



NONPROFIT ORGANIZATIONS

ALERT

NONPROFIT GOVERNANCE: SIGNATORY AUTHORITY OF OFFICERS AND THE IMPORTANCE OF A THOROUGH BYLAW REVIEW

By Richard S. Caputo

After the president of Penn State University executed a consent decree with the NCAA, numerous parties announced they may bring a federal lawsuit against the athletic association alleging the university president had no authority to do so.

The power to bind an entity is an important governance issue that must be carefully considered. We recommend your organization undertake a review of its bylaws to determine whether your officers have the power to bind your organization and if so, whether that power is limited in some manner.

Generally, officers should not have the power to bind if the transaction/action at issue is a fundamental one. In those cases, officers should only have the power to bind the corporation after the full board approves the transaction.

Also, you should review your bylaw provisions dealing with committees and their powers. Ensure your bylaws not only allow your board to create committees but also accurately reflect what powers your committees have. Confirm that your committees have no ability to bind the corporation with respect to fundamental transactions. That power should be left to the full board.

The power to bind is among the key provisions that should be included in all bylaws. It is important to confirm that all bylaws also:

- Note which officers have the power to bind the corporation and confirm that such "power" is restricted in

the case of "fundamental transactions."

- State that no committee has the power to bind the corporation in the case of "fundamental transactions."
- Reflect that the board should approve "ordinary" transactions by majority vote and fundamental transactions by super-majority vote.
- Indicate that the corporation will indemnify its directors/trustees and officers and can purchase liability insurance on behalf of its directors/trustees and officers.
- Note that the directors/trustees shall receive annual financial reports.
- Direct how the directors/trustees can satisfy the presumption of reasonableness under Code Section 4958.
- Indicate the process that must be followed when there is a "conflict of interest."
- Discuss how directors/trustees are appointed and removed (especially relevant when the corporation is formed as a subordinate entity).
- Note whether the corporation has members and if so, address the following:
 - Membership classes and qualifications
 - Member rights
 - Suspension and termination of members
 - Actions members may take
 - How the membership may take an action.
 - Calling and notices for membership meetings

- Conducting membership meetings

Common bylaw problems that many corporations encounter include:

- Ultra vires action due to outdated mission statement/purpose.
- Terms of directors/trustees are not staggered.
- Board actions by e-mail vote or proxy.
- Long notice period for a special meeting of the board may preclude the board from responding to an emergency.
- Quorum requirement is too low. It should not be less than 51 percent.
- Failure to distinguish between the "directors who are present at a meeting at which a quorum exists" and "directors then in office" when describing the requirements for particular board actions.
- No differentiation between board and non-board committees.
- Executive committees given more authority than permissible under the law.
- Volunteer board chair holds the title of CEO without consideration of whether the Executive Director would be in a more appropriate position to carry out the associated responsibilities.
- Board of directors/trustees consists of the officers of the corporation.
- Officer job descriptions do not meet actual practice.
- Inclusion of provisions for "board officers" and "corporate officers" without clarity about their respective duties and responsibilities.
- No provision for electing or appointing subordinate officers.
- Failure to contain indemnification provisions.
- Indemnification provisions do not reflect the board's decision whether to maximize protection of the

organization's directors, officers and/or other agents.

- Reporting requirements and policies not required by law and not consistently observed.
- Lack of clarity on whether the organization has voting members.
- Unclear membership qualification provisions.
- Membership termination provisions do not provide due process.
- Members given management and/or governance responsibilities that create a greater exposure to liability than necessary.
- Notice provisions for membership meetings do not comply with the law and/or are inconsistent with actual practice.
- Quorum requirement is too high, leaving the organization unable to hold a valid membership meeting to take required actions such as an election of directors.
- Incorporation of Robert's Rules.
- Conflicting provisions that result in fights among directors and/or members and can lead to litigation and damaging media coverage.
- Modification of statutory provisions that changes their meaning and results in a failure to comply with applicable laws.
- No consecutive (full) term limits.
- Consents are not filed with the board minutes.

Once your bylaws have been reviewed (and if necessary, revised), you should review your organization's Signatory Policy and Disbursement Policy to confirm those policies are consistent with your bylaws.

If you have any questions regarding the foregoing or wish to discuss what constitutes a fundamental transaction, please contact Richard S. Caputo, Chair of Fox Rothschild's Nonprofit Organizations Group, at 610.458.3121 or rcaputo@foxrothschild.com.

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