber available to approximately 5,000 members in western York County and parts of Cherokee County, South Carolina. Comporium will be the service provider and will also offer streaming video, voice, home automation and security services.

Source: Coop Law Blog, *York Electric Cooperative and Comporium Latest in Telco Electric Broadband Partnership*, EVERSHEDS SUTHERLAND (Jan. 12, 2021), https://www.cooplawblog.com/2021/01/york-electric-cooperative-and-comporium-latest-in-telco-electric-broadband-partnership/.

41. Tatanka Ridge Wind Farm Achieved Commercial Operation; Dairyland Power Cooperative the Offtaker

Tatanka Ridge Wind Farm, a 56-wind turbine facility located in Deuel County, South Dakota, achieved commercial operation on January 5, 2021. Dairyland Power Cooperative has a power purchase agreement with Tatanka Ridge Wind, LLC, for 51.6 MW of renewable energy. Dairyland's portion of Tatanka Ridge's output will deliver enough renewable energy to power approximately 16,000 homes.

Source: Coop Law Blog, *Tatanka Ridge Wind Farm Achieved Commercial Operation; Diaryland Power Cooperative the Offtaker*, EVERSHEDS SUTHERLAND (Jan. 19, 2021), https://www.cooplawblog.com/2021/01/tatanka-ridge-wind-farm-achieved-commercial-operation-dairyland-power-cooperative-the-offtaker/.

42. Louisiana Coops Issue RFP for 925 MW of Capacity

On December 23, 2020, Southwest Louisiana Electric Membership Corporation, Pointe Coupee Electric Membership Corporation and Concordia Electric Cooperative Inc. issued a Request for Proposal (RFP) seeking power supply solutions for annual peak demand of 925 MW and 2,900,000 MWh of annual energy. The RFP was jointly issued, but the coops anticipate executing separate independent contracts for services.

Source: Coop Law Blog, *Louisiana Coops Issue RFP for 925 MW of Capacity*, EVERSHEDS SUTHERLAND (Jan. 22, 2021), https://www.cooplawblog.com/2021/01/louisiana-coops-issue-rfp-for-925-mw-of-capacity/.

43. Members of Congress Call on the FCC to Vet Prospective Rural Broadband Providers

A bipartisan group of senators and House members asked the Federal Communications Commission (FCC) to verify the promises that broadband providers are making in their bid proposals to the recent Rural Digital Opportunity Fund Auction. This request is being made at the urging of the National Rural Electric Cooperative Association due to the concerns that some of the winning bidders may not have the technical, financial, managerial or operational skills and resources to support their ambitious plans.

Source: Coop Law Blog, Members of Congress Call on the FCC to Vet Prospective Rural Broadband Providers (Jan. 29, 2021), https://www.cooplawblog.com/2021/01/members-of-congress-call-on-the-fcc-to-vet-prospective-rural-broadband-providers/.

44. Southwest Power Pool Starts Energy Balancing Market in West

Southwest Power Pool announced on Monday, February 1, that at midnight it launched its Western Energy Imbalance Service (WEIS) market. Several regional utilities are participating in this WEIS market, including Basin Electric Power Cooperative, Deseret Power Electric Cooperative and Tri-State Generation and Transmission Association.

Source: Coop Law Blog, *Southwest Power Pool Starts Energy Balancing Market in West*, EVERSHEDS SUTHERLAND (Feb. 2, 2021), https://www.cooplawblog.com/2021/02/southwest-power-pool-starts-energy-balancing-market-in-west/.

45. NRECA Expresses Concerns Regarding Winning Bidders in Rural Digital Opportunity Fund Action

The National Rural Electric Cooperative Association (NRECA) sent a letter to the Federal Communications Commission (FCC), accompanied by a white paper from the NRECA and the National Rural Telecommunications Cooperative, detailing concerns about certain winning bids in the first phase of the recent Rural Digital Opportunity Fund Auction and offering remedies if an FCC review determines that any winners are unable to meet the commitments set forth in their bids.

Source: Coop Law Blog, *NRECA Expresses Concerns Regarding Winning Bidders in Rural Digital Opportunity Fund Action*, EVERSHEDS SUTHERLAND (Feb. 5, 2021), https://www.cooplawblog.com/2021/02/nreca-expresses-concerns-regarding-winning-bidders-in-rural-digital-opportunity-fund-auction/.

46. NRECA Urges Congress to Pass $10 Billion in Low-Income Energy Aid

The National Rural Electric Cooperative Association (NRECA) and six other energy groups wrote a letter to leaders of the House and Senate Appropriations Subcommittees on Labor, Health and Human Services, Education, and related agencies urging Congress to approve an additional $10 billion in emergency assistance to low-income Americans struggling to pay their electric bills during the COVID-19 pandemic. The letter asks for additional funds to be added to the Low-Income Home Energy Assistance Program, which provides help with home heating and cooling for low-income households, including the elderly, the disabled, and families with young children.

Source: Coop Law Blog, *NRECA Urges Congress to Pass $10 Billion in Low-Income Energy Aid*, EVERSHEDS SUTHERLAND (Feb. 8, 2021), https://www.cooplawblog.com/2021/02/nreca-urges-congress-to-pass-10-billion-in-low-income-energy-aid/.

47. NRECA International to Operate Nigerian Utility

NRECA International has signed a $10 million, five-year contract to take over the operation of a struggling distribution utility in south-central Nigeria and transform it into a profitable company that provides high-quality service to its customers.

Source: Coop Law Blog, *NRECA International to Operate Nigerian Utility*, EVERSHEDS SUTHERLAND (Feb. 9, 2021), https://www.cooplawblog.com/2021/02/nreca-international-to-operate-nigerian-utility/.

48. Oklahoma Court Confirms Big Businesses Must Stick with Electric Cooperative

A large industrial Oklahoma cooperative customer brought suit seeking to add a well powered by Northwestern Electric Cooperative to an energy supply it receives from an investor-owned utility as a cost-saving measure. An Oklahoma Court confirmed the order of the Oklahoma Corporation Commission keeping the cooperative as the power provider.

Source: Coop Law Blog, *Oklahoma Court Confirms Big Businesses Must Stick with Electric Cooperative*, EVERSHEDS SUTHERLAND (Feb. 12, 2021), https://www.cooplawblog.com/2021/02/oklahoma-court-confirms-big-businesses-must-stick-with-electric-cooperative/.

49. Coops, Wireless and Partnerships Likeliest Ways to Connect Rural America

A recent report produced by the Federal Reserve Bank of Richmond shows that coops, wireless and partnerships are the best ways to bring broadband to rural America. The biggest challenges to the cooperative approach are ambiguous laws regarding broadband provision by coops.

Source: Coop Law Blog, *Coops, Wireless and Partnerships Likeliest Ways to Connect Rural America*, EVERSHEDS SUTHERLAND (Feb. 12, 2021), https://www.cooplawblog.com/2021/02/coops-wireless-and-partnerships-likeliest-ways-to-connect-rural-america/.

50. SEEM Members Submit Filing for Proposed Advanced Bilateral Market Platform

The Southeast Energy Exchange Market (SEEM) members recently filed with the Federal Energy Regulatory Commission for the approval of an automated, intra-hour energy exchange that aims to lower costs to customers and optimize renewable energy resources. The new SEEM platform will facilitate sub-hourly, bilateral trading, allowing participants to buy and sell power close to the time the energy is consumed, utilizing available unreserved transmission. Founding members of SEEM are expected to include Associated Electric Cooperative, Dalton Utilities, Dominion Energy South Carolina, Duke Energy Carolinas, Duke Energy Progress, Georgia System Operations Corporation, Georgia Transmission Corporation, LG&E and KU Energy, MEAG Power, NCEMC, Oglethorpe Power Corp., PowerSouth, Santee Cooper, Southern Company and TVA.

Source: Coop Law Blog, *SEEM Members Submit Filing for Proposed Advanced Bilateral Market Platform*, EVERSHEDS SUTHERLAND (Feb. 15, 2021), https://www.cooplawblog.com/2021/02/seem-members-submit-filing-for-proposed-advanced-bilateral-market-platform/.

51. Maryland Electric Cooperative Launches Broadband Subsidiary

After much debate over removing Choptank Electric Cooperative (Choptank) from the oversight of the Maryland Public Service Commission, Choptank has launched Choptank Fiber, a wholly-owned broadband subsidiary. Choptank Fiber will take a community-by-community approach to installing broadband, using the monthly subscription revenue of established communities to invest in the development of new communities.

Source: Coop Law Blog, *Maryland Electric Cooperative Launches Broadband Subsidiary*, EVERSHEDS SUTHERLAND (Feb. 19, 2021), https://www.cooplawblog.com/2021/02/maryland-electric-cooperative-launches-broadband-subsidiary/.

52. NRECA Asks federal Agency for Rural-Friendly Broadband Grants Rules

The National Rural Electric Cooperative Association (NRECA) recently sent a letter to the National Telecommunications & Information Administration (NTIA) arguing that broadband grants worth $300 million should only go toward proven technologies, and some rural areas should remain eligible for this funding even if they have won awards in other specific federal efforts to bridge the digital divide. The February 17 letter incorporates concerns that regions covered by initial winners in the Federal Communication Commission's Rural Digital Opportunity Fund (RDOF) auction and similar programs will be locked out of new broadband funding if an RDOF grantee proves unable to provide adequate service. NRECA also recommended that NTIA consider the far-reaching impacts of the pandemic on supply chains and labor and, if necessary, allow grantees to spend funds beyond the program's one-year deadline.

Source: Coop Law Blog, *NRECA Asks Federal Agency for Rural-Friendly Broadband Grants Rules*, EVERSHEDS SUTHERLAND (Feb. 22, 2021), https://www.cooplawblog.com/2021/02/nreca-asks-federal-agency-for-rural-friendly-broadband-grants-rules/.

53. Brazos Electric Power Cooperative, Inc. Files for Bankruptcy

Brazos Electric Power Cooperative, Inc. (Brazos) recently filed bankruptcy in federal court in Houston, citing a disputed $1.8 billion bill from the state's grid operator, Electric Reliability Council of Texas (ERCOT). Brazos is one of dozens of electricity providers in Texas facing enormous charges stemming from severe cold snap last month. Unusually frigid temperatures knocked out nearly half of the state's power plants in mid-February, leaving 4.3 million people without heat or light for days and bursting water pipes that damaged homes and businesses. Brazos and others that committed to provide power to the grid, and could not during the winter storm, were required to buy replacement power at high rates and cover other firms' unpaid fees. The attorney general of Texas has launched an investigation into the blackout, calling for ERCOT and others to provide documents on the outages, pricing and emergency, saying they mismanaged the crisis.

Source: Coop Law Blog, *Brazos Electric Power Cooperative, Inc. Files for Bankruptcy*, EVERSHEDS SUTHERLAND (Mar. 1, 2021), https://www.cooplawblog.com/2021/03/brazos-electric-power-cooperative-inc-files-for-bankruptcy/.

54. Texas Coop Requests Suspension of ERCOT Invoicing, Billing, Collection

Rayburn Country Electric Cooperative asked Texas state regulators to order the Electric Reliability Corporation of Texas (ERCOT) to suspend invoicing, billing and collection of charges related to February's power outages after it was discovered that ERCOT may have charged $16 billion more than it should have during the mid-February winter storm. The coop says charges "stand to cause Texans financial devastation, with sky-high bills from the basic failure of the energy markets."

Source: Coop Law Blog, *Texas Coop Requests Suspension of ERCOT Invoicing, Billing, Collection*, EVERSHEDS SUTHERLAND (Mar. 5, 2021), https://www.cooplawblog.com/2021/03/texas-coop-requests-suspension-of-ercot-invoicing-billing-collection/.

55. NRECA Urges NTIA to Award Grants for Tribal Land Broadband Expansion

The National Telecommunications & Information Administration (NTIA) is currently formulating its Tribal Broadband Connectivity Grants Program, which was created by the pandemic relief passed by Congress in December 2020. The National Rural Electric Cooperative Association (NRECA) is recommending that NTIA implement the Program with flexibility and efficiency, offering grants to tribal communities even If they were covered by previous broadband auctions.

Source: Coop Law Blog, *NRECA Urges NTIA to Award Grants for Tribal Land Broadband Expansion*, EVERSHEDS SUTHERLAND (Mar. 12, 2021), https://www.cooplawblog.com/2021/03/nreca-urges-ntia-to-award-grants-for-tribal-land-broadband-expansion/.

56. J. Andrew Don Selected as CEO of CFC

Effective May 3, 2021, J. Andrew Don will serve as Chief Executive Officer of the National Rural Utilities Cooperative Finance Corporation (CFC). Don currently serves as CFC's Chief Financial Officer.

Source: Coop Law Blog, *J. Andrew Don Selected as CEO of CFC*, EVERSHEDS SUTHERLAND (Mar. 12, 2021), https://www.cooplawblog.com/2021/03/j-andrew-don-selected-as-ceo-of-cfc/.

57. VEC and GMP Announce Broadband Deployment Program

Vermont Electric Co-op (VEC) and Green Mountain Power (GMP) each launched a Broadband Deployment Program to help rural Vermonters get connected to broadband quickly and cost-effectively. The plans approved Friday by the Vermont Public Utility Commission lower the cost for broadband providers to connect the hardest-to-serve customers by offering up to $2,000 per unserved location for infrastructure connection costs. The program aims to create greater equity for customers to access the economic, educational and social benefits that come with connectivity, including the ability to choose innovative energy services that rely on broadband availability.

Source: Coop Law Blog, *VEC and GMP Announce Broadband Deployment Program*, EVERSHEDS SUTHERLAND (Mar. 15, 2021), https://www.cooplawblog.com/2021/03/vec-and-gmp-announce-broadband-deployment-program/.

58. USDA Invests $598 Million in Rural Electric Infrastructure after Severe Weather

The U.S. Department of Agriculture (USDA) announced today a $598 million rural electric loan package to build or improve electric infrastructure in 11 states through the Electric Loan Program. This funding will benefit 460,000 rural residents and businesses in Arizona, Kentucky, Maine, Minnesota, Missouri, New Mexico, North Dakota, Oklahoma, South Carolina, Utah and Virginia. Several of the loans will help expand smart grid technologies.

Source: Coop Law Blog, *USDA Invests $598 Million in Rural Electric Infrastructure after Severe Weather*, EVERSHEDS SUTHERLAND (Mar. 16, 2021), https://www.cooplawblog.com/2021/03/usda-invests-598-million-in-rural-electric-infrastructure-after-severe-weather/.

59. New Cyber Technology Provides Real-Time Defense

New technology developed to rapidly identify and defend against emerging cybersecurity threats is being demonstrated at a growing number of electric cooperatives nationwide. The technology is being developed by the National Rural Electric Cooperative Association and its partners BlackByte Cyber Security LLC and Referentia Systems Inc. through a cooperative agreement with the U.S. Department of Energy.

Source: Coop Law Blog, *New Cyber Technology Provides Real-Time Defense*, EVERSHEDS SUTHERLAND (Mar. 16, 2021), https://www.cooplawblog.com/2021/03/new-cyber-technology-provides-real-time-defense/.

60. RUS Loan Repricing Bill Reintroduced

A bipartisan group of legislators reintroduced the Flexible Financing for Rural America Act this week. The law would permit electric coops to reprice loans from the U.S. Department of Agriculture's Rural Utilities Service (RUS) at current rates without prepayment penalties, potentially resulting in savings of $10 billion for about 500 coops.

Source: Coop Law Blog, *RUS Loan Repricing Bill Reintroduced*, EVERSHEDS SUTHERLAND (Mar. 26, 2021), https://www.cooplawblog.com/2021/03/rus-loan-repricing-bill-reintroduced/.

61. Electric Coop Ranks with Top Innovative Businesses

BARC Electric Cooperative was named the seventh most innovative company in North America in 2021 by Fast Company, the media firm that ranks advancements across all sectors worldwide. Serving nearly 13,000 members in Virginia's Shenandoah Valley region, Millboro-based BARC is the first electric coop bestowed the honor.

Source: Coop Law Blog, *Electric Coop Ranks With Top Innovative Businesses*, EVERSHEDS SUTHERLAND (Mar. 30, 2021), https://www.cooplawblog.com/2021/03/electric-coop-ranks-with-top-innovative-businesses/.

62. Cobb EMC Announces 2030 Clean Energy Goals

Over the last decade, Cobb EMC has been investing in smart, renewable energy technology for its members and is on schedule to attain its clean energy goals by 2030. The installation of rooftop solar panels on campus, the completion of a Solar Flower Garden, the activation of battery storage, and additional utility-scale solar later this year are all keeping Cobb EMC's sustainability goals on track.

Source: Coop Law Blog, *Cobb EMC Announces 2030 Clean Energy Goals*, EVERSHEDS SUTHERLAND (Mar. 30, 2021), https://www.cooplawblog.com/2021/03/cobb-emc-announces-2030-clean-energy-goals/.

63. NRECA Reacts to Biden Infrastructure Plan

In a statement released Wednesday, the National Rural Electric Cooperative Association (NRECA) announced it was encouraged to see electric coop priorities reflected in President Biden's infrastructure proposal. Select provisions that will benefit coops and their customer-members are $100 billion to update the nation's energy grid and expand existing transmission infrastructure, and $15 billion for energy demonstration projects, including utility-scale battery storage, carbon capture and storage, and advanced nuclear energy.

Source: Coop Law Blog, *NRECA Reacts to Biden Infrastructure Plan*, EVERSHEDS SUTHERLAND (Apr. 2, 2021), https://www.cooplawblog.com/2021/04/nreca-reacts-to-biden-infrastructure-plan/.

64. Colorado Coop's Empower Program Helps Make Energy Efficiency Affordable

An electric cooperative in Colorado is bundling its energy-efficiency programs and many of its consumer services under a single brand and making them available to those working or living near its service territory. Specifically, San Isabel Electric Association's Empower Program aims to identify qualified contractors and suppliers of proven products and helps find ways to finance improvements and upgrades for its members and others who live and work in southern Colorado.

Source: Coop Law Blog, *Colorado Coop's Empower Program Helps Make Energy Efficiency Affordable*, EVERSHEDS SUTHERLAND (Apr. 5, 2021), https://www.cooplawblog.com/2021/04/colorado-coops-empower-program-helps-make-energy-efficiency-affordable/.

65. NRECA Expresses Concerns Regarding Expected Timing for Notices of Defaults in the Rural Digital Opportunity Fund Auction

The National Rural Electric Cooperative Association (NRECA) made a request on April 1 to the Federal Communications Commission (FCC) urging the FCC to publicly announce defaults by winning bidders in the Rural Digital Opportunity Fund Auction (RDOF), so that unserved rural communities can pursue other public broadband resources. Without timely public notices of such defaults, rural areas no longer covered by the RDOF may be ineligible for other existing and forthcoming federal, state and local rural broadband programs.

Source: Coop Law Blog, *NRECA Expresses Concerns Regarding Expected Timing for Notices of Defaults in the Rural Digital Opportunity Fund Auction*, EVERSHEDS SUTHERLAND (Apr. 8, 2021), https://www.cooplawblog.com/2021/04/nreca-expresses-concerns-regarding-expected-timing-for-notices-of-defaults-in-the-rural-digital-opportunity-fund-auction/.

66. Vermont Electric Cooperative Pledges To Be Carbon-Free by 2023

Vermont Electric Cooperative, Vermont's largest member-owned electric utility, has pledged to move to a 100% carbon-free power supply by 2023. The electric cooperative said the carbon-free decision was made by the board of directors to reflect customer demand for clean energy and to meet state goals to fight climate change. The coop serves about 32,000 members in 75 communities in northern Vermont.

Source: Coop Law Blog, *Vermont Electric Cooperative Pledges To Be Carbon-Free by 2023*, EVERSHEDS SUTHERLAND (Apr. 12, 2021), https://www.cooplawblog.com/2021/04/vermont-electric-cooperative-pledges-to-be-carbon-free-by-2023/.

67. Electric Coop Leaders Convene Virtual Fly-Ins

More than 1,500 electric cooperative CEOs and other coop representatives will take coop priorities to Capitol Hill April 19-23 for the National Rural Electric Cooperative Association's (NRECA) Legislative Conference and congressional visits. The conference and meetings with lawmakers will be conducted virtually. Coop leaders will highlight three priorities during the congressional visits: (1) refinancing Rural Utilities Service loans, (2) rural broadband, and (3) comparable tax credits for energy innovation.

Source: Coop Law Blog, *Electric Coop Leaders Convene Virtual Fly-ins*, EVERSHEDS SUTHERLAND (Apr. 19, 2021), https://www.cooplawblog.com/2021/04/electric-coop-leaders-convene-virtual-fly-ins/.

68. Georgia EMC Partners to Expand Broadband

Washington EMC, a Georgia electric cooperative, will form a new partnership with Conexon Connect to provide high-speed fiber internet to more than 12,000 homes and businesses in 10 middle Georgia counties. Georgia's Governor Brian Kemp was on site in Washington County, Georgia to make the announcement.

Source: Coop Law Blog, *Georgia EMC Partners to Expand Broadband*, EVERSHEDS SUTHERLAND (Apr. 20, 2021), https://www.cooplawblog.com/2021/04/georgia-emc-partners-to-expand-broadband/.

69. NRECA Reacts to Biden Infrastructure Plan

As the Treasury Department writes rules to govern the funds to be dispersed to state and local governments under the American Rescue Plan, the National Rural Electric Cooperative Association (NRECA) is resisting efforts by some large telecommunications companies to place restrictions that it argues would harm regions without adequate broadband access. The Plan includes $219 billion for states and $130 billion for local governments that can be used for broadband, and another $10 billion for new capital projects.

Source: Coop Law Blog, *NRECA Reacts to Biden Infrastructure Plan*, EVERSHEDS SUTHERLAND (Apr. 23, 2021), https://www.cooplawblog.com/2021/04/nreca-reacts-to-biden-infrastructure-plan-2/.

70. Senators Introduce Bill to Protect Electric Grid

Senators Murkowski, Manchin, Risch, King and Rosen have introduced the Protecting Resources on the Electric Grid with Cybersecurity Technology (PROTECT) Act. The Act seeks to enhance electric grid security by incentivizing cybersecurity investment.

Source: Coop Law Blog, *Senators Introduce Bill to Protect Electric Grid*, EVERSHEDS SUTHERLAND (Apr. 30, 2021), https://www.cooplawblog.com/2021/04/senators-introduce-bill-to-protect-electric-grid/.

71. NRECA Reacts to Biden's Commitment to Rural Communities

The National Rural Electric Cooperative Association (NRECA) announced it was encouraged to hear President Biden prioritize the needs of rural America in his address to Congress. Specifically appreciated was his emphasis on the need to modernize rural infrastructure and expand rural broadband access.

Source: Coop Law Blog, *NRECA Reacts to Biden's Commitment to Rural Communities*, EVERSHEDS SUTHERLAND (Apr. 30, 2021), https://www.cooplawblog.com/2021/04/nreca-reacts-to-bidens-commitment-to-rural-communities/.

72. Harris Praises Electric Cooperative's Rural Broadband Leadership

Vice President Harris recently praised the work of electric cooperatives in delivering affordable broadband internet access to rural areas, comparing it to the electrification efforts in the 1930s. The Biden administration has proposed a $100 billion investment in rural broadband.

Source: Coop Law Blog, *Harris Praises Electric Cooperative's Rural Broadband Leadership*, EVERSHEDS SUTHERLAND (Apr. 30, 2021), https://www.cooplawblog.com/2021/04/harris-praises-electric-cooperatives-rural-broadband-leadership/.

73. Blue Ridge Electric Erects Structures to Enhance Dove Fields

Blue Ridge Electric Cooperative recently donated equipment, staff and poles to put up two segments of non-active power lines at Tall Pines Wildlife Management Area dove fields in Greenville County, South Carolina. The lines give doves additional habitat and a place to roost where they can rest and keep their eyes on birds of prey. The lines also give wildlife biologists an easy way to keep track of how many doves are using the fields.

Source: Coop Law Blog, *Blue Ridge Electric Erects Structures to Enhance Dove Fields*, EVERSHEDS SUTHERLAND (May 3, 2021), https://www.cooplawblog.com/2021/05/blue-ridge-electric-erects-structures-to-enhance-dove-fields/.

74. NRECA Urges Congress to Give Coops Direct-Pay Incentives for Clean Energy

The National Rural Electric Cooperative Association (NRECA) is urging congressional leaders to provide electric cooperatives with direct payments to develop clean energy projects, which would give coops incentives comparable to the tax breaks granted to investor-owned utilities. For-profit utilities have long received federal tax breaks for providing power from solar, wind and other renewable energy sources, but not-for-profit coops and public power utilities have not been able to tap into those programs because they are exempt from federal income taxes.

Source: Coop Law Blog, *NRECA Urges Congress to Give Coops Direct-Pay Incentives for Clean Energy*, EVERSHEDS SUTHERLAND (May 24, 2021), https://www.cooplawblog.com/2021/05/nreca-urges-congress-to-give-coops-direct-pay-incentives-for-clean-energy/.

75. Colorado Coop Uses Electricity From Methane

Methane from the Elk Creek Mine Plant is being converted to electricity and moved to the regional power grid, where it is used by Holy Cross Electric Cooperative. The electricity comes at a premium, but the coop is willing to pay the higher price to fulfill its clean energy goals.

Source: Coop Law Blog, *Colorado Coop Uses Electricity from Methane*, EVERSHEDS SUTHERLAND (June 1, 2021), https://www.cooplawblog.com/2021/06/colorado-coop-uses-electricity-from-methane/.

76. Missouri Coop Expanding Fiber to Rural Areas

Osage Valley Electric Coop is teaming up with Conexon Connect to bring fiber access to rural areas. The program is a 5-year, $75 million dollar project that is expected to bring fiber internet to 16,300 homes and businesses.

Source: Coop Law Blog, *Missouri Coop Expanding Fiber to Rural Areas*, EVERSHEDS SUTHERLAND (June 1, 2021), https://www.cooplawblog.com/2021/06/missouri-coop-expanding-fiber-to-rural-areas/.

77. Kentucky Coop Solar Project to Power Corvette Factory

Western Rural Electric Cooperative is developing a nearly 145 megawatt solar and storage project that will power a GM Chevy Corvette assembly plant. The project is a part of TVA's Green Invest Initiative and will assist GM in achieving its goal of going carbon-neutral by 2040.

Source: Coop Law Blog, *Kentucky Coop Solar Project to Power Corvette Factory*, EVERSHEDS SUTHERLAND (June 6, 2021), https://www.cooplawblog.com/2021/06/kentucky-coop-solar-project-to-power-corvette-factory/.

78. Indiana Coop Developing Solar Installations at Retiring Coal Plant

Hoosier Energy Rural Electric Cooperative Hallador Energy Company are teaming up to develop approximately 200 megawatts of energy from solar and battery storage near the Merom Coal Generation Station, which is expected to retire in May 2023.

Source: Coop Law Blog, *Indiana Coop Developing Solar Installations at Retiring Coal Plant*, EVERSHEDS SUTHERLAND (June 6, 2021), https://www.cooplawblog.com/2021/06/indiana-coop-developing-solar-installations-at-retiring-coal-plant/.

79. Coop to Use Helicopter to Trim Trees

EnerstarElectric Cooperative is teaming up with Aerial Solutions to use a helicopter with a suspended saw to chop down trees to prevent interference with power lines in its service area this month. The trimming process is expected to last two weeks, and the amount of time in each specific area will vary from a few hours to a full day.

Source: Coop Law Blog, *Coop to Use Helicopter to Trim Trees*, EVERSHEDS SUTHERLAND (June 6, 2021), https://www.cooplawblog.com/2021/06/coop-to-use-helicopter-to-trim-trees/.

80. Kentucky Coop Eyes More Sustainable Future

In November, East Kentucky Power Cooperative (EKPC) laid out a sustainability plan for its 16 owner-member cooperatives, aiming to reduce carbon dioxide emissions by 35% by 2035 and increase energy from renewable sources by 15% by 2035. Despite the COVID-19 pandemic, EKPC has kept work and projects on track to meet this goal.

Source: Coop Law Blog, *Kentucky Coop Eyes More Sustainable Future*, EVERSHEDS SUTHERLAND (June 11, 2021), https://www.cooplawblog.com/2021/06/kentucky-coop-eyes-more-sustainable-future/.

81. Arizona Cooperative Saves Bear Caught on Power Pole

A bear was found tangled in power pole wires of Sulphur Springs Valley Electric Cooperative. Company linemen immediately disabled the power so the bear would not be electrocuted and freed the animal.

Source: Coop Law Blog, *Arizona Cooperative Saves Bear Caught on Power Pole*, EVERSHEDS SUTHERLAND (June 11, 2021), https://www.cooplawblog.com/2021/06/arizona-cooperative-saves-bear-caught-on-power-pole/.

82. NRECA Concerned Over Increasing Postal Rates

The National Rural Electric Cooperative Association (NRECA) is concerned about postal rate increases well above inflation that will go into effect in August. Rural communities that rely on the postal service are particularly hurt by these rate increases.

Source: Coop Law Blog, *NRECA Concerned Over Increasing Postal Rates*, EVERSHEDS SUTHERLAND (June 11, 2021), https://www.cooplawblog.com/2021/06/nreca-concerned-over-increasing-postal-rates/.

83. Broadband Access Expanding in Virginia

The Governor of Virginia, Ralph Northam, recently signed HB2304 and SB1413 in Franklin, Virginia. The law will expand broadband access in Virginia by allowing investor-owned electric utilities to recover costs of, and revenue from, expanding broadband to unserved areas. This paves the way for Virginia's electric cooperatives to create partnerships with other investor-owned electric utilities to establish broadband in their service areas.

Source: Coop Law Blog, *Broadband Access Expanding in Virginia*, EVERSHEDS SUTHERLAND (June 14, 2021), https://www.cooplawblog.com/2021/06/broadband-access-expanded-in-virginia/.

84. Electric Cooperative in Florida Donates $2 Million

Withlacoochee River Electric Cooperative (WREC) donated more than half a million dollars to two high schools in Hernando and Pasco counties and awarded $1.3 million in post-secondary scholarships to children of members in its five-county service area. Funding came from WREC's educational foundation.

Source: Coop Law Blog, *Electric Cooperative in Florida Donates $2 Million*, EVERSHEDS SUTHERLAND (June 15, 2021), https://www.cooplawblog.com/2021/06/electric-cooperative-in-florida-donates-2-million/.

85. CEO of Minnkota Power Cooperative Urges Congress to Boost Carbon Capture Technologies

Mac McLennan, President and CEO of Minnkota Power Cooperative, recently urged members of the Senate Energy and Natural Resources Subcommittee on Energy to prioritize reliability and resiliency in the wake of power stability issues across the country. Specifically, Mr. McLennan asked Congress to support carbon capture technologies through passage of the Carbon Capture Modernization Act. This bill would make it easier for electric cooperatives to access incentives to retrofit coal plants with technologies that capture carbon dioxide emissions.

Source: Coop Law Blog, *CEO of Minnkota Power Cooperative Urges Congress to Boost Carbon Capture Technologies*, EVERSHEDS SUTHERLAND (June 24, 2021), https://www.cooplawblog.com/2021/06/ceo-of-minnkota-power-cooperative-urges-congress-to-boost-carbon-capture-technologies/.

86. NRECA and Other Coops Aid in Rollout of ODIN

The National Rural Electric Cooperative Association (NRECA), along with the National Information Solutions Cooperative and several other coops and public power districts, are supporting development and deployment of the Outage Data Initiative Nationwide system, or

ODIN. ODIN, which is now available for deployment and use, provides outage details by county, postal code or geo-position, including data on repair and restoration estimates.

Source: Coop Law Blog, *NRECA and Other Coops Aid in Rollout of Odin*, EVERSHEDS SUTHERLAND (July 1, 2021), https://www.cooplawblog.com/2021/07/nreca-and-other-coops-aid-in-rollout-of-odin/.

87. Alabama Electric Cooperative Hit by Ransomware Attack

Wiregrass Electric Cooperative, which serves about 25,000 members in southeastern Alabama, announced that it was hit by a ransomware attack that temporarily prevented customers from accessing their account information. According to Wiregrass Electric Cooperative, no data was compromised in the attack, but member account information and payment systems were taken offline for maintenance and as a precaution.

Source: Coop Law Blog, *Alabama Electric Cooperative Hit by Ransomware Attack*, EVERSHEDS SUTHERLAND (July 6, 2021), https://www.cooplawblog.com/2021/07/alabama-electric-cooperative-hit-by-ransomware-attack/.

88. Louisiana Electric Cooperative to Offer Broadband Services

A rural Louisiana electric coop has decided to go into the broadband internet business. The board of directors of Northeast Louisiana Electric Power Cooperative voted Tuesday to borrow $54 million to set up the infrastructure for broadband access in its coverage area.

Source: Coop Law Blog, *Louisiana Electric Cooperative to Offer Broadband Services*, EVERSHEDS SUTHERLAND (July 6, 2021), https://www.cooplawblog.com/2021/07/louisiana-electric-cooperative-to-offer-broadband-services/

89. Northern Neck Broadband Project to Deliver Universal Internet Access

Northern Neck Electric Cooperative, Dominion Energy Virginia and All Points Broadband recently celebrated groundbreaking on the first phase of a project that will deliver fiber-optic broadband access to approximately 7,200 currently unserved households and businesses in Virginia's Northern Neck region. This phase of the project will use a $10 million grant from the Virginia Telecommunication Initiative, along with federal and local funding and private investment. Dominion Energy is installing over 200 miles of fiber from Fredericksburg to Kilmarnock, which will serve as the backbone for the project. Northern Neck Electric Cooperative will work alongside Dominion Energy and All Points Broadband to extend the network, improving their electric grid and power poles along the way.

Source: Coop Law Blog, *Northern Neck Broadband Project to Deliver Universal Internet Access*, EVERSHEDS SUTHERLAND (July 12, 2021), https://www.cooplawblog.com/2021/07/northern-neck-broadband-project-to-deliver-universal-internet-access/

90. Several Kansas Co-ops Enter Into Dispute

Three farmers co-ops are asking that the company they use for marketing and grain sales be liquidated and its profits dispersed. Alleging unfair actions and the violation of a credit agreement by the company, they are asking for approximately $5 million to be returned to them.

Farmers Cooperative Elevator Company of Halstead, Cooperative Grain and Supply of Hillsboro and Central Prairie Co-op of Sterling filed a petition in district court in early February against

Team Marketing Alliance of Moundridge. In that petition, they ask that the company be dissolved.

Source: Hutchinson Newspaper, *Several Kansas Co-ops Enter into Dispute*, (February 11, 2021) https://www.hutchnews.com/story/business/agricultural/2021/02/11/some-kansas-co-ops-may-part-ways-marketing-arm-cooperative

91. U.S. Tobacco Cooperative Inc. Files for Chapter 11 Protection to Fulfill Short-Term Grower Contracts and Reorganize for the Future

U.S. Tobacco Cooperative Inc. (USTC) took the extraordinary step to file for Chapter 11 protection in Federal Court for the sole purpose of meeting short-term contractual obligations to member-growers during crop season 2021.

Source: News Release, *U.S. Tobacco Cooperative Inc. Files for Chapter 11 Protection to Fulfill Short-Term Grower Contracts and Reorganize for the Future* (July 7, 2021) https://www.USTC-Files-Chapter-11-Protection_0707211.pdf (usleaf.com)

92. Darigold Invests in Climate-Friendly Modernization

Darigold, Inc. is building a new premium protein and butter operation which will feature a suite of state-of-the-art technologies and strategies designed to reduce greenhouse gas emissions. When operational, these strategies will cut per unit emissions by 25% compared to our existing baseline.

Source: News Release, *Darigold Invests in Climate-Friendly Modernization* (July 1, 2021) https://www.marigold invests in climate-friendly modernization | Darigold

Calculating Patronage Dividends

2021 Final Subcommittee Report
Calculating Patronage Dividends

Chairman
Teresa Castanias, CPA
1500 E. Split Rock Drive, Unit 1
Ivins, Utah 84738
tereecastanias@gmail.com

Vice Chairman
Jon Cowell
Maryland & Virginia Milk Producers
Cooperative Association
1985 Isaac Newton Square West, Suite 200
Reston, Virginia 20190-5094
Jcowell@mdvamilk.com

Vice Chairman
Jared Kempel
Baker Tilly Virchow Krause, LLP
Ten Terrace Court
Madison, Wisconsin 53707-7398
jared.kempel@bakertilly.com

The Subcommittee is reporting on a number of areas this year. In our report, we will address the following developments during the year:

A. Update on Section 199 cases

B. New Section 199A

C. Section 163(j) – Final Regulations

D. PPP Loans and impact on Cooperatives

A. <u>Update on Section 199 cases</u>:

There were several issues that arose with the application of Section 199 with many cooperatives. One involved the fact that many grain cooperatives did not initially understand that their grain check payment to the member/farmer was a "per unit retain paid in money" (PURPIM) under Subchapter T. When the IRS National Office issued a private letter ruling to one large grain marketing and supply cooperative, many other grain cooperatives took note, and began to amend their returns to take the Section 199 deduction (aka Domestic Production Activities Deduction or DPAD). The IRS did not approve of these amendments, and began auditing the returns it found. When the IRS denied the claim because it believed that the grain check could not be a PURPIM if the member and cooperative did not understand that at the time, the cooperatives protested. IRS Appeals ultimately offered a settlement that almost all cooperatives impacted accepted. However, Ag Processing filed suit in Tax Court on several issues, and one of the issues is whether a cooperative can go back and correct its original treatment of grain payments. This case has been decided in Tax Court.

The other major issue that has persisted is whether nonexempt cooperatives are required to do two DPAD computations (one for patronage activities and another for nonpatronage/nonmember activities). The IRS says that the cooperative must do two because of the decision in the Farm Service case. Some cooperatives disagree and do a single computation. Others disagree with the

IRS, but do not want to run the risk of being wrong, particularly where they are passing through large amounts of DPAD to their members. Two cases have been decided in Tax Court this year involving this issue – Ag Processing and GROWMARK.

In the case Ag Processing Inc., a Cooperative and Subsidiaries, Petitioner v. Commissioner of Internal Revenue, Respondent, Docket No. 23479-14 (issued October 16, 2019), Tax Court Judge Elizabeth Paris ruled payments AGP made to its members (and similar payments it received from a cooperative of which it was a member) are per-unit retains paid in money (PURPIMs) and should be treated as such in computing its section 199 domestic production activities deduction (DPAD).

Judge Paris further ruled that section 199(d)(3) does not require separate DPAD computations for patronage and nonpatronage activities. However, once DPAD is computed it must be allocated between patronage and nonpatronage activities.

Finally, Judge Paris ruled on the issue of whether AGP's expanded affiliated group may have a net operating loss (NOL) if its DPAD -- after allocating to its patronage and nonpatronage accounts -- exceeds its taxable income. The judge concluded reg. section 1.199-7 does not apply, so under section 172(d)(7) DPAD may not be used to create or increase an NOL.

In the case GROWMARK Inc. & Subsidiaries, Petitioner v. Commissioner of Internal Revenue, Respondent, T.C. Memo 2019-161 (issued December 11, 2019), Tax Court Judge Elizabeth Paris ruled that section 199(d)(3) does not require separate domestic production activities deduction (DPAD) computations for patronage and nonpatronage activities. However, once DPAD is computed it must be allocated between patronage and nonpatronage activities.

Judge Paris further ruled that because the Schedule G allocation is done pursuant to subchapter T (not section 199), the taxpayer should allocate the aggregated DPAD on its Schedule G using the same method it used for other Schedule G allocations. GROWMARK had argued that its DPAD should be allocated on the basis of its qualified production activities income (QPAI).

In summary, these two cases conclude the following:

- DPAD should be determined on an aggregate basis.
- The resulting amount should then be allocated between patronage and nonpatronage.
- Patronage DPAD may not be used against nonpatronage income.
- The cases do not address the reverse situation on using nonpatronage DPAD against patronage income.

The final outcome on these cases is to be determined upon the agreement of the parties to the specific computation methodology. In Ag Processing, the years under exam in the case were 2008 and 2009. Ag Processing computed the DPAD on a total company basis, and then allocated the DPAD to patronage and nonpatronage activities based on their patronage/nonpatronage percentages in those years. This put more DPAD to their nonpatronage activities in those years. The IRS has argued that the allocation of the DPAD should be based on QPAI (Qualified Production Activities Income). This would put more of the DPAD on the patronage side in years when nothing can be allocated to the members. GROWMARK will have a similar issue with the IRS when the energy credit portion of their case is finally resolved. As they say, the devil is in the details.

While these cases relate specifically to prior Section 199, it is expected that the decisions will play a role in how the new Section 199A(g) is handled by cooperatives. The current Final Regulations for Section 199A(g) take a "no netting" position for DPAD, specifically stating that patronage DPAD cannot be used against nonpatronage income, and nonpatronage DPAD (of an exempt cooperative) may not be used against patronage income. In addition, the Final Regulations state that nonexempt cooperatives will do a patronage-only DPAD computation, without nonpatronage Qualified Production Activities Income (QPAI) and wages. It also states that exempt cooperatives will do separate patronage and nonpatronage computations. Both Ag Processing and GROWMARK cases state that cooperatives are not required to do separate computations. The Ag Processing approach is inconsistent with the approach taken by the Proposed Regulations for exempt cooperatives, and simply exclude nonpatronage items for nonexempt cooperatives. As Treasury and the IRS are still working on the revisions to the Proposed Regulations for Section 199A(g), we will have to wait to see what they do in response to these cases.

B. <u>New Section 199A</u>:

Section 199 was repealed effective December 31, 2017. New Section 199A(g) was structured to allow agricultural and horticultural cooperatives to continue to use the rules of old Section 199 to compute a benefit similar to the old Section 199 amount. The rules allowed the cooperative to pass-through all, some, or none of the new Section 199A(g) deduction to the members, but the members filing individual or pass-through entity returns (such as partnership or S corporation) would have to adjust their own Section 199A(a) computation. The rules also indicated that a C corporation member who received a pass-through of the 199A(g) deduction could not use it in computing the C corporation's tax.

Congress gave Treasury the authority to write regulations to address issues in the new Section 199A, including Section 199A(g). Over the course of the last 18 months, Treasury and the IRS have issued a number of proposed and some final regulations in this area. The Proposed Regulations for Section 199A(g) were issued in June 2019. The Treasury Department did not act on the final regulations for Section 199A(g) until January 14, 2021 after OMB's Office of Information and Regulatory Affairs (OIRA) completed its review of the final regulations on January 8, 2021. The Treasury Department and OMB were working to issue the final regulations related to the Tax Cuts and Jobs Act prior to the change in the Administration. Thus, the final regulations for Section 199A were published in the Federal Register on January 19, 2021. A copy of NCFC's Analysis of the Final Section 199A(g) Regulations and Action Steps memo is attached to our report.

We are highlighting a few areas of discussion that have been raised in our Subcommittee discussion:

- The definition of "patronage" in the Regulations

- The Regulations dropped the "bucketing of losses" concept
- The Preamble in the Regulations discusses "book/tax" and restored the language in the old Section 199 regulations

NCFC's goal remains preventing a tax increase on farmers and ranchers at a time when they can least afford it and work done by many of our members has been critical in making that case. A summary of NCFC's Analysis of Final Section 199A(g) Regulations and Action Steps is attached.

Issues that have been raised by LTA members of our Committee include:

· What are the implications to a cooperative that is using the federal tax basis for the provisions of the TCJA of 2017, including Section 199A, interest expense limitations, bonus depreciation and other depreciation issues, and new meals and entertainment limitations?

· What are cooperatives doing to communicate the new Section 199A changes to their members? An additional aspect to this issue is the fact that the new Section 199A pass-through 199A(g) deduction cannot be used by "C" corporation members. Many cooperatives have considered ways to identify those members, but have mostly decided not to attempt to do so as the members can change their status at any time, and so it is difficult to make use of the information. Cooperatives are trying to be sure their membership understands that the Section 199A(g) deduction cannot be used by a C corporation member.

· What is being done on cooperative Form 1099-PATR, particularly with new box 7 for "qualified payments"?

· Many more cooperatives allocated their old Section 199 deduction (DPAD) to their members before December 31, 2017 in order to ensure that it may be used by members. The amended law passed in March 2018 was made retroactive to January 1, 2018, but it did allow the cooperative to compute and pass through its old DPAD after the end of its fiscal year, and the members are allowed to claim it. There are a number of issues that have been raised by this situation.

  - There was no guidance in the old regulations on how these early allocations would be done. There is a wide variety of approaches that have been taken. What will be the IRS/Treasury reaction to this situation?
  - Now that more cooperatives have accelerated the deductions, many cooperative managers and tax practitioners believe that the members will want this to continue. So now it may be helpful to have some guidance or discuss the issue more openly in our cooperative meetings to develop some guidelines.
  - Cooperatives may also be interested in advising their members earlier in the year about the likely amounts that will be distributed to facilitate the members' tax planning.

C. **Final Regulations under Section 163(j) – Implications for Cooperatives**:

On July 28, 2020, the Treasury Department released final regulations with guidance on applying the limitations on the deductibility of business interest expense (BIE) under IRC Section 163(j) (the Final Regulations), which was significantly modified by the Tax Cuts and Jobs Act (TCJA) and then temporarily modified by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The Final Regulations provide guidance on what constitutes interest for purposes of the limitation, how to calculate the limitation, which taxpayers and trades or business are subject to the limitation, and how the limitation applies in certain contexts (e.g., consolidated groups). The final regulations were published in the Federal Register on September 14, 2020 and contain minor editorial changes. In response to questions from taxpayers and practitioners, the final regulations published in the Federal Register clarify that taxpayers may rely on the final regulations for any taxable year beginning after December 31, 2017, provided that certain conditions are met.

· Background

IRC Section 163(j) limits the deduction for business interest expense for tax years beginning after December 31, 2017, to the sum of

(1) the taxpayer's business interest income (BII),

(2) 30% (or 50%, as applicable) of the taxpayer's adjusted taxable income (ATI), and

(3) the taxpayer's floor plan financing interest.

It is important to note that the 30% limitation applies to taxpayers for years beginning after January 1, 2021 (i.e. for 2021 tax returns). The limitation has been at 50% for the last few years, so this may impact some cooperatives in the calendar 2021 or fiscal 2022 year. The depreciation adjustment will end in the calendar 2022 or fiscal 2023 year.

Business interest expense (BIE) is interest that is paid or accrued on indebtedness that is properly allocable to a trade or business. The IRC Section 163(j) limitation does not apply to certain trades or businesses, such as an electing real property trade or business, an electing farming business and certain activities of regulated utilities. Certain activities, such as performing services as an employee, are excluded from being a trade or business. The business interest expense limitation also does not apply to certain small businesses whose average annual gross receipts for the three preceding years are $26 million or less. The $26 million threshold applies for the 2020 tax year and will be adjusted annually for inflation.

An electing farming business means (1) a farming business (as defined in section 263A(d)(1)) which makes the election, or (2) any trade or business of a specified agricultural or horticultural cooperative (as defined in section 199A(g)(2)) with respect to which the cooperative makes the election. An electing farming business must use the alternative depreciation system, see section 168(g)(1(G). This covers all depreciable assets of the trade or business.

· Selected Significant Changes from Proposed Regulations

The final regulations are 569 pages and cover a wide array of issues. This section is focused on only some of the significant changes from the Proposed Regulations, and particularly ones that impact cooperatives. There are likely to be some issues that will impact your cooperative that are not covered here. Therefore, it is recommended that the reader review the Final Regulations in their entirety.

The most important for cooperatives is Treas. Reg. 1.163(j)-4(b)(6) which provides for purposes of computing its ATI, a cooperative's tentative taxable income is not reduced by the amount of any patronage dividend under Section 1382(b)(1) or by any amount paid in redemption of nonqualified written notices of allocation distributed as patronage dividends under section 1382(b)(2), any amount described in section 1382(c), or any equivalent amount deducted by an organization that operates on a cooperative basis but is not subject to taxation under sections 1381 through 1388. This is a positive addition for cooperatives that was requested by NCFC. The Final Regulations are careful to only allow an add-back for patronage dividends as defined in Section 1388(a), and not for per-unit retain amounts under Section 1382(b)(3) or (4), either paid in money or written notices of allocation. Cooperatives should note this difference and determine the impact on their situation. The rules also apply to those cooperatives that operate under pre-Subchapter T rules, such as certain rural electric and rural telephone cooperatives.

Treas. Reg. 1.163(j)-9 discusses the rules related to the election allowed for certain excepted trades or businesses, including agricultural and horticultural cooperatives and small businesses with less than $26 million in average annual gross receipts in 2020 (indexed for inflation). These small businesses can include other types of cooperatives. The election applies to the taxable year in which the election is made and all subsequent taxable years. The election is irrevocable. The taxpayers making this election must use the alternative depreciation system for certain types of property under section 163(j)(11) and cannot claim the additional first year depreciation deduction under section 168(k) for those types of property. The Final Regulations contain information on the time and manner of making the election and the information to be included in the election statement. The election automatically terminates if a taxpayer ceases to engage in the electing trade or business. Example 1 of the Final Regulations illustrate the importance of determining and identifying the electing trade or business. In this example, a sole proprietor farmer had two trades or businesses – a dairy and orchard. He made the election only for the dairy.

Many cooperatives with inventories will be positively impacted by one of the significant changes from the 2018 Proposed Regulations. The Final Regulations permit depreciation, amortization or depletion that is capitalized into inventory under IRC Section 263A to be added back to TTI when calculating ATI for that tax year. This addback is allowed for taxable years beginning before 2021. In this regard, the Final Regulations allow taxpayers that previously chose to follow the 2018 Proposed Regulations to follow the Final Regulations.

The Final Regulations contain changes in the definition of "interest", expanded anti-avoidance rules, changes related to the CARES Act, and the relationship to other tax provisions that affect interest deductions. There are other rules in the Final Regulations that may impact cooperatives that are part of a consolidated group or have investments in partnerships.

In December 2020, the Treasury Department issued final regulations addressing some additional areas under Section 163(j), specifically the application of the limitation in contexts involving pass-through entities, regulated investment companies (RICs), and controlled foreign corporations. The regulations also provide guidance regarding the definitions of real property development and syndicate. Cooperatives with these types of issues should review them for guidance.

Most cooperatives that the Subcommittee has discussed this with say that the Section 163(j) limitation will be a much bigger issue in 2 years when the limitation is based on Earnings before Taxes only, rather than now where the limitation is based on Earnings before Interest, Depreciation and Taxes.

Congress was considering major changes to the tax law this Fall. One of the items under consideration is limiting the carryover period for the interest expense limitation to just 5 years. Currently the law allows an unlimited carryover period. While Congress failed to pass new tax law this fall, this is another area to watch.

D. <u>PPP Loans and Impact on Cooperative's Patronage Dividend</u>:

The Coronavirus Aid, Relief, and Economic Security (CARES) Act of 2020 created a government loan program called the Paycheck Protection Program (PPP). Farmer cooperatives that meet the size criteria under the program (generally under 500 employees for PPP) are eligible. PPP provides $349 billion for small business loans to cover qualified payroll costs, rent, utilities, and interest on mortgage and other debt obligations. The loan amounts will be forgiven as long as:

- The loan proceeds are used to cover payroll costs and most mortgage interest, rent, and utility costs over the covered period (8-weeks or 24-weeks) after the loan is made; and
- Employee and compensation levels are maintained.

There are many issues related to the PPP program that are being addressed by other Subcommittees. In our report, we will focus on whether the PPP loan amount that is forgiven is considered patronage income, and what the results will be for a cooperative's patronage dividend deduction where the cooperative is using the book (GAAP) method of paying patronage, the tax (federal income tax) method of paying patronage, or a hybrid method of paying patronage.

In December 2020, Congress passed the SECURE Act which, among other things, confirmed that expenses paid by a taxpayer that are used to justify the taxpayer's PPP loan forgiveness are deductible on the taxpayer's federal income tax return. (N.B. The state tax treatment is dependent on each state's tax law.)

For book (GAAP) purposes, the PPP loan forgiveness is recognized as income when the loan is forgiven, or when it is clear that the borrower has met the conditions for forgiveness under the law. The expenses that were used to support the forgiveness are also deductions for GAAP purposes. So there is a net zero effect of the loan forgiveness for GAAP purposes on net income.

For federal income tax purposes, the PPP loan forgiveness is not recognized as income when the loan is forgiven. The expenses that are used to support the forgiveness are also deductions for federal income tax purposes. So there is a net loss effect on the loan forgiveness for federal income tax purposes on net income.

For example, assume the cooperative has $1,000,000 in GAAP and federal income tax income before getting a PPP loan. It gets a PPP loan of $1,000,000 in 2020, and incurs $1,000,000 in qualified PPP expenses in the applicable forgiveness period. The GAAP and federal income tax income for the cooperative would be as follows:

	GAAP	Fed Tax Income
GAAP and Federal Tax Income	$1,000,000	$1,000,000
PPP loan forgiveness income	$1,000,000	$ 0
PPP loan expenses	($1,000,000)	($1,000,000)
Net income for patronage purposes	$1,000,000	$ 0

The cooperative using the book (GAAP) method of paying patronage needs to determine how much of the income is related to patronage, and then consider the need for reasonable reserves and potential issues related to the SBA's audit of their PPP loan forgiveness documentation. After considering these factors, a patronage dividend can be issued at the direction of the Board.

The cooperative using the federal income tax method of paying patronage does not have any income to distribute because the PPP loan forgiveness is not considered federal taxable income but the expenses used to support the loan forgiveness are deductible.

Since the pandemic started so quickly and the government's response with the PPP loan program has had many issues, it is unlikely that any cooperative boards were able to make adjustments to their patronage computations before the beginning of the cooperative's tax year. Even those with a hybrid method or those that allow the board to adjust the patronage computation would still have to do it before the beginning of the tax year.

For the cooperative that is on the book basis and wants to pay out the PPP as part of their patronage dividend, a note of caution has been raised by our Subcommittee members. The concern of some practitioners is how an SBA audit of the PPP application would look at the payout of the PPP funds to members as a patronage dividend. The question may be raised as to whether the PPP funds are really patronage income. While there are certainly strong arguments as to the patronage character of the PPP funds, it may be an issue that would be costly to resolve with the SBA.

As all of these areas that we have addressed in this report remain fluid, the Subcommittee is interested in any issues related to how cooperatives are applying the holdings in the GROWMARK and AGP cases to their situations. We are also interested in what issues cooperatives are having with the new Section 199A, Form 1099-PATR and Section 163(j) rules. The Sample Bylaw group is also considering whether changes might be warranted in those documents to reflect the new laws and issues created by the pandemic. Finally, any issues related to the cooperative issues surrounding the PPP loans and CARES Act are also appreciated. Please feel free to contact the Chair or Vice-Chairs about issues of interest to you.

National Council of Farmer Cooperatives

Tel: 202-626-8700
Fax: 202-626-8722
50 F Street, NW Suite 900
Washington, DC 20001
www.ncfc.org

Final Treasury regulations applicable to farmer cooperatives
Treatment of issues identified in NCFC submission

Nonpatronage limitation

Notice of Proposed Rulemaking (NPRM): The proposed regulation requires a non-exempt cooperative to undertake a four-step method to allocate its income between patronage and nonpatronage activity. The section 199A(g) deduction is allowed only with respect to the patronage activity. Exempt cooperatives are allowed a separately allocated section 199A(g) deduction for their nonpatronage activity.

NCFC submission: Treasury has no authority to limit the section 199A(g) deduction for non-exempt cooperatives to only patronage activity. The legislative history and grant of regulatory authority make it clear that section 199A(g) was intended to replicate the section 199 regulations. Section 199 took nonpatronage activity into account.

NCFC compromise: As an alternative, NCFC proposed that a non-exempt cooperative would compute its section 199A(g) deduction with respect to all its activity and then allocate that deduction between patronage and nonpatronage activity pursuant to any reasonable method, including a method based on relative qualified production activity income (QPAI). The section 199A(g) amount allocated to nonpatronage income would be disallowed.

Final regulations: The final regulations follow the proposed regulations. In addition, the final regulations provide that if the domestic production gross receipts (DPGR) of a specified cooperative from nonpatronage activity for the year are less than 10 percent of total DPGR, the nonpatronage disallowance will not apply.

Section 1388 changes

NPRM: The proposed regulation attempts to define patronage activity based on current, but uncited, case law. Our understanding of current law is that activity that “actually facilitates” or is “directly related” to a cooperative’s purpose is patronage activity. The proposed regulations only incorporate the “actually facilitates” test of case law. Further, the proposed regulations apply the definition on a transaction-by-transaction basis, rather than on a broader activity basis. Finally, the proposed regulations would provide that nonpatronage and patronage losses or deductions may only offset nonpatronage and patronage income, respectively.

NCFC submission: These rules are unnecessary and should be dropped. However, if Treasury decides to define "patronage activity," it should:

(1) reconcile the definition with Treas. reg. sec. 1.1382(c)(2), taking into account case law and the IRS acquiescence to the *Farmland Industries* case;
(2) clarify that the "directly related" standard applies to income and deductions from activities that actually facilitate or are directly related to the cooperative's purpose, and
(3) express the cases that NCFC believes represent well-settled law.

The rules regarding the use of deductions or losses should be dropped or reconciled with case law and established IRS practice.

Final regulations: The final regulations retained definitions for patronage and nonpatronage activity, and largely followed the NCFC recommendations. Specifically, the final regulations:

(1) Reconcile the new definition with current with Treas. reg. sec. 1.1382(c)(2).
(2) Provide that the determination of patronage versus nonpatronage is determined by applying the "directly related use" test – but does not define such test.
(3) Further provides an "actually facilitates" test to define at least a subset of patronage sourced items on a transactional, rather than activity, basis.
(4) Discuss applicable law in the preamble, specifically Rev. Rul. 69-576 and *Farmland Industries* as cited in the NCFC submission.
(5) Drop the netting rule of the proposed regulations.

<u>Method to calculate patronage amounts</u>

NPRM: Prop. Treas. reg. section. 1.199A-8(b)(5)(ii)(C) implies that a cooperative must use the same method of accounting to determine taxable income and distributions under section 1382(b) and qualified payments.

NCFC submission: The implication that a cooperative must use the same method to calculate taxable income and patronage amounts is incorrect and inconsistent with prior IRS positions, including tax forms. The final regulations should clarify that a cooperative is not bound to use its tax method to calculate amounts allocable to patrons.

Final regulations: The final regulations agree with the NCFC comment and drop the consistency requirement of the proposed regulations.

<u>Methods of allocation</u>

NPRM: The proposed regulations require a specified cooperative to allocate its gross receipts for the taxable year between domestic production gross receipts ("DPGR") and non-DPGR based on "*a* reasonable method" that "must be consistently applied from one taxable year to another."

NCFC submission: The final regulations should follow prior section 199 regulations that allow the use of "*any* reasonable method" to allocate items and allow such methods to be changed without IRS permission.

Final regulations: The final regulations provide that the method used to allocate amounts should be applied consistently from year to year, but if such method becomes unreasonable, the taxpayer must change to another reasonable method without permission from the IRS.

Treatment of cooperative as a flow-thru entity

NPRM: Prop. reg. sec. 1.199A-7 treats all cooperatives, including specified cooperatives, as flow-through entities, in part, with respect to payments to their patrons.

Specifically, prop. Treas. reg. secs. 1.199A-7(c)(2) and (3) would require (1) a patron to determine whether payments received from a cooperative are related to the patron's trade or business, and (2) a cooperative to determine whether its items of income, gain, deduction and loss are from activities that qualify for the section 199A(a) deduction. Prop. Treas. reg. secs. 1.199A-7(d)(2) and (3) require patrons and cooperatives to make the same determinations and same reporting with respect to specified service trades or businesses ("SSTBs").

NCFC submission: Such treatment is inappropriate and reflects a basic misunderstanding of how Subchapter T has operated since its inception. Even if this treatment was appropriate, it represents an administrative burden to specified cooperatives and their patrons that outweighs the benefits to the government. Few cooperatives will engage in SSTB activities. In any event, the determination of whether a section 199A(g) deduction should be disallowed because it relates to SSTB activity should be determined at the patron level based on the patron's activity and relationship to the cooperative.

Final regulations: The final regulations generally follow the proposed regulations, including the rule that if the specified cooperation does not provide the reporting required by the regulation by the due date of Form 1099-PATR, the amount of distributions that may be included in the patron's QBI is presumed to be zero. A cooperative can rebut the presumption with a corrected 1099-PATR.

C corporations as patrons

NPRM: The proposed regulations treat a marketing cooperative as having manufactured, produced, grown or extracted ("MPGE") any agricultural or horticultural product of its patrons, including patrons that are C corporations. The preamble to the proposed regulations solicits comments as to whether this is the appropriate rule.

The preamble provides that a specified cooperative may not "pass through to a C corporation any of the section 199A(g) deduction of the Specified Cooperative."

NCFC submission: NCFC agrees with the MPGE attribution rule.

The final regulations should clarify that the ultimate determination of whether a patron is eligible to claim a section 199A(g) deduction rests with the patron, and a cooperative will not be penalized if it passes through information relating to the section 199A(g) deduction to an ineligible corporate patron.

Final regulations: The final regulations do not impose any requirements for a cooperative to know the tax status of its patron. In addition, the final regulations provide that if the cooperative knows that a patron is a C corporation, the cooperative may retain such patron's allocable share of its section 199A(g) deduction. The final regulations provide an example of the operation of this rule.

Reporting requirements

NPRM: The proposed regulations and new IRS Form 1099-PATR impose various new reporting requirements on specified cooperatives.

NCFC submission: Specified cooperatives should be allowed to elect out of section 199A(g) to avoid burdensome calculation, recordkeeping, and reporting requirements.

Final regulations: The final regulations do not provide the election-out, citing a lack of authority.

Definition of agricultural and horticultural product

NPRM: The preamble to the proposed regulations specifically requests comments on the definition of agricultural and horticultural products, and suggests referencing non-tax laws to define such products.

NCFC submission: A definition was not necessary, but if final regulations provided one, references to non-tax laws are inappropriate. Instead, NCFC provided a *de novo* definition.

Final regulations: The final regulations retain a definition of agricultural and horticultural products based on the Cooperative Marketing Act of 1926. The final regulation accepted a portion of the NCFC alternative definition by providing several nonexclusive examples of items that qualify as agricultural and horticultural products. Items that were in the NCFC definition but that were not used as examples in the final regulations were insects and other animals. It did not include farm waste products. The NCFC definition also applied to products produced on ranches, plantations, truck farms, urban farms (including hydroponics), feedlots, orchards, groves bogs, greenhouse, and similar operations. The final regulation dd not include this clarification.

Treatment of supplies

NPRM: The proposed regulations provide that "agricultural or horticultural products include fertilizer, diesel fuel and other supplies used in agricultural or horticultural production *that are MPGE by a Specified Cooperative*."

NCFC submission: The italicized words above are inappropriate, inconsistent with the statute and prior section 199 regulations, and should be deleted. In additional, final regulations should provide that:

(1) "supplies" include items purchased, as well as manufactured, by a specified cooperative, and

(2) the definition of "supplies" includes seed, feed, herbicides, pesticides, tools, fencing, replacement parts for farm machinery and similar items used in agricultural and horticultural production (in addition to "fertilizer, diesel fuel, and other supplies.")

The final regulations should include examples regarding supplies from prior section 199 regulations and provide additional examples to clarify the additional concepts suggested by NCFC.

Final regulations: The final regulations did not remove the italicized words. The explanation in the preamble is that the Joint Committee on Taxation's explanation of the 2018 Act is that "the definition of specified cooperative no longer includes a cooperative solely engaged in the provision of supplies, equipment, or services to farmers or other specified … cooperatives." This reference is taken completely out of context. The intent of the 2018 Act was not to exclude farm supply cooperatives. Rather, it referred to the re-drafting of section 199A(g) from the original TCJA provision (which specifically referenced supply contracts) to the 2018 Act version, which replicated the section 199 definition of a specified cooperative. Under section 199, a supply cooperative qualified as a specified cooperative under regulations that treated supplies as agricultural and horticultural products.

The final regulations clarify that supplies such as seed, feed, herbicides, and pesticides qualify as agricultural and horticultural products. The final regulations did not include the NCFC suggestion describing supplies to include tools, fencing, and replacement parts for farm machinery.

The final regulation clarifies, consistent with prior section 199 regulations, that packaging, repackaging, labelling or installing activity engaged in conjunction with an as agricultural and horticultural product that the cooperative MPGEs will also qualify. But such activities will not qualify if the cooperative engages in no other MPGE activity.

<u>Treatment of intangible property and related income</u>

NPRM: The proposed regulations provide that agricultural or horticultural products do not include intangible property.

NCFC submission: The final regulations should clarify, in the text and perhaps with an example, that qualified DPGR includes gross receipts received pursuant to a contract between a specified cooperative and a third-party manufacturer where, under such contract, the cooperative sells agricultural products to the manufacturer and the cooperative receives royalty or license fee income on the sale of finished products containing such agricultural products as an ingredient.

Final regulations: The final regulations do not include the NCFC example because it was fact specific, and the result could turn on any number of factors. The final regulations modify the intangible property exclusion to clarify that it does not apply to intangible property incorporated into tangible qualified property, and add two simple examples involving the licensing of brand names to distinguish qualified intangibles from disqualified intangibles.

Definition of a specified cooperative

NPRM: The proposed regulation provides that a specified cooperative is, among other things, a cooperative that "is engaged in the marketing of agricultural or horticultural products that have *been MPGE in whole or significant part within the United States by the patrons of the cooperative*."

NCFC submission: The italicized words above are inappropriate, inconsistent with prior section 199 regulations, and should be deleted.

Final regulations: The final regulations follow the proposed regulations without appearing to address the NCFC comment in the preamble. The preamble does provide that a specified cooperative no longer includes a cooperative solely engaged in the provision of supplies, equipment, or services to farmers or other specified cooperatives. It is unclear whether this statement refers to the proposed or final regulations. (See the discussion of supplies above).

Definition of qualified payments

NPRM: The proposed regulations do not provide a definition of "qualified payment" beyond that provided in the statute and prior section 199 regulations.

NCFC submission: The concept of "qualified payments" is more important under section 199A(g) than it was under section 199 because of reporting requirements required by specified cooperatives and adjustments required by patrons. At the very least, final regulations should clarify that qualified payments do not include amounts paid to patrons by specified cooperatives with respect to activities that do not qualify as producing DPGR from the sale of agricultural or horticultural products and thus do not generate QPAI.

In addition, at the IRS meeting, NCFC requested that if the section 199A(g) deduction is subject to the wage limitation, the amount that the cooperative reports to its patrons as a qualified payment should be reduced accordingly

Final regulations: The final regulations adopt the recommendation in the submission that reportable qualified payments should be determined with respect to activities that generate DPGR.

The final regulations do not adopt the recommendation discussed in the IRS meeting to reduce the amount of reportable qualified payments where the section 199A(g) deduction is wage or otherwise limited.

Examples

NPRM: The NPRM has several examples to demonstrate the operation of the rules therein.

NCFC submission: Examples in the final regulations should:

(1) Clarify the scope of per-unit retain allocations in examples 1 and 2 of prop. Treas. reg. sec. 1.199A-8(e);
(2) Restore examples 1 and 2 of prior Treas. reg. sec. 1.199-3(e)(5) to clarify that the storage of farm products gives rise to qualified MPGE;
(3) Restore examples of Treas. reg. sec. 1.199-6(m) to provide additional clarity and eliminate any unnecessary confusion regarding their omission; and
(4) Clarify how NOL carryforwards are used when a cooperative is allowed a deduction under section 1382(b) in examples 6 and 7 of prop. Treas. reg. sec. 1.199A-8(e) for purposes of determining the section 199A(g) deduction for the year.

Final regulations: The final regulations:

(1) Clarify the treatment of the per-unit retain allocations in the examples;
(2) Include modified versions examples 1 and 2 of prior Treas. reg. sec. 1.199-3(e)(5) relating to the storage of farm products;
(3) Include versions of Examples 1–3 from prior Treas. reg. sec. 1.199-6(m); and
(4) Clarify how NOL carryforwards are used when a cooperative is allowed a deduction under section 1382(b) for purposes of determining the section 199A(g) deduction for the year.

However, with respect to the use of NOLs, the proposed regulations do not exactly adopt the ordering rule suggested in the NCFC proposed example. NCFC proposed that a cooperative should determine its section 199A(g) deduction without regard to any NOL carried into the taxable year. The final regulations require the NOL to be used before the section 199A(g) deduction, but only to the extent the cooperative had taxable income after taking the deductions for payments to patrons into account. The result of the final regulation is a stacking rule not quite as beneficial as that recommended by NCFC, but is not as onerous as that suggested by the proposed regulations.

<u>Treatment of partnerships</u>

NPRM: The proposed regulations provide some basic rules regarding partnership interests of specified cooperatives.

NCFC submission: The proposed regulations do not fully replicate the regulations governing partnerships under former section 199(f)(1). Final regulations should also make it clear that:

(1) a specified cooperative takes into account its allocable share of W-2 wages with respect to its interest in a partnership, and
(2) the gross receipts of the partnership from its activities (including MPGE, storage, handling, processing and marketing activities) are DPGR as if such activities were conducted by the specified cooperative directly.

Final regulations: The final regulations largely adopt the NCFC comments.

Expanded Affiliated Groups (EAGs) and other organizational structures

NPRM: The proposed regulations provide that only the relevant items of specified cooperatives in an EAG are taken into account in determining the section 199A(g) deduction of the group. The proposed regulations also do not replicate other affiliation rules from the section 199 regulations.

NCFC submission: Final regulations should clarify that if a specified cooperative controls a C corporation, a group of controlled C corporations or any partnerships, the activity (including W-2 wages) of such controlled entities (whether or not cooperatives) is taken into account under section 199A(g) in the same manner as it was taken into account under section 199.

Final regulations should clarify the treatment of federated cooperatives. Specifically, the final regulations should treat a section 199A(g) deduction passed to a specified cooperative in the same manner as a section 199A(g) generated by the cooperative from its own qualified activities.

Final regulations should clarify that a non-exempt cooperative may calculate its section 199A(g) deduction and pass it through to an exempt cooperative which, in turn, may pass it through to its patrons.

Final regulations: The final regulations do not include the NCFC recommendation to include the activity of non-cooperative subsidies in its section 199A(g) calculation. The final regulations include additional examples to demonstrate the operation of the EAG rules.

Effective date issues

NPRM: The preamble to the proposed regulations generally provides that the final regulations will be effective for taxable years *beginning* after final regulations are published in the Federal Register. The language in the proposed regulations provides that the final regulations will be effective for taxable years *ending* after final regulations are published in the Federal Register.

The proposed regulations provide transition rules for the repeal of section 199.

NCFC submission: The final regulations should be effective for taxable years *beginning* after final regulations are published in the Federal Register.

Final guidance should not provide explicit rules for the transition rule and instead provide that any reasonable application of the transition rule will be deemed appropriate.

Final regulations: The final regulations are effective for taxable years beginning after publication of the regulations. A taxpayer can elect to apply the regulations, in their entirety, before such date.

The final regulations drop the explicit rules for the transition rules, cross references the transition rule in the 2018 statute, and allows reasonable methods to identify payments that qualify under section 199 but not section 199A(g).

Litigation Between Cooperatives and Their Members, Including Member Insolvency

2021 Final Report for LTA Subcommittee
Litigation Between Cooperatives and Their Members

Chair:	Daniel C. Mott, Esq. Fredrikson & Byron, P.A. 200 South Sixth Street Suite 4000 Minneapolis, MN 55402-1425 Phone: (612) 492-7322 Fax: (612) 492-7077 dmott@fredlaw.com
Vice-Chair:	Matt Aufman, Esq. Welch Foods Inc. 300 Baker Avenue Suite 300 Concord, MA 01742 Phone: (978) 371-3834 maufman@welchs.com
Vice-Chair:	Todd Eskelsen, Esq. Eskelsen Law Group 4011 Glenridge Street Kensington, MD 20895 Phone: (240) 460-1115 teskelsen@eskelaw.com

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Table of Contents

I. Case Updates

A. <u>Settlement</u>: *Sharp Farms v. Speaks,* 917 F.3d 276 (4th Cir. 2019) (originally in 2020 Report).

<u>Background</u>

This appeal of a class action lawsuit is the culmination of a longstanding dispute. U.S. Tobacco Cooperative is an agricultural cooperative of flue-cured tobacco growers in North Carolina. Since its formation in 1946, the Cooperative has administered a federal price-support program designed to stabilize tobacco prices for member growers through purchasing their unsold tobacco at a guaranteed minimum price and marketing the tobacco to buyers. Current and former members brought a putative class action suit against the cooperative, alleging that after Congress enacted the Fair and Equitable Tobacco Reform Act and ended the Tobacco Price Support Program, the cooperative's purpose ended and it should have been forced to distribute its reserves and been judicially dissolved.

<u>2012</u>

In 2012, the plaintiffs filed a class-action complaint against the cooperative, seeking a declaratory judgment, distribution of the reserve funds to members, and judicial dissolution of the Cooperative.

<u>2012-2017</u>

The plaintiffs stayed the case for several years while a parallel class action[1] involving the cooperative took place. The plaintiffs allowed the other proceedings to take place first because it could have affected their case.[2] Some of the members of the other class action lawsuit were also members of this class action.

<u>District Court Proceedings</u>

In May 2017, the parties mediated the case and moved for the district court to certify the class and approve the $24 million settlement as fair, reasonable, and adequate for the class members. The United States District Court for the Eastern District of North Carolina entered an order granting the parties motion for approval of the class settlement. Objectors to the class settlement (the members who were a part of the other class action) and a would-be intervenor appealed.

[1] *Fisher v. Flue-Cured Tobacco Coop. Stabilization Corp*., 369 N.C. 202, 794 S.E.2d 699, 703 (2016) ("*Fisher-Lewis*"). *Fisher-Lewis* was the

[2] *Sharp Farms v. Speaks*, 917 F.3d 276 (4th Cir. 2019)

Appellate Court Proceedings

On February 28, 2019, the United States Court of Appeals for the Fourth Circuit held that the district court abused its discretion in approving the $24 million settlement as fair, reasonable, and adequate. The case was remanded to the district court for further proceedings. As a result of this ruling, the court in *Lewis*, which consisted of a subset of members from *Speaks*, entered an Amended Court Order on May 7, 2019 and again on December 30, 2019.

2020

In March 2020, the District Court granted defendant's motion to clarify a court order from 2018 certifying class counsel.[3] Meanwhile, in June 2020, plaintiffs in *Lewis* filed a Motion for Partial Summary Judgment

2021 – *Lewis*

In April 2021, the Court in *Lewis* granted the plaintiff's Motion for Partial Summary Judgment, holding that the cooperative owed withheld capital to the plaintiffs. *Lewis* stopped short of calculating the amount owed (the capital withheld in excess of reasonable reserves); the court left it to the discretion of a jury.

B. Arbitration Clauses: *Baria v. Singing River Electric Cooperative*, 2019 WL 2343841 (S.D. Miss.) (originally in 2020 Report).

Background

The Singing River Electric Cooperative ("Singing River") is a rural electric cooperative that provides electricity to tens of thousands of Mississippi residents and businesses. This case is a putative class action suit. The plaintiffs, who are rate paying members of Singing River, alleged that Singing River wrongfully withheld and continued to wrongfully withhold patronage capital from current and former members that, under Mississippi law, should have been disbursed to the cooperative's members.

The plaintiffs filed their complaint in the Circuit Court of Jackson County, Mississippi on March 22, 2019. Singing River then removed the case to federal district court and filed a Motion to Compel Arbitration, invoking Section 4 of the Federal Arbitration Act ("FAA"). Thereafter, plaintiffs responded to the motion and filed a Motion for Limited Lifting of the Stay of Discovery.

[3] *Speaks v. U.S. Tobacco Cooperative, Inc.*, 2020 WL 1485965 (E.D.N.C. 2020).

2019

The Court granted Singing River's Motion to Compel Arbitration for various reasons. First, the parties had entered into a valid arbitration agreement. Mississippi law provides that the powers of a corporation shall be vested in and exercised by a board of directors. The board of directors is empowered to adopt and amend bylaws for the management and regulation of the affairs of the corporation (including terms and conditions and other such appropriate or desirable matters). Any person is allowed to become and remain a cooperative member if the person uses the energy and complies with the terms and conditions of membership, including the bylaws provisions, which explicitly stated that any controversy or claim arising out of or relating to patronage capital shall be resolved by binding arbitration.[4] Second, the parties agreed to delegate threshold questions about the arbitration provision to an arbitrator. Lastly, the plaintiffs did not specifically challenge the validity of the delegation clause.

The Court also denied the plaintiffs motion for a lift of the stay of discovery. The court held that the plaintiffs did not make a compelling showing that arbitration-related discovery was required because none of the issues before the Court required consideration of additional evidence.

2020

In March 2020, the plaintiffs' moved under Rule 59(e) for reconsideration of the Court's decision, arguing that (i) they did not assent to the inclusion of an arbitration provision in their contract with the cooperative, (ii) the arbitration provision and its delegation clause were the products of coercion, and (iii) it would be inequitable to condition the receipt of a basic public necessity - in this case, electricity - upon assent to an arbitration agreement. Although plaintiff's motion for reconsideration was granted, the court rejected plaintiffs' reconsideration arguments and also rejected Singing River's argument that all contracts for service with Mississippi power cooperatives automatically incorporate the cooperative's by-laws by operation of Mississippi statute. Instead, the court held that while it was undisputed the parties had executed a contract, the court did not have information to determine the specific terms of that contract. Based on the Mississippi Supreme Court's recent holding in an electrical cooperative case[5] that the beginning point of any inquiry into the meaning of an electrical cooperative's bylaws was the user's application for service and because neither of the parties had provided the court with a copy of plaintiff's application for service, the court required the parties continue the case to flesh out the specifics of the contract. However, the court noted that, should Singing River disagree with the outcome of this motion, it need only produce copies of the applications and demonstrate that they incorporated the terms of the bylaws which would end the case.

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[4] *Baria v. Singing River Electric Cooperative*, 2019 WL 2343841, 4 (S.D. Miss.).

[5] *The Door Shop, Inc v. Alcorn County Elec. Power Ass'n,* 261 So. 3d 1099, 1104 (Miss. 2018).

2020 – 2020 WL 4006330 (S.D. Miss.)

In April 2020, Singing River filed a Notice of Appeal, a Motion to Stay the case pending resolution of the appeal, and a Motion to Dismiss. To support the Motion to Dismiss, Singing River cited the Court's ruling in a similar case involving a different power cooperative.[6] Specifically, Singing River argued that the Mississippi legislature, under Miss. Code Ann. § 77-5-235 and the prior version of the statute, granted the cooperative discretion to determine how much money it should hold in reserve. The Court granted Singing River's Motion to Dismiss, holding that the statute grants the "cooperatives the discretion to retain capital reserves for improvements and other contingencies, and neither version grants members an unconditional, absolute right to the return of such funds." 2020 WL 4006330 at 7. The Court dismissed the case with prejudice.

C. Patronage Capital Litigation: *Butler v. Coast Electric Power Ass'n.*, 926 F. 3d 190 (5th Cir. 2019) (originally in 2020 Report).

Background

The three cooperatives involved in this case are Mississippi-based power cooperatives. Members of the three rural power cooperatives filed state court actions alleging that cooperatives failed to refund excess patronage capital to them, as required by state law. They requested a refund of capital above a specific ratio of equity to assets established in the cooperatives' agreements with the federal Rural Utilities Service, and the appointment of the appointment of a trustee or a receiver to oversee the repayment process. The three cooperatives removed the case to federal court.

Trial Court Proceedings

After removal, the United States District Court for the Southern District of Mississippi, remanded cases to state court, and the cooperatives appealed. Appeals were consolidated.

Appellate Court Proceedings

Federal Preemption Defense

In this case, the cooperatives asserted a federal preemption defense. They argued that the Mississippi Code § 77-5-235(5)'s refund requirement conflicted with Congress's purposes and objectives as expressed in the Rural Electrification Act, federal regulations, and the cooperatives' loan agreements with the Rural Utility Service (RUS).

[6] *Harper v. S. Pine Elec. Coop.*, 2020 WL 2120413 (S.D. Miss. Feb. 12, 2020); *Harper v. S. Pine Elec. Coop.*, 2020 WL 2114366 (S.D. Miss. May 4, 2020)

The United States Court of Appeals for the Fifth Circuit held that the cooperatives had a colorable federal preemption defense, therefore, the cooperatives were entitled to remove under 28 U.S.C. § 1442's provision for federal officer removal.

The Fifth Circuit recognized that the relationship between federal law and regulations and the defendants' Rural Utility Service loan agreements raised an important issue. The relevant loan agreements required approval before making distributions of patronage capital. Therefore, federal law preempted the Mississippi Code § 77-5-235(5)'s refund requirement and the defendants were entitled to be heard in federal court.

The court reversed the district court's decision to remand the consolidated cases to state court.

<u>2020</u>

The cases appear to be separated but wrapped up in procedural issues between state and federal courts.

II. New Cases

A. <u>Patronage Capital Litigation</u>: *Harper v. Southern Pine Electric Cooperative*, No. 20-60451 (5th Cir. filed February 8, 2021).[7]

<u>Background</u>

Plaintiffs in this case are members of the Southern Pine Electric Cooperative ("Southern Pine"), an electric cooperative in Mississippi. Plaintiffs claim that Southern Pine is required to distribute to them $112.5 million in "excess revenues" under Mississippi's Electric Power Association Law, which requires cooperatives like Southern Pine to distribute to their members all "revenues and receipts not needed" for "operating and maintenance . . . [including] the payment of such principal and interest . . . and reserves." Miss. Code Ann. § 77-5-235(5). Plaintiffs further contend that Southern Pine violated the previously enacted version of § 77-5-235(5), Section 20 of the 1936 Electric Power Association Act, because its accumulated income, in the amount of $248 million, "far exceeds what is reasonably necessary to maintain reasonable working reserves."

<u>Trial Court Proceedings</u>

Plaintiff sued in state court, but Southern Pine asserted federal jurisdiction because it met the requirements for federal officer removal under 28 U.S.C. § 1442(a)(1), the federal officer removal statute. Even though the trial court granted Plaintiffs motion, the 5th Circuit Court of Appeals reversed the trial court decision, holding that the federal district court had jurisdiction.

[7] *Harper v. Southern Pine Electric Cooperative*, No. 20-60451 (5th Cir. filed February 8,2021). Opinion available at http://www.ca5.uscourts.gov/opinions/pub/20/20-60451-CV0.pdf.

The district court then granted Southern Pine's motion to dismiss the Plaintiff's claim for failure to state a claim. Plaintiffs appealed the district court's ruling to the 5th Circuit Court of Appeals.

Appellate Court Proceedings

To answer the question of whether Plaintiffs have stated a claim upon which relief can be granted, the 5th Circuit looked at the statute's plain language. § 77-5-235(5) permits the cooperative's board to determine, and "from time to time prescribe," the revenues to be held as "reserves". Only after doing so, must the board distribute the leftovers. In other words, Southern Pine need not distribute leftover revenues before the board has determined the amount that is in excess. Because no other statute requires Southern Pine to distribute excess revenues before determining the amount that is in excess, Plaintiff's failed to state a claim for relief. The 5th Circuit affirmed the district court's decision in favor of Southern Pine.

III. Substantive Legal Issue: Governance Issues Presented During COVID-19

For the last few years, the Subcommittee has addressed a substantive legal issue of interest to LTA members in addition to the Report's customary review of relevant cases. This year our discussion will focus on the governance issues facing cooperatives due to the COVID-19 pandemic. This section will address the challenges and opportunities for conducting virtual meetings and holding elections, as well as reference the strategies cooperatives across multiple states have taken to adapt to the public health emergency.

A. Virtual meetings

The sudden disruption caused by the COVID-19 pandemic forced cooperatives across the country to adapt their practices to comply with public health guidelines. With members unable to meet in person, cooperatives, aided by state governments, created alternate processes for holding required annual and board meetings. Moving forward, cooperatives should consider updating their bylaws to account for a future pandemic, national emergency, or other *force majeure* event.

a. State law and Executive Orders

The COVID-19 pandemic presented immediate issues for cooperatives whose state laws require in-person meetings. In Minnesota, for example, state law requires cooperatives to meet "at the principal place of business . . . or at another conveniently located place as determined by the bylaws or the board." Minn. Stat. § 308A.611(2). In Minnesota, and across many states, the statutes presuppose the term "place" to mean a physical location. In New York, the statute expressly requires annual shareholder meetings be "held at a physical location." NY Bus Corp L § 602. The immediate need to social distance forced cooperatives to update their bylaws to allow for virtual meetings, especially in instances where the state did not waive in-person meeting requirements, like Wisconsin.

To address these issues, governors across the United States signed multiple executive orders providing cooperatives with flexibility to meet virtually and provide electronic notice of meetings. In Minnesota, Governor Walz signed Executive Order 20-86, temporarily suspended state law that required annual meetings to be held in person. The Order allowed cooperatives and cooperative associations flexibility to waive in-person meeting requirements, vote remotely for director elections, and forgo annual regular member meetings if a virtual meeting was not feasible.[8] In Louisiana, Governor Edwards temporarily suspended the statute that required shareholder meetings to be noticed and held at a physical location.[9] In New York, Governor Cuomo authorized required cooperative annual meetings to be conducted virtually.[10] Currently, legislation to make this change permanent is pending in the New York legislature. These changes have allowed cooperatives to continue to conduct member meetings and conduct annual director elections.

Below is a list of executive orders passed in 2020 which allowed cooperatives, and corporations more broadly, to meet virtually.[11] It is important to note that this list is neither exhaustive nor current, and in most cases these Orders have expired and will likely not be available to cooperatives in 2021. Please refer to your state government's website for guidance.

Executive Orders allowing for virtual meetings	
Alaska	COVID-19 Outbreak Health Order No. 3
Arkansas	Executive Order 20-15
Louisiana	Proclamation 37 JBE 2020
Minnesota	Executive Order 20-86
Mississippi	Executive Order 1538
New Mexico	Executive Order 2020-81
New York	Executive Order 202.8
North Carolina	Executive Order 212
North Dakota	Executive Order 2020-37
Rhode Island	Executive Order 20-22

b. Recommendation: Cooperatives should consider amending the bylaws and other governance provisions to allow for virtual meetings to the extent permitted by

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[8] Minn. Exec. Order No. 20-86 (August 26, 2020), https://mn.gov/governor/assets/4a.%20EO%2020-86%20Coop%20Remote_Voting_tcm1055-444957.pdf

[9] La. Proclamation No. 37 JBE 2020, Section 5 (March 26, 2020), https://gov.louisiana.gov/assets/Proclamations/2020/modified/37-JBE-2020-Public-Health-Emergency-COVID-19.pdf

[10] N.Y. Exec. Order No. 202.8 (March 7, 2020), https://www.governor.ny.gov/news/no-2028-continuing-temporary-suspension-and-modification-laws-relating-disaster-emergency

[11] Information compiled from The Council of State Government, COVID-19 Resources for State Leaders, https://web.csg.org/covid19/executive-orders/

applicable law.

Cooperatives should consider amending the bylaws to allow for virtual meetings in the event of a future pandemic, national emergency, or *force majeure*. Platforms like Zoom, Facebook, and YouTube have made virtual meetings commonplace. In 2021, the Paulding Putnam Electric Cooperative, based out of Northwest Louisiana, attracted more than 1,000 viewers to its annual meeting streamed virtually over Facebook and YouTube.[12]

Before amending the bylaws to allow for virtual meetings, cooperatives should consider what is permitted by applicable state law as well as the following:

<u>How often will the cooperative meet?</u>

Cooperatives should consider the frequency of virtual meetings it wishes to hold. Since every cooperative is unique in size and geography, there is no one-size-fits-all formula. Some cooperatives may wish to hold every meeting virtually if its members are spread out across the country. Others may wish only to announce election results virtually. Yet others may prefer a hybrid model in which it holds district-level meetings in person and its annual meetings virtually. In the end, the cooperative's bylaw committee should determine the specific needs and goals of the cooperative and use virtual meeting platforms as tools to address those needs and further those goals.

<u>What type of business can the cooperative conduct virtually?</u>

Cooperatives should identify the type of business that can be conducted virtually. For example, may the cooperative fill emergency board vacancies in a virtual meeting? Should the cooperative limit the content of a virtual meeting? The Dakota Valley Electric Cooperative, for example, modified its 2020 annual meeting to include only the election of directors by mail-in ballot, as permitted by its bylaws. Similarly, the Washington Electric Co-Op, based out of Vermont, held a "limited business" virtual meeting where it only announced its board's mail-in election results. Accordingly, the type of business the bylaws allow the cooperative members to transact virtually determines how it responds to future emergencies.

<u>What quorum rules apply to virtual meetings?</u>

The cooperative should also consider how quorum applies to virtual meetings. Some cooperatives updated the bylaws to apply in-person quorum requirements to virtual meetings. Others amended the quorum requirements to reflect the type of business conducted at the virtual meeting. For example, the Claiborne Electric Co-Op added language making clear that a quorum applies only to its membership meetings, not to director election meetings. Again, the cooperative's quorum rules as applied to virtual meetings may determine how a cooperative

[12] https://ppec.coop/85-Virtual-Annual-Meeting

responds to future emergencies.

B. Remote elections

Over 2020 and 2021, many cooperatives updated their election procedures to allow for remote voting processes. Cooperatives used various methods to engage members in elections that did not require an in-person vote. Some cooperatives established online voting procedures while others amended the bylaws to allow for ballots to be mailed or dropped off at a designated drop box. Other cooperatives allowed its members to vote during virtual annual meetings. Each of these options raised new opportunities and considerations for member-engagement.

a. State law and Executive Orders

State law gives cooperatives wide discretion over its elections. In Minnesota, state law allows cooperative members to elect its directors "in the manner provided . . . in the bylaws." Minn. Rev. Stat. § 308A.311(1). Further, a "member may not vote by mail or electronic means for a director unless . . . authorized . . . by the articles or bylaws." Minn. Rev. Stat. § 308A.311 (4)(a). Although giving cooperatives wide discretion over its own affairs is a positive thing, the statute fails to lay out alternate processes in the event that the methods outlined in the bylaws are not feasible. For example, what happens when a cooperative that only allows for in-person voting cannot meet in person to vote? Like with virtual meetings, governors exempted many of these requirements in their executive orders. In Minnesota, Executive Order 20-86 allowed cooperatives to conduct mail-in elections even if the cooperative's bylaws prevented them.[13] In the event of a future pandemic, national emergency, or other *force majeure* event, cooperatives should consider amending the bylaws to allow for alternate election procedures.

b. Recommendation: Cooperatives should consider amending the bylaws and other governance provisions to allow for remote elections if permitted by applicable law.

Cooperatives interested in holding mail-in, drop-off, or online ballot elections must ensure that the processes they establish meet the technical requirements of state law. In Minnesota, a member may vote by mail if approved by the board and may vote by electronic means if the cooperative is able to *authenticate* that it is the cooperative member who is casting the vote." Minn. Stat. § 308A.311 (4)(d) (emphasis added). To authenticate that it is the member casting the vote, cooperatives have come up with various solutions. The DVEC, for example, used mail ballots sent to members with active accounts.[14] Paulding Putnam, on the other hand, turned to an

[13] Sarah E. Tucher, *Executive Order Assists Minnesota Cooperatives During the COVID-19 Peacetime Emergency* (Sep. 1, 2020), https://www.fredlaw.com/news__media/executive-order-assists-minnesota-cooperatives-during-the-covid-19-peacetime-emergency/

[14] Dakota Valley Electric Co-op election voting will be by mail only, https://www.dakotavalley.com/sites/dakotavalley/files/DVEC%20Co-op%20Election%20Voting%20Will%20Be%20By%20Mail%20Only.pdf

online electronic voting platform to authenticate its voters.

Before amending the bylaws to allow for remote elections, cooperatives should consider the following:

<u>How will the cooperative streamline and authenticate its elections?</u>

Cooperatives interested in streamlining its elections—whether by mail, drop-off, or online—may wish to partner with an online voting platform. Some cooperatives, like Paulding Putnam, turned to Survey & Ballot Systems ("SBS"). SBS is a full-service election management system that provides online, mobile, and mail election management for cooperatives, unions, hospitals, and HOAs to name a few.[15] SBS is transparent and secure, allowing for real-time election results through its DirectVoteLive program. Through SBS, Paulding Putnam Electric Cooperative engaged more than 2,100 members (19% of its total membership) in its 2021 elections, the largest number of votes cast in the cooperative's history.[16] With members across the nation increasingly requesting to vote from anywhere, SBS has proven that cooperatives can continue to engage, and even increase the engagement of its members, all while saving on postage, printing, mailing, and staff costs.

On the other hand, partnering with an election management system may be too costly or overly complicated for smaller cooperatives. In this case, cooperative may wish to manage their own elections. Cooperatives that decide to manage their own elections should consider the method that will most engage its members. If the cooperative decides to hold a mail-in or drop-off elections, it should consider the location of the drop boxes as well as who will be in attendance to count the ballots. For example, DVEC stated that "the only people physically in attendance [to count ballots] will be the tellers . . . , the cooperative attorney and limited office staff."

<u>When will the cooperative hold elections?</u>

Cooperatives should also consider when and how often it holds its elections. The Claiborne Electric Co-Op, for example, voted to move director election meetings from the district meeting to the annual meeting, allowing for more members to participate. Further, while some cooperatives held "live" elections at the annual meeting, others used the annual meeting to announce mail-in election results, which must have been returned at least 1 day prior to the annual meeting. Since each method serves a different purpose, cooperatives should identify how the timing of the election furthers the goals of the organization.

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[15] Survey & Ballot Systems, https://www.surveyandballotsystems.com/

[16] Paulding Putnam Electric Cooperative, *News Release to the Media* (March 22, 2021), https://ppec.coop/85-Virtual-Annual-Meeting ("More than 2,100 members (19%) voted in PPEC's 2021 elections – the largest number of votes ever cast in the co-op's election history.")

C. The recent pandemic has resulted in many cooperatives recognizing the need to review and modernize their Bylaws. How does your cooperative know it is time to update the bylaws?

<u>Does your cooperative have a process of bylaw review?</u>

It is crucial for cooperatives to establish and maintain a process for review of its bylaws. Some cooperatives task its bylaw committee with the review process, while others use their full boards. In either case, the cooperative should come up with a periodic review process. This will ensure that the cooperative stays attuned to its member's needs as well as changing circumstances.

<u>Have your bylaws been updated since the start of the COVID-19 pandemic?</u>

A lot has changed since the start of the pandemic. Many members, for health reasons or out of convenience, require flexibility in how they attend required meetings or vote in Board elections. These shifts require cooperatives to update the bylaws in line with its members' needs and create procedures to facilitate future changes. With new technologies allowing for greater, safer, and more secure connectivity, the time is now to update your organization's bylaws.

<u>How does state law interact with your cooperative's bylaws?</u>

Often, state statutes may override an organization's bylaws. In other cases, such as with the COVID-19 Executive Orders noted earlier, state orders may allow for more flexibility than the cooperative knows about. Cooperatives seeking to update the bylaws should consult an attorney who understands these issues.

D. Conclusion

The COVID-19 pandemic presented immediate governance issues for cooperatives. Before the pandemic, many state laws required in-person notice and meetings. When COVID-19 made in-person gatherings life-threatening, governors from across the country issued executive orders providing cooperatives flexibility to meet state requirements while complying with CDC guidelines. In most states, the executive orders waived in-person meetings and allowed cooperatives to hold remote elections. This flexibility enabled cooperatives to continue to transact business as necessary.

This report has identified some of the governance issues cooperatives grappled with during the pandemic. In many cases, virtual meetings and remote elections increased member engagement and participation. However, there is no one-size-fits-all formula. Cooperatives should consider their unique needs and goals before amending the bylaws. In the end, however, cooperatives should establish processes that enable the organization to operative during a future pandemic, national emergency, or other *force majeure* event.

AMT, Tax Accounting and State and Local Tax Issues Affecting Agricultural Cooperatives

Alternative Minimum Tax

Federal

C corporations were subject to the alternative minimum tax (AMT) to the extent their tentative minimum tax exceeded their regular tax. There was an exemption from the AMT for "small" C corporations. The Tax Cuts and Jobs Act repealed the corporate AMT for all C corporations for tax years beginning after December 31, 2017.

Although AMT has been repealed for post-2017 tax years, the new five-year NOL carryback period provided for in the CARES Act means losses could be carried back to years in which AMT applies. For purposes of determining the C corporation's alternative minimum taxable income in the pre-2018 year, the amount of alternative tax net operating loss arising in the post-2017 year is zero. Therefore, NOLs carried back to pre-2018 tax years may implicate the corporate AMT, requiring calculations of modified taxable income and adjustments to the NOL for AMT purposes, potentially leading to significantly reduced net benefits from the carryback.

States

As of September 2021, there are six states that currently collect corporate AMTs: Alaska, California, Connecticut, Kentucky, Minnesota, and New York. Alaska, California, Kentucky, and Minnesota have corporate AMTs that do not conform to the federal provision and continue to collect them. Connecticut and New York are unique in that their capital stock taxes function as AMTs, with corporations remitting corporate tax on the greater of their liability under a net income or capital stock base.

Minnesota specifically allows an exemption from AMT for cooperatives. Per Minn. Stat. §290.0921 Subd. 3a the following entities are not subject to alternative minimum tax and are not required to complete Form AMTI:

- cooperatives taxable under subchapter T of the IRC or organized under chapter 308 or a similar law of another state
- regulated investment companies (RICs)
- real estate investment trusts (REITs)
- real estate mortgage investment conduits (REMICs)
- small corporations exempt from federal AMT under IRC section 55(e) as amended through December 16, 2016.

If you do not fit the categories above and your Minnesota net income (from Form M4I, line 7), combined with your adjustments and tax preferences (including adjusted current earnings), exceeds $40,000 or your allowable exemption amount, you must file Schedule AMTI.

Section 199A(g) and the States

The TCJA repealed Section 199 and essentially replaced it with Section 199A(g) for cooperatives, that was at least legislative intent. The state tax treatment of Section 199 varied across states, from some states allowing it while other states decoupling from it. With the repeal of Section 199 for all entities at the federal level and the fact that many states had already decoupled from it there was no longer a concern for this deduction at the state level. With the implementation of Section 199A many states saw this as a pass through and individual issue and not a corporate matter as it was not available for corporations. However, many states appear to have overlooked or not yet realized there is a deduction for specified agricultural and horticultural cooperatives under Section 199A(g).

For most states, many cooperatives to date have relied on the IRC conformity date for the particular state to determine if the cooperative can take the 199A(g) deduction for state tax purposes as most states have not specifically addressed the deduction. Some states are aware of the cooperative deduction at the federal level and have recently attempted to decouple from it however it did not make it into the final bill that was signed. Minnesota (see below) and Illinois are examples of such an attempt in the last few months. Below is a sampling of some Midwest states and how Section 199A(g) is being treated for the particular state given IRC conformity, the passage of the TCJA in December 2017, and no action by the state to decouple from it to date.

Illinois: Rolling conformity, current IRC = 199A(g) deductible

Indiana: 3.31.21 conformity. Before January 1, 2021, the IRC conformity date was January 1, 2020. = 199A(g) deductible

Iowa: Rolling conformity, current IRC = 199A(g) deductible

> *Note: The Iowa Department of Revenue did address the 199A(g) deduction and its applicability (see New DPAD 199A(g) Deduction for Specified Agricultural and Horticultural Cooperatives | Iowa Department Of Revenue)*

Michigan: 1.1.18 conformity = 199A(g) deductible

Minnesota: 12.31.18 conformity = 199A(g) deductible

> *Department of Revenue Analysis of H.F. 991 (Marquart) / S.F. 961 (Nelson) –* ***This is what was proposed and analyzed, it did not pass.***
>
> *Addition for Cooperatives (Article 1, Sections 3, 8, 1, 20, 21, 24)*
>
> *Effective beginning with tax year 2021*
>
> *Public Law 115-97, known as the Tax Cuts and Jobs Act (TCJA), created a deduction for qualified business income (QBI, including qualified dividends received from an agricultural or horticultural cooperative. As a result, farmers had a tax incentive to sell their crops to a cooperative rather than a private company, to qualify for the QBI deduction. This provision was informally known as the "grain glitch".*

The Consolidated Appropriations Act of 2018 (Public Law 115-141, enacted March 23, 2018, fixed the grain glitch, but allowed specified cooperatives a deduction generally equal to 9% of qualified domestic activities income. This deduction was in place of the domestic production activities deduction, which was repealed by the TCJA.

Minnesota had never conformed to the domestic production activities deduction, so its repeal had no effect on Minnesota tax liability. However, when Minnesota conformed to the TCJA and the Consolidated Appropriations Act, it allowed the domestic production activities deduction for cooperatives under Section 199A. This was a new deduction beyond what had been allowed before the TCJA, giving an additional tax benefit for specified cooperatives.

The bill would create an addition to income for cooperatives that claim a federal deduction under Section 199A. The effect of the bill is to restore the definition of tax able income for cooperatives to what it was prior to the TCJA.

- *The fiscal impact of the addition is unknown.*
- *About 340 cooperatives filed returns in tax year 2018 with total taxable income of about $30M. Over the past three years, total federal taxable income of cooperatives has averaged about $106M per year. The amount of Section 199A deductions by cooperatives is unknown.*
- *The bill would increase the taxable income of cooperatives, raising revenue by an unknown amount beginning in fiscal year 2022.*

Wisconsin: 12.31.20 conformity = 199A(g) deductible

Paycheck Protection Program (PPP) Loan Forgiveness as Taxable-CARES Act and CAA, 2021

The CARES Act and CAA, 2021 provide that Paycheck Protection Program (PPP) loan forgiveness income is excluded from gross income for purposes of the Internal Revenue Code (unlike most other income from the cancellation of indebtedness), but do not actually amend provisions in the Internal Revenue Code itself. Some states conform to this exclusion from gross income for all PPP loans and do not differentiate between PPP loans made available under the CARES Act or under the CAA, 2021. Other states decouple from the federal treatment entirely, treating PPP loan forgiveness income as taxable income. States that conform to the CARES Act but do not currently conform to the CAA, 2021 would conform to this treatment only with respect to PPP loans issued under the terms of the CARES Act. This chart shows whether states treat PPP loan forgiveness income as included in, or excluded from, income for corporate income tax purposes.

State	PPP Loan Forgiveness Income	Authority	Editorial Reference
AK	Excluded. Because Alaska conforms to the IRC as updated by the CARES Act and CAA 2021, Alaska does not treat PPP loan forgiveness as taxable income.	Alaska Stat. § 43.20.021(a)	¶11,044; ¶ 3001AK:1000
AL	Excluded. Alabama explicitly conforms to the federal gross income exclusion for Paycheck Protection Program (PPP) loan forgiveness income.	L. 2021 1 § 3 ; "Guidance Related to Governor Kay Ivey's 21st Supplemental Emergency Proclamation," Ala. Dept. Rev., issued 12/18/2020, updated 01/06/2021.	¶11,044; ¶ 3001AL:1000
AR	Excluded. Update: 04/04/2021 Effective for tax years beginning on or after January 1, 2019, Arkansas explicitly provides an exclusion from gross income for PPP loan amounts forgiven under the CARES Act.	Ark. Code Ann. § 26-51-404(b)(31)	¶11,044; ¶ 3001AR:1000

AZ	Excluded. Arizona conforms to the IRC as of a specified date (see ¶10,720), For the purpose of computing income tax for tax years beginning from and after December 31, 2020, Arizona conforms to the Internal Revenue Code of 1986, as amended, in effect on March 11, 2021, including those provisions that became effective during 2020 with the specific adoption of all retroactive effective dates. Therefore, Arizona conforms to the federal exclusion of PPP loan forgiveness from taxable income.	N/A	¶11,044
CA	Excluded. Update: 05/10/2021 California provides an exclusion from gross income for PPP loan amounts forgiven pursuant to the CARES Act and the CAA, 2021. California also provides an exclusion from gross income for Economic Injury Disaster Loan (EIDL) advance grant amounts issued pursuant to the CARES Act and the CAA, 2021.	Cal. Rev. & Tax. Cd. § 24308.6	¶11,044; ¶ 3001CA:1000
CO	Excluded. Update: 05/03/2021 Colorado generally conforms to the federal gross income exclusion for PPP loan forgiveness income. However, Colorado regulations provide that this conformity applies only	Colo. Rev. Stat. § 39-22-304(1) ; Colo. Rev. Stat. § 39-22-103(5.3) ; Colo. Code Regs. § 39-22-103(5.3) ; Email from Colorado Department of Revenue to Checkpoint, 02/19/2021; Website Post: CARES Act Payment Protection Program (PPP) Loans, Colo. Dept. Rev.,	¶11,044; ¶ 3001CO:1000

	on a prospective basis, so amendments to the IRC enacted after the last day of a tax year do not impact Colorado tax liability for that tax year. Guidance from the Colorado Department of Revenue indicates that the Colorado tax liability of taxpayers with tax years ending prior to December 27, 2020, will not be impacted by the provisions of the CAA. For those taxpayers, Colorado will not conform to the provisions of the CAA, so first-draw or second-draw PPP loans disbursed in 2021 may not be excluded from Colorado taxable income.	03/11/2021	
CT	Excluded. Because Connecticut conforms to the IRC as updated by the CARES Act, Connecticut does not treat Paycheck Protection Program (PPP) loan forgiveness as taxable income.	OCG-10, Office of the Commissioner Guidance regarding the CARES Act, revised 02/25/2021	¶11,044; ¶ 3001CT:1000
DC	Excluded. District law provides a gross income exclusion for covered Paycheck Protection Program (PPP) loan amounts that is tied to the CARES Act. Currently, no statutory exclusion specifically exists for PPP loans awarded and forgiven under CAA §276(b), which applies to new PPP loans disbursed through the March 31, 2021 covered period. The District of Columbia may conform, however, because of	D.C. Code Ann. § 47-1801.04(28) ; D.C. Code Ann. § 47-1803.02(a) ; D.C. Code Ann. § 47-1803.02(a)(2)(GG) ; Dist. of Columbia Revenue Notice No. 2021-04, , 04/14/2021	¶11,044; ¶ 3001DC:1000

	its "rolling conformity" with the IRC and the starting point for calculating District taxable income is federal gross income.		
DE	Excluded. Because Delaware conforms to the current IRC as updated by the CARES Act, the Consolidated Appropriations Act, 2021, and the PPP Extension Act of 2021, Delaware does not treat PPP loan forgiveness as taxable income.	Del. Code Ann. 30 § 1903	¶11,044; ¶ 3001DE:1000
FL	Excluded. Update: 07/06/2021 Because Florida conforms to the IRC as updated by the CARES Act and CAA 2021, Florida does not treat PPP loan forgiveness as taxable income.	Fla. Stat. § 220.03(1)(n)	¶11,044; ¶ 3001FL:1000
GA	Excluded. Because Georgia's conformity date includes changes made by the CARES Act, Georgia does not treat PPP loan forgiveness as taxable income.	Ga. Code Ann. § 48-1-2(14) ; Income Tax Federal Changes, Ga. Dept. of Rev., updated 04/05/2021	¶11,044; ¶ 3001GA:1000
HI	Excluded. Update: 07/02/2021 Effective for tax years beginning after December 31, 2020, Hawaii conforms to the IRC as updated by the CARES Act and the CAA, 2021. Accordingly, PPP loan forgiveness income from PPP loans authorized under those federal acts is not treated as	Haw. Rev. Stat. § 235-2.3(a) ; Hawaii Tax Information Release No. 2020-06, , 10/20/2020	¶11,044; ¶ 3001HI:1000

	taxable income.		
IA	Excluded. Because Iowa conforms to the IRC as updated by the CARES Act, Iowa does not treat PPP loan forgiveness as taxable income.	Iowa Code § 422.3(5) ; Nonconformity to Retroactive Provisions of CARES Act of 2020, IDR, updated 07/14/2020; COVID-19 Income Tax FAQs, Iowa Dept. Rev., updated 5/15/2020	¶11,044; ¶ 3001IA:1000
ID	Excluded for tax years beginning on or after January 1, 2021. Effective for tax years beginning on or after January 1, 2021, Idaho conforms to the IRC as amended and in effect on January 1, 2021 (including updates by the CARES Act and CAA). However, for tax years that began during 2020, Idaho's conformity date was January 1, 2020 and did not include amendments made by the CARES Act or CAA that treat PPP loan forgiveness income as nontaxable income.	Idaho Code § 63-3004	¶11,044; ¶ 3001ID:1000
IL	Excluded. Illinois conforms to the IRC as updated by the CARES Act; therefore, Illinois does not treat PPP loan forgiveness as taxable income.	ILCS Chapter 35 § 5/1501(a)(11)	¶11,044; ¶ 3001IL:1000
IN	Excluded. Indiana conforms to IRC as of March 31, 2021, and follows certain federal tax treatment for various exemptions, deductions, and other rules incorporated into federal law outside the	Ind. Code § 6-3-1-11 ; Indiana Information Bulletin No. IT119, , 05/01/2021; Paycheck Protection Program (PPP) Loans and Deductibility of Expenses Paid for with the PPP Proceeds, Indiana Dept. Rev., 02/01/2020	¶11,044; ¶ 3001IN:1000

	Internal Revenue Code as of March 31, 2021. Indiana follows the exclusion of Paycheck Protection Program loan forgiveness from adjusted gross income because the forgiveness provision is found in Title 15 of the United States Code.		
KS	Excluded. Because Kansas conforms to the IRC as updated by the CARES Act and the CAA, 2021, Kansas does not treat PPP loan forgiveness as taxable income.	Kan. Stat. Ann. § 79-32,109(a)(1)	¶11,044; ¶ 3001KS:1000
KY	Excluded. Loans forgiven under the CARES Act Paycheck Protection Program that are excluded from gross income for federal income tax purposes are also excluded for Kentucky income tax purposes, including PPP loans authorized under the CAA (i.e., first-draw PPP loans in 2021 and second-draw PPP loans).	Kentucky Covid-19 Tax Relief: Frequently Asked Questions, revised 02/01/2021; Ky. Rev. Stat. Ann. § 141.017(1)(c) ; Ky. Rev. Stat. Ann. § 141.039(1)(h) ; Ky. Rev. Stat. Ann. § 141.039(2)(c)	¶11,044; ¶ 3001KY:1000
LA	Excluded. Because Louisiana conforms to the IRC as updated by the CARES Act, PPP loan forgiveness is not subject to state income tax. Guidance from the Louisiana Department of Revenue also indicates that the state conforms to the federal gross income exclusion for PPP loan forgiveness income.	La. Rev. Stat. Ann. § 47:287.701 ; News Release, Louisiana Department of Revenue, 01/25/2021; News Release, Louisiana Department of Revenue, 02/11/2021	¶11,044; ¶ 3001LA:1000
MA	Excluded.	Mass. Gen. L. Chapter 63 § 1 ;	¶11,044; ¶ 3001MA:1000

	Because Massachusetts conforms to the IRC as updated by the CARES Act, Massachusetts does not treat PPP loan forgiveness as taxable income. An S corporation with gross receipts totaling $6 million or more is also subject to an entity-level excise. Forgiven PPP loan proceeds will be excluded from income for purposes of that calculation.	PPP and Coronavirus Relief Grant Funds FAQs, Mass. Dept. of Rev., 03/01/2021	
MD	Excluded. Because Maryland conforms to the IRC as updated by the federal CARES Act, Maryland does not treat PPP loan forgiveness as taxable income.	Md. Code Ann. Tax-Gen. § 10-108 ; News Release, Maryland Comptroller's Office, 01/21/2021; Maryland Tax Alert 04-07-21, Maryland Comptroller's Office, 04/07/2021	¶11,044; ¶ 3001MD:1000
ME	Excluded. Because Maine conforms to the IRC as updated by the CARES Act and the CAA, 2021, Maine excludes PPP loan forgiveness from taxable income.	Me. Rev. Stat. Ann. 36 § 111(1-A)	¶11,044; ¶ 3001ME:1000
MI	Excluded. Because Michigan conforms to the IRC as of a fixed date or, at the option of the taxpayer the Internal Revenue Code in effect for the tax year, forgiven PPP loans that are excluded from the computation of federal income tax are similarly excluded from the computation of the tax base under the CIT. In other words, the Michigan tax base for corporations using the IRC in	Mich. Comp. Laws Ann. § 206.603(3) ; Mich. Comp. Laws Ann. § 206.623(2) ; Mich. Comp. Laws Ann. § 208.1201(1) ; Mich. Comp. Laws Ann. § 208.1105(2) ; Notice: Treatment of Paycheck Protection Program (PPP) Loans Under the Michigan Income Tax Act, Mich. Dept. Treas., 04/19/2021	¶11,044; ¶ 3001MI:1000

	effect for the tax year fully conforms to the federal income tax treatment of PPP loans. This analysis differs in the rare cases where a taxpayer that elects to use the IRC in effect on January 1, 2018. The Consolidated Appropriations Act, 2021- enacted March 27, 2020- excluding forgiven PPP loans from gross income was neither within the IRC on January 1, 2018 nor given retroactive impact; therefore, a taxpayer electing to use this version of the IRC must include forgiven loan amounts in gross income.		
MN	Excluded. Update: 07/08/2021 Effective July 2, 2021, and effective retroactively for Minnesota tax purposes at the same time as the changes were effective for federal purposes, Minnesota conforms to the CARES Act, Minnesota may exclude PPP loan forgiveness from taxable income. Prior to 7/2/2021, Minnesota included PPP loan forgiveness as taxable income.	Minn. Stat. § 290.0111, Subd. 3	¶11,044; ¶ 3001MN:1000
MO	Excluded. Because Missouri conforms to the IRC as currently in effect, it conforms to the IRC as updated by the CARES Act and does not treat PPP loan forgiveness as taxable income.	Mo. Rev. Stat. § 143.091 ; Mo. Rev. Stat. § 143.431(1)	¶11,044; ¶ 3001MO:1000
MS	Excluded.	Miss. Code Ann. § 27-7-15(4)(ll) ;	¶11,044; ¶ 3001MS:1000

	Mississippi has no federal conformity statute and will apply current IRC to the extent that its state law incorporates them by reference. Mississippi has specifically exempted from gross income cancelled indebtedness and any amounts received as advances or grants under the CARES Act. However, Mississippi has not provided guidance with regard to the treatment of PPP loans under the CAA, 2021.	Miss. Code Ann. § 27-7-15(4)(mm)	
MT	Excluded. Montana conforms to the IRC as amended, and has specifically stated that PPP loan forgiveness under the CARES Act and the CAA, 2021 is excluded from gross income.	Mont. Code Ann. § 15-31-113 ; Montana DOR Release: Paycheck Protection Program (PPP) Tax and Deduction Clarifications, May 12, 2020; CARES Act, Mont. Dept. Rev., 08/13/2020; Paycheck Protection Program Debt Cancellation Not Taxable, Mont. Dept. Rev., 01/26/2021	¶11,044; ¶ 3001MT:1000
NC	Excluded under the CARES Act but included under CAA, 2021. Because North Carolina conforms to the IRC as updated by the CARES Act, North Carolina does not treat PPP loan forgiveness as taxable income. However, North Carolina has not yet conformed to the IRC as updated by CAA, 2021, and therefore, would treat PPP loans forgiven pursuant to provisions in the CAA as taxable income.	N.C. Gen. Stat. § 105-228.90(b)(7) ; N.C. Gen. Stat. § 105-130.2(15)	¶11,044; ¶ 3001NC:1000
ND	Excluded. Because North Dakota conforms to the IRC as updated by the	N.D. Cent. Code § 57-38-01(5) ; N.D. Cent. Code § 57-38-01(13)	¶11,044; ¶ 3001ND:1000

	CARES Act and the CAA, 2021, North Dakota does not treat PPP loan forgiveness as taxable income.		
NE	Excluded. Because Nebraska conforms to the IRC, as updated by the CARES Act and the CAA, Nebraska does not include PPP loan forgiveness income in taxable income.	Neb. Rev. Stat. § 77-2714 ; Effects of the Coronavirus Aid, Relief, and Economic Security Act on the State of Nebraska's Tax Revenue, Nebraska Dept. of Revenue, 05/27/2020; Business Income Taxes FAQs, Neb. Dept. of Revenue, 02/26/2021	¶11,044; ¶ 3001NE:1000
NH	Excluded. Effective June 10, 2021 and applicable to taxable years ending after March 3, 2020, corresponding with the date of the enactment of the federal Coronavirus Aid, Relief, and Economic Security Act, under the business profits tax the business income of a taxpayer received by reason of forgiveness of indebtedness issued or created under the federal Paycheck Protection Program (PPP) is excluded from gross business income.	N.H. Rev. Stat. Ann. § 77-A:3-c ; New Hampshire Technical Information Release No. 2021-003, , 06/21/2021	¶11,044; ¶ 3001NH:1000
NJ	Excluded. Because New Jersey conforms to current federal tax law, New Jersey does not treat PPP loan forgiveness as taxable income.	N.J. Rev. Stat. § 54:10A-4(k) ; NJ Office of the Governor, PPP Loans Will Be Tax Exempt and Expenses Will Be Tax Deductible, 02/09/2021.	¶11,044; ¶ 3001NJ:1000
NM	Excluded. Because New Mexico conforms to the IRC as updated by the CARES Act and the federal CAA,	NMSA 1978 § 7-2A-2(L) ; Bulletin B-100.37, 02/01/2021	¶11,044; ¶ 3001NM:1000

	2021, New Mexico does not treat PPP loan forgiveness as taxable income.		
NV	N/A	N/A	N/A
NY	Excluded. New York has advised that it "follows the federal treatment for both personal income and corporation taxes. If the forgiven loan is excluded from federal income, it is also excluded from New York income."	N.Y. Tax Law § 208(9)(b) ; New York State Tax Implications of the Federal CARES Act, N.Y. Dept. of Taxation and Finance, 01/13/2021	¶11,044; ¶ 3001NY:1000
OH	N/A	N/A	N/A
OK	Excluded. Because Oklahoma conforms to the IRC as updated by the CARES Act, Oklahoma does not treat PPP loan forgiveness as taxable income.	Okla. Stat. 68 § 2353(2) ; OTC Corporate Questions, Oklahoma Tax Commission, 03/17/2021	¶11,044; ¶ 3001OK:1000
OR	Excluded. Oregon conforms to the IRS as updated by the CARES Act and the CAA, 2021. Forgiven Paycheck Protection Program (PPP) loan debt is excluded from gross income and is not taxable if employers met the requirements for loan forgiveness.	Or. Rev. Stat. § 317.010(7) ; Oregon Department of Revenue, Frequently Asked Questions-Paycheck Protection Program	¶11,044; ¶ 3001OR:1000
PA	Excluded. Because Pennsylvania conforms to the IRC as updated by the CARES Act, Pennsylvania does not treat PPP loan forgiveness as taxable income.	Pa. Stat. Ann. 72 § 7401(3)(1)(a)	¶11,044; ¶ 3001PA:1000

RI	Excluded. Update: 12/10/21 Rhode Island: For tax years beginning on or after January 1, 2020, any PPP loan forgiveness amount that exceeds $250,000 is includable in gross income of businesses and individuals. For any PPP loan forgiven during the 2020 tax year, interest and penalties will be waived on the portion of each PPP loan that is taxable under the corporate income tax, the bank excise tax or the individual income tax, provided that the tax is paid in full on or before March 31, 2022. [R.I. Gen. Laws §44-30-12(b) .]	R.I. Gen. Laws § 44-11-11	¶11,044; ¶ 3001RI:1000
SC	Excluded. Update: 05/18/2021 Effective May 18, 2021, South Carolina does specifically adopt the CARES Act and CAA treatment of PPP loan forgiveness and excludes it from taxable income. To the extent loans under the PPP are forgiven and excluded from gross income for federal income tax purposes, those loans are excluded for South Carolina income tax purposes.	L. 2021 H4017 1(B) ; S.C. Code Ann. § 12-6-40(A)(1) ; L. 2019 147 § 2A ; South Carolina Information Letter No. 20-28, , 11/02/2020.	¶11,044; ¶ 3001SC:1000
SD	N/A	N/A	N/A

TN	Excluded. Because Tennessee conforms to current federal tax law, Tennessee does not treat PPP loan forgiveness as taxable income.	Tenn. Code Ann. § 67-4-2006(a)(1) ; Tennessee DOR-CARES Act FAQs, 07/29/2020.	¶11,044; ¶ 3001TN:1000
TX	Excluded. Update: 05/11/2021 Effective May 8, 2021, qualifying loan or grant proceeds under the CARES Act and CAA must be excluded from total revenue in calculating the Texas franchise tax.	Tex. Tax Code Ann. § 171.10131(b)(1) ; News Release, Texas Comptroller of Public Accounts, 05/12/2021	¶11,044; ¶ 3001TX:1000
UT	Included. Utah specifically excludes from the state income tax base income from loans forgiven in accordance with 15 U.S.C. § 636(a)(36), but only to the extent that deductions for expenditures paid with the loan proceeds are disallowed. For federal tax purposes, taxpayers exclude from income forgiven PPP loan income and are allowed a deduction for expenses paid with PPP loan proceeds. Likewise, a similar paycheck protection loan that is authorized by the federal government is not included in adjusted gross income if the loan is (1) provided in response to Covid-19; (2) forgiven if the borrower meets the expenditure requirements; and (3) exempt from federal income tax, to the	Utah Code Ann. § 59-7-101(22) ; Utah Code Ann. § 59-7-101(33)(c)(i) ; FAQs and Information about PPP Loans, Utah State Tax Comm'n, 03/22/2021	¶11,044; ¶ 3001UT:1000

	extent that a deduction for the expenditures paid with the loan is disallowed.		
VA	Included. Update: 04/05/2021 Virginia conforms to the IRC as of a specific date, and generally conforms to the CARES Act; however, Virginia limits the amount of Paycheck Protection Plan (PPP) loan forgiveness that is not taxable. Virginia will limit the federal deduction for expenses paid with proceeds of forgiven PPP loans to $100,000.	Va. Code Ann. § 58.1-301(B) ; Va. Code Ann. § 58.1-322.03(17) ; Virginia Tax Bulletin No. 21-4, , 03/15/2021	¶11,044; ¶ 3001VA:1000
VT	Excluded for the 2020 and 2021 tax year. Update: 06/08/2021 PPP loans forgiven in 2020 are not taxable in Vermont. Effective March 21, 2021, PPP loans forgiven in 2021 are also not taxable in Vermont for tax year 2021 state income taxes.	Vt. Stat. Ann. 32 § 5824 ; L. 2021 9 § 23c repealed by,L. 2021 73 § 25 ;Update: Covid-19 for Taxpayers, Tax Treatment of Forgiven PPP Loans in Vermont, Vt. Dept. of Taxes, 06/01/2021.	¶11,044; ¶ 3001VT:1000
WA	N/A	N/A	N/A
WI	Excluded. Wisconsin specifically adopts provisions included in Division A of the CARES Act and conforms to the IRC as updated by the federal CAA, 2021, with exceptions, including the provision that provides that an eligible recipient of a PPP loan is eligible for forgiveness of indebtedness on a covered loan.	Wis. Stat. § 71.22(4)(m)(1) ; Wis. Stat. § 71.22(4)(l)(3) ; Wisconsin Adopts Certain Provisions of Federal CARES Act, Wis. Dept. Rev., 04/20/2021	¶11,044; ¶ 3001WI:1000
WV	Excluded.	W. Va. Code § 11-24-3(a) ; W.	¶11,044; ¶ 3001WV:1000

	Because West Virginia conforms to the IRC as updated by the CARES Act and CAA, 2021, West Virginia excludes PPP loan forgiveness from taxable income.	Va. Code § 11-24-3(c)	
WY	N/A	N/A	N/A

Deduction for Expenses Paid with Forgiven Paycheck Protection Program (PPP) Loans-CAA, 2021

For federal income tax purposes, no deduction is ordinarily permitted for otherwise deductible expenses allocable to tax-exempt income. However, the Consolidated Appropriations Act, 2021 (CAA, 2021) clarified that otherwise deductible expenses paid with proceeds from a Paycheck Protection Program (PPP) loan remain deductible, despite the exclusion from gross income for PPP loan forgiveness income. Most states permit a deduction for expenses paid with proceeds of forgiven PPP loans. Significantly, states that treat forgiven PPP loans as taxable income (in contrast to the federal tax treatment), would generally continue to treat expenses paid with proceeds of those loans as deductible--the treatment of otherwise deductible expenses paid with taxable income was not modified by the CAA, 2021. This chart shows whether states provide a deduction for expenses paid with proceeds of forgiven PPP loans.

State	Deduction for Expenses Paid with Forgiven PPP Loans	Authority	Editorial Reference
AK	Yes. Because Alaska conforms to the IRC as updated by the federal CAA, 2021, Alaska allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Plan (PPP) loans.	Alaska Stat. § 43.20.021(a) ; Alaska Stat. § 43.20.300(a) ; Alaska Stat. § 43.20.340(5)	¶11,044; ¶ 3001AK:1000

AL	Yes. Alabama explicitly conforms to the federal allowance of deductions for otherwise deductible expenses funded with exempt loan proceeds. Because the calculation of Alabama corporate income tax and financial institution excise tax begins with a taxpayer's federal taxable income, the allowance of these deductions at the federal level will flow through to the taxpayer's calculation of Alabama taxable income, without the need for any adjustment on the taxpayer's Alabama return.	L. 2021 1 § 3 ; "Guidance Related to Governor Kay Ivey's 21st Supplemental Emergency Proclamation," Ala. Dept. Rev., issued 12/18/2020, updated 01/06/2021.	¶11,044; ¶ 3001AL:1000
AR	Yes. Update: 03/04/2021 Effective for tax years beginning on or after January 1, 2019, Arkansas explicitly conforms to the federal deduction for expenses paid with proceeds of forgiven PPP loans.	Ark. Code Ann. § 26-51-404(b)(31)(A)	¶11,044; ¶ 3001AR:1000
AZ	Yes. Because Arizona adopts the IRC as of a specified date (see ¶10,720), the state has adopted the changes enacted by the CAA, 2021.	N/A	¶11,044
CA	Yes. Update: 05/10/2021 California conforms to the provisions in the CAA, 2021, that allow a deduction for expenses	Cal. Rev. & Tax. Cd. § 24308.6	¶11,044; ¶ 3001CA:1000

	paid with the proceeds of forgiven PPP loans, except for taxpayers that either are publicly-traded companies or fail to meet the reduction in gross receipts requirements in the CAA, 2021 (generally, to meet those requirements, a taxpayer's gross receipts during a quarter in 2020 must be at least 25% less than its gross receipts for the same quarter in 2019).		
CO	Yes. Update: 05/03/2021 Colorado generally conforms to the federal allowance of deductions associated with expenses funded with forgiven PPP loan proceeds. However, Colorado regulations provide that this conformity applies only on a prospective basis, so amendments to the IRC enacted after the last day of a tax year do not impact Colorado tax liability for that tax year. Guidance from the Colorado Department of Revenue indicates that the state, therefore, does not conform to the provisions of the CAA for taxpayers with tax years ending prior to December 27, 2020. For those taxpayers, Colorado will not allow deductions for expenses related to exempt PPP loan forgiveness income. However, to the extent the associated PPP loan forgiveness income is taxable for Colorado purposes, otherwise deductible expenses would presumably	Colo. Rev. Stat. § 39-22-304(1) ; Colo. Rev. Stat. § 39-22-103(5.3) ; Colo. Code Regs. § 39-22-103(5.3) ; Email from Colorado Department of Revenue to Checkpoint, 02/19/2021; Website Post: CARES Act Payment Protection Program (PPP) Loans, Colo. Dept. Rev., 03/11/2021	¶11,044; ¶ 3001CO:1000

	remain deductible.		
CT	Yes. Because Connecticut conforms to the IRC as updated by the federal CAA, 2021, Connecticut allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	OCG-10, Office of the Commissioner Guidance regarding the CARES Act, revised 02/25/2021	¶11,044; ¶ 3001CT:1000
DC	Yes. Guidance from the D.C. Office of Tax and Revenue indicates that expenses funded with PPP loan proceeds are deductible to the same extent allowed under the Internal Revenue Code.	Dist. of Columbia Revenue Notice No. 2021-04, , 04/14/2021	¶11,044; ¶ 3001DC:1000
DE	Yes. Because Delaware conforms to the current IRC as updated by the federal CAA, 2021, Delaware allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	Del. Code Ann. 30 § 1903	¶11,044; ¶ 3001DE:1000
FL	Yes. Update: 07/06/2021 Because Florida conforms to the IRC as updated by the federal CAA, 2021, Florida allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Plan (PPP) loans.	Fla. Stat. § 220.03(1)(n)	¶11,044; ¶ 3001FL:1000
GA	Yes. Update: 02/25/2021	Ga. Code Ann. § 48-1-2(14) ; Income Tax Federal Changes, Ga. Dept. of Rev., updated	¶11,044; ¶ 3001GA:1000

	Georgia's federal conformity date is January 1, 2021 which includes the Consolidated Appropriations Act of 2021, so Georgia allows a deduction for expenses paid with proceeds of forgiven PPP loans.	04/05/2021	
HI	Yes. Update: 07/09/2021 Hawaii conforms to the IRC as amended as of December 31, 2020, and has adopted the allowance of deductions for expenses paid with forgiven PPP loans provided by the CAA, 2021. However, Hawaii Department of Taxation guidance provides that if the expenses paid by the taxpayer entitle it to the PPP loan forgiveness, and the taxpayer has a reasonable expectation of forgiveness, the deductions are not allowed on the Hawaii return.	Haw. Rev. Stat. § 235-2.3(a) ; Hawaii Tax Information Release No. 2021-05, , 07/02/2021	¶11,044; ¶ 3001HI:1000
IA	Yes. Because Iowa conforms to the IRC as updated by the federal CAA, 2021, Iowa adopts the changes made by the Consolidated Appropriations Act of 2021 and allows a deduction for expenses paid with proceeds of forgiven PPP loans.	Iowa Code § 422.3(5) ; Guidance on Federal Consolidated Appropriations Act of 2021, Iowa Dept. of Rev., 02/04/2021	¶11,044; ¶ 3001IA:1000
ID	Yes. Effective for tax years beginning on or after January 1, 2021, Idaho conforms to the IRC as	Idaho Code § 63-3004	¶11,044; ¶ 3001ID:1000

	amended and in effect on January 1, 2021 (including updates by the CARES Act and CAA). However, for tax years that began during 2020, Idaho's conformity date was January 1, 2020 and did not include amendments made by the CARES Act or CAA. To the extent PPP loan forgiveness may have been treated as taxable income for tax years beginning during 2020, otherwise deductible business expenses paid with proceeds from loans are deductible.		
IL	Yes. Illinois provides a deduction for business expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	How does a federal paycheck protection program loan affect my Illinois taxes, Ill. Dept. of Rev., 01/29/2021	¶11,044; ¶ 3001IL:1000
IN	Yes. Indiana conforms to IRC as of March 31, 2021, and follows certain federal tax treatment for various exemptions, deductions, and other rules incorporated into federal law outside the Internal Revenue Code as of March 31, 2021. Due to the addition of clarifying provisions outside the Internal Revenue Code in the COVID-related Tax Relief Act of 2020, Indiana permits the deductibility of related expenses, notwithstanding IRC § 265.	Ind. Code § 6-3-1-11 ; Indiana Information Bulletin No. IT119, , 05/01/2021; Paycheck Protection Program (PPP) Loans and Deductibility of Expenses Paid for with the PPP Proceeds, Indiana Dept. Rev., 02/01/2020	¶11,044; ¶ 3001IN:1000
KS	Yes.	Kan. Stat. Ann. § 79-32,109(a)(1)	¶11,044; ¶ 3001KS:1000

	Because Kansas conforms to the IRC as updated by the federal CAA, 2021, Kansas allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.		
KY	Yes. A deduction is allowed for expenses paid with forgiven Paycheck Protection Program (PPP) loans for taxable years ending on or after March 27, 2020, but before January 1, 2022.	Ky. Rev. Stat. Ann. § 141.017(1)(c) ; Ky. Rev. Stat. Ann. § 141.039(1)(h) ; Ky. Rev. Stat. Ann. § 141.039(2)(c)	¶11,044; ¶ 3001KY:1000
LA	Yes. Because Louisiana conforms to the IRC as currently in effect, it conforms to the IRC as updated by the federal CAA, 2021 and allows the federal deduction for expenses paid with proceeds of forgiven PPP loans.	La. Rev. Stat. Ann. § 47:287.69 ; La. Rev. Stat. Ann. § 47:287.701(A)	¶11,044; ¶ 3001LA:1000
MA	Yes. Because Massachusetts conforms to the IRC as updated by the federal CAA, 2021, Massachusetts adopts the changes made by the federal Consolidated Appropriations Act of 2021 and allows to the deduction of expenses paid with forgivable Paycheck Protection Program (PPP) loan proceeds. If expenses are deductible on the federal return, they are also deductible on the Massachusetts return.	Mass. Gen. L. Chapter 63 § 1 ; PPP and Coronavirus Relief Grant Funds FAQs, Mass. Dept. of Rev., 03/01/2021; Massachusetts Technical Information Release No. 21-6, , 04/30/2021	¶11,044; ¶ 3001MA:1000

MD	Yes. Because Maryland conforms to the IRC as updated by the federal CAA, 2021, Maryland allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	Md. Code Ann. Tax-Gen. § 10-108 ; Maryland Tax Alert 04-07-21, Maryland Comptroller's Office, 04/07/2021	¶11,044; ¶ 3001MD:1000
ME	Yes. Because Maine conforms to the IRC as updated by the federal CAA, 2021, Maine allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Plan (PPP) loans.	Me. Rev. Stat. Ann. 36 § 111(1-A)	¶11,044; ¶ 3001ME:1000
MI	Yes. Because Michigan conforms to the IRC as of a fixed date or, at the option of the taxpayer the Internal Revenue Code in effect for the tax year, business expenses paid for by PPP loans that are deductible at the federal level remain deductible in computing the Michigan tax base under the CIT.	Mich. Comp. Laws Ann. § 206.603(3) ; Mich. Comp. Laws Ann. § 206.623(2) ; Mich. Comp. Laws Ann. § 208.1201(1) ; Mich. Comp. Laws Ann. § 208.1105(2) ; Notice: Treatment of Paycheck Protection Program (PPP) Loans Under the Michigan Income Tax Act, Mich. Dept. Treas., 04/19/2021	¶11,044; ¶ 3001MI:1000
MN	Yes. Update: 07/08/2021 Effective July 2, 2021, and effective retroactively for Minnesota tax purposes at the same time as the changes were effective for federal purposes, Minnesota conform to the federal deduction for expenses paid with proceeds of forgiven	Minn. Stat. § 290.0111, Subd. 4	¶11,044; ¶ 3001MN:1000

	Paycheck Protection Program (PPP) loans. Prior to 7/2/2021, Minnesota did not allow a deduction for expenses paid with forgiven PPP loans.		
MO	Yes. Because Missouri conforms to the IRC as currently in effect, it conforms to the IRC as updated by the federal CAA, 2021 and allows the federal deduction for expenses paid with proceeds of forgiven PPP loans.	Mo. Rev. Stat. § 143.091 ; Mo. Rev. Stat. § 143.121 ; Mo. Rev. Stat. § 143.431(1)	¶11,044; ¶ 3001MO:1000
MS	Yes. Update: 04/19/2021 Mississippi has no federal conformity statute and will apply current IRC to the extent that its state law incorporates them by reference. Because Mississippi has specifically stated that payments for deductible expenses made with PPP funds authorized under the CARES Act, the CAA, 2021, the COVID-19 Economic Injury Disaster Loan Program, the 2020 COVID-19 Mississippi Business Assistance Act, and/or the Rental Assistance Grant Program are deductible if they are allowed as deductions for federal income tax purposes, Mississippi conforms to the changes made by the CAA, 2021 with regard to the deduction for expenses paid with proceeds of forgiven PPP loans. However, Mississippi does not allow a deduction for	Miss. Code Ann. § 27-7-109 ; Miss. Code Ann. § 57-121-7(4)(d)	¶11,044; ¶ 3001MS:1000

	otherwise deductible payments paid with funds received under the PPP established by the CARES Act, but only to the extent those payments are not allowed as deductions for federal income tax purposes. To the extent such payments are allowed as deductions for federal income tax purposes, those expenses are deemed to have been incurred in connection with earning and distributing taxable income, notwithstanding that such payments resulted in forgiveness of loans received.		
MT	No. Although Montana conforms to the IRC as amended and Montana generally adopts the changes made by the federal Consolidated Appropriations Act, 2021, Montana has specifically stated that because the CAA, 2021 allows taxpayers to deduct expenses paid for with funds received from PPP loans, those expenses are included in the calculation of Montana adjusted gross income.	Mont. Code Ann. § 15-31-113 ; Paycheck Protection Program Debt Cancellation Not Taxable, Mont. Dept. Rev., 01/26/2021	¶11,044; ¶ 3001MT:1000
NC	No. North Carolina requires an addback of expenses deducted on the federal return if: payment of the expenses results in PPP loan forgiveness; and the taxpayers excluded from gross income the amount of the	N.C. Gen. Stat. § 105-130.5(a)(32)	¶11,044; ¶ 3001NC:1000

	forgiven PPP loan.		
ND	Yes. Because North Dakota conforms to the IRC as updated by the federal CAA, 2021, North Dakota allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	N.D. Cent. Code § 57-38-01(5) ; N.D. Cent. Code § 57-38-01(13)	¶11,044; ¶ 3001ND:1000
NE	Yes. Nebraska permits a deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	Neb. Rev. Stat. § 77-2714 ; Business Income Taxes FAQs, Neb. Dept. of Revenue, 02/26/2021	¶11,044; ¶ 3001NE:1000
NH	Yes. Taxpayers are permitted a deduction for the expenses of operating a business, even if paid for with federal-level relief in accordance with the applicable version of the IRC and BPT statute.	New Hampshire Technical Information Release No. 2021-001, , 01/20/2021	¶11,044; ¶ 3001NH:1000
NJ	Yes. Because New Jersey conforms to current federal tax law, New Jersey allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans. Furthermore, New Jersey has enacted legislation to prevent taxpayers from being denied a deduction for expenses paid for forgiven PPP loans from the CARES Act or any subsequent expansion of federal	N.J. Rev. Stat. § 54:10A-4(k) ; NJ Office of the Governor, PPP Loans Will Be Tax Exempt and Expenses Will Be Tax Deductible, 02/09/2021; L. 2021 Chapter 90 § 2	¶11,044; ¶ 3001NJ:1000

	PPP loans.		
NM	Yes. Because New Mexico conforms to the IRC as updated (¶10,720) by the federal CAA, 2021, New Mexico allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	Bulletin B-100.37, 02/01/2021	¶11,044; ¶ 3001NM:1000
NV	N/A	N/A	N/A
NY	Yes. New York has advised that any expenses associated with PPP loans that are deducted federally are automatically deducted from New York income.	N.Y. Tax Law § 208(9)(b) ; New York State Tax Implications of the Federal CARES Act, N.Y. Dept. of Taxation and Finance, 01/13/2021	¶11,044; ¶ 3001NY:1000
OH	N/A	N/A	N/A
OK	Yes. Because Oklahoma conforms to the IRC as updated by the federal CAA, 2021, Oklahoma allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	Okla. Stat. 68 § 2353(2) ; OTC Corporate Questions, Oklahoma Tax Commission, 03/17/2021	¶11,044; ¶ 3001OK:1000
OR	Yes. Because Oregon conforms to the IRC as updated by the federal CAA, 2021, Oregon adopts the changes made by the Consolidated Appropriations Act of 2021. Oregon provides a deduction for expenses paid	Or. Rev. Stat. § 317.010(7) ; Oregon Department of Revenue, Frequently Asked Questions-Paycheck Protection Program	¶11,044; ¶ 3001OR:1000

	with proceeds of forgiven Paycheck Protection Program (PPP) loans.		
PA	Yes. Because Pennsylvania conforms to the IRC as updated by the federal CAA, 2021, Pennsylvania allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	Pa. Stat. Ann. 72 § 7401(3)(1)(a)	¶11,044; ¶ 3001PA:1000
RI	Yes. Because Rhode Island conforms to the IRC as updated by the federal CAA, 2021, Rhode Island allows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	R.I. Gen. Laws § 44-11-11	¶11,044; ¶ 3001RI:1000
SC	Yes. Update: 05/18/2021 Effective May 18,2021, South Carolina follows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans under the federal CARES Act and CCA.	L. 2021 H4017 1(B) ; S.C. Code Ann. § 12-6-40(A)(1) ; South Carolina Information Letter No. 20-28, , 11/02/2020; L. 2019 147 § 2A ; .	¶11,044; ¶ 3001SC:1000
SD	N/A	N/A	N/A
TN	Yes. Because Tennessee conforms to current federal tax law, Tennessee allows the federal deduction for expenses paid with proceeds of forgiven	Tenn. Code Ann. § 67-4-2006(a)(1) ; ¶ 3001TN:1000	¶11,044

	Paycheck Protection Program (PPP) loans.		
TX	Yes. Update: 05/11/2021 Effective May 8, 2021, any expense paid using qualifying loan or grant proceeds under the CAA may be included as cost of goods sold (COGS) or compensation in calculating the Texas franchise tax.	Tex. Tax Code Ann. § 171.10131(b)(2) ; Tex. Tax Code Ann. § 171.10131(b)(3) ; News Release, Texas Comptroller of Public Accounts, 05/12/2021	¶11,044; ¶ 3001TX:1000
UT	Yes. However, PPP expenses are treated as fully deductible only to the extent that the PPP loan is added back as taxable income in the year it is forgiven for federal tax purposes.	Utah Code Ann. § 59-7-101(22) ; Utah Code Ann. § 59-7-101(33)(c)(i) ; FAQs and Information about PPP Loans, Utah State Tax Comm'n, 03/22/2021	¶11,044; ¶ 3001UT:1000
VA	No. Update: 04/05/2021 Virginia generally conforms to the IRC as of a specific date, and partially conforms to the IRC as updated by the Federal CAA, 2021. Virginia will limit the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Plan (PPP) loans to $100,000.	Va. Code Ann. § 58.1-301(B) ; Va. Code Ann. § 58.1-322.03(17) ; Virginia Tax Bulletin No. 21-4, , 03/15/2021	¶11,044; ¶ 3001VA:1000
VT	Yes. Update: 04/29/2021 Vermont conforms to the IRC as updated by the federal CAA, 2021. Vermont allows the federal deduction for expenses paid with proceeds of forgiven	Vt. Stat. Ann. 32 § 5824 ; Update: Covid-19 for Taxpayers, Tax Treatment of Forgiven PPP Loans in Vermont, Vt. Dept. of Taxes, 06/01/2021.	¶11,044; ¶ 3001VT:1000

	Paycheck Protection Plan (PPP) loans for 2020 and 2021. Business expenses paid using PPP loans are also deductible in tax year 2021.		
WA	N/A	N/A	N/A
WI	Yes. Because Wisconsin conforms to the IRC as updated by the federal CAA, 2021, with exceptions, Wisconsin follows the federal deduction for expenses paid with proceeds of forgiven Paycheck Protection Program (PPP) loans.	Wis. Stat. § 71.22(4)(L)(3) ; Wis. Stat. § 71.22(4)(m)(1) ; Wisconsin Dept. Rev. Tax Bulletin No. 212, , 02/01/2021; New Wisconsin Tax Laws Affect 2020 Wisconsin Tax Returns, Wis. Dept. Rev., 02/19/2021	¶11,044; ¶ 3001WI:1000
WV	Yes. Because West Virginia conforms to the IRC as updated by the federal CAA, 2021, West Virginia provides a deduction for expenses paid with proceeds of forgiven PPP loans.	W. Va. Code § 11-24-3(a) ; W. Va. Code § 11-24-3(c)	¶11,044; ¶ 3001WV:1000
WY	N/A	N/A	N/A

Last run 9/7/2021

The Tax Cuts and Jobs Act enacted in December 2017 repealed the Alternative Minimum Tax (AMT) on corporations. However, President Biden's proposal of a minimum book tax would effectively reinstitute AMT.

President Biden's Made in America Tax Plan, released in April 2021, includes a revenue proposal that imposes a 15 percent minimum tax on corporations' worldwide book income in excess of $2 billion. In particular, taxpayers would calculate book tentative minimum tax (BTMT) equal to 15 percent of worldwide pre-tax book income (calculated after subtracting book net operating loss deductions from book income), less General Business Credits (including R&D, clean energy and housing tax credits) and foreign tax credits. The book income tax equals the excess, if any, of tentative minimum tax over regular tax. Additionally, taxpayers would be allowed to claim a book tax credit (generated by a positive book tax liability) against regular tax in future years but this credit could not reduce tax liability below book tentative minimum tax in that year.

Biden's proposal is targeted toward the largest US companies that report multi-billion dollars of pre-tax net income on their financial statements but pay no income tax. The Administration believes the minimum book tax would require the affected companies to "bear meaningful federal income tax liabilities".

Following Congress' August 2021 passage of a $3.5 trillion budget resolution, the US House of Representatives' Ways and Means Committee approved tax increase proposals to be included in the budget reconciliation. While the proposals agree with several provisions within the Biden plan, the Ways and Means Committee plan excludes a minimum book tax. Many tax practioners believe the exclusion signals that the minimum book tax concept most likely will not survive final legislation, if any.

In the event that Biden's minimum book tax proposal does become enacted law, the $2 billion book income threshold makes the concept largely not applicable to the cooperative community; however, it is important to keep an eye on in case the threshold amount was negotiated lower.

Antitrust

January 26, 2022

NCFC Legal, Tax & Accounting Committee
Final 2021 Report--Antitrust Subcommittee

Donald M. Barnes, *Chair*
Porter Wright Morris & Arthur LLP
2020 K Street, N.W.
Suite 600
Washington, DC 20006
DBarnes@porterwright.com

Michael A. Lindsay, *Vice-Chair*
Dorsey & Whitney LLP
50 South Sixth Street
Suite 1500
Minneapolis, MN 55402-1498
lindsay.michael@dorsey.com

Christopher E. Ondeck, *Vice-Chair*
Proskauer Rose LLP
1001 Pennsylvania Avenue, N.W.
Suite 400 S
Washington, DC 20004
condeck@proskauer.com

Contributing Editors:

Lucy S. Clippinger, Esq.
Baker & Miller PLLC

Vanessa G. Jacobsen, Esq.
Eimer Stahl LLP

Jay L. Levine, Esq.
Porter Wright Morris & Arthur LLP

TABLE OF CONTENTS

In its prior reports, the Antitrust Subcommittee reported on several long-running cases involving issues of supply management programs, the status of integrated producers, inadvertent inclusion of non-producer entities as members, and other cooperative behaviors. This report provides an update on those cases.

I. *Winters v. Ocean Spray Cranberries, Inc.*, No. 1:12-cv-12016 (D Mass.) (Michael Lindsay and Jack Huerter)

Ocean Spray was sued in 2012 by a putative class of independent cranberry growers and Ocean Spray B Pool members alleging that the operations of Ocean Spray's B Pool and its cranberry concentrate commodity auction violate Sections 1 and 2 of the Sherman Act, the Capper-Volstead Act, a 1957 Consent Decree, and Massachusetts General Laws Chapter 93A prohibiting unfair trade practices ("Chapter 93A") pursuant to which triple damages are available. The case was litigated for ten years. On December 3, 2021, the parties filed a joint stipulation for dismissal of the case with prejudice.

A. The Original Complaint

The Plaintiffs (as quoted in the opinion) described the B Pool this way:

> "…in 2006 OS split its cooperative into two groups: the "A Pool" and the 'B Pool.' 'A Pool' Members continue with the old model; they are paid based on the sales and profitability of OS-branded products. 'B Pool' members are paid based on the price of cranberries sold to industrial buyers; in other words, 'B Pool' members get the 'commodity price' of cranberries. Thus, the two groups are at economic cross-purposes. 'A Pool' growers want the price of cranberries to be low. Assuming steady pricing of OS's brand name products, lower cranberry prices mean a higher profit margin, and with higher profits come higher compensation to 'A Pool' members. 'B Pool' members want the price of cranberries to be high. If the commodity price is higher, they get more money because their compensation and the commodity price are one and the same."

The Plaintiffs (as quoted in the Court's opinion on the initial motion to dismiss, discussed below) described the commodity auctions conducted by Ocean Spray this way:

> "The price buyers pay at these auctions determines how much OS pays the 'B Pool' members and independent growers for their cranberries. Unlike a typical auction, at which bidders compete and the highest price wins, OS pre-sets the sale price and informs each bidder of the amount of concentrate on which it is allowed to bid. What is more, OS sets the price below the cost of production for the growers. As a result of these low prices, consumer goods manufacturers terminated their contracts with independent growers and turned to OS to supply their cranberries. Independent growers have been forced either to accept the low price OS pays them or exit the market altogether. And by fixing a low commodity price, OS ensures a higher profit margin for its 'A Pool' members at the expense of its 'B Pool' members."

B. Initial Grant of Motion to Dismiss

Judge Zobel dismissed Plaintiffs' allegations that:

1. the operation of the B Pool 'violates' the mutual benefit provision of the Capper-Volstead Act because the 'text and purpose of' the Act does not create a cause of action;
2. the 'B Pool' violates a 1957 Consent Decree executed by Ocean Spray's predecessor prohibiting discrimination 'among members in the administration of any pooling of cranberries' because Plaintiffs lack standing to enforce the Consent Decree; and
3. Ocean Spray conspired with its wholly owned subsidiary, Ocean Spray Brands, LLC, because a party is incapable of conspiring with itself.

The Chapter 93A causes of action which accompanied each of these allegations of an underlying statutory or other legal violation were also dismissed. Judge Zobel retained those causes of action under Sections 1 and 2 of the Sherman Act and Chapter 93A based on Plaintiffs' allegations that:

1. Ocean Spray engaged in prohibited exclusionary conduct by controlling the quantity allotted to each bidder and the price each bidder paid in the cranberry commodity auctions and that Ocean Spray engaged in predatory pricing because, for example, in 2009, the first year of the cranberry commodity auction, the average amount per barrel paid to 'B Pool' and independent growers dropped sharply, but remained stable for 'A Pool' members; and
2. Two B Pool members, Winters and Sogn, were terminated in retaliation for participation in this lawsuit.

Ocean Spray filed a motion on May 27, 2014, asking the Court to amend its May Order to include a certification to permit Ocean Spray to seek interlocutory leave to appeal to the First Circuit for review of the *Twombly* pleading standard. Specifically, Ocean Spray argued that there is a substantial difference of opinion following the Supreme Court's decision in *Bell Atlantic Corp. v. Twombly* on the question of "whether a plaintiff can state a predatory pricing claim without alleging that the defendant priced below its costs." Judge Zobel denied that motion in July 2014.

C. Motion for Partial Summary Judgment

On January 6, 2015, plaintiffs filed a motion asking the Court to award partial summary judgment on liability (but not damages) for the alleged antitrust violation, and Ocean Spray filed a cross-motion. On May 14, 2015, the Court denied plaintiffs' motion and granted Ocean Spray's motion in part and denied it in part.[1]

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[1] *Growers 1-7 v. Ocean Spray Cranberries, Inc.*, File No. 12-12016-RWZ (D. Mass. May 14, 2015).

1. Ocean Spray's Motion

Ocean Spray argued that plaintiffs lacked standing to assert the monopolization and monopsonization claims. The Court divided its analysis between the two claims, which it described as follows:

> "Because Ocean Spray sits in the middle of the three-tiered cranberry-products industry, it may be the subject of either monopsonization or traditional monopolization claims. In the first market, the one for raw cranberries, growers are the sellers and handlers, like Ocean Spray, are buyers. This is the market in which Ocean Spray might behave as a monopsonist. In the second market, the one for cranberry products, handlers, like Ocean Spray, are sellers and cranberry product consumers are the buyers. This is the market in which Ocean Spray might behave as a traditional monopolist. Plaintiffs' "monopsonization" claim therefore must refer to the grower–handler market, and their "monopolization" claim must refer to the handler–consumer market."

As to the monopsonization claim, the Court found that the alleged harm – "a competition-reducing effect that prevents the market from allocating resources to their most valued uses" – was the kind of injury that the antitrust laws were designed to protect against, and that as sellers to an alleged monopsonist, the plaintiffs had standing to assert that claim. Courts typically find that direct customers or competitors have standing to assert antitrust claims, and the plaintiff suppliers "walk in the same shoes as customers in a traditional monopolistic market." As to the monopolization claim, however, the Court granted Ocean Spray's motion, because "Plaintiffs' injuries are indirect—they are harmed because the independent handlers are harmed. Plaintiffs are neither competitors nor customers of Ocean Spray in the handler–consumer market."

The Court denied Ocean Spray's motion to dismiss plaintiffs' state law claims, both because (a) one of the federal antitrust claims survived, (b) plaintiffs alleged that Ocean Spray's conduct violated "the competitive standards" set out in a consent decree the Court had entered more than 50 years ago, and (c) there was a dispute of fact as to whether Ocean Spray engaged in unfair trade practices by breaching contracts with independent handlers to which the independent growers are third-party beneficiaries.

The Court also denied a motion to dismiss retaliation claims by two named plaintiffs whose contracts Ocean Spray had elected not to renew, expressly on the basis that they were plaintiffs in this action. The Court found that a non-breaching termination of an at-will contract or a non-renewal of a contract "may, under some circumstances, constitute a [Massachusetts section] 93A violation."

2. Plaintiffs' Motion

As to the monopolization claims, the Court denied plaintiffs' motion for summary judgment because it had found they had no standing to assert the claim. As to the plaintiffs' state law (section 93A) claim, the Court found that "a reasonable jury may conclude that defendants' conduct did not violate an established concept of fairness or that it did not cause plaintiffs' harms."

D. Discovery

In its May 14, 2015 order, the Court vacated all existing stays, ordered plaintiffs to refile their class certification motion (revised, as necessary, in light of the Court's order), and gave defendants two weeks to respond. The Court added that all counsel of record should participate in an upcoming status conference "[t]o help get this now three-year-old case moving . . ." On May 19, 2015, however, the Court vacated that schedule, quoting Ocean Spray's observation that "no discovery has taken place in this case whatsoever" and noting that Ocean Spray's motion "raises important concerns about the timing of class certification briefing that merit full consideration."

Following a June 16, 2015 status conference, the Court issued a scheduling order on June 19, 2015, rejecting the parties' proposed schedules, which would "bog this case down in what appears to be endless and costly discovery," and setting the Court's own very tight schedule: immediate exchange of written discovery requests, depositions to commence on August 3, 2015, fact discovery to close on November 20, 2015, and mediation sometime after December 1, 2015, but evidently before January 8, 2016 (when the parties were to file another status report). The Court noted that "Ocean Spray bitterly opposes this condensed schedule, contending that it will not have sufficient time to cultivate its defenses." The Court disagreed but said that it was "open to extending fact discovery if either party can show a legitimate need for additional information and/or materials after the November 30, 2015, deadline" but cautioned the parties "not [to] expect to receive any extensions" and to "ensure that their highest priority discovery is completed early."

E. Denial of Motion for Class Certification

In that same order, the Court set a schedule for a motion for class certification. That motion was briefed, and a hearing was held on February 23, 2016. On May 10, 2016, the Court denied the motion for class certification. The decision was based on three reasons. First, the proposed class definition did not supply objective terms by which the members of the class could be ascertained and required individualized inquiries of each grower to determine whether the grower belongs to the class. Second, the class representatives could not adequately represent the interests of the class – because several putative class members had denounced, under oath, the objectives of the class action and actually wanted the class action to fail. Many class members had acreage in both the "A" pool and the "B" pool, and an enormous class action judgment would have jeopardized the cooperative's ability to serve its members. Third, the proposed class included numerous members who may well not have been injured by the conduct at issue.

F. Second Motion for Summary Judgment

On January 3, 2017, the Court entered a scheduling order. The Court rejected plaintiffs' proposal for six "bellwether" trials (because the trials would not help in showing that each of the remaining plaintiffs had suffered impact from the alleged violations) and instead directed Ocean Spray to file its summary judgment motion by January 17, 2017.

Ocean Spray filed a motion for partial summary judgment on January 17, 2017. The motion sought judgment on plaintiff's Sherman Act section 2 claim for monopsonization and on the state law claim for unfair/deceptive practices. As to the federal claim, Ocean Spray argued that Plaintiffs have not suffered antitrust injury (because they do not participate in the market in which the alleged anticompetitive conduct took place), that they lack standing (because their claims are too remote), that their claims are barred under the *Illinois Brick* doctrine, and that Ocean Spray does not have the ability to establish or maintain a monopsony. As to the state-law claim, Ocean Spray argued that Plaintiffs have no claim because they do not do business with Ocean Spray. (The motion does not address the separate claim by two plaintiffs who allege that Ocean Spray "retaliated" against them for filing the original lawsuit.) Plaintiffs opposed the motion, but their brief was filed under seal, and no public version is available on the docket. Ocean Spray replied on February 21. On February 14, a subgroup of plaintiffs filed a motion for partial summary judgment.[2]

On July 13, 2017, the Court heard argument on both pending motions for partial summary judgment. On October 31, 2017, the Court ruled on the motions. The Court described the case as involving claims that Ocean Spray "has unlawfully manipulated the price of cranberry juice concentrate and discriminated against 'B Pool' members of the cooperative" and thus engaged in monopsony conduct in violation of section 2 of the Sherman Act. The Court determined that there were four B pool plaintiffs and approximately 47 independent grower plaintiffs. The Court divided the plaintiffs into three groups: the "B" pool plaintiffs, the independent growers that did business with Cranberries Limited, Inc. ("CLI," an independent handler that had a toll processing agreement with Ocean Spray); and the independent growers that did not do business with CLI.

- <u>B Pool Growers</u>. The Court rejected Ocean Spray's argument that these plaintiffs had not suffered antitrust injury (more accurately, antitrust standing). Ocean Spray argued that the alleged violation occurred in the handler-consumer market, not the handler-grower market in which the B Pool plaintiffs participated. The Court found that plaintiffs' "allegation seems to be that the auction was necessary to restrain the grower–handler market; the price paid to the B pool is directly tied to the auction price." Using the *McCready* doctrine, the Court determined that these plaintiffs had standing to pursue the monopsonization claim.

- <u>Non-CLI Growers</u>. The Court described the alleged sequence of events as follows: "Ocean Spray [allegedly] causes independent handlers to pay independent growers prices below the cost of production for their fruit. The chain of events seems to be that the auction price of Ocean Spray's concentrate sets the price at which independent handlers sell their concentrate. Then, the price at which independent handlers sell their concentrate determines the price independent handlers pay independent growers for their fruit." The Court found their harm too remote and indirect to give them standing to assert a claim against Ocean Spray. The plaintiffs acknowledged other factors that could have contributed to their injuries, and the Court determined that there could be other parties more directly positioned to assert a claim (the B Growers and the CLI plaintiffs).

[2] The grounds for their motion are not readily determinable from the public record of the filing, but the Court's subsequent ruling disclosed the substance.

- CLI Growers. These growers (or at least the one on whom the Court focused) have crop purchase agreements with CLI. CLI in turn has an agreement with Ocean Spray to purchase any cranberry concentrate that CLI is unable to sell. The growers alleged that they were injured because “the price Ocean Spray pays CLI for concentrate is essentially the artificially depressed auction price, which then determines the price the growers receive.” The Court acknowledged that the CLI growers were only indirect sellers to Ocean Spray but found that *Illinois Brick* did not bar their claims because there was a fact issue as to whether they came within the cost-plus contract exception.

The Court denied plaintiffs’ motion for summary judgment because there remained genuine disputes of material facts (including “questions as to the fairness of the auction and any causal connection to plaintiffs’ harms”). The Court required, plaintiffs, however, to provide an accurate list of the plaintiffs who remain at this juncture and [to] . . . articulate the jurisdictional basis for remaining claims.”

Ocean Spray sought reconsideration of the Court’s ruling or, in the alternative, certification for an interlocutory appeal. On January 2, 2018, the Court denied the motion for reconsideration but granted the motion to certify the case for appeal on the question of whether the *Illinois Brick* doctrine precluded the independent growers’ claims. The Court stayed proceedings on the indirect grower claims but not as to the B Pool grower claims.

G. Interlocutory Appeal

On January 12, 2018, Ocean Spray filed its petition asking the U.S. Court of Appeals for the First Circuit to exercise its discretion to grant interlocutory review.[3] Ocean Spray submitted two questions for review:

(1) Whether a court may rely on the multi-factor balancing test for antitrust standing announced in [*Associated General Contractors*] to refuse to apply the categorical bar announced in Illinois Brick; and

(2) Whether an indirect seller can establish a ‘pre-existing cost-plus contract’ exception to *Illinois Brick* where (a) the contract at issue is not a pure cost-plus contract, and (b) the contract is not for a fixed quantity regardless of price.

Ocean Spray asked that the Court grant the petition because the questions that the district court had certified involved controlling questions of law on which there were substantial grounds for difference of opinion. Ocean Spray argued that the district court had improperly conflated the *Illinois Brick* rule with a more nuanced analysis of antitrust standing as described in *Associated General Contractors of California.* Moreover, the “cost-plus exception” to *Illinois Brick* did not apply, and the district court’s decision had created an intra-circuit split within the First Circuit (because another court, after questioning whether the cost-plus exception exists at all, had held that it must be “narrowly construed”). Finally, Ocean Spray argued that granting the petition

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[3] Ocean Spray Cranberries, Inc.’s Petition for Permission to Appeal Pursuant to Fed. R. App. P. 5 and 28 U.S.C. § 1292(b), *Winters v. Ocean Spray Cranberries, Inc.,* Case: 18-8001, Document: 00117244026 (1st Cir. Jan. 12, 2018).

would materially advance termination of the litigation because it could avoid the need for additional discovery and 24 separate trials on the claims of individual plaintiffs.

On January 22, 2018, plaintiff-respondents filed their opposition to Ocean Spray's petition.[4] They argued that granting the petition would result in piecemeal litigation, that *Illinois Brick* is not relevant to exclusionary conduct, that the cost-plus exception applied in any event, and that a full trial on the claims not subject to the interlocutory appeal would be helpful in deciding the issues on which Ocean Spray sought review.

Nothing happened for the following eight months. On October 9, 2018, plaintiff's counsel submitted a letter inquiring as to the case status. On October 12, 2018, the Clerk of Court for the First Circuit Court of Appeals responded that the petition for interlocutory review "remains pending and will be addressed in due course." On February 21, 2019, the case was submitted to an appellate panel. On May 5, 2019, Plaintiffs filed a motion asking that the Court expedite the file.

On May 8, 2019 – almost seventeen months after Ocean Spray filed its petition – the First Circuit denied Ocean Spray's request for interlocutory appellate review.[5]

H. Remand Proceedings in District Court

On May 31, 2019, the district court set a status conference for June 20, 2019. The parties filed status reports in advance of the conference, as well as responses to each other's status reports.

Approximately 24 plaintiffs remain in the case, but the district court decided against trying all cases at one time. Plaintiff proposed a set of eight plaintiffs for the first trial. After objections from Ocean Spray, plaintiffs withdrew two of the proposed group, and the court declined any further modification.

In July 2019, Ocean Spray filed a motion for entry of judgment as to the "non-CLI" plaintiffs. This motion is based on these plaintiffs' admission that the only claim they make is an antitrust claim, which an earlier order of the district court had dismissed.[6] These plaintiffs opposed the motion, but on grounds that Ocean Spray believed were an attempt to raise new legal theories. Accordingly, in August 2019, Ocean Spray filed a motion to strike these new theories.[7] On October 22, 2019, the court denied Ocean Spray's motions.

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[4] Respondents-Plaintiffs' Opposition to Ocean Spray Cranberries, Inc.'s Petition for Permission to Appeal Pursuant to Fed. R. App. P. 5 and 28 U.S.C. § 1292(b), *Winters v. Ocean Spray Cranberries, Inc.,* Case: 18-8001, Document: 00117244026 (1st Cir. Jan. 22, 2018).

[5] Judgment, *Winters v. Ocean Spray Cranberries, Inc.,* Case: 18-8001, Document: 00117436873 (1st Cir. May 8, 2018). This is about the same amount of time that the Third Circuit took to decide that it lacked jurisdiction to review an interlocutory appeal in the *Mushrooms* litigation, although in that case the district court had not certified the issue for appeal

[6] Ocean Spray Cranberries, Inc.'s Memorandum In Support Of Its Motion For Final Judgment On The Claims Of The Non-CLI Independent Grower Plaintiffs, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document: 323 (D. Mass. July 17, 2019).

[7] Ocean Spray Cranberries, Inc.'s Memorandum In Support Of Its Motion To Strike Plaintiffs' New Theories Of Liability For Their Chapter 93a Claim And Request For Reconsideration In Their Purported Opposition To The Motion For Final Judgment, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document: 331 (D. Mass. Aug. 13, 2019).

Plaintiffs served significant additional discovery requests. On October 3, 2020, Ocean Spray counsel filed a letter informing the court that plaintiffs had served a seventh request for the production of documents, including 36 individual requests and had informed defense counsel that they intended to take 14 additional depositions,[8] and on October 7, plaintiffs responded. On October 10, plaintiffs filed a motion for certain depositions (although apparently for fewer than they had originally sought[9]) and for certain other discovery relief,[10] and Ocean Spray filed a motion for a protective order and for an order quashing nonparty subpoenas.[11] On October 22, the court granted plaintiffs' motion as to depositions, denied the motion as to the other discovery issues, and denied Ocean Spray's motion.[12] The court added this observation: "If counsel restrain themselves to simple, direct questions and refrain from unnecessary objections, no deposition should last more than a half day."

On December 17, 2019, plaintiffs filed two motions: one to compel production of documents that Ocean Spray had withheld on privilege grounds,[13] and another for leave to file an amended complaint.[14] On January 23, 2020, the court denied the motion for leave to amend as untimely.[15] In the same order, the court ordered that the contested documents be submitted for *in camera* review, along with "a one sentence explanation by each side for each document or each series of related documents."[16] The court later denied motion as to two documents and granted it as to the remaining documents at issue.[17]

A final pretrial conference had been set for April 8, 2020, with a trial date of May 11, 2020,[18] but on March 23, 2020 the court granted Ocean Spray's motion for a

[8] Letter of Margaret Zwisler to Hon. Rya W. Zobel, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document: 345 (D. Mass. Oct. 3, 2019).
[9] Order at 2 n.1, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 352 (D. Mass. Oct. 22, 2019). ("The parties refer to second depositions of Randy Papadellis and Francis Podvin in their letters and motions. But plaintiffs have not noticed those depositions or subpoenaed those witnesses; Ocean Spray has not sought a protective order, and the issue is therefore not before this court.").
[10] Plaintiffs' Motion to Compel Compliance with the Protective Order Of June 30, 2015, for Leave to Take a Deposition to Preserve Testimony for Trial, and to Compel Attendance of Certain Witnesses at Depositions, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 347 (D. Mass. Oct. 10, 2019).
[11] Memorandum in Support of Ocean Spray Cranberries, Inc. and Certain Non-Parties' Emergency Motion for Protective Order and to Quash Subpoenas, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 348 (D. Mass. Oct. 10, 2019).
[12] Order, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 352 (D. Mass. Oct. 22, 2019).
[13] Plaintiffs' Motion to Compel Defendant Ocean Spray to Produce Documents Withheld on the Basis of Privilege, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 355 (D. Mass. Dec. 17, 2019).
[14] Motion for Leave to File Amended Complaint to Conform to the Evidence Adduced in Discovery (Redacted), *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 357 (D. Mass. Dec. 17, 2019).
[15] Order, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 372 (D. Mass. Jan. 23, 2020) ("The motion for leave to amend the complaint (Docket #357) is denied because it is untimely.").
[16] Order, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 372 (D. Mass. Jan. 23, 2020).
[17] *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ Document 384 (D. Mass. Feb. 13, 2020). In the same order, the court denied plaintiffs' motion to extend the deadline for filing responsive expert reports.
[18] Order, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 340 (D. Mass. Aug. 21, 2019).

continuance without setting further deadlines.[19] The court held a status conference on September 8, 2020.

I. Settlement Status

The parties conducted a mediation in January 2016 but did not reach a settlement. On January 8, 2020, plaintiffs' counsel informed the court that plaintiffs had sought to renew settlement discussions in summer 2019.[20] In February 2020, the court "encourage[d] counsel to consider mediation and settlement discussions."[21] One year later, the parties requested a hearing and asked the court to appoint a mediator. The court heard the parties on February 25, 2021, and on March 2, the court formally appointed Magistrate Judge Judith G. Dein as mediator. A mediation was scheduled for May 25, 2021.

On December 3, 2021, the parties filed a joint stipulation for dismissal of the case with prejudice. The court signed an order for dismissal later that same day. The stipulation referred to a "confidential agreement dated December 2, 2021" but provided no details about it.

II. *CWT* Antitrust Litigation (Vanessa Jacobsen)

In September and October of 2011, complaints were filed in the Northern District of California against Agri-mark, Inc., Dairy Farmers of America, Inc. (DFA), Dairylea Cooperative Inc., Land O' Lakes, Inc., and National Milk Producers Federation.[22] The plaintiffs in these cases attacked the Cooperatives Working Together ("CWT") program. The lawsuits alleged that the CWT program constituted a conspiracy to reduce the supply of dairy cattle and thereby artificially raised the price of milk in violation of the antitrust laws. As more fully explained below, similar cases were filed and, after a complex procedural history, ended up in the Southern District of Illinois. In September 2015, a separate case was filed in the Middle District of Florida based upon substantially similar allegations. All cases have now settled.

A. California Litigation Status

In June 2017, a judge in the Northern District of California approved a settlement between the defendants and the consumer classes (indirect purchasers). That agreement resolved all of the claims for purchases of fluid milk and fresh dairy products of approximately 73 million consumer class members from fifteen state classes against the Defendants in that case for $52 million. Three individuals appealed the final approval order to the Ninth Circuit. Two of the appeals were dismissed, and the third[23] raised three objections to the settlement: (1) notice of the settlement to potential class members was insufficient; (2) incentive payments to the named plaintiffs were excessive; and (3) the expert damages report should have been available for class

[19] Order, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ, Document 398 (D. Mass. Mar. 23, 2020).
[20] Letter to Hon. Rya Zobel, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ Document 361 (D. Mass. Jan. 8, 2020).
[21] Order Modifying the Case Schedule, *Winters v. Ocean Spray Cranberries, Inc.,* Case 1:12-cv-12016-RWZ Document 387 (D. Mass. Feb. 20, 2020).
[22] *Edwards v. Nat'l Milk Producers Fed'n,* No. 3:11-cv-04766 (N.D. Cal.); *Robb v. Nat'l Milk Producers Fed'n,* No. 11-4791 (N.D. Cal.); *Boys & Girls Club of the East Valley v. Nat'l Milk Producers Fed'n,* No. 11-5253 (N.D. Cal.); *Stephen L. LaFrance Holding, Inc. v. National Milk Producers Federation,* No. 12-4142 (N.D. Ca.).
[23] *Edwards v. Nat'l Milk Producers Fed'n*, No. 17-16459 (9th Cir.).

members' review. Class plaintiffs filed their answering brief on November 1, 2018. On September 9, 2019, plaintiffs filed a citation to supplemental authority, directing the court to a recent Ninth Circuit decision affirming approval of a class action settlement in another case over the objections of the same individual objector. The appellant filed a response on September 19, 2019. On February 24, 2020, plaintiffs filed a notice pursuant to Ninth Circuit Rule 25-2, notifying the court that the parties had not received notice of oral argument or submission on the briefs within 15 months after the completion of briefing, and on April 27, 2021, the Ninth Circuit issued an order affirming the judgment of the district court.

At the time that the settlement was reached, motions for summary judgment on Capper-Volstead immunity and other substantive issues had been pending before the district court for approximately one year. Also pending before the court was a motion to decertify the case for class action treatment based upon plaintiffs' proffered evidence of impact and damages. That motion for decertification also was fully briefed and had been pending for more than five months. The court had not yet heard argument relating to any of these motions.

B. Southern Illinois Litigation Status

After the first cases were filed in the Northern District of California, a "copycat" suit was filed in the Eastern District of Pennsylvania on behalf of purported direct purchasers of "raw milk." The Judicial Panel on Multidistrict Litigation denied the Pennsylvania plaintiffs' first motion to transfer the Pennsylvania action, but the defendants successfully moved the Pennsylvania court for a transfer of venue to the Northern District of California under 28 U.S.C. § 1404. Shortly after transfer, the plaintiffs in the Pennsylvania case voluntarily dismissed their action. Counsel for these plaintiffs then filed similar actions in the Southern District of Illinois on behalf of new purported direct purchasers ("DPPs") of "raw milk" and "manufactured dairy products" sold directly by defendants. The court in Illinois and the Judicial Panel on Multidistrict Litigation denied defendants' subsequent motions for a transfer of venue to the North District of California.

On September 11, 2015, DPPs amended their complaint and their legal positions to state class action claims only for direct purchases of butter and cheese. On September 29, 2017, the court certified classes of all persons or entities that purchased cheese or butter directly from a CWT member during the relevant time period. Defendants sought permission to appeal the class certification order to the Seventh Circuit, but the Seventh Circuit denied their request on January 11, 2018, and their petition for rehearing on February 15, 2018.

After fact discovery closed on November 30, 2018, and the parties exchanged disclosures of economic experts, the parties filed under seal a number of dispositive motions: DPPs' renewed motion for partial summary judgment, filed on April 11, 2019; Defendants' motion for summary judgment, filed on May 20, 2019; Defendants' *Daubert* motion to exclude the opinions of DPPs' economic expert, filed on May 31, 2019; and Defendants' motion to decertify the classes, filed on August 2, 2019. The parties also filed a number of pretrial motions in advance of a jury trial that was scheduled to begin on October 1, 2019. On September 3, 2019, the court canceled the trial date, noting "the number and complexity of pending motions."

On December 4, 2019, DPPs filed a motion for preliminary approval of a proposed class action settlement. Under the proposed settlement, Defendant National Milk Producers Federation agreed to pay the class $220 million in exchange for a release of DPPs' claims against all Defendants. Defendants continued to deny that they were liable and expressly denied that DPPs' allegations have any factual or legal merit. On January 10, 2020, the court preliminarily approved the proposed settlement and set a deadline of February 26, 2020, for DPPs to file a motion and memorandum in support of final approval and for class counsel to file a motion for attorneys' fees, and a deadline March 17, 2020, for any written objections to the settlement. On April 27, 2020, the court held a final fairness hearing, at which the court granted DPP's motion for final approval of the settlement and class counsel's motion for attorneys' fees and entered final judgment in the case.

C. Florida Litigation Status

On September 23, 2015, southeastern grocery store chain Winn-Dixie Stores, Inc. filed suit in the Middle District of Florida against Agri-mark, Inc., Dairy Farmers of America, Inc., Dairylea Cooperative Inc., Land O' Lakes, Inc., National Milk Producers Federation, and Southeast Milk, Inc. The Florida complaint alleges similar theories of liability as the California and Illinois cases, but seeks damages only on behalf of Winn-Dixie. The suit seeks damages on all purchases of "raw milk, processed or fluid milk, and/or other milk products" by Winn-Dixie under federal antitrust laws.

After discovery closed on March 30, 2018, the court granted defendants' motion to bifurcate summary judgment, allowing them to first move for summary judgment on issues of standing and statute of limitations, and then, if necessary, to file a later motion for summary judgment on issues of liability and damages.

On August 20, 2018, the parties filed the first round of dispositive motions. Defendants moved for summary judgment on issues of standing and statute of limitations and moved to exclude the opinions of Winn-Dixie's economic expert. Winn-Dixie moved for partial summary judgment on issues of liability, including on the issue of Capper-Volstead immunity, but the court stayed briefing on that motion until after the court ruled on defendants' motion for summary judgment. Winn-Dixie also filed a *Daubert* motion to exclude the opinions of defendants' expert. On August 24, 2019, Winn-Dixie moved to strike a portion of defendants' motion for summary judgment based on standing on the ground that defendants had not sufficiently identified the issue as an affirmative defense in their discovery responses.

On January 16, 2019, the court granted in part and denied in part defendants' motion for summary judgment on statute of limitations and standing issues. The court resolved some issues related to the statute of limitations in defendants' favor but left other issues to be decided by a jury. The court denied without prejudice defendants' motion for summary judgment based on issues of standing, ordering defendants to refile that portion of their motion by February 15, 2019. The court also denied without prejudice the parties' *Daubert* motions, Winn-Dixie's motion for partial summary judgment, and Winn-Dixie's motion to strike the portion of defendants' motion for summary judgment related to standing. The court ordered the parties to refile those motions along with any other dispositive motions by May 1, 2019. Finally, the court ordered the parties to notify the court whether they would agree to participate in a settlement conference with the magistrate judge.

On February 15, 2019, defendants renewed their motion for summary judgment based on standing. Winn-Dixie filed an opposition to the renewed motion on March 1, 2019. On April 18, 2019, the court granted in part and denied in part the motion. The court concluded that defendants had shown as a matter of law that Winn-Dixie lacks standing to claim damages for certain indirect purchases made through a grocery wholesaler. The court concluded that defendants did not establish as a matter of law that Winn-Dixie assigned its antitrust claims to an affiliate of one of the defendants when it sold its dairy processing plants.

On May 1, 2019, the parties refiled their *Daubert* motions, and Winn-Dixie renewed its previously-filed motion for partial summary judgment based on liability and its motion to strike defendants' defense of lack of standing. Defendants filed a new motion for summary judgment based on antitrust immunity, liability, and the standard of review. The parties filed oppositions to each of those motions on May 22, 2019.

In November 2019, the court issued a number of rulings in advance of the trial, which was scheduled to begin in January 2020. On November 1, 2019, the court denied Winn-Dixie's motion to strike Defendants' standing defense. On November 14, 2019, the court denied Winn-Dixie's motion to continue the trial to March 2020 because of a scheduling conflict for Winn-Dixie's counsel, making clear that the trial would go ahead in January as scheduled. On November 20, 2019, the court denied Winn-Dixie's *Daubert* motion to exclude the opinions of Defendants' experts. The court granted in part and denied in part Defendants' *Daubert* motion to exclude the opinions of Winn-Dixie's expert, ruling that the expert could testify but limiting that testimony to damages that were not barred by the statute of limitations.

On December 9, 2019, the court issued an order granting in part and denying part Defendants' motion for summary judgment on antitrust immunity, liability, and the standard of review and denied Winn-Dixie's motion for partial summary judgment. First, the court ruled that the rule of reason standard governed Winn-Dixie's claim under Section 1 of the Sherman Act, rather the per se standard, because the alleged restraint on trade—the CWT herd retirement program—was vertical, not horizontal. Second, the court denied Defendants' motion for summary judgment based on the Capper-Volstead Act ("CVA") and the Clayton Act, concluding that whether Defendants could claim immunity under those statutes presented a question of fact for the jury. In particular, the court identified two material issues of fact: (1) "whether the concept of 'marketing' under the CVA is inextricably linked to herd management to somehow exclude 'producing' or 'production' under the CVA," and (2) "whether non-farmers and non-cooperatives participated in the HRP."

As for the first question, Defendants had argued that the CWT herd retirement program constituted "marketing" within the meaning of the CVA because it involved the marketing of milk and beef. The court found no dispute that the program involved the marketing of beef but concluded that that fact was not sufficient to show that the CVA applies. Instead, the court explained that Defendants were not entitled to summary judgment on the issue of antitrust immunity because of "the copious evidence that the [herd retirement program] intended to reduce the number of dairy cows to decrease the milk supply to strengthen and stabilize the regulated milk price that farmers received for their milk." As for the second question, the court identified a material issue of fact as to whether CWT had any members who were not farmers or cooperatives of farmers, such as cheese manufacturers. Defendants had argued that the undisputed evidence showed that all members of CWT were farmers or Capper-Volstead-qualified cooperatives.

On December 18, 2019, the court held a final pretrial conference, at which it heard oral argument on the parties' motions *in limine* and other pretrial motions. On December 19, 2019, the court denied Winn-Dixie's motion for reconsideration of the denial of its motion for partial summary judgment. The court granted Defendants' motion to enforce the court's prior orders limiting damages to those purchases that occurred within the statute of limitations. On December 23, 2019, the court ruled on the parties' motions *in limine* and issued a scheduling order stating that the jury trial would commence on January 6, 2020. On December 31, 2019, the parties' filed a Joint Notice of Settlement, stating that they had reached a settlement in principle, obviating the need for trial. On January 2, 2020, the court issued an order canceling the trial, administratively closing the case, and ordering the parties to file a joint stipulated form order or judgment by March 2, 2020. On February 2, 2020, the parties filed a joint stipulation of dismissal, and on February 5, 2020, the court dismissed the case with prejudice.

III. *In re Processed Egg Products Antitrust Litigation*, 08-md-02002 (E.D. Pa.) (Don Barnes and Jay Levine)

The eggs antitrust litigation is in its thirteenth year. The claims arise out of allegations originally asserted in over a dozen separate lawsuits that sixteen egg farmers and their cooperative, United Egg Producers ("UEP"), engaged in a conspiracy to raise the price of shell eggs and egg products by reducing egg supply. The conspirators allegedly agreed to reduce the supply of eggs by increasing cage space per hen, coordinating molting and slaughter schedules and hen reductions, and exporting eggs at a loss through United States Egg Marketers ("USEM"). The plaintiffs also argued that the egg producers conduct was not protected under the Capper-Volstead Act because, among other things, the cooperative failed to meet the requirements of the Act because certain members were not farmers, certain members were vertically integrated and the conduct concerned pre-production supply management.

A. Litigation Summary

The federal litigation was consolidated for pretrial purposes in the Eastern District of Pennsylvania, consisting of three distinct plaintiff groups. Separate class actions were filed on behalf of 1) Direct Purchasers (supermarkets, fast food chains, and restaurants); and 2) Indirect Purchasers (consumers). In addition, seventeen (17) of the largest supermarket chains and food processing companies in America opted out of the Direct Purchaser class and filed individual suits. This last plaintiff group was further divided between the plaintiffs that originally filed in Philadelphia and those that filed in Chicago (Kraft, Nestle, General Mills and Kellogg's).

1. Settlements

Over the years, various defendants have reached settlements with various groups of plaintiffs. To date, eight egg producers and their cooperative have settled with the Direct Purchaser Class for a total of approximately $136,000,000, and another producer was dismissed from the case. Three egg producers remained as defendants. All egg producers except one have settled with the opt-out supermarket chains and food processing companies for undisclosed amounts. The cooperatives have not settled with the opt-out retailers. All producers except three (as well as the cooperatives) have settled with the Chicago-based opt-out plaintiffs. Certain egg producers have entered into a settlement agreement with the individual Indirect Purchaser class representatives.

2. Litigation Status

The actions filed by the Indirect Purchasers were finally dismissed on July 17, 2018.

After a 6-week trial, the jury in the Direct Purchaser class case returned a verdict in favor of defendant egg farmers on June 14, 2018. The Direct Purchaser class appealed that verdict, which the Third Circuit denied. The case is now over.

Similarly, the case brought by all of the opt-out retailers that filed in Philadelphia went to trial this past October. After a 6-week trial, the jury returned a verdict on December 12 for the defendants. Plaintiffs appealed to the Third Circuit, which denied their appeal. The case is now over, except that Rose Acre is seeking its costs.

The case brought by the Chicago-based opt-out plaintiffs awaits a trial date in Chicago.

B. Direct Purchaser Class Litigation

1. Procedural Status

On September 18, 2015, the Court ruled on the Direct Purchaser class certification motion. It denied the Direct Purchaser's motion to certify an egg products subclass but granted the motion to certify a subclass of shell egg purchasers.

The Direct Purchaser class case was tried to a jury starting on May 2, 2018. On June 14, 2018, the jury returned a verdict in favor of the three defendants on liability. Judgment in favor of the defendants was entered on June 19, 2018. The Direct Purchaser class then filed a motion to alter the judgment and/or for a new trial against Defendant Rose Acre Farms, which was denied by the Court on December 14, 2018. The Direct Purchaser class filed a notice of appeal on January 8, 2019 and Rose Acre Farms filed a notice of cross appeal on January 22, 2019. Oral argument was held in March 2020 and on June 22, 2020 the Third Circuit affirmed judgment in favor of Rose Acre. The Direct Purchaser Plaintiffs petitioned for rehearing and rehearing *en banc*, which was denied.

2. Capper Volstead Rulings

a. Who is a Farmer

On September 13, 2016, the Judge granted in part and denied in part plaintiffs' motion for summary judgment regarding the affirmative defenses asserted by the defendants based upon statutory agricultural cooperative exemptions from federal antitrust law. The Judge found that UEP was not an agricultural cooperative within the meaning of the Capper-Volstead Act because one of the members during the alleged conspiracy period did not own a farm. As such, the Judge held that the member did not qualify as a producer or farmer as defined by the statute. "[T]he record is clear that, despite their involvement in the husbanding of the chickens, and even the ownership of some chickens, Sauder did not own any of the farms where its eggs were produced. Under the circumstances, the Court finds this arrangement is indistinguishable from a preplanting contract, which the Court in *National Broiler* held was not the kind of investment

Congress intended to protect under Capper-Volstead."[24] But the Judge found that plaintiffs had presented insufficient evidence to prove that United States Egg Marketers was not a Capper-Volstead protected cooperative; therefore, the motion was denied as to USEM.

b. USEM and the Meaning of "Value"

At the close of the Direct Purchasers class' case, plaintiffs moved for a directed verdict regarding defendants' Capper-Volstead affirmative defense as applied to USEM, claiming that USEM could not prove that it met the "50% Rule".[25] The Court initially denied the motion but requested briefing from the parties regarding the meaning of "value" under the Act. The egg producers argued that "value" was equivalent to volume. The defendants proved that member "volume" exceeded non-member volume for every transaction. After considering the parties' arguments, the Court ruled that the definition of "value" was the equivalent of the price received by producers for the goods sold through the cooperative.[26] Based on the Court's definition of value, plaintiffs renewed their motion for a directed verdict, which the Court granted. The Court found that there was insufficient evidence to determine whether USEM met the statutory requirements for antitrust immunity and dismissed the defendants' affirmative defense.

c. "Good Faith"

The motions for summary judgment filed by individual defendants were all denied. In denying the individual motions for summary judgment, the Court held that a "good faith" belief in the Capper-Volstead status of the cooperative was not a defense available to the cooperative's members. "Given the lack of express direction from Congress, the Court cannot find the existence of an implicit exception to the antitrust laws that the Defendants' request. Until Congress may be motivated to turn its attention to this gaping hole, diligent policing by co-operative members of the membership rules is the only available protection."[27] Each of the moving defendants asked the Court to certify its order for interlocutory appeal, which the Court denied.

Once the Direct Purchaser class appealed its loss at trial to the Third Circuit, Rose Acre filed a conditional cross-appeal, arguing that a cooperative member's "good faith" belief in the applicability of the Capper Volstead exemption should provide that member with protection from antitrust liability. In other words, a farmer should not be placed at risk of ruinous antitrust treble damages because the cooperative failed a structural test under the Act.

In September 2019, the National Council of Farmer Cooperatives filed an Amicus brief (written by Michael Lindsay and his team at Dorsey & Whitney) arguing for the existence and availability of a "good-faith" defense even if the statutory Capper-Volstead exemption is held not to apply in a given case.

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[24] *In re Processed Egg Prods. Antitrust Litig.*, No. 08-md-2002, 2016 U.S. Dist. LEXIS 123772, at *15-16 (E.D. Pa. Sep. 13, 2016).

[25] The Capper Volstead Act requires "[t]hat the association shall not deal in the products of nonmembers to an amount greater in value than such as are handled by it for members." 7 U.S.C. § 291. This statutory requirement is commonly referred to as the "50% Rule."

[26] *In re Processed Egg Prods. Antitrust Litig.*, No. 08-md-2002, ECF No. 1743 (E.D. Pa. June 1, 2018).

[27] *In re Processed Egg Prods. Antitrust Litig.*, No. 08-md-2002, 2016 U.S. Dist. LEXIS 133110, at *44 (E.D. Pa. Sep. 28, 2016).

C. Direct Action Plaintiffs Litigation

On September 6, 2016, the Court granted defendants motion for summary judgment regarding damages based on egg product purchases. This affected some of the claims brought by the Philadelphia opt-out plaintiffs and all of the claims brought by the Chicago-based op-out plaintiffs. Plaintiffs appealed that decision to the Third Circuit, which reversed and remanded the decision to the Court for further proceedings on January 22, 2018. Defendants then requested leave to file a new motion for summary judgment in light of the guidance received from the Third Circuit, which the Court granted. On August 17, 2018, defendants filed new motions for summary judgment, and the briefing schedule for those motions ended on October 10, 2018. Oral argument was held on December 19, 2008 and on June 11, 2019 the defense motion was denied.

1. Direct Action Plaintiffs -- Philadelphia

Fourteen additional companies opted out of the Direct Purchaser Class and have been litigating their individual antitrust claims for $1 billion single damages for alleged overcharges for shell eggs and egg products. Prior to trial, two plaintiffs – Conopco and Heinz – dismissed their claims. The remaining plaintiffs included Kroger, A&P, Albertson's, Giant Eagle, H.E. Butt, Hy Vee, Publix, Roundy's, Safeway, Super Valu, Walgreen's, and Winn-Dixie.

During the course of the litigation, in addition to numerous procedural and evidentiary motions, Defendants also filed a motion for summary judgment regarding liability, which the Court granted in part and denied in part. The Judge found that the animal husbandry program aspect of the alleged conspiracy had to be analyzed under the rule of reason, despite plaintiffs' insistence that the conduct was *per se* illegal. The Judge also declined to find that plaintiffs had waived their right to proceed under the rule of reason and, therefore, denied defendants' request to dismiss the case.

The Court also granted in part and denied in part defendants' motion for summary judgment regarding damages. The Court found that plaintiffs could not recover damages from sales to Arizona or from the sale of eggs produced in Arizona after October 1, 2009 due to the Arizona state regulations that mandated compliance with the husbandry program at issue. In addition, the Court held that plaintiffs could not recover damages for sales from non-defendants. But the Court disagreed with defendants that plaintiffs could not recover damages for sales after September 25, 2008, the date on which the first complaint was filed.

The trial began on October 31, 2019, and like the class case, was bifurcated – the first phase would determine liability and only if a defendant was found liable would the jury proceed to determine the amount of damages. On December 12, the jury returned a defense verdict for all defendants – Rose Acre Farms, UEP and USEM. Judgment was entered on December 17, 2019 and an amended judgment (correcting the case name) was entered on January 7, 2020. Plaintiffs appealed to the Third Circuit and on March 15, 2021, the judgment was affirmed. Direct Action Plaintiffs petitioned for a rehearing *en banc*, which was denied, and they did not seek review from the Supreme Court. As in the class case, the National Council of Farmer Cooperatives filed an Amicus brief (written by Michael Lindsay and his team at Dorsey & Whitney) arguing for the existence and availability of a "good-faith" defense even if the statutory Capper-Volstead exemption is held not to apply in a given case.

2. Direct Action Plaintiffs -- Chicago

Because claims for egg product overcharges brought by four large food manufacturing companies were originally transferred in January 2012 by the Judicial Panel on Multidistrict Litigation from the Northern District of Illinois (Chicago) to the Eastern District of Pennsylvania (Philadelphia), by law they were required to be returned to their original forum for trial. On August 19, 2019 the egg product claims of Kraft Foods, Kellogg, General Mills and Nestle were remanded to the Northern District of Illinois.

Trial has not yet been set for this case.

D. Kansas Litigation Status

In 2010, Associated Wholesale Grocers ("AWG"), a retailer-owned cooperative serving over 2,400 retail member stores, filed an antitrust lawsuit against the same egg producers who were defending the multidistrict litigation in federal court.

On September 2, 2014, an Order was entered dismissing all remaining claims with prejudice and that case is now over.

IV. In re: Mushroom Direct Purchaser Antitrust Litigation, No. 06-cv-00620 (E.D. Pa.) (Chris Ondeck)

A. History

The multidistrict mushroom antitrust litigation is now into its sixteenth year. Originally filed in February 2006 on the heels of a government investigation and consent decree, the consolidated litigation includes class actions by direct purchasers and two individual customer actions against the Eastern Mushroom Marketing Cooperative and thirty-seven of its members and officers. The suit alleged violations of Sections 1 and 2 of the Sherman Act and Section 7 of the Clayton Act (15 U.S.C. §§ 1, 2, 18). The suit attacks the co-op's minimum pricing program and "supply control" program.

The "supply control" allegations involve the purchase and resale of out-of-production mushroom farms with deed restrictions that prohibit future mushroom production on the property.

In August 2013, the defendants' filed a motion for adjudication of plaintiffs' antitrust claims under the rule of reason. At the same time, the plaintiffs filed a cross-motion for partial summary judgment, asserting that the defendants have engaged in a *per se* illegal horizontal conspiracy to fix prices and restrict supply. On May 26, 2015, the Judge ruled that the price-fixing claims would be subject to "rule of reason" analysis while the "supply restriction" claims were per se illegal. Both sides filed motions for reconsideration, which have been denied. Defendants renewed these motions for reconsideration in 2019, in light of certain rulings in the *Eggs* litigation. These motions were again denied.

On November 22, 2016, the Court certified a class of direct purchasers of fresh agaricus mushrooms who purchased those mushrooms from the defendants or the alleged co-conspirators during the period of February 4, 2001 through August 8, 2005. In January 2018, the direct purchaser class reached a settlement with three defendants, totaling $11,875,000, which was later approved by the court. In August 2019, the Court preliminarily approved a settlement among class defendants and purchasers in the "non-Western" United States. The Court granted final approval of that settlement on January 9, 2020.

B. Capper Volstead Rulings

On March 26, 2009, the Court granted plaintiffs' motion for summary judgment on the availability of Capper-Volstead immunity for the cooperative. The Court found that at least one of its members was non-farmer processor, which foreclosed Capper-Volstead protections for the cooperative and its members.

On January 6, 2014, defendants filed a motion for partial summary judgment, under seal, on the issue of entitlement to Capper-Volstead immunity from plaintiffs' Section 1 claims and for reconsideration of the Court's March 2009 adverse Capper Volstead opinion. A hearing was held on the motion for summary judgment on June 8, 2016. That motion was denied.

On October 14, 2014, Judge O'Neill issued a decision holding that Capper-Volstead Act immunity may be destroyed by technical noncompliance, such as the accidental execution of a membership agreement by a distributor entity that was commonly owned by the mushroom farming entity. The Court also refused to recognize that a vertically integrated grower/distributor was a "single economic entity" as a predicate for a finding of conspiratorial conduct. The Court also held that the growers' good-faith reliance on counsel did not preserve their Capper-Volstead immunity because a violation of Section 1 of the Sherman Act does not require specific intent.

The district court certified the order for interlocutory appeal pursuant to 28 U.S.C. § 1292(b). *In re Mushroom Direct Purchaser Antitrust Litigation,* no. 2:06-cv-00620 (E.D. Pa., Oct. 14, 2014). On December 2, 2014, however, the United States Court of Appeals for the Third Circuit entered a one page order rejecting the certification and refusing to take the appeal. *In re Mushroom Direct Purchaser Antitrust Litigation,* no. 14-8135 (3d Cir., 12/2/2014). No federal appellate court has yet ruled on these important Capper-Volstead Act issues.

C. Price-Fixing Claim Will Be Evaluated under Rule of Reason

On May 26, 2015, Judge O'Neill ruled that the plaintiffs' price-fixing claims would be evaluated under the rule of reason, and not under the *per se* standard as plaintiffs had sought. The Court reasoned that certain defendants had contracted with downstream distributors for the sale of their mushrooms, and that therefore this aspect of the price-fixing allegations contained a vertical aspect and falls under the rule of reason standard. The plaintiffs subsequently moved for reconsideration, or in the alternative, interlocutory appeal; the Court denied both. In contrast, the Court has ruled that the supply control allegations will be evaluated under the *per se* standard.

Judge O'Neill also ruled on March 6, 2017 that the president of the mushroom cooperative EMMC, John Pia (also head of one of the defendant mushroom producers) would not be granted summary judgment and would continue as a defendant in his personal capacity. The plaintiffs cited Mr. Pia's personal participation in EMMC committees, and communications with nonmembers about mushroom prices, as bases for his potential liability in his personal capacity.

In May 2019, the Court ruled on a variety of *motions in limine*. It ruled, *inter alia*, that (1) (consistent with its prior ruling), Defendants cannot introduce evidence regarding "good faith" or "reliance on counsel" defenses; (2) Defendants may not reference the Capper-Volstead Act to argue they are immune under the Act; (3) Defendants may not argue that the case was "lawyer driven"; and (4) the parties may not reference the DOJ investigation regarding the industry.

A trial was tentatively scheduled for 2020 but, as noted below, all claims save one have been settled.

D. Opt-Out Lawsuits

Four supermarket chains, Publix, Giant Eagle, and together Winn Dixie and Bi-Lo filed "copycat" antitrust suit against the same mushroom cooperative and mushroom growers also in the Eastern District of Pennsylvania.[28]They have effectively "opted out" of the original lawsuit filed on behalf of a direct purchaser class hoping to get a larger recovery with their own individual lawsuit. Publix and Giant Eagle opted out early on in the case in 2006. Following the adjudication of summary judgment motions, Publix and Giant Eagle had a tentative trial date of May 2020. Winn Dixie and Bi-Lo filed an opt out complaint in 2015, and they have amended their complaint several times (most recently in 2019). Winn-Dixie's opt-out case is moving forward before Judge Schiller. Numerous grower-defendants have answered the amended complaint, triggering discovery obligations. In January 2020, Judge Schiller modified the discovery order, ruling that fact discovery will continue through March 2020, expert discovery continued through the Spring and Summer of 2020, with Summary Judgment briefing to concluded in October 2020.

E. Key Takeaways

One of the key takeaways from the *Mushroom* litigation is the practical importance of a cooperative seeking to ensure that the proper entity is registered on a cooperative's membership roster. That precise issue weighed against the Court's application of Capper-Volstead protections in the Mushrooms case. Specifically, in denying defendants' motion for summary judgment on the issue of Capper-Volstead immunity, Judge O'Neill found that the inadvertent inclusion of a single non-grower distributor, M. Cutone, in Eastern Mushroom Marketing Cooperative's ("EMMC") membership was "sufficient to destroy defendants' Capper–Volstead immunity." M. Cutone was one of several companies owned by the Cutone family, which also owned a grower entity, M&V. Because M. Cutone (and not M&V) was listed on the EMMC membership roster, the court held that "the existence of even one non-farmer member in an agricultural cooperative is sufficient to destroy Capper–Volstead immunity." (A similar rationale was subsequently applied in the *Eggs* case.) Even though M. Cutone was affiliated with M&V and had the same owners, the court held that "this cannot be considered a *de minimis* exception." These decisions highlight the possibility that plaintiffs and courts will scrutinize the exact names of corporate entities on a cooperative's membership rolls. On a practical level, cooperatives should screen members for their status as farmers and make sure their membership rolls are accurate.

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[28] *Winn-Dixie Stores, Inc. v. Eastern Mushroom Marketing Cooperative, Inc.*, Case No. 5:15-cv-06480 (E.D. Pa.).

F. Settlements

On August 19, 2019 the judge entered an order preliminarily approving settlements with the class.

To date twenty-six defendants, including the cooperative, have paid or have agreed to pay $44,200,000.

On June 29, 2020, Bi-Lo filed a motion for leave to opt out of the Second Round of Settlement Classes. Associated Grocers, Diversified Foods & Seasonings, M. Robert Enterprises, M.L. Robert, II, L.L.C., Market Fair, Inc., and WM Rosenstein & Sons Co. opposed this motion on July 2. On July 6, Brownstone Mushroom Farms, Inc., C&C Carriage Mushroom Co., Cardile Mushrooms, Inc., Country Fresh Mushroom Co., Easter Mushroom Marketing Cooperative, Inc., Robert A. Feranto, Jr., Forest Mushroom, Inc., Franklin Farms, Inc., Gino Gaspari & Sons, Inc., Giorgi Mushrooms Company, Giorgio Foods, Inc., Harvest Fresh Farms, Inc., Kaoin Mushroom Farms, Inc., Louis M. Marson, Jr., Inc., M.D. Basciani & Sons, Inc., Mario Cutone Mushroom Co., Inc., Modern Mushrooms Farms, Inc., Monterey Mushrooms, Inc., Mushroom Alliance, Inc., Oakshire Mushroom Farms, Inc., Phillips Mushrooms Farms, LP, John PIA, Michael PIA, Sher-Rockee Mushroom Farm, South Mill Mushroom Sales, Inc., To-Jo Fresh Mushrooms, Inc., and United Mushrooms Farms Cooperative, Inc. filed an opposition to this motion.

On Sept. 1, 2020, the court granted in part Defendants' motion for summary judgment against Bi-Lo, for its claims for damages. On the same day, the Court also denied Bi-Lo's motion for leave to remove claims from the class action settlement.

Throughout 2021, settlement fees from the direct purchaser settlements continued to be distributed. On September 2, 2021, the court granted Plaintiffs' Motion for Second Distribution of the Net Settlement Fund. This distribution was ordered in accordance with the pro rata percentage amounts for the claimants that submitted claim forms. The plaintiffs' motion for the distribution indicated that once the second distribution has been completed, they will seek an order granting permission for the final remaining amounts in the settlement fund to be distributed.

In addition, jury selection for the trial of the outstanding claims by Bi-Lo and Winn Dixie is set to commence on February 28, 2022. Because there remain numerous pending motions the trial may be further delayed.

V. Dairy Antitrust Litigation (Lucy S. Clippinger)

In the last twelve years, multiple antitrust lawsuits have been filed against Dairy Farmers of America, Inc., Dean Foods Company, and various alleged co-conspirators in federal courts in Vermont, Tennessee, California, Mississippi, and Illinois. All of these cases have been settled, and the cases that have been settled in the last several years are summarized below. For information about earlier-settled dairy antitrust cases, please review previous years' Antitrust Subcommittee reports.

A. *Allen v. Dairy Farmers of America, Inc.*, No. 5:09-CV-00230 (D. Vt.)

This case was filed on behalf of dairy farmers, including classes of Dairy Farmers of America ("DFA") members and non-members, who produced Grade A milk in the Northeast (Order 1) and sold it through DFA's affiliate, Dairy Marketing Services ("DMS"). The farmers alleged a conspiracy among DFA, Dean Foods, DMS, and H.P. Hood, which purportedly reduced the milk price to the dairy farmer class members.

While the plaintiffs reached a settlement with Dean that was approved in 2011, the case against DFA and DMS was scheduled to start trial in April 2014. On February 3, 2014, defendants filed a motion for summary judgment that was granted in part and denied in part after oral arguments on May 8, 2014. The Court granted the motion with regard to plaintiffs' relevant geographic market definition, but denied the motion for summary judgment on the alleged monopsony and monopsony conspiracy claims.

On the "eve of trial" and after five years of intensely disputed litigation, the parties requested the Court's preliminary approval of a proposed settlement agreement. In December 2015, the parties reached a revised settlement providing for a $50 million payment in exchange for a release of the claims asserted in this action as well as claims "arising out of the conduct alleged in the Complaint" as to specified released parties. The agreement also included various conduct remedies that were in place for a four-year period.

On June 7, 2016, the Court ordered final approval of the proposed settlement.

Two class representatives appealed the approval of the settlement, arguing that it was the result of collusion and that class members had been coerced into expressing support for the settlement. The Court of Appeals issued a summary order rejecting those arguments in 2018, affirming the district court's finding that there was no evidence of collusion and finding that the settlement was reasonable and had substantial support from class members. [29]

1. Opt-Out Litigation: *Sitts et al. v. Dairy Farmers of America, Inc.*, No. 2:16-cv-00287 (D. Vt .)

In 2016, approximately 115 farmers who claimed to be members of the *Allen* class filed an "opt-out" complaint against DFA and DMS. *See Sitts et al. v. Dairy Farmers of America, Inc.,* File No. 2:16-cv-00287 (D. Vt.). The complaint alleged monopolization and restraint-of-trade claims under the Sherman Act. The central allegation was that through various acquisitions and agreements with other dairy companies (such as Dean and National Dairy Holdings), DFA had reduced the market prices available to independent dairy farmers for their milk and had forced farmers to join or remain in DFA.

Several Capper-Volstead Act issues arose in the case. At the summary judgment stage the district court held that remaining material issues of disputed fact included whether any alleged monopsony power was obtained through predatory means and was therefore not entitled to immunity under the Capper-Volstead Act.

Additionally, one of the motions *in limine* related to the meaning of the "mutual benefit" clause of the Capper-Volstead Act. Plaintiffs argued that they could present evidence of a cooperative's executive's decisions and board's decisions, including decisions to invest in

[29] *See* Summary Order, *Allen v. Dairy Farmers of America. Inc.,* Docket No. 16-1944 (2d Cir.).

processing facilities, to argue that the cooperative was not "operated for the mutual benefit of the members thereof, as such producers," as required by Capper-Volstead. The Defendants argued that the "mutual benefit" requirement of the act is an objective structural requirement that does not permit a searching inquiry into the wisdom of past business judgments. The U.S. Department of Justice filed a Statement of Interest[30] on behalf of the United States regarding the Capper-Volstead Act generally, with a brief discussion of the "mutual benefit" requirement being considered by the Court.

The Department of Justice's submission was surprising, as one section could be read to suggest that a cooperative may not meet the "mutual benefit" requirement of Capper-Volstead if its members profit too much from processing the members' raw products and then selling the finished products, rather than the sale of the members unprocessed raw products to processors. In response to the Statement of Interest, NCFC and two other non-party organizations sought leave to file a joint brief regarding the proper interpretation of the "mutual benefit" requirement.[31] Unfortunately, the Court denied the motion to file the brief.

On September 28, 2020, before the Court had issued any ruling on the meaning of the "mutual benefit" provision in the Capper-Volstead Act, the suit was dismissed after the parties settled on undisclosed terms.

B. Dean Foods Bankruptcy and Resultant Government Investigation and Private Litigation

Dairy processor Dean Foods announced in November of 2019 that it had filed for Chapter 11 Bankruptcy. Following bankruptcy hearings, a bidding process, and a merger review by the Department of Justice and two states, Dairy Farmers of America, Inc. ("DFA") was permitted to purchase 44 of Dean's milk processing plants. The Department of Justice's antitrust merger investigation was closed after DFA entered into a consent judgment in which it agreed to divest three of the plants.

2. Consent Judgment between the United States and DFA[32]

The Department of Justice explained in its Competitive Impact Statement in support of the Court entering the proposed Consent Judgment that it considered one particular document in formulating the proposed Consent Judgment. The Department acknowledged that it and DFA disagree as to whether the Capper-Volstead Act permits farmers and cooperatives to collectively market processed fluid milk, but that DFA's Chief Executive Officer had submitted a letter that the Department viewed as decreasing the likelihood that competition would be harmed through joint output or price coordination on fluid milk.

The letter from DFA's CEO made a commitment that DFA would not jointly market, process, or sell fluid milk or fresh milk products in the United States with non-DFA members, or

[30] *See* Statement of Interest on Behalf of the United States of America, *Sitts, et al. v. Dairy Farmers of America, Inc. et al*, No. 2:16-cv-00287-cr (D. Vt. July 27, 2020), ECF No. 285.
[31] *See* Motion for Leave to File the Brief of the Amici Curiae, *Sitts, et al. v. Dairy Farmers of America, Inc. et al*, No. 2:16-cv-00287-cr (D. Vt. Aug. 5, 2020), ECF No. 292 (proposed amicus brief attached as Exhibit A).
[32] The docket can be found at *United States, et al. v. Dairy Farmers of America, Inc., et al.*, Case No. Case: 1:20-cv-02658 (N.D. Ill).

otherwise coordinate with non-member producers or cooperatives as to output, price, or other terms for such products.

On October 6, 2020, the Court entered the Consent Final Judgment. Following the entry of judgment, and in response to a motion made by DFA and supported by the United States, the Court permitted DFA to retain one of the three plants it had agreed to divest due to the failure to locate a purchaser capable of operating the plant.

3. Food Lion, LLC, et al. v. Dairy Farmers of America, Inc., Case No. 1:20-cv-00442-CCE-JLW (M.D.N.C.)

On May 19, 2020, Food Lion, LLC and Maryland & Virginia Milk Producers Cooperative Association, Inc. (collectively, "Plaintiffs") filed suit against DFA challenging DFA's purchase of three of Dean's plants out of bankruptcy under Section 7 of the Clayton Act and Section 2 of the Sherman Act. The three plants at issue are fluid milk processing plants located in North and South Carolina. Plaintiffs' suit seeks divestiture of at least one of the three plants.

Plaintiffs initially sought a preliminary injunction requiring DFA to take various steps with regard to the three plants. However, rather than litigating the preliminary injunction motion, the parties agreed to a stipulated material change order regarding the plants, and further agreed to proceed on an expedited discovery schedule.

DFA moved to dismiss the Plaintiffs' case on June 16, 2020, arguing that the Plaintiffs lacked both constitutional standing and antitrust standing, that they had failed to state any plausible antitrust claims, and that their claims were barred by the Failing Company Doctrine. The Court denied the motion to dismiss on July 24, 2020, issuing a brief order stating that the Plaintiffs had plausibly alleged jurisdiction and facts in support of antitrust claims. The Court stated that DFA's arguments should be considered in a fuller record, and noted that the denial was without prejudice to a motion for summary judgment.

Prior to the close of fact discovery, the parties settled on undisclosed terms.

VI. Capper-Volstead Legislation/Regulation Project

Litigation over the last several years has created greater uncertainty about the efforts that a cooperative must undertake to ensure compliance with the "producers only" requirement of the Capper-Volstead Act. In 2017, several members of the LTA recommended that NCFC consider approaching the Department of Agriculture for a rulemaking that would provide cooperatives somewhat greater assurance. A working group developed the following language:

> This [part/subpart] establishes policy, procedures, and remedies under Section 2 of the Capper-Volstead Act, 7 U.S.C. §292 ("Section 2").
>
> 1. For purposes of exercising the powers provided under Section 2, the Secretary shall determine whether the association at issue qualifies as an association under Section 1 of the Capper-Volstead Act, 7 U.S.C. §291 ("Section 1").
> 2. If the Secretary finds that an association has admitted or includes, as members, one or more persons not otherwise qualified for membership under Section 1, the Secretary shall nevertheless consider the association as qualifying under

> Section 1 if the association (i) has taken, in good faith, reasonable steps to limit its membership to producers, and (ii) upon determining that a member is or has become a non-producer, [promptly] terminates that membership.

In early 2020 NCFC met with members of the USDA Capper-Volstead Committee to discuss the issue of membership. On August 27, 2020, NCFC submitted a letter to USDA's then-General Counsel Stephen Vaden urging that USDA exercise its policy authority and provide agricultural cooperatives with some common-sense guidance to help farmers and cooperatives avoid the potentially ruinous consequences of the *Egg* and *Mushroom* rulings (discussed elsewhere in this report). NCFC expects to continue this dialogue with USDA.

VII. Antitrust Update on Other Agricultural Commodities (Lucy S. Clippinger)

Since 2016, both private parties and the U.S. Government have pursued antitrust actions or investigations against agricultural companies. While these suits have not yet involved agricultural cooperatives, we are staying informed about their progress in case they develop in ways that could have implications for agricultural cooperatives. Brief summaries and status updates regarding the ongoing antitrust activity involving agricultural commodities are below.

A. Broiler Chicken Antitrust Activity

1. Private Litigation – *In re Broiler Chicken Antitrust Litigation*, Case No. 1:16-cv-0863 (N.D. Ill.)

In 2016, various purported classes of direct purchasers, indirect purchasers, and consumer purchasers filed complaints asserting antitrust claims against broiler chicken companies, including Tyson Foods. Inc., Pilgrim's Pride Corporation, Sanderson Farms, Inc., Perdue Farms, Inc., and Koch Foods, Inc., based on allegations that the companies conspired to reduce the supply of broiler chickens, partially through Agri Stats, a company that collected and distributed market data for various agricultural industries. Over the next several years, the class actions were joined by suits brought on behalf of some large direct purchasers of broiler chickens.

While several defendants have settled with classes of Plaintiffs, most of the actions are continuing, with the cases moving into expert discovery in September of 2021.

In addition to the class actions, various direct purchasers have joined the administratively consolidated broiler chicken case to assert their claims individually, including fast-food chains such as McDonalds, grocery chains such as Winn-Dixie (which has used the same approach in previous antitrust class actions brought against agricultural cooperatives), and companies such as Campbell Soup.

2. Federal Criminal Litigation – *United States v. Penn, et al.*, Case No. 1:20-cr-152-PAB (D. Colo.)

On June 2, 2020, the United States indicted four broiler chicken executives, charging them with violations of Section 1 of the Sherman Act. The indictment alleges that the executives and co-conspirators engaged in a conspiracy to rig bids and fix prices for broiler chickens.

On June 10, 2020, Tyson Foods announced that it had previously uncovered information related to the government's broiler chicken investigation, which it self-reported to the

Department of Justice. Tyson stated that it was "fully cooperating with the DOJ as part of its application for leniency under the DOJ's Corporate Leniency Program."[33] In October of 2020 and the summer of 2021, additional individuals and corporations were indicted. It was announced in February of 2021 that Pilgrim's Pride had pleaded guilty and agreed to pay a fine of more than $100 million.[34] Discovery and motion practice in the other criminal cases are ongoing.

B. Beef and Cattle Antitrust Activity

1. Private Litigation – *In re Cattle Antitrust Litigation*, Case No. 20-cv-01319-JRT-HB (D. Minn.)

In 2019, purported classes of indirect and direct beef purchasers, as well as cattle ranchers and persons who dealt in live cattle futures and options, filed suit against major beef packing companies and their affiliates. The classes allege that major beef packers engaged in a conspiracy to suppress the price of fed cattle that they purchased, and also conspired to manipulate the price of live cattle futures and options traded on the Chicago Mercantile Exchange. Similar to the broiler chicken case, some of the allegations relate to Agri Stats' reporting of industry data. These cases have now been administratively consolidated under one case, as has an individual direct-action suit filed by Winn-Dixie in early August of 2021.

On September 14, 2021, the district court issued an order denying the vast majority of the pending motions to dismiss, although granting some motions in part. The written decision was filed under seal, so the details are unknown.

2. Federal Investigation

Following the filing of private complaints against the four major beef packing companies, the Department of Justice's Antitrust Division opened an investigation into the beef packing industry. As part of its investigation, the government issued Civil Investigative Demands to all four major beef packing companies that are defendants in the private litigation in June of 2020.[35]

C. *In re Pork Antitrust Litigation*, Case No. 0:18-cv-01776-JRT-HB (D. Minn.)

Purported classes of direct and indirect pork purchasers filed suit in 2016 against Tyson Foods, Hormel, and other major pork companies for allegedly engaging in a conspiracy to reduce or limit the supply of pork in violation of the antitrust laws. The claims also related to Agri Stats' industry reports. One major defendant has settled with the plaintiffs, but discovery with other defendants is ongoing. Additionally, Winn-Dixie joined the consolidated action as an individual direct-action plaintiff, and the Commonwealth of Puerto Rico has also asserted claims. Fact discovery is currently ongoing.

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[33] *Tyson Foods' Statement on Department of Justice Indictment in Broiler Chicken Investigation*, dated June 10, 2020, available at: https://www.tysonfoods.com/news/news-releases/2020/6/tyson-foods-statement-department-justice-indictment-broiler-chicken (last retrieved Sept. 24, 2020).

[34] *One of the Nation's Largest Chicken Producers Pleads Guilty to Price Fixing and is Sentenced to a $107 Million Criminal Fine*, dated February 23, 2021, available at https://www.justice.gov/opa/pr/one-nation-s-largest-chicken-producers-pleads-guilty-price-fixing-and-sentenced-107-million (last retrieved Sept. 14, 2021).

[35] The details of the Civil Investigative Demands come from a September 10, 2020 decision issued by the court in the ongoing private litigation. The decision can be found at ECF No. 259, In re Cattle Antitrust Litigation, Case No. 0:19-cv-01222 (D. Minn.).

D. Turkey Antitrust Litigation

Since December of 2019, two class actions have been filed against major turkey companies alleging a conspiracy to reduce or limit output in violation of federal and state antitrust laws, with reference to Agri Stats' dissemination of market information. *Olean Wholesale Grocery Cooperative, Inc., et al. v. Agri Stats, Inc., et al.*, Case No. 1:19-cv-08318 (N.D. Ill.), is a purported direct purchaser class action, while *Sandee's Catering v. Agri Stats, Inc., et al.*, Case No. 1:20-cv-02295 (N.D. Ill.), is a purported indirect purchaser class action. In October of 2020, the court denied the direct purchaser defendants' joint motion to dismiss, but did dismiss the plaintiffs' allegations of a *per se* violation of the Sherman Act. While some defendants have settled, discovery in the direct purchaser action is ongoing, with fact discovery scheduled to close in June of 2022.

In the indirect purchaser case, the Court denied in part and granted in part the defendants' motion to dismiss in October of 2020. The plaintiffs filed an amended complaint in November of 2020, and the parties are now engaged in discovery. Some settlements have occurred, but fact discovery for remaining defendants is scheduled to close in June of 2022.

In early August of 2021, Winn-Dixie filed an individual direct action asserting similar claims against the same defendants, *Winn-Dixie Stores, Inc. v. Agri Stats, Inc.,* Case No. 1:21-cv-04131 (N.D. Ill.). The case has not yet been consolidated with the other cases.

E. Seafood Antitrust Litigation

1. Tuna - In re Packaged Seafoods Antitrust Litigation, 15-MD-2670 (S.D. Cal.)

Antitrust suits have also been filed against the major makers of packaged tuna, claiming that the defendants engaged in a price-fixing conspiracy. The claims against packaged tuna companies have proceeded in tandem with a Department of Justice investigation into price-fixing, which has led to some guilty pleas. The civil action involves multiple purported classes of various types of purchasers, as well as some individual plaintiffs who have brought direct actions, such as Winn-Dixie. After the district court granted the three plaintiff classes' bids for class certification, a panel of the Ninth Circuit Court of Appeals vacated that decision in early 2021, holding that the district court had failed to resolve whether the classes included large numbers of uninjured members. The Ninth Circuit is rehearing that decision *en banc*, with oral argument scheduled to take place on September 22, 2021.

2. Salmon - *In re Farm-Raised Salmon & Salmon Products Antitrust Litigation*, 1:19-cv-21551 (S.D. Fla.) (direct purchaser); *Wood Mountain Fish LLC v. Mowi ASA*, 1:19-cv-22128 (S.D. Fla.) (indirect purchaser)

In 2019, purported classes of direct and indirect purchasers filed separate suits against a series of major salmon producers, included producers outside the United States, claiming that they conspired to raise the price of salmon, including through alleged manipulation of the NASDAW Salmon Index. In the direct purchaser class action, the complaint has survived a motion to dismiss, and are currently engaged in class certification discovery. In the indirect case, the complaint has been amended a series of times, and a motion to dismiss filed on September

10, 2021, is currently pending. The Department of Justice is also reportedly investigating the allegations, and issued subpoenas in 2019.

VIII. Update on Executive Order regarding Competition (Chris Ondeck)

On July 9, 2021, President Biden issued a wide-ranging executive order ("EO") to "promot[e] competition in the American economy." The Order includes a specific focus on protecting the interests of farmers. It states "[c]onsolidation in the agricultural industry is making it too hard for small family farms to survive. Farmers are squeezed between concentrated market power in the agricultural input industries — seed, fertilizer, feed, and equipment suppliers — and concentrated market power in the channels for selling agricultural products. As a result, farmers' share of the value of their agricultural products has decreased, and poultry farmers, hog farmers, cattle ranchers, and other agricultural workers struggle to retain autonomy and to make sustainable returns." In his remarks related to the EO, the President reinforced these views: "Small and family farms, first-time farmers — like veterans coming home and Black and Latino and Indigenous farmers — they're seeing price hikes for seed, lopsided contracts, shrinking profits, and growing debt."

The overarching impetus of the President's order is to require executive branch agencies to enforce the existing antitrust laws "vigorously" in multiple industries, including agriculture, technology, and healthcare. The goals include addressing "overconcentration, monopolization, and unfair competition." As a result of the order, the federal government will be taking several actions both broadly and in the agriculture sector more specifically. In addition to the broad mandate to increase antitrust enforcement, the Department of Justice will likely be amending its guidelines providing advance guidance as to its analysis of mergers that increase market power. Antitrust commentators expect that merger guidance and future antitrust enforcement will move beyond a "consumer welfare" standard and will incorporate further considerations such as hidden or indirect costs, and impact on employments and related wage and comp issues. In addition, the antitrust agencies may shift to a view that consolidation in certain industries is presumptively anticompetitive.

The EO's agriculture-specific measures direct the USDA to promulgate rules regarding (i) the "Packers and Stockyards Act," (ii) "Made in the USA" labels for meat, and (iii) the right to repair equipment. The USDA is also tasked with creating a plan for increasing farmers' access to markets including through such means as model contracts, transparency rules, whistleblower protections. The EO does not contain specific provisions for cooperatives.

The EO contains specific directives to implement its objectives to the heads of several agencies – including the Secretary of Agriculture. In pertinent part, the EO requires the Secretary of Agriculture:

> (iii) to ensure that farmers have greater opportunities to access markets and receive a fair return for their products, not later than 180 days after the date of this order, submit a report to the Chair of the White House Competition Council, with a plan to promote competition in the agricultural industries and to support value-added agriculture and alternative food distribution systems through such means as:

(A) the creation or expansion of useful information for farmers, such as model contracts, to lower transaction costs and help farmers negotiate fair deals;

(B) measures to encourage improvements in transparency and standards so that consumers may choose to purchase products that support fair treatment of farmers and agricultural workers and sustainable agricultural practices;

(C) measures to enhance price discovery, increase transparency, and improve the functioning of the cattle and other livestock markets;

(D) enhanced tools, including any new legislative authorities needed, to protect whistleblowers, monitor agricultural markets, and enforce relevant laws;

(E) any investments or other support that could bolster competition within highly concentrated agricultural markets; and

(F) any other means that the Secretary of Agriculture deems appropriate;

(iv) to improve farmers' and smaller food processors' access to retail markets, not later than 300 days after the date of this order, in consultation with the Chair of the FTC, submit a report to the Chair of the White House Competition Council, on the effect of retail concentration and retailers' practices on the conditions of competition in the food industries, including any practices that may violate the Federal Trade Commission Act, the Robinson-Patman Act (Public Law 74-692, 49 Stat. 1526, 15 U.S.C. 13 et seq.), or other relevant laws, and on grants, loans, and other support that may enhance access to retail markets by local and regional food enterprises.

On January 24, 2022, the White House Competition Council met to discuss the administration's progress on easing prices. The taskforce includes, among others, Treasury Secretary Janet Yellen, Attorney General Merrick Garland, Transportation Secretary Pete Buttigieg, Agriculture Secretary Tom Vilsack, Commerce Secretary Gina Raimondo, Labor Secretary Marty Walsh and Health and Human Services Secretary Xavier Becerra. In response to the EO, many agencies have become more aggressive in challenging proposed mergers in a variety of industries. The President's remarks in advance of the meeting indicated that the administration will be heavily focused on mergers that might increase consumer prices. As part of the administration's approach to the agriculture industry, Attorney General Garland and the Department of Agriculture announced plans to coordinate federal enforcement agencies' efforts, including a new joint portal where farmers and ranchers can lodge concerns about potential violations of the Clayton Act, Sherman Act, or Packers and Stockyards Act.

Environmental Laws and Regulations

Legal, Tax & Accounting Committee
2021 Final Subcommittee Report
Environmental Laws and Regulations

Dorsey & Whitney LLP
B. Andrew Brown, Partner (Chair)
Brian B. Bell, Partner
Paul K. Beck, Associate
Mike Norton, Associate

Introduction

Over the course of 2021, the Biden Administration has begun slowly but methodically to implement the President's ambitious environmental agenda, which is centered around actions to stem climate change and reversing many environmental policies of the Trump Administration. On his first day in office, President Biden issued an Executive Order requiring agencies to review all regulations, guidance and other policies issued during the Trump Administration for their consistency with the new President's policy toward environmental protection and climate change. Exec. Order 13,390, 74 Fed. Reg. 50,911, *Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis* (Jan. 20, 2021). On March 10, 2021, the U.S. Senate confirmed Michael S. Regan as the new U.S. Environmental Protection Agency ("EPA") Commissioner.

Biofuels

On March 30, 2021, the EPA issued a final rule extending the compliance deadlines for the 2019 renewable fuel standards for small refineries, and extending the compliance deadlines for the 2020 renewable fuel standards for all obligated parties. Envtl. Protection Agency, *Extension of 2019 and 2020 Renewable Fuel Standard Compliance and Attest Engagement Reporting Deadlines*, 86 Fed. Reg. 17,073 (April 1, 2021). The new deadline for small refiners to comply with the 2019 requirements is November 30, 2021, and the new deadline for complying with 2020 requirements is January 31, 2022.

On December 7, 2021, the EPA issued a proposed rule setting biofuel volumes under the Renewable Fuel Standard ("RFS") for 2020, 2021 and 2022. *Renewable Fuel Standard (RFS) Program: RFS Annual Rules*, Proposed Rule, prepublication version available at https://www.epa.gov/sites/default/files/2021-12/documents/rfs-2020-2021-2022-rvo-standards-nprm-2021-12-07.pdf (Dec. 7, 2021). The proposed rule would retroactively lower the 2020 blending requirements to reflect economic hardships associated with the COVID-19 pandemic, and proposes to set 2021 blending requirements at the levels the EPA is expecting to see in the market this year. For 2022, the proposed rule would ramp up biofuel blending requirements to the highest levels ever proposed, and also proposes an additional 250-million-gallon "supplemental obligation" to the volumes proposed for 2022 to address the remand of the 2014-2016 RFS volume obligation by the D.C. Circuit Court of Appeals in *Americans for Clean Energy v. EPA*, 864 F.3d 691 (D.C. Cir. 2017). In that case, the D.C. Circuit invalidated the EPA's waiver of 500 million gallons in the 2014-2016 rule. As a result, the EPA has proposed to add 250 million supplemental gallons in 2022 and stated its intention to do the same in 2023. The required volumes that the EPA proposed for each of the biofuel categories are set forth in the table below.

Proposed Volume Requirements for 2020-2022			
	2020	**2021**	**2022**
Cellulosic biofuel (million gallons)	510	620	770
Biomass-based diesel (billion gallons)	2.43	2.43	2.76
Advanced biofuel (billion gallons)	4.63	5.20	5.77
Total Renewable fuel (billion gallons)	17.13	18.52	20.77
Supplemental Standard (million gallons)	n/a	n/a	250

As part of its rulemaking package announced on December 7, 2021, the EPA also proposed to deny 65 petitions for small-refinery exemptions ("SREs") for waiver of RFS requirements for one or more compliance years between 2016 and 2021. Various biofuels organizations had criticized the Trump Administration's expansion of the SRE program to waive blending requirements for small refiners, and the Biden Administration appears committed to cutting back this program.

In a 6-3 ruling in June, the United States Supreme Court reversed a 10th Circuit Court of Appeals decision that had vacated SREs granted to three small refiners in Wyoming, Utah, and Oklahoma because their exemptions had lapsed for several years before being renewed by EPA. *HollyFrontier Cheyenne Refining, LLC v. Renewable Fuels Ass'n*, 141 S. Ct. 2172 (2021). At issue was whether the refiners could receive an "extension" of their SREs when they had initially received an exemption but had let the exemption lapse. In a majority opinion by Justice Gorsuch, the Court held that "[i]t is entirely natural — and consistent with ordinary usage — to seek an 'extension' of time even after some lapse." The Court held that this interpretation is consistent with the meaning of extension in other federal laws, and is consistent with the statutory language allowing small refiners to receive SREs "at any time."

Meanwhile, consolidated litigation is ongoing in the D.C. Circuit Court of Appeals regarding the EPA's implementation of the 2020 RFS blending requirements, which were finalized in February 2020 but are now proposed to be revised downward in the December 7, 2021 Proposed Rule. *RFS Power Coalition v. U.S. Envt'l Protection Agency*, No. 20-1046 (D.C. Cir. 2021). Both refiner groups and biofuel industry groups have challenged the 2020 RFS standards, particularly with regard to how EPA accounted for SREs when it calculated the standards for the 2020 rule. On December 8, 2021, the day after it announced its proposal to retroactively reduce RFS blending levels for 2020, the EPA filed a brief in the case requesting voluntary remand of the 2020 RFS requirements to allow for its ongoing rulemaking to continue.

Waters and Wetlands Regulation

On November 18, 2021, the EPA and U.S. Army Corps of Engineers ("Army Corps") issued a proposed rule to revise the definition of "Waters of the United States" ("WOTUS") under the Clean Water Act. U.S. Envt'l Protection Agency, *Revised Definition of "Waters of the United States,"* Proposed Rule, 86 Fed. Reg. 69,372, (Dec. 7, 2021). The definition of WOTUS was revised in 2015 by the Obama Administration, before being repealed by the Trump Administration and revised again in a final rule issued on April 21, 2020. *Navigable Waters Protection Rule: Definition of "Waters of the United States,"* Final Rule, 85 Fed. Reg. 22,250 (April 21, 2020). On August 30, 2021, a federal District Court judge in Arizona vacated and remanded the Navigable Waters Protection Rule ("NWPR") for reconsideration to the EPA and Army Corps. *Pascua Yaqui Tribe v. U.S. Envt'l Protection Agency*, No. CV-20-00266 (D. Ariz. August 30, 2021). The court held that the agencies published the NWPR in the face of feedback from the EPA Science Advisory Board that the NWPR conflicts with established science and weakens protection of the nation's waters in contravention of the Clean Water Act's objectives. The Biden Administration's proposed rule would eliminate the NWPR and return to the pre-2015 definition of WOTUS, with updates to reflect Supreme Court decisions. Specifically, the proposed rule would codify the "significant nexus standard" that was articulated by Justice Anthony Kennedy in *Rapanos v. United States*, 547 U.S. 715 (2006), which EPA and the Army Corps interpret to mean "waters that either alone or in combination with similarly situated waters in the region, significantly affect the chemical, physical or biological integrity of traditional navigable waters, interstate waters or the territorial seas." Proposed Rule, 86 Fed. Reg. at 69,373.

While the proposed WOTUS rule is pending, the EPA and Army Corps have halted implementation of the NWPR due to the Arizona case and are interpreting "waters of the United States" consistent with the pre-2015 regulatory regime until further notice. Thus, the agencies' currently-effective guidance dates to 2008. *See* "Clean Water Act Jurisdiction Following the U.S. Supreme Court's Decision in *Rapanos v. United States & Carabell v. United States*," (Dec. 8, 2008), *available at*: https://www.epa.gov/sites/default/files/2016-02/documents/cwa_jurisdiction_following_rapanos120208.pdf.

On October 21, 2021, the U.S. District Court for the Northern District of California vacated and remanded the Trump Administration's 2020 Clean Water Act ("CWA") Section 401 Certification Rule. *In re Clean Water Act Rulemaking*, 2021 U.S. Dist. LEXIS 203567 (N.D. Cal. 2021). Under Section 401 of the CWA, the federal government may not issue a permit to discharge into WOTUS unless the state and/or tribe where the proposed discharge would originate issues a water quality certification or waives the requirement. 33 U.S.C. § 1341. Critics have alleged that this certification authority has been abused by states to block major infrastructure projects, and the 2020 rule narrowed the scope of state and tribal review and imposed time limits. U.S. Envt'l Protection Agency, *Clean Water Act Section 401 Certification Rule*, 85 Fed. Reg. 42,210 (July 13, 2020). In vacating the rule, the court found that the EPA did not adequately explain its departure from the U.S. Supreme Court's decision in *PUD No. 1 of Jefferson Cty v. Wash. Dep't of Ecology*, 511 U.S. 700 (1994), which held that states and tribes have the authority under Section 401 to impose conditions on the proposed activity. Prior to the vacatur and remand, the EPA had already issued a Notice of Intention to Reconsider and Revise the Clean Water Act Section 401 Certification Rule, 86 Fed. Reg. 29,541 (June 2, 2021).

Pesticide and Fertilizer Product Regulation

On August 18, 2021, the EPA banned the use of the pesticide chlorpyrifos on food by issuing a final rule revoking all chlorpyrifos "tolerances," which establish an amount of a pesticide that is allowed on food. U.S. Envt'l Protection Agency, *Chlorpyrifos; Tolerance Revocations*, Final Rule, 86 Fed. Reg. 48,315 (Aug. 30, 2021). The final rule was issued in response to an April order by the Ninth Circuit Court of Appeals, which directed the EPA to issue a final rule in response to the 2007 petition by two environmental advocacy groups to revoke all chlorpyrifos tolerances. *League of United Latin Am. Citizens v. Regan*, 996 F.3d 673 (9th Cir. Apr. 29, 2021). The EPA proposed to revoke all tolerances in 2015, but this action was reversed by the Trump Administration and the petition was denied in 2017. The groups' challenge of the Trump Administration's denial resulted in the 9th Circuit decision mandating a decision from the EPA.

In May, the Ninth Circuit Court of Appeals upheld a $25 million judgment in the first bellwether trial in multidistrict litigation against Monsanto over claims that the company's Roundup product causes cancer. *Hardeman v. Monsanto Co.,* 997 F.3d 941 (9th Cir. May 14, 2021). The court held that Mr. Hardeman's failure-to-warn claims under California law are not preempted by the Federal Insecticide, Fungicide, and Rodenticide Act ("FIFRA") because the laws' requirements are mutually consistent. Monsanto has since filed a writ of certiorari seeking review by the U.S. Supreme Court.

Separately, a federal district court judge in California rejected a proposed $2 billion settlement to cover future claims that Roundup causes cancer, finding that while the settlement would benefit Bayer AG (Monsanto's parent company), it has "tenuous" benefits for class members. Order on Motion for Settlement, No. 3:16-md-02741 (N.D. Cal. May 26, 2021). The settlement would have covered two groups of Roundup users: those who have been diagnosed with non-Hodgkin's lymphoma but have not yet filed suit, and those who have been exposed to Roundup but have not yet developed cancer. In response to this and other litigation surrounding Roundup that has already settled, Bayer has announced that it will replace Roundup with different products that use a different active ingredient in the U.S. by 2023, although glyphosate-based products will still be available for professional and agricultural customers.

In November, Senator Cory Booker (D-NJ) introduced the Protect America's Children from Toxic Pesticides Act of 2021 ("PACTPA") (S. 4406, H.R. 7490 in the House), which would update FIFRA to ban the sales of pesticides containing paraquat herbicides, neonicotinoid insecticides and organophosphate insecticide—prone to damage pollinators and endanger agricultural workers—that are not authorized by the EPA. The bill would also call for an EPA review of 72 pesticides that remain for sale in the U.S. but are banned by the E.U.

Biotechnology

On January 13, 2021, the U.S. Department of Agriculture ("USDA") and Food and Drug Administration ("FDA") executed a Memorandum of Understanding ("MOU") regarding the regulation of certain animals developed for agricultural purposes using genetic engineering. The MOU provides that the USDA will oversee the safety of certain genetically modified farm animals. The MOU moves some of FDA's pre-existing animal biotechnology regulatory oversight to USDA. The FDA will continue to review genetic modifications for nonagricultural uses and the regulation of dairy products, table and shell eggs, certain meat products, and feed derived from animals developed using genetic engineering. Mem. of Understanding between U.S. Dep't of Agriculture and U.S. Food and Drug Admin. (Jan. 13, 2021), *available at:* https://www.aphis.usda.gov/biotechnology/downloads/mou-usda-fda.pdf. This MOU is notable because the FDA Commissioner refused to sign the MOU, expressing concern regarding the MOU's legality. But the Assistant Secretary for Health and Public Health Services signed the MOU on FDA's behalf.

The MOU dovetails with the USDA's Advanced Notice of Proposed Rulemaking for regulations for the movement of animals modified or developed by genetic engineering. Under the to-be-proposed regulations, the USDA would assess animals modified or developed using genetic engineering that may increase the animal's susceptibility to pests or diseases. The USDA would assess whether the slaughtering and processing of these animals would result in a product that is adulterated or misbranded. *See* U.S. Dep't of Agriculture, Regulation of the Movement of Animals Modified or Developed by Genetic Engineering, 85 Fed. Reg. 84,269 (Dec. 28, 2020).

The Biden Administration has not taken action on the proposed EPA rule to exempt certain genetically engineered plants from regulatory reviews. *Pesticides; Exemptions of Certain Plant-Incorporated Protectants (PIPs) Derived from Newer Technologies*, Proposed Rule, 85 Fed. Reg. 64,308 (Oct. 9, 2020). Under the proposed rule, certain Plant-Incorporated Protectants ("PIP") created in plants using biotechnology would be exempt from FIFRA and the Federal Food, Drug, and Cosmetic Act ("FFDCA"). The pesticidal substances must be found in plants that are sexually compatible. Additionally, the PIPs must 1) pose no greater risk than PIPs that meet EPA safety requirements, and 2) not have been able to be created through conventional breeding. Developers may either submit a self-determination letter to EPA, affirming that their product meets the exemption criteria or request confirmation from EPA, or a producer may both submit a self-determination letter and request confirmation from EPA.

Feedlot Regulation and Litigation

On July 13, 2021, Sen. Booker introduced the Farm System Reform Act of 2021 (S. 2332). Representative Ro Khanna (D-CA17) introduced companion legislation in the House of Representatives (H.R. 4421) on the same day. The bill seeks to place an immediate moratorium on new large concentrated animal feeding operations and phase out large factory farms by January 1, 2040. The legislation also seeks to hold corporate integrators responsible for harm caused by factory farms, provide a $100 billion buyout program for contract farmers who want to transition from factory farms, strengthen the Packers and Stockyards Act to protect family farmers and ranchers, restore mandatory Country of Origin labelling ("COOL") for meat, and prohibit USDA from labelling foreign imported meat products as "Product of USA." The bill has been referred to the Senate Committee on Agriculture, Nutrition, and Forestry, and the House Committees on Agriculture and Transportation & Infrastructure, where it is awaiting action. Senator Booker has introduced similar legislation in the previous two Congresses.

That same month, as part of a wider whole-of-government effort across all industries, President Biden signed Executive Order 14036. Exec. Order No. 14,036, *Promoting Competition in the American Economy*, 86 Fed. Reg. 36,987, (July 9, 2021). The Order directed the Secretary of Agriculture to issue new rules under the Packers and Stockyards Act to strengthen regulations concerning unfair, unjustly discriminatory, or deceptive practices as well as unreasonable preferences, advantages, prejudices, or disadvantages—with particular attention to reinforcing the interpretation that a violation of the Packers and Stockyards Act need not be an industry-wide harm but rather the "unfair, unjustly discriminatory, or deceptive" treatment of one farmer while also updating the definitions for such criteria. The order further directs USDA to initiate rulemaking that would prohibit unfair practices related to contract grower tournament pricing systems, dominant among poultry integrators, when they exercise extraordinary control over inputs and risk factors that exacerbate economic vulnerability. The order also directs USDA to issue new COOL rules defining when meat can bear a "Product of the USA" label and strengthen alternative food distribution systems like farmers markets, while also directing the FTC to limit equipment manufacturers from restricting farmers' ability to repair their own tractors or use third-party, independent repair shops. Neither the USDA nor the FTC have issued a notice of proposed rulemaking seeking comments as they relate to EO 14036.

There was no significant federal appellate litigation related to substantive feedlot regulation in 2021.

Air and Climate Change Regulation

On January 19, 2021, a three-judge panel of the D.C. Circuit vacated the Trump Administration's Affordable Clean Energy ("ACE") rule and the repeal of the Obama Administration's Clean Power Plan ("CPP"). *Am. Lung Ass'n v. EPA*, 985 F.3d 914 (2021). The court held that the rescission of the CPP and the promulgation of the ACE rule were arbitrary and capricious because they rested on a misinterpretation of Section 111 of the Clean Air Act. Specifically, the Court concluded that there was no statutory basis for the EPA to conclude that the term "best system of emission reduction" ("BSER") is limited to improvements "at" or "to" a power plant, rather than including substitution with lower-emitting power sources. This decision technically allows the Biden Administration to enforce the Clean Power Plan, but most observers expect the new Administration to announce its own plan for addressing greenhouse gas emissions ("GHG") in the coming months.

On April 5, 2021, the D.C. Circuit granted the Biden Administration's request to vacate a Trump Administration rule that would have prevented EPA from setting standards to reduce GHG emissions from stationary sources. Order Granting Motion for Voluntary Vacatur, *California v. EPA*, (D.C. Cir. Apr. 5, 2021). The Trump Administration's rule exempted stationary sources from regulation unless they emitted 3% or more of the total amount of U.S. GHG emissions. U.S. Envt'l Protection Agency, *Pollutant-Specific Significant Contribution Finding for Greenhouse Gas Emissions From New, Modified, and Reconstructed Stationary Sources: Electric Utility Generating Units, and Process for Determining Significance of Other New Source Performance Standards Source Categories*, 86 Fed. Reg. 2542 (Jan. 13, 2021). This decision allows the Biden Administration to bypass the otherwise lengthy process to repeal the old rule and begin new rulemaking.

The Supreme Court granted review of four similar, consolidated cases regarding EPA authority in October. *West Virginia v. EPA*, 142 S. Ct. 420 (2021) (No. 20-1530). The Biden Administration has argued there was no need for review by the Court given the Clean Power

Plan "is no longer in effect and EPA does not intend to resurrect it." EPA Administrator Regan has instead announced that the EPA will undertake a new rulemaking to limit carbon pollution from power plants. The Supreme Court is expected to take aim at the non-delegation doctrine, specifically as it relates Congress's ability to regulate GHG via the EPA but also more broadly on statutory construction and the limits of delegating rulemaking to federal agencies.

Another Supreme Court decision in May could clarify if climate change tort litigation belongs in state or federal court. In a 7-1 ruling, the Court resolved a circuit split on appellate review of remand orders in an appellate court decision that removed climate-related infrastructure damages against energy companies to state court. *BP p.l.c. v. Mayor of Balt.*, 141 S. Ct. 1532 (2021). The decision vacated and remanded cases in the First, Ninth, and Tenth Circuits. While the decision largely pertained to procedural review, it along with a Second Circuit case brought by New York City may further answer if climate change-related damages should be sought in federal court under the Clean Air Act or in state venues.

In November as part of the COP26 proceedings in Glasgow, President Biden announced the EPA intends to limit methane emissions from oil and gas rigs across the country—rules that were rescinded in the Trump Administration—as part of a wide-ranging U.S. Methane Emissions Reduction Action Plan. The White House, U.S. Methane Emissions Reduction Action Plan (Nov. 2, 2021), *available at*: https://www.whitehouse.gov/wp-content/uploads/2021/11/US-Methane-Emissions-Reduction-Action-Plan-1.pdf. In the plan, the USDA was directed to work with farmers to identify voluntary, incentive-based approaches to achieving our climate goals. Among the proposals, the USDA is developing alternative manure management systems and on-farm renewable energy generation, revamping the commodities market for agricultural products with climate benefits, and quantifying methane emissions while assessing reduction strategies via the Agricultural Research Service, Economic Research Service, and National Institute of Food and Agriculture. In all, the Administration is poised to mandate methane emissions regulations for oil and gas via rulemaking under the Clean Air Act, while taking a more voluntary, program-based approach with agriculture.

Land Regulation and Conservation

On June 1, 2021, the Department of Interior suspended all oil and gas leases in the Arctic National Wildlife Refuge, pending completion of a comprehensive analysis under the National Environmental Policy Act (NEPA). U.S. Dep't of the Interior, Interior Department Suspends Oil and Gas Leases in Arctic National Wildlife Refuge (June 1, 2021), *available at*: https://www.doi.gov/pressreleases/interior-department-suspends-oil-and-gas-leases-arctic-national-wildlife-refuge. The Trump Administration had established and begun administering an oil and gas program in the Coastal Plan of the Arctic Refuge under authority granted from the Tax Cuts and Jobs Act of 2017, and issued nine leases in January of 2021. Fifteen state attorneys general filed suit alleging the lease sale did not include sufficient environmental review. State of Washington et al., v. Bernhardt et al., No. 3:20-cv-00224 (D. Alaska). Several Native American tribes have filed a similar lawsuit. Native Village of Venetie Tribal Gov't v. Bernhardt, No. 3:20-cv-00223 (D. Alaska). Interior Secretary Deb Haaland stated that the Trump Administration's leasing program had "multiple legal deficiencies in the underlying record supporting the leases." In response, the Alaska Industrial Development and Export Authority filed a lawsuit in November against the Biden Administration, alleging the DOI action contravened the law as set forth in the Tax Cuts and Jobs Act. *Alaska Industrial Development and Export Authority v. Biden et al.*, No. 3:21-cv-00245 (D. Alaska).

Outside of the Arctic National Wildlife Refuge, President Biden had ordered a halt to new oil and gas leases on public lands and waters upon taking office in January. As a result, a federal judge in Louisiana issued a preliminary injunction in June at the behest of oil-producing states, stating that the Administration could not stop leasing without congressional approval. Given that ruling, the Department of Interior completed their review in November, releasing a report that proposed increasing royalty rates and rents, prioritizing leasing in areas known to have potential, and avoiding leasing in areas that can be developed for wildlife conservation, recreation, or cultural resources. U.S. Dep't of the Interior, Report on the Federal Oil and Gas Leasing Program (Nov. 26, 2021), *available at*: https://www.doi.gov/sites/doi.gov/files/report-on-the-federal-oil-and-gas-leasing-program-doi-eo-14008.pdf. No regulations are expected to address leases on private lands, short of the aforementioned regulations regarding methane emissions, which will include establishing standards for old wells, more frequent and stringent leak monitoring, and the capture of natural gas found alongside oil.

On wildlife conservation more generally, the Biden Administration sought a stay to litigation by environmental groups challenging rollbacks of the Endangered Species Act ("ESA") by the Trump Administration. The Trump Administration had added economic assessments for extending ESA protections and rescinded a 40-year-old rule that provided the same protections for threatened species as those provided endangered species. The Biden Administration argued that new rulemaking by the Fish and Wildlife Service and National Marine Fisheries Service made the litigation superfluous. The judge initially granted a temporary stay then failed to extend it. At present, the government has sought a voluntary remand, in effect granting the relief sought by the plaintiffs.

Digest of Cases

NCFC LTA Subcommittee Report

Digest of Cooperative Tax Developments – 2021 Final

George W. Benson
McDermott Will & Emery LLP
Chicago, Illinois

This digest describes the significant cooperative tax developments during 2021. The focus is upon federal income taxes and upon issues of taxation that are peculiar to Subchapter T cooperatives. In addition, some developments affecting the taxation of other kinds of cooperative or mutual organizations or of interest to taxpayers involved in agriculture are included where those developments may have some interest to Subchapter T cooperatives.

In this digest, the Tax Cuts and Jobs Act of 2017, P.L.115-97 (December 22, 2017), is referred to as the "**TCJA**." The Coronavirus Aid, Relief, and Economic Security Act, P.L. 116-36 (March 27, 2020), is referred to as the "**CARES Act**." The Consolidated Appropriations Act, 2021, P.L. 116-260 (December 27, 2020), is referred to as the "**CAA**." The American Rescue Plan Act of 2021, P.L. 117-2 (March 11, 2021), is referred to as the "**ARPA**." The currently stalled Build Back Better Act is referred to as "**Reconciliation**."

Index and Capsule Summary

Section 199A(g)

1. Section 199A(g) developments. Final regulations. What is unfavorable; what is favorable. What's next? IRS targets old Section 199 refund claims.

Section 163(j)

2. Section 163(j) developments. Temporary relaxation of rules soon will be ending and so will ability to add back depreciation. Review of cooperative option to elect out; what is its scope? The interplay of Section 163(j) and Section 481 explored in CCA 202123007.

Developments peculiar to Subchapter T

3. No private letter rulings related to cooperatives were issued during the year. Why? Have all cooperative tax issues been resolved? Increased user fee. The IRS focus has shifted to providing guidance of a more general nature.

4. Ltrs. 202103016 (October 27, 2020) and 202105011 (November 10, 2020). Organizations that call themselves "cooperatives" or that operate like cooperatives continue to apply for and be denied exempt status.

5. *Ag Processing Inc a cooperative v. Commissioner*, 153 T.C. 34 (October 16, 2019) and *GROWMARK, Inc. v. Commissioner*, T.C. Memo. 2019-61 (December 11, 2019). Each is still awaiting further action by the Tax Court before a final decision can be entered and the time for appeal can begin to run.

Cooperative statistics

6. 2020 IRS Data Book, Publication 55-B (Rev. June 2021) – 2020 statistics for cooperative tax returns and IRS audit activity are generally consistent with those of prior years. Cooperative numbers continue to shrink. Little audit activity.

Selected proposed and final regulations implementing the TCJA

7. T.D. 9942, 86 Fed. Reg. 254 (January 5, 2021) – regulations implementing new small business simplified accounting rules in Sections 263A, 448, 460 and 471.

8. T.D. 9941, 86 Fed. Reg. 810 (January 6, 2021) – regulations implementing the TCJA's changes to the "all events" test and the treatment of advance payments received by accrual basis taxpayers.

Coronavirus Legislation – Cares Act, CAA and ARPA selected topics of potential interest to cooperatives

9. Developments affecting the deductibility of charitable contributions – relatively narrow, temporary changes to charitable contribution limitations.

10. Tax treatment of Payroll Protection Program loan forgiveness clarified; practical issues for cooperatives.

11. Temporary 100% expensing in 2021 and 2022 "for food or beverages provided by a restaurant."

Miscellaneous

12. Little-used special rule for cooperatives seeking legal and other fees upon the successful conclusion of a dispute with the IRS – description of Section 7430, no net worth test for cooperatives with 500 employees or fewer, not easy to obtain relief, qualified offers, limitation on how much can be awarded, other sections incorporating the special rule.

13. Refund claim issues – avoiding procedural issues that can complicate obtaining the requested refunds; new rules for refund claims claiming increased research credit.

14. Research credit claims. Proceed with caution. For fiscal years beginning in 2022, research expenses must be capitalized and amortized (unless Congress acts).

State tax developments involving farming businesses and/or cooperatives

15. Oregon Rule No. 150-317-1160 (effective July 29, 2020). Provides guidance regarding the exclusion from the Oregon corporate activity tax of farmer sales to an Oregon Subchapter T cooperative.

16. *StateLine Cooperative v. Iowa Property Assessment Appeal Board*, Case No. 19-0674 (Iowa Supreme Court – April 30, 2021). This case involves the extent to which storage bins in a feed mill can be treated as "machinery used in manufacturing establishments" eligible for a property tax exemption. The Iowa Supreme Court found that some qualified and others did not, affirming the lower court decision described in last year's Digest in part and reversing in part.

Detailed Analysis

Section 199A(g)

1. Section 199A(g) developments.

The final Section 199A(g) regulations were published in the Federal Register on January 19, 2021. While there are some positive changes from the proposed regulations, most of what troubled cooperatives appears unchanged in the final regulations.

For instance:

- The final regulations continue to provide that nonexempt cooperatives are not entitled to DPAD with respect to nonpatronage activities and to require exempt cooperatives to compute DPAD separately for patronage and nonpatronage activities. For this purpose, "nonpatronage" activities include nonmember sales of farm products as well as traditional nonpatronage activities. This is by far the most objectionable portion of the final regulations. There continue to be efforts in Washington, spearheaded by NCFC, to correct the way the regulations treat nonmember business.

- The final regulations continue to impose additional reporting requirements on cooperatives. At the end of the day, these requirements are probably mostly a nuisance, and they set a bad precedent. The reporting requirements treat cooperatives as if they were pure pass-through entities like partnerships, limited liability companies or S corporations. In fact, they are not. The final regulations include a "zero presumption rule," which penalizes patrons if members do not provide the information required.

Much effort has been expended by the cooperative community trying to preserve the benefits cooperatives and their members enjoyed under Section 199 in the face of the general repeal of Section 199 for all other businesses as part of the TCJA. While cooperatives did not get everything they wanted, I think it is safe to say that a large portion of the benefits were preserved for most cooperatives. The fix of the "grain glitch" chipped away at the benefits and extended them only through taxable years beginning in 2025, and the final regulations chip away further, but significant benefits remain.

The negative aspects of the final regulations have received the bulk of the attention. Set forth below are some positive changes:

- Broad definition of "farm products."

Section 199 applied to sales of any qualified production property. New Section 199A(g) applies only to sales of agricultural or horticultural products so the definition of what is an agricultural or horticultural product is important.

While the final regulations continue to cross-reference the Cooperative Marketing Act of 1926 (which does not contain a definition), they also contain a broad definition of the term.[1] They recognize that the term includes "processed or manufactured products." They provide that the term includes "fertilizer, diesel fuel and other supplies (for example seed, feed, herbicides, and pesticides) used in agricultural or horticultural production that are MPGE by a Specified Cooperative." They retain the so-called "farm products exception"[2] and restore examples illustrating this exception that had been omitted from the proposed regulations.[3]

- Farm supplies.

As noted above, the final regulations expand the nonexclusive list of farm supplies recognized to be "farm products" and continue the "farm products exception." Both are positive.

The final regulations do add some qualifying language:

> "In addition, agricultural or horticultural products include fertilizer, diesel fuel, and other supplies (for example, seed, feed, herbicides, and pesticides) used in agricultural or horticultural production <u>that are MPGE by a Specified Cooperative</u>."[4]

Is this language meant to exclude farm supplies that a cooperative does not itself manufacture or produce? Query whether the "farm products exception" provides the necessary MPGE in such a situation?

The "farm products exception," which was restored in the final regulations, provides:

> "The term MPGE also includes storage, handling, or other processing activities (other than transportation activities) within the United States related to the sale, exchange, or other disposition of agricultural or horticultural products only if the products are consumed in connection with or incorporated into the MPGE of

[1] Treas. Reg. § 1.199A-8(a)(4).
[2] Treas. Reg. § 1.199A-9(f)(1).
[3] Treas. Reg. § 1.199A-9(f)(5).
[4] Treas. Reg. § 1.199A-8(a)(4).

> agricultural or horticultural products, whether or not by the Specified Cooperative."[5]

As a threshold matter, does the "farm products exception" apply in determining whether a cooperative is a "specified cooperative?" This question is relevant for a cooperative engaged only in the sale of farm supplies.[6]

Section 199A(g)(4) provides that the term "specified cooperative" includes a cooperative engaged "in the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product…" Under Section 199 which had a comparable definition, many cooperatives believed it did, but the regulations did not address the question. When the bill that became the TCJA was under consideration, cooperatives were able to convince Congress to clarify the definition of "specified cooperative" to confirm that conclusion,[7] but the new language was dropped when the language to fix the grain glitch reverted to the Section 199 language.

The preamble to the final regulations contains the following statement:

> "The definition of Specified Cooperative is consistent with section 199A(g)(4) and the Joint Committee Report, and reflects the 2018 Act's amendment to the definition provided by section 11011(a) of the TCJA; that is, a Specified Cooperative no longer includes a Cooperative solely engaged in the provision of supplies, equipment, or services to farmers or other Specified Cooperatives."

This statement is misleading. In fact, Congress returned to the "specified cooperative" definition of Section 199, which did not directly address the status of a cooperative engaged only in the sale of farm supplies. If a farm supply cooperative meets the "farm products exception" and thus is regarded as having satisfied the MPGE requirement, isn't that enough?

The definition of "farm product" includes farm supplies "<u>that are MPGE by a Specified Cooperative.</u>" The preamble to the final regulations makes it clear that the IRS/Treasury rejected comments by cooperatives asking that the MPGE requirement be removed. But there is no comment as to whether the MPGE requirement is satisfied when the "farm products exception" applies.

Cooperatives also asked for clarification of the relationship of the "farm products exception" to the portion of the final regulations that provides"

> "If the Specified Cooperative packages, repackages, or labels agricultural or horticultural products and engages in no other MPGE activity with respect to those agricultural or horticultural products, the packaging, repackaging, or

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[5] Treas. Reg. § 1.199A-9(f)(1).

[6] A cooperative selling farm supplies it does not manufacture presumably meets the definition if it also is engaged in marketing farm products or in manufacturing farm products. The threshold question is present when the sole business of a cooperative is selling farm products it does not manufacture.

[7] In the TCJA as originally enacted, the definition of "specified cooperative" provided that it applied to cooperatives engaged in "the provision of supplies, equipment, or services to farmers or to [other specified cooperatives]."

> labeling does not qualify as MPGE with respect to those agricultural or horticultural products."

In the preamble to the final regulations, the IRS/Treasury declined to make any changes to address the relationship, other than to observe:

> "A logical reading of these paragraphs is that the storage, handling, and other processing activities that are described in [the farm products exception] are activities that are more extensive than [packaging, repackaging, labeling and installing]."

Section 199 limited the DPAD that could be claimed with respect to oil-related qualified production activities income.[8] This provision was originally intended to limit benefits that could be claimed by big oil companies, but it was not limited to big companies. Proposed regulations related to the limitation were released on August 27, 2015.[9] The proposed regulations were drafted with regular corporate businesses in mind, not cooperatives. The definition in the proposed regulations of "oil-related QPAI" included QPAI attributable to transportation and distribution. However, the preamble made it clear that, if all a company did was transportation and distribution, the sales did not qualify as DPGR.[10] If such sales were treated as DPGR as a result of the application of the de minimis rule or as income from embedded services, then the proposed regulations made it clear that QPAI related to that income would be treated as "oil-related QPAI" and reduced.

The reduction for oil-related QPAI was carried over into Section 199A(g)(5)(E).

The final regulations under Section 199A(g) follow the proposed regulations under Section 199, providing generally that "oil-related DPGR does not include gross receipts derived from the transportation or distribution of oil, gas, or any primary product thereof" except to the extent that such gross receipts are treated as part of DPGR as a result of the de minimis rule or as income from embedded services.[11] Query how this rule applies to a cooperative selling diesel fuel to farmers for use in tractors? Presumably the receipts from such sales (but not from transportation) would qualify as DPGR under the "farm products exception." Are they "oil-related DPGR?"

- Treatment of corporate patrons.

Corporate patrons (other than S corporation patrons) are not entitled to use DPAD passed through to them. The preamble to the final regulations confirms that a cooperative will not be penalized for passing through DPAD to such patrons. It states that "the ultimate determination of whether the deduction that is passed through can be used is the responsibility of the patron."

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[8] Note that the reduction did not affect inclusion of wages related to oil-related income in the computation of DPAD.
[9] They were later withdrawn after the TCJA repealed Section 199.
[10] See the preamble to the 2015 proposed regulations under Section 199 which provided: "In general, gross receipts from the transportation and distribution of QPP are not includable in DPGR because those activities are not considered part of the MPGE of QPP."
[11] Treas. Reg. § 1.199A-8(b)(7).

A patron that is a nonexempt specified cooperative is permitted to deduct DPAD passed through to it "to the extent it relates to its patronage gross income and related deductions."[12] Only an exempt specified cooperative is permitted to deduct DPAD passed through to it that relates to nonpatronage activities.[13]

The final regulations go on to provide that, if the cooperative determines that a patron is not an eligible taxpayer, then the cooperative can retain and use DPAD attributable to that patron even when passing through DPAD to its other patrons.[14] This provides cooperatives with more flexibility when passing DPAD through, but exercising that flexibility depends upon knowing which patrons are C corporations, something that may be difficult to determine with certainty in many cases.

- Changed de minimis rule.

The regulations under Section 199 included a de minimis[15] rule that could be employed in computing a cooperative's DPAD. So do the final regulations under new Section 199A(g), but the rule has been modified to reflect other changes in the final regulations.

Under Section 199, the de minimis rule permitted a cooperative with only a small amount of gross receipts that did not qualify as domestic production gross receipts ("DPGR") to treat all gross receipts as DPGR. Treas. Reg. § 1.199-1(c)(3) provided that "[a]ll of a taxpayer's gross receipts may be treated as DPGR if less than 5 percent of the taxpayer's total gross receipts are non-DPGR…" This was intended to simplify accounting.

Under the final Section 199A(g) regulations, nonexempt cooperatives are limited to DPAD determined based upon patronage DPGR, patronage QPAI and taxable income and W-2 wages attributable to patronage DPGR. As a result, gross receipts now can fall into three buckets – patronage DPGR, nonpatronage DPGR (which includes nonmember DPGR if nonmembers do not share in patronage dividends), and non-DPGR (which can be patronage or nonpatronage).

The de minimis rule in the final regulations reflects this change. It now focuses on whether nonpatronage DPGR and non-DPGR are small compared to total gross receipts. "Small" is defined as less than 10 percent. See, Treas. Reg. § 1.199A-9(c)(3)(i). If nonpatronage DPGR and non-DPGR are small, then all gross receipts can be treated as patronage DPGR.

On the surface, it might seem like the final regulations liberalized the de minimis rule, but that is not necessarily the case for a cooperative that does business with nonmembers who are not entitled to share in patronage dividends. Nonmember business often gave rise to DPGR under Section 199, but must now be treated as giving rise to non-DPGR for purposes of the new de minimis test. See, Treas. Reg. § 1.199A-8(b)(ii) ("A Specified Cooperative cannot use its nonpatronage gross receipts and related deductions to calculate its section 199A(g) deduction,

[12] Treas. Reg. § 1.199A-8(d)(5).
[13] Treas. Reg. § 1.199A-8(d)(5).
[14] Treas. Reg. § 1.199A-8(d)(1)(ii).
[15] The term "de minimis" derives from a legal proverb – "de minimis non curat lex" (the law does not concern itself with trifles).

other than treating all of its nonpatronage gross receipts as patronage non-DPGR for purposes of applying the de minimis rules…").

The preamble to the final regulations observes:

> "The final regulations, however, revise the rules for applicable gross receipts … to allow a Specified Cooperative to include all nonpatronage gross receipts in non-DPGR for purposes of the de minimis rules …, while also increasing the de minimis percentage … from 5 percent to 10 percent. … Applying the de minimis rule … after these revisions means that a Specified Cooperative when calculating its patronage section 199A(g) deduction can treat all of its gross receipts as DPGR when the Specified Cooperative derives less than 10 percent of its total gross receipts from non-DPGR (with non-DPGR now possibly including all gross receipts from nonpatronage as well as other patronage non-DPGR)."

If the de minimis rule applies to recharacterize nonpatronage DPGR and non-DPGR as patronage DPGR, related expenses and wages are also recharacterized.

Generally, the de minimis test is applied at the cooperative level. The regulations do not specify how a cooperative's share of gross receipts from a partnership enters into the determination.[16] They provide that if a cooperative is part of an expanded affiliated group ("EAG"), but not a member of a consolidated group, then the test continues to be applied at the cooperative level. However, if the cooperative is part of a consolidated group, "then the determination of whether less than 10 percent of the Specified Cooperative's total gross receipts are non-DPGR is made at the consolidated group level." Treas. Reg. § 1.199A-9(c)(3)(i).

- Definitions of patronage and nonpatronage.

The final regulations include a definition of patronage and nonpatronage in new Treas. Reg. § 1.1388-1(f). This definition is applicable to all Subchapter T cooperatives, not just specified cooperatives. Presumably, it applies in all situations where it is necessary to distinguish patronage income from nonpatronage income.

Several things should be noted about this definition. It uses new verbiage ("directly related use test")[17] to describe the test to be applied. However, the preamble to the final regulations confirms that the "intent of adding § 1.1388-1(f) was to incorporate the 'directly related' test, which is the current legal standard for making the determination." The preamble cites both Rev. Rul. 69-576, 1969-2 C.B. 166 and *Farmland Industries v. Commissioner,* 78 T.C.M. 846 (1999). The preamble observes that the test "does not eliminate the necessity for factual analysis." This new regulation appears to formally adopt in regulation form the approach outlined in the action

[16] The regulations under Section 199 provided that in the case of a partnership "the determination of whether less than 5 percent of the pass-thru entity's total gross receipts are non-DPGR is made at the pass-thru entity level. In the case of an owner of a pass-thru entity, the determination of whether less than 5 percent of the owner's total gross receipts are non-DPGR is made at the owner level, taking into account all gross receipts of the owner from its other trade or business activities and the owner's share of the gross receipts of the pass-thru entity." Treas. Reg. § 1.199-1(d)(3).

[17] Historically, how income is "used" by a cooperative has not been relevant in determining whether the income is patronage or nonpatronage. It does not appear that choice of the word "use" is intended to change that.

on decision following the IRS loss in the *Farmland Industries* case. See, Action on Decision 2001-003 (March 28, 2001).

It is interesting that the new definition does not attempt to clarify the status of "nonmember" income for cooperatives that do not pay patronage dividends to nonmembers. For years, when the IRS has referred to nonpatronage income, it has included nonmember income along with true nonpatronage income.[18] In *CF Industries v. Commissioner*, T.C. Memo. 1994-107, the Tax Court did not agree with this approach, recognizing three categories of income, member patronage, nonmember patronage and nonpatronage. Usually, it does not make a difference.

Finally, the IRS modified the definition of "income from sources other than patronage" contained in Treas. Reg. § 1.1382-3(c)(2), removing language that had given rise to the per se test the IRS one time tried to impose and replacing it with a cross-reference to the new regulation.

- Neutrality regarding other perennial Subchapter T issues.

The proposed regulation contained a provision that would have prohibited cooperatives from netting nonpatronage losses against patronage income. While there have been disputes from time to time over the years regarding such netting,[19] for many years the IRS has permitted (but not required) cooperatives to engage in such netting. Cooperatives were concerned that the IRS was attempting to use the Section 199A(g) regulation project to change this. The good news is that the prohibition was dropped in the final regulations. The preamble does not express any view as to the status of such netting. It states simply that "the 'netting' rule is not needed to define patronage and nonpatronage," which is true.

Another perennial issue in the cooperative world has been whether the reference to "net earnings" in Section 1388(a) is to taxable income or book income. While there is a published ruling that states that "net earnings" means taxable income, years ago, after discussion with the cooperative industry, the IRS adopted the approach of letting cooperatives use either taxable income or book income.

The Section 199 regulations contained language that was viewed by many in the cooperative industry as confirming IRS practice. That language was not included in the proposed regulations, but, at the request of cooperatives, has been restored in the final regulations. See, examples 7 and 8 of Treas. Reg. § 1.199A-8(e), both of which contain the following statement: "whether patronage net earnings are distributed on book or Federal income tax net earnings."

The definition of "taxable income" contained in the proposed regulations contained an ambiguous sentence that cooperatives were concerned could be read as suggesting that patronage

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[18] It apparently bases this on the definition of "patron" contained in Treas. Reg. § 1.1388-1(e) as including only persons "with whom or for whom the cooperative does business on a cooperative basis." However, this definition is not completely consistent with the use of the term "patron" in Subchapter T. It should be noted that the term "patron" is defined twice in the Section 199A(g) regulations, both times by cross-referencing Treas. Reg. § 1.1388-1(e).

[19] Note, this netting is different than the kind of netting in the *Farm Service* case (netting patronage losses against nonpatronage income).

dividends had to be based on taxable income.[20] This sentence was dropped in the final regulations.

It should be noted that there is some discussion of this issue in the preamble to the final regulations. The preamble states that the matter "is outside of the scope of the final regulations" and that "no inference as to the deductibility of distributions to patrons under section 1382 is intended."

- Clarification of PURPIC definition.

The proposed regulations contained two seemingly identical marketing cooperative examples where in one case payments were treated as PURPIMs and in the other they were not. The final regulations eliminate the confusion created by these examples by eliminating the example where the payments were not treated as PURPIMs.

Some cooperatives that do not benefit from Section 199A(g) because they have little W-2 wages requested that cooperatives should have the option to elect out of Section 199A(g). The IRS did not agree. The preamble states:

> "There is no statutory provision providing for an opt-out of these Code sections. In the parallel situation under former section 199, there also was no opt-out provision. …
>
> The Treasury Department and the IRS believe that an agreement to treat a payment that otherwise meets the definition of qualified payment as something else would be inappropriate and ineffective. A payment meeting the definition of a qualified payment should be characterized as a qualified payment."

Others argued that the Section 199A(b)(7) reduction patrons must make to their own DPAD computation for qualified payments received from cooperatives should be adjusted where a portion of the qualified payments do not result in DPAD because the cooperative is wage-limited. The preamble to the final regulations describes this request and why it was denied.

- Members and SSTBs.

As noted above, cooperatives which are engaged in a specified service trade or business ("SSTB") are required to report to members any earnings from that business included in their patronage dividends (or other qualified payments). Members can not include that portion of their qualified payments in their own Section 199A(a) pass-through deduction computation.

This situation will likely only arise where cooperatives are providing SSTB services to members, charging members for the services, generating net earnings from doing so and including those earnings in patronage dividends. However, the charges for such services are very likely expenses of members' farming business. Isn't it double counting to treat all of the expense as

[20] "Taxable income is determined using the same method of accounting used to determine distributions under section 1382(b) and qualified payments to eligible taxpayers."

reducing qualified business income of a farmer for Section 199A(a) purposes and treating any patronage dividend related to those expenses as not includable in qualified business income?

The IRS agreed, and provides for relief, allowing members to allocate a portion of their expense to the SSTB income excluded from their Section 199A(a) computation (but not in excess of that SSTB income).[21]

This is the right result, but a better result would have been simply to eliminate cooperative reporting related to SSTBs. That reporting is relegated to a nuisance for cooperatives and members. It probably will rarely come into play (since cooperatives rarely engage in SSTBs) and when it does come into play the special rule should effectively neutralize it. So what is the point?

- Effective date.

The preamble to the proposed regulations stated that the final regulations would be effective for fiscal years beginning after the date final regulations appeared in the Federal Register. However, the actual language of the proposed regulations provided that they would be effective for fiscal years ending after the date the final regulations appeared in the Federal Register.

The final regulations state that they provide that they "apply to" taxable years beginning after January 19, 2021 (which was the date the final regulations were published in the Federal Register).[22]

The preamble to the regulations provides that they are "effective on January 14, 2021." The effect of this language is not clear. This language may have been intended to try to prevent any freeze order for regulatory projects issued by the new Biden Administration from applying to the regulations in the event they did not appear in the Federal Register on or before January 19.

The fix of the "grain glitch" is applicable as if included in the original TCJA (i.e., for taxable years begging after 2017 and before 2026). It will be interesting to see what issues may arise out of IRS audits of the early years of Section 199A(g) with respect to what precisely is the law in years to which the regulations are not applicable.[23]

[21] Treas. Reg. § 1.199A-7(d)(3)(ii).

[22] Treas. Reg. §§ 1.199A-7(h)(1), 1.199A-8(h), 1.199A-9(k), 1.199A-10(j), 1.199-11(h), and 1.199A-12(j). Cooperatives are given the option of applying the rules retroactively "provided the taxpayers apply the rules in their entirety and in a consistent manner." The final regulations also provide a special transition rule for Section 199A(a) computation purposes for patrons who receive qualified payments from cooperatives which the cooperatives had taken into account in DPAD computations under old Section 199. See, Treas. Reg. § 1.199A-7(h)(2) and (3).

[23] For instance, if a cooperative claimed DPAD with respect to nonmember sales in early years, the IRS should not be able to rely upon the final regulations to challenge that position (and thus should not be able to invoke *Chevron* deference for the position taken in the regulation). At least in theory, any issue for those years should be resolved based upon the statutory language of Section 199A(g) and its legislative history.

What's next?

As noted above, there are still efforts underway to get Treasury and the IRS to reconsider the positions taken in the final regulations, particularly related to nonmember income. At this point, these efforts probably are a long shot.

It is possible to challenge regulations in court. Litigation is not a very good means to resolve issues of the sort the final regulations present. It is slow, costly and usually involves assuming a measure of tax risk most cooperatives would prefer to avoid. Regulations are given a presumption of correctness (called *Chevron* deference) which makes challenge difficult. However, here, where the regulations clearly deviate from the plain language of the Code (at least so it seems to cooperatives), a successful challenge is conceivable.

As noted above, issues may arise with respect to the meaning of the statutory language in the early years of Section 199A(g) where the final regulations are not applicable and positions taken in the regulations do not enjoy *Chevron* deference. However, by the time those issues arise and are resolved Section 199A(g) may have terminated.

Section 199A(g) is scheduled to terminate for taxable years beginning in 2026. Eventually cooperatives may have another fight on their hands to retain it.

Currently the Democrat caucus in Congress has Section 199A in its sights (along with many other provisions of the Code) as it seeks ways to raise revenue to finance what it would like to include in Reconciliation. Senator Wyden (the chairman of the Senate Finance Committee) has circulated draft legislation to simplify Section 199A while at the same time eliminating the benefits of Section 199A(a) for high-income taxpayers. Interestingly, that proposal appears to leave Section 199A(g) largely unchanged, though there are a few drafting items that might benefit from clarification.

If anything, if the Wyden proposal was adopted in its present form, the competitive balance might shift slightly in favor of cooperatives. High-income farmers today can end up worse off when they do business with cooperatives, particularly if cooperatives do not pass any DPAD through to them. If Section 199A(a) deductions were no longer available to high-income taxpayers in general, cooperatives might be the only game in town for high-income farmers so any Section 199A(g) DPAD passed through to them would be a benefit (and, where cooperatives do not pass DPAD through, nothing would be lost).

At year end, the last version of the stalled Reconciliation bill did not make any changes to Section 199A. It will be interesting to see what 2022 brings.

Section 199 – a historical footnote.

At this point, several years after the repeal of Section 199, most cooperatives have claimed whatever they felt appropriate for Section 199 years.

That apparently was not the case for many other taxpayers. In a news release earlier this year the IRS reported that "[i]n the wake of the repeal, the IRS has received a wave of questionable amended returns and claims for tax benefits in the billions of dollars." IR-2021-45 (February 25, 2021). Several years ago, LB&I opened a campaign to risk assess claims under old Section 199. The news release observed that “[a] large majority of the filings involve taxpayers who are claiming DPAD for the first time based on studies conducted after the fact which contain unreasonable assumptions of facts and law.”

The news release contained the following warning:

> “Examiners have been advised to consider Section 6676, Erroneous Claim for Refund or Credit, penalties, other applicable penalties, and referrals to the Office of Professional Responsibility (OPR), when appropriate. Taxpayers and their advisors should ensure they have documentation to support their position and should expect that the IRS may impose appropriate penalties unless taxpayers establish that they have reasonable cause. A study does not necessarily provide reasonable cause.”

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Section 163(j)

2. Section 163(j) developments.

As a result of the TCJA, there are new limitations found in Section 163(j) on the deductibility of business interest. For this purpose, “business interest” is defined as “any interest paid or accrued on indebtedness properly allocable to a trade or business.” Section 163(j)(5).

Section 163(j) limits the deduction for business interest expense to (i) the amount of business interest income, plus (ii) 30% (50% for taxable years beginning in 2019 and 2020) of adjusted taxable income (“ATI”), and (iii) any floor plan financing interest. ATI is taxable income computed without regard to (i) any business interest income, (ii) any net operating loss deduction, (iii) any Section 199A deduction, and (iv), for taxable years beginning before 2022, any deductions for amortization, depreciation and depletion.

In computing ATI, cooperatives are permitted by Treas. Reg. § 1.163(j)-4(A)(6) to add-back patronage dividends and amounts paid in redemption of nonqualified written notices of allocation. That add-back was discussed in last year’s Digest. Note that it is not applicable to PURPIMs, PURPICs and amounts paid in redemption of nonqualified PURPICs.

In the case of many cooperatives, Section 163(j) has so far not been a problem because of the ability to add-back deductions for amortization and depreciation as well as patronage dividends and because of the relaxed 50% limitation for 2019 and 2020. However, the picture may be different for fiscal years beginning in 2022 when taxpayers will no longer be able to add-back depreciation and amortization in determining ATI.

Cooperatives facing the limitation have one other option that might be helpful at least in some instances.

Section 163(j) generally applies to all taxpayers (including Subchapter T cooperatives) engaged in a trade of business and to all business interest. It does not apply to personal interest and to investment interest. In addition, there are a few other exceptions.

- Certain small businesses are exempt. See, Section 163(j)(3).

- Taxpayers engaged in certain businesses can elect to treat those businesses as not "trades or businesses" for purposes of Section 163(j). See, Section 163(j)(7). The effect is that interest attributable to those businesses is not "business interest" and thus is not subject to Section 163(j). The businesses with respect to which such an election may be made are certain real property, farming and utility businesses.

The cooperative election out.

Certain cooperatives are eligible to be treated as farming businesses for this purpose. Section 163(j)(7)(A)(iii) provides that the term "trade or business" does not include "any trade or business of a specified agricultural or horticultural cooperative (as defined in section 199A(g)) with respect to which the cooperative makes an election…"

The regulations provide that an election under Section 163(j) "is made with respect to each eligible trade or business of the taxpayer and applies only to such trade of business for which the election is made." Treas. Reg. § 1.163(j)-9(c)(1). Since an election can extend to "any" trade or business conducted the cooperative, presumably most electing cooperatives will specify that their elections cover <u>all</u> trades or businesses they conduct (i.e., all of their activities). For other kinds of electing taxpayers, the election is limited to specified trades or businesses. If they conduct other businesses, those businesses are "non-excepted" and remain subject to Section 163(j).

The scope of a cooperative's Section 163(j)(7) election is not clear. It is clear that the election potentially covers "any trade or business <u>of … [the] cooperative</u> … with respect to which the election is made." This would seem to suggest that it covers both patronage and nonpatronage business activities of a cooperative.

But what if a cooperative is part of a consolidated return? Is the election limited to any trade or business of the cooperative itself or does it extend to any trade or business conducted by the group? What if the cooperative is engaged in business X and it has a noncooperative subsidiary also engaged in business X, does the election extend to the subsidiary's business X activities? A consolidated group is treated as a single taxpayer for purposes of computing the Section 163(j) limitation for consolidated groups. See, Treas. Reg. § 1.163(j)-4(d)). For most Section 163(j)(7) elections, an election covers a specific trade or business and it extends to all entities within the group conducting the trade or business. See, Treas. Reg. § 1.163(j)-10(a)(4)). Arguably, a cooperative election is different. The language of the statute appears to limit the election to trades or businesses conducted by the cooperative. While it could be argued that the single taxpayer construct makes the election applicable to all businesses conducted by the group, it is unlikely under the single taxpayer concept that the consolidated group would qualify as a specified agricultural cooperative eligible to make an election. The election seems to be the election of the cooperative itself and limited to businesses conducted by the cooperative itself.

Equally unclear is the effect of an election upon partnerships and limited liability companies of which a cooperative is a partner or member. Section 163(j) contains complicated rules for partnerships (and for limited liability companies taxed as partnerships). These rules generally "silo" each partnership and apply the limitation at the partnership level. If business interest paid by a partnership exceeds what the partnership can deduct applying Section 163(j) at the partnership level, partners are allocated "excess business interest expense" which they cannot currently deduct. Rather, the partners must carry the excess business interest expense over until the partnership is in a position where it has excess limitation and allocates "excess taxable income" or "excess business interest income" to them. At that point, the excess business interest expense is treated as business interest expense incurred by the partners to the extent of the "excess taxable income" or "excess business interest income" allocated to them.

These rules generally apply to cooperatives that are members of partnerships.

The regulations contain special rules for partnerships that are exempt from Section 163(j) as small businesses or that are engaged in a trade or business which is an excepted business as a result of a Section 163(j) election.

- Generally, the Section 163(j) rules do not apply either at the partnership or partner level to interest income of a partnership that qualifies as a small business that is exempt pursuant to Section 163(j)(3). Treas. Reg. § 1.163(j)-6(m)(1).

- Where a partnership has made an election under Section 163(j)(7) and is engaged in both excepted and non-excepted business, the Section 163(j) limitations do not apply at either the partnership or partner level to interest attributable to the excepted businesses, but do apply to interest attributable to non-excepted businesses. Treas. Reg. § 1.163(j)-6(m)(2).

However, these rules are unlikely to apply to most partnerships which have cooperative members.

The regulations do not specifically address situations where a partnership is not exempt and is not engaged in an excepted business, but its partner is, a situation likely faced by cooperatives making a Section 163(j)(7) election. Can the partner currently deduct any "excess business interest expense" on the grounds that it relates to an excepted business that it is conducting? The regulations do not address this question, but it would seem likely that the partnership silo rules would prevent it from doing so.

Generally, business interest expense that is not deductible because of Section 163(j) in one year, is treated as business interest in the subsequent year, subject to the Section 163(j) limitation. If a taxpayer with a business interest expense carryforward becomes exempt, Treas. Reg. § 1.163(j)-2(c)(2) provides that the carryover amount is no longer subject to Section 163(j). Arguably, while the regulations do not say, the same rule should apply if a taxpayer becomes effectively exempt because it is a cooperative making a Section 163(j)(7) election.

However, this rule does not appear to apply to excess business interest expense allocated to a taxpayer from a partnership which is carrying over when the taxpayer later either becomes exempt or an excepted business. Generally that interest is not regarded as paid by the taxpayer until the taxpayer is allocated excess taxable income or excess interest income from the partnership. See, Treas. Reg. § 1.163(j)-6(m)(3). Consequently, that amount could continue to carryover.

One thing that is clear is that an election out is permanent. It can be changed only with the consent of the IRS.

In addition, cooperatives that elect out must use the alternative depreciation system for all assets with lives more than 10 years. This requires adjusting depreciation on existing assets going forward as well as using the longer lives going forward. Whether this limitation applies to assets of subsidiaries probably depends upon the position a cooperative takes as to the scope of the election.

It is my impression that many (most?) cooperatives have not elected out so far because they have not needed to and because they do not want to commit to using slower depreciation seemingly permanently.

CCA 202123007 – impact of Section 481 adjustments arising from accounting method changes on Section 163(j).

The limitation on the deduction of interest expense contained in Section 163(j) might have seemed simple to its Congressional architects, but it has proved very complicated to implement. Most areas of tax law are directly or indirectly affected. The IRS and taxpayers who are affected by the limitation will likely be wrestling with its intricacies for years to come.

A recent IRS Chief Counsel memorandum is a case in point. See, CCA 202123007 (May 10, 2021). Generally, for most taxpayers, the Section 163(j) limitation is equal to business interest income plus 30% (50% for taxable years beginning in 2019 and 2020) of "adjusted taxable income." Cooperatives are permitted to add back patronage dividends in determining adjusted taxable income.

For years beginning before January 1, 2022, all taxpayers are permitted to add back depreciation in figuring adjusted taxable income. CCA 202123007 involves a taxpayer who had originally put a 7-year life on an asset acquired in 2017 (and who did not claim additional first-year depreciation). The taxpayer later determined that the asset should have had a 5-year life. In 2020, the taxpayer sought permission to change its method of accounting for the asset, changing its life from 7 to 5 years (and not claiming additional first-year depreciation). Permission was granted.

The change resulted in a negative Section 481(a) adjustment, which the taxpayer was entitled to deduct in 2020. The question posed was whether the Section 481(a) deduction retained its character as depreciation, which, although deducted in determining the corporation's tentative taxable income, could be added back in determining adjusted taxable income for Section 163(j) purposes. The CCA concluded that it did.[24]

That conclusion is reasonable and taxpayer favorable for taxpayers running into a Section 163(j) limitation. However, the CCA suggests that if the taxpayer's year of change was a taxable year beginning on or after January 1, 2022, when depreciation can no longer be added back, the Section 481(a) adjustment would reduce tentative taxable income and not be added back in determining adjusted taxable income (an unfavorable result).

The CCA also observes that if the Section 481(a) adjustment had been positive (as it would have been if an asset's life had been changed from 5 years to 7 years), and if the change was taken into account in a taxable year beginning before January 1, 2022, then the Section 481(a) change would increase tentative taxable income, but be offset by a negative depreciation add-back in determining adjusted taxable income. The CCA suggests that if the positive Section 481(a) adjustment was taken into account over four years and those years included years beginning both before and after January 1, 2022, the negative add-back would apply only to the taxable years beginning before January 1, 2022.

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<u>Developments peculiar to Subchapter T</u>

3. For the first time in years, there were no cooperative private letter rulings.[25]

This is the first time that I can recall where there have been no private letter rulings addressing cooperative issues. One might ask why this is. Certainly all cooperative tax issues have not been resolved.

I think that there may be several reasons why this is the case.

- Rulings are down across the board.

This is not just a cooperative phenomenon. In the past few years, there has been a steady decline in the number of private letter rulings. The IRS appears to prefer focusing its limited resources on more general guidance.

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[24] At the ABA Section of Taxation fall meeting, the IRS cautioned against reading this guidance as necessarily concluding that all kinds of Section 481(a) adjustments retain their character. See, "IRS Depreciation Addback Memo Not All that Broad," by Nathan J. Richman, *Tax Notes Today* (September 23, 2021).

[25] Other kinds of IRS guidance have also declined in recent years as the IRS has focused its attention on regulations. While at one time the IRS published several hundred revenue rulings each year (including over the years, a number addressing Subchapter T issues), that number has slowed to a trickle, and the last published ruling addressing a cooperative issue was in 1993. The number of e-mailed chief counsel advice memoranda has also declined in recent years. The decline has been exacerbated by IRS assertions of privilege so that only 18 (out of 1,858) were released in 2020.

- Everyone was busy.

During the past year, the IRS National Office was extremely busy generating guidance regarding tax law changes contained in the TCJA, the Cares Act, the CAA and ARPA. Taxpayers and their advisors were busy reading what they released and generally absorbing the many changes that have been made.

- Cost.

The "user fee" for private letter rulings keeps going up. Once there was no fee, and then for many years the fee was relatively modest. That is no longer the case. For 2021 it was increased from $30,000 to $38,000. (The good news is that is not being increased again for 2022.) When added to the cost of preparing the request, responding to IRS requests, etc., rulings now are relatively expensive.[26]

The IRS does not publicly admit that the higher user fees are designed to discourage ruling requests, but that is the effect they have had.

- Increased uncertainty as to the result.

At one time, the persons in charge of cooperative rulings were knowledgeable about Subchapter T and relatively sympathetic to cooperatives (at least on some issues). With retirements in recent years, that is no longer the case. The reaction of the IRS National Office is no longer as predictable as it once was. As evidenced by the Section 199A(g) regulations project, the individuals in the IRS National Office no longer seem to have much sympathy for cooperatives.

- The ruling process is slow.

Getting answers to private letter ruling requests has always taken time. At one time, the ruling group handling cooperative ruling requests generally responded within four months. Now, the time seems to have slipped to six months. The time factor places limitations upon what questions are suitable subjects for a request.

- COVID.

This year and last year the all-purpose explanation for everything seems to be the coronavirus situation, and that, undoubtedly, has contributed to the fall off in rulings.

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4. Ltrs. 202103016 (October 27, 2020) and 202105011 (November 10, 2020).

Each year, there seem to be a handful of rulings[27] issued denying tax exempt status to organizations describing themselves as "cooperatives," but not organized to operate as

[26] Having said that, they are relatively inexpensive compared to at least one alternative, namely obtaining tax insurance from a private insurer.
[27] Note that the filing fee for exempt requests (including requests for confirmation of Section 521 status) is only $600. Many of these requests appear to have been submitted without assistance of a professional advisor.

contemplated by Subchapter T, or to organizations organized to serve private business interests that perhaps could have been organized as Subchapter T cooperatives. Farmers' markets are an example. Some of these rulings have been noted in past Digests.

Ltr. 202103016 (October 27, 2020) provides an example.

This ruling denied an exemption request filed by a gallery which sought recognition as an exempt Section 501(c)(6) business league. The denial stated that the gallery was organized to benefit members by developing a local market for their handcrafted items and to benefit the community at large by helping to develop a local tourist market. The gallery operated during the summer months. Members consigned items to the gallery for sale to the public. When an item was sold, the gallery remitted the proceeds less a 20% commission to the member. The commission was designed to cover the gallery's expenses. The gallery had some other sources of income. It charged members an initial sign-up fee and annual dues. It received donations from the community. Members were expected to actively support the organization by working (without compensation) in the gallery and serving on committees.

While the entity apparently described itself as a "cooperative," the denial contained no mention of what it did with net earnings. There is no indication that it would have been obligated to share such earnings among members on a patronage basis.

The IRS concluded that the organization was "engaged in a regular business of a kind ordinarily operated on a for profit basis…" Section 501(c)(6) business leagues "should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons." The IRS concluded: "You are … rendering particular services … for individual persons rather than promoting the general business conditions of a particular line of business."

This organization could have organized itself as nonexempt Subchapter T cooperative and avoided any corporate level tax on its net earnings. However, obtaining exempt status to avoid tax on earnings may not have been its objective. It may have been seeking exempt status to make it easier to obtain donations from the public or from other organizations (or perhaps state or local governments) to help support its operations. For instance, some potential supporters may only be able to provide donations to exempt organizations. Individual donors or businesses may have wanted to be able to deduct the amounts they donate. Subchapter T status would not help it in that regard.

Another example is provided by Ltr. 202105011 (November 10, 2020).

This ruling denied exemption to an organization formed to cultivate medical marijuana and to provide its members with safe access to that marijuana. The ruling indicates that its activities would be in conformance with state and local law, but not federal law since the Controlled Substances Act classifies marijuana as an illegal controlled substance.

Exempt status was denied for failure to provide the IRS with all the information it requested. But the denial also states that "the information we have indicates that even if you did provide the requested information, you would not qualify for exemption." The denial goes on to state:

> "You are a cooperative organization that cultivates and distributes cannabis only to your members. You have not provided any details on how the prices are determined, but members reimburse all expenses in addition to the reasonable compensation for your services related to providing them with medical marijuana. As a cooperative, your activities benefit private interests more than incidentally, which precludes exemption…"

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5. *Ag Processing Inc a cooperative v. Commissioner*, 153 T.C. 34 (October 16, 2019) and *GROWMARK, Inc. v. Commissioner*, T.C. Memo. 2019-61 (December 11, 2019).

These decisions were rendered almost two years ago, but are still not final (so time for appeal has not yet begun to run).

After the Tax Court renders a decision, the parties do what is referred to as a Rule 155 computation, showing the dollar impact of the decision. The Tax Court then formally enters the decision, and the time for appeal begins to run.

The *GROWMARK* case has not yet reached the Rule 155 computation stage. There is another issue in that case (unrelated to cooperative taxation), which the Tax Court split off to be handled in a separate opinion, and that separate issue has not yet been decided. Until it is, the Rule 155 computations cannot be done.

In *Ag Processing*, the parties were unable to agree upon the Rule 155 computation and have asked the Tax Court for further guidance. What is in dispute is how to allocate Ag Processing's DPAD (which the Tax Court concluded should be computed in a single aggregate computation combining patronage and nonpatronage activities) between patronage and nonpatronage. Should the allocation be based upon the member/nonmember business ratio (Ag Processing's view) or should it be based on the ratio of patronage/nonpatronage QPAI ratio (the IRS view)? If QPAI is used, almost all the DPAD ends up characterized as patronage, which Ag Processing largely cannot use because of the Tax Court's holding that patronage DPAD cannot be used against nonpatronage income. Supplemental briefs on this issue were filed in March, 2020, and the parties are waiting for guidance.

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<u>Cooperative statistics</u>

6. 2020 IRS Data Book, Publication 55-B (Rev. June 2021).

The IRS recently released its Data Book for 2020 describing its activities during its fiscal year 2020 (beginning October 1, 2019 and ending September 30, 2020).

In recent years, the IRS Data Books have included line item information regarding cooperative tax returns (Form 1120-C). The information historically has been hard to interpret because of the reporting format. However, four things are clear:

- There are not many Subchapter T cooperatives. This year's Data Book reports receipt of 7,524 cooperative tax returns (Form 1120-C) for tax year 2018. In prior years, the number of reported returns was consistently approximately 9,000. The drop is unexplained (1,500 cooperatives did not go out of business during the past year). Perhaps it is attributable to reporting anomalies arising from the coronavirus situation. It will be interesting to see what is reported next year.

- Not many cooperative tax returns are audited. The 2020 Data Book reports that only 13 of the 7,524 returns for 2018 have so far been examined (or 0.2%). This low audit rate is consistent with the reported rates for 2017 (0.2%), 2016 (0.2%) and 2015 (0.3%).

- Audits of cooperative returns have not been very productive for the IRS (which may explain why there are so few audits). The IRS reported that it closed 28 examinations during its fiscal year 2020. Most were closed on an agreed basis with a total of $228,000 of proposed deficiencies. Five were unagreed. They involved a total of $166,000 of proposed deficiencies.

- Refund claims attract examinations. The IRS reported that it completed examinations of 16 amended returns involving refund claims during its fiscal year 2020. It reported denying 7 claims totaling $4,168,000 and allowing 9 claims totaling $2,464,000.

In addition, the Data Book reported that the IRS received 4 applications for Section 521 status during its 2020 fiscal year, a low, but not surprising, number.

The figures reported over the years in the Data Books for cooperative audits have seemed to understate audit activity. However, even if the actual number of audits is a multiple of those reported, the overall level of audit activity would still be very low. In the years to come, this could change. The Biden administration has proposed significant increases in IRS funding over the next few years focused on enforcement and compliance and there have been reports that some parts of the IRS have already begun hiring agents in anticipation of that funding.

The most recent USDA report on agricultural cooperatives identifies 1,779 agricultural cooperatives in 2019. The USDA figures showed 2,314 agricultural cooperatives in 2008. Each year since then the number has declined. See, Agricultural Cooperative Statistics 2019, USDA Rural Development Service Report 83 (January 2021). (This report contains other interesting statistics. For instance, 317 cooperatives (17.8%) are 100 years old or older. The average board size of those that reported was 8, but of those with total sales of $1 billion or higher, it was 16. In 2019, the combined book income statement of all agricultural cooperatives reports an effective income tax rate of roughly 1.6%.)

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<u>Selected proposed and final regulations implementing the TCJA</u>

7. T.D. 9942, 86 Fed. Reg. 254 (January 5, 2021) – regulations implementing new small business simplified accounting rules in Sections 263A, 448, 460 and 471.

Several provisions in the TCJA expanded, added and harmonized small business simplified accounting rules. The provisions were effective for taxable years beginning after December 31, 2017.

<u>Section 448</u> provides, with certain exceptions, that C corporations, partnerships which have a C corporation as a partner, and tax shelters may not use the cash receipts and disbursements method of accounting. The exceptions include farming businesses, qualified personal service corporations and businesses which meet a gross receipts test (and, in each case, which are not tax shelters). Prior to the TCJA, businesses having gross receipts of not more than $5 million were classified as small businesses for this purpose. The TCJA changed that to having less than $25 million adjusted for inflation of "average annual gross receipts … for the 3-taxable-year period ending with the taxable year which precedes such taxable year..." See, Section 448(c). For 2021, the inflation-adjusted threshold is $26 million. See, Rev. Proc. 2020-45 (October 26, 2020).

<u>Section 263A</u> requires certain direct and indirect costs to be allocated to property produced by a taxpayer or acquired for resale under what are referred to as the UNICAP rules. There are certain exceptions to this rule, including an exception for cash basis farmers producing animals and plants with a pre-productive period of two years or less. See, Sections 263A(d) and (e). Cash basis farmers who do not fit within this exception are nevertheless, with certain exceptions, permitted to elect out of Section 263A, provided, among other things, they agree to use the alternative depreciation system for farming assets. See, Treas. Reg. § 1.263A-4 for details as to the farming exception and the election out. The TCJA added an exception for any small businesses (other than tax shelters) meeting the gross receipts test of Section 448(c).

<u>Section 471</u> generally requires taxpayers to use inventories "whenever in the opinion of the Secretary the use of inventories is necessary in order to determine the income of" the taxpayer. The TCJA added a new Section 471(c) which relaxes this requirement in the case of small businesses (other than tax shelters) meeting the gross receipts test of Section 448(c). That section provides that "the taxpayer's method of accounting for inventory … shall not be treated as failing to clearly reflect income if such method either (i) treats inventory as non-incidental materials and supplies, or (ii) conforms to such taxpayer's method of accounting reflected in an applicable financial statement of the taxpayer with respect to such taxable year or, if the taxpayer does not have any applicable financial statement with respect to such taxable year, the books and records of the taxpayer prepared in accordance with the taxpayer's accounting procedures."

Finally, <u>Section 460</u> requires that taxpayers determine income from long-term contracts under the percentage of completion method. Section 460(e) provides an exception from these rules for home construction contracts and for contracts entered into by small businesses (other than tax shelters) meeting the gross receipts test of Section 448(c) who estimate that the contracts will be completed with a two-year period. The TCJA raised the gross receipts threshold for this purpose from $10 million to $25 million.

A few months after enactment, the IRS issued Rev. Proc. 2018-40 (August 20, 2018) describing how small businesses can obtain consent to change to a simplified method of accounting permitted under the TCJA. On August 5, 2020, the Treasury/IRS issued proposed regulations. In early January, just before the change in administration, the Treasury/IRS issued final regulations implementing the new accounting rules. See, T.D. 9942, 86 FR 254 (January 5, 2021).

The centerpiece of the final regulations is new Treas. Reg. § 1.448-2. That section contains guidance as to how to go about determining whether a small business meets the gross receipts test. It also contains guidance to help determine whether a small business is a tax shelter. Several provisions are worth noting.

- Defining a "tax shelter" has always been difficult. That term includes "syndicates" which the regulations state include a partnership or other entity (other than a C corporation) "if more than 35 percent of the losses of such entity during the taxable year … are allocated to limited partners or limited entrepreneurs." The regulations make it clear that this test is based upon losses actually allocated (rather than allocable) and allow taxpayers to elect annually to use the allocations made in the prior year for this purpose.

- The regulations presume that "marketed arrangements in which persons carrying on farming activities using the services of a common managerial or administrative service will be presumed to have the principal purpose of tax avoidance if such persons use borrowed funds to prepay a substantial portion of their farming expenses." This follows language in Treas. Reg. § 1.448-1T(b)(4).

- For purposes of the gross receipts test, the regulations cross-reference Treas. Reg. § 1.448-1T(f)(2)(ii), (iii) and (iv) for rules related to aggregation of related entities, short taxable years, and the determination of gross receipts.

- The final regulations essentially carry over the definition of "farming business" contained in Treas. Reg. § 1.448-1T(d). That definition distinguishes between "processing activities which are normally incident to the growing, raising or harvesting of agricultural products" (e.g., picking, washing, inspecting and packaging fruits and vegetables) and processing activities "beyond activities normally incident to the growing, raising, or harvesting such products" (e.g., using grain to produce bread, cereal or other similar food products or slaughtering, processing, packaging meat)." They provide that a taxpayer engaging in a farming business and another business is not precluded from using the cash method with respect to its farming business even though it may be precluded from doing to for its other business.

Another important part of the final regulations is Treas. Reg. § 1.471-1(b). As noted above, while small businesses are not held to the same inventory accounting standards as large businesses, they are not simply allowed to expense any inventory items in the year produced or purchased. Rather, a small business is given a choice between using (i) the non-incidental materials and supplies method (referred to as the "section 471(c) NIMS inventory method"), (ii) the method of its applicable financial statement ("AFS section 471(c) inventory method"), or, (iii) if they do not have an applicable financial statement, the method used in its books and records ("non-AFS section 471(c) method").

The final regulations describe each of these alternative methods and provide examples illustrating their use. The preamble to the final regulations is also helpful in understanding what the Treasury/IRS considered in prescribing the rules.

- Under the NIMS method, a taxpayer must keep track of non-incidental materials and supplies and deduct their cost only in the taxable year the supplies are used or consumed in the taxpayer's business. For this purpose, materials and supplies sold to customers are treated as used or consumed in the year of sale. Inventory costs for this purpose include just direct material costs of property produced or the costs of property acquired for resale.

- The final regulations cross-reference Section 451(b)(3) and the regulations thereunder for purposes of defining what is an applicable financial statement. Generally, an AFS is a financial statement that is certified as being prepared in accordance with GAAP or IFRS and that meets certain other requirements. Also included are financial statements filed with certain specified regulatory or governmental bodies. The final regulations provide that "costs that are generally required to be capitalized to inventory under section 471(a) but that the taxpayer does not capitalize to inventory on its AFS are not required to be capitalized to inventory." An example shows the application of this rule to a small business with an AFS that is prepared on an accrual basis, where the inventory method used in those financial statements is followed.

- Small businesses without an AFS are allowed to follow "the method of accounting used for inventory in the taxpayer's books and records that properly reflect its business activities for non-tax purposes and are prepared in accordance with the taxpayer's accounting procedures." The preamble states that the books and records include "the totality of the taxpayer's documents and electronically-stored data" so that both work papers and physical counts of inventory are included. Examples illustrate the application of this method where the books and records themselves do not reflect inventories, but a physical count is performed and is used for various purposes. Here, as well, the final regulations provide that "costs that are generally required to be capitalized to inventory under section 471(a), but that the taxpayer does not capitalize in its books and records are not required to be capitalized to inventory." Included are several examples illustrating this rule.

With respect to Section 263A, the preamble to the final regulations points out the lack of clarity that exists as to what must be capitalized under pre-Section 263A rules for self-constructed assets if Section 263A does not apply. One commenter asked the IRS to clarify this in the final regulations, but the IRS declined, stating that "the requested clarification is beyond the scope of these regulations.

Some farming businesses that have elected out of Section 263A (and thus given up accelerated depreciation) might qualify as small businesses and want to revoke their prior election. In addition, some farming businesses qualifying as small businesses might grow out of the small business exception and want to elect out as farming businesses. The final regulations tweak existing regulations to provide guidance in such situations. See, new Treas. Reg. § 1.263A-4(d)(5) and (6).

The final regulations are generally applicable for taxable years beginning on or after the date they were published in the *Federal Register*, i.e., January 5, 2021. Taxpayers are permitted to apply the regulations for a taxable year beginning after December 31, 2017, provided that in doing so they follow the regulations in their entirety. Alternatively, taxpayers are permitted to follow the proposed regulations in prior years, but must do so in their entirety.

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8. T.D. 9941, 86 Fed. Reg. 810 (January 6, 2021) – regulations implementing the TCJA's changes to the "all events" test and the treatment of advance payments received by accrual basis taxpayers.

As part of the TJCA, Congress modified the accrual "all events" test and adopted new rules for advance payments received by accrual basis taxpayers. Final regulations implementing these changes were publicly released on December 21, 2020, and published in the *Federal Register* on January 6, 2021. See, T.D. 9941, 86 FR 810 (January 6, 2021).

Change to the "all events" test.

The TCJA amended Section 451(b) to provide that, for accrual method taxpayers, "the all events test for an item of gross income (or portion thereof) shall not be treated as met any later than when such item (or portion thereof) is taken into account as revenue in (i) an applicable financial statement of the taxpayer, or (ii) such other statement as the Secretary may specify for purposes of this subsection." New Treas. Reg. § 1.451-3 provides guidance for implementing this new rule (referred to in the regulations as the "AFS income inclusion rule").

The AFS income inclusion rule applies to accrual basis taxpayers with an applicable financial statement ("AFS") as defined in Treas. Reg. § 1.451-3(b)(5). Generally, an AFS is a financial statement prepared in accordance with GAAP or IFRS. Also included are certain other financial statements (other than a tax returns) filed with the federal or a state government or agency or a self-regulatory agency. The final regulations contain rules dealing with more complex situations, such as situations where an AFS covers groups of entities and where a taxpayer's financial accounting year is different than its taxable year. See, Treas. Reg. § 1.451-3(j).

As a general matter, under the AFS income inclusion rule, "the all events test … for any item of gross income, or portion thereof, is met no later than when that item, or portion thereof, is taken into account as AFS revenue…" This brings the recognition of income for tax purposes more in line with the recognition of income for financial statement purposes. There are some important exceptions to this rule:

- It does not apply to taxpayers that do not have an AFS.

- It does not apply to mortgage servicing contracts.

- It does not apply "if the timing of income inclusion for that item, or portion thereof, is determined using a special method of accounting." Treas. Reg. § 1.451-3(b)(13) contains a nonexclusive list of special methods of accounting for this purpose. Examples of methods on the list include the crop method of accounting, methods of accounting provided in Sections 453 to 460, mark-to-market accounting under Section 475, etc. While not on the list, the method of accounting for patronage dividends and per-unit retain allocations provided in Section 1385 should be regarded as a special method of accounting for this purpose.

The final regulations state that the AFS income inclusion rule does not "change the treatment of a transaction or the character of an item for Federal income tax purposes. Treas. Reg. § 1.451-3(g). So, for instance, the fact that a transaction is treated as a sale or as a financing for AFS purposes does not affect the timing of the recognition of income from the transaction if it is treated as a lease, license or similar transaction for federal income tax purposes.

In addition, the final regulations state that the AFS income inclusion rule is intended to affect the time at which the all events test is treated as satisfied "and therefore does not change the applicability of any exclusion provision, or the treatment of non-recognition transactions." See, Treas. Reg. § 1.451-3(h) and examples illustrating this limitation. So the AFS income inclusion rule would not be triggered by financial statement recognition of income upon the forgiveness of a Payroll Protection Program loan. Nor would it be triggered if income is recognized for financial statement purposes upon an exchange of real properties which qualifies for nonrecognition purposes under Section 1031.

However, the final regulations do not provide additional guidance as to the distinction between recognition and realization.

> "Practitioners were hoping for better examples of income realization for tax purposes and a clear definition of something that would not be realized for tax purposes but might be recognized for financial statement purposes.
>
> For example, practitioners are unsure what to do in the case of 'unbilled revenue' or 'unbilled receivables' for the provision of goods, in which someone may perform a service for a single deliverable that takes a while to complete… In that situation, the company may record revenue for AFS purposes but it's not earned until it completes the deliverable…
>
> Previously, the company didn't need to realize that income for tax purposes because it wasn't fixed and determinable, but the new AFS rule could require recognition in that situation…"[28]

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[28] "Realization Punt in Final Biz Accounting Regs May Risk Audits," by Amy Lee Rosen, *Law360* (February 17, 2021).

When an AFS income inclusion is required, the amount to be included is not always the amount of revenue reported on the AFS. See, Treas. Reg. § 1.451-3(c)(2) The revenue reported on the AFS is increased by the amount of any "(1) cost of goods sold and liabilities that are required to be accounted for under other provisions of the Code such as section 461, including liabilities for allowances, rebates, chargebacks, rewards issued in credit card transactions and other reward programs, and refunds…" and "(2) amounts anticipated to be in dispute or anticipated to be uncollectable." Unless the taxpayer chooses to apply what is described as the "alternative AFS revenue method," the AFS revenue is reduced by any amount the taxpayer would not have a legal right to retain if the customer were to terminate the contract on the last day of the taxable year (the "unenforceable rights exception"). Also, the AFS revenue should be adjusted to exclude a financing component if the contract had a significant financing component. (As noted below, these exclusions also apply for taxpayers with applicable financial statements under the new advance payment rules.)

Note that the unenforceable rights exception is the default rule. The alternative AFS revenue method requires an election, which, once made, requires IRS approval to change. Commentators have pointed out difficulties of applying the unenforceable rights exception:

> "The AFS income inclusion rule generally requires taxpayers to exclude from AFS revenue amounts that they do not have an enforceable right to collect at the end of the tax year. However, the application of this rule requires a detailed understanding of the facts of the transaction resulting in the revenue, as well as a comparison of the AFS standard used to report that revenue and a legal analysis of whether the taxpayer has an unenforceable right to that revenue (taking into account potential equitable recoveries)."[29]

The alternative AFS revenue method allows taxpayers to avoid this complication, but it comes at a cost. It may require a taxpayer to include in income amounts to which it does not yet have a legal right.

The Treasury/IRS recognized that the application of the AFS income inclusion rule to sales of inventory could result in mismatches of revenue and expense. The final regulations provide for an "AFS cost offset method." If advance payments are also involved, the taxpayer must also use the "advance payment cost offset method." The rules applicable to these methods are contained in Treas. Reg. § 1.451-3(d) and -8(e). While some taxpayers have observed that the AFS cost offset method is better than nothing (which is what the proposed regulations provided), they are disappointed that final regulations did not go further towards full book/tax conformity by allowing an offset for estimated expenses.

Special rules are provided for contracts with multiple performance obligations (Treas. Reg. § 1.451-3(e)) and for multi-year contracts (Treas. Reg. § 1.451-3(f)).

[29] "The Unenforceable Rights Exception to AFS Income Inclusion," by Scott H. Rabinowitz and David A Schneider, *Tax Notes Federal* (February 22, 2021).

New rules for advance payments.

Accrual basis taxpayers are, generally, required to include advance payments in income in the year of receipt even though accrual might not otherwise make sense under the all-events test. Realizing that the general rule can result in a significant mismatch of revenue and expense, before the TCJA the IRS permitted taxpayers to defer recognition of advance payments in certain situations. See, Rev. Proc. 2004-34, 2004-1 C.B. 991, and Treas. Reg. § 1.451-5.

The TCJA changed that. Now advance payments are governed exclusively by new Section 451(c), which, in pertinent part, provides:

> "(1) In General. – A taxpayer which computes taxable income under the accrual method of accounting and receives any advance payment during the taxable year, shall –
>
> > (A) except as provided in subparagraph (B), include such advance payment in gross income for such taxable year, or
> >
> > (B) if the taxpayer elects the application of this subparagraph with respect to the category of advance payments to which such advance payment belongs, the taxpayer shall –
> >
> > > (i) to the extent that any portion of such advance payment is required under subsection (b) [the "AFS income inclusion rule"] to be included in gross income in the taxable year in which such payment is received, so include such portion, and
> > >
> > > (ii) include the remaining portion of such advance payment in gross income in the taxable year following the taxable year in which such payment is received."

As part of T.D. 9941, the Treasury promulgated new Treas. Reg. § 1.451-8 (advance payments for goods, services and certain other items). This new regulation is applicable to taxable years beginning on or after January 6, 2021. A taxpayer can choose to apply the rules contained in the regulations to prior taxable years provided that it does so in their entirety and in a consistent manner.

The term "advance payment" is defined in Section 451(c)(4) and Treas. Reg. § 1.451-8(a)(1). It includes any payment received by the taxpayer if "(A) the full inclusion of the payment in the gross income of the taxpayer for the taxable year of receipt is a permissible method of accounting, without regard to this section; [and] (B) any portion of the payment is taken into account as AFS revenue for a subsequent taxable year, or, if the taxpayer does not have an applicable financial statement … any portion of the payment is earned by the taxpayer in a subsequent taxable year." For this purpose, the definition of "AFS" follows that used in new Treas. Reg. § 1.451-3 described above.

Advance payments are payments for services, the sale of goods, the use of intellectual property, eligible gift card sales, memberships in an organization and certain other things. Advance payments do not include rent, insurance premiums, payments with respect to financial instruments, and certain other things.

The final regulations begin by providing that, as a general rule, "an accrual method taxpayer shall include an advance payment … in gross income no later than in the taxable year in which the taxpayer receives the advance payment." Treas. Reg. § 1.451-8(b).

However, they then provide that taxpayers with an AFS may elect the "deferral method." Under that method a taxpayer "must (i) include the advance payment, or any portion thereof, in gross income in the taxable year of receipt to the extent taken into account as AFS revenue as of the end of such taxable year…; and (ii) include the remaining portion of such advance payment in gross income in the taxable year following the taxable year in which such payment is received (next succeeding year)." Treas. Reg. § 1.451-8(c). There are special adjustments to what is reported for financial purposes for determining what is "taken into account as AFS revenue" that that are like those described above for the new all-events test.

Taxpayers without an AFS, are eligible to use the "non-AFS deferral method." Under that method, a taxpayer "includes the advance payment in gross income for the taxable year of receipt to the extent that it is earned in that taxable year and includes the remaining portion of the advance payment in gross income in the next succeeding year." Treas. Reg. § 1.451-8(d)(3). For this purpose, a payment is deemed earned when the all-events test is met, without regard to when the payment is received by the taxpayer.

The regulation allows taxpayers to adopt the "advance payment cost offset method" for advance payments from the sale of inventory. Under this method, a taxpayer is permitted to reduce what it otherwise would have included in income for a taxable year prior to the year the inventory is transferred "by the cost of goods in progress offset for the taxable year." This method does not permit taxpayers to include costs that will be incurred in the subsequent year in the offset. As noted above, if the taxpayer adopts the advance payment cost offset method, it must also adopt the AFS cost offset method.

There is a special carve-out from the advance payment rules for payments received for goods two years or more in advance of delivery (the "specified good exception") unless the taxpayer elects the "specified good section 451(c) method."

The final regulations contain a number of examples illustrating the application of the rules. The examples address such things as the sales of gift cards, sales of products or services where the customer earns miles or other rewards, sales of products where the customer receives a discount voucher for future purchases, etc. Special rules apply to contracts with multiple performance obligations. The regulations provide that "any payments received under the contract are allocated to the corresponding item of gross income in the same manner as such payments are allocated to the performance obligations in the taxpayer's AFS." Treas. Reg. § 1.451-8(c)(8).

Effective date.

Generally, the final regulations are effective for tax years that start on or after January 1, 2021, but there are options for adopting the rules earlier.

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<u>Coronavirus Legislation – Cares Act, CAA and ARPA selected topics of potential interest to cooperatives</u>

9. Developments affecting the deductibility of charitable contributions – temporary changes to charitable contribution limitations.

Cooperatives and the taxable income limitation.

Cooperatives that make significant charitable contributions often find the historic corporate "10% of taxable income limitation" on charitable deductions to be constraining. See, Section 170(b)(2)(A). After exclusions/deductions for per-unit retain allocations and patronage dividends, many cooperatives have little taxable income and thus cannot deduct all they contribute.

There is a special definition of "taxable income" for this purpose contained in Section 170(b)(2)(D). That definition lists several adjustments to ordinary taxable income in determining "taxable income" for purposes of the limitation. But there is no adjustment permitting cooperatives to add back per-unit retain allocations or patronage dividends as there is in the statute for DPAD purposes. Nor is there a delegation of authority to Treasury to make other exceptions as there was in Section 163(j). As a result, while strong policy/equity arguments can be made that cooperatives should be permitted to add back patronage dividends, Section 170(b)(2)(D) probably needs to be amended to allow that to be done.

CARES Act and CAA temporary relaxation of the limitation.

Having said that, the CARES Act temporarily increased the corporate limitation for certain "qualified contributions" from 10% to 25% of taxable income and for contributions of food inventory from 15% to 25%. For this purpose, "qualified contributions" are cash contributions to most charitable organizations made during <u>calendar 2020</u> which the taxpayer elects to have covered. Also included are contributions of "food inventory" covered by Section 170(e)(3)(C).

The Consolidated Appropriations Act, 2021 ("CAA") extends the CARES Act relaxation of the corporate limitation to include contributions made during <u>calendar 2021</u>.

CAA contribution provision for "qualified disaster relief contributions.

Separately, the CAA provides a narrow special 100% limitation for "qualified disaster relief contributions." This special limitation is also elective. "Qualified disaster relief contributions" are defined as contributions "for relief efforts in one or more qualified disaster areas." They must be made during the period beginning 1/1/2020 and ending "on the date which is 60 days after the date of enactment of this Act." The CCA was signed by the President on December 27, so 60 days after the date of enactment ran on February 25, 2021.

In IR-2021-27 (January 29, 2021), the IRS provided further guidance as to the scope of this 100% limitation. The information release states:

> "Under the new law, qualified disaster areas are those in which a major disaster has been declared under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act. <u>This does not include any disaster declaration related to COVID-19</u>. Otherwise, it includes any major disaster declaration made by the President during the period beginning on Jan. 1, 2020, and ending on February 25, 2021, as long as it is for an occurrence specified by the Federal Emergency Management Agency as beginning after Dec. 27, 2019, and no later than Dec. 27, 2020." (emphasis added).

The donor must follow the usual recordkeeping requirements that apply to charitable contributions, including obtaining a contemporaneous written acknowledgment ("CWA") from the charity prior to the due date for its return. The statute also requires affirmation from the charity that the contributions was used, or is to be used, for relief efforts in one or more qualified disaster areas (a "disaster relief statement"). Having said that, because the provision was not enacted until the end of December and guidance was not released until the end of January, IR-2021-27 states that the IRS "will not challenge a corporation's deduction of any qualified contribution made before Feb. 1, 2021, solely on the grounds that the corporation's CWA does not include the disaster relief statement."

Treatment of charitable contributions from inventory.

Current tax law can present tax issues when items of food are contributed from inventory.

For many years, the Treasury's annual Priority Guidance Plan has included "guidance under §170(e)(3) regarding charitable contributions of inventory." See, for example, Department of the Treasury, 2020-2021 Priority Guidance Plan (November 17, 2020), at 8. Treasury/IRS has been requested to clarify that, when a taxpayer contributes food from its inventory to food banks, shelters and other charitable organizations, the taxpayer can deduct current year costs capitalized to inventory as cost of goods sold. Since guidance has not been forthcoming, Darden Restaurants recently requested that the item be retained on the 2021-2022 Priority Guidance Plan. See, Letter from Darden Restaurants, Inc. to the Internal Revenue Service regarding "Inclusion of Section 170(e)(3) Guidance Project on the 2021-2022 Priority Guidance Plan" (May 1, 2021). Unfortunately, this request was not granted, and the guidance was dropped from the 2021-2022 Priority Guidance Plan (September 9, 2021).

This request, if it had been granted, would have been helpful as far as it went for cooperatives constrained by the taxable income limitation. However, it would be helpful if the issue addressed was broadened to include the treatment of all inventory costs, not just current year cost. Under the current regulations, prior year costs of property contributed from inventory that have been capitalized to inventory cannot be deducted as cost of goods sold. Rather, they must be removed from inventory and classified and deducted as a charitable contribution subject to the limitations on charitable contributions.[30] It would be helpful if prior year costs as well as any

[30] See, Treas. Reg. §§ 1.170A-1(c)(4) and 1.170A-4A(c). "Notwithstanding the rules of § 1.170-1(c)(4), the donor of the property which is inventory contributed under this section must make a corresponding adjustment to cost of goods sold by decreasing the cost of goods sold by the lesser of the fair market value of the contributed item or the amount of basis determined under paragraph (c)(2) of this section."

current year costs could be deducted as cost of goods sold. However, this would require changes to the existing regulations, a task the IRS would be unlikely to undertake.

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10. Tax treatment of Payroll Protection Program loan forgiveness clarified; practical issues for cooperatives.

Last year we reported upon the controversy that arose when the IRS took the position that, while participants in the Payroll Protection Program ("PPP") were not required to include PPP loan proceeds in income, they were required to reduce deductible expenses when their loans were forgiven. See, Notice 2020-32 and Rev. Rul. 2020-27. This seemed to many to be contrary to Congressional intent when the PPP was authorized.

The controversy was resolved by Congress in the Consolidated Appropriations Act, 2021, signed into law on December 27, 2020. That act provided:

> "(1) no amount shall be included in the gross income of a borrower by reason of forgiveness of [PPP] indebtedness…, [and]
>
> (2) no deduction shall be denied, no attribute shall be reduced, and no basis increase shall be denied, by reason of the exclusion from gross income provided by paragraph (1) …"

Early in 2021, the IRS issued Rev. Rul. 2021-2, declaring Notice 2020-32 and Rev. Rul. 2020-27 obsolete. That was followed by Rev. Proc. 2021-20 addressing what businesses that received PPP loans and did not deduct expenses because of the original IRS guidance on a return already filed should do.

Since then, most (but not all) states have indicated that they will follow the federal treatment of PPP loan forgiveness.

The favorable resolution of this issue results, all else being equal, in the book income of a business with a forgiven PPP loan exceeding taxable income (or the book loss being less than the tax loss). The difference is permanent.

This can present issues for a cooperative. While there was considerable business uncertainty when cooperatives obtained PPP loans in 2020, most cooperatives, particularly agricultural cooperatives, were not shut down by the pandemic, and the later forgiveness of the PPP loans ended up increasing their net book income.

The threshold issue is whether the book income resulting from a forgiven PPP loan is patronage-sourced. There is no clear answer. However, if a cooperative's only business is a patronage business, a strong case can be made that the income is patronage. But if the cooperative conducts the patronage business both with members who share in patronage dividends and with nonmembers who do not, the book patronage income resulting from the forgiven PPP loan likely must be apportioned between member and nonmember. If the cooperative conducts a nonpatronage business, some portion should also be allocated to the nonpatronage business.

Book/tax differences present unique issues for cooperatives.

- Cooperatives that base their patronage dividends on book income may, all else being equal, end up paying an amount of patronage dividends in excess of their taxable patronage income for the year. Questions may arise as to whether the excess can create a loss for tax purposes, what the character of any loss is, and whether there are limitations on the use of the loss.

- Cooperatives that base their patronage dividends on taxable income will, all else being equal, end up paying an amount of patronage dividends that is less than their book income. The result for book purposes may be an addition to unallocated retained earnings. From the perspective of the cooperative, additional unallocated capital may very well be welcome, but members may question why the income resulting from the forgiven PPP loan proceeds was not included in patronage dividends. If, in response to member pressure, a cooperative decides to distribute the amount of the forgiven PPP loan anyway, other questions arise.

The issues identified above are only some of the corporate and tax issues that may arise.[31]

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11. Temporary 100% expensing of restaurant meals.

The TCJA placed a 50-percent limitation on deductions for certain otherwise deductible food and beverage expenses. See, Section 274(n)(1). However, the CAA temporarily relaxed this rule, allowing a 100-percent deduction for a subset of otherwise deductible food and beverage expenses, namely, those paid or incurred in 2021 and 2022 "for food or beverages provided by a restaurant." Section 274(n)(2)(D).

In Notice 2021-25, 2021-17 IRB 1, the IRS provided guidance as to the scope of the 100-percent deduction. It focuses on the meaning of "provided by a restaurant." The term "restaurant" is defined as "a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business's premises." Excluded from the term "restaurant" is any business that "primarily sells pre-packaged food or beverages not for immediate consumption" such as a grocery store, drug store, liquor store, convenience store, newsstand, vending machine or kiosk. Food or beverages acquired from such locations can, if the other requirements of Section 274 are met, still qualify for the 50-percent deduction. Also excluded from the 100-pecent deduction are eating facilities on the premises of the employer and furnishing meals excluded from an employee's gross income under Section 199 and employer-operated eating facilities treated as a de minimis fringe under Section 132(e)(2).

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[31] Among other things, cooperatives distributing the forgiven loan proceeds to members should consider what, if any, effect doing so might have if the SBA examined them and questioned the representations they made when originally applying for the loan.

Miscellaneous

12. Little-used special rule for cooperatives seeking legal fees after prevailing in a tax case.

Under certain narrowly-defined circumstances, some taxpayers who prevail in an administrative or court proceeding with the IRS may be entitled to reasonable administrative or litigation costs incurred in connection with the proceeding. See, Section 7430, which is patterned on the Equal Access to Justice Act, 28 U.S.C. § 2412.

Section 7430 is targeted to small taxpayers. It incorporates the requirements of the Equal Access to Justice Act. See, Section 7430(c)(4)(A)(ii). In the case of individuals, the relief is available only for those whose net worth did not exceed $2 million at the time the case commenced. For corporations, the relief is generally available only if, at the time the case commenced, the corporation had a net worth which did not exceed $7 million <u>and</u> did not have more than 500 employees.

However, there is a special rule for cooperatives which was added to the law in 1980 by P.L. 96-481 (October 21, 1980).[32] The net worth test does not apply to farmer cooperatives "defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. 1141j(a))." See 28 U.S.C. § 2412(d)(2)(B). Cooperatives described in that section are eligible for relief under Section 7430 (assuming all other requirements are met) if they do not have more than 500 employees at the time the case was commenced.

The Agricultural Marketing Act definition is identical to the definition contained in the Capper-Volstead Act. To qualify, an association must be "operated for the mutual benefit of the members thereof as … producers or purchasers," it must either be organized on a one-member, one-vote basis or must not pay dividends on stock or membership capital in excess of 8 per centum per year, and the value of the business it conducts with members must equal or exceed the value of business conducted with nonmembers.

Over the years, there have been many cases dealing with claims for costs under Section 7430. Only one of the cases has involved a cooperative. See, *Columbus Fruit & Vegetable Cooperative Association v. United States*, 8 Cl. Ct. 525 (U.S. Claims Court 1985), which awarded legal fees after Columbus Fruit prevailed in an IRS challenge to its cooperative status because it did not do more than 50% of its business on a patronage basis.[33]

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[32] This addition appears to be the result of lobbying efforts by Sunkist. Sunkist was at the time the target of an extended antitrust investigation by the FTC, which had cost it many dollars to defend, and which Sunkist felt unjustified. See, Hearings Before the Subcommittee on Improvements in Judicial Machinery of the Committee on the Judiciary, United States Senate, Ninety-sixth Congress, First Session, on S. 265 (Equal Access to Justice Act of 1979), April 19, 20 and 21, 1979, pages 62-76.

[33] There is no discussion in the case of the net worth/employee requirement or of the special rule for cooperatives. Because of the amount of nonmember business, Columbus Fruit would not have met the requirements for the special rule for cooperatives. Presumably, its net worth and employee head count were beneath the thresholds set in the statute.

Generally, to be eligible to claim such costs, the taxpayer must be the "prevailing party" and the position of the Government must not be "substantially justified." There are other requirements as well. A complete description of this provision is beyond the scope of this article, which is intended principally to highlight the existence of the special cooperative rule.

This provision can be a tool for reaching a reasonable settlement of a case. Where a taxpayer makes a "qualified offer" during the "qualified offer period" which the Government does not accept, the taxpayer will be treated as the prevailing party in litigation if the result is more favorable than the offer even though it would not otherwise be regarded as having prevailed.

It should be noted that most of the hundreds of reported cases under Section 7430 involve taxpayer losses. Even when taxpayers win, they rarely recover more than a fraction of their litigation costs. By statute, there is a cap set on attorney's fees of $125 per hour, adjusted by inflation, "unless the court determines than an increase in the cost of living or a special factor, such as the limited availability of qualified attorneys for such proceeding, the difficulty of the issues presented in the case, or the local availability of tax expertise, justifies a higher rate." Section 7430(c)(1)(B)(iii). For 2021, the inflation adjusted rate was $210 per hour. For 2021, it will be $220 per hour.

Courts have been stingy in awarding costs.

- For instance, in *Columbus Fruit*, the Court refused to award more than the then statutory rate of $75 per hour, "if for no other reason that plaintiff was retreading ground argued before other courts."

- More recently, in *Charles P. Adkins v. United States*, 127 AFTR 2d 2021-2519 (U.S. Court of Federal Claims 2021), the Court refused to award more than the inflation adjusted statutory rate (observing, "the fact their attorneys are experienced tax litigators is not a special factor justifying an increase in the cap…") and reduced the reimbursed hours. The net effect was to award $60,800.60 (instead of the requested $185,330.40).

- In *Jesse C. Morreale v. Commissioner*, T.C. Memo 2021-90 (July 15, 2021), the Tax Court awarded the taxpayer only a fraction of the legal fees requested. The taxpayer requested $411,000, but was awarded only $15,034. A large portion of the claimed costs related to a bankruptcy proceeding (where the tax issue surfaced), not to the Tax Court proceeding, and the Tax Court held those not covered by Section 7430. In addition, the Tax Court allowed all the hours related to the case itself, but disallowed some of the claimed hours related to the fee petition (since they related to correcting a procedural fault) and limited the award to the statutory rate.

  The taxpayer argued that he could not have hired qualified counsel at the statutory rate. But the Tax Court was not impressed.

  > "While petitioner may or may not have been able to retain counsel at the statutory rate, he cannot show that his market lacked competent counsel overall. Even assuming that petitioner's claims are accurate, he has shown only that he could not retain those counsel <u>at the statutory rate</u> – and that is

> not enough to establish a special a special factor permitting an upward departure. … Moreover, while this case has a long knotted procedural background, the issues involved are ordinary questions of proper accounting methods and substantiation. These are not the types of egregiously complex legal or factual matters that justify an upward departure from the statutory rate." (emphasis in original).

Several other sections of the Internal Revenue Code incorporate the definition of small taxpayer included in Section 7430(c)(4)(A)(ii) and thus can potentially benefit cooperatives that qualify under that section.

Most notable is Section 7491,[34] which, under certain circumstances shifts the burden of proof in litigation for taxpayers described in Section 7430(c)(4)(A)(ii). In tax litigation, generally the taxpayer has the burden of proving matters in dispute. For small taxpayers, the burden of proof can be shifted to the Government if the "taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B." To qualify for this, besides being a small taxpayer, the taxpayer must show that it has (i) complied with requirements in the Code to substantiate the item, (ii) maintained all records required under the Code, and (iii) "cooperated with reasonable requests by the [IRS] for witnesses, information, documents, meetings, and interviews."

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13. Refund claim issues; new special rule for research credit claims.

If refund claims end up in court, the last thing taxpayers want is to have the litigation expand to include tangential issues related to the form, content, or timeliness of the claims themselves. Litigation is slow enough without involving side issues that could largely have been avoided if the refund claims had been carefully drafted.

Section 7422(a) provides that "no suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected … until a claim for refund or credit has been duly filed…" This means what it says. A refund suit cannot be commenced in either a U.S. District Court or the U.S. Court of Federal Claims without a valid refund claim. See, for example, *Naresh Channaveerappa v. United States*, Case No. 1:20-CV-1732 (October 26, 2021) (order dismissing case because "Plaintiffs did not file a legally compliant request for refund").

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[34] There are also special provisions for small taxpayers in Sections 6404, 6656 and 7431. Under certain circumstances, Section 6404(e) provides authority for the IRS to abate interest "attributable to unreasonable errors and delays by the Internal Revenue Service." Section 6404(h) provides small taxpayers with the ability to bring an action in Tax Court (rather than having to bring a refund suit in District Court or the Court of Federal Claims) if the IRS refuses to abate interest and the failure was an "abuse of discretion." Section 6656(c) provides that the IRS may waive any penalties imposed by reason of a small first-time depositor's "inadvertent failure to deposit any employment tax." Section 7431(c)(3) provides that in addition to damages and costs a small taxpayer may be awarded reasonable attorney fees (determined as in the case of Section 7430(c)(4)) if it prevails in litigation seeking civil damages for unauthorized inspection or disclosure of returns and return information.

Claims must be timely filed and must adequately put the IRS on notice as to what is being claimed.

Treas. Reg. § 301.6402-2(a)(1) provides that "[c]redits or refunds of overpayments may not be allowed or made after the expiration of the statutory period of limitation properly applicable unless, before the expiration of such period, a claim therefore has been filed by the taxpayer." Treas. Reg. § 301.6402-2(b)(1) states:

> "No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period. The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the IRS of the exact basis thereof. The statement of the grounds and facts must be verified by a written declaration that it is made under the penalties of perjury. A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund or credit."

For regular corporations, refund claims are made by filing Form 1120X (Amended U.S. Corporation Income Tax Return) with the IRS. For cooperatives, refund claims are made using an amended Form 1120-C (U.S. Income Tax Return for Cooperative Associations). The instructions to that form state:

> "If the cooperative must change its originally filed return for any year, it should file a new return including any required attachments. Use the revision of the form applicable to the year being amended. The amended return must provide all the information called for by the form and instructions, not just the new or corrected information. Check the 'Amended return' box."

Timely filing.

Generally federal claims for refund of income taxes must be filed within three years after the date a corporation filed its original return or within two years after the date the corporation paid the tax, whichever is later. A return filed before the due date is considered filed on the due date.

For tax purposes, timely mailing (evidenced by a timely postmark) generally is timely filing for documents that actually reach the IRS, provided that the letter bears a legible postmark. See, Section 7502(a).

However, there are exceptions to this rule.

First, if the claim arrives after the due date without a postmark and it was not sent by registered or certified mail (or by use of a duly designated private delivery service), the taxpayer may very well be out of luck. See, for instance, *McCaffery v. United States*, 128 AFTR 2d 2021-5451 (Fed. Cl. August 9, 2021) where the Court of Federal Claims refused to consider evidence of when a refund was actually mailed when it arrived after the due date and did not have a postmark.

> "But on the plain text of section 7502, the deemed delivery rule only applies if a postmark or equivalent marking is made: The date of the postmark is what matters, not the date of the mailing. … Similarly, the regulations provide for extrinsic evidence only to prove the contents of an illegible postmark, not to prove time of mailing when there was no postmark."

The court recognized that the result was "harsh," particularly since it appeared clear that the claim had been timely mailed, but "the text controls."

<u>Second</u>, the rule does not apply if a claim never arrives at the IRS (or the IRS asserts it never arrived). In such a case, Treas. Reg. § 301.7502-1(e)(ii) provides:

> "Other than direct proof of actual delivery, proof of proper use of registered or certified mail, and proof of proper use of a duly designated [private delivery service] …, are the exclusive means to establish prima facie evidence of delivery of a document to the agency, officer, or office with which the document is required to be filed. No other evidence of a postmark or of mailing will be prima facie evidence of delivery or raise a presumption that the document was delivered."

This second exception is illustrated by a recent decision of a District Court in New Jersey. See, *Charles Crispino, Jr. v. United States*, Civ. No. 17-13751 (July 26, 2021), where the court dismissed the taxpayer's claim, concluding that the regulations were valid and supplanted any common-law mail-box rule.

Adequately describing what is being claimed – the "specificity requirement."

The regulation also provides that a "claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the IRS of the exact basis thereof." Occasionally the IRS tries to have cases dismissed because of an asserted failure of the refund claim to meet this requirement. Obviously, claims that simply assert that the taxpayer is entitled to a refund without any explanation as to why do not meet this standard. But just how detailed must the description of the basis of the claims be?

Two recent U.S. District Court decisions, both in Utah, illustrate potential problems that sketchy refund claims can create. See, *Premier Tech, Inc. v. United States*, 128 AFTR 2d 2021-5220 (July 15, 2021), and *Intermountain Electronics, Inc. v. United States*, 128 AFTR 2d 2021-5240 (July 16, 2021).

Both cases dealt with research credit claims based on studies conducted by the AlliantGroup LP. Research credit claims often present difficult factual issues. While many companies that claim research credit are in fact entitled to what they claim, the IRS believes that many claims are unwarranted. It has included research credit claims on its annual "dirty dozen" list of tax scams for the past few year. See, IR-2021-144 (July 1, 2021). See, also, "Research Credit Claims Audit Techniques Guide (RCCATG): Credit for Increasing Research Activities § 41," available at the IRS website.

https://www.irs.gov/businesses/research-credit-claims-audit-techniques-guide-rccatg-credit-for-increasing-research-activities-ss-41 [35]

The two cases were decided by the same court a day apart, but by different judges who took somewhat different approaches. In each, the Government argued that the refund claims contained insufficient detail and that the case should be dismissed because of that. In addition, in each the Government also argued that the pleadings in the complaints filed with the court lacked sufficient detail to state a claim and the cases should be dismissed.

In *Premier Tech*, the judge held for the taxpayer on both arguments. With respect to the Government's argument that the refund claim was not sufficiently specific, the judge observed:

> "The purpose of this requirement 'is to afford the Service an opportunity to consider and dispose of the claim without the expense and time which would be consumed if every claim had to be litigated.' There is not a precise rule for what level of detail satisfies the specificity requirement, but it is not a high standard. Some courts have explained, '[t]he specificity requirement is met if the basic issue is evident from the record, and the IRS is aware of the nature of the claim.' Another court has said that 'to be a valid return for purposes of a refund claim, the return must contain sufficient data to allow calculation of tax.' And another court has said the taxpayer 'need only set forth facts in the claim sufficient to enable the IRS to make an intelligent review of the claim'
>
> Premier's amended return is sufficiently specific….
>
> The amended return is complete and puts the IRS on notice about the nature of the claim, the entity claiming the credit, and the legal theory upon which the claim is founded. The amended return has sufficient data to calculate the tax and enough information to allow the IRS to efficiently investigate the requirement so 26 U.S.C. § 41 and make an informed determination about the refund."

The judge also concluded that the complaint contained sufficient information to survive a motion to dismiss for failure to state a claim.

In *Intermountain Electronics*, the judge cast doubt as to the Government's argument that the claim was not sufficiently specific (characterizing what the Government asserted should have been included as placing "quite a heavy burden on taxpayers"), but concluded she did not need to address that issue. She concluded that the IRS waived the regulatory specificity requirements when it investigated Intermountain's claim and denied it.

[35] Additional guidance recently was released including a set of frequently asked questions (available at: https://www.irs.gov/businesses/corporations/research-credit-claims-section-41-on-amended-returns-frequently-asked-questions) and guidance to IRS personnel handling refund claims involving research credits (LB&I-04-0122-0001).

However, she went on to decide that Intermountain's complaint did not contain sufficient detail. She dismissed it for failure to state a claim, but without prejudice, allowing Intermountain to file an amended complaint that she said should contain:

> "… sufficient factual matter to advise the court and the Government of the nature of its claim. This should include the facts underlying its belief that it is entitled to a refund, such as the activities it believes constituted qualified research activities. The amended complaint should also articulate the ways in which the IRS improperly denied Intermountain's claim for refund."

The IRS pushes back – new rule requiring "specificity" for research credit claims.

Not long after the decisions in *Premier Tech* and *Intermountain Electronics*, the IRS issued IR-2021-203 (October 15, 2021), requiring that all research credit claims for refund filed on or after January 10, 2022, contain extensive information and providing that after that date "there will be a one-year transition period during which taxpayers will have 30 days to perfect a research credit claim for refund prior to the IRS' final determination on that claim." Released at the same time was a 20-page IRS Chief Counsel Memorandum specifying what must be included in research credit claims and discussing the consequences of filing deficient claims. FAA 20214101F (September 17, 2021) (the "Memorandum").

The news release and Memorandum require refund claims to include the following information:

> "… for a Section 41 research credit claim for refund to be considered a valid claim, taxpayers are required to provide the following information at the time the refund claim is filed with the IRS:
>
> - All business components to which the Section 41 research credit claim relates for that year.
> - For each business component, identify all research activities performed and name the individuals who performed each research activity, as well as the information each individual sought to discover.
> - Provide the total qualified employee wage expenses, total qualified supply expenses, and total qualified contract research expenses for the claim year."

This information must be provided in a written statement (not simply through the production of documents) which must be signed under penalties of perjury.

The reaction of the taxpayer community to the news release and Memorandum has been negative. Does the IRS have legal authority for its position? Is what it proposes to require reasonable? Such detailed information is not required to be included when research credit is claimed on original returns. Why should refund claims be treated differently? Is the IRS analysis in the Memorandum of what is required in a refund claim just applicable to refund claims involving the research credit? If so, what justifies treating research credit claims differently? Note, there is nothing in the news release suggesting that other claims must have comparable detail.

If the IRS goes forward, the likely result will be to significantly complicate future research credit refund claims, perhaps require "perfection" of prior claims, and add another issue to all research credit disputes.

As a matter of strategy, the Memorandum recommends that the IRS should simply reject outright (without audit) any research credit refund claims that do not meet the new standards. It suggests doing so for two reasons, both of which are tactical.

> First, courts have found that, when claims are audited, the IRS waives any argument that the "specificity requirement" is not met. This was done in *Intermountain Electric*. Another recent example, also involving a research credit claim, is *Harper v. United States*, 127 AFTR 2d 2021-1027 (9th Cir. 2021). While the District Court agreed with the IRS that the claim was insufficient, the Ninth Circuit reversed. The court concluded that the IRS had waived any failure to meet the "specificity requirement" after conducting a four-year audit, with "extensive correspondence between the government and Taxpayer, and … over 112,000 pages of documentation produced by Taxpayer."
>
> Second, courts have often been lenient when taxpayers "perfect" deficient claims that were timely filed, but not "perfected" until after the statute of limitations for filing claims expired. The Memorandum notes that summarily rejecting claims not containing all of the prescribed information "may preclude a taxpayer from amending or perfecting their refund claim if the refund claim failed to follow procedural requirements and the statute of limitations to file a new refund claim has expired." The news release and Memorandum both require that the requested information be included "at the time the refund claim is filed with the IRS."

While these requirements seem like administrative over-reach, taxpayers who plan to file research credit refund claims should study this news release and Memorandum carefully and keep on the watch for further developments. Also, taxpayers who have filed research credit refund claims that are pending will need to be on the alert for clarification as to what the IRS contemplates must be done during the "one-year transition period" to perfect prior claims.

Protecting against a later assertion of "variance."

The first sentence of Treas. Reg. § 301.6402-2(b)(1) precludes a taxpayer from asserting an issue in court that was not set forth in the refund claim. It does so by providing that no refund will be allowed "except upon one or more of the grounds set forth" in a timely claim.

A taxpayer that raises a new matter for the first time in its pleadings or briefs runs the risk of having the matter dismissed without regard to its merits. As the Court of Appeals recently observed in *Green v. United States*, 880 F.3d 519 (10th Cir. 2018):

> "Together, § 7422(a) and Treasury Reg. § 301.6402-2(b)(1) give rise to what courts have described as the 'substantial variance' rule. This rule bars a taxpayer from presenting claims in a tax refund suit that 'substantially vary' the legal theories and factual bases set forth in the tax refund claim presented to the IRS. Of relevance here, any legal theory not expressly or impliedly contained in the application for refund cannot be considered by a court in which a suit for refund is subsequently initiated." (citations and quotation marks deleted).

Variance arguments arise when claims totally unrelated to the original refund claim are later made. They also can arise where alternative theories are raised.

Amended returns should include all claims for the year in question. If, after a claim is filed and while the statute is still open, the taxpayer discovers additional items that should have been included, an additional claim should be filed. Also, taxpayers should be careful how they describe the grounds for their claims so that the description is broad enough to cover the arguments the taxpayer anticipates later using in court to support the claims.

Application to cooperatives.

As noted above, there is no form for cooperatives to use for refund claims comparable to Form 1120X used for refund claims filed by regular corporations. Cooperatives should consider attaching a schedule to an amended Form 1120-C that follows the format of Form 1120X. The Form 1120X contains a section inviting an explanation of the basis for the claim. Care should be taken so the explanation meets the "specificity requirement" and adequately covers what is being claimed so it precludes a later "variance" attack.

Cooperatives should always follow the practice of sending refund claims by registered or certified mail (or by use of a duly designated private delivery service). This provides a means to prove timely filing if the claim is delivered to the IRS after the last day for filing and the envelope does not have a postmark or if the IRS asserts it never received the claim.

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14. Cases dealing with the research credit.

The Internal Revenue Code contains two provisions designed to provide incentives for businesses to conduct research activities – Sections 41 and 174.

<u>Section 174</u> currently permits research and experimental expenses to be deducted.[36] Starting in taxable years beginning after December 31, 2021, taxpayers will be required to capitalize and amortize all research expenses over five years.[37] (The stalled Reconciliation bill contains a

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[36] Section 174(b) also permits taxpayers to elect to capitalize research and experimental expenditures and to amortize them over a period of not less than 60 months. Alternatively, a taxpayer may elect to capitalize and amortize research and experimental expenses over a 10-year period pursuant to Section 59(e).

[37] This change was made by the TCJA. The amortization period is fifteen years for foreign research. New Section 174(c)(3) also provides that "any amount paid or incurred in connection with the development of any software shall be treated as a research or experimental expenditure."

provision that would have delayed capitalization for four years. It will be interesting to see whether such a delay will find its way into any tax legislation that gets enacted in 2022.)

Section 41 provides taxpayers with a credit for increasing research activities. After years of serving as the poster child for the oft-repeated maxim that "nothing is so permanent as a temporary government program," the Section 41 credit was finally made permanent by the Protecting Americans from Tax Hikes Act of 2015. In the 2020 Treasury review of tax expenditures it is listed as having an estimated ten-year revenue cost of $237.8 billion, putting it 20th on the list of tax expenditures. See, "Tax Expenditures" prepared by the U.S. Department of the Treasury, Office of Tax Analysis (February 26, 2020).

Expenses that qualify for the research credit are a subset of those that qualify as research and experimental expenses under Section 174. The amount deducted (or amortized) under Section 174 must be reduced by credits claimed under Section 41. See, Section 280C(c).

Proving entitlement to the Section 41 credit can be difficult.[38] It often is difficult to draw the line between what qualifies and what does not. Taxpayers usually do not have a nontax reason for maintaining the records needed to prove their entitlement to the credit adding further complications.

A prior Digests described the Tax Court's rejection of a wheat miller's research credit claims for a variety of projects. *Siemer Milling Company v. Commissioner*, T.C. Memo. 2019-37 (April 15, 2019). In case decided this year, the Tax Court rejected almost all the research credit claimed by another taxpayer. See, *Little Sandy Coal Company v. Commissioner*, T.C. Memo. 2021-15 (February 11, 2021).

Little Sandy claimed the research credit for expenses incurred by its shipbuilding subsidiary, Corn Island Shipyard, Inc. ("CIS"), in developing eleven vessels. For reasons described below, the Tax Court rejected its claim in its entirety.

For expenses to qualify as qualified research expenses, they must be incurred in connection with qualified research. Research is qualified research if it meets four tests – the Section 174 test, the technological information test, the business component test, and the process of experimentation test. In addition, a project may not fall within the following categories – research after commercial production, adaptation of existing business components to a particular customer's needs, and duplication of existing business components. Efficiency surveys, market research, routine data collection and quality control testing are also excluded.

The Tax Court opinion focused on two of CIS' eleven projects, – the development of a tanker and of a dry dock – which the parties agreed were representative of the other projects in dispute. Focusing on representative projects is common in research credit litigation since that litigation is

[38] In an effort to simplify compliance, in 2017 the IRS Large Business and International ("LB&I") Division issued a directive which permitted taxpayers to use an adjusted ASC 730 Financial Statement R&D amount to determine qualified research expenses for Section 41 purposes. See, News Release 2017-158 (September 22, 2017). This program has had mixed results. Recently, the terms were tightened. The revised program terms remove the statement that, if a taxpayer complies with the program's requirements, "LB&I examiners will not challenge QREs which are the Adjusted ASC 730 Financial Statement R&E costs for the Credit Year." See, IR-2020-211 (September 15, 2020).

so fact intensive. Normally, after the court renders its decision on the representative projects, the parties are able to agree how to apply that decision to other projects in dispute.

The Tax Court focused on the fourth test, namely whether all (or substantially all)[39] of the claimed research expenses with respect to the tanker and the dry dock were for activities which constituted a "process of experimentation."

> "The fourth, and probably most stringent,[5] requirement of qualified research is that substantially all of the activities involved in the research must 'constitute elements of a process of experimentation for a purpose' related to 'a new or improved function,' 'performance,' or 'reliability or quality.' Sec. 41(d)(1)(C), (3)(A)."
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> 5. As we observed in *Union Carbide* … Congress added the process of experimentation requirement to sec. 41 because of the legislators' "concern[] that taxpayers had been claiming the credit 'for virtually any expenses related to product development' as opposed to high technology." Although sec. 174 and the process of experimentation requirement both focus on the elimination of uncertainty, the latter "imposes a more structured method of discovering information than section 174 requires and may not include all actions a taxpayer takes to resolve uncertainty."

Little Sandy argued that it met that test because the overall project involved something novel and required experimentation. CIS had never built a dry dock or a vessel like the tanker and, as a result, faced many challenges. The Tax Court concluded that was not enough. While the projects might have involved research, only costs related of actual experimentation qualified:

> "We have no doubt that CIS' efforts to design the tanker and dry dock involved activities that 'constitute[d] elements of a process of experimentation' for a purpose related to 'a new or improved function,' 'performance,' or 'reliability or quality.' See, sec. 41(d)(1)(C), (3)(A). … That the design of each vessel involved iterative processes … should not be surprising: CIS had never designed and built a dry dock before and, while the Apex tanker was based on the <u>Penn 80</u>, there were, as respondent admits, 'many differences between the two vessels.' As noted above, however, petitioner has not demonstrated that <u>substantially all</u> of CIS' research activities in developing either the Apex tanker or the dry dock constituted elements of a process of experimentation for one of the purposes specified in section 41(d)(3)(A)." (emphasis in original).

Little Sandy pointed to *Trinity Industries v. United States*, 691 F. Supp. 2d 688 (N. D. Texas 2010), *aff'd in part and rem'd in part*, 757 F.3d 400 (5th Cir. 2014). In that case, a District Court allowed a shipbuilder to claim all costs related to the development of two vessels after

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[39] Treas. Reg. § 1.41-4(a)(6) provides that all expenditures of a project will meet the process of experimentation test if "substantially all" (defined as 80% or more) do: "… if 80 percent (or more) of a taxpayer's research activities with respect to a business component constitute elements of a process of experimentation for a purpose described in section 41(d)(3), the substantially all requirement is satisfied even if the remaining 20 percent (or less) of a taxpayer's research activities with respect to the business component do not constitute elements of a process of experimentation for a purpose described in section 41(d)(3), so long as those remaining research activities satisfy the requirements of section 41(d)(1)(A) and are not otherwise excluded under section 41(d)(4)."

demonstrating the vessels were novel without any further analysis of whether the expenses related to a process of experimentation. The Tax Court dismissed that case:

> "Because the District Court in *Trinity Indus*. did not explain how it arrived at its finding that the taxpayer's research on two of the vessels in issue satisfied the substantially all test of section 41(d)(1)(C), and because, in each case, the court stated its finding after a recitation of those aspects of the vessels that were new or redesigned, we can understand how petitioner might have interpreted the court's substantially all analysis to have turned on an assessment of the proportion of novel elements in each vessel. If that understanding of the court's analysis is correct, however, we judge the analysis unsupported by the governing regulations and thus decline to follow it."

In the case of both the tanker and the dry dock, Little Sandy argued that the production costs of actually constructing the tanker and dry dock qualified as costs of a pilot or experimental model and thus could be said to be research expenses or expenses incurred in "direct support of research activities which constitute qualified research." The Tax Court recognized that "when a taxpayer constructs a physical product for the purpose of assessing the viability of its concept, the construction costs can be considered costs of developing the concept of the product and thus can be deducted under section 174" and that expenses of producing an experimental model can qualify under Section 41. However, it said that it was not necessary for it to decide whether the tanker and dry docks were pilot models because Little Sandy had not established that "substantially all" of the other claimed expenses qualified as research expenses.

The Tax Court clearly felt that Little Sandy "had thrown in the kitchen sink" (though it did not use those words). It observed that some portion of the expenses might have qualified under the "shrinking back rule," which allows a taxpayer to claim the research credit for qualifying portions of a project if the whole project does not qualify. However, Little Sandy chose to employ an "all or nothing" strategy in the litigation, and the Tax Court concluded there was not sufficient evidence in the record for it to be able to apply that rule:

> "… the record is not sufficiently detailed to allow us to determine activities related to specific elements of either the tanker and the dry dock that may have been part of a process of experimentation. It may well be that CIS' research in regard to some – even many – elements of those vessels satisfied the process of experimentation requirement and the other tests applied in the definition of qualified research. But petitioner has not given us the means of making that determination."

It will be interesting to see whether Little Sandy appeals. Some commentators have argued that the Tax Court was too restrictive in its analysis.

The Tax Court's opinion (by agreement of the parties) did not address the accuracy-related penalty asserted by the IRS in the case. At the end, it observes that the Tax Court will "issue an order directing the parties to advise us concerning the need for a second trial to address petitioner's liability for the accuracy-related penalty respondent determined or any other issues relevant to petitioner's Federal income tax liability for the year in issue not resolved by this opinion."

A couple of months after deciding *Little Sandy*, the Tax Court returned to the research credit in a case involving a clothes designer that had claimed research credit based upon a study conducted by a tax consulting firm (AlliantGroup). *Leon Max v. Commissioner*, T.C. Memo. 2021-37 (March 29, 2021). This case details how the designer developed new clothes before sending them off to China for production. There is no doubt that the designer regularly developed new products through a process that involved creativity to respond the ever-changing market. However, that did not convince the Tax Court that its activities qualified for the research credit.

In fact, the Tax Court concluded that the designer flunked three of the four tests outlined above and said it unnecessary to address the fourth test. As a result, the Tax Court denied the claimed credit in its entirety.

According to the Court, the Section 174 test was not met because the process did not involve the kinds of uncertainties contemplated by section 174, the designer's activities were not investigative in nature, but rather involved "common solutions to common problems." The designer "had the requisite information to solve problems as they arose" and much of what was involved was simply "quality control." The technological information test was not met because the designer did not "engage in hard sciences." While there might be scientific principles behind some of the things involved in dress design, the process is not one of experimentation. The Court likened a designer to a baseball centerfielder:

> "I am confident that there is a formula out there that can be used to calculate the place point of impact, if you launch a spherical projectile at a particular rate and speed and angle, and where it will land. I'm sure there are devices that our military uses to figure out exactly where such a thing would land. … I don't think that makes a centerfielder a mathematician."

Likewise, the process of experimentation test was not met. The development process was largely focused on cosmetic purposes. It did not use "hard sciences to achieve a business goal." The designer did not show that "substantially all the garments underwent a process of experimentation." The Tax Court did not decide that last test, the business component test, observing that since the taxpayer "did not satisfy any of the previous tests, we need not address this final test."

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State tax developments involving farming businesses and/or cooperatives

15. Oregon Rule No. 150-317-1160 (effective July 29, 2020).

Oregon's relatively new commercial activity tax has an exclusion for "farmer sales to an agricultural cooperative in [Oregon] that is a cooperative organization described in section 1381 of the Internal Revenue Code." ORS 317A.100(1)(b)(TT).[40]

Oregon provided guidance with respect to this language in Rule No. 150-317-1160 (effective July 29, 2020). This rule provides two examples, one illustrating a sale that is excluded and the other illustrating a sale that is not. The first involves a person engaged in the business of growing and harvesting berries who sells berries to a Subchapter T cooperative located in Oregon. Not surprisingly, that sale qualifies for exclusion. The second involves a person who sells grass seed to an Oregon cooperative, but who "is not involved in growing or harvesting the grass seed or other products it sells." That sale does not qualify for the exclusion.

The proposed rule would have applied only to sales to exempt (Section 521) Subchapter T cooperatives. In response to a comment received from a cooperative, the final rule was revised to apply to sales to both exempt and nonexempt Subchapter T cooperatives.

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16. *Stateline Cooperative v. Iowa Property Assessment Appeal Board*,
Case No. 19-0674 (Iowa Supreme Court, April 30, 2021).

In last year's Digest, we described the decision on an Iowa Court of Appeals decision in a case involving StateLine Cooperative. That decision recently was affirmed in part and reversed in part by the Iowa Supreme Court.

The controversy involved whether certain bins at a feed mill qualified for an exemption from property tax as "machinery used in manufacturing establishments." The feed mill had (i) two large stand-alone silos for corn used in the manufacture of feed, (ii) twenty-four overhead bins holding milled corn and other components used in the feed manufacturing process, and (iii) eighteen load-out bins holding finished products until shipped to customers. The parties agreed that the load-out bins were not exempt, but disagreed as to the status of the corn silos and overhead bins.

As described last year, the Court of Appeals concluded the corn silos and overhead bins qualified, but the load-out bins did not, observing that the storage feature of the silos and overhead bins "is only temporary and incidental, and their primary purpose is to serve directly in the manufacturing process."

The Supreme Court disagreed with the treatment of the corn silos. It observed that they were separate buildings, similar to other grain storage facilities. In fact, the smaller of the two had

[40] The statute provides that the commercial activities tax does not apply to Section 521 cooperatives. ORS 317A.100(4)(f). There is no comparable exclusion for nonexempt Subchapter T cooperatives.

served that purpose for thirty-five years prior to the construction of the feed mill. The Court observed that "no processing or manufacturing occurs at the silos themselves." It concluded:

> "They should thus be viewed as storage buildings. Just as the load-out bins are the epilogue to the manufacturing process, and thus not a part of the process itself, the corn silos are the prologue."

However, it agreed with the Court of Appeals that the overhead bins qualified:

> "They are part of the sequential manufacturing process at the feed mill building. They discharge directly into the scale and then the mixer. They do not appear to have any independent value as storage apart from this particular manufacturing process. Nor does the fact that they are structurally part of the building alter the situation."

But it did not stop there. The parties also disagreed as to the value of the overhead bins. The Property Assessment Appeal Board concluded that Stateline's evidence was not reliable and thus assigned no value to the bins. The Court of Appeals found that to be unreasonable and arbitrary. The Supreme Court agreed. However, the Court of Appeals had then taken the evidence in the record and determined a value. The Supreme Court concluded that it should not have done so given the conflicting evidence in the record. It remanded the case to the Property Assessment Appeal Board for further proceedings to determine the appropriate value of the overhead bins for exemption purposes.

Employment and Benefits Law

NCFC Subcommittee #11: Employment and Benefits Law
Part I: 2021 Final Retirement Benefit Developments

Marla Aspinwall, Loeb & Loeb LLP

I. Radical Changes Proposed for Retirement Plans: The recently released Way & Means Budget Tax Proposal would make multiple significant changes to the taxation of retirement plans and individual retirement accounts ("IRAs"):

- **Contribution Limits on Retirement Accounts**. IRA contributions would be prohibited for a taxable year if the aggregate value of an individual's IRAs and defined contribution retirement accounts ("DCRAs") exceeds $10 million as of the end of the prior taxable year. Additionally, employers would be subject to reporting requirements for DCRAs with aggregate balances in excess of $2.5 million. The limit on contributions would only apply to single taxpayers with taxable income over $400,000, married taxpayers filing jointly with taxable income over $450,000, and heads of households with taxable income over $425,000 (all indexed for inflation) ("Income Threshold").

- **Increase in Minimum Required Distributions**. An individual with an aggregate balance of $10 million or more in IRAs and/or DCRA and annual taxable income above the Income Threshold would be required to make minimum distributions from such accounts for each taxable year and would not be permitted to make further contributions to IRAs or Roth IRAs. The minimum distribution would generally equal 50% of the excess of the aggregate balance of such accounts above $10 million. An individual with an aggregate balance of $20 million or more in such accounts would be required to make a distribution of the lesser of the amount needed to bring the aggregate balance down to $20 million or the aggregate balance in the individual's Roth IRA(s) and Roth DCRA(s).

- **Rollovers to Roth IRAs**. Taxpayers with income above the Income Threshold would be prohibited from converting IRAs and employer-sponsored retirement accounts to Roth IRAs, which would eliminate the so-called "back-door" Roth IRA conversions that effectively permit taxpayers to avoid the income limitations applicable to Roth IRA contributions under current law.

- **Statute of Limitations on IRA Noncompliance Increased**. The bill expands the statute of limitations for IRA noncompliance related to valuation-related misreporting and prohibited transactions from 3 years to 6 years.

- **Prohibitions on Certain IRA Investments**. IRAs would be prohibited from holding any investments that are not tradable on an established securities market and in which the IRA owner has a 10% direct or indirect ownership interest. Additionally, IRAs would be prohibited from investing in an entity in which the IRA owner is an officer. The proposal also provides that for purposes of the prohibited transaction rules, an IRA owner (as well as certain persons related to the IRA owner) would be treated as a "disqualified person."

II. Implementation of Prior Changes under SECURE Act and CARES Act: In addition to watching sweeping changes immerge under the budget proposal, employers and retirement plan administrators have also been busy in 2021 implementing multiple existing changes under the Setting Every Community Up for Retirement Enhancement Act (the “SECURE Act”) adopted in December 2019 and the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) adopted in March 2020. Below are some of the more significant changes applicable to qualified retirement plans under these prior acts:

SECURE Act Changes:

- Required Minimum Distribution age postponed from age 70½ to age 72
- More rapid distribution of 401(k) and IRA accounts on participant’s death
- Part-time employees eligible to participate in 401(k) plans
- Qualified Automatic Contribution Arrangement maximum increased from 10% to 15%
- Pension plans may permit certain in-service distributions starting at age 59½
- Greater ability for qualified retirement plans to offer annuities
- Penalty-free distributions for births and adoptions
- New 401(k) nonelective contribution safe harbors

CARES Act Changes:

- Penalty-free virus-related distributions were available to be taken in 2020 up to $100,000
- Plan loan limits increased to lesser of $100,000 or 100% of vested account balance for 2020 with extension of time to repay
- No Required Minimum Distributions were required for 2020
- Pension plan funding relief was also provided

NCFC LTA Subcommittee #11: Employment and Benefits Law
Part II: 2021 (Draft) Employment Law Developments

Daniel Hall, Deputy General Counsel, GROWMARK
Courtney Thomas, Staff Attorney, GROWMARK

I. Developments in Employment Law

1. Biden Era National Labor Relations Board Agenda

As with each new President, there has been staffing changes in the National Labor Relations Board ("NLRB"). On January 20, 2021, President Biden appointed Board Member Lauren McFerran as the Chairwoman of the NLRN. On July 21, 2021, the Senate confirmed Jennifer Abruzzo as the new NLRB General Counsel after Biden's termination of then sitting General Counsel Peter Robb. Shortly after her confirmation, Abruzzo issued a memorandum instructing regional offices to send particular cases to her office for consideration. This new prioritization of issues should alert employers to upcoming significant changes to the law in addition to aggressive new penalties. Some of the issues of focus include the following: (1) Expanding Damages for Unfair Labor Practices, (2) reverting back to Obama-era standards for scrutinizing workplace/employee handbooks, (3) creating more stringent standards for determining independent contractor status, (4) Confidentiality and non-disparagement provisions in separation agreements along with confidentiality rules in workplace investigations, and (5) protecting employee misconduct while engaging in a protected concerted activity. A copy of Memorandum GC 21-04 can be found here:
https://www.jacksonlewis.com/sites/default/files/docs/GC21-04MandatorySubmissionstoAdvice.pdf

2. Equal Employment Opportunity Commission 2020 Statistics

In March, the Equal Employment Opportunity Commission ("EEOC") released its enforcements and litigation statistics for Fiscal Year 2020. It saw the lowest number of charges file in the last twenty years, with nearly 67,000 charges filed. However, it is important to note that the monetary benefits recovered by the EEOC increased. The EEOC recovered a total of $535.4 million dollars on behalf of claimants. The types of charges ranked by charges filed are relation, disability, race, sex (including pregnancy, gender and sexual harassment) and age. Another trend worth noting is that sexual harassment uptick we saw after the 2018 #MeToo movement has come back down. This may be related to multiple factors such as people working from home more, employers taking initial allegations more seriously, and increased corporate training and focus on the issue. Some states, such as Illinois and New York, have mandated sexual harassment training in the workplace. Don't get too comfortable with this decrease, given COVID distractions and the white house turning blue and the Biden administration's focus on enhanced enforcement of workplace bias laws, it would not be surprising to see an uptick in the numbers in the coming years. A copy of the EEOC Charge Statistics can be found here: https://www.eeoc.gov/statistics/charge-statistics-charges-filed-eeoc-fy-1997-through-fy-2020

II. COVID Laws and Regulations

Commencing in late 2019 (and early 2020 for the U.S.), the world has been embroiled in a battle with the spread of the coronavirus and its variants. This battle has significantly impacted people in all aspects of their lives: work, recreation, health care, politics, family and relationships, shopping, supplies of consumer and manufacturing goods and etc. It would not be possible to talk about Employment Law developments in the U.S. (and throughout the world for that matter) without discussion of the impact of the coronavirus and the risks of COVID on and in the workplace. The shutdown, social distancing, masking recommendations and availability of several vaccines to combat COVID, in addition to the politicization of the disease and efforts to control it have almost taken over the field.

Just as examples, COVID, and the legal response to the need to protect workers, has impacted the following areas in employment:

- Labor – rules were instituted to allow for easier mail-in voting in union elections;
- Health – both the ADA and FMLA now require practitioners to consider the impact of COVID restrictions and regulations under these acts;
- Unemployment and COBRA – both were impacted by government stimulus packages and extensions of benefits;
- Other Issues –
    - Remote Work;
    - Privacy and Data Collection (re: employees);
    - Essential work and essential businesses;
    - Vaccine mandates; proof of vaccination and exemptions to vaccination and masking.

Finally, there has been a plethora of new state and local laws addressing pandemic restrictions having an impact – indirectly and directly – on employment law. Larger (and not so large) municipalities have also gotten into the act and added their own complications.

It would be impossible to list all of the federal, state and local legislation dealing with COVID issues, but the practitioner should understand that any question impacting employment law in today's world may very likely involve some COVID calculus as well as the usual set of employment law risk questions that the attorney must ask when dealing with an employment question. Just as examples, consider the following common employment situations that an HR attorney may deal with on a daily basis and how the current pandemic brings in new and novel issues:

- What to do with an employee who had pre-pandemic absence issues which have increased or continued under COVID?
- How to deal with employees refusing to mask or get vaccinated?
- Can (or should we) mandate vaccinations for employees?
- How do we protect employees from vendors and/or customers who are not engaging in safe behavior?
- How do we deal with religious and medical exemption requests related to remote work, accommodations, and employee participation in the employer's efforts to provide a safe workplace?

III. Federal COVID Resources -- https://www.usa.gov/coronavirus

1. **Executive – https://www.whitehouse.gov/covidplan/**

   https://www.whitehouse.gov/briefing-room/presidential-actions/2021/09/09/executive-order-on-requiring-coronavirus-disease-2019-vaccination-for-federal-employees/

2. **Congress -- https://www.cdc.gov/coronavirus/2019-ncov/index.html (Text of the "American Rescue Plan Act of 2021")**

   https://www.congress.gov/116/bills/hr748/BILLS-116hr748enr.pdf (Text of the "CARES Act")

3. **Administrative –**
   i. **DoL -- https://www.dol.gov/general/american-rescue-plan**

      https://www.dol.gov/coronavirus

   ii. **OSHA – https://www.osha.gov/coronavirus**

      https://www.osha.gov/publications/bytopic/coronavirus-(covid-19)

   iii. **EEOC -- https://www.eeoc.gov/coronavirus**

   iv. **Treasury -- https://home.treasury.gov/policy-issues/coronavirus**

      https://home.treasury.gov/policy-issues/coronavirus/about-the-cares-act

v. **HHS -- https://www.hhs.gov/coronavirus/index.html**

vi. **DHS – https://www.dhs.gov/coronavirus**

vii. **CDC -- https://www.cdc.gov/coronavirus/2019-ncov/index.html**

viii. **Department of Agriculture -- https://www.usda.gov/coronavirus**

ix. **Department of Education -- https://www.ed.gov/coronavirus**

x. **Other Federal Agencies (103 listed) with COVID resources and pages -- https://www.usa.gov/government-coronavirus-response**

IV. State COVID Resources

i. **National Governors Association – https://www.nga.org/coronavirus/**

ii. **Law Firm Pages Collecting State Actions -- https://www.huschblackwell.com/state-by-state-covid-19-guidance**

https://btlaw.com/en/insights/blogs#?pageType=Practice&itemName=COVID-19%20Coronavirus%20Resources

https://www.dorsey.com/newsresources/publications/client-alerts/2020/coronavirus-resources

https://www.mcguirewoods.com/coronavirus-impact

iii. **Other Entities – https://public.findlaw.com/coronavirus-laws.html**

https://www.americanbar.org/news/abanews/aba-news-archives/2020/07/_tsunami_-of-legal-issues-in-wake-of-covid-19/

https://www.illinoislegalaid.org/legal-information/legal-issues-during-covid-19-pandemic

https://www.aarp.org/politics-society/government-elections/info-2020/coronavirus-state-restrictions.html

https://www.ncsl.org/research/health/state-action-on-coronavirus-covid-19.aspx

https://www.insuremytrip.com/travel-advice/travel-planning/travel-restrictions-by-state/

This is only a tiny selection of the available resources online. They are provided as the most current resources available on the subject of COVID-19. The HR practitioner will need to consider not only Federal and State laws, but must also look to local municipal and/or county governmental entities to complete their review.