

## Good Governance — Ensuring That Your Association's Governing Documents Pass Legal Muster

Noting how time-consuming that association board meetings have become, your new chairman proposes that the frequency of such meetings be decreased by one each year. Then, the chairman recommends that the board be able to act between meetings through the use of email polling and voting.

While the chairman's streamlining suggestions may be an innovative approach to the time crunch faced by members of the board, they also may be contrary to your association's own governing documents and to relevant state law. Many association bylaws set forth exactly how many board meetings are to take place each year; and many states' nonprofit corporation laws prohibit a board's ability to take official corporate action outside of a traditional board meeting setting.

An association executive or an association board member who is familiar with the association's own bylaws, articles of incorporation, and relevant state law likely would have been able to quickly identify how the chairman's proposals were inconsistent with the governing documents and/or state law. For instance, under most state nonprofit corporation laws, boards are not permitted to vote by email at all and only by fax if it constitutes a "unanimous written consent." And even in states where membership (as opposed to board) voting by email or fax is permitted, some states require such voting authorization to be expressly provided for in the articles of incorporation. But who has the time to be familiar with these legalese-heavy documents? And who really cares if association procedure does not match its governing documents and state law?

Before addressing these questions, some background on corporate legal issues may be helpful.

Approximately two-thirds of all trade and professional associations are nonprofit corporations that have been recognized by the Internal Revenue Service as exempt from federal income tax under section 501(c)(6) of the Internal Revenue Code; approximately one-third are exempt under section 501(c)(3). While an association's tax-exempt status is a creature of federal law, its status as a nonprofit corporation is governed by state law. Most associations are incorporated in the state in which they are located, but they are not required to be incorporated in their geographic "home." In the event that an association is incorporated in one state but is located or otherwise does business in another, it generally will be required to register as a "foreign" corporation approved to do business in the state(s) in which the association is operating. Note that for matters relating to corporate governance (and certain other matters such as merger and dissolution), your association is governed by the nonprofit corporation law of the state in which it is incorporated.

When it is formed, a nonprofit corporation files articles of incorporation (also referred to as a "certificate of incorporation" or "charter") with the state. This document is viewed in many respects as a contract between the corporation and the state. The articles set forth the name and purposes of the organization, and often other information regarding members' voting rights, board composition, dissolution, etc., consistent with the state nonprofit corporation statute. State law generally sets forth minimum approval requirements — including required member approval if the organization has members with voting rights — for amending this document. Each time an association's articles of incorporation are amended, a new filing is required to be made with the state (usually with the secretary of state's office).

An association's bylaws can be viewed — and have been by the courts — as a contract between the corporation and its members. This document sets forth provisions addressing the association's management, its membership structure, issues regarding board terms and qualification, and similar matters. The association's bylaws may not be inconsistent with state law or with its articles of incorporation.

In order of hierarchy, state law is on top, followed by the articles of incorporation, the bylaws, and any board-approved governance policies or procedures, in that order. Each document at the lower end of the hierarchy must be fully consistent and compliant with the documents above.

Courts will require corporations to act in a manner consistent with their own bylaws, articles of incorporation, and with state law. Board members may be held personally liable for actions that are held by a court to be in violation of the corporation's bylaws, articles of incorporation, or state law, and a corporation can be held liable for breaching the "contract" (bylaws) between the corporation and its members (a corporation also can be forced to comply with the requirements of its governing documents). While such legal challenges are seldom the result of an investigation by state officials, it is not infrequent that a disgruntled member will bring (or threaten to bring) a lawsuit alleging improper corporate action. Often, the disgruntled member will be an unsuccessful candidate for a leadership post who will allege that he or she was denied the post because the procedures set forth in the bylaws were not followed.

So, how does your association ensure that it is operating in a manner that is consistent with state law, its articles of incorporation, and its bylaws? One effective approach is to, on a regular basis, review the relevant documents and update them when necessary. Following are some points to remember in conducting such a review:

**1. Form a committee.** Establish a committee of the board for the purpose of reviewing the association's bylaws and articles of incorporation. Committee members should be advised that it may not be necessary to propose amendments to these documents, but they should familiarize themselves with the provisions and be encouraged to speak up at board meetings and in other settings where they feel a proposed action might be inconsistent with the association's governing documents.

**2. The articles of incorporation should not address day-to-day operational issues.** Amending the articles of incorporation is not always an easy process, generally requiring a membership vote to effectuate the amendment. Thus, this document should be relatively broad and general, with more specific provisions regarding governance, membership, committees, meetings of the board and membership, and similar matters addressed in the corporation's bylaws.

**3. The bylaws should provide room for the board and staff to act.** The corporation's bylaws should allow the board and staff some flexibility to make modest governance changes without having to go through a bylaw amendment process every time a small change in the governance process is desired. For instance, many associations' bylaws include very specific provisions regarding the manner in which membership dues may be assessed. It is often more advisable from an ease-of-administration standpoint to merely state in the bylaws that membership dues amounts shall be set from time to time by the board. In fact, delegating more authority to the board through the bylaws – if politically palatable within the association – can significantly streamline the governance process in reducing the need for what can be a very time-consuming, costly and distracting bylaw amendment process (especially when membership approval is required for bylaw amendments).

**4. The bylaws should be clear and easy to understand, consistent with themselves, and consistent with the articles and state law.** The bylaws set the ground rules for the association's governance and thus are (or should be) consulted with great frequency by the board, staff and members. Lack of clarity in the bylaws is a frequent but avoidable cause of disputes and headaches. It also is imperative to ensure that the bylaws are consistent with themselves – another common but avoidable problem – and that they are fully consistent both with the articles of incorporation and with the relevant state nonprofit corporation statute.

**5. Make sure the documents reflect reality.** The individuals reviewing the association's governing documents should be urged to pay particular attention to areas in which the association's governing documents do not reflect the reality of the association's actual practices. For instance, an association may have a provision in its bylaws stating that the annual membership meeting must take place in a particular month, but over the years the organization may have not always held its annual meetings during that month.

While merely a "technical" violation of a bylaw provision, it is also an avoidable one. Moreover, there have been many instances where "technical" violations have come back to haunt the association down the road.

**6. Consult an attorney.** Attorneys who are versed in nonprofit corporate law should be consulted before an association pursues amendments to its bylaws or articles of incorporation. The attorney also will be able to tell you if the proposed amendments or other provisions of your governing documents are consistent with state law requirements – a task sometimes easier said than done.

**7. Follow the proper amendment process.** In addition to state law requirements, bylaws and articles of incorporation frequently contain their own provisions for how to go about making amendments. Be certain that state law requirements as well as those set forth in the governing documents are strictly adhered to during the amendment process.