



## Nonprofit Bylaws - Words Matter!

### Words Matter!

#### Be Careful When Writing Bylaws and Policies

By Robert C. Andringa, Ph.D. and Robert Erven Brown, Esq.

### We live in a litigious society!

The civil justice system in America contains two radically different subsystems:

- One is a *stable* institution providing modest compensation for plaintiffs who claim slight or moderate injuries in automobile and other accidents. This type of case has been the major source of litigation for 50 years.
- The second is an *unstable* system which spawns continually increasing awards for claims for all injuries, serious or not, in product liability, malpractice, street hazards and workplace accidents. Most troubling, this unstable system is now being used for “social” injuries, arising from the cultural clash of sexual freedom with religious traditions.

The United States is the most litigious country in the world. 80% of the world’s lawyers live in the United States. Nonprofit organizations, especially those that are faith-based, are more subject to lawsuits than ever before.

### How This Silent Threat Impacts Ministries<sup>1</sup>

The threat to ministries does not rest in the everyday “run of the mill” operation of our legal system. A 2010 paper published by the Harvard Center for Law, Economics and Business, highlighted the “peculiarly dysfunctional way judges handle disputes in discrete legal areas such as class actions and punitive damages.”<sup>2</sup>

Coffee spills, Pokémon class actions, tobacco settlements, sexual abuse lawsuits, and more. Settlements, both official and unofficial of these abuse claims, are estimated to exceed \$4

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<sup>1</sup> Free Download of Legal Realities: Silent Threats to Ministries at [silentthreats.com](http://silentthreats.com)

<sup>2</sup> J. Mark Ramseyer & Eric B. Rasmusen at the Harvard Center for Law, Economics and Business published a paper entitled “Comparative Litigation Rates” in November 2010. This paper can be downloaded without charge from: The Harvard John M. Olin Discussion Paper Series: [Http://www.law.harvard.edu/programs/olin\\_center/](http://www.law.harvard.edu/programs/olin_center/)

billion. The real damage done by these lawsuits is to remove the reluctance of the general population against suing religious organizations.

Combine the litigious trend in America with an “open season” on religious organizations, and the stage is set for “*social injury*” claims arising from discrimination against “protected classes.”

Examples of these cases are well known and include the florist, the cake baker, the photographer, the T-shirt maker, and the owners of a wedding chapel, who refused to provide services as part of a gay wedding.

### **Take Away**

Church and ministry leaders no longer enjoy the historic protection once phrased as “charitable immunity.” Although small vestiges of this doctrine remain in Massachusetts, Colorado, and, perhaps, one or two other states, the vast majority of jurisdictions no longer protect ministries either by statute, by case law, or by common reluctance to sue charities.

### **Cherish and Protect Your Corporate Shield**

Knowing that ministries can be sued and, in fact often will be sued, it is important to focus on the proactive steps that must be taken *before a claim arises*.

As ministry leaders, your overriding concern must be to preserve the “Corporate Shield” which your legal status as a corporation provides members, directors and officers by shielding their personal assets against a claim arising from corporate activities. The first line of defense depends on having, and following, well-drafted articles of incorporation, corporate bylaws, policies, and practices.

*When a judge reviews a request to pierce the corporate veil, the judge will look first to your “organizational documents”, i.e., articles of incorporation, bylaws and board policies, to determine if the Corporation is operating in accordance with them.*

### **Culture War Claims**

Good organizational documents provide bedrock support for a judicial finding that a valid corporate shield exists to protect members’ and directors’ personal assets. These also are critical if the ministry’s characterization as a “religious organization” is challenged by a member of a protected class seeking damages based on a claim of sexual orientation discrimination, for example.

The importance of good organizational documents was clearly highlighted in the *Spencer v. World Vision, Inc.* case involving an employee terminated for failing to abide by the organization's statement of faith. The World Vision decision focused on its documented policies and its proof of consistent operation as a "religious corporation, association, or society" by showing that it:

- is organized for a religious purpose,
- is engaged primarily in carrying out that religious purpose,
- holds itself out to the public as an entity for carrying out that religious purpose,
- and does not engage primarily or substantially in the exchange of goods or services for money beyond nominal amounts.

If you intend to defend yourself in court as a religious organization today, then your organizational documents must be reviewed and revised with the help of competent legal and tax counsel to enhance your chances of success.

### **Keys to Word Choice in Organizational Documents**

Here are some specific, practical word choices to bolster the defense of your ministry:

#### **1. Avoid the word "shall" most of the time.**

Work through the document to eliminate this word whenever possible. It is a "red flag" for plaintiffs seeking evidence that your leadership does not follow bylaws and policies.

When possible, choose less absolute phrases like:

- the board "may consider ..."
- the CEO "will ordinarily, ..."
- he "may choose to do ..."
- she "usually ..."

Using the word "shall" alone leaves no discretion in the hands of your board to deal with changing circumstances. If your bylaws provide, for example, that "the annual meeting shall be held on the second Tuesday of January at 1 PM," what happens if the board forgets, omits, or simply decides to have it on a different time and day? If the bylaws fail to grant discretion in setting the meeting, or if the board fails to amend the bylaws, then, arguably, the action was taken in contravention of this plain language.

Without getting too technical, there is some case law that says actions taken in contravention of bylaws are "voidable" at best and, at worst, "void." If a reviewing court finds the action is "void," then it means the action never happened! This could result in a hapless officer signing documents in reliance on resolutions that the officer thought were adopted in the meeting but

which a Court may rule never happened. That could lead to a finding that the officer acted in his *personal* capacity since he was not authorized to act on behalf of the Corporation!

## **2. Maximize Board Discretion**

Reality has a way of intervening in the best-laid plans. Assumptions made by bylaw drafting committees in earlier decades about societal values and behavioral norms have changed radically. Unfortunately, we routinely encounter bylaws written in the 1960's or 1970's that have not been substantively amended since they were drafted.

Consider allowing maximum discretion for the board to deal with problems based on the then current conditions, rather than assuming that the bylaw drafting committee of today can possibly anticipate the precise nature of problems that will face boards of tomorrow.

Since amending bylaws typically requires a super majority vote, and often-lengthy advance notice, keep bylaws brief and limited to policies that are not expected to change. Address more changeable topics in a board policies manual.

## **3. Avoid Fixed Borrowing Limitation Amounts**

The officer who signs for a loan on behalf of the ministry is exposed to personal liability if he is not authorized, in writing, to act as "an authorized agent" of the corporation. If she or he was not acting as an "authorized agent", i.e., because the Board's approval process did not follow its organizational documents, then this officer acted in a *personal* capacity. This type of action needlessly exposes the corporate officer to *personal* liability for what was supposed to have been a corporate debt. Examples of dangerous wording in the bylaws that cause unauthorized action include:

- A well-meaning bylaw committee set a borrowing limitation of \$50,000 back in the 1990's. Twenty years later the Board violated the policy by approving a higher loan amount.
- Bylaws requiring, say, a 75% majority to approve a loan exceeding X amount, can be disastrous if the board forgets about this requirement and approves a loan by a simple majority.

Here is an important warning for a corporate officer who is being asked to sign documents on behalf of the ministry. Prior to signing documents, it is a "best practice" for the officer to assume personal responsibility to verify that the proposed action is documented by a written resolution that complies with the organizational documents in that it:

- Occurs at a meeting following proper notice of the meeting to the directors or members,
- Occurs a meeting where the required quorum is established,

- Is approved in writing by the required majority of the directors,
- Specifically authorizes the named officer to act, and,
- Specifically describes the action to be taken.

### **Keys to Writing Bylaws**

- Restrict bylaws to the essentials.
- Have experienced legal counsel/CPA review bylaw drafts.
- If your ministry cannot afford legal counsel/CPA, carefully consider whether you should expose your personal assets to the risk of loss for a corporate debt.
- If the ministry you serve cannot afford to defend you if the actions are challenged, then consider declining to serve on that board.
- Include a mandatory indemnification provision in bylaws for officers and directors.
- Obtain proof that directors and officers liability insurance is in effect.
- Ensure that the bylaws and meeting minutes reflect what the board actually does in practice.
- Either comply with, or amend, your bylaws. Do not ignore them.

### **Keys to Writing a Board Policies Manual**

- Organize board policies in a one up-to-date manual.
- Confirm that they are consistent with the articles and bylaws.
- Don't rely on minutes from past years that often result in re-creating a policy, conflicting policies, forgotten policies, unclear policies that do not guide future behavior, etc.
- Start writing with a good template. (See [www.TheAndringaGroup.com](http://www.TheAndringaGroup.com) for the Andringa BPM template.)
- Ask the CEO to prepare the first draft for board consideration; then adopt major sections when they are ready for board action.
- Include language in your BPM that these policies supersede any conflicting previous policies.
- Use the BPM as a living document. Invite the CEO to suggest changes prior to every board meeting. After discussion, amend agreed upon sections so that the policies remain timely and effective.
- Calendar a thorough policies review around Halloween each year. (It helps ward off litigation ghosts!)

*“Look, I am sending you out as sheep among wolves. So be as shrewd as snakes and harmless as doves.” Matt 10:16*

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Dr. Bob Andringa has consulted with or trained more than 500 nonprofit CEOs and their boards, most of them faith-based, since 1985. He is a co-author of *Nonprofit Board Answer Book* and

*Good Governance for Nonprofits*. Bob and his wife, Sue, live in Scottsdale, AZ. Connect with Bob at [bobandringa@mac.com](mailto:bobandringa@mac.com).

Robert Erven Brown, Esq. founded the Church and Ministry Law Group at Gallagher & Kennedy, PA which provides legal services to hundreds of church, para-church and other nonprofit organizations around the United States. Bob and his wife Kathy live in Phoenix, AZ.

Along with many other free resources for nonprofits, Bob's book, *Legal Realities: The Silent Threat to Ministries* is available at <http://churchandministrylaw.gknet.com/free-resources/>. Reach Bob on his direct line at 602-740-1032 or at [Bob.Brown@GKnet.com](mailto:Bob.Brown@GKnet.com).