

IN THE COURT OF APPEALS OF IOWA

No. 7-402 / 06-1060
Filed September 19, 2007

CENTRAL IOWA POWER COOPERATIVE,
Plaintiff-Appellee,

vs.

**CONSUMERS ENERGY, EAST-CENTRAL
IOWA RURAL ELECTRIC COOPERATIVE,
FARMERS ELECTRIC COOPERATIVE, INC.,
MAQUOKETA VALLEY ELECTRIC COOPERATIVE,
PELLA COOPERATIVE ELECTRIC ASSOCIATION,
and T.I.P. RURAL ELECTRIC COOPERATIVE,**
Defendants-Appellants.

Appeal from the Iowa District Court for Polk County, Scott D. Rosenberg,
Judge.

The defendants appeal from the ruling on a petition for declaratory
judgment. **AFFIRMED.**

Fred L. Dorr of Wasker, Dorr, Wimmer & Marcouiller, P.C., West Des
Moines, for appellants.

William Fanter and Jason C. Palmer of Bradshaw, Fowler, Proctor &
Fairgrave, P.C., Des Moines, for appellee.

Heard by Huitink, P.J., and Vogel and Baker, JJ.

BAKER, J.

The plaintiff in this action, Central Iowa Power Cooperative (CIPCO), filed a petition seeking a declaration that an amendment to its corporate bylaws was duly adopted and thus effective. The defendants, six “member associations” of CIPCO, filed an answer and counterclaim seeking an alternate declaration seeking to void the bylaw and asking the court to order CIPCO to seat a new board member. The district court upheld CIPCO’s bylaw amendment and dismissed the counterclaim. The defendants appeal.

Background Facts.

CIPCO is a generating and transmission cooperative (G&T) that accumulates and transmits electrical energy. It is comprised of twelve electrical distribution cooperatives and a municipal cooperative association that receive energy from CIPCO and which then delivers that energy to its customers throughout southern and eastern Iowa.¹ CIPCO’s business and affairs are managed by a board of directors, as are each of the member associations governed by their own board of directors.

The member associations each nominate a director to serve on the CIPCO board. Additionally, each member association is entitled to select one “authorized representative” to send to the CIPCO meetings. One primary role of the authorized representatives is to cast votes in the annual elections for the

¹ Those member associations are Clark Electric Cooperative, Inc., Consumer’s Energy, East-Central Iowa Rural Electric Cooperative, Eastern Iowa Light & Power Cooperative, Farmers Electric Cooperative, Inc., Guthrie County Rural Electric Cooperative Association, Linn County Rural Electric Cooperative, Maquoketa Valley Electric Cooperative, Midland Power Cooperative, Pella Cooperative Electric Association, South Iowa Municipal Electric Cooperative Association, Southwest Iowa Rural Electric Cooperative, and T.I.P. Rural Electric Cooperative.

CIPCO board. An individual is nominated for the CIPCO board by the representatives from his or her member association. After receiving these nominations, the representatives of all of the member associations vote to elect the CIPCO board. Thus, a nominee from one member association is subject to the vote and approval of the representatives from all of the other associations.

On December 10, 2004, the local board of one of the member associations, Maquoketa Valley Electric Cooperative, sought to remove its CIPCO board director, Dick Bishop, and replace him with Jim Lauzon, the association's manager who was also its chief executive officer. Maquoketa Valley's legal counsel, John Ward, had earlier advised that it could replace its CIPCO director and replace it with its chief executive officer. On December 15, Maquoketa Valley's local board president, Bruce Reade, forwarded a letter to Keith Wirt, then chairman of the CIPCO board, advising him of the local board's attempted action.

This attempted action was met with disfavor by members of the CIPCO board, and on December 17 after consulting with attorney Ward, Wirt called a special meeting of the board to be held on December 20. The purpose of the meeting, as stated in its notice, was to consider a bylaw amendment prohibiting *employees* of a member association, such as Jim Lauzon, from becoming CIPCO board directors.

At the start of that meeting, three CIPCO board members submitted identical letters to Wirt which insisted the first order of business at the meeting be to seat Jim Lauzon as a new CIPCO board director. Attorney Ward was asked to give his advice on this request. He responded that because Bishop remained a

duly elected board member, the proposed action violated CIPCO's articles and bylaws. Based on this advice, the board took no action on the request to seat Lauzon. Rather, it considered and voted on a proposal to amend its bylaws relating to the qualifications of persons to serve as a CIPCO director. That proposed amendment stated:

In order to become or remain a director or to hold any position of trust in the Association, a person shall be required to be (a) a director of a corporate member of the Association who is not an employee of said corporate member, or (b) an officer of a corporate member of the Association who is not an employee of said corporate member.

After extended debate, the CIPCO board voted to approve the above amended bylaw, on a vote of eleven in favor and three opposed.² The stated rationale of the amendment prohibiting employees of its member associations from serving as a CIPCO director was that a paid employee of an association would present a conflict of interest that would manifest itself in decision making marked by a preference for the local board's interests rather than CIPCO's interests. Prior to this time, no employee had ever been put forward as a possible CIPCO board director.

Subsequent to this board action, a dispute over the bylaw amendment arose between CIPCO and the six member associations named as defendants in this action. As a result, CIPCO filed this declaratory judgment action, in which it sought a declaration that the amendment was valid and effective. The defendants' counterclaim contends CIPCO should have seated Lauzon as a

² Pursuant to Iowa law and CIPCO's bylaws, seventy-five percent of the board was required to vote for this amendment in order to pass.

director. The counterclaim sought a further declaration that member associations may unilaterally remove their director from the CIPCO board.

Following a trial, the district court issued a ruling in which it upheld CIPCO's December 20, 2004 bylaw amendment and dismissed the defendants' counterclaims. In particular, it held that the actions taken to remove and replace a member of the CIPCO board were not undertaken in violation of the articles and bylaws of CIPCO. The defendants have appealed from this ruling.

Scope of Review.

We review declaratory judgment actions according to the manner in which the case was tried in the district court. *Smith v. Bertram*, 603 N.W.2d 568, 570 (Iowa 1999). This action was tried in equity, and the parties agree that our review is de novo. See Iowa R. App. P. 6.4. While we are not bound by the trial court's findings of fact, we give weight to those findings, especially with respect to the credibility of witnesses. *Owens v. Brownlie*, 610 N.W.2d 860, 865 (Iowa 2000).

Fiduciary Duties.

The defendants first maintain the court "erred in failing to recognize continuous and simultaneous fiduciary duties of CIPCO board members to both CIPCO and its member cooperatives." The defendants cite three components in this assertion of error: (1) a duty to keep cooperative members informed; (2) a conflict of interest; and (3) a duty to recognize a fiduciary obligation to members. They assert that a CIPCO director's duty is not served by looking solely to the best interests of CIPCO; rather, that directors should act in a manner that is also

consistent with and mindful of their responsibilities to their member associations as well.

On this issue, the district court held:

A CIPCO Board director has the same duties of loyalty and care to CIPCO that any other corporate director would have to his or her corporation. More importantly, these duties clearly run to the corporation, not primarily and solely to a member entity that claims it is “represented” by the board member. Thus, officers and directors of a corporation, like Bishop, owe a fiduciary duty to the company and its shareholders on matters related to the corporation. Any duty or obligation to the member associations is fulfilled by actions done in the best interest of CIPCO that in turn inure to the benefit of all member associations.

(Citations omitted.)

As a subset of this fiduciary duty argument, the defendants argue the CIPCO board breached its “duty of obedience” in failing to keep cooperative members informed of its December 20, 2004 board meeting. In addition, they urge that due to a conflict of interest, Director Bishop breached a duty of loyalty when he participated in the vote that amended CIPCO’s bylaws. Our analysis of the defendants’ claims leads us to two guiding principles in this case: (1) an application of the “business judgment rule,” and (2) the question of to whom a fiduciary duty is owed by a CIPCO director.

We turn to the first of those two issues. Iowa Code section 490.830 requires directors to discharge their duties:

- (a) In good faith, and
- (b) In a manner the director reasonably believes to be in the best interests of the corporation.

These obligations represent a fiduciary duty to a company and its shareholders.

Cookies Food Prods., Inc. v. Lakes Warehouse Distrib., Inc., 430 N.W.2d 447,

451 (Iowa 1988). They include two types of duties: (1) a duty of care and (2) a duty of loyalty. *Id.* Generally, the decisions of directors are presumed to be informed, made in good faith, and believed to be made in the best interests of the company. *Id.* at 453. This presumption is known as the business judgment rule. *Id.* In light of this presumption, the burden of proving a violation of a duty of care rests with the defendants. *Id.*

The purpose of the rule is to severely limit second-guessing of business decisions which have been made by those whom the corporation has chosen to make them. *Hanrahan v. Kruidenier*, 473 N.W.2d 184, 186 (Iowa 1991). Courts are disinclined to interfere in internal corporate operations involving management decisions, subject to the principle of majority control. *See Wolf v. Lutheran Mut. Life Ins. Co.*, 236 Iowa 334, 341-42, 18 N.W.2d 804, 809 (1945). The selection and retention or dismissal of officers, directors, and employees are examples of such internal corporate operations. *Connolly v. Bain*, 484 N.W.2d 207, 211 (Iowa Ct. App. 1992).

We believe the decision here to amend and tighten the qualifications for membership to the board of directors fits squarely within the protections afforded by the business judgment rule. As testified to by several board members, they all generally believed that allowing a paid employee of a member association to sit on the CIPCO board would create an undesirable conflict of interest that would manifest itself in preferential treatment for the local association rather than for CIPCO. As director Norman Van Zante testified, he opined that it would be hard for a local manager to take a position contrary to his or her local board and that as a CIPCO director it was their duty to “do what is good for the CIPCO

organization and all of its members, not just one particular member” This rationale is both reasonable and prudent. This justification is precisely the type of decision that is protected from second-guessing by courts.

Next, we ask to whom were the directors’ fiduciary duties owed and whether that duty was properly discharged in this case. An officer or director of a corporation owes a fiduciary duty to the corporation and its stockholders. *Production Credit Ass’n of Fargo v. Ista*, 451 N.W.2d 118, 121 (N.D. 1990). This duty, however, extends only to the stockholders *collectively*. See *In re Black*, 787 F.2d 503, 506 (10th Cir. 1986). As a fiduciary in this sense, a director’s first duty is to act in all things of trust wholly for the benefit of the corporation. *Ista*, 451 N.W.2d at 121; see also *Rowen v. Le Mars Mut. Ins. Co. of Iowa*, 282 N.W.2d 639, 654 (Iowa 1979) (noting a director’s “duty is to the entire body of shareholders”).

The record supports that the directors were aware of their proper roles and duties. The directors are to use independent judgment in carrying out this duty, and they are not in that position merely to serve as a rubber stamp of certain members of their underlying constituencies. Because the directors properly exercised independent judgment on this amendment, and because their actions are protected and presumed valid under the business judgment rule, we find no cause to overturn the vote on account of any breach of a duty to inform or a duty of loyalty.

Finally, the defendants assert that Bishop had a conflict of interest and that he should not have voted, citing Iowa Code section 490.832 (2005) (director conflict of interest). This issue was neither addressed nor decided by the trial

court, and thus is not preserved for appellate review. See *Meier v. Senecaut*, 641 N.W.2d 532, 537 (Iowa 2002). Even were we to address this issue, we find that there was no conflict of interest. A conflict is defined as “a transaction with the corporation in which a director of the corporation has a direct or indirect interest.” Iowa Code § 490.832(1). There is no “transaction” in this case. Although there may have been a difference in opinion between Bishop and the defendants, that does not constitute a conflict of interest that would void his vote. Without a transaction, where a director acts in good faith and in a manner the director reasonably believes to be in the best interests of the corporation, the director’s actions cannot be assailed. Iowa Code § 490.830; *Hanrahan*, 473 N.W.2d at 186.

The trial court found, and we agree, that Bishop acted in good faith and in a manner that he reasonably believed to be in the best interests of the corporation. As was evident from Bishop’s testimony, he voted in a manner that he felt best for CIPCO, and derivatively, for its member associations. The testimony of every other board director indicated the same, that is, that they were motivated by the best interests of CIPCO. As noted before, these positions were taken in light of the belief that to allow an employee of a member association to serve on the CIPCO board would lead to a conflict. There is no merit to this claim.

Director Nullification.

The defendants next argue the court failed to properly address a “director nullification issue” which they assert was raised below. Specifically, they assert the bylaw contravenes the Iowa Code and would render one category of possible

directors a nullity. We reject this claim and conclude the amendment is not inconsistent with or violative of either the Iowa Code or the cooperative's articles. At the time of the bylaw amendment, Iowa Code section 499.36(2)(a) provided that a director of a cooperative association "must be a member of the association or an officer or a member of a member association," while CIPCO's articles in Article IX, section I, similarly provided that its directors "shall be chosen from the officers or members of the incorporated cooperative association" The articles contemplate additional qualifications when those qualifications "do not conflict with law or these Articles of Incorporation." CIPCO Articles Art. IX, § 1.

As noted, the amendment served to prohibit any employee of a member association from serving as a CIPCO director. We believe the board's characterization of this new bylaw is accurate. They state the amendment "simply restricts classes of persons made eligible in the articles by preventing employees of the member associations from being a CIPCO director." Thus, it is simply an "additional qualification" and thus authorized by CIPCO's articles. Nor do we find persuasive the defendants' position that this amendment would render a nullity of the class of officers authorized to serve as a CIPCO director. As CIPCO accurately points out, Dick Bishop, as a non-employee officer of the member association, remained qualified to serve as a CIPCO director. Nothing in the Code prohibits this further qualification.

The defendants further argue the court erred in determining that "no bad faith existed on the part of the CIPCO board in attempting to amend the corporate bylaws" They believe the bad faith warranted the court in intervening to void the bylaw amendment. Directors of a corporation stand in a

fiduciary relationship corporation and are required to act in the utmost good faith when dealing with corporate matters. *Berger v. Amana Soc.*, 253 Iowa 378, 384 111 N.W.2d 753, 756-57 (1962). As we noted above, upon our de novo review of the record, we find no evidence that director Bishop or any other CIPCO director acted in bad faith.

AFFIRMED.