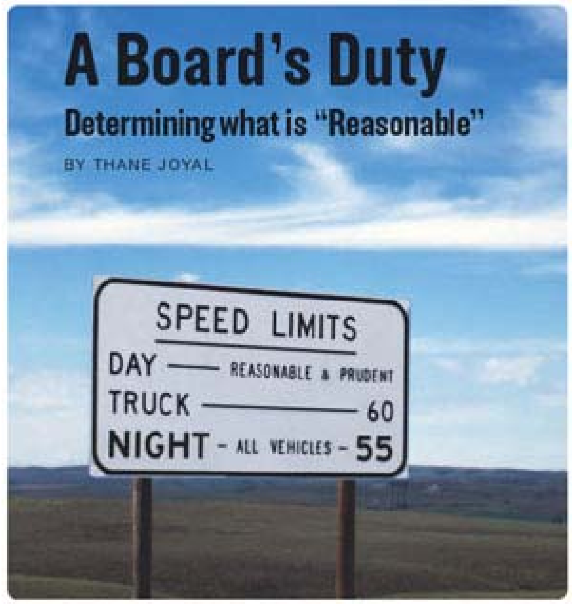
Cooperative Grocer
FOR RETAILERS AND COOPERATORS

From #138, September - October 2008

A Board's Duty

Determining what is

BY THANE JOYAL



The man in the wilderness asked of me,
How many strawberries grow in the sea?
I answered him as I thought good
As many as red herrings grow in the wood.
-Old Nursery rhym

When I talk to members of a board of directors about its legal roles and responsibilities, I always try to say, within the first five minutes, "You know, as a board you don't have to be right, you just have to be reasonable."

I think it is very important to let people know that, as a member of a board of directors, they have a number of special duties to the owners of the co-op. Sometimes people are intimidated by the concept of duty, but these are special duties that are designed to ensure the board's success. Success in this context simply means that the board is governing on behalf of its owners by making decisions that are reasonably prudent.

Boards that use the Policy Governance model rely heavily on their review of the general manager's monitoring reports to assure the cooperative's owners that the board is upholding its duties. The concept of reasonability is important here too: the board must assure itself that the general manager's interpretation of the board's written policies are reasonable.

Deciding whether an action or an interpretation is reasonable can seem difficult. The Man in the Wilderness thinks it is reasonable to look for strawberries in the sea. Another may disagree, and indeed, we can imagine wild circumstances in which it might be reasonable to look for strawberries in the sea: perhaps a boatload of strawberries recently foundered off the coast. Thus, we can see that circumstance dictates whether a particular action is reasonable.

One of the most important duties of the cooperative board of directors is its fiduciary responsibility to the cooperative. A fiduciary responsibility generally can be thought of as a special relationship in which one group of people (the owners) places its property in the trust of another (the board of directors), requiring as a condition that board members behave in an unselfish manner and that the board as a whole is reasonably prudent in its decision-making.

Deciding whether a person has acted unselfishly is hard: how can we know another person's state of mind? Fortunately, there are objective standards that we can look at to make this decision. Does the board member or her immediate family personally benefit economically from her decisions in a way that is unfair to the cooperative? Are there other factors present which would call the board member's objectivity into question? It is important to look at the decision made by the board as a whole to evaluate its propriety. Does the decision meet the test for reasonableness articulated in this article?

Unselfishness is not a difficult concept for directors of cooperative entities to understand or to put into practice. The primary purpose of establishing a cooperative is to provide economic benefit to the cooperative's owners. Cooperative directors need to understand immediately that their role is to govern the cooperative on behalf of its owners. One of the most exciting challenges of being a cooperative board member is bringing the diverse needs of the ownership into focus, while putting aside one's own idiosyncratic self-interest.

A cooperative is a legal entity, created by a group of people using the business organization laws created by their state legislature. Retail food cooperatives may be established in any of a wide variety of legal forms, but many generally are organized either as not-for-profit corporations or cooperative corporations, depending on what structure was available at the time the cooperative formed. It is worthwhile for a board member to look at the cooperative's Articles of Incorporation in order to understand the state business law authorizing its formation.

State business organization law sets forth the general duties of the board of directors, which are largely the same from state to state, corporation to corporation. These are the duty of loyalty, duty of care and duty of attention. Kathryn Sedo summarized these duties succinctly in her 1986 article, "Legal Duties and Responsibilities of Board Members," available on the Cooperative Grocer website (www.cooperativegrocer.coop/articles/index.php?id=8).

Business judgment rule
When serious circumstances arise, however, a reviewing court will not only look to the applicable state statutes, which set forth the specific duties of directors, but it will also apply the "business judgment rule" to determine whether the board has breached its obligation. Because the United States' legal tradition is founded on the English common law, under which judges made decisions by applying precedents in previous cases to the facts at hand, doctrines such as the business judgment rule persist as independent guidelines that overlay and inform whatever standards a state legislature may have written into its business organization law.

The business judgment rule limits a court's scrutiny of the substance of a board's decisions. "Broadly stated, the rule is that if the directors of a business acted on an informed basis and in good faith while making a decision, then the decision will be upheld despite any adverse consequences that resulted from the decision." (Kathryn Sedo, supra.) The law is kind to directors. It recognizes that under different kinds of conditions, people appropriately use different decision-making processes. Increasingly, however, courts look closely at the board's decision-making process, examining, in Ms. Sedo's words:

- the time devoted to the decisions,
- the complexity of the decisions,
- the decision process itself,
- the amount of notice provided before meetings,
- the availability of written information and data, and
- the financial interests of the directors involved in the decision.

Governance
Many boards use the Policy Governance model as a powerful tool to structure governance. In brief, Policy Governance offers a way to clearly delegate authority to a single person, typically the cooperative's general manager; and then to monitor the performance of the organization according to clearly articulated written policies. (For more about Policy Governance see John Carver, *Boards that Make a Difference*, published by Jossey Bass.)

Whether using Policy Governance or another system, boards can protect their actions from challenge and take full advantage of the business judgment rule by following three key steps:

Ensure that all delegation of authority to the general manager is through written policies and that all of the policies are monitored.

- Rigorously ensure that the general manager (or other person monitoring a policy) provides adequate data to support assertions contained in the monitoring reports.
- Maintain excellent minutes of all board actions, including decisions concerning monitoring reports creating a paper trail to the specific monitoring report received (include date and title of report), the conclusions asserted in the report (in compliance or not), and the board's action (accepted, not accepted, accepted with consequence, etc).

When monitoring the general manager's performance with respect to board policy, there are really only two important questions:

- Was the general manager's interpretation of the policy reasonable?
- Does the data provided by the general manager support the conclusion with respect to the policy?

Boards are often distracted by the question of compliance: Does the monitoring report show that the policy is being met? This can be an irrelevant distraction, such as the question raised by the "Man in the Wilderness" at the beginning of this article.

It is more important that the data provided by the general manager be adequate and that the interpretation be reasonable than it is to show compliance. Remember: the purpose of monitoring the general manager's performance against explicit written policies is to ensure that the board is doing its job and to hold the general manager accountable. The board must ensure that the organization is being managed on behalf of its owners, in accordance with the established policies.

It can feel uncomfortable to accept a report that shows noncompliance with board policies, but this may be wholly appropriate: it depends on the circumstances. Any monitoring report that asserts non-compliance should be on the board's agenda for discussion. The board should always expect, and the general manager should always deliver, management's assessment of severity, implications and trend, an explanation of resulting actions taken by management, a timeline for future reporting, and an expectation as to when management expects compliance will be achieved. This greatly simplifies the board's response in that it can, again, judge management's response (based on reasonableness) rather than initiating problem-solving.

Depending upon the outcome of that discussion of reasonableness, the board may decide to take action or not. Board action can range from requiring additional monitoring to, in an extreme case, replacing the general manager.

Reasonableness
This raises another important point: What if the interpretation is "reasonable," but it is not what one or more board members intended? (I am repeatedly tempted to assume that people who disagree with me are unreasonable!) Remember: the general manager should not be expected to provide an interpretation that every director approves of, rather the interpretation must be one that the board as a whole finds reasonable. In the context of group process, the concept of "reasonability" acts as an objective standard to provide a check on arbitrariness. It may be that instead of deciding that an interpretation by management is unreasonable, the board may realize that its policy simply did not achieve the desired results. In this case, the board can revise the policy in a way that makes it more likely that the manager's next interpretation will not only be reasonable, but will also lead to more desirable results.

I once saw a picture of a speed limit sign that greeted drivers in Montana, reading as follows: Day-Reasonable and Prudent, Truck-60 mph, Night-55 mph.

I like the idea of being pulled over by Montana state trooper trying to enforce the speed limit on that sign. Suddenly the concept of reasonable is not at all abstract! At a minimum, I would need to be able to explain the reasons for my decision to travel at the rate I had chosen.

Reasonability is clearly related to reason, which is defined by Merriam-Webster as "the power of comprehending, inferring, or thinking, especially in orderly rational ways." Precedent might also help me justify my decision as reasonable: If I were able to show that successful and safe drivers traveled at the rate I had chosen, it would be an objective measure of its reasonability. I might also draw in an expert to demonstrate the reasonability of my choice.

In the same way, a board member seeking to justify a decision or a general manager supporting a particular policy interpretation might use these approaches to document the reasonability of their action or interpretation: by providing evidence that there is good precedent for their decision, that many or most of their peers do it this way, that there is a body of current research leading them in this direction. By building an interpretation around these three kinds of "reason," a board member or a general manager demonstrates that he or she is using the power delegated to them in a responsible and accountable manner.

In the final analysis, the power of the concept of reasonability is that it derives from our shared notion of reality: we intuitively understand its limits. In the context of group decision-making, the very process of having a discussion about whether a particular interpretation is reasonable ensures that it will be so. No matter how reasonable a general manager believes an interpretation to be, or a board member believes an action to be, the scrutiny afforded during group decision-making provides protection against distortion of the process by idiosyncratic self-interest.

There may be no strawberries in the sea, nor red herring growing in the wood. Yet when it comes to determining whether an action taken by a board or an interpretation of board policies by a general manager is reasonable, we need not feel at sea. Circumstance dictates what we consider to be reasonable, and group process protects the board from arbitrary decision-making. Bringing our most professional and compassionate selves to each board meeting is the most certain way to ensure that our cooperatives are properly governed. See you at the co-op!

back to current issue contents

Home | **Current Issue** | **Index of Topics** | **Index of Issues** | **To Subscribe** | **To Advertise** | **Contact Us** | **Special Publications** | **Food Co-op Directory** | **About Co-ops** | **Links and Resources**

Editor: Dave Gutknecht dave@cooperativegrocer.coop
Managing Publisher: Dan Nordley dan@triangleparkcreative.com
Webmaster: webmaster@cooperativegrocer.coop