

NEW YORK NOT-FOR-PROFIT CORPORATIONS – THE BYLAWS AS ROADMAP FOR THE BOARD

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Certain types of governance structure, particular patterns of conduct, and habits of deliberation tend to foster the careful and scrupulous performance of the board's responsibilities. A selection of practical, concrete ways in which nonprofit organizations can facilitate appropriate conduct by their officers and directors are discussed in this outline.

A. Facilitating the Duty of Care

In concrete terms, the duty of care requires the director to be attentive to the affairs of the organization and to actively oversee the way in which its assets are managed. Particular structural mechanisms and procedures will aid organizations in carrying out their functions and reaching decisions in a careful and responsive manner.

1. To facilitate the directors' careful attention to corporate affairs, it is advisable to have structural features that maximize the likelihood that directors will have access to appropriate information and will carry out their responsibilities in the most efficient and conducive environment, including the following:
 - a. Formation of standing committees with responsibility for important functions, such as audit, compensation and budget, and personnel. This will allow for more focused attention on particular issues, with the full board either delegating decision-making to this smaller group or relying on the committee's more considered recommendations.
 - b. Requiring regular meetings of the board, with a minimum number of meetings per year specified in the bylaws. This will increase the likelihood that, at each meeting, directors will be exposed to a manageable amount of information and have time to make decisions in a responsible manner.
 - c. Requiring written agendas, minutes, and meaningful written materials to be distributed to the board in advance of the meetings. This will give the board sufficient notice of the matters to be discussed and allow time for necessary pre-meeting preparation by the board members.

- d. Board size sufficiently large to allow diverse views and interests, but not so large as to be unwieldy. The bylaws should specify a minimum and maximum number of directors in the bylaws.
 - e. While not generally specified in the bylaws, board composition is a key structural factor toward assuring that responsibilities are discharged carefully. Boards should include people with substantive familiarity with the work of the organization, management and financial background, and people who can exercise judgment independent of the CEO and/or the controlling faction of the board.
 - f. Sufficient board turnover to guard against burn-out and excessive clubbiness, both of which tend to stifle lively debate and careful attention. Term limits should also be considered.
 - g. Limitation of the number of staff members that can serve on the board and/or delineation of the issues that must be discussed without board members from the staff in attendance. This is a partial brake on the common tendency toward staff control and domination of the board.
2. In addition, the duty of care requires that directors be in a position to exercise meaningful oversight, by behaving in certain ways, including:
- a. Becoming familiar with important corporate documents, such as the certificate of incorporation and by-laws.
 - b. Regular monitoring of organization's finances, either directly or through the appropriate standing committees.
 - c. Access to, and direct review of, corporate books and records.
 - d. Regular attendance at board and committee meetings. Many practitioners recommend that the bylaws include an attendance policy and/or automatic expulsion of directors with more than a specified number of unexcused absences.
 - e. Careful review of any written materials disseminated in advance of meetings or during the course of meetings.
 - f. Delegation to qualified professionals of tasks requiring specialized expertise, especially if no one on the board has such expertise, and the regular opportunity to question such experts about issues facing the board. See N-PCL § 717(b) (allowing delegation to committees or experts and good faith reliance on information supplied by delegees).

- g. Insistence upon access to sufficient information, opportunity, and time to allow for informed and prudent decisions concerning issues facing the corporation.

B. Assuring the Duty of Loyalty

1. Common Trouble Spots. The governance structure of the organization must include features that facilitate each board member's duty to give undivided loyalty to the interests of the organization. The organization should have written procedures and policies that govern common dual loyalty situations such as:

- a. Setting compensation for board members who are also employees of the organization or providing services to the organization. Compensation for the CEO who sits on the board is an especially tricky issue.
- b. Contracts for goods or services between the organization and a firm owned or controlled by a board member, e.g., a bank, software vendor, or architectural firm.
- c. Investment of organizational funds in companies or other investment vehicles where board members are also investors or otherwise have an interest in the investment.
- d. Boards comprised of individuals in the same substantive field as the organization or affiliated with entities that seek funding from the same sources as the organization.

2. Conflict of Interest Policies. The not-for-profit should institute policies that address potential or actual conflicts of interest and set standards for permissible and impermissible conduct. These should track federal Treasury regulations relating to the so-called "safe harbor procedures" related to transactions between a corporate insider and the organization. Treas. Reg. § 53.4958-6.

- a. A decision to approve an interested transaction must be made in advance by the board (or an authorized committee), composed entirely of individuals who do not have a conflict of interest with respect to the transaction and, thus, are truly "disinterested."
- b. The Board or committee must have obtained and relied upon appropriate comparability data in making its decision. Appropriate data as to comparability may include appraisals, other offers or, in the case of compensation decisions, documented compensation levels of persons working in similar positions in similar organizations, reliable surveys of compensation levels, and expert studies.

- c. The interested director may meet with other members to answer questions, but may not be present during debate and voting on the transaction.
- d. The board or committee must document the basis for its decision within 60 days of the action taken, or before their next meeting. The documentation must include: a) the terms of the transaction and the date approved; b) the members of the board, or committee, who participated in the discussion and who voted on it; c) the comparability data relied upon and how it was compiled; and d) the actions of any member of the board or committee having a conflict of interest with respect to the transaction.

3. Other Governance Provisions. In order to avoid situations where a board member's interest may improperly conflict (or appear to conflict) with the organization's interests, the not-for-profit should create an organizational structure where the best interests of the organization can be vigorously analyzed and pursued, through such mechanisms as:

- a. A board that is made up of individuals of diverse backgrounds and interests and is large enough so that no single faction controls. As discussed above, this will also facilitate the careful performance of the board's oversight.
- b. Similarly, a board that turns over at regular intervals and has term limits will facilitate a fresh look at whether the organization's contracts and business arrangement serve the organization's best interests, as opposed to private interests of board members on staff, while helping the board perform its responsibilities carefully.
- c. Lines of authority and committee structure within the board which encourage a sharing of power among people with diverse perspectives and economic interests will tend to safeguard against conflict situations.