

## **Chapter Three: Operation of the Cooperative** **The Michigan Cooperative Law Primer**

As a democratic based organization, the cooperative operates in a manner much like a city or township. The membership's authority is set forth in the bylaws. It elects a board of directors. This is done at an annual meeting. Members also have the right to petition for a special meeting of the membership in order to remove a board member, or seek an amendment of the articles of incorporation or the bylaws.

Under the typical bylaws, the board is given broad authority to act on behalf of the corporation. To the surprise of many, this includes the ability to borrow money and mortgage the property. While there are limits to the board's authority, those restrictions usually deal with extraordinary events, such as dissolving the corporation, going into bankruptcy and the like.

To run the cooperative on a day to day basis, a management agent is hired by the board. This management agent is charged with collecting the carrying charges, paying the bills, preparing a budget for the board's approval, and dealing with the members and contractors on behalf of the corporation. An independent auditor is also engaged by the board to perform an annual financial audit of the accounting records and to produce a report for the board and HUD if a relationship with that agency exists. Finally, a cooperative attorney is engaged by the board to protect the cooperative, to provide legal advice to the board, represent it in litigation, and to handle eviction cases. It is important that the cooperative attorney be independent of the management agent since the board needs such expertise in negotiating, drafting and dealing with management contract issues.

There are several important documents that provide legal direction to how the cooperative operates. The governing documents of your cooperative are the tools of corporate control. They set the ground rules within which the members and board must operate. They are the standards by which courts will judge issues. Ignorance of them and how they work among themselves will leave you defenseless to those who do know how to use them. It is the difference between winning and losing.

Here, we provide a survey of the governing documents of the Cooperative. It is not as simple as one would expect. The governing documents include what you normally think: the articles of incorporation and bylaws. But it is really much more expansive than that; to fully understand your governing documents, you need to recognize that there is a much larger universe of documents which govern the cooperative. This list is an attempt to alert you to the general contours of the universe of documents but it is not exhaustive.

## **The Cooperative's Own Documents**

The Articles of Incorporation is a document filed with the State and is, therefore, a public document. It is usually broad and general. It can be amended by the members only, once the corporation has been formed. Important clauses include the purpose of the corporation; the amendment procedure and provisions regarding the board of directors.

Bylaws is a document that is not filed with the State. HUD should have the bylaws. Under the Regulatory Agreement, HUD is to approve them. They are usually detailed and descriptive. They can be amended by the members only. Important clauses include what constitutes quorum for meetings of the members and the board; authority of the board; amendment procedure; and who can call a special meeting of the members.

Board Policies, while not generally recognized as a governing document are, nevertheless, significant. They are not filed with the State or HUD. They are adopted and amended by the board. While relatively easy to change, if ignored it can create a basis for overturning an inconsistent board decision. For instance, a poorly written policy on fines and rule violations may cause a judge to become confused as to how or even whether a board can evict a member.

## ***The HUD Environment***

There is a Regulatory Agreement when the cooperative has received a HUD-backed loan or other form of assistance. This constitutes a contract between the cooperative and HUD. It is not filed with the State. It limits the authority of the board on a wide range of matters, including the need to get HUD's approval to sue. It even allows HUD to remove the board. It exists while original HUD-insured mortgage is in effect.

Coupled with the Regulatory Agreement is the HUD Handbook. It is incorporated through the Regulatory Agreement and may be amended by HUD. It expires to be relevant when the Regulatory Agreement ends.

The National Housing Act is incorporated through the Regulatory Agreement but sometimes the Articles will incorporate the Act. It may be amended by Congress. Its duration depends on how it is incorporated. If only incorporated through Regulatory Agreement, it ends when the Regulatory Agreement expires. If incorporated through the Articles, you need to check that language; as it may affect the scope or operation of the cooperative inadvertently, even beyond the existence of the Regulatory Agreement. Associated with the Housing Act is the Code of Federal Regulations for HUD, as a supplement to the Act, as a means of "fleshing out" the Congressional intent of the Act.

## ***State Corporate Law***

The Nonprofit Corporation Act defines the parameters of corporate affairs. Of importance are mandatory provisions that all corporations must place in their articles or bylaws, and permissive provisions that corporations may take advantage of by placing them into the articles or bylaws. An example is the relatively new provisions that limit liability on directors and officers, as well as other volunteers - if adopted by the corporation.

If the articles and bylaws are silent, the Act may furnish direction. Other mandatory requirements are found in the Act. For example, filing of the annual report with the State is required in order to maintain corporate status. Failure to do so in Michigan results in loss of corporate status. If sued, you do not have a corporate shield to protect the individual members from personal liability. In addition, someone else may take your corporate name.

In Michigan, attached to the end of the Nonprofit Corporation Act is a chapter that deals specifically with cooperatives. It allows a housing cooperative to “opt in?” in order to take advantage of its provisions. Thus, it is important to know whether your cooperative did so, because it has provisions that are inconsistent with the other sections of the Nonprofit Corporation Act.

## ***Parliamentary Procedure***

While not normally thought of as a “governing document” Roberts Rules has this status since the Bylaws often make it the “fall back” resource to supply parliamentary procedure when the articles and bylaws are silent. A couple examples of important procedures to know are the motion for reconsideration which may be made by one on the prevailing side - so if you are going to lose a vote because others who support your position are not present, you may want to vote with the majority present in order to preserve your right to bring it up again; and the motion to adjourn, which is always in order and not debatable. Likewise, a motion to table is not debatable and may be made at any time during the discussion of an issue where a motion is pending.

## ***Federal, State & Local Regulatory Framework***

Again, it is important to recognize that cooperatives operate within the broader body of law and even though this is not generally regarded as “governing documents” the articles, bylaws, and other governing documents can be preempted by changes in these laws. For instance, the Michigan Elliot-Larsen Civil Rights Act impacts proxies that limit the right of a married member to appoint only his or her spouse, which is a violation of marital discrimination prohibition.

### ***Contractual & Covenant Framework***

As with federal, state & local laws, the cooperative must operate within the parameters of its contracts and covenants. Contracts can be breached but if exposes the cooperative to liability for damages. One example is a covenant which runs with the land, which limits the cooperative as to its use of property; thus, you may not be able to build or use an adjacent lot owned by the cooperative. Another illustration is if the cooperative refinances, the lender may impose some conditions that must be honored to avoid a default and foreclosure of the mortgage, such as retaining certain reserves.

### ***The Hierarchy of Documents***

The hierarchy of the governing documents is complex, and the interplay between them requires legal expertise. With the foregoing caveat, the general hierarchy is:

Federal, state & local law, including corporate law  
The HUD Regulatory Agreement and associated HUD laws  
Covenants & contracts  
Articles of Incorporation  
Bylaws  
Roberts Rules  
Board Policies

### ***Amendments***

To amend the articles or bylaws, the cooperative must follow the process described within these documents themselves. If HUD is still involved, it must approve of them. If these documents do not proscribe the process, then you must resort to the State corporate law for direction.

### ***Lessons to Learn***

There are important lessons to be learned about governing documents. First, although many cooperatives have “boilerplate” clauses, this is misleading and every cooperative must be viewed within its own environment, taking into account the entire universe of applicable governing documents. Do not assume that your cooperative is governed in the same manner as others.

Next, remember that the universe of governing documents consists of the “visible” -articles; bylaws; and HUD regulatory agreement - as well as the “invisible” – the State corporate statute; federal, state and local law; and Roberts Rules, etc.

Make sure you keep your governing documents protected; one of the worse things that can happen is to not have certainty in this area. Follow the procedures of safeguarding and keeping them in order.

To be effective, you must recognize the interaction of the various governing documents we have identified. Qualified legal assistance is required for more sophisticated issues, as they can become quite complex. There is a hierarchy that must be considered. For example, if state law prohibits some act, then it preempts bylaws that allow that act.

Finally, bear in mind that HUD plays a dominant role while the original mortgage is still in effect; once it is gone, so goes the Regulatory Agreement. This provides you with an opportunity to address problems of the past, eliminate confusing language that will then be obsolete, and consider other options such as moving from limited equity to market rate - if it makes sense for your cooperative. This is a rather involved decision that requires an analysis of your members' economics as well as the market conditions of the surrounding area.

#### Disclaimer

This primer is intended to provide the reader with a starting point to understand the law of housing cooperatives in Michigan. It should not be used as a substitute for qualified legal advice from a competent, experienced attorney licensed to practice law in the state of Michigan.

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