

#77.20

1/28/76

Second Supplement to Memorandum 76-7

Subject: Study 77.20 - Nonprofit Corporations (Organization)

Attached hereto is a memorandum from Mr. Robert Sullivan commenting on several aspects of the staff draft of the nonprofit corporation law. Items 1-3 relate to Memorandum 76-7; items 4-5 relate to Memorandum 76-9. We plan to consider the comments at the time we take up the particular sections to which they relate.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

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Memorandum 76-7

MEMORANDUM

EXHIBIT I

FOR FILE

ROBERT E. SULLIVAN
(D. Callahan)

January 26, 1976

California Law Revision
Commission - Draft of
Proposed New General
Nonprofit Corporation Law

I have reviewed the material received from the staff of the California Law Revision Commission concerning the proposed new General Nonprofit Corporation Law ("Nonprofit Law"), through and including material dated December 19, 1975 (Memorandum No. 76-9). In general the material was difficult to review, because the draft sections of the new Nonprofit Law have been prepared and circulated almost section by section. This procedure, although I am sure necessary under the circumstances, makes it difficult to evaluate the interaction of the Nonprofit Law as a whole. I hope that the Commission will be willing to accept comments on the Nonprofit Law de novo when a complete draft is available. I also recommend that as soon as the draft is completed all of the Nonprofit Law should be circulated in one document complete with appropriate commentary. However, I believe that so far the draft is a vast improvement over the draft that I reviewed in my memoranda of June 18 and June 19, 1974. The following constitute my specific comments on the draft and accompanying memoranda:

1. Execution of Articles - Memorandum No. 76-7: I think the acknowledgement requirement, although an improvement over requiring a notary to sign, is redundant. See § 103(b)(2) of the Delaware Corporation Law, where the one signature of the person signing the instrument by law constitutes the acknowledgement. The procedure described is however that specified in the General Corporation Law, Section 149.

2. Section 5221 and Commentary in Memorandum No. 76-7: I am not entirely sure that the concept of an incorporator has no meaning, particularly if a minimum of three directors will be required. It is at least arguable that the incorporator's responsibility for the operation of a corporation is something less than that of a director. This makes being an incorporator more attractive to attorneys than executing articles as first directors. The Nonprofit Law should be written to provide that a corporation can be formed by one or more incorporators, thus simplifying the mechanical process of obtaining signatures and yet still enable the Nonprofit Law to require at least three first directors. The draft thus requires three persons to execute

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articles of incorporation rather than just one. See Section 103(a)(1) of the Delaware Corporation Law. More importantly the proposal is inconsistent with the procedure adopted in the new California General Corporation Law. See Section 200. The Nonprofit Law should be consistent with the General Corporation Law in such matters.

3. Section 5122: I believe the definition of articles should include all documents that should be included in the preparation of a certified copy of the articles of incorporation. This properly would include agreements of merger and other charter documents. I do not understand the reference to "certificates of determination" - a term which I believe is applicable only to stock corporations.

4. Section 5261: It is stated that the Commission has suggested adding a provision precluding the board of directors from adopting, amending or repealing bylaw provisions which affect members' voting rights. We believe strongly that this should not be done. For example, several years ago a church that was incorporated under the Nonprofit Corporation Law could not verify who its members were. The bylaws provided that "a majority" of the members constituted a quorum. We recommended that the church amend its bylaws to make 50 members a quorum, and restate who were the current members. If the Commission's suggestion is adopted, there may be frequent situations where nonprofit corporations are paralyzed by their inability to ascertain or locate their members and also be unable to similarly modify voting requirements.

It should be remembered that while not desirable, or to be recommended, some nonprofit corporations are rather sloppy in keeping records and track of members. Building in restrictions of the type suggested, although having an aura of fairness, will more frequently result in such nonprofit corporations finding themselves in a legal "box," from which there is no escape.

5. Section 5400: I do not see any significant policy objective in making artificial persons ineligible for membership in nonprofit corporations unless articles or bylaws provided otherwise. It seems to me the law should be reversed. Again this is just building a trap for the unwary.


Robert E. Sullivan