

## *New Director Orientation*

*Congratulations for being selected to serve on the board of your cooperative. Not only is it a great honor, it is also a large responsibility. The decisions you and the other board members make will not only affect your own operation but the operation of hundreds of your neighbors.*

*The motto of cooperatives is "doing together what we can not do alone." And that is why your cooperative was formed, to help the member/owners receive fair prices for their products and be charged a fair price for their input.*

*As you prepare for your service on the board, you must remember that cooperative businesses are similar to other business, but there are also some very important differences.*

*The following programs will help you better understand those similarities and differences. It will also help you understand your responsibility and how to be a better board member.*

*As you look at the following items on the Director's Pledge, you will find many of them are obvious and would be taken for granted. Others may create some concerns or cause you to question them.*

*As mentioned earlier, being a director is not easy and it does come with responsibilities.*

## *A Director's Pledge*

1. I pledge to do my best for the cooperative association that has elected me to serve in a position of honor and trust.

### *I Will.*

2. Above all things be honest and diligent.
3. Place the interests of the association above my own personal interests.
4. Give as careful attention to the affairs of the cooperative as I give to my own business.
5. Give the necessary time to board meetings and other deliberations.
6. Study the business and problems of the association, and the broader considerations that affect its welfare.
7. Strive for continued and increased efficiency in the association.
8. Be prompt and attentive to all meetings of the directors so that there is no loss of valuable time.
9. Do independent and careful thinking, express my honest opinion, and not be a rubber stamp.
10. Be open-minded and a team worker and realize that the individual views of board members cannot always prevail.
11. Remember that the majority rules and that the minority must fall in line.
12. Present the views of the board of directors to fellow members rather than my own, whenever I speak for the association.
13. Strive to keep this a members' cooperative and not let it become a directors' or managers' cooperative.
14. Represent the association in its entirety and not just the members from my community.
15. Do all in my power to have the association controlled democratically, including the election of directors.
16. Welcome new ideas or "new blood" as a means of keeping life in the association and the service to the patrons at a high level.
17. Do everything possible to inform members and patrons of established policies and programs of the association.
18. Be a good listener to the reactions of the members and patrons as a means of better shaping the policies of the association.
19. Curb emotion and apply reason and common sense to all problems.
20. Patronize the association whenever possible and promptly pay all statements from the association.

## *I Will Not*

21. Consider myself indispensable.
22. Expect any special privileges from the association because I am a director.
23. Become financially interested in any business or agency that has interests adverse to those of the association.
24. Interfere with the management, but will limit myself to the formulation of business and management policies.
25. Approve the employment of close relatives of directors and executives in the association.
26. Discuss the affairs of the association with employees, other than the management, unless delegated by the board of directors to do so.
27. Carry grudges against other directors, the management, employees, members or patrons.



***Which ones of the above items did you agree with most?***

***Which ones did you have the most trouble with?***

***You may want to discuss the ones that give you the most trouble with the chairman of your board.***

## What is a cooperative Business?

A cooperative is a business voluntarily owned and controlled by its users and operated for them on a non-profit basis.

## What does a cooperative do?

A cooperative provides its user-owners goods and services at cost.

**Please note: Making a profit to reinvest into the business is a cost of doing business.**

## Where does a cooperative fit in the American private competitive enterprise system?



Joe's T.V. Repair = Individual  
Carl's & Mary's Bakery = Partnership  
Northern Hardware Inc. = Corporate

## What is an LLC?

An other form of business that you see more and more of is a Limited Liability Company. A LLC is a company that permits a "pass through" for income tax treatment. A Partnership might form a LLC so it could limit its liability exposure, much like a corporation.

## How Is A Federated Cooperative Different From a Centralized Cooperative?

With a federated system the members own the local cooperative and the local cooperative owns the regional cooperative. CoBank and CHS, Inc. are examples of a federated system or cooperative.

With a centralized system the farmer members own the regional cooperative and the regional cooperative owns the local. The CHS, Inc. regional cooperatives would be an example of a centralized system or cooperative.

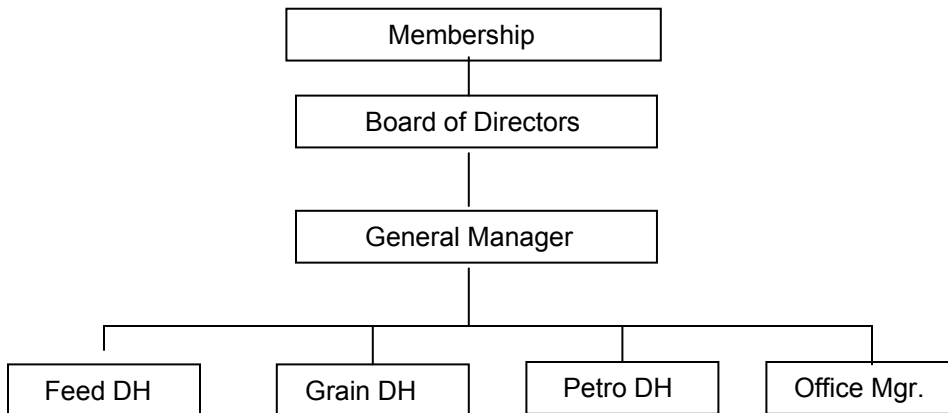
## Teamwork — The Board and Managers

The selection of a competent general manager is probably the most important responsibility of a board.

The board and managers work as a team but they have different responsibilities and objectives. Consider the following:

1. Ultimate accountability to members is vested in the board of directors, who may subsequently grant certain authority to officers, agents and employees including the general manager. The general manager, in turn, is accountable to the board and initiates action within the boundaries of authority granted by the board.
2. The board of directors is primarily concerned with idea decisions while management is primarily concerned with action decisions.
3. Decisions on overall objectives, policies and goals are the responsibility of the board.
4. Decisions related to how and when objectives, goals and policies are to be attained are the responsibility of management.
5. Decisions involving long-range and consequential commitment of resources, as well as the organization and control of the resources, are the board's responsibility.
6. Decisions involving intermediate and short-range commitment of resources as well as the organization and control of resources, are the responsibility of management.
7. Decisions related to the assurance of capable management succession by providing for executive depth and training are the board's responsibility.
8. Decisions specifying the ideal pattern of board performance, and for the review of and perpetuation of the ideal through indoctrination and training of directors, are the board's responsibility.
9. Control over long-range financial commitments, financial structure, objectives, policies, public and member relations, and overall management performance are decisions for the board.
10. Control over operations, subordinate managers and employees, budgets, procurement, production, marketing plans and employee relations programs are decisions for management.

## Proper Structure of a Board and General Manager Team



It is important to remember that board members do not listen to complaints by employees. If the employees try, the board members should tell them to take it up with the manager. If the complaint has to do with something improper or unethical, the board member should tell the employee to go to the chairman of the board.

## Articles of Incorporation and Bylaws

Even though it requires extra effort on the part of a new director, it is important that you take the time to look over your cooperative's articles of incorporation and bylaws.

The articles of incorporation, or charter, is the most fundamental and authoritative document in which a cooperative business operates. The charter is a contract between the business and the state. The language should be consistent with federal and state laws, IRS regulations and USDA regulations. The charter may be restated and amended by resolution approved by the board of directors and then ratified by the members by a majority vote of members present and voting at an annual or special meeting with a quorum present when the notice of the meeting contains a statement of the proposed amendment (SDCL §47-15-8).

The bylaws represent the operating agreement with voting members of the cooperative. Since they contain the operational rules of the cooperative, they are usually amended more often than the charter. The bylaws should be consistent with the same laws and regulations as the charter. Amending the bylaws normally requires simply majority vote of all members present and voting at a duly called meeting (SDCL §47-15-16 and §47-15-17).

## Legal Responsibilities

The information below is not meant to take the place of an attorney. It will give you some guidelines on how to protect yourself and your personal operations from litigation. If you are in doubt or have concerns it is highly recommended that you seek the advice of your attorney.

### Legal Responsibilities of Cooperative Directors

#### Overview

1. The statutory legal framework for cooperative directors is found in the South Dakota Code, Chapter 47-17. Cooperatives, like corporations, are fictitious persons and may only act through their agents, officers or employees.
2. Cooperatives must have at least five directors unless the association membership is less than 50 members in which case a minimum of three directors is required (SDCL 47-17-3). Only members of the cooperative may act as directors.
3. Directors are responsible for the general directions of the cooperative. They grant authority to others to act on behalf of the cooperative. This authority may be express, implied or apparent.
4. The board of directors acts through its officers. The board may elect a president, one or more vice presidents, a secretary, a treasurer or a joint secretary/treasurer. SDCL 47-17-14 requires that all principal officers, except the secretary and treasurer, must be directors.
  - a. Officers of the board of directors must devote such time and effort to their duties as is reasonably required to perform those duties.
  - b. Generally, no director can bind the cooperative unless so authorized by the bylaws or the Board of Directors.
5. Cooperatives in South Dakota must have a resident agent (SDCL §47-15-18.1). This person's address is listed with the Secretary of State's office in Pierre. The agent resident serves as a contact person for those doing business in the state with the cooperative. Often, the resident agent receives service of process when the cooperative is sued.
6. Some cooperative bylaws provide that no director may be in competition with the association on whose board he or she sits.
7. Election of cooperative directors is governed by the bylaws of the association. They are elected by the members from their own number at a duly called annual meeting with a quorum present.
  - a. Directors are elected by majority vote.
  - b. The bylaws may provide that directors may be elected by district (SDCL §47-17-4).
8. Directors must be natural persons, but may be authorized representatives of non natural persons.
9. Unless restricted by the bylaws, directors may meet by teleconference (SDCL §47-17-8). Directors may also waive formal notice of a meeting (SDCL §47-17-10) or act by signing a consent resolution (SDCL §47-17-13).

## **Holding Office**

1. Cooperative directors hold office according to statutory provisions and as provided in the articles of incorporation and/or bylaws. They hold office until successors are duly elected and qualified unless earlier removed.
2. Board vacancies are filled by the remaining directors, but only until the next annual meeting unless the bylaws provide that an appointed director may fill the remaining term of the vacated position.
3. Removal of directors may be accomplished by the majority vote of all members unless the bylaws provide otherwise (SDCL §47-17-5).

## **Notice of Meetings**

1. Notice of board meetings is required. Specific notice provisions are provided for in the bylaws. Attendance at the meeting waives any notice problem except if the member's attendance is for the purpose of objecting to notice.
2. The open meetings statutes do not apply to cooperatives. Therefore, board meetings may be closed with only the board members present.

## **Member Access to Records**

1. The board must have a policy as to member access to its records. A recommended policy is that access is only for demonstrated business purposes.

## **Binding Actions by the Board**

1. The board may take action only at a duly called meeting with a quorum present. Unless the bylaws require more, a majority of the board is a quorum.
2. A dissenting director may ask that votes of individual board members be reflected in the minutes. Otherwise, all members are deemed to have voted with the majority.
3. The bylaws may provide for an executive committee of three or more directors and may allot to it some of the functions and powers of the board with certain express exceptions (SDCL §47-17-12).

## **Minutes of the Meetings**

1. Minutes show what authority is granted to officers and agents of the cooperative. There is no legal requirement that minutes be kept. However, minutes reflect board action and are indispensable if the board is ever sued. They should be kept. They are prima facie evidence of actions taken. This means that if the minutes are unrebutted, they are deemed to represent that the action did occur.
2. At a minimum, minutes should reflect the date and hour of the meeting, those who were present, that a quorum was represented, actions taken and dissenting votes if registered. Minutes should also reflect defeated actions as well as important discussions.
3. The secretary should be mindful of the "business judgment rule", especially if the action was controversial. The minutes should reflect that there was discussion of the issue and inquiry and

consideration of alternatives. If the directors rely on outside reports, those should be listed in the minutes to demonstrate that the directors investigated and were knowledgeable about the subject.

4. Auditors, creditors and others will review minutes. Minutes should always reflect reports received, even if they require no action.
5. It is generally better to err on the side of length than brevity. Minutes are important to demonstrate the board is acting properly.

### **Exercise of Authority by Boards of Directors**

1. The cooperative's board of directors, exercising their reasonable good faith business judgment, possess the paramount right to corporate control and management. This basic premise of corporate law is a defense to most claims by stockholders and members.
2. Board authority may be limited by statute, by contract and by articles and bylaws.
3. The board must always act in the best interest of the cooperative.
4. Limitations on board authority include the following:
  - a. Statutory provisions require membership approval of a board resolution. Some examples are:
    - Amendment of articles or bylaws
    - Dispose of substantially all the association's assets
    - Agree to merge or consolidate
    - Dissolution
  - b. Other limitations may appear in the articles of incorporation.
  - c. Board authority is also limited by the good faith obligations directors owe to the cooperative. For example, a director has no authority to purchase association assets for an inadequate price or use association property for his or her own purposes because it breaches a director's fiduciary duty.

### **Duties and Liabilities**

1. Any time there is authority, there also is a duty and potential liability.
2. Directors are fiduciaries and are responsible for the management of the cooperative and the custody, use and value of its assets on behalf of its members.
3. There is an obligation of trust and confidence to members. A director must act in good faith and always in the best interest of the cooperative.
4. There is a duty to obey the law.
5. A director must devote all necessary time to the cooperative of which he or she is a director.
6. A director has a duty to stay informed or to become so if it appears he or she is not informed.
7. Habitual nonattendance at meetings is a breach of duty.

8. Any intentional deviation from these standards or duties which results in injury or damage to the cooperative or its members constitutes willful mismanagement for which directors may be held personally accountable.
9. Directors are generally only liable to the cooperative or its members, not to third parties.
10. A cooperative may indemnify officers, agents and employees for damages or costs arising pursuant to their good faith acts on behalf of the cooperative (SDCL §47-17-19).

## The Business Judgment Rule

1. The business judgment rule recognizes that business decisions invariably involve risk evaluation and assumption. Because association directors do not commit themselves to full time employment by the cooperative, they may make decisions that eventually prove to be erroneous. The business judgment rule prevents courts from interfering in complex corporate decision making. It is "a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson v. Lewis*, 473 A.2d 805,812 (Del. 1984).
2. Though directors have duties as described above, they may rely on reports and information provided by competent persons who are more closely connected with the day-to-day business; e.g. the manager, attorneys, accountants, bookkeepers, etc.
3. Things to do to attempt to prevent violation of business judgment rules include:
  - ◆ Regularly attend meetings
  - ◆ Read furnished materials (minutes, reports, etc.) and question them
  - ◆ Participate in discussions
  - ◆ Make independent inquiries
  - ◆ Register objections
  - ◆ Review reports
4. Examples of potential violations include:
  - a. Competition with the cooperative. Unless the bylaws provide otherwise, a director may engage in a competing business as long as he or she exercises good faith and fair dealing and does not damage the cooperative. There is a narrow line. This activity is subject to close scrutiny.
  - b. Taking personal advantage of the cooperative. A director may be held liable for taking advantage of or profiting from the cooperative's opportunity to profit. For example, a director purchases land from the cooperative and then resells it at a higher profit to a third party. The director did not act in the best interests of the cooperative, but in his or her own best interest. It was a private profit derived from the status as a director. A director may buy from and sell to the cooperative as long as the transaction is fair and arms length.
  - c. Voting by a director with an interest in the transaction. The issue here is self-dealing.

If the director is a creditor of the association, the director should not vote on matters dealing with security for the loan or extension of credit. If the director is a debtor of the association, he or she should not vote on any matter related to the debt.

## Other Areas of Potential Liability

1. If directors assume personal liability through contract. For example, a creditor might require personal guarantees or life insurance on directors. Such contracts should never be signed without the counsel of the director's personal attorney.
2. Filing false reports.
3. Misrepresentation in sale of corporate bonds or securities.
4. If the board delegates a function to a specific director and through a breach and personal fault, the director damages a third party. The association is potentially liable, but the individual may be primarily liable.
5. "Violation" of members rights, including:
  - a. Rights of withdrawing members in equity redemption may be a potential area for liability.
  - b. Members' rights to inspect books and records.
  - c. Members' rights to patronage distribution and accounting thereof.
  - d. Losses occurring because director did not attend to their duties.
  - e. Violation of bylaws.
  - f. Failure to obtain or maintain adequate insurance or bonds.
  - g. Excessive compensation to directors.
  - h. Speculation or permitting speculation.
  - i. Negligence in handling of accounts receivable collection of directors or any other person if it causes damage or loss to the association.

## Indemnification and Insurance

1. Even though a cooperative does not technically need a bylaw to indemnify directors, most have them. Indemnification simply means that in the event a director commits an act resulting in his/her personal liability, the cooperative will pay that portion of liability and/or legal expenses incurred. This is in addition to any "vicarious" corporate liability. Depending on the bylaws, indemnification is not mandatory.

Generally, for an illegal act to give rise to potential indemnification, it must have been committed during the course of the individual's duties as a representative of the cooperative. Unless the bylaw provides for additional indemnification, the board may still refuse to pay damages and/or expenses on behalf of the individual director in the event he or she loses the lawsuit.

2. Cooperatives may purchase insurance to protect its directors and officers. This is generally referred to as Director and Officer Liability Insurance. It generally covers negligent acts by a director, officer or employee committed during the course of his or her duties as a representative of the cooperative. D&O insurance is expensive and in many cases is no longer cost/beneficial for companies. On the other hand, many directors will be reluctant to serve as directors if the association does not carry D&O insurance.

## **How to be a good board member**

1. Be on time. If they have to wait on you then they are being punished for being on time.
2. Be prepared. Read the agenda, supplemental material and the minutes from last meeting before the meeting.
3. Remember to take off your "producer" hat and put on your "director" hat before the meeting. Your decisions should be based on what is best for the cooperative, not what is best for you.
4. Be willing to express your opinion even if you are in the minority.
5. Respect the opinions of others.
6. Don't lose your temper.
7. Remember the majority rules and all board members should support the board decision, both at the meeting and in visiting with members.
8. Always be positive and be willing to work for solutions.
9. Be willing to help in any way that would make the board more productive.
10. If you are the experienced director, encourage new directors to participate.

## **Conclusion**

After reading the above material, you now know that being a director is an important position and has a lot of responsibilities. Being an effective board member will be a challenge but with a little effort you will become an asset to your cooperative and its membership.

As mentioned earlier, this information is not all there is to know about being a good director. If you are attentive and willing to listen you will expand your knowledge at every board meeting.

Even though a lot of your understanding will come from that all familiar "school of hard knocks" there are others that are willing to help.

Many cooperative directors may attend a wide variety of educational programs. Most of the regionals serving South Dakota provide information meetings for both directors and managers. Please take time to attend these educational offerings so you can be the best you can be.

**Remember, education is expensive, but not as expensive as ignorance!  
Good luck!**