NONPROFIT

A Nonprofit Bylaws Checkup: Where to Start

09.29.15 | Linda J. Rosenthal, JD

There's a good reason why you're likely to find an amendment clause in your nonprofit's bylaws: It's meant to be used from time to time.

The amendment bylaw wasn't thrown into the mix as an afterthought, or as filler to pad the document's page-count to make it look more impressive.

It's perfectly acceptable, often advisable, and sometimes absolutely necessary to review and update your corporate bylaws.

But too many nonprofits, including venerable institutions that have been around for generations, neglect this critical task.

That was our message in *Bylaws are Sometimes Like a Decades-Old Hairstyle* (June 11, 2014):

Big hair, long bangs, and enough hairspray to withstand a Category 4 hurricane: The style was new and fresh in the '80s. Everyone was doing it. It worked. It seemed like a good idea at the time….But walk around today with a hairdo like that, and people will snigger and stare.

If only it were that easy to realize that your organization's bylaws are outdated.

Bylaws Overdue for a Checkup?

If your nonprofit has recently adopted or updated bylaws with the help of experienced counsel familiar with the laws of your state and the federal tax exemption rules, it's likely that you're good to go for a while. A general rule-of-thumb is to review bylaws about once every year or two, or whenever there are significant changes in your mission, operations, or activities.

Many organizations, though, don't fit within this limited "no-review-needed-yet" exception. Even if your nonprofit is operating much the same as it has always done, if the bylaws were originally drafted without specific reference to your state's corporation law, or were cobbled together with bits and pieces from sample documents from who knows where, then it's time to act. Dig out and dust off that three-ring binder – (impressive in its gold-embossed glory) – that was ordered when the articles of incorporation were first filed.

What, Exactly, Are Bylaws?

A useful first step is making sure that all decision-makers understand the purposes and functions of the two key – and distinct – corporate governing documents: the articles of incorporation and the bylaws.

What role does each document play in the legal structure and operations of a nonprofit? How much leeway does an organization have in drafting them so they fully comply with law while also accommodating the group's needs? Are they flexible and practical? Do they avoid unnecessary complications or obstacles?

Around the nation, the general model for corporate law is fairly standard, but the devil is in the details. Each state has its own rules for how its nonprofit corporations are formed, how they must operate, and how they are monitored.

This blog post is specific to California organizations. Unlike some other jurisdictions, the Golden State has a highly particularized statutory scheme. So it's particularly important that governing documents are drafted with the California law in mind.

Articles of Incorporation

Simply put, a corporation is a legal entity that is separate and independent of the individuals involved in it. This entity exists only if, and when, a state government grants it permission to be formed and to operate there.

In California, the legal authority to form and operate a nonprofit corporation comes from the statutes comprising the California Nonprofit Corporation Law; that is, sections 5000 et seq. of the Corporations Code. More specifically, nonprofits that qualify for section 501(c)(3) federal tax exemption are created under the Nonprofit Public Benefit Corporation Law at sections 5110 – 6910.

How do the founders – the incorporators – get the initial permission to be a corporation? "One or more persons may form a [California nonprofit public benefit] corporation … by executing and filing articles of incorporation" in the California Secretary of State's office. When that office reviews and accepts the document for filing, "[t]he corporate existence begins…." (Corporations Code section 5120)

Generally, articles of incorporation are brief documents – about two pages long. That's because state law mandates – ("*The articles of incorporation … shall set forth…*") – only a few bits of basic information: corporate name, purpose, and the name and street address of the corporation and of the initial "agent for service of process."

A few optional clauses – ("*The articles of incorporation may set forth . . .*") – are also permitted, but most organizations stick with the mandatory basic declarations, unless there are good reasons not to keep the document slimmed down.

State governments, including California, also allow and recommend that nonprofits include certain additional language required by federal and state tax agencies concerning compliance with the rules for tax-exemption.

There's now a fillable form on the Secretary of State's website that generates an acceptable, complete articles of incorporation for a California Nonprofit Public Benefit Corporation. But this form should be used with caution. For example, in California, a Nonprofit Public Benefit Corporation can be formed for a "public" purpose… but a "public" purpose is not necessarily an "exempt" purpose under the meaning of the Internal Revenue Code. Sometimes the IRS doesn't like it when that particular box on the form is selected.

Keep the articles of incorporation short and sweet. Don't tinker around with it unnecessarily. It's the bylaws where you can and should create a custom and comprehensive document.

Bylaws

The document titled articles of incorporation, with several mandatory clauses, is absolutely required. It's the launch pad for the corporation's very existence.

As a practical matter, corporations have bylaws, too. It's customary. It's expected. The folks at the IRS Exempt Organizations Division will flip out if you don't produce bylaws when they ask to see it.

And, typically, the bylaws document is much longer than the articles. A common criticism is that corporations throw everything but the kitchen sink into the document.

California nonprofit public benefit corporations are granted various powers including the power to "adopt, amend, or repeal bylaws." [Section 5140(b)]. It's optional: "bylaws *may* be adopted, amended or repealed by the board . . . " [Section 5150(a); emph added)].

However, in most cases, having bylaws becomes mandatory because of this one requirement:

The bylaws shall set forth (unless that provision is contained in the articles, …) the number of directors of the corporation, or that the number of directors shall not be less than a stated minimum nor more than a stated maximum with the exact number of directors to be fixed, within the limits specified, . . . [Section 5151(a); emph. added]

Most organizations don't include this clause in the articles of incorporation because it's optional there, and they intend to have bylaws in any event.

Other than this mandatory item, the bylaws " . . . may contain any provision, not in conflict with law, or the articles, for the management of the activities and for the conduct of the affairs of the corporation, …" [Section 5151(c)]

Section 5151(c) continues with a (non-exhaustive) list of various matters that may be included, including – for example – details about "calling, conducting, and giving notice of" meetings;

directors' "qualifications, duties and compensation"; and the "appointment, duties, compensation, and tenure of officers."

In later sections of the Nonprofit Public Benefit Corporation Law, default rules on these and other matters concerning corporate governance and operations are described. Just a few of these are mandatory; you'll recognize them by the use of the term "shall." Many others are suggested or optional; those statute sections use the term "may."

The optional default provisions apply unless the corporation adopts bylaws that modify them. Here's an example:

[Generally] … , directors shall be elected for the terms, not longer than four years, as are fixed in the articles or bylaws. However, the terms of directors of a corporation without members may be up to six years. In the absence of any provision in the articles or bylaws, the term shall be one year. The articles or bylaws may provide for staggering the terms of directors by dividing the total number of directors into groups and the number of directors in each group need not be uniform. No amendment of the articles or bylaws may extend the term of a director beyond that for which the director was elected, … [Section 5220(a); emph. added]

Multiple Purposes

California bylaws serve multiple purposes:

- to alter the standard, default provisions;
- to add additional operating rules not mentioned in the statutes; and
- to compile in a single document how the corporation will be governed; namely, a handy reference manual for all those concerned: the directors, officers, staff, and counsel.

The bottom line is that there is significant room for custom drafting. What goes into this second-most-important corporate document should be a matter of considerable initial thought and it should be reviewed periodically.

Of course, it's also important to know what to leave out. You don't want bylaws that comply with some other state's law. You also don't want too much detail. For instance, the bylaws can permit the corporation to draft and adopt specific written policy documents; for example: employment, social media, whistleblowing, conflict of interest). But release this information in separate handbooks or manuals.

Conclusion

A final word of advice: Leave out provisions that are inflexible and cumbersome.

A good example: Omit any requirement or recommendation to use Robert's Rules of Order. We devoted an entire blog post – *Who is Robert and Should Nonprofits Follow His Rules of Order?* (August 28, 2014) – to explaining why we agree with the astute commentator who advised: "…[A]void [it] 'like the plague.'"

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