



## **Training for Those Charged with Governance**

# **Legal & Ethical Responsibilities of Cooperative Board Directors**

**Michael W. Droke**

**Partner, Cooperatives**

**Firmwide Leader, Food & Agribusiness**

**July 26, 2023**

# The Source of Board & Director Authority

- **The authority of boards and its directors is only that which is given to them by**
  - Statute,
  - Law,
  - Articles of Incorporation,
  - Bylaws, and
  - Properly created and implemented policies.
- **Ultimately, the authority to act comes from the members of the cooperative.**



# The Role of Boards and Directors

- The business affairs of a cooperative are carried out under the direction of the board of directors.
  - Management, not the Board, is responsible for managing the company.
  - The fundamental role of the Board is to oversee management by monitoring performance and compliance with policies, strategy and law.

“The Role of a Director is Not to Provide  
Management. It is to Assure That  
Management is Provided.”

--- Norman R. Augustine

# General Principles – The Director's Credo

- **A director shall discharge his/her duties:**
  - In good faith,
  - With the level of care, diligence and deliberation,
  - An ordinary person, in a similar position, using common sense and practical wisdom,
  - Would exercise under similar circumstances,
  - In a manner he/she reasonably believed
  - To be in the best interests of the cooperative.

# The Director as a “Fiduciary”

- “A person having duties involving good faith, trust, special confidence, and candor towards another.”
- Fiduciary duties are imposed to protect the weaker party against abuse of the fiduciary relationship.



# General Principles: Duties or Standards of Conduct

- **Duties are essentially the “standards of conduct” of a board and its directors. They specify how the responsibilities must be carried out. These duties are imposed on both the board as a whole and each individual director.**



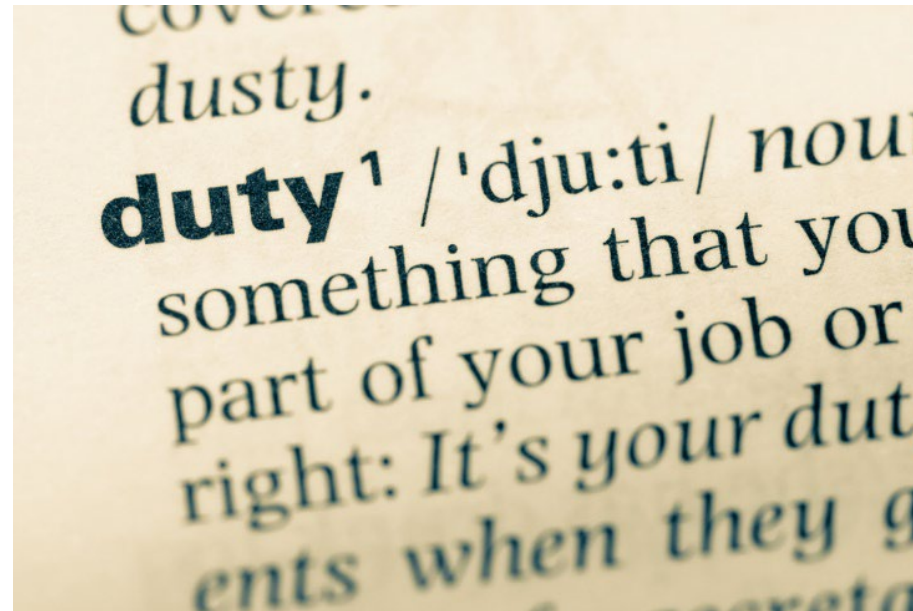
# Board Responsibilities

1. **Represent cooperative members as a whole – not just the ones that voted for them**
2. **Establish cooperative policies**
3. **Hire and supervise management**
4. **Preserve (and grow) cooperative assets**
5. **Preserve the cooperative character of the organization**
6. **Assess the cooperative's performance**
7. **Inform members, respecting need for confidentiality**



# Duties Owned by the Board & Directors

- Corporate directors and officers owe certain duties to a cooperative and its owners.
  - A duty of loyalty or obedience to the cooperative.
  - A duty of care in administering the cooperative's affairs.
  - A duty of candor when communicating with owners.
  - A duty of confidentiality as to boardroom deliberations and confidential information.





# Duty of Loyalty

- **A director must place the interests of a cooperative and its owners over any personal interests (Independence)**
- **A conflict of interest arises when a director is on both sides, or derives personal benefit from, a position or transaction (Disinterested)**
- **Cooperative directors have an obligation to disclose possible conflicts of interest that are outside the normal set of cooperative conflicts.**

# Duty of Loyalty

- A director is “interested” in a challenged transaction if he/she will receive a personal benefit not equally shared by other members.
- A director lacks the required “independence” if his/her decision is based on extraneous considerations or influences.

# Conflicts of Interest

- Inherent in cooperative boards.
- Manageable conflicts.
- Unmanageable conflicts.
- Disclosure is key.



## Duty of Loyalty: *What do you do?*

- You receive a call from a real estate agent who is looking to sell property you're very interested in, but also think the co-op would want to buy. *What do you do?*
- The Co-op is looking to do business with a local business. You are a part-owner of that business. *What do you do?*
- The Co-op proposes to terminate a vendor in favor of another local company. Your daughter is an executive at the vendor. *What do you do?*

# Duty of Care

- **The duty of care requires that directors act with the diligence and competence of a reasonably prudent person in a similar position under like circumstances.**
  - Directors must avail themselves of all material information reasonably available to them.



# Duty of Care

- The duty of care is very much a question of the adequacy of the process
  - Number of board meetings/discussions
  - Related committee reports
  - Related management reports
  - Seeking legal counsel
  - Seeking use of consultants and/or experts

# Duty of Care

- Directors may rely in good faith on information prepared by officers, employees, committees and experts
  - So long as the expert(s) relied upon are competent and the opinions sought are within the person's realm of professional expertise
  - The directors' fiduciary duties cannot be delegated to these experts





## Duty of Care: *What do you do?*

- The Board meeting is this evening. You received a huge email from the Co-op's CEO which you didn't have time to read. *What do you do?*
- The Co-op's CFO just gave a presentation on the four options to recapitalize the balance sheet. You aren't sure what the word "recapitalize" means and the balance sheet doesn't make sense. *What do you do?*
- The CEO proposed to switch major suppliers immediately. The other Board members agree, but you don't think you have enough information. *What do you do?*
- The CEO proposes to sell a plant. The other Board members agree, but you do not. *What do you do?*

# Duties of Candor and Confidentiality

- **Directors must balance the need to be honest with members with the need to protect confidential information of members or of the cooperative.**
- **“Loose lips sink ships” is still an important warning, even in a cooperative**

## Duties of Candor and Confidentiality: What do you do?

- Yesterday's Board meeting was very contentious. You disagreed with the outcome of the vote. You're at the local restaurant and a Co-op member you represent asked what happened at the meeting. *What do you do?*
- You are really upset with the Co-op CFO. You get a call from your co-op representative / field staff. *What do you do?*



# The Business Judgment Rule

- **Absent fraud or self-dealing, and an adherence to the board's authority and its duties, business judgments made by directors will typically not be overturned by the courts and will not lead to director or board liability.**

# The Business Judgment Rule

- **When a directors action is challenged, the standard of judicial review is “the business judgment rule”**
  - The business judgment rule places the burden of proof on a member/owner to demonstrate that there is a reasonable basis for questioning whether the board, acting in good faith, satisfied either the duty of loyalty or the duty of care.

# The Business Judgment Rule

- **A court will not substitute its judgment for that of the board and will uphold a board's decision as long as that decision is based on any rational business purpose, the board acted in good faith and on an informed basis.**
- **If either the duty of loyalty or care or good faith is lacking, the burden of proof shifts to the board to demonstrate the fairness of the transaction/decision.**



# Business Judgment Rule:

## What do you do?

- The Co-op is considering a major transaction. This is the first you have heard of it. *What do you do?*
- The Co-op is considering selling a large piece of property to an unsolicited buyer. *What do you do?*
- The Co-op is considering reclassifying several members as “inactive members” with significant implications to that member. *What do you do?*



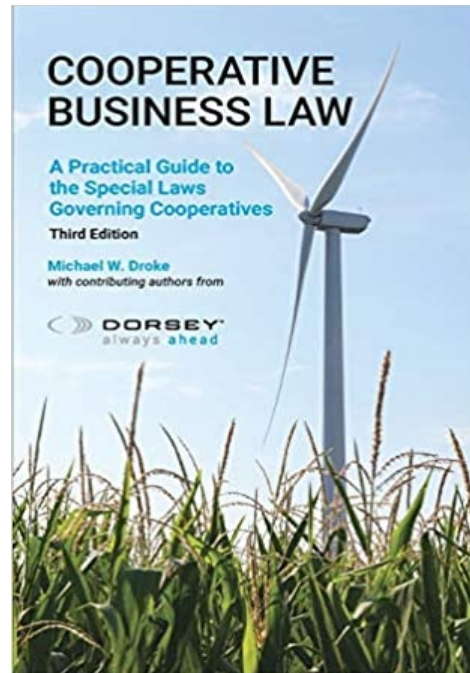
# Managing Director Risk – by Agreement and Insurance

- **Indemnification**
  - Articles and/or Bylaws
  - Contract
- **Directors and Officers Insurance (types)**
  - Side A coverage – individual coverage when indemnification is unavailable.
  - Side B coverage – individual coverage when indemnification is available – company reimbursement
  - Side C coverage – entity coverage
  - Independent Director Liability coverage

# Questions?



**Mike Droke**  
**Partner, Cooperatives**  
**Firmwide Leader, Food & Agriculture**  
Dorsey & Whitney LLP  
[droke.michael@dorsey.com](mailto:droke.michael@dorsey.com)  
(206) 903-8709 (direct)  
(206) 914-6745



[https://www.amazon.com/dp/0991405544/ref=cm\\_sw\\_r\\_cp\\_api\\_i\\_E9SmFb5X99QXT](https://www.amazon.com/dp/0991405544/ref=cm_sw_r_cp_api_i_E9SmFb5X99QXT)



**Michael W. Droke**

Partner

[droke.michael@dorsey.com](mailto:droke.michael@dorsey.com)

Seattle, Washington

(206) 903-8709

Mike started his career as a client, not a lawyer. He represented the same company where he worked in management, thus “walking both sides of the street.” As a lawyer, Mike had devoted his practice to practical, results-oriented advice and litigation representation in situations where the law, facts or business risks are ambiguous.

Mike’s practice is devoted to the areas of agriculture and cooperative law, and in the food and agriculture industries. He has litigated across the United States, and advised across the United States. Throughout his career, a substantial part of Mike’s practice has been representing agriculture and food-based companies. He acts as outside general counsel in that industry, handles corporate governance, and manages complicated domestic and international transactions.

On the business side, Mike developed Dorsey’s LegalMine Document Review Solution from concept to operation. He has also held leadership roles as Office Head for Seattle (where he negotiated a large office move, and the office was named one of Washington’s Best Workplaces) and as co-head of the Labor & Employment and other practice groups.

Mike is the author of Cooperative Business Law, now available on Amazon.com.

## Legal Notice

**This presentation is intended for general information purposes only and should not be construed as legal advice or legal opinions on any specific facts or circumstances. An attorney-client relationship is not created through this presentation.**