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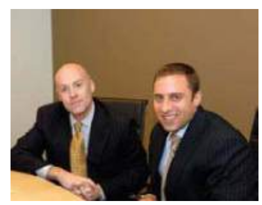
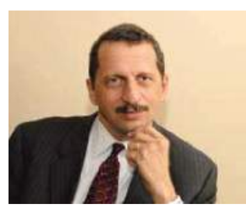
What Every Board Needs to Know

Attorney Survey '09
















Partner Adam Leitman Bailey

ADAM LEITMAN BAILEY

ISSUE Having decided its bylaws and proprietary lease desperately need to be revised, how does the board get shareholder approval?

BACKSTORY It is a familiar story: the co-op corporation had a set of bylaws and a proprietary lease that were both antiquated. Not only were they poorly drafted, but they were rife with internal inconsistencies, con icts with current law, and irrelevant provisions regarding the original sponsor. They did not adequately meet the current needs of the co-op. The time had clearly come for change, and the board asked its attorneys to draft revised documents.

And that is where the story ends for far too many boards. Because preparing revised documents is the easy part. But getting to the desired result – obtaining approval of two-thirds of the shareholders – is the hard part.

First, the entire board needs to support all of the proposed changes. Revisions that are endorsed by only four out of seven board members will never garner the support of a sufficient number of shareholders. We worked tirelessly with the board, revising, tweaking, adding, and amending the proposed changes until we had a document that the board unanimously supported.

Then, there is the presentation to the shareholders. Will the revisions be presented to the shareholders as all or nothing? Will a piecemeal approach run the risk of so eviscerating the changes that all the effort will yield no meaningful result? Together with the board, we devised a hybrid approach. We organized the proposed revisions into a few meaningful groups: those that brought the corporation into compliance with laws and current practices of well-run buildings; those that eliminated no-longer-relevant provisions; and those that affected quality of life and the board's ability to effectively manage the building.

The materials were sent to the shareholders, together with proxies and ballots. The board members actively solicited the shareholders' support. The date of the annual meeting arrived, and it appeared that the overwhelming majority of those present were in favor of the changes. Success?

No. Only slightly more than 50 percent of the shares were represented at the meeting, making it impossible to achieve the necessary two-thirds approval. If the proposals were put to vote, months of effort would have been for naught and the process would have to begin again next year.

Instead of letting that happen, we advised our client to take the following procedural steps. First, delay the voting. To accomplish that, a motion was made, seconded and voted upon to postpone the vote to a later date. And then, rather than conclude the annual meeting, a motion was made to adjourn it to a later, unspecified date. Had the meeting concluded, the ballots and proxies would have been useless for the next meeting. But by adjourning to a later date, we kept the meeting and proxies "alive" saving the directors from going back to the people who had already voted, and allowed them to focus exclusively on collecting proxies from those who had not yet voted. Additionally, by adjourning to a date to be determined, the board could wait until it knew sufficient votes were in hand,

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and only then reconvene the meeting for the purpose of voting. Once in hand, the meeting was reconvened, the voting (by now, a mere formality) took place, and the new documents took effect.

COMMENT A periodic review of the bylaws and proprietary lease is vital to every co-op, especially when it has not been done for a long time. Basic procedural matters (such as timing of the annual meeting, methods for giving notice, or quorum requirements) should be reviewed, as well as more substantive issues. Areas we have frequently addressed with our clients include qualifications for directors (must they be shareholders? must they be residents?), the number of directors, term limits, the length of term or provisions for staggered terms. The method of voting (cumulative or straight) for board members should be considered. Current provisions empowering the board to impose fines for violations of the lease or house rules, fees for apartment transfers, subletting, alterations, or use of building facilities (e.g. storage areas) must be reviewed.

Often, we find that such provisions are entirely lacking (even though the board has been imposing such charges for years). Provisions for the indemnification of directors and officers should be expanded to take full advantage of protections allowed under current law. Subletting policies should be reviewed. Procedures for resolving disputes between shareholders (e.g., mandatory mediation) can be adopted. Every building has its own way of doing things, and what works in one building may not be appropriate elsewhere. The attorney must understand how your building operates, and, working with the board, draft documents that suit the particular building's needs. Once the board agrees on the changes, the shareholder approval process must proceed in strict accordance with the bylaws, and the notices, ballots and, proxies must be all be drafted in such a way as to maximize the board's opportunity to garner the necessary votes.

—Adam Leitman Bailey