DIRECTOR’S LEGAL LIABILITIES

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POWER!

• All corporate power is held by the board of directors with only a few exceptions.

POWER OF THE BOARD

• Borrow money
• Issue mortgages
• Accept members
• Expel members
• Establish prices
• Employ personnel
• Contract services
• Retire equity
• Call member meetings
• Choose banks
• Adopt budgets
• Adopt work plans
• Elect officers
LEGAL AUTHORITY OF THE BOARD:
• Authority expressly granted by statute, articles, or bylaws
• Apparent authority occurs when the cooperative acts in a way that allows third parties to rely on the representations of the person with apparent authority.
• Board members only have authority at a duly called board meeting with a quorum present.

LEGAL LIMITATIONS OF THE BOARD
• Amendment of a charter
• Call a special meeting
• Request removal of a director
• Dispose of substantially all corporate assets
• Amend bylaws
• Agree to merge or consolidate
• Dissolution
• Other limitations specified in the articles of incorporation.

Business Judgment Rule
• The basic responsibility of directors is to exercise their business judgment to act in a manner reasonably believed to be in the best interests of the company and its stockholders.
• As long as directors comply with the business judgment rule, their decisions are usually protected from judicial scrutiny and second-guessing.
BUSINESS JUDGMENT RULE

A director is not personably liable for an errant business decision if...

- Acted on an informed basis
- In good faith, without a disabling conflict
- For a valid business purpose

Acting on an Informed Basis

- Directors need to probe and understand information and transactions under consideration
- Micro-management by a Board is not required, but exercise diligence – ask questions and receive understandable answers

Acting on an Informed Basis (continued)

- Directors entitled to rely on internal reports (including financial), if presented by employees the directors reasonably believe to be reliable
- Directors entitled to rely on reports by outside advisors reasonably believed to be qualified
BUSINESS JUDGMENT RULE

• PRACTICAL TEST: treat the decision the same as you would your own personal business.
• ULTIMATE TEST: what would a prudent person do in similar situations?

PREVENTION OF VIOLATION OF THE BUSINESS JUDGMENT RULE

• Regularly attend meetings
• Disperse furnished materials such as minutes and reports in meetings and question them.
• Participate in discussions
• Make independent inquiries
• Register objections
• Review stockholder reports.

GUIDELINES FOR DEALING WITH POTENTIAL CONFLICTS OF INTEREST

Three steps…

1. Disclose
2. Answer questions
3. Abstain
TYPES OF CONFLICTS OF INTEREST
- Association with a competing organization
- Nepotism
- Insider transaction
- Improper compensation/use of corporate funds

CONFIDENTIALITY
The only exceptions to the confidentiality rule are if it is a general public disclosure or if it is a matter of public record.

MEMBER ACCESS TO INFORMATION
A director must maintain confidentiality in protecting the cooperative's best interests and financial viability.

- Do not discuss with membership, employees, or the general public:
  - Disputed or confidential corporate actions, policies, or issues
  - Any issue related to personnel, real estate, market strategy, and goals
  - Pending litigation
  - Financial status of the cooperative
**Director’s Liability in Fraud Prevention**

- Directors entitled to rely on internal reports (including financial) if presented by employees the directors reasonably believe to be reliable.
- Directors entitled to rely on reports by outside advisors reasonably believed to be qualified.
- Vigilance requires that any compliance criticisms or identified audit or control deficiencies are quickly resolved.

**New Actions Required of the Board for the Audit**

- "We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud."
- "We have no knowledge of fraud or suspected fraud affecting the company involving management, employees who have significant roles in internal control, or others where the fraud could have a material effect on the financial statements."
- "We have no knowledge of any allegations of fraud or suspected fraud affecting the company received in communications from employees, former employees, regulators, or others."

**OTHER AREAS OF POTENTIAL DIRECTOR LIABILITY**

- Filing false reports
- Misrepresentation in the sale of bonds or securities
- Violation of members’ rights in equity redemption
- Violation of members’ rights to inspect books and records
- Losses occurring because directors did not attend to duties
- Violation of bylaws
- Speculation or permitting speculation
- Negligence in handling of accounts receivable collection
AVOIDING LIABILITY: FINANCIAL ISSUES

• Boards should regularly review all financial statements to stay informed.
• Respond to any issues identified by auditor or warehouse examiner.
• Understand grain hedging program and have implemented appropriate controls.

YOU HOLD THE MOST POWERFUL POSITION IN THE COOPERATIVE.

Treat It With Respect and Appreciate the Honor You Have Been Given by Your Members.