

# **THE MICHIGAN COOPERATIVE LAW PRIMER**

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# The Michigan Cooperative Housing Law Primer

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## Chapter One: The Nature of Cooperative Housing

Cooperative housing is a unique form of home ownership, distinct from that of traditional single family ownership and renting. It is often aligned with condominium ownership, but there are vast legal differences between owning a condominium and living in a cooperative. The similarities and differences among these forms of housing will be described in detail below.

As the name implies, cooperative housing is an effort of all its tenants, bound together as members of a corporation. This corporation, in turn, owns the property and rents the units to its various members. Thus, the cooperative is really a small community. Its members share a common bond, and work together in order to conduct business. Like no other form of housing, the cooperative gives this sense of “community” to its members.

In order to understand the nature of the cooperative, it is vital to realize that each “owner” is actually a member - or shareholder - in the cooperative corporation. Each member, in turn, is also a “tenant”. There is no landlord in the usual sense - rather, the landlord is the cooperative, owned by all the members.

Knowing that the cooperative unit owner wears these two hats - member and tenant - is critical to appreciate the great value of being in the cooperative community. It is not an “us versus them” situation. Rather, it is simply “us.” We are the cooperative. No greedy landlord collects rent. There is no profit margin in the rent - which is actually called “carrying charges.” We decide what to charge ourselves, and that is based on the costs of operating and maintaining the property that we all own an interest in.

As noted above, the cooperative is a corporation. It is a nonprofit corporation since there are no investors that have a profit motive. It is, instead, owned by the members. The members, in turn, elect a board of directors. The board of directors is given authority to make decisions for the corporation. Thus, it should be evident why each member needs to understand that he or she is in a community which thrives best when the members realize that they are owners and participate in the democratic process of electing the board.

For this reason, new members should be required to attend an orientation program that explains the basic principles of cooperative housing. Too many members of cooperatives today view themselves as simply tenants. They complain about how the cooperative is operated without realizing that they hold the power to effectuate change by attending membership meetings and exercising their right to vote. This attitude, borne of ignorance, evidences itself by how these members treat their unit and their neighbors.

## Chapter Two: Comparisons to Other Forms of Home Ownership

Much has been written and is available on the web that compares the various types of home ownership with cooperatives. Some of the more important differences are explained here. A more exhaustive list may be found at [www.MichCoopLaw.com](http://www.MichCoopLaw.com).

### *Responsibility for Repairs and Maintenance*

One of the most significant advantages to being a cooperative member flows from the fact that the corporation owns all of the property. When something wears out, needs fixing or replacement, or is damaged, the coop member is not called upon to take care of it, or to personally pay for it. Rather, it rests with the cooperative to take care of it.

Thus, the cooperative takes care of removing snow, fixing garbage disposals and leaky toilets, replacing roofs, and everything else that the property needs. In the case of a condominium, the owner has to take care of everything that goes wrong within the four walls of his or her unit. A single family homeowner is responsible for everything - inside and outside.

For busy or older cooperative members, this is a great relief. They do not worry about maintenance issues. If something needs to be fixed, a work order is filled out and filed with the office. A trained maintenance employee or contractor comes out and fixes the problem at no cost - directly - to the member.

## *Screening Prospective Members*

Another major advantage is the cooperative's right to screen applicants. This means that before a person is allowed to acquire a membership in the cooperative and the corresponding right to live in a unit, he or she must submit to financial and other scrutiny. There must be a demonstrated ability to pay the monthly carrying charge; and certain cooperatives may have income limitations. Some cooperatives go even further and investigate an applicant's criminal history. Applicants may also be subject to interviews. All of these measures help protect the cooperative community from a financially or otherwise unstable person becoming a member.

This stands in sharp contrast with every other form of home ownership. A co-owner of a condo unit may freely sell his or her unit. The condo association has no right to look into the new person's background. You, as a condo owner, may end up living next to a sex offender - with no recourse, except to move out.

## *Regulating the Conduct of Members*

A cooperative board has a unique ability to adopt rules and regulations, in addition to those contained in the occupancy agreement, to address issues that arise within the cooperative community. Once promulgated and distributed to each member, these rules can be enforced through the summary proceedings act, with a violator being subject to eviction. This does not require approval by the membership.

In contrast, the condominium association is bound by the master deed and bylaws. This presents a dilemma when an unanticipated problem occurs: changes are up to the co-owners to approve. Thus, a meeting of the co-owners must be convened and the matter voted upon. Assuming this hurdle is overcome, the remedy is foreclosure through a cumbersome, time consuming process that can be expensive.

## *Policing the Rules*

Whether it is the regulations that govern a member's conduct, or the requirement that financial obligations be paid, the cooperative

has a huge advantage over a condominium association. Under Michigan law, a cooperative has the right to invoke the “Summary Proceedings Act” which is the ability to use the landlord-tenant laws to evict a member who does not pay or creates a disturbance, or otherwise fails to abide by the rules.

No such right exists for a condominium association. Its recourse - in the event that monthly payment is not made, is to place a lien on the unit of the defaulting co-owner and to exercise foreclosure rights. The problem with this remedy is that it is much longer and costly. It could take thousands of dollars and more than half a year to achieve the same result as a cooperative can obtain in a matter of weeks.

While more is written below on the specifics of the cooperative’s remedies for dealing with members who fail to pay or violate the rules, suffice it to say at this juncture that a clear and distinct advantage exists here for cooperatives.

### *Financing Availability*

Since a cooperative owns the entire property, it is in a much better position to obtain loans. This becomes important when major expenditures are needed, such as interior renovations, roof repairs and the like. Lenders want collateral, and the property serves as a nice way of providing security for mortgage loans. This is usually not available to condo associations, since they typically do not own extensive amounts of property - as the condo co-owners own their units. Thus the condo association has little to offer in the way of collateral.

On the other hand, at present time, a condo co-owner does have an advantage over a coop member, in terms of the ability to finance the acquisition of his or her unit. A condo co-owner may use his or her unit as collateral for a loan by which the loan proceeds are used to purchase the unit. In the case of a coop, a member does not have legal title to his or her unit and, therefore, is unable to offer it as collateral.

Over time, and as our efforts to educate lenders on the intricacies of coop law continue, we expect them to start making share loans.

Indeed, there are certain lenders willing to do so now. But the practice is not yet widespread, unlike in New York where some of the more expensive housing is in the form of a coop unit and lenders there are quite familiar with the ins and outs of share loans.

### Chapter Three: Operation of the Cooperative

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.

#### Chapter Four: Refinancing Your Cooperative Mortgage

With the unprecedented and sustained drop in interest rates, a growing number of cooperatives are examining the possibility of refinancing their original mortgages. Many of our clients have found mortgages which cost the same or less than the existing mortgage. This makes it a popular option, since it allows for an infusion of capital that not only retires the old debt but also funds capital improvements to upgrade the property.

The first step in the process is to obtain proposals from various lenders. Most cooperatives are familiar with the National Cooperative Bank, located in Washington, D.C. This lender has the advantage of being well versed with cooperatives, which makes it easier to deal with. The officers of NCB are knowledgeable of the inner workings of cooperatives, and have done these refinancings many times. Moreover, NCB is interested in becoming a major force in share loans, so new members can finance loans to acquire their memberships, a tool that is rather appealing to cooperative boards as an aid to improving the marketability of their properties.

However, we have seen several other lenders who are aggressively pursuing loans to cooperatives. We are compiling a growing list of these lenders and will be happy to furnish this information. Many times, these lenders have offered interest rates that are lower than the NCB proposal. Thus, it pays to shop around.

Once a lender has been identified that offers a reasonable proposal, two steps should be undertaken. One is to determine the monthly payment, since a selling point to the membership is that carrying charges will not be increased because of the new loan. A second task is to share the proposal with the membership.

Under most bylaws, the decision to refinance rests with the cooperative board. HUD has tried to argue with us that the membership must approve the new loan; however, we have successfully challenged this position. HUD has acquiesced to our position, and now simply wants to see that the membership is aware of the refinancing. It wants to see that an informational meeting was held, with proper notice. While we do not believe that HUD can insist on this, we advise our clients to hold an informational meeting to advise the membership as a matter of political expediency and pragmatism.

Once these steps are completed, there are a number of tasks that remain. The lender's commitment letter will set forth a number of requirements. Among them are:

ALTA Survey: This is a rather detailed site plan of the entire property which is prepared by a registered surveyor, usually on staff with an engineering firm. It seeks to identify all of the buildings and other improvements, the boundaries, and any encroachments. This enables the lender to know what its collateral is and whether there are any concerns with the property.

Environmental Assessment: This is an evaluation of the property, done by a title record review and physical inspection, in order to ascertain any environmental concerns that would affect the marketability of the property should a default in the mortgage occur. It is done by an environmental engineer.

Title Commitment: A search of the land title records by a licensed title insurance company will be required. We have found that there are occasional problems discovered, such as a stray deed that has been recorded in the chain of title by a member or third party that has to be corrected; we also have found that sometimes the original developer has not properly conveyed internal roads to the cooperative. Should there be any such clouds on the title, our services are engaged to clear them up.

Beyond these tasks, there are a number of documents and records that we need to provide the lender, which engages its own attorneys to verify that the cooperative is in good standing, that the loan has been approved by the board through proper procedure, and that the officers signing the documents are authorized to do so. In addition, the original lender must provide a payoff letter that sets forth the current balance. On occasion, HUD has directed the original lender to refrain from doing so. We have managed to override this directive by threatening litigation against HUD.

If the cooperative is organized as a low or moderate income housing facility, HUD will insist upon the cooperative signing an "Agreement." This will replace the Regulatory Agreement, and require the cooperative to continue to serve the needs of these income groups for the duration of the term of the Regulatory Agreement.

In any event, once the new mortgage has been closed, HUD will provide a release of the Regulatory Agreement. This instrument needs to be recorded in the chain of title with the land title records. Also, the original lender needs to provide a discharge of the mortgage, which is also to be recorded.

There may be a need to amend certain provisions in the cooperative's articles of incorporation, bylaws and occupancy agreement. A separate article explains in detail the types of changes that are either needed or desirable. We have helped many of our cooperative clients through this procedure, which culminates with a membership vote on these changes.

#### Chapter Five: After the Mortgage is Paid Off: Changes to the Governing Documents

Excitement is growing as cooperatives that were developed over three decades ago look ahead to the day when their original mortgages are finally paid off. Boards everywhere are asking what lies ahead, and how they should prepare. This chapter gives valuable guidance on how to look at the issue and to plan properly for the mortgage burning (and its corresponding HUD regulatory agreement termination) event.

First, it is important to debunk certain myths. First, there are many members who hold the belief that they will somehow automatically own their units when the mortgage is discharged. This is simply false. The legal structure of the cooperative is unaltered, regardless of the mortgage. The member will still be a member on the morning after; and he or she will still have a proprietary lease (known as an occupancy agreement). The very same board will run the cooperative as the day before. In essence, there is no change except the removal of debt from the balance sheet, and expiration of the HUD regulatory agreement.

This leads to the second myth. Many believe that the cooperative must take some action at the time the mortgage is paid off. Nothing is farther than the truth. Cooperatives are corporate entities, with perpetual existence. This means that they will continue on and on,

and theoretically forever. Therefore, no rush to take some action is needed.

We do not mean to imply that the board should not evaluate its options. As fiduciaries, board members need to be ever vigilant and consider opportunities. But our point is that the cooperative does not have to do something - rather, it may choose to do so. The difference lies between “must” and “may.”

So what does it mean to discharge the mortgage? Simply an end to payments to that lender, and the end of HUD’s close oversight of the cooperative through its regulatory agreement. And while there is no need to join the “herd” of cooperatives in a headlong rush to the future, it is advisable for boards to inform themselves of opportunities and options in the post-HUD era.

We recommend that the board undertake careful and deliberate study. It must be ready to debunk myths. It needs to have answers for members who suddenly want to convert the cooperative into condominium units in an attempt to get rich quick. It ought to be ready to lead.

As aids to the board’s study of the post-HUD era, organizations such as Midwest Association of Housing Cooperatives [[www.mahc.coop](http://www.mahc.coop)] and National Association of Housing Cooperatives [[www.coophousing.org](http://www.coophousing.org)] hold frequent classes. Also, a group of professionals in southeastern Michigan have held a series of forums to facilitate study and discussion on the options [[www.coopsinthefuture.com](http://www.coopsinthefuture.com)]. We suggest that boards - or committees formed to advise the boards - take advantage of these resources, as well as consulting with the cooperative’s own professionals. Beyond the expertise of these professionals, there are networking opportunities with other similarly situated cooperatives that are wrestling with identical concerns, allowing the exchange of experiences.

A library should be amassed from the literature obtained in this quest for guidance within the board records. Written opinions should be requested of the cooperative’s professionals on the ques-

tion. This is an important proactive measure to protect the board from lawsuits brought by members, since it creates evidence that the board relied on expert advice - thus invoking the business judgment rule, that can be used to defeat challenges to the ultimate decisions made.

As noted above, the cooperative - regardless of whether it is a limited equity or a market rate type - need not take any action simply because the mortgage is paid off and HUD is gone. Beyond doing nothing are a few options that need to be understood in order to fulfill the board's role as fiduciaries.

For the limited equity cooperative, it may consider transforming itself to a market rate. The obvious reason for doing so is to unleash the captive equity, and allow the market to determine what an outgoing member can sell his or her membership for. While this may sound appealing and a clear choice, it is not so simple. If a cooperative is located within a depressed market area, memberships may not be so marketable and capable of commanding a significant sum from buyers. This may result in vacancies and those members who remain get saddled with covering the costs of empty units.

Moreover, the membership may believe in the goal of providing low and moderate income people with affordable housing options. Thus, as a matter of policy, the cooperative may wish to remain limited equity.

Another choice, which we do not embrace, is the conversion to condominiums. While we oppose this option, it still must be studied and considered. Members will raise it because it is commonly felt that it represents a pot of gold for those who remain at the cooperative through the conversion process and then sell their condo units for significant returns. A board needs to know of the pros and cons of condo versus cooperative, and be ready to explain why the cooperative form of ownership is preferred.

As an aside, we oppose the condo option for two reasons: one is philosophical and the other is pragmatic. We believe that the cooperative form is vastly superior because it allows for pooling

resources and taking care of the needs of the membership through a democratic process, engendering a mindset that promotes the community as a whole. Condos, on the other hand, promote an “us versus them” attitude.

Pragmatically, cooperatives are superior in how the law allows problems to be dealt with. We are allowed to use summary proceedings to evict problem members. We can screen applicants and keep out criminals. Our boards can promulgate rules and regulations to deal with evolving issues such as pets, parking, and people problems. Condos cannot deal effectively with any of these matters.

Additionally, the experience with converting to condos in Michigan is very limited. A number of legal issues, ranging from property taxation and assessment, to fairness among the membership, can and probably will give rise to expensive litigation. Why rush into a situation that is nearly certain to place the cooperative in financial jeopardy as it undergoes months or years of lawsuits and appeals? Thus, if for no other reason, we have urged caution and deliberation to our clients. We think it best, even for those who want to convert to condos, to go slow and let others pave the legal trail through a morass of issues.

One more point is important to bear in mind: HUD has stated adamantly that no cooperative funds are to be expended to undertake the condo conversion while the regulatory agreement is still in effect. This fact may be useful to slow down those who are promoting the condo conversion approach.

Beyond the issues of condo versus cooperative, or limited equity versus market rate, is the option to refinance. This move achieves several goals: eliminates the original mortgage and replaces it with a new mortgage that allows for cash infusion to get some improvements done; and it eliminates the burden of operating under HUD. We discuss refinancing in greater detail in another article. But there is a side effect that is important to note for this discussion: the new lender will not allow the cooperative to convert to condo so long as the refinancing mortgage is in place.

## Chapter Six: Preserving the Cooperative Into the Future

As most cooperatives reach the point where their original mortgages are paid off, and the HUD Regulatory Agreement ends, a debate occurs on whether they should remain as a form of housing cooperative, or convert to condominiums. This chapter is designed to help those boards that want to remain as a cooperative by taking steps to prevent future boards or memberships from undoing the decision.

Which tool described in this chapter that is most suitable will depend on the political climate of your cooperative. Some of our clients have divisions among the board or membership that make it unfeasible to undertake the more extreme measures available. Thus, the starting point is to evaluate what can pass political muster in your cooperative.

Before undertaking any of these strategies, it is necessary to examine your cooperative's Regulatory Agreement to determine whether HUD approval is needed. In most instances, such approval will be required. Since this article is written at a time when there has been no reported attempts to secure HUD approval of any of these strategies, we do not know how HUD will react, and at what level - whether at the district office or at the national office - it will be made. While we suspect that HUD continues to support housing cooperatives as a superior form of home ownership, we cannot predict whether it will agree with the policy of binding future boards and members. To that end, we recommend that you await termination of the Regulatory Agreement in order to bypass the issue altogether.

Amending the bylaws is one option. Here, you can mandate that any future decision to change the cooperative character of the corporation requires a supernumerary vote of the membership. You can choose the percent - between majority vote and unanimous vote. You can also specify that it be by the membership of record - or just those which constitute a quorum. Obviously, if you want to make it very difficult to change from cooperative, you will want to specify a very high percentage of those members of record. This change will need be approved by the membership under the current bylaw requirements for quorum and voting for amendments.

Another option is to place a supernumerary vote requirement in the articles of incorporation. The same issues associated with the bylaw amendment are applicable here. This change will usually require a vote of the membership. A thorough search of bylaws and articles is necessary to make this determination. The benefit of placing the limitation here is that articles are public documents, and open for inspection by all - unlike the bylaws, which are not recorded in the public registry.

Variations to the supernumerary vote requirement may be considered. For example, you may amend either the bylaws or the articles to not only require a higher membership vote, but also mandate that the board also approve it - so there would be two separate requirements. And the board approval can be a simple majority of those present at a meeting with quorum, or some variation thereof - such as unanimous approval of all board members.

A third choice is to handle it through an instrument which is recorded in the cooperative's chain of title. In essence, this places developers on notice as they perform their due process in conjunction with their takeover bid. The authority of the board to direct this measure is dependent upon the bylaws and articles; if both are silent, the state statute should be researched.

Another approach may be the recording of a covenant that mandates the continuation of income maximums for incoming member-applicants in the case of limited equity cooperatives. That is, even though HUD and its income restrictions have expired, it may be possible to mandate the continuation of those restrictions - at least the income ceiling - in order to preserve the character of the cooperative, by using a covenant that runs with the land into the future.

More radical still is the concept of transferring title to the assets of the cooperative corporation into trust for the benefit of the membership, present and future. A trust document will be required, which may provide that there is no choice - that the property is to remain a cooperative for either a defined number of years as a minimum or for a perpetual term. A trustee needs to be appointed and a line of succession determined. It may be deemed appropriate for the cooperative board to serve as ex officio trustees.

Since this is a most severe alternative, it should not be attempted without full support of the board and membership. It requires a significant investment in time and money to agree and draft the terms of the trust document. To our knowledge, no cooperative has ever tried to do this, so it carries with it the risk of legal challenge by the current membership. If done correctly, there will also have to be changes to some of the current governing documents in order to place future members on notice that their rights have been affected to this extreme degree.

Finally, it should be noted that most bylaws allow the board to make the decision on refinancing. If the cooperative enters into a new loan arrangement, it is typically precluded from making any changes to the form of the entity until and unless the new loan is paid off. Of course, if there is a prepayment penalty, it becomes expensive and unlikely that future boards will want to do anything while those obstructions are in place.

Whatever option is selected, it will require competent legal counsel to provide expert guidance and drafting in order to do it right. For example, a doctrine in the law known as the prohibition against restraint in alienation of property needs to be circumvented by careful drafting. The risks are too great to attempt this without thorough consideration of the ramifications of the choices, in light of current law.

## Chapter Seven: Effective Cooperative Boards

A successful board requires an understanding of the principals discussed in this chapter by each director. There must also be a commitment by all of the board to adhere to them. Thus, it is essential that new board members be given the necessary training in order to understand these concepts.

First, there needs to be an understanding of the roles of the various players. The board must understand clearly that it is the final authority, subject to HUD if it is still in the picture, and further subject to the governing documents. It must make the policy decisions. While member input ought to be sought on important matters, the

board should not abdicate its jurisdiction. For example, most bylaws say that the decision to refinance rests with the board.

This also applies to the professionals of the cooperative. The roles of the attorney and management agent are to support, inform and guide the board. However, the board is the ultimate word. Too often we learn of boards which are dominated by the management agent, even to the extent that the directors must beg for funds to plant flowers. This is wrong. The board needs to view itself as the head of the organization.

For this reason, it is imperative that the board seek out professionals which understand these roles and respect the board's authority. If a professional has the proper commitment to the principal of cooperative governance, that management agent or attorney will have joined and become active in the two leading organizations of the cooperative movement: the National Association of Housing Cooperatives [[www.coophousing.org](http://www.coophousing.org)] and the Midwest Association of Housing Cooperatives [[www.mahc.coop](http://www.mahc.coop)]. Check with these associations for a list of professionals from which you should seek proposals and interview them to determine their experience, expertise and philosophy.

When a cooperative board has the right team of professionals assembled, it can make great progress. Without the right management agent or attorney, little can be expected. Thus, it is advisable to take the time necessary to make the hiring decision.

Once the board has engaged good professionals, it must work at communicating well with them. The management agent needs to be involved with the day to day operations, and has the duty to keep the board well informed. The attorney needs to be brought into discussions with the board at the outset of any matter which could lead to a legal dispute. It is always better to get the proper advice before a mistake is made.

In Michigan, there is a doctrine known as the "business judgment rule." This shields a board and individual directors from liability when it relies on professional advice. Protect yourself and the

board by always seeking legal opinions before you make major decisions. Require such advice to be in writing and make certain that it is filed with the minutes.

The types of issues that require legal input include significant contracts, and anything that binds the cooperative by large amounts of money or for a long period of time. Moreover, if there is any question or doubt as to the board's authority or the meaning of any governing document, professional legal advice is warranted. Any time it appears that there may be a lawsuit, involve the attorney. Remember that it is less costly in the end to bring the attorney into the situation early on so the matter can be properly handled at an early stage.

The board reserves to itself the right to engage the auditor. This is a vital decision that must not be abdicated. The financial integrity of the information contained in the audit reports must be relied upon by the board. The annual audit is the way the board is supposed to satisfy itself that the financial records and affairs of the cooperative is being properly handled. Thus, you must choose the auditor you trust. While the management agent can furnish names of qualified and experienced certified public accountants, do not let the selection to be made by any one other than your board.

Always insist that the auditor present a written letter that identifies any issues he or she discovers during the course of the audit. Make sure you read it, and require the auditor to attend a meeting to discuss it. This is your duty. Find out what the records disclose.

Another rule is to insist that the operations rest with the management agent. The board sits as a policy maker. It leaves it to the management agent to implement the board's decisions. Make sure that the board does not interfere with that performance.

Next, be sure to review the management agent's performance at least annually. Give feedback on what is being done well, as well as the shortcomings of the management agent. Also, keep the length of the contract short or have the right to cancel when you are unhappy. The same holds true of the attorney. In fact, we advise

that the relationship with the cooperative attorney be terminable at will since if the board has lost confidence in the attorney, it is counter-productive to keep the attorney.

Board members only have power when assembled as a board. While it is common for officers such as the president to make decisions and give direction outside the board room, the rule for other directors is that they are ordinary members of the cooperative when they are not in the board meeting. Do not tolerate directors to exceed their authority.

Successful boards also have a working relationship with all of its directors. While it is not necessary to become fast friends, it is essential that each director be kept in the information loop, be treated with respect and have a role in each meeting. Sometimes a board retreat is needed to improve upon the interpersonal relationships and there are cooperative consultants that will assist in facilitating such events.

Finally, it is important to realize that directors are fiduciaries. This means that you must act in the best interests of the cooperative as a whole. Directors should avoid conflicts and the appearance of impropriety. You must strive to be beyond reproach as you make decisions. Your personal interests must be subordinate to the good of the cooperative community.

## Chapter Eight: Dealing With Problems

This chapter addresses many of the problems that confront most cooperatives. Nearly every cooperative has three basic problems: pets, parking and people disturbing other members. As discussed above, an unique aspect of cooperative housing is the authority of the board to promulgate rules which, taken together with the occupancy agreement, serve as an effective means to deal with problems within the cooperative community.

Thus, the board can regulate matters such as parking, pets, improvements to the interior premises, patios and screening fences, and a host of other concerns. The board may give out assigned

parking, and may limit the number of vehicles any member may park within the cooperative. Pets may be banned, limited, or licensed.<sup>1</sup> Renovations and upgrades inside the units may be prohibited unless the member first secures a permit from the manager. Likewise, the size and location of screening fences, patios and placement of satellite antennae may also be regulated by the board.<sup>2</sup>

Once the board settles upon a rule, it needs to be made known to the members before it can be enforced. A written handbook is typically used, and distributed to each member. It is advisable to obtain proof that each member received it. A receipt bearing the signature of each member, or an affidavit of service, provides the evidence necessary to defeat the inevitable claim of an offending member's defense that he or she never saw that rule.

The rules may establish a penalty system that provides fines, and may increase for successive violations. For example, the first time a member fails to pick up his dog's feces may be fined \$25, followed by \$50 for the second, and so on. The rules also may provide for an appeal process whereby the board or designated hearing officer acts as judge or jury in case the fine is contested.

Careful drafting of cooperative rules is essential. It is these rules which will be scrutinized by courts that are asked to issue a judgment that allows the cooperative to take back the unit and terminate the membership. As such, it is really a legal document. Defense attorneys will attack the language in it, and judges will be called upon to interpret. The cooperative attorney needs to be involved in the process of drafting these rules to ensure that they will past muster.

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<sup>1</sup> Subject to the American with Disabilities Act.

<sup>2</sup> Satellite antennae are subject to control by the Federal Communications Commission, so cooperative rules must be consistent with FCC rules.

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When drafting and enforcing the rules, it is important that discrimination be avoided. A cooperative cannot single out protected groups of members as subjects of its rules and enforcement powers. Protection is given by state and federal law to prevent discrimination on the basis of race, gender, marital status, national origin, and age.

It is also essential that the rules not limit themselves to fines as penalties. There should be an express provision that allows the board to decide to take more drastic action. Rules need to refer to the cooperative's right to invoke the Michigan Summary Proceedings Act.

This Act is a state law that is used to evict a member. If a member fails to pay carrying charges or other financial charges, such as fines, the cooperative may issue a notice to quit that allows the member seven days to pay, or a complaint may be filed in the local district court. A summary hearing is scheduled, usually within two weeks. At that time, the cooperative asks for a judgment that grants the member another ten days to pay a sum that now includes court costs and attorney fees, or suffer eviction.<sup>3</sup> After the tenth day, the cooperative may ask the court to issue a writ of restitution that directs a court officer to enter the premises of the member, change the locks and throw the member's personal property out to the curb.<sup>4</sup>

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<sup>3</sup> A member has the right to ask for a jury trial and to contest the allegations. Most judges are good at seeing through efforts to unnecessarily delay the process and will attempt to get the member to admit to the allegations, so the case will proceed quickly through the court. Unfortunately, some judges will accommodate the member and set the matter for a trial on a date sometime later.

<sup>4</sup> If the member pays the amount of the judgment, the cooperative's efforts to evict are foiled. Many members take advantage of this, and some even play the game each month. To combat this, it is advisable to add a rule that provides that a member who is habitually late may be evicted. A common definition of habitual delinquency is being late more than three times within a twelve month period, or three consecutive months.

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Where the member violates the cooperative's rules, the court process follows the same track, but a thirty day period is built in to the notice to quit, rather than seven days. There is also a drastically shorter process available to the cooperative if there is an urgent situation, such as a fire hazard or serious criminal activity that endangers the lives of other members. This can take the form of a seven day notice to quit, or an emergency petition to the judge to accelerate it even faster.

## Chapter Nine: Frequently Asked Questions

### *Election Procedures*

One of the toughest challenges of a cooperative board is getting members to turn out for the annual meeting. A cause of this problem is apathy and a lack of understanding by members that they are stakeholders and have the power to control their own destiny by exercising their right to vote and participate. Cooperatives that have a solid orientation program for new members which teach the fundamentals of cooperative living and explain that members are more than mere tenants have less of a problem with this. Others resort to “give-aways” for those who do attend as an incentive, such as drawings for free carrying charges, televisions, and the like also overcome this challenge.

Most boards are tempted to try different approaches to elections. Some seek to use absentee ballots and others want to have day-long voting places. Unless the bylaws permit this, the cooperative is on shaky ground. That is why we suggest that boards think about amending bylaws when the opportunity exists to allow for such flexible alternatives. Another approach is to simply lower the quorum requirement, but we regard this as less desirable because it defeats the purpose of being a cooperative in the first place, and places the power to control the cooperative in the hands of a few members.

A further word is merited here to clarify the difference between absentee ballots and proxies. Most bylaws do allow proxies. This

is a grant to authority, made by the member who is not attending, to a member who will be there. It is like a power of attorney - it authorizes the person who carries the proxy to vote on any issue that may come before the membership in any way that he or she sees fit. In contrast, the absentee ballot is a form that lists the questions, such as who should be elected to the board, and is marked by the voting member and turned in to the office before the meeting. Unfortunately, this is not usually allowed by the typical bylaws - unless amended to authorize it.

### *Freedom of Information Act*

Occasionally there is a question of whether a cooperative must furnish information requested by a member, under the assumption that the Freedom of Information Act applies. This is a state law that allows anyone to ask for records from a “public body.” As noted below, a cooperative does not fall within the definition of “public body.” Accordingly, this law does not apply to cooperatives.

The bylaws do, though, allow certain information to be made available to members. The specific language of the bylaws need to be consulted since the type and amount of information turns on the precise language of the specific cooperative’s bylaws. Typically, the financial audit is required to be produced, and sometimes more information is mandated by the bylaws.

### *Open Meetings Act*

Many people assume that cooperatives are bound to follow the Open Meetings Act, and that boards must be open to membership attendance and participation. Because city councils must hold open meetings and can convene into closed sessions for limited purposes, it is believed that cooperative boards must do the same. However, unless the bylaws or articles of incorporation provide to the contrary, this belief is misplaced.

The Open Meetings Act is a state law that applies to “public bodies” which means governmental units such as cities and school boards. A cooperative does not fall within this definition and is, therefore, not required to hold open meetings. Some cooperative boards, even knowing that they are not legally bound to do so, will hold regularly scheduled open meetings so members can attend and speak. This is done for political reasons and designed to promote a sense that the boards have nothing to hide from their membership.

### *Decision Making Authority*

A common question is whether the members can make decisions for the board as a kind of referendum, or direct that the board undertake a certain task. The bylaws provide the power of the board and must be read closely. However, the usual bylaw provision is broadly written in favor of granting authority to the board. The members cannot usurp the discretion of the board by adopting mandates. The board reserves the right and duty to make decisions on how the cooperative is to be run, with limited exceptions found in the State law. The rationale for this power residing in the board is that the directors have special fiduciary duties to act on behalf of the corporation as a whole, without regard to special interests.

Currently, the issue of refinancing is common. Here, a typical bylaw provision makes this decision the exclusive function of the board. While good and frequent communication with the membership is to be encouraged, and even straw votes may be useful as a political matter, the fact remains that the board is the ultimate decision-maker on whether to refinance the mortgage.

Of course, the membership retains the right to remove or elect directors. But this control is indirect. Direct interference by the membership into the board’s jurisdiction must be resisted as unlawful.

## Chapter Ten: Resources

Because cooperatives are relatively uncommon in Michigan, boards need to know where to turn for help. Not every management company or lawyer knows how to properly assist. For that reason, this chapter provides you with resources to use when you encounter a problem that requires expertise of those who understand cooperatives.

As noted earlier, there are associations that are dedicated to helping. NAHC and MAHC are helpful organizations that provide education and information. It is important to belong to them, and attend their conferences. One of the benefits of doing so is the opportunity to network with other boards and to be able to call upon those you meet there to give their experience.

Pentiuk, Couvreur & Kobiljak, P.C. is a law firm in Michigan that has years of experience in helping cooperatives. We have established a special website where we make available, at no charge, informative articles that may be useful to you at [www.MichCoopLaw.com](http://www.MichCoopLaw.com). In addition, the firm publishes the “Michigan Cooperative Law Journal” on a quarterly basis and is mailed to anyone who wants it, free of charge. We also have an electronic coop law letter which is sent monthly to those who sign up for it through e-mail to us at [firm@pck-law.com](mailto:firm@pck-law.com).

Always seek advice for your specific problem, though. Each cooperative has its own set of governing documents and they may differ materially in respect to the matter that is affecting your cooperative.

### 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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