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Legal Alert: Is a Membership Structure Right for Your Organization? UPDATED

Newly-forming nonprofit organizations incorporating in New York are faced with the choice of whether to have a membership governance structure, or a non-membership structure with only a Board of Directors. Similarly, an existing organization may revisit this choice as the needs and characteristics of the organization change, and may wonder how it can change from a membership to non-membership organization, or vice versa.

What is a Membership Structure?

It may be helpful to think of members as having a role similar to shareholders in a for-profit corporation. Like shareholders, members have the power to shape the nonprofit organization because they elect the organization's Board of Directors. Members also must vote on some fundamental corporate changes, such as amending the Certificate of Incorporation, transferring all or substantially all of the corporation's assets, or dissolving the corporation.

For organizations that prioritize a democratic, grassroots model, membership may be an appealing option. However, it is important to consider whether the membership structure will become overly burdensome. An organization with members must be sure to have *at least* one membership meeting annually, at which members will vote to elect the Board of Directors. Additional or special meetings of members may also be called as needed. An organization with members must also be careful to keep careful track of its membership lists, as members must receive proper notice of meetings. Often, organizations find that it can be difficult to keep track of members, making achieving certain corporate actions a challenge, if membership lists are not accurately maintained and quorum requirements cannot be met for member votes.

What is a "nominal" member?

There is often confusion surrounding the term "member" in the nonprofit sector. The legal definition as proscribed by the nonprofit corporation law can be distinct from other less binding forms of membership. A classic example is a nonprofit art museum that has "members" in the sense that a supporter of the museum may pay annual dues to the museum and, in return, receive a monthly newsletter and free admission. However, this individual does *not* vote to elect the museum's Board of Directors. This is what we could consider a *nominal member* of the organization, rather than a legal member.

Frequently, an organization's goals can be achieved without having a legal membership structure. Organizations can create incentives to increase the involvement of a grassroots community network by involving them as nominal members who support the organization through dues and may have special, nominal privileges, but who do not vote to elect the Board of Directors or to initiate other corporate changes and key decisions.

Special Concerns with Membership Structures:

If a nonprofit organization does choose to have legal members, then:

- ❖ Any fees for membership must be clearly stated in the bylaws.
- ❖ There must be an annual meeting of members, designed to provide the members with an opportunity to conduct key corporate business and elect directors, as specified in the bylaws.
- ❖ Members have derivative rights to sue on behalf of the corporation in order to protect against wrongs to it (if they can muster more than 5 percent of their fellow members to support the suit).
- ❖ Not all legal members must be allowed to vote on key corporate actions. An organization may choose to create different classes of members, giving each class different powers with respect to the corporation. Nonetheless, at least one class of members *must* have full voting rights.
- ❖ Effective July 1, 2019, the nonprofit organization must have a minimum of three (3) members. However, this requirement does not apply to nonprofits with certain types of “corporate” membership structures. A nonprofit organization whose sole member is a corporation, joint stock association, unincorporated association or partnership can continue to have a sole membership structure as long as the sole member (i.e. the corporation, joint stock association, unincorporated association or partnership) is owned or controlled by a minimum of three (3) persons.¹

Frequently Asked Questions:

My organization has a legal membership structure. What is the minimum number of members we are required to have?

Effective July 1, 2019, all nonprofits with a legal membership structure must have a minimum of three (3) members. However, a nonprofit organization whose sole member is a corporation, joint-stock association, unincorporated association or partnership can retain its sole member structure as long as such sole member is owned or controlled by a minimum of three (3) persons. “Control” could be shown through the Board of Directors, whose duties as fiduciaries generally include having oversight over the nonprofit organization’s mission, assets, programs, and management. Thus, a nonprofit organization whose sole member is another nonprofit organization that is in compliance with the New York statutory requirement to have at least three (3) board members should be able to retain its sole membership structure.

Is it possible that our organization could inadvertently create a legal membership structure if we start charging dues to those who are involved with our organization?

¹ Assembly Bill 10336 amending the Not-for-Profit Corporation Law §601, signed by Governor Cuomo on December 21, 2018.

No, an organization will not create a membership legal structure simply as a result of charging dues. The only way a non-member organization can transition to a membership legal structure is if it amends its bylaws or its Certificate of Incorporation to specifically provide that the organization shall have members.

My organization has a legal membership structure but would like to change our corporate structure so that we no longer have a membership structure. How can we do this?

This depends on whether the membership structure was specified in the Certificate of Incorporation or only in the bylaws. See the next questions.

If a corporation's Certificate of Incorporation does not require members, then is amendment of bylaws to specify that there will be no members going forward sufficient to convert the corporation to a non-membership corporation?

Yes, an amendment of the bylaws is sufficient to undo a membership structure if membership is only provided for in the organization's bylaws, and not its Certificate of Incorporation. Note, however, that the members will have to vote to amend the bylaws to make this change.

What if the organization's Certificate of Incorporation provides that the organization shall have members?

If the Certificate of Incorporation provides that the organization shall have members, an amendment to the Certificate will be necessary in order to do away with the membership structure. To do this, the organization's membership will have to vote to approve such amendment.

Note that, prior to the Nonprofit Revitalization Act in 2013, Type C organizations were charitable and required to have members. However, organizations that were formerly Type C now have the option to convert to non-member organizations by amending the Certificate of Incorporation.

What should I do if my organization's bylaws or Certificate of Incorporation state that the organization is a membership corporation, but we have not operated as a membership corporation?

You should consult with an attorney about how best to proceed. In order to resolve this issue, you may need to track down the last known members of the corporation. It is often the case in these situations that the Board members of the corporation were also at some point designated as the members of the corporation, but the resolution for your organization will depend on the facts involved.

This alert is meant to provide general information only, not legal advice. Please contact Bee-Seon Keum at Lawyers Alliance for New York at (212) 219-1800 ext. 240 or bkeum@lawyersalliance.org, or visit our website www.lawyersalliance.org for further information.

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