

R E S E A R C H M E M O R A N D U M

FROM: John Edward Dallas  
TO: MHA Board, Val Orselli  
CC: Steve Herrick  
DATE: October 21, 2010  
RE: Review of Co-op Information Package – Part III

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INTRODUCTION

Supplementing my October 9 and 12 research memorandums are my further comments on the Co-op Information Package, or the Plan, based on my review of the draft e-mailed to me by Val on October 5.

ISSUE NO. 1

The present draft of the Plan contains no provision for the creation of committees of the Board of Directors, including the executive committee. Indeed, the Plan offers no explicit mechanism for the establishment of committees, standing or ad hoc, and the appointment of their members.

Section 3.02 (“Power and Duties”) of Article III (“Directors”) of the Bylaws confers upon the Board of Directors “*all* powers and duties necessary to administer the affairs of the Corporation including, but not limited to, the election of the officers of the Corporation.” This Bylaws section also vests the board with the discretion to “do *all* such acts and things except those acts which by law, these By-Laws or the Certificate of Incorporation, are directed to be exercised and done by the Shareholders or are expressly prohibited.” (Emphases added.)

Given the Board of Director’s sweeping Bylaws-based authority, in the absence of any reference in the Certificate of Incorporation or the Bylaws addressing the formation of committees, the Board would make the decision. However, regarding, for example, the creation of the executive committee – widely but erroneously presumed to be a board within a board or, even worse, an inherently fully-empowered substitute for the entire board between board meetings – state law imposes various restrictions.

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To begin with, the executive committee can have only the authority the full board of directors bestows upon it. State law says: “If the certificate of incorporation or the bylaws so provide, the board, by resolution adopted by a majority of the entire board, may designate from among its members an executive committee and other committees, each consisting of one or more directors, and each of which, *to the extent* provided in the resolution or in the certificate of incorporation or bylaws, shall have all the authority of the board.”<sup>1</sup> (Emphasis added.)

Assuming that Article III, Section 302 of the Bylaws satisfies the primary prerequisite of the preceding section of state law —“If the certificate of incorporation or the bylaws so provide”<sup>2</sup>— the executive committee’s composition and authority must then fulfill two statutorily-required conditions: They must be the result of (1) a resolution (2) adopted by a majority of the *entire* board. Significantly, the latter condition implies an absolute majority of the directors, as opposed to a majority of the directors present at a meeting at which a quorum is present.

As a way of ensuring that certain important matters are reserved for consideration by the full board of directors, whose members shareholders elect with the expectation that they will make corporate decisions as a full rather fractional collective, state law prohibits a board of directors from granting certain powers to the executive committee and, consequently, the executive committee is restricted from:

- Submitting to shareholders any action required by state law to be approved by shareholders
- Filling vacancies on the board of directors or any committee of the board of directors (including the executive committee)
- Amending, repealing, or adopting the bylaws
- Determining compensation of directors for serving on the board or any committee
- Amending or repealing any board resolution (for instance, the one creating the executive committee)<sup>3</sup>

To return to Article III, Section 302 of the Bylaws, in the event the extensive powers it grants to the board of directors fall short of the requirement under state law of a provision in the certificate of incorporation or the bylaws authorizing the board of directors to create committees, I recommend that specific language be written into the Bylaws permitting the creation of the executive committee and any other committees, standing or ad hoc, envisioned by the MHA Board of Directors. In addition, I recommend a catchall provision such as the following: “Other Committees. The Board of Directors shall also have the power to appoint such other committees, standing or ad hoc, in accordance with Section 712 of the Business Corporation Law, as it deems appropriate.”

Finally, it is often overlooked that minutes must be kept of an executive committee's meetings. In this regard state law mandates: "Each corporation shall keep correct and complete books and records of account and shall keep minutes of the proceedings of its shareholders, board and executive committee, if any...."<sup>4</sup>

## ISSUE NO. 2

Section 2.08 ("Eligibility to Vote; Good Standing") in Article II ("Shareholders") of the Bylaws says: "A shareholder shall not be in good standing and shall not be eligible to vote or to be elected to the Board who is shown on the books or management account of the Corporation to be more than two months delinquent in maintenance due to the Corporation or whose tenancy has been terminated by the Corporation by reason of a substantial lease violation."

This validity of this provision is legally questionable. State law mandates that every shareholder can vote unless the certificate of incorporation, *not* the bylaws, says otherwise. Specifically regarding limitations on shareholders' right to vote, state law says: "The certificate of incorporation may provide, except as limited by section 501 (Authorized shares), either absolutely or conditionally, that the holders of any designated class or series of shares shall not be entitled to vote, or it may otherwise limit or define the respective voting powers of the several classes or series of shares, and, except as otherwise provided in this chapter, such provisions of such certificate shall prevail, according to their tenor, in all elections and all proceedings, over the provisions of this chapter which authorizes any action by shareholders."<sup>5</sup>

Furthermore, according to state law: "The bylaws may contain any provision relating to the business of the corporation, the conduct of its affairs, its rights or powers of *the rights* or powers of *its shareholders*, directors or officers, *not inconsistent with this chapter* or any other statute of this state *or the certificate of incorporation.*" (Emphasis added.)

In sum, if a corporation's restriction of a shareholders' right to vote is not articulated in the certificate of incorporation, where it is required under state law, it cannot in the alternative be asserted in the bylaws.

## ISSUE NO. 3

Section 2.06 ("Quorum") of Article II ("Shareholders") of the Bylaws says: "At all meetings of the shareholders of the Corporation, the presence, in person or by proxy or *mail-in*, of one half (1/2) of all shareholders eligible to vote shall be necessary to

constitute a quorum for the transaction of business.” In particular, this section’s construction of a mail-in meeting is questionable.

First, there is no such a thing as a meeting by mail-in. However, state law does authorize shareholders to conduct business – to take action by vote on a particular issue – without holding a meeting. This is known as written consent or action by consent.

As importantly, states law requires that such a consent be in writing and signed (consented to) by all the shareholders entitled to vote. Specifically, state law says: “Whenever under this chapter shareholders are required or permitted to take any action by vote, such action may be taken without a meeting on written consent, setting forth the action so taken, signed by the holders of *all outstanding shares entitled to vote thereon...*”<sup>6</sup> (Emphasis added.) In other words, unanimous consent is required. Therefore, the existing Bylaws requirement of one-half of all shareholders eligible to vote “by mail-in” does not pass legal muster.

State law does allow for less than unanimous consent, but only if there exists in a corporation’s certificate of incorporation a provision that allows for it. The law says: “...[O]r, if the certificate of incorporation permits, signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. In addition, this paragraph shall not be construed to alter or modify the provisions of any section or any provision in a certificate of incorporation not inconsistent with this chapter under which the written consent of the holders of less than all outstanding shares is sufficient for corporate action.”<sup>7</sup> No such provision is found in the Plan’s Bylaws.

Logically, everything stated above applies also to Section 17.01 (“General”) of Article XVII (“Amendments to By-Laws”) of the Bylaws, which references the quorum requirements in Article 2 previously discussed. Section 17.01 of Article XVII says: “...[A]ny provision of these By-Laws may be amended, modified, added to, or deleted by the affirmative vote of not less than  $\frac{66}{100}$  in number of all Shareholders either taken at a duly constituted meeting thereof or *given in writing without a meeting* as provided in Article Two hereof.” (Emphasis added.) As is the case with so-called mail in meetings, amending the Bylaws without holding a meeting requires unanimous consent.

#### ISSUE NO. 4

To promote transparency, encourage shareholder participation, and acquaint shareholders with board governance, it is not uncommon for housing co-ops to have a provision in

their bylaws requiring the board of directors to hold a certain number of open board meetings. In the Mitchell-Lama co-op where I once lived and served as board president, the board was required to have four open board meetings, in addition to the annual membership meeting. I recommend, then, the following provision: “The Board of Directors shall hold three board meetings open to the Shareholders. The meetings shall take in the months of January, April, and July, with the date, time, and location to be determined by the board of directors. Provision shall be made at the meetings for Shareholders to address the board. The minutes of each meeting shall be made readily and promptly available to Shareholders.”

#### ISSUE NO. 5

Also absent from the Plan Bylaws is a provision for a parliamentary authority, which, in the final analysis, is key to having fair, efficient, and effective board, committee, and shareholder meetings, where the will of the majority prevails yet the voice of the minority is heard. I propose the following provision: “The rules of parliamentary procedure contained in the current edition of ‘Robert’s Rules of Order, Newly Revised’ shall govern the proceedings of the meetings of the corporation in all cases in which they apply and in which they are not inconsistent with these Bylaws, the corporation’s Certificate of Incorporation, and any special rules of order which the Board of Directors may from time to time adopt.”

#### ISSUE NO. 6

In order to make the Bylaws comply more fully with state law, I recommend that to the beginning of Section 6.06 (“Examination of Books”) of Article VI (“Fiscal Management”) of the Bylaws be added the following language: “The corporation shall keep correct and complete books and records of account and shall also keep minutes of the proceedings of shareholders, the Board of Directors, the executive committee and other committees established or authorized by the Board of Directors, and shall keep at the office of the corporation current and complete lists of shareholders, the board of directors, and committee members.”

I also propose that the following clause be inserted: “All books and records of the corporation may be inspected by any Board member or director for any proper corporate purpose at any reasonable time.” Although codification of this access might seem unwarranted, given the sweeping powers and thus the stature in the corporation had by the board of directors *as a whole*, misconception very frequently trumps common sense, resulting in a board within board, with officers seemingly in the know, their additional

knowledge imbuing them with disproportionate power, and the non-officers in the dark, resentful and unintentionally and embarrassedly ineffective. The misconception is that only officers should have the privilege of unfettered access to all the books and records of the corporation. Common sense, on the other hand, which is reflected in the law, is that since all board members have a legal and unwaivable duty to exercise loyalty, care, and prudence in monitoring the affairs of the corporation for its well-being, all of them under the law have an equal right to have access to all the documents and information they need to execute their duties.

#### ISSUE NO. 7

Regarding the duties of the Secretary of the Board of Directors, the Bylaws say that he or she “shall record or file...minutes.” In most organizations the Secretary is given the option of having someone else record the minutes, such as an employee of the corporation. The important thing is that the Secretary ensure that minutes are kept. Therefore, I recommend a minor change: “shall keep, or cause to be kept, and file...minutes.”

#### ISSUE NO. 8

Section 4.06 (“Other Offices”) of Article IV (“Officers”) empowers the Board of Directors to supplement the officers designated in the Bylaws as they see fit. I believe that it should be specified that only board members may be appointed as additional officers and that they have such as powers and duties as the Board alone, not the President or the Board, may prescribe.

## ENDNOTES

<sup>1</sup> B.C.L. § 712(a)

<sup>2</sup> *Id.*

<sup>3</sup> B.C.L. § 712(a)(1)-(5).

<sup>4</sup> B.C.L. § 624(a).

<sup>5</sup> B.C.L. § 601(b).

<sup>6</sup> B.C.L. § 615(a).

<sup>7</sup> *Id.*