

Bylaws: How Strong Is Your Co-op's Foundation?

By [Karen Zimbelman](#)
[015 February - March - 1988](#)

A quick assessment for board members:

- Are you thoroughly familiar with your co-op's bylaws and Articles?
- Do you understand all aspects of your bylaws and Articles?
- Can your members or fellow directors read and understand your bylaws the first time through?
- Do your bylaws consistently answer procedural questions without providing so much detail that you have to change them each time your board changes the way it wants to operate?

If you answer "no" to any of these questions, you need to devote some time to your bylaws.

Bylaws work may not be the most fun part of your job as a director, they may not make the best reading, and it may not be why you ran for the co-op's board. But your bylaws are undoubtedly one of the most important elements of the foundation your co-op is built upon. Indeed, it is inevitable that a co-op that ignores poor or weak bylaws will someday face problems in ambiguous or undefined procedures. There is no substitute for solid, well-written bylaws as protection for members and directors. And, while it is certainly common for one or two directors on a board to be most familiar with the bylaws, it is imperative that all directors understand them generally and know what they cover. There is no greater responsibility you can fulfill for your members than to provide them with an excellent legal foundation for their co-op.

What do you as a responsible director want to look for in your bylaws? How do you evaluate your current bylaws and decide whether what you need is a completely new version or simply a few sections? What is the best way to make any changes in your bylaws?

To begin, one very important point: There is no reason for your bylaws to be hard to read or understand. Your bylaws, and any other legal documents, for that matter, serve as your rules governing the procedures of your co-op. They are written to provide directors and members with definitions of organizational procedures, rights and responsibilities, not to mystify or confuse. In order to be precise and accurate, they must be very carefully worded. However, even complex legal concepts can be written in a way that is understandable and accessible to the non-legal professional; your bylaws should be such a document.

The Basics: Articles and Bylaws

Let's propose a few definitions and points about the legal structure of corporations. Bylaws are not the only element of your legal foundation; they follow another important document -- your Articles of Incorporation. Simplifying matters somewhat, it works like this:

A group of people decides to organize a co-op and determines that it would be best to have the organization incorporated. In most states, they may choose among various types of corporate statutes -- general business, non-profit (not necessarily tax-exempt), or cooperative; sometimes separate statutes exist for consumer, farmer, worker or housing co-ops. However, certain characteristics -- such as the use of the word cooperative or distribution of patronage refunds -- may require the use of an appropriate cooperative statute.

Essentially, the Articles of Incorporation serve two basic functions: 1) to provide certain basic information required by the state (corporate name, purposes, registered agent, ownership, etc.), and 2) to provide other information as to how the organization will comply with the statute of incorporation. In the first case, it is fair to say that your Articles should serve only to define how your co-op will meet the requirements of the state statute. In the second case, the co-op will often have the opportunity to choose among various policies or procedures authorized by the statute (such as whether the co-op will require a majority or two-thirds vote to make a change in its Articles) or even to authorize some provisions about which the statute is silent. Not to be overlooked are various provisions which, although not required to be included in the Articles, may be helpful in minimizing potential legal problems -- in tax and securities law, for example. Obviously, this is an area requiring sophisticated legal services and where it is best to solicit the assistance of a lawyer familiar with co-ops. In general, articles should be relatively short and, again, even when dealing with complex topics, worded clearly enough for non-legal professionals to understand.

Next come the bylaws. Bylaws generally provide for more specific definition of terms, rights and responsibilities; however, they must not be too specific. In general, bylaws should define the basic rights and responsibilities members have in voting and capitalizing the co-op and the basic responsibilities of directors and management. Bylaws should be flexible enough to deal with changing business and market conditions and the general procedures that will be followed to make organizational decisions (not operational decisions). Bylaws should define the co-op's basic democratic structure and provide the general rules for the internal governance of the co-op, not codify specific decisions or policies.

The amount of overlap between your Articles and bylaws is largely up to you, but it is wise to repeat in your bylaws those items that you will want to refer to in the course of doing business. In this way, you won't have to refer to the statute, your Articles and your bylaws to make sure that all areas are covered but will be able to use your bylaws as your primary reference tool.

For instance, suppose that a statute requires 30 days written notice of the annual meeting to the members. A lawyer may recommend that this requirement need not be included in the Articles; you are already bound to it by the law. Technically, it would also not be necessary to include in your bylaws. However, since you know that this is an item you will want to refer to often, it would be advisable to repeat this item in your bylaws.

Alternatively, you may decide that your co-op would like a more stringent or different requirement than the statute. (Be careful, it must be consistent with the statute). For example, if you want to require 45 days written notice for your annual meeting, your bylaws are the best place to add such a requirement. This way, if you decide to change this requirement, it won't be necessary to change your Articles of Incorporation, only your bylaws. In addition, note that a change in your Articles will require filing with the appropriate state office, while no such procedure and expense is required for changes in bylaws, which are completely internal to the coop.

In sum, the Articles serve to establish the corporation and document to the state how the co-op will conform with the particular statute of incorporation. Bylaws serve as a more procedural and more accessible reference to the legal standards that define how to conduct corporate business as well as rights, responsibilities and protections.

The Good, the Bad, and the Ugly: Evaluating Your Bylaws

How do you distinguish good bylaws from bad? First of all, you want to make sure they are structured in a logical fashion, that they define and address issues in a logical and clearly defined manner. For instance, you should be able to flip through your bylaws and easily find the section that will define the terms of directors or under what conditions members' capital will be refunded by the co-op. There should be no important definitions or concepts buried in a multi-sentence paragraph with a general heading; all major concepts and points should have a self-explanatory heading or sub-heading.

Secondly, your bylaws should be flexible; they should "stand the test of time" by providing solid legal parameters for your organization within which the board can select specific procedures. For instance, bylaws should state that the board will hold regular meetings and maybe even provide for a minimum number of days notice to hold a board meeting; but they should not be so detailed as to require how often the board will meet, or state that the board shall meet "on Tuesday evenings." Directors are elected to use their judgment in watching over the affairs of the co-op, not to meet a certain number of times; you as directors certainly don't want to be in violation of your bylaws because you elect to skip a meeting when there is no pressing business and the majority of directors will be on vacation. Striking the balance between an appropriate level of specificity and too much detail is, to some degree, a trick and is one of the reasons it is advisable to have outside help in reviewing bylaws for your co-op.

Recommended Structure for Co-op Bylaws

with recommendations and notes on content (in parentheses)

1. ORGANIZATION

- name of organization
- purpose of organization (no need to be same as "mission statement")
- duration ("perpetual")
- location of the principal office
- fiscal year (generally optional)

II. MEMBERSHIP

- admission and qualifications for membership (should say, at least, that membership is voluntary and open to those interested and not with interests adverse to the co-op)
- rights of members
- duties of members (e.g., notify co-op of change of address, provide capital needed to operate the co-op, etc.)
- transferability (co-op memberships should never be transferable)
- rights to information (establish rights, limits and procedures)
- termination (for "inactive" members -- not patronizing of voting; for "cause"; or voluntarily by member)

III. CAPITAL CONTRIBUTIONS

- obligations (members are obliged to contribute to the capital needs of the business -- establishes the "ownership" of the company by members)
- how capital contributions are made, obligation of co-op to keep records
- certificates (if membership certificates will be issues)
- redemption -- how it will happen, terms for re-payment, board discretion, limits if less than par value (be sure that it is clear that membership shares cannot be redeemed at full value if they are impaired)

IV. DISTRIBUTION OF SURPLUS

- obligation to allocate and distribute net savings, at discretion of the board of directors (otherwise, without this "pre-existing legal obligation," it may be difficult to obtain the tax advantage of making patronage refunds)
- method of allocation (proportionate to patronage)
- define "distributable net savings" (allow for board discretion to reduce for reasonable reserves to be retained by the co-op)
- distribution and notice -- what form, when (usually within 18 months and 15 days of the close of the fiscal year), portion payable in cash (minimum 20 percent)
- automatic consent and acceptance of tax liability by members when they cash their checks
- deferred patronage refunds (the 80 percent not paid in cash) -- how handled, how accessible to members

V. MEETINGS OF MEMBERS

- annual meeting -- purpose, when (e.g., "in the fall" or "within six months of the close of the fiscal year")
- notice of annual meeting (what type of notice, how distributed)
- special meetings -- procedure for calling, general purposes
- quorum for decision-making
- voting procedures (provide for mail ballots)
- proxy (should clearly state that there is no proxy voting)
- issues submitted by members -- how gotten on agenda

VI. BOARD OF DIRECTORS

- powers, number of seats (fixed number, not a range)
- qualifications (often missing -- should say "member in good standing," not associated with interests adverse to the co-op, define whether employees are eligible to be directors)
- nomination procedure (establish nominations committee and process)
- elections and terms (when terms begin, staggering of terms, length, elected "by majority vote")
- conflict of interest (duty to disclose)
- compensation (provide for reimbursement, whether directors can receive compensation for services in addition to role as director, and need to disclose such)
- removal (for cause or without cause)
- vacancies (who can fill vacancies, replacement in office until when)
- employee directors (also called "internal directors"; elections/nominations procedure if different, limits) -- optional

VII. MEETINGS OF THE BOARD

- regular meetings (provide for regular, schedule meetings; perhaps establish need for advance notice for a board meeting; don't require meetings of a certain frequency or specific schedule)
- special meetings (how to call, who can call, etc.)
- quorum for board decision-making
- open and closed meetings (parameters for open and closed meetings)
- allowance for telephone conference calls ("where all directors can hear each other") -- optional
- action without a meeting (procedure for taking action without a meeting)

VIII. OFFICERS AND COMMITTEES OF THE BOARD

- establish officers (president, vice president, treasurer, secretary)
- duties of officers
- committees (especially necessary if giving committees any powers of the board between meetings; probably good establish audit and nominating committees)

IX. AGENTS BONDING AND INDEMNIFICATION

- General Manager/Chief Executive Officer hired by board to manage affairs of the corporation
- bonding of officers, agents, etc.
- indemnification -- must be carefully worded to protect directors and co-op

X. NOTICE AND WAIVER

- notice (definition of what constitutes "notice," e.g., "shall be deemed delivered when deposited in the mail with first-class postage with names and addresses as they appear in the records of the co-op")
- waiver of notice (provision for waiver of notice by participating in voting or by attending meetings unless participating specifically to object that the meeting is not lawfully convened)

XI. AMENDMENT

- how changes will be made to the bylaws -- who can change, what percentage of votes necessary to make change

XII. DISSOLUTION (optional)

- provisions for distribution of assets upon dissolution of company (generally repetitive of Articles)

Thirdly, your bylaws should cover all major topics necessary to ensure that the legal structure of the organization is clear, what the authority of the board is, how the finances of the corporation work, and what procedures will be followed in routine and special circumstances (voting, holding meetings, recalling a director, etc.). They should be comprehensive in their coverage so that they will give you a reliable, fair and democratic structure to use no matter what issue is presented before the co-op. At the same time, they should be concise enough to be comprehensible. There is no reason for your bylaws to be longer than 6-8 single-sided pages.

Finally, your bylaws should be prepared by -- or, in the case of a small co-op, at least reviewed by -- a legal professional, and should be in conformity with the state statute and your Articles of Incorporation. All too often, co-ops have bylaws that contradict their Articles because no one realized there were constraints on making changes or made sure the changes wouldn't conflict with the Articles. The statute and Articles should define the minimum standards; bylaws should, consistent with those standards, further define overall organizational procedure. Because your bylaws are binding and can have a profound effect on you as directors as well as the viability of the co-op, never consider a bylaw change that has not been written by a legal professional or, at the very least, been carefully and thoroughly reviewed by one. A good lawyer, one who is familiar with corporate law and the special legal framework that exists for co-ops, will be invaluable in providing you with expertise and advice on how to safely, accurately and legally structure your cooperative. This is not an area for self-education; don't try to do it on your own!

Reform or Revolution: Changing Your Bylaws

How do you decide whether you need to completely rewrite your bylaws or just change a few sections? Probably the most important factors here are the structure and how extensive the changes will be. If your current bylaws are structured well and you feel the sections are logical, comprehensive and clearly labeled, then only minor changes will be necessary. However, if the changes are extensive, e.g., you have continued use of obsolete terms or frequent references to something you want to eliminate, then it will probably be easier to start from scratch.

Start by contacting a lawyer familiar with co-ops. Many states have a statewide association of co-ops and maintain a list of attorneys who work with their co-op members. Note that it is not necessary to work with a lawyer in your state or hometown. While it may be easier, it is also true that writing bylaws is a somewhat specialized line of legal work and, in my experience, very few attorneys devote much quality time to it. The lawyer who writes your bylaws doesn't have to be your on-going legal counsel for other matters.

You'll want to review the general structure and specifics you want covered with your attorney. In that process, by all means, ask his/her opinion. Lawyers will prepare legal documents to say whatever you ask them to and, generally, won't counsel you against a provision (one that is considered a "matter of personal choice") unless you ask. Let him/her know that you are interested in his/her judgment on matters you are addressing.

Finally, keep it simple. You'll need to address routine, complex, and unusual situations all at once; do so in a straightforward, clear fashion. Insist on nothing less than well-written, clearly structured, easily understandable bylaws. You owe it to yourselves and to your members.