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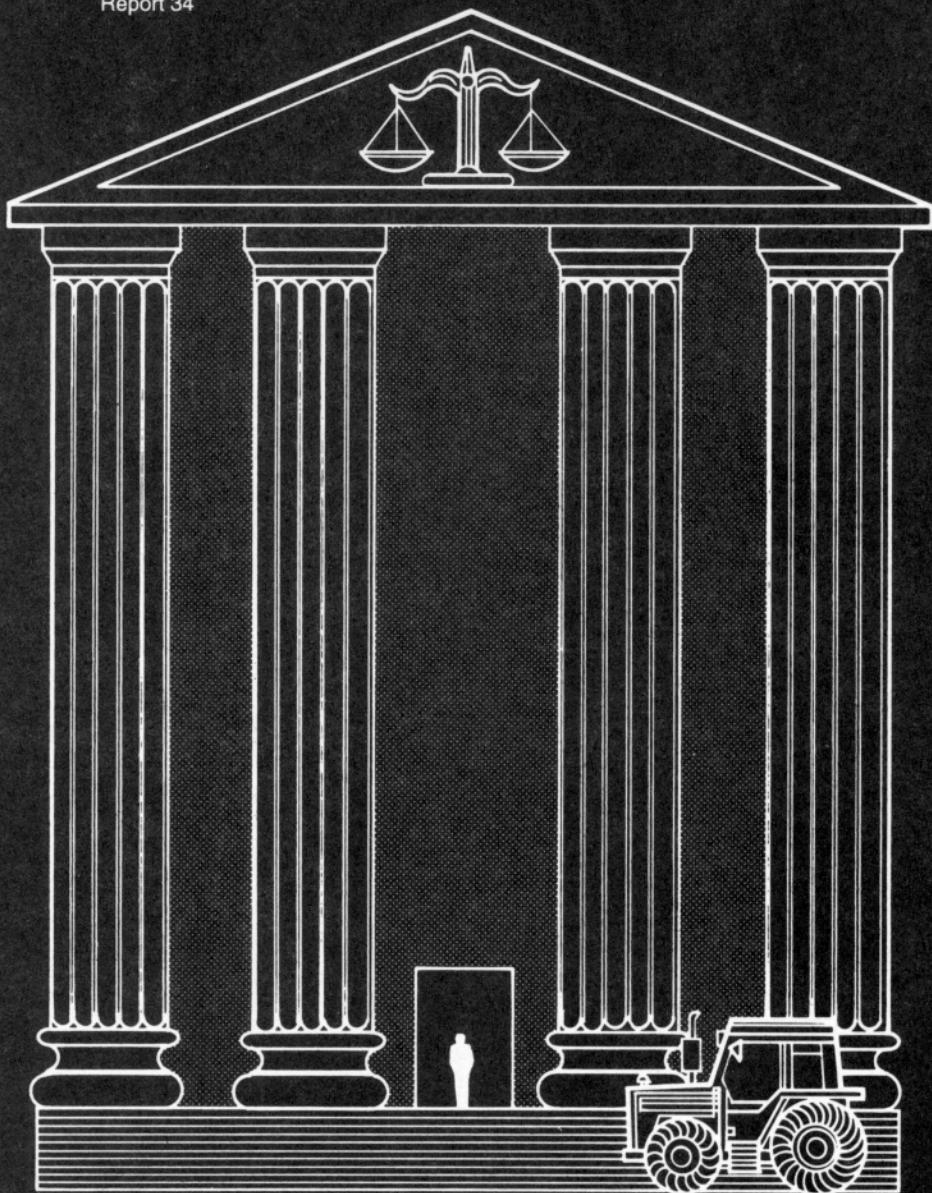


United States
Department of
Agriculture

Rural Business/
Cooperative
Service

Cooperative
Information
Report 34

Director Liability in Agricultural Cooperatives



Abstract

Director Liability in Agricultural Cooperatives

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under a cooperative research agreement with

Agricultural Cooperative Service

U.S. Department of Agriculture

Farmers and others who serve as directors of farmer cooperatives are subject to responsibility rules applicable to all corporations and are subject to the same liabilities when those responsibilities are not met. This study surveys and discusses sources of liability faced by cooperative directors and suggests practices and behavior that may help avoid liability risks. The common law sources of liability are described. Liability of directors for criminal activities is noted, and statutory laws placing liability on directors for their violation are outlined. Liabilities for improper distribution of dividends, depletion of capital, improper patronage refunds, and antitrust violations are singled out for discussion.

Key Words: Agricultural cooperatives, cooperative law, directors, director liability, cooperative management

Cooperative Information Report No. 34

December 1984

Reviewed and approved for reprinting February 1996

Preface

“Membership on the board of directors of a cooperative is ordinarily looked upon as a post of honor, but the board member who has examined the statutes and court decisions on the subject will also look upon the office as a post of great legal responsibility. Not only does the welfare of the cooperative rest upon the board as a group, but the office of director carries with it the possibility of large personal liability both at common law and under statutes.”

This statement, made first in the 1929 edition of *Legal Phases of Farmer Cooperatives*, is as true today as it was more than 50 years ago. A number of publications have addressed the issue of director responsibilities, but none has focused on the more disturbing aspect of serving as a cooperative director--personal liability. This publication surveys situations and laws related to cooperative directors' personal liability for actions taken and decisions made as a director.

An attempt has been made in this study to anticipate an increase in lawsuits against cooperative directors by reviewing situations where they have become involved in lawsuits and by analyzing and applying specific corporate law to those situations where there has been little or no litigation against cooperative directors. This study also identifies areas of legal liability where cooperative directors are treated differently from those of noncooperative corporations.

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Highlights

Directors of agricultural cooperatives are key persons in the organization. Their position as decisionmakers carries with it serious responsibilities and liabilities. Because cooperatives operating under principles of member ownership and democratic control usually elect directors from the membership, directors may have little or no experience as executives of a complex business enterprise.

Directors require guidance in carrying out their duty to manage the affairs of the cooperative while protecting themselves from adverse consequences of avoidable errors or wrongful acts. The subject of director liability is as complex as the operation of the cooperative itself.

The Problem

Cooperative directors, like directors of investor-owned corporations, are charged with the ultimate responsibility of operating the cooperative by acting in concert as a board of directors to set policy, overseeing the cooperative's operation, and making top-level decisions affecting the welfare of the cooperative and its members. When a director violates a duty imposed by statute, common law, or a rule of the cooperative, he or she could be held liable. Directors can be sued by other directors, by the cooperative's members, by third parties, and can be sued or criminally prosecuted by agencies of Federal or State Government.

Common Law Liability

Directors are held to certain standards of conduct and performance. Liability may be founded on common law rules or on statutory law.

Common law, arising from judicial decisions, requires directors to act as fiduciaries for the benefit of the cooperative and its members. Directors therefore have a duty to act with undivided loyalty, diligence, and obedience. If directors don't act accordingly and the cooperative or member suffers any loss, they could be held liable. These duties require directors to maintain a high standard of careful conduct. A director must avoid conflicts of interest, favoritism, dishonesty, carelessness, violation of rules and statutes, and many other acts that constitute breach of fiduciary duty.

Directors are liable for negligence that injures the cooperative, members, or third parties. Negligence is chargeable when a director's failure to comply with a duty of reasonable care causes damage to another's person or property. The concept of negligence is broad and

represents a tremendous potential hazard to directors. A duty to act or to refrain from injurious carelessness may be based on a statute, common law, or rule of the cooperative. Some examples of duties are supervision of officers, diligence in handling the cooperative's business, and reasonable inquiry about matters requiring investigation. Directors may avoid liability through operation of the business judgment rule, ratification by the cooperative, or the plaintiff's failure to prove causation.

Intentional injuries (torts) are another source of director liability. Cooperatives are active in many fields of business activity, so directors may be charged for the cooperative's wrongs. Therefore, they must be careful to avoid causing intentional injuries. Liability can result from actions such as misrepresentation, nuisance, and conversion.

Criminal Liability

Directors may be charged alone or along with the cooperative for violations of Federal and State criminal laws. Because most criminal violations require proof of intent, there can be criminal negligence as well, especially where laws protecting health and safety are concerned.

Statutes imposing criminal liability on directors cover areas such as food purity, occupational safety, handling of chemicals, and environmental regulation. Laws also regulate conditions of employment and disposal of agricultural commodities. Obvious acts of dishonesty such as fraud, embezzlement, and theft subject the director to liability.

Securities

Cooperatives may issue several kinds of instruments to members and other persons. Some of these instruments are considered securities and are subject to Federal and State regulation designed to protect investors. If the instrument is a security, directors have special liabilities.

Issuing and trading securities are strictly regulated. Reports, disclosure, and correct and complete prospectuses are required. Because directors must sign these documents, any fraud or negligently incorrect information in them can result in director liability. Directors must obtain advice of qualified counsel in dealing with instruments that may be securities.

Records and Finances

Although directors are seldom charged with violating laws concerning records and finances, liability exists nonetheless. Directors can be held liable for false or misleading financial statements that cause a loss to another person. Directors have responsibilities, often explicitly detailed in statutes, to see that books and records are properly maintained. Cooperatives may be required to make periodic reports on their financial situation to a State agency or to members. If the cooperative fails to do so, directors can be held accountable. Member access to records may be demanded of directors who in many States are required by statute to allow access or be held liable.

The cooperative's books of account provide the basis for many decisions by the board of directors. Directors may rely in good faith on books and financial statements if there is no reason to doubt their correctness or authenticity. They must, however, see that an appropriate system of bookkeeping is adopted and used to guard against error.

The tax status of cooperatives, different in some respects from that of other corporations, can trigger requirements of income reporting and tax payments that must be accomplished by officers acting for the cooperative. Failure to file returns or filing incorrect returns can result in director liability for civil or criminal violations.

Distribution of dividends, patronage refunds, or retained equities can cause liability to directors. They must comply with statutes and the cooperative's rules regarding interest limitations, minimum cash distributions, and retentions for reserve accounts. Members have sued directors to compel a distribution of retained equities, but that is a matter within the reasonable discretion of the board of directors unless mandated otherwise by a statute or cooperative rule.

Directors must comply with statutes and rules governing the cooperative's capital structure. They may not act to impair the capital stock or other instruments. Directors who consent to indebtedness of the cooperative beyond statutory limits can be held liable for the excess debt. Payments to shareholders that result in cooperative insolvency is another ground for director liability. Directors are liable for depletion of capital caused by commodities speculation, mismanagement, unjustified reliance on others, and wrongful distribution of assets on liquidation.

Patronage Refunds and Retained Equities

Payments of refunds and equities to member-patrons are usually

a matter within the discretion of the board of directors. Abuse of discretion may occur, however, if the board shows favoritism or no rational reason for resisting a demand for payment. Liability is usually found in the cooperative, not the directors, when a claimant demonstrates a right to be paid. Directors, however, have a fiduciary obligation to members, and abuse of discretion may violate fiduciary duty.

Antitrust Regulation

Laws against monopolies, constraint of trade, and unfair pricing are fully applicable to cooperatives and their directors. Although few directors of cooperatives have been prosecuted under antitrust and related laws, they are still liable for violations. Penalties may include treble damages. Directors have no defense of good faith, ignorance of law, or in the fact that they acted merely as the cooperative's agent.

Liability may be based on a director's acquiescence in or ratification of illegal acts, as well as an authorization, ordering, or commission of an illegal act. Conspiracy to violate antitrust laws is an offense for which a director can be punished. Both civil and criminal penalties may be assessed against a culpable director.

A director may be sued for antitrust violations by other directors or cooperative members in a derivative suit brought to enforce the cooperative's rights. Both civil and criminal actions may be brought against directors by the Department of Justice or the Federal Trade Commission.

Indemnification and Insurance

Cooperatives have the right, and in some instances the obligation, to reimburse a director for expenses incurred in defending against legal actions. If directors have adhered to a proper standard of conduct, they can be indemnified for costs of counsel, court expenses, and the amount of judgments rendered against them. Directors may insist on indemnification if their defense in the action is successful. The right to indemnification depends on State statutes and the cooperative's rules.

Insurance against costs resulting from director liability is increasingly available. Not all risks are insurable; however, most liabilities caused by good faith error or simple negligence may be covered. The board should consider the possible means of insuring directors against costs resulting from liability.

Director Liability in Agricultural Cooperatives

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DIRECTORS AND COOPERATIVES

The board of directors of an agricultural cooperative is elected by the membership to govern the cooperative. The board is responsible for the management, specific operating policies, and supervision of business performance. In carrying out these responsibilities, directors are often faced with important questions about the legality of their actions.

Many farmers asked to serve as directors are not fully informed or aware of their legal responsibilities and liabilities that accompany such service. In addition to being legally responsible to the membership, a director can be held personally liable for actions as a board member.

A director is sometimes told service on the board will not take much time because the board meets infrequently, operates informally, and the real business of the cooperative is managed by key hired personnel. Actually, the growing burden of director responsibility, the increased assertiveness of members, and economic conditions suggest every director should be concerned with the personal liability associated with the position.

Cooperatives, like other corporations, are viewed in law as business organizations. They are usually incorporated under State law. Cooperatives differ from other corporations most notably in their purpose: to provide a service to member-owners at cost rather than produce profit to distribute to owners on the basis of their investment. Otherwise, with a few significant exceptions, the cooperative functions similarly to an investor-oriented corporation.

The cooperative director serves in substantially the same capacity as does a director of another corporation. Courts and legal scholars apply the principles of corporate law when a question rises about cooperatives and when no relevant cooperative cases are available. Relatively few cases deal specifically with director liability in a cooperative. However, this situation could change quickly.

The simplest way directors can reduce the risk of an adverse legal action is to resist the temptation to do something wrong or achieve personal gain at the expense of the cooperative, exercise the highest quality of care in official actions, and hold themselves to a justifiably high standard of honesty.

How Directors are Sued

Many reasons can prompt civil or criminal action against a director. Basically, a director can be sued or prosecuted four ways:

Criminal actions may be brought in the public interest by Federal, State, or local authorities.

A civil suit **may** be brought by a third party, such as a person who had contracted with a cooperative or bought something from the **cooperative**.

A director **could** be sued by the cooperative in an action brought by a majority of the other directors.

Any stockholder may bring action against a director on behalf of and for the benefit of the cooperative.

Some reasons directors are sued or prosecuted include:

- violation of statute
- violation of bylaws or articles of incorporation
- fraud
- negligence
- commission of torts or crimes
- antitrust violations
- securities law violations
- misappropriation or misuse of the assets and property of the cooperative
- authorizing preferential treatment to directors
- speculating on the commodities markets
- paying patronage refunds in cash exceeding current savings
- failure to require financial statements with resulting injury to the business
- failure to give annual reports to members

- illegal political activity
- becoming a party to contracts with the cooperative that differ from its contracts with other parties
- failure to attend board meetings to the extent the cooperative suffers financial problems as a result of inattention
- obtaining a property interest adverse to the cooperative
- operating a business that competes with the cooperative
- failure to adequately insure the cooperative's assets or obligations.

In most cases where the cooperative and its directors are successfully sued, the cooperative may be hurt financially and may have to change its operations. It is not likely, judging from past experiences, that the directors will be held personally liable for their actions.

COMMON LAW LIABILITY

Common law liabilities are based on judge-made doctrines that often have preceded statutory liability and are still recognized as sources of liability. The many and varied State statutes on director liability are not examined in this publication. Common law doctrines are the source of much litigation concerning directors and are nearly universal. They express the high standard of conduct a director must observe. The fiduciary duties of loyalty, due care, and obedience are part of a director's role as steward of the cooperative. The duties place a heavy burden of personal risk on a director for failure to comply with them.

Fiduciary Duty

A director is a fiduciary and owes fiduciary duty to the cooperative, to its members, to other directors, and occasionally to the cooperative's creditors. A fiduciary status signifies a special relationship between a director and the cooperative, characterized by trust and confidence in a director and by a director's integrity and candor toward the cooperative. As a fiduciary, a director is obliged to act prudently and primarily for the benefit of the cooperative and to avoid benefiting personally or prejudicing the cooperative unless complete disclosure is first made and consent obtained. A director has by virtue of the position assumed a fiduciary duty and is therefore liable for damages resulting from a breach of the duty. Three

principal aspects of a director's fiduciary duty are loyalty, due care, and obedience.

Loyalty A director's duty of loyalty is most comprehensive and most frequently litigated. It includes a duty of undivided loyalty, a duty to forego seizure of the cooperative's business opportunity, a duty to refrain from conflicts of interest, and a duty of honesty and good faith. These duties are owed to all members and shareholders, to the cooperative as an entity, to other directors, and may extend to the cooperative's general creditors.

Breaches of the undivided loyalty duty can occur if a director prefers one group of members over another group, or if the interests of any one group of members are disregarded. A director may take no special advantages not available to the membership.

Additionally, loyalty prohibits a director from appropriating opportunities that properly belong to the cooperative. The difficult question is identifying which opportunities are rightfully the cooperatives's and therefore prohibited to directors. To be considered as belonging to the cooperative, the opportunity must be one that it could and would take for itself if given the chance. But if the opportunity has been rejected in good faith by the cooperative for reasons of financial or other disability, and no misrepresentation by the director has occurred, then the director may personally pursue the opportunity.

Conflicts of interest between a director and the cooperative unfortunately can occur rather easily. In general, a conflict exists if a director uses the position or the cooperative's assets for personal gain, resulting in a breach of the fiduciary duty of loyalty. A director has the obligation to disclose a recognized conflict of interest. Conflicts may include a director's involvement with a competing business, use of a director's position to blunt the cooperative's competitive effort for the benefit of another enterprise, and a director's sitting on more than one board.

Conflicts of interest can occur in business transactions between a director and the cooperative. Self-dealing by a director can be a breach of loyalty in view of the constraints against taking special advantage or profiting by the director's position. In transactions with the cooperative, a director must disclose personal interest, be honest and fair, and not retain unfair or secret profits.

Finally, the fiduciary duty of loyalty raises an obligation to act honestly and in good faith. Honesty prohibits deeds such as misappropriation of

cooperative assets, a director's sale of influence with the board, undisclosed profits or commissions, or any other act of dishonesty that harms the cooperative or secretly enriches a director. Good faith prohibits a director from committing or condoning fraud. Good faith requires a director to behave toward the cooperative with utmost fidelity and fairness, a standard stricter than that demanded in normal marketplace relations. Good faith also requires an intent to benefit the cooperative.

Due Care A director owes a fiduciary duty of due care to the cooperative. The standard of conduct in State law may be phrased in terms of diligence or reasonable care, but the standard of due care under Section 35 of the Model Business Corporation Act (**MBCA**) is defined as the degree of skill, diligence, and care that ordinarily prudent men would exercise in similar circumstances in like positions. Section 35 provides a flexible standard of conduct for both professional and nonprofessional directors, while still requiring the exercise of due care's essential feature: prudence.

Under this standard, exact limits of the duty are defined by circumstances and needs of the particular business, type of business, and customs and usage in the business. A director's failure to use the degree of care required by the particular situation can result in personal liability for losses suffered by the cooperative. Due care requires exercise of independent judgment that is vigilant, skeptical, scrutinizing, and at all times honest and unbiased.

Though not normally expected to personally operate the cooperative, a director has the duty of delegating responsibility and monitoring performance — a duty of prudent selection and adequate supervision — as a function of the duty of due care. It is no defense to breaches of this duty that a director was a mere figurehead or was not compensated. Further, as a part of this duty, a director is presumed to have knowledge of the contents of the cooperative's books and records, and to have knowledge of a director's duties.

Corresponding with a director's duty of due care is the right to rely on certain parties and information. Assuming the director has no knowledge to the contrary that would make reliance unwarranted, a director may rely on: advice of counsel, officers, or employees whom a director reasonably believes to be competent; public accountants; other experts; and committees of the board. Reasonable reliance on statements, opinions, or reports from these sources satisfies the fiduciary duty of due care.

Because a director is required to make so many decisions, some error is bound to occur despite all reasonable precautions. The so-called "business

judgment” rule was developed to prevent a director from being held liable for business losses when duties were performed in good faith, for the best interests of the business, and in the exercise of unbiased, independent judgment. The business judgment rule recognizes a director is not an insurer of business success and the director is required to do only what reasonably can be done. The rule recognizes that without allowance for honest error, no director could afford the risk of liability associated with the position. Several States have codified a form of the business judgment rule. Codification of the rule also occurs in those States that have adopted Section 35 of MBCA.

Obedience The third principal fiduciary duty is obedience. A director must comply with the cooperative’s charter, articles of incorporation, and bylaws, as well as with statutes and contracts. Obedience is required in a director’s role as an agent for the cooperative. Accordingly, a director may act only within the limits of the power granted.

The case of ***Fagerberg v. Phoenix Flour Mills Co.*** 50 Ariz. 227, 71 P.2d 1022 (1937), illustrates the requirements of the obedience duty. Part of the plaintiff mill’s operations included entering the wheat futures market for legitimate hedging purposes. Two directors went beyond their assignment and secretly used hedging funds to buy futures on margin as a speculation. Large losses resulted. In an action against the directors, the court held they had engaged in unauthorized and ***ultra vires*** activity and were jointly liable for the loss.

Directors have been held liable for other ***ultra vires*** acts such as engaging in a line of business not authorized by the bylaws, making payments to silence complaints of unlawful business activity, causing depreciation of stock value, and publication of a libel.

Of course, the party to whom a director owes obedience will vary depending on the conduct in question. If the conduct involves a failure to obey a positive commandment (nonfeasance), obedience is owed only to the cooperative and gives no cause of action to third parties. But if the conduct is wrongly doing some permissible act (misfeasance), a director may be directly liable to the person injured, including the cooperative or a third party. A director may be relieved of liability to the cooperative when ***ultra vires*** actions are ratified by all voting members, whether ratification is prior or subsequent to the action, so long as notice and disclosure are given.

Negligence

A director can be sued for negligence as a result of official actions or failures

to act that cause injury to the cooperative or a third party. A director's conduct may give rise to both legal and equitable remedies for some injured parties. If a director breaches a fiduciary duty and injures a party to whom the duty is owed, that conduct can result in the **plaintiff's** having equitable remedies such as an injunction or accounting. A director's conduct could be negligent as well as a breach of fiduciary duty (for example, when the duty of due care is negligently breached). The plaintiff then can choose between equitable remedies and legal remedies, which include consequential and punitive damages.

If the director owes no fiduciary duty to a party injured by the director's negligence, the party has no equitable remedies and may sue only in an action for negligence. The plaintiff in a negligence action must prove these elements: duty owed by the director; failure to conform to the standard of conduct, or breach of duty; causal link between the breach and resulting injury; and actual loss or damage to the plaintiff.

Perhaps least clear is the standard of conduct a director must observe to avoid a charge of negligence. Violation of the standard is sometimes referred to as "gross" or "ordinary" negligence, or simply conduct that fails to meet the requisite standard of care. When applied to cases involving directors, distinctions between these standards seem to vanish. Because almost every case of negligence must be evaluated on its own particular circumstances, the standard of care is dictated by fact as much as by law. Liability may be more realistically assessed by considering the areas of conduct in which directors owe a duty of care.

A director has a duty of care and diligence in administration of the cooperative and safeguarding its assets. The director has ultimate responsibility but may delegate specific tasks. The director can select trustworthy officers and employees but must maintain some supervision and oversight of their activities. A director can be charged for wrongful acts of employees or officers if a director has been negligent in their selection or supervision.

In ***Parish v. Maryland & Virginia Milk Producers Ass'n.***, 250 Md. 24, 242 A.2d 512 (1966), directors were charged with negligence for improper supervision of officers. After they were put on notice that certain officers had breached their fiduciary duties, the directors failed to act against those **officers**. The directors' duty to act was owed both to the cooperative and to third parties harmed by the acts of its agents, because the harm could have been prevented by directors' diligence.

While a director need not be personally involved in operating the business of the cooperative, a director does have a management duty. That duty is not diligently discharged if a director repeatedly misses board meetings or otherwise avoids paying careful attention to the cooperative's activities. It is no defense for a director to claim to be a mere figurehead or to be ignorant if ignorance results from a failure to be diligent.

Diligence requires in some instances that a director investigate certain matters, such as the known questionable character and activities of agents and proposed transactions of the cooperative. A director must review and be familiar with contents of reports, books, and records of the cooperative to be aware of significant developments and as a means of verifying oral representations of others. Again, ***Parish v. Maryland & Virginia Milk Producers Ass'n*** is a useful example. Most of the directors' misdeeds in this case resulted from unjustifiable reliance on representations of unfaithful officers. Some of the directors' mistakes, however, were prima facie evidence of gross negligence, as when they approved the high-priced purchase of a dairy that clearly violated antitrust laws, then sold the dairy at a price substantially below its value and without security. Liability for the dairy transaction was based on the directors' presence at the meetings where these actions were approved and the absence of their dissents in the minutes.

A director is liable for misfeasance when a loss is caused by acts of incompetence or recklessness. One example is failure to make an accurate statement in registering securities. A director owes a duty to securities owners to accurately report the cooperative's state of affairs and can be charged for negligently disclosing untrue information or omitting material facts in the registration statement. Failure to conform to statutory duties has sometimes been held to be negligence as a matter of law, causing liability independent of that arising from failure to observe the nonstatutory duty of diligence. Conceivably, this principle of negligence liability resulting from violation of a statutory duty might be extended, at least far enough to show some evidence of negligence, to violations of a cooperative's bylaws or articles of incorporation.

Ordinarily, a director may avoid a charge of negligence just by attending meetings and being inquisitive. But a director still can make a business decision that causes a loss to the cooperative or its members. If a director has acted diligently and in good faith, and the loss results from an honest mistake of independent judgment, the director may be protected by the business judgment rule. While this rule generally allows directors discretion free from second-guessing by the courts, it has limited applicability to some types of violations such as Federal securities, antitrust, and labor law

violations. Yet even allegations that a director's fiduciary duty has been breached may sometimes be defeated by the business judgment rule. In any event, the business judgment rule is not directly a defense against negligence, but rather prevents the exercise of honest judgment from being called negligence, and thus it can help avoid costly litigation.

Another barrier to establishing a charge of negligence is the plaintiffs burden to prove cause. A director may breach a duty and still not be charged if the breach was not the direct cause of the plaintiffs loss. Though some courts may employ reasoning generous to a deserving plaintiff, not every breach of duty followed by loss will support a charge of negligence.

The principal defense against, or avoidance of, charges of negligence is a director's adherence to a careful standard of conduct. While the standard is always judgmental and based on the particular circumstances, a complacent and thoughtless director invites litigation and a prudent, interested director minimizes the liability risk.

Perhaps equally important, if a director has the ill fortune to commit an act of negligence causing a loss to the cooperative, the act can still be ratified by the voting membership. This could be a reasonable course of action if it would be fruitless or self-defeating to sue the director. It usually is better to devote valuable resources to the cooperative's business rather than to futile litigation.

Above all, a director is advised to insure against suits for negligence by at least attending all or almost all board meetings, asking questions about reports and representations, having any dissent reported in the minutes, and seeking advice of counsel when in doubt.

Intentional Torts

Directors can be charged for intentional torts. As an agent of the cooperative, a director may be sued when third parties are injured even though the act was on behalf of the cooperative. A director can be charged for tortious action toward the cooperative.

Directors can be charged by both third parties and the cooperative for deceit or misrepresentation. Liability is based on the loss resulting from a director's fraud or deceit. A director can be charged for writing checks against insufficient funds, misrepresentations about security backing bonds, refusal to return fraudulently obtained money after learning of the misrepresentation, negligently making false representations, and making misrepresentations to creditors.

Liability is greater when a director has a fiduciary relationship to the plaintiff. Misrepresentations to the cooperative can even occur by nondisclosure, which really amounts to misleading by silence. To avoid a charge of fraud or deceit, a director must not make negligent or knowingly false misrepresentations, either by assertion or omission, designed to make another person act on the assertion or omission.

Additional intentional torts include nuisance (ordering or consenting to the creation or maintenance of a nuisance) and conversion (serious interference with another's personal property). To illustrate, directors of a bankrupt grain milling company were sued for an alleged conversion when the plaintiffs demand for grain in exchange for warehouse receipts was not met. The directors did not actively participate in the operation of the company, but did participate in meetings and had carefully reviewed written and oral reports on the company's condition. However, they were unaware of the transactions resulting in the plaintiffs holding the warehouse receipts, and therefore had neither knowledge of nor had acquiesced in those transactions. Because of the directors' diligence and lack of knowledge, the claims against them were dismissed. This case shows that a director's liability in tort must be based on negligence or participation.

CRIMINAL LIABILITY

A trend in recent years has been to fix criminal liability on corporate decisionmakers. Environmental consciousness, the growth in Government regulation, and a heightened public sense that responsible persons in the business organization should account personally for violations committed in the conduct of the business have all combined to place directors in an increasingly vulnerable position.

A special group of crimes, the "public welfare" offenses, have developed that dispense with the traditional scienter (previous knowledge or guilty knowledge) requirement for criminal liability. This development involving liability includes the doctrine of the responsible corporate official, who will be found liable along with the business organization itself. The doctrine reflects the strong public policy that the public health and safety take precedence over burdens on businesses and the individuals who control them.

Public Health and Environment

One case especially serves to alert directors of cooperatives of the risk of criminal liability. In *United States v. Park*, 421 U.S. 658 (1975), the defendant

was president of a business that stored food. Inspectors found violations of the Federal Food, Drug and Cosmetic Act (FDCA). These violations were reported to the defendant, who ordered remedial action. When reinspection showed unsanitary conditions continued, the defendant was charged with criminal violation of FDCA. The defendant argued that he had done all he could and discharged his obligations by ordering reliable employees to cure the violations. The United States Supreme Court held the defendant criminally liable because he had a responsible relationship to the situation causing the violations, could have prevented it, but had failed to do so. Liability was based on the defendant's position and authority and on his duty under FDCA to exercise the highest standard of foresight and vigilance. Indeed, the court dispensed with any requirement that the defendant be aware of wrongdoing.

The principle of "responsible corporate official" as laid down in the *Park* case makes it crucial that directors properly supervise officers and employees to ensure FDCA rules are observed.

Director liability exists for other special statutes and rules. The Poultry Products Inspection Act makes it unlawful to deal in misbranded or adulterated poultry products and states that "any person" who violates its provisions is criminally liable. The Wholesome Meat Act creates numerous responsibilities for processors of cattle, sheep, swine, and the like. The Clean Air Act has an express provision that responsible corporate officers may be sued for knowing violations of regulatory orders or standards of performance, or for making false statements involving air pollution. The Federal Water Pollution Control Act (FWPCA) provides that willful or negligent violations of its sections relating to effluents, standards of performance, toxic pollutants, permit conditions, and recordkeeping are punishable as criminal offenses. Liability for water pollution can exist under the Refuse Act, which prohibits pollution of, or the dumping of debris into, navigable waterways. Cooperatives involved in the distribution and application of insecticides, fungicides, and rodenticides are within the authority of the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA), which provides that a distributor who knowingly violates FIFRA provisions is subject to criminal liability. The Consumer Product Safety Act regulates possibly injurious products and specifically provides for director liability in the event of a willful violation. The Toxic Substance Control Act (TSCA) is intended to control the use of chemicals not already covered by FIFRA.

While some of these statutes have no express provision for applying the principle of "responsible corporate official," actions that imperil the public health and safety can be attributed to responsible directors under the rule of

Park. Certainly, absence of specific provisions about responsible persons in management does not prevent application of the *Palko* doctrine. This list of some Federal statutes concerning environment and public health at least should put responsible directors on notice that their conduct must be vigilantly prudent in this developing area of the law.

Other Criminal Acts

Numerous acts in addition to the public welfare offenses are proscribed and punished as criminal offenses. In operating a cooperative, a director may break the law through lack of caution or as a result of wrongful intent, either of which can satisfy the usual scienter requirement that the individual willingly or knowingly did the act in question. Therefore, carelessness is as much to be guarded against as is bad purpose. The concept of responsible corporate official is fully applicable to the many criminal statutes that provide that "any person" who violates a particular prohibition shall be criminally liable. Several criminal statutes specifically provide (more by way of emphasis than necessity) that directors are liable for violations.

Liability for employment policies can occur in the areas of safety, hours, and wages. The principal statute concerning employment safety is the Occupational Safety and Health Act (OSHA). This law is intended to provide a work place free from hazards, and violations of it are analogous to the public welfare offenses. Although criminal prosecutions have been relatively few under OSHA, potential liability exists in view of the numerous hazards that can occur in handling, processing, and distributing agricultural commodities and supplies. Directors who are aware of safety problems or OSHA violations must act to reduce or eliminate danger to employees. Otherwise, directors could be charged with a criminal offense under OSHA.

Similarly, wage and hour policies can result in directors' criminal liability under the Fair Labor Standards Act. This law is concerned with minimum wages, maximum hours, child labor, and related subjects. Its penalties are applicable to "any person who willfully violates" the Act's provisions.

Commodity Credit Corporation (CCC) operates a Grain Reserve Program. After a CCC price support loan has been granted, the grain may be placed in the reserve and cannot be removed by "any person," subject to penalty, until the national average market price reaches a designated level. A director who votes for an early removal of reserve grain conceivably could be sued.

Directors' criminal liability is becoming greater with the growing diversity of cooperative activities and business ventures. However, it would be impossible to relate here all the many specialized activities that have spawned control agencies and regulations. In addition to Federal laws, every State has laws to punish various acts of dishonesty such as fraud, embezzlement, and theft. As a result, where activities are regulated by Federal or State agencies, a director must seek appropriate advice about the often particular requirements of action or avoidance in the supervision of the cooperative.

SECURITIES REGULATION

Agricultural cooperatives have a variety of financial arrangements with members and others for sources of equity capital. Some of these arrangements fall into the category of securities. When they do, directors of cooperatives can have special liabilities in connection with the issuance and transaction of the security. Risk can be minimized by seeking counsel of a securities lawyer.

Several financial relationships between cooperatives and members are not considered to be securities. However, the Securities and Exchange Commission (SEC) has not given assurance on some financing methods that it would not prosecute for failing to register them as a security. If the cooperative can arrange financing without issuing securities, a director can be spared liability for securities violations.

Even if securities are issued, they may be exempt from the requirement to register and associated liabilities. Less than half of all agricultural cooperatives qualify for tax treatment under Section 521 of the Internal Revenue Code. However, Section 521 allows an exemption from registration under the Securities Act of 1933 so transferable shares or other securities may be issued by these cooperatives without director liability for registration violations. Some cooperatives may be exempt from the provisions of the 1934 Securities Act, which requires, among other things, registration for certain securities traded on a national exchange or in the over-the-counter market.

Additional exemptions are based on how the security is transacted, such as exchange of securities, intrastate sales, and private or limited offerings. These exemptions can save the cooperative the expense of registration and avoid director liability for registration violations.

If the cooperative, the security, or the transaction is not exempt under the

1933 and 1934 Securities Acts, a director may be charged with securities violations in several areas. Even if an exemption applies, a director still can be charged for violations of the antifraud provisions of the Securities Acts.

In addition to Federal liabilities, a director must be aware of liability under State securities regulations. States have adopted so-called blue sky laws concurrently with Federal securities laws. Each State has a blue sky law that can contain registration requirements and antifraud provisions. Many provide specific exemptions for agricultural cooperatives and their securities, but considerable diversity appears in these provisions.

RECORDS AND FINANCES

Few suits have been successful against directors of cooperatives for liability associated with records and finances. Most cases involving records and finances have been against the cooperative. Nevertheless, it is likely an increasing number of suits may develop against directors. Suits will be based on corporate analogies and legal precedents. The next logical step in suing for damages resulting from financial dealings with a cooperative is to sue the decisionmakers, the directors, when their actions have caused the financial injury.

False or Misleading Financial Statements

performance of corporate duties (mismanagement of the business) in the wake of insolvency and the closing of the elevator. The auditor's report showed substantial mismanagement and improper use of funds, including personal use of corporate funds. The court said the directors had breached their fiduciary duty to the corporation even though they had neither assumed active duties nor involved themselves in the day-to-day affairs or financial management of the corporation. Where directors have knowledge of mismanagement and misappropriation and fail to take steps to correct these facts, they breach their duty. However, the court went on to say that for liability to be found a director's knowledge must at the least amount to acquiescence.

Direct rulings by the courts on the general duty to keep correct books and records, in the absence of any specific statutory requirement, are few in number. However, in the general course of a corporation's business, it is necessary that proper books of account be kept. Thus, even where a statute does not require a record of the corporation's business transactions to be kept, the director, by virtue of the position as a trustee with respect to members, should see that proper books of account are kept. However, the duty to keep full and accurate accounts does not mean a director must be able to render a bookkeeper's account of all receipts and disbursements.

Reports

Most States require incorporated cooperative associations to make periodic reports to a State agency concerning the association's business affairs. Some State statutes require cooperatives to make the same annual reports required of other corporations. Others require cooperative marketing associations to make annual reports that may differ somewhat from annual reports made by other corporations. An association that fails to file required annual reports may be subject to penalties. These penalties range from loss of good standing to involuntary dissolution.

Accordingly, directors of a cooperative have been charged for failure to file annual reports and for filing false reports when their actions have caused injury. In one case, the court held directors of the cooperative liable for its debts to the plaintiffs because the directors failed to file an annual report and made a false report in violation of State statute. The directors had delayed filing the report for 3 months after being elected. An annual report had not been filed in previous years. The report also contained false statements about the solvency of the cooperative.

In a recent case, a cooperative's creditors sued it, contending individual

directors were liable along with the cooperative on certain leasing agreements for which the cooperative was in default because of the failure to file a required annual report. However, annual reports were filed during the period in which the leasing agreements were made. The Supreme Court of Montana acknowledged the penal nature of the directors' statutory liability for failing to file an annual report, but held the directors were only liable for the debts of the cooperative incurred during the period of default in making and filing the annual report.

Although State statutes may require an annual report to be filed with a State agency or official, it may not always be necessary to furnish the membership with annual reports. In one case, the court held the directors of the cooperative were not guilty of fraud and mismanagement for failure to furnish annual reports when the cooperative discontinued furnishing annual reports because of lack of membership interest.

Inspection of Records

A director has a liability concerning inspection of records. Many State statutes require association books either to be open to inspection by members or to be distributed to members. A director may be charged for failure to comply with this type of statute. Courts generally will allow shareholders to examine corporate records if they show "good cause" to discover evidence in their claim against the corporation.

Reliance on Records, Books, and Reports

A number of States have adopted statutory provisions that allow directors to rely in good faith on the corporate books of account or on financial statements of officers having supervision of the accounts. Good faith reliance is recognized as an absolute defense. The Model Business Corporation Act provides that a director may rely on information, opinions, reports, or statements prepared or presented by officers and employees, counsel, public accountants, committees of the board, and others if they are, or if the director reasonably believes them to be, reliable and competent. Also, some State cooperative statutes recognize the reliance defense. Even in the absence of statute, directors may, in the exercise of due care, ordinarily rely on the advice and reports of officers, provided the directors exercise good business judgment concerning the accuracy of the reports furnished them and use care to inspect the reports.

Accounting Procedures

A director can be sued if the cooperative does not follow proper accounting procedures. Directors should see that an approved system of bookkeeping is adopted to protect against mistakes and false entries. This does not mean, however, that the duty of supervision requires a director to proceed on the theory that officers' and employees' actions are under suspicion, that a director is required to examine the books, or that an expert accountant must be employed to detect embezzlement.

Therefore, without a specific statute to the contrary, or until something happens to put reasonably prudent directors on notice, directors are entitled to assume that officers, if selected with reasonable care, are honest and following an approved system.

Tax Liability

Liability associated with records and finances may relate to taxation. Circumstances can exist under which a corporation, or its officers, directors, and employees, will be held civilly or criminally responsible for errors, misstatements, and omissions (whether accidental or intentional) that might occur in the corporate Federal or State income tax return. It is clear a corporation's directors, officers, and employees can be convicted of tax evasion while acting on behalf of the corporation. In criminal tax cases, the prosecutor can decide to try the corporation alone, the responsible officers, directors, and employees alone, or join them all as defendants.

The Internal Revenue Code (IRC) and other Federal statutes specifically set forth a series of substantive acts that, if violated in connection with the preparation and filing of corporate Federal income tax returns, can result in civil and criminal sanctions against corporations, their officers, directors, and employees. The IRC also says an officer or employee of a corporation can be punished for any tax crimes committed in connection with official corporate duties. Furthermore, civil fraud sanctions are contained in the IRC. Both the corporation and its officers may be assessed penalties for violations of the fraud and negligence provisions of the IRC because violations depend on the acts and intent of the officers.

Improper Distribution of Dividends

A director may be sued for violating various limits on interest or dividends or for violating restrictions on changes and modifications in dividends.

State statutes or articles or bylaws of the cooperative can limit dividends or interest payable on capital stock. Limits can apply to common stock, preferred stock, or patronage-based equity. An alternative requirement of the Capper-Volstead Act provides that an association may not pay dividends on stock or membership capital in excess of 8 percent per annum. Most States place a maximum limit on interest or dividends paid on common or membership stock and preferred stock. Changes in capital stock structure or modification of rights to dividends or interest may include changes in the amount of capital stock and changes in preferences for various classes of stock. Changes are normally made by an amendment to the articles of incorporation or bylaws. However, some State statutes specifically describe circumstances and voting requirements necessary for such modifications.

Cases have arisen where shareholders have sought to require distributions by the board of directors. Although shareholders generally have sued only the cooperative association, directors could become targets. In one case, a court said failure to pay dividends and allow redemptive rights was an abuse of director discretion because the charter and its bylaws required a revolving fund for the retirement of stock in those years when adequate capital had been accumulated. The court held it was not valid to pay active members first to meet the competition for those members, especially when the directors' business with the cooperative comprised 80 percent of its total business.

In another case, preferred stockholders brought an action for an accounting and an order compelling an agricultural cooperative to comply with its articles of incorporation requiring payment of dividends on and retirement of preferred stock. A dividend of 6 percent was to have preference over all other dividends and distributions, and preferred stock was to be retired when a reserve account established for that purpose exceeded a specific amount. The cooperative paid patronage refunds out of its net margins rather than build up the reserve account. Losses were charged against the general reserve and no allocation was made to the retirement reserve account. Although the board of directors of the cooperative were all common stockholders, the operation of the cooperative was financed by preferred stock. The court said directors of the cooperative abused their discretion in failing to develop and maintain a rational balance between the amounts paid to the preferred stockholders and the active members, and in failing to provide, maintain, and build the preferred stock retirement reserve account required by the articles of incorporation.

Some questions arise over whether shareholders can successfully sue directors personally to pay required dividends. One case concerning

misfeasance (specifically, the misappropriation of corporate property) and the right to dividends indicates that if a cooperative's member tried to enforce a personal right to a declaration of dividends, the court could first require the member to bring a derivative action (a shareholder's suit on the business's behalf to enforce the corporate claim). Misappropriation can occur, for example, by paying patronage dividends rather than required preferred stock dividends, or by purchasing unnecessary assets rather than paying dividends. The court in this case noted that a suit to compel a declaration of dividends is a suit to vindicate primary and personal rights and is not the proper basis of a derivative suit. Once restitution of corporate property is obtained by means of a derivative suit, however, proper dividend payments could be made. If the directors still refused to declare dividends, an individual action could then be brought. Of course, an individual action could be brought initially to compel payment of dividends for monies available that had not been misappropriated or misused (i.e., where the directors merely refused to declare a dividend).

Depletion of Capital

Generally, a business corporation may repurchase its own stock provided its capital stock is not impaired. This general principle has been applied to cooperatives. Many States place limitations on common and preferred stock repurchased by cooperatives. Suits can arise over stock purchase plans or restrictions on stock repurchase. In suits seeking to defeat stock purchase plans, courts have upheld the purchase so long as the corporation does not use its funds or property for a stock purchase that, when accomplished, would cause any impairment of its capital stock or its financial status, or that would diminish the corporation's ability to pay its debts or lessen the security of its creditors.

In one case, a former member of a fishermen's cooperative sought to recover the value of his stock or membership interest in the cooperative, as well as to have an accounting for patronage to which he was allegedly entitled. The court held that an amended bylaw adopted by the cooperative, which altered the consideration to be received upon the redemption of shares from "fair book value" to original purchase price, did not change the former member's right under the bylaw in effect when he purchased his stock. The court found the amended bylaw infringed upon a vested right of the plaintiff and exceeded the authority of the cooperative to amend the bylaws. Though directors were not held personally responsible, a similar interference by directors with members' vested rights could result in their being charged for *ultra vires* acts.

Additionally, suits may arise over debts and losses sustained by the cooperative. Some States place credit limitations on cooperatives. Wyoming makes directors liable to creditors when they consent to an excess of indebtedness over assets or subscribed stock. A director can be liable for payment of dividends or refunds causing the association to become insolvent unless the director filed an objection to the board action causing the insolvency.

In one case, a chemical company sold fertilizer to an agricultural cooperative. After the cooperative became insolvent, the company sought to recover the unpaid portion of the purchase price from directors of the cooperative on the ground that the directors had negligently permitted the indebtedness or liabilities of the cooperative to exceed the limits permitted in the bylaws, and were therefore liable for the balance due. The court said the seller could not recover from the directors if the seller knew the indebtedness limit was exceeded. However, the court also said the burden was on the directors to prove the seller knew the cooperative had exceeded its limits of indebtedness. The court found the directors liable.

Similarly, commodities speculation that results in depletion of capital can provoke lawsuits against directors. Some courts, noting specific authority to buy or sell commodities outside the State, have held speculative transactions to be legitimate (not ***ultra vires*** and not gambling or otherwise unlawful), and therefore actions against the directors of these companies were not successful. In contrast, when directors have used certain funds to speculate without authority, other courts have said that although directors are authorized to handle ordinary business affairs according to their best judgment, they are not excused by good faith from responsibility for speculative losses unauthorized and outside of the corporation's ordinary and usual scope of business. Courts following this line of reasoning generally label speculative transactions as ***ultra vires***, if not absolutely illegal. On the other hand, courts have upheld hedging practices of cooperatives as not being ***ultra vires*** not outside the objects for which the corporation was created.

Certainly, mismanagement or misuse of funds can injure the member and confer standing to sue the directors for breach of fiduciary duty. When challenged for mismanagement or misuse of funds, directors have traditionally relied on the "business judgment rule" as a defense. Another common defense is reliance upon others, which is allowed because directors are not normally required to supervise day-to-day operations.

Finally, it should be noted that State statutes following the Model Business

Corporation Act may impose liability on directors for wrongful distribution of the assets of the cooperative upon liquidation, and for any loans made to any director or officer, unless the loans are repaid in full.

Patronage Refunds and Retained Equities

Patronage refunds have traditionally been the method cooperative associations use to operate at cost and return net margins or savings to patrons on the basis of business done with the association. Although use of patronage refunds is widespread, many State statutes do not describe them in any detail. However, several terms used with respect to patronage refunds are implicitly defined in statutes. In addition to references made to the nonprofit nature of cooperatives, many statutes refer directly to the distribution of net margins or savings. In other words, certain statutory language may be taken as direct or indirect recognition of the patronage refund system and the requirement that net margins or savings be returned to patrons.

The timing, level, and manner of redeeming patronage equities is usually covered in the bylaws and is usually held to be a matter within the discretion of the board of directors. Nevertheless, equity redemption is still an important issue. The dual demands of cooperative financing and member requests for redemption may conflict.

No cases have held directors personally liable for failure to pay patronage refunds or credits, but cases have been decided against the cooperative on the basis of abuse of director discretion. Courts more commonly side with the cooperative and its directors and are hesitant to interfere in this aspect of a cooperative's business. In the absence of bylaws, articles of incorporation, or statutes requiring payment, courts usually have held that boards of directors may in their reasonable discretion deny payment on demand to any member of the cooperative, even to the estates of deceased members, especially if expansion of operations would otherwise be seriously jeopardized, or where payment would cause undue financial hardship to the cooperative.

Courts have recognized, however, that a plaintiff-member may be able to show abuse of director discretion. Decisions finding abuse have been based on proof of the cooperative's sound financial condition, lack of equality of treatment in repayment of capital credits, or that directors have a fiduciary obligation to members in regard to decisions affecting member capital.

One court, upholding the plaintiff-member's claim against a cooperative

that had refused upon demand to make payment of deferred dividends, held the directors had abused their discretion because they had previously paid deferred dividends to other members in a like situation, because the cooperative was in a healthy financial condition, because the directors could not show payment of deferred dividends would create any undue hardship, and because the cooperative had received a benefit from the plaintiffs dividends.

Suits involving directors can arise as a result of disagreements over **setoffs**. The member can claim a **setoff** for accrued but unpaid patronage dividends or equity credits, and can even demand the balance due. Then questions arise concerning whether the directors should have declared payments or made distributions, whether indebtedness is due and payable, and whether there has been an abuse of discretion. Decisions have gone both ways in regard to allowing **setoffs** for patronage dividends.

Questions involving patronage dividends can arise when cooperatives merge. In one case involving an alleged merger, the court said when agricultural cooperatives merge, dissatisfied members are entitled to revolving fund credits at the discretion of the board of directors because the right to payment simply follows the fund. But when there actually is not a merger, but rather a sale of assets followed by a dissolution of the “merged” cooperative (the one going out of existence), dissatisfied members of the “merged” cooperative are entitled to immediate payments of their revolving fund credits.

Other Actions of Directors

Directors of cooperative associations are liable for their actions in a variety of other circumstances relating to records and finances. Directors can be sued for breaches or defaults in the cooperative’s marketing agreements when the cooperative’s payments were insufficient. These defaults can constitute mismanagement of the cooperative’s affairs. However, if directors make good faith errors of judgment in marketing-sales transactions, no liability normally is placed on them or the cooperative.

Directors who have permitted another director to conduct the corporation as a personal affair have been charged with misapplication of corporate funds when they acted without reasonable care in failing to preserve, conserve, and protect the assets of the corporation. Conversely, directors of a farmers’ grain cooperative were not charged for an alleged willful conversion of grain belonging to a farmer when his oats were sold and no remittance made to him. In that case, the court said nothing indicated the

directors did not exercise care and prudence in selection of the manager (who arranged the wrongful transactions), and neither did the directors assume general supervision of the conduct of the business nor did they have knowledge of, or acquiesce in, the wrongful conduct of the manager.

Finally, many State “conflict of interest” statutes prohibit a director from becoming a party to a contract for profit with the association differing in any way from business relations with regular members, or holders of common stock, or others, or differing from generally current terms. Nevertheless, despite a conflict of interest statute, one court upheld the right of a cooperative to employ a director as a business manager for a fair remuneration. On the other hand, in a derivative action against a cooperative and its directors and former directors, another court found failure of the board of directors to investigate two employees’ conflicts of interest, after having actual knowledge that they were faithless employees, was *prima facie* (self-evident) gross negligence and culpable mismanagement for which the directors were liable because of resulting losses to the cooperative.

Few cases have held directors personally liable for authorizing false or misleading financial statements and reports, improper distributions of dividends, depletion of capital, improper payment of or denial of payment of patronage dividends, for failure to give annual reports, or for authorizing other actions involving misappropriation or misuse of cooperative property or funds.

ANTITRUST REGULATION

It is most important for directors to be knowledgeable about the cooperative’s relationship with antitrust laws. Agricultural cooperatives are not totally immune from antitrust prosecution and civil proceedings despite exemptions granted by the Capper-Volstead Act, other Federal statutes, and State antitrust statutes. Uncertainties pervade the antitrust laws, especially concerning the personal criminal and civil liability of directors. Moreover, antitrust law is one area where corporate law diverges considerably from cooperative law because of the specific exemptions from antitrust laws that apply to farmer cooperatives. Otherwise, many principles of antitrust law apply equally to cooperatives and other corporations.

Applicable Corporate Antitrust Principles

The primary purpose underlying the antitrust laws was the desire of Congress to protect the public from business combinations that tended to

monopolize and restrain interstate trade. To implement this purpose, a procedure was established authorizing the Federal Government to investigate suspected violations and institute both criminal and civil proceedings. Further compliance was ensured by Congressional solicitation of participation by private individuals in enforcement. To encourage private suits for antitrust violations, Congress enacted Section 4 of the Clayton Act, which gives to anyone injured in “business or property” by reason of an antitrust violation of any kind an action for treble damages (triple the amount of damages actually suffered).

Section 4 of the Clayton Act places no limitation on the person the private litigant may name as a defendant in a treble damage suit. Therefore, questions can arise about directors’ liability under the treble damage provision. Although private antitrust suits are numerous, relatively few cases have named corporate officers and directors as defendants. This is understandable considering the greater likelihood of a corporation being able to satisfy a large treble damage judgment. However, some plaintiffs do sue both the executive and the corporation. A plaintiff can decide to sue the director alone where the corporation is insolvent.

The corporate executive is liable for torts personally committed. Consequently, a director cannot use the corporation to shield unlawful conduct. However, if a director’s tort is committed within the scope of director authority, the corporation as principal also may be liable with its agent, and an injured third person may look to either or both for satisfaction.

An antitrust action by a private individual seeking treble damages is an action based on the defendant’s personal liability for the damages actually caused to “business or property.” The leading case applying the agency rule of liability for treble damages to a corporate executive is *Kentucky- Tennessee Light & Power Co. v. Nashville Coal Co.*, 37 F. Supp. 728 (W.D. Ky. 1941), affirmed 136 F.2d 12 (6th Cir. 1943). The court held that if the participation in the unlawful antitrust transaction were proved, the executive would not be relieved of liability merely because he was an agent of the corporation making the illegal payment; he must personally bear the consequences of his own tortious conduct.

Under antitrust laws, a director cannot escape liability on the grounds of acting with good intentions or in good faith, or that the violation of the law was not recognized.

Even where an officer is not charged with active participation in prohibited

conduct, liability can result from passive acquiescence or ratification of illegal activities. To prove acquiescence, it must be shown that an official had knowledge and approved of the activities and their unlawful objective. Of course, an officer will have little to fear if, upon learning of illegal activities, the officer repudiates and disassociates from them. However, actual knowledge is not the sole requirement. Once put on notice that something is unlawful, an officer is charged with knowledge of all a reasonable inquiry would have revealed.

A second legal theory imposing civil treble damage liability on directors is based on the corporation's criminal liability. Section 14 of the Clayton Act, the so-called personal guilt provision, provides that whenever a corporation violates any of the penal provisions of the antitrust laws, the violations will be applied also to those of its individual directors, officers, or agents who authorized, ordered, or did any of the illegal acts.

The Supreme Court of the United States has never held mere corporate liability sufficient to extend liability to corporate agents who have no consciousness of wrong-doing. On the other hand, Congress, by express statutory provision in Section 14 of the Clayton Act, has applied the antitrust laws to corporate officers as distinct from corporations. The history of Section 14 shows it was enacted to create a method of punishing directors who took part in unlawful conduct under the antitrust laws. This places a director's liability on an equal footing with that of the corporation, so both are within the civil liability provisions of Section 4 of the Clayton Act.

The Supreme Court has held that Section 14 of the Clayton Act does not provide an exclusive remedy for violations of Section 1 of the Sherman Act, and therefore does not preclude prosecution of corporate personnel under the Sherman Act. Most of the litigation in antitrust centers on the more stringent criminal penalties of the Sherman Act. Thus, any corporate officer can be prosecuted who: knowingly participates in an illegal contract, combination, or conspiracy; authorizes, orders, or helps perpetuate the crime; or acts toward those ends in a representative capacity.

Sections 1 and 2 of the Sherman Act refer to offenses committed by any "person" or "persons." Those provisions apply to "every person engaged in business whose activities might restrain or monopolize commercial intercourse among the States." Liability under the Sherman Act has been extended to all persons who knowingly participated in, aided, or abetted a violation of its provisions. The Supreme Court has included individual corporate officers and directors in the definition of "persons" because a corporation can act only through its officers and directors.

An individual director cannot be charged with conspiring with the corporation to restrain trade or to monopolize or attempt to monopolize trade in violation of Sections 1 and 2 of the Sherman Act. Most courts have taken the view that a conspiracy requires at least two persons or entities, and there is only one entity (the corporation) where the executive acts for the corporation in the ordinary scope of duties. When acting in other than a purely official capacity, however, an officer is regarded by the law as an entity separate from the corporation and a conspiracy can be in violation of either Section 1 or 2 of the Sherman Act.

It is well recognized a conspiracy between a parent corporation and its subsidiaries or between two or more subsidiaries can be in violation of the Sherman Act where the purpose and effect of the concerted action is to restrain the trade of outsider entities. Presumably, a conspiracy can also exist between the officers of the corporation and the officers of the subsidiary or between the officers of one entity and another corporate entity.

A distinction can be made between Sections 1 and 2 in this regard because Section 1 does not make a restraint of trade, standing by itself, a substantive offense. Because a corporation is incapable of violating Section 1 by itself, it follows that concerted action between members of the same corporate family does not constitute a conspiracy within the meaning of Section 1. However, in Section 2 cases under the rationale recognized by some authorities, if the corporation itself can violate the antitrust laws, its officers and directors or its subsidiary corporations can conspire to commit a Section 2 offense (e.g., by devising a monopoly scheme).

The matter of whether a cooperative and its subsidiaries, and therefore its directors, officers, and employees, can conspire to violate the antitrust laws has been a subject of frequent litigation. Most cases have considered only the threshold question of whether the organizations themselves have conspired to violate the antitrust laws, and not the question of whether the directors are individually liable for conspiracy. But by analogy it can be argued that the Capper-Volstead exemption to the antitrust laws will not protect combinations of producer and nonproducer interests, and therefore directors involved in the conspiracy may be held liable for Sherman Act violations. Additionally, Section 2(a) of the Clayton Act, as amended by Section 1 of the Robinson-Patman Act, specifically prohibits “any person” from engaging in certain discriminatory pricing practices. Courts have uniformly held that an officer, director, or employee of a corporation may be sued in an individual capacity for acts done on behalf of the corporate employer if those acts violate the Robinson-Patman Act. Corporate

personnel have been held liable under this section for unlawful or improper acts in which they knowingly participated. Further, Section 3 of the Robinson-Patman Act makes it a crime to sell goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor. Sales made below cost without any legitimate commercial objective and with specific intent to destroy competition violate the antitrust laws because of Section 3. However, Section 4 of the act provides a limited exemption for cooperative associations by allowing them to return to their members all or any part of the net margins or surplus resulting from the cooperative's trading operations. Section 4 applies only to the payment of net margins to members, however, and does not give cooperative associations blanket exemption from the prohibitions of the Robinson-Patman or the antitrust laws generally.

Derivative Suit – Personal Liability for Antitrust Violation

A corporate officer has a fiduciary relationship to shareholders of the corporation. Thus, an officer owes shareholders and the corporation a duty to employ only reasonable means in performing the management functions. To violate the antitrust laws in performing those duties is not an exercise of reasonable care. If officers do act outside the scope of their authority in violating the antitrust laws, they may be liable to the corporation for any damages. An officer can be liable to the corporation for its fines, single or treble damages, and litigation expenses. If the corporation unjustifiably refuses to enforce its cause of action against an officer, one or more of its shareholders may bring a derivative suit against the guilty officer and seek recovery on behalf of the corporation.

To maintain a derivative suit, the shareholder must allege and prove the officer has breached fiduciary duty (e.g., by a willful violation of statute) to the corporation and to shareholders. Secondly, the shareholder must prove an officer knew, or with the exercise of reasonable care should have known, that antitrust laws were being violated. The third element to be proved is that the corporation has suffered an injury because of the unlawful conduct of an officer. Proof used to establish the injury must be of an independent nature. The damages recovered against an officer in a derivative action are single damages, not the treble damages awarded under Section 4 of the Clayton Act.

Criminal Antitrust Enforcement

The Antitrust Division of the Department of Justice and the Federal Trade Commission have primary authority to enforce the antitrust laws. The

Antitrust Division has authority for enforcing the Sherman Act, the Clayton Act, and the Robinson-Patman Act. Jurisdiction is shared with the Federal Trade Commission with respect to the Clayton and **Robinson-Patman** Acts. The Federal Trade Commission enforces Section 5 of the Federal Trade Commission Act, which declares as unlawful unfair methods of competition and unfair or deceptive acts or practices in, or affecting, commerce. The Federal Trade Commission has no authority, however, to act solely in the interests of individual complainants who have been exposed to unlawful practices. Even so, violations of the Sherman or Clayton Acts also may be violations of the Federal Trade Commission Act.

Whether a criminal or civil action will be brought by the Antitrust Division depends in part on the defendant's conduct. It is a rule of the Antitrust Division that criminal prosecution will be initiated for willful violations of the law (willfulness may be established by actions constituting ***per se*** offenses or by intentional violations). Not all antitrust statutes, however, are criminal in nature. Criminal actions may be brought under Sections 1-3 of the Sherman Act, Section 14 of the Clayton Act, and Section 3 of the Robinson-Patman Act. But even if the Antitrust Division does not initiate criminal prosecution, it is not precluded from filing a civil action based on the same alleged violation. Indeed, it is agency policy to do so.

Realities of Personal Liability

In the vast majority of civil antitrust cases, proof of damages is not simple. Proof cannot be based on conjectural theories of injury or remote economic injury that would involve the courts in difficult cause and effect relationships. Plaintiffs must allege and prove they were forced to pay higher prices due to a defendant's restrictions, that market price rose as a result of a defendant's activities, and that they were within a defendant's "target area" of alleged anticompetitive behavior. A significant causal relationship must be shown to exist between the violation and the injury.

The leading case for holding directors and officers of a corporation liable for antitrust violations is ***Hartford-Empire Co. v. United States*, 323 U.S. 386 (1945)**. Although the directors of a corporation can be sued personally for antitrust violations, this case pointed out that shareholders and employees of a corporation may have no individual claim for personal relief under the antitrust laws for injuries they suffer as a consequence of injury done to a corporation by the directors in violation of antitrust laws. Normally, the proper course of action for this type of injury is a shareholder derivative action for breach of fiduciary duty.

In few cases over the years have a cooperative's officers or directors been sued individually for violations of antitrust law. Moreover, when directors have been specifically named as defendants, they usually have not been held liable. In derivative actions against officers and directors of cooperatives, as with actions against executives of other corporations, courts generally find liability only for gross and culpable negligence in the management of the cooperative. Contentions that directors of cooperatives should be held to a higher standard of care like that imposed on trustees of an express trust have gone unheeded. The courts have held the fiduciary relationship that exists in the cooperative setting is not the "Simon-pure" relationship governing in the law of trusts. In other actions, courts have limited the liability of officers and directors of cooperatives to participation in "inherently wrongful conduct." Thus, plaintiffs in antitrust suits must prove gross and culpable negligence or inherently wrongful conduct in the management of the cooperative before directors will be held liable.

Nevertheless, in areas where the Capper-Volstead exemption does not extend, the courts have sometimes been strict with individual directors. In one case, a charge of conspiracy to restrain trade by price-fixing was inferred from course of dealing and circumstances when a cooperative raised "out-of-store" prices even though wholesale prices had not been increased, fixed different prices for different customers, gave secret cash rebates, indiscriminately cut prices without valid explanation and not in an effort to meet the competition, and utilized deceptive practices and bullying methods. The antitrust exemptions did not apply in this case because the actions of the cooperative (supplier) affected noncooperatives (customers); therefore, the defendant-cooperative was subject to the antitrust laws. The court said fixing retail prices violated Section 1 of the Sherman Act, and predatory acts showed intent to monopolize in violation of Section 2. The court awarded damages against the defendants, as well as attorneys' fees, and issued an injunction prohibiting the cooperative's unlawful actions.

In another private antitrust action against a farmers' marketing cooperative in which officers and directors also were named defendants, the court held a corporate officer acting in official capacity can individually perform predatory acts for which the officer is personally responsible. The court said the corporation as principal is responsible for the acts of its agents who violate the antitrust laws, but the agents also can be individually responsible. The court said further that officers or directors acting in other than their normal capacity can be held individually responsible for conspiracy to monopolize, and the corporation as principal also may be responsible for their violations.

State Antitrust Laws

Most States have statutes concerning agricultural marketing cooperatives that include a provision to the effect that a cooperative incorporated pursuant to State statute does not violate the antitrust laws of the State by either operations or by agreements with members. Another common statutory provision does not refer specifically to antitrust rules but permits activities among cooperative associations that might otherwise have antitrust implications. Forty-three States have statutes with this type of provision allowing inter-association agreements. The public policy of these types of statutes generally has been upheld by the courts.

INDEMNIFICATION AND INSURANCE

Because even the most careful, faithful, and knowledgeable director may become a defendant in a lawsuit based on official actions or position, some thought should be given to protecting the director through indemnification and insurance.

Indemnification

Indemnification is the act of a cooperative in reimbursing the director for expenses resulting from legal actions taken against the director in official capacity. In the typical case, the director is sued by a third party or by members or shareholders of the cooperative in a derivative action. A director can incur expenses of counsel, court, and settlement or judgment. Depending on the nature of the legal action, it may be possible to reimburse a director for some or all of these expenses through indemnification from the cooperative.

Statutory provisions for corporate indemnification exist in every State. These statutes apply to corporate directors and therefore to the directors of incorporated cooperatives. Most statutes are a recognizable version of the Model Business Corporation Act Section 5, which, as revised in 1980, provides for and puts limitations on indemnification. A director may be indemnified for some or all expenses by right or by discretion. But under some circumstances, a director may be barred from indemnification altogether.

To qualify for indemnification, it must be determined that a director of a cooperative has met the prescribed standard of conduct of the Model Business Corporation Act or the cooperative's bylaws. In one recent case, an employee of a cooperative was denied indemnification when found guilty

of making illegal campaign contributions in which the directors had acquiesced. A bylaw allowed indemnification to the extent permitted by law, but only for acts done in good faith. The court held a knowing violation of law, though done to benefit the cooperative, was not an act in good faith, and the employee was left to pay the fine and attorney fees out of his own pocket.

Nevertheless, directors have been indemnified by right even though they had not been found innocent. In one case, directors had been criminally convicted of securities violations. After reversal of the convictions, they were retried. The suit was finally settled by pleas of nolo contendere and the directors' agreements not to appeal in return for additional charges being dropped. The company resisted a demand for indemnification, claiming the directors had not made a successful defense. The court held that any outcome to a criminal charge other than a conviction was successful for purposes of indemnification, and there could be partial indemnification on any successfully defended independent count.

While components of Section 5 are found in the statutes of most States, variations are many. Because some States place significant limitations on the otherwise generous indemnification provisions of Section 5, directors and attorneys must be aware of the scope of possibilities for indemnification in their particular jurisdiction.

Insurance

Businesses are looking more frequently to insurance policies to cover director liability. The general increase in litigation with directors as defendants and the high cost of litigation recently have prompted a demand for and availability of insurance policies intended to accomplish the twin goals of insuring directors against liabilities not covered by indemnification and indemnifying the business concern when it suffers a loss in indemnifying the director.

As a primary matter, each cooperative must decide whether insurance of this type (commonly referred to as a director and officer, or D & O, policy) is a worthwhile investment, because costs and risks will vary.

In brief, suggestions for protecting directors by indemnification and insurance follow:

- (1) Provide in a bylaw that directors shall be indemnified to the full extent permitted by law.

- (2) Include in the bylaw specific provisions relating to settlements, partially successful defenses against multiple charges, and expenses in defending against securities law violations where acts are not deliberately wrongful.
- (3) When applying for insurance, poll each director individually to avoid misrepresentative answers in the application that, as warranties, may allow the insurer to avoid liability.
- (4) To reduce the expense of a D & O policy, shop around for low premiums, consider a high deductible, consider a special policy limited to a particular risk or event, and consider insuring only the directors, and not the cooperative, for expenses of indemnification.

Appendix: Glossary

Abuse of Discretion: a board of director's act or failure to act, concerning a matter within the board's discretion (e.g., retiring a member's reserved equity), in a manner that is irrational, discriminatory, arbitrary, or otherwise clearly unsupportable by any proper business purpose.

Accounting: an equitable judicial remedy requiring the defendant to give up profits or funds wrongfully acquired (e.g., by a breach of fiduciary duty).

Adulteration: act or omission to act by which food becomes unfit for consumption under Food & Drug Administration regulations.

Agent: a role the director assumes in representing the cooperative to third parties or acting on the cooperative's behalf; the cooperative then assumes the character of the agent-director's principal, to whom the director owes fiduciary duty.

Articles of Incorporation: a document filed with a government agency containing required information about the cooperative's structure and operation. The articles set up basic rules along with bylaws under which the cooperative is run.

Blue **Sky Law** popular name for State statutes controlling offers and sales of securities and intended to protect investors from fraudulent schemes that "have no more basis than so many feet of blue sky."

Bona Fide: good faith; refers to acts done honestly, sincerely, without deceit or fraud.

Business or Corporate Opportunity: the cooperative's interest in a business transaction, whether the interest is tangible or intangible, present or future, that is in opposition to the interests of its fiduciary (e.g., a director). A business opportunity usually represents a chance for the business organization to secure or act on its interest and thus should be denied to the fiduciary who is barred by the duty of undivided loyalty from taking the opportunity as his or her own.

Bylaw: a rule adopted by a cooperative to govern the conduct of its affairs. Bylaws are often the source of directors' responsibilities and liabilities.

Capital: as used in this work, the assets held by the cooperative that represent contributions of the members and shareholders, and which the cooperative owes them after creditors' claims are liquidated.

Capper-Volstead Act: a Federal law that allows farmers to collectively market agricultural products through cooperative associations without violating antitrust laws merely for having acted as a group.

Causation: an element to be proved in an action in tort against a director. Liability-inducing causation must be proximate (i.e., direct or reasonably probable as the source of injury), not remote or incidental.

Clayton Act gives a limited exemption to the Sherman Act, allowing nonstock cooperatives to operate without being considered combinations in restraint of trade merely because of organizational structure; allows a plaintiff in an antitrust suit to recover treble damages.

Commodities **Speculation:** the act of incurring purchase or sale obligations in the futures market that exceed the cooperative's needs to hedge against unfavorable price fluctuations.

Common Law: case law, or the body of law, principles, and rules of action that has its source in usage and custom as announced by judicial decisions, as opposed to statutory law.

Conflict of Interest: a clash between the personal pecuniary interest of the fiduciary/director and the interests of the cooperative to which the fiduciary duty of undivided loyalty is owed.

Contract an agreement between two or more persons that creates an obligation courts will enforce. A contract requires competent, assenting parties, a subject matter, and an exchange or promise. Some contracts are enforceable even though orally made.

Conversion: unauthorized control or disposition of another's personal property inconsistent with the rights of the owner.

Damages: refers both to the injury suffered and the monetary compensation that may be recovered in court.

Deceit: an untrue statement of fact intended to deceive or mislead.

Derivative Suit: a suit filed by a member or shareholder of the cooperative and instituted on the cooperative's behalf, enforcing the cooperative's right against another (e.g., a director) when the cooperative fails to assert its right (as by neglect or intransigence of the board of directors).

Diligence: attentiveness, care, and prudence such as is properly to be expected from a reasonable person under the circumstances.

Dissolution: termination of the cooperative's existence, as by winding it up in voluntary dissolution under appropriate corporate law, or by bankruptcy proceedings.

Dividend: distribution to a shareholder based on investment or ownership. Courts sometimes use the term "patronage dividends" when referring to patronage refunds, which are distributions of net margins according to patronage.

Embezzlement: the taking or conversion of another's money or property of which the embezzler acquired possession through an office, employment, or position of trust.

Equitable Remedy: refers to the kinds of judicial relief traditionally available in courts of equity. Federal and most state courts have merged law and equity to make equitable remedies available in civil suits. Remedies include accounting, injunction, specific performance, and restitution.

Equity Redemption: payment of cash or other property for previously issued equities.

Fiduciary: a person with a duty, created by his own undertaking, to act primarily for the benefit of another in matters connected with the undertaking. Breach of fiduciary duty results in liability for damages caused the person to whom the duty is owed.

Fraud: an intentional false representation, unfair scheme, or deceit intended to make another act in reliance to his or her detriment or in derogation of his or her right.

Futures: refers to a kind of contract giving a present right to or obligation of future delivery at a fixed price. Cooperatives often engage in the commodities futures market to secure a price for members' agricultural commodities.

Hedge: a means of protecting commodity sellers against price fluctuations. The seller (or cooperative) makes a futures contract for sale of the amount of the commodity he or she expects to deliver to guard against unfavorable movement in price at the time for delivery. At the time for delivery, the seller will make a purchase contract to offset the previous sales contract,

with the effect that any movement in contract price is countered by the actual sale of the commodity, and the seller's original futures sale contract price is secured.

Injunction: a commandment by a court requiring the party enjoined to do or refrain from doing a particular thing where the conduct or failure to act, threatened or current, harms a plaintiff who has no other remedy.

Insolvency: the condition of being unable to pay debts as they fall due or in the usual course of business.

Liability: a broad term that can include every form of legal hazard, obligation or responsibility whether absolute, contingent, or likely.

Libel: a false and unprivileged publication in writing that tends to harm a person's reputation or injure that person in business or profession.

Malfeasance: a wrongful act that the actor has no legal right to do, such as when a director uses the position for personal enrichment by misappropriating cooperative assets.

Misappropriation: the taking or using of another's property with the purpose of benefiting the appropriator.

Misfeasance: the improper performance of an act that the actor has authority to perform, such as when a director approves a contract on the cooperative's behalf that contains disadvantageous terms that could have been deleted had the director been diligent.

Misrepresentation: an untrue statement of fact intended to deceive or mislead.

Negligence: the omission to do something that a reasonably prudent person would have done under the circumstances, or the failure to use appropriate care, where there is a duty to act or be careful.

Net Margins: Gross income from all sources minus all allowable expenses. Net savings, net earnings, and net income are often used in place of net margins.

Nolo Contendere: a plea in a criminal case that neither admits nor denies the charge, though penalty may be imposed pursuant to the plea. The plea may not, however, be used against the defendant in a civil suit based on the same facts (as where a director is charged with violations of antitrust law).

Nondisclosure: a **concealment** of or failure to disclose information that ought to be disclosed; a type of fraud.

Nonfeasance: failure to perform some act that one has a duty to perform, as when a director who is required by the cooperative's bylaws to attend meetings of the board never attends.

Nuisance: an activity or use of property that causes disturbance of or interference with another's reasonable use and enjoyment of his or her property.

Patronage **Refund:** net margins of a cooperative allocated to a patron in proportion to the value or quantity of the individual's patronage, whether distributed in cash or left in the cooperative. Refunds left in the cooperative may be in qualified or nonqualified form. Also known as patronage dividends.

Per Se: in itself; inherently. Per se violations are those in which the act complained of is enough to cause liability without further proof of harm (e.g., certain antitrust violations).

Per-Unit Retain: equity invested in a cooperative based on the value or quantity of products marketed or supplies procured for the patron. Funds are usually withheld from the proceeds of products marketed or, added to, the price of supplies.

Prima Facie: on the face of it; a fact presumed true unless disproved by evidence to the contrary.

Principal: the party on whose behalf an agent acts. Directors often act as agents for the cooperative and are controlled in that role by the cooperative's instructions, bylaws, contracts, and articles of incorporation. Agents owe fiduciary duty to their principals and are liable for damages caused by breach of the duty.

Public Welfare Offenses: a group of crimes (e.g., violations of the Food, Drug & Cosmetic Act) that have in common the purpose of protecting public health and safety, and which permit responsible corporate officials to be held criminally liable when the business organization is found guilty of a violation.

Ratification: the act of the cooperative's members in adopting and being bound by acts of a director that the cooperative could have disavowed, such as when a director makes an unauthorized contract.

Responsible Corporate **Official**: an official in a business organization (conceivably, a cooperative director) who had authority to halt violations of health and safety laws but who failed to do so and hence is liable for the violation.

Restitution: the act of restoring something (usually money) to its rightful owner by requiring its return from one who has been unjustly enriched at the owner's expense, such as when by nondisclosure a director profits to the cooperative's disadvantage.

Retained **Equity**: equity invested in the cooperative by evidences of investment (certificates, stock, capital credits) issued as part of a patronage refund instead of cash, or through per unit capital retains.

Revolving Fund Plan: a system of cooperative financing by patrons where the earliest investments are redeemed as new investments are made to meet the cooperative's financial needs.

Robinson-Patman Act a Federal law that prohibits discriminatory pricing that tends to create a monopoly or injure competition. Price differentials must be based on cost of manufacture, sale, delivery, quantity discounts, or purchaser's status as a wholesaler.

Security: as used in contract law, property that is encumbered to secure payment of an obligation and which the security holder may obtain or cause to be sold on default of the obligation.

Securities: investment instruments evidencing a right to participate in corporate earnings and/or to distribution of corporate property, and that are subject to regulation under Federal securities laws or States' blue sky laws (e.g., stocks, bonds, notes). Cooperatives' membership certificates and stock shares evidencing membership are usually not considered to be securities.

Self-Dealing: a transaction in which a trustee, who owes strict fidelity to his or her fiduciary, engages where self-interest is opposed to duty (for example, where a director purchases from the cooperative at favorable prices not generally available).

Setoff: a claim to cancel part of a debt in recognition of a debt owed the claimant, as when a cooperative member who owes the cooperative (e.g., for supplies) seeks to reduce that debt by claiming a **setoff** for amounts the cooperative allegedly owes the member; such member-claimant may seek

to show (probably unsuccessfully) that retained equities are debt subject to being used in setoff.

Sherman Antitrust Act: the basic Federal antitrust law, it contains broad prohibitions of conduct in unreasonable restraint of trade and monopolization.

Stock: as used here, stock refers to certificates evidencing contribution to the cooperative and entitling the holder to an ownership interest in the cooperative. A cooperative may issue both common and preferred stock; preferred stockholders have a prior claim on dividends and, in the event of dissolution, assets.

Third Party: as used here, a party who is neither a member nor director of the cooperative, nor the cooperative itself (e.g., a creditor or other claimant).

Tort: an injury to person or property in violation of a duty raised by operation of law (i.e., a noncontractual duty).

Trustee: one who has a fiduciary obligation with respect to another's property, with a duty to faithfully act solely for the benefit of the owner. A director is a trustee of the cooperative's and members' assets.

Unfair Profits: profits made by a director in a transaction with the cooperative that are so much greater than profits usually made in such transactions as to constitute a breach of fiduciary duty.

Ultra Vires: an act beyond the scope of one's powers, as when a director approves the entry of a cooperative into a line of business forbidden under its articles of incorporation, or when the director on behalf of the cooperative makes a contract that is in violation of a bylaw, article of incorporation, or statute.

Vested Right: a right that has so accrued and settled in a person that it is not subject to cancellation by another person.