

Memorandum 76-67

Subject: Study 77.40 - Nonprofit Corporations (Members)

Organization

The staff draft of Chapter 4, attached to Memorandum 76-9, consisted of 11 sections which largely continued the provisions of existing Sections 9602 through 9611. These have been revised in accordance with Commission decisions at its February 1976 meeting and placed in Articles 1 (General provisions) and 4 (Transfer and termination) of the revised draft of Chapter 4. Also in Articles 1 and 4 are provisions adapted from Chapter 4 (Shares and share certificates) of the new General Corporation Law.

Article 2 contains a scheme of liability (for subscribers and purchasers of memberships, transferees and fiduciaries) for the payment of the purchase price of memberships. Article 3 contains all provisions relating to setting a record date for determining membership for voting and other purposes. The sections in both of these articles are similar to provisions of the new General Corporation Law and to existing statutes.

Discussion of Individual Sections

Article 1 - General Provisions

Sections 5410 (Members), 5411 (Membership classes), 5412 (Directors as members), 5413 (Reduction of members below stated number), 5414 (Membership certificates), and 5419 (Liability of members) have previously received tentative approval from the Commission.

§ 5415. Surrender and exchange for new certificate

This section continues existing law which gives a corporation the **right to** substitute a new certificate for outstanding stock certificates, typically when

a stock split or change in the rights or preferences of the shares has occurred. Section 2407. It is unclear whether this section presently applies to nonprofit corporation through Section 9002, both because there is a specific Division 2 provision relating to membership certificates (Section 9607) and because the chapter in which Section 2407 is located begins with a section implying that its coverage is limited to stock corporations (Section 2400). The staff is uncertain how often the circumstances covered by Section 5415 will occur in the operation of nonprofit corporations.

§ 5416. Options

This section is the same in substance as Section 404 of the new General Corporation Law, which continues portions of existing Sections 1103 and 1104. Section 5415 contains a presumption that option rights are non-transferable, similar to that for memberships found in Section 5420. The staff is uncertain whether or how often nonprofit corporations make use of options.

§ 5417. Consideration

Section 5416 specifies acceptable consideration for the purchase of memberships comparable to the requirements of Section 409. Both Sections 409 and 5416 differ from existing law (Section 1109) in disallowing a shareholder's or member's promissory note as consideration, unless adequately secured by collateral other than the share or membership being purchased.

§ 5418. Partly paid memberships

This section specifically authorizes the issuance of memberships before full payment has been made and provides that a record of the partly paid nature of the membership will be kept (and set forth on the membership certificate, if any). It is taken from Sections 409(d) and 410(b) of the new business corporation law. Section 5418 forms the basis for the liability rules (for the unpaid portion of the membership price) of Article 2.

Article 2. Liabilities in connection with issue of memberships

Sections 5420 through 5427 are comparable to Sections 410 through 415, adapted to nonprofit corporation terminology, and existing Sections 1300 through 1304, 1306, and 1310. The effect of this article is to make every person who subscribes to purchase a membership or buys a membership on a partly paid basis liable to the nonprofit corporation for the balance of the purchase price, to make similarly liable most transferees of partly paid memberships who take them with knowledge of their unpaid status, to exempt from such liability any transferee taking without such knowledge, to impose liability for the unpaid price on the funds or estate held by a person holding the membership in a fiduciary or representative capacity while exempting such person from personal liability, and to allow a creditor of the corporation to enforce such liability for unpaid memberships only after securing judgment against the corporation.

Article 3. Record date for determining members

The Commission reviewed the record date provisions in March 1976 in connection with Chapter 7 (Voting of memberships). Since the record date governs membership rights other than voting, the Commission requested relocation of these provisions. The staff recommends placement in Chapter 4.

The record date provisions have been split into five sections and constitute a separate article. They generally follow the comparable provisions of the new business corporation law.

Article 4. Transfer and termination

Sections 5440 (Transfer of membership) and 5443 (Withdrawal of members) have previously received tentative approval.

§ 5441. Termination of membership

Existing Section 9608 provides that nonprofit corporations may terminate memberships as provided in their articles and that, unless the bylaws otherwise provide, all rights cease upon death. In reviewing a draft section continuing

these provisions, the Commission directed the staff to redraft the section to provide for the following:

(1) A presumption against termination of membership, or property rights associated with membership, on death.

(2) A requirement for due process in the expulsion of any member.

Sections 5441 and 5442 contain these provisions.

Section 5441 continues the general authority of the nonprofit corporation bylaws to provide for membership termination and the presumption (in the absence of contrary bylaws) of membership termination on death. The general termination authority is limited by subdivision (c), which requires that notice and opportunity to be heard be accorded any member who is to be expelled. The Comment notes that the type and extent of notice and hearing required will vary according to the organization and the significance of the member's interest at stake. Subdivision (c) specifically excepts termination for failure to pay dues or assessments (Section 5500) from its scope. This is in accord with the determination in the DeMille case that a hearing is not required for suspension of membership on such grounds and is parallel to the Pennsylvania statutes which require notice, trial and conviction for expulsion except where the ground is nonpayment of dues or assessment (where notice alone is required). DeMille v. American Fed. of Radio Artists, 32 Cal.2d 139 (1947); Pa. Stat. Ann. tit. 15, §§ 7545(c), 7767(b) (1972).

§ 5442. Termination of rights

The staff has been unable to discover any state statutes preserving any membership rights after the death of a member. Subdivision (a) of Section 5442 continues the existing presumption that all membership rights cease upon termination of membership, but subdivision (b) provides for continuation of the member's property interests in the corporation or its property in the event of his death, unless the bylaws provide otherwise. The Comment

describes the type of rights which continue and explains that the membership itself and associated benefits do not continue.

The staff believes that such a presumption against termination of certain property interests by death is preferable to a general rule against termination of the membership. This section will protect what are normally thought of as the vested rights of a member (dissolution distribution, required repurchase of the membership by the corporation, an interest in any specific property owned by the corporation, etc.) without imposing unnecessary membership requirements on nonprofit corporations (such as forcing acceptance of widows, heirs or others as members). For charitable and other corporations in which membership carries no proprietary rights, this section will not change existing law. Corporations whose memberships are chiefly valuable for the access to benefits they provide will have to establish rules for descent of memberships in their bylaws, if that is desired, also as under existing law.

It is not appropriate to require the corporation to buy the membership of a deceased member in order to protect his ownership interests. No distribution of assets to members normally takes place until dissolution, unless repurchase of the memberships is specifically provided in the bylaws. There is no reason that heirs of deceased members should be able to accelerate the "dissolution" process; what they have inherited is simply the right to certain future property distributions. As long as no immediate distribution is to be required, the imposition of a claims period upon heirs is also unnecessary. If the corporation wishes to provide for the immediate repurchase of memberships upon death, the bylaws may also provide an appropriate procedure.

§ 5444. Liability for transfer

Section 5444 is comparable to Section 420 of the new business corporation law, which is in turn derived from Sections 2413, 2414, and 2415 of existing General

Corporation Law. See discussion of Section 5415 regarding application of this chapter of General Corporation Law to nonprofit corporations. It is unclear whether this provision will often be utilized by nonprofit corporations.

Respectfully submitted,

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