405/756

77.400 10/1/76

Memorandum 76-83

Subject: Study 77.400 - Nonprofit Corporations (General Reaction to Tentative Recommendation; Basic Approach of Tentative Recommendation)

BACKGROUND

The Commission's Tentative Recommendation Relating to Nonprofit Corporation Law was distributed for comment in late July 1976. It was sent to almost 300 persons who had expressed an interest in reviewing the tentative recommendation, comprised mainly of attorneys and representatives of nonprofit corporations, but also including state agencies involved with nonprofit corporations, judges, law professors, and other persons dealing with nonprofit corporations.

Attached to this memorandum are 61 exhibits containing comments on the tentative recommendation. We anticipate receiving additional comments within the next few days and over the next few months. We have made clear to interested persons that their late comments will be considered whenever received but that it is better if they be received before the Commission's recommendation is sent to the printer. It is more difficult to make changes after the bill is introduced because a legislative committee report must be adopted to revise the Comments.

We draw your attention to Exhibit XXX, and note that the State Bar Committee on Corporations apparently plans to submit no comments at this time. However, the Special Subcommittee on Nonprofit Corporations of the State Bar Committee on Taxation has submitted its general comments (Exhibit XXV) and individual detailed comments of members of this subcommittee have been (Exhibits XXXXVII, XXXXVIII) or will be submitted in the near future.

We plan in this memorandum to present the staff analysis of the overall reaction to the tentative recommendation and an analysis of the comments on the basic approach of the tentative draft.

Separate memoranda will be prepared on other aspects:

Memorandum 76-90 -- Division 2 (Nonprofit Corporation Law)

Memorandum 76-91 -- Division 4 (Provisions Applicable to Corporations Generally)

Memorandum 76-92 -- Conforming Changes

Memorandum 76-93 -- Cooperatives and Other Special Corporations

OVERALL REACTION TO TENTATIVE RECOMMENDATION

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The comments on the tentative recommendation were in general highly favorable. The persons who reviewed the proposals characterized them in such terms as "excellent," "well done," "thorough," and "commendable." Professor Oleck (Exhibit III) stated that it is "probably the best statute ever proposed on this subject"; the nonprofit corporations subcommittee of the State Bar Committee on Taxation (Exhibit XXV) "completely and enthusiastically endorse[s] the approach taken." You should read the attached exhibits to get an overall feeling concerning the reaction to the tentative recommendation. It is obvious that many of the persons who submitted comments made a careful study of the tentative recommendation.

Among the more specific comments directed to the general character of the tentative recommendation were that it simplifies and clarifies the law (Exhibits V, IX, XIII, XVI, XXXIV, XXXVIII), that its use of self-executing provisions is good (Exhibit XVII), that the concept of having a single statute applicable to all nonprofit corporations is sound (Exhibits XX, XXXIV), that the method of paralleling the business corporation law is good (Exhibit XIV), and that the general drafting philosophy of the tentative recommendation is desirable (Exhibit XXIV).

One commentator (Exhibit XIII), believes the Commission should include revision of the tax laws as part of its study, and another believes that the law relating to nonprofit associations should be included (Exhibit IV). The staff believes that neither of these is practical within the scope of the present project. It would be possible to undertake review of the tax laws relating to nonprofit corporations as a related project, as well as of nonprofit associations, if the Commission so desires; of course, the tax law project could include only state and local taxation.

Another commentator (Exhibit VIII), believes that the tentative recommendation "fails to take into account the vase difference between the diverse human elements and management make-up" of business and nonprofit corporations. As a consequence, the tentative recommendation would generally provide inadequate protection to the individual member.

It is the commentator's "firm belief that your basic approach should be directed much more toward the protection of individual members." By way of contrast, Exhibit XXXVII, being a "members rights thinking person" is impressed with the emphasis the tentative recommendation places on "preservation of members' rights and control of the Board of Directors to assume adequate limitations on management."

Exhibit XXXVI raises the question whether the tentative recommendation will cause formation of nonprofit corporations for land marketing schemes. It notes that "a great number of fiduciary and legal strictures seem to be not nearly severe enough." Without more specific criticism, the staff is unable to comment on this point.

BASIC APPROACH OF TENTATIVE DRAFT

The letter of transmittal which forwarded the tentative recommendation for comment included the following request.

> Your comments are solicited now regarding all of the following:
>
> (1) The basic approach of the tentative draft--a comprehensive nonprofit corporation law (one that is complete in itself and does not require reference over to the business corporation law) and the addition of a new Division 4 to Title 1 of the Corporations Code (which will contain provisions applicable to all corporations, profit and nonprofit).

The vast majority of the persons who submitted comments approved the basic approach of the tentative draft. Two State Bar committees reviewed the draft; one "completely and enthusiastically endorses the approach taken" but the other is opposed to the concept of Division 4. Only two of the 60 persons who submitted comments objected to the concept of Division 4; one objection was made on the basis that the nonprofit corporation law should be complete in itself without having a separate Division 4.

This memorandum first sets out a summary of the comments received on the basic approach. Following this summary is a discussion of the statutory scheme proposed in the tentative recommendation and then an analysis of the contents of Division 4.

Summary of Comments on Basic Approach

State Bar Committee on Corporations

A letter from the Chairman of the State Bar Committee on Corporations (Exhibit XXX) states:

> For the reasons indicated at the meeting, our Committee is opposed to Division 4 of the Commission's tentative recommendation, and feels that the definitions and general provisions presently contained in the General Corporation Law should be retained in such law. To the extent that such provisions are appropriate for nonprofit corporations, they may be incorporated by reference or repeated with appropriate modification.

Special Subcommittee on Nonprofit Corporations

By way of contrast, a letter from the Chairman of the Special Subcommittee on Nonprofit Corporations of the State Bar Committee on Taxation (Exhibit XXV) states:

> Our reactions were as follows:
>
> 1. The approach taken--a separate and independent nonprofit corporation law--is desirable and meets with the unanimous approval of our Committee.
>
> 2. The idea of combining sections that deal with provisions equally appropriate to non-profit and profit corporations was also desirable.
>
> In short, our Committee completely and enthusiastically endorses the approach taken in this legislative draft.

Other Reactions

With the exception noted below, the basic approach taken in the tentative recommendation was either generally or specifically approved by the persons who commented on the tentative recommendation. Some writers objected to the organization of Division 2; this is not discussed in this memorandum. See Memorandum 76-90.

General approval. Some of the comments received expressed general approval of the tentative recommendation without referring specifically to the basic approach. See Exhibits II, III (Professor Oleck--"probably is the best statute ever proposed on this subject"), IV ("excellent proposal"), V ("proposal is to be commended"), IX (provisions "are clearly put and considerably easier to understand (and thus easier to comply with) than before"), XXI ("discovered no significant defects"), XXXII ("draft is entitled to high commendation"), XXXIV ("We believe your recommendations to be good and well-researched and proposed. I'm

sure that the results of your excellent efforts will simplify the law and improve its uniform application with respect to all nonprofit corporations."), LXI ("I can find no areas of the proposed new Non-profit Corporation Code with which I disagree.").

Specific approval. Many of the comments specifically approved the basic approach. See Exhibits XI ("basic approach of the Commission, i.e., a nonprofit corporation law which is complete in itself is good; it will contribute to economy of time and money"), XIII ("I think that the overall approach of the Commission and its consultant is excellent. The non-profit law has been confusing for years and the adoption of a new general corporation law has made it imperative that something be done about the non-profit law. I am delighted to see that this is being done at this time, and I hope that the Legislature will be able to move promptly on the Commission's recommendations. . . . To me, the policy of simplification is paramount. There are many small non-profit corporations in this state who either receive no legal advice at all or receive free legal advice. Many attorneys--and I am afraid that at times I have fallen into this category myself--are not as careful as they should be in the advice rendered to the non-profit corporations. Therefore, a clear, concise statute with a minimum number of cross-references is necessary."), XIV ("Nonprofit corporations are an increasingly important segment of corporate law. I thoroughly concur with the concept that the non-profit corporation law should be complete in itself. I think the basic approach of the tentative draft is excellent."), XV ("support the idea of a separate nonprofit corporation code and am appreciative of the basic thrust of the commission's work"), XVI ("Generally, the recommendations for the rewrite and consolidation of the nonprofit corporation law into the 17 chapters is well done and is a big step toward simplification and clarification of the law."), XVII ("Part I and Part II, has been reviewed by me. I am impressed by its comprehensive nature and thoroughness in scope and coverage."), XVIII ("I agree that a separate, independent statute governing California non profit corporations is desirable, although I do not necessarily agree with the statement made at page five of the recommendation to the effect that the existing law has not worked well in practice. . . . I believe that it is quite sound to establish a separate Section of the Corporations Code for provisions that are applicable both to business corporations and non profit corpo-

rations."), XIX ("This letter should not be construed as a general criticism of the draft. On the whole, the draft provisions would seem to provide an excellent substitute for the existing nonprofit corporation law. The authors of the draft should be congratulated for their fine work."), XX ("As a general matter, I think that the idea of a basic, self-contained Non-Profit Corporation Law is an important step forward in this area. . . . I hope that no matter what happens with reference to the recommendations, that the concept of a specific body of law relating to all non-profit corporations is put into effect by the California legislature."), XXIV ("The Club supports the general approach taken by the Commission in drafting a complete and self-contained non-profit corporation law. We believe this approach will facilitate the use and understanding of the statutes applicable to nonprofit corporations by both lawyers and laymen. This is particularly important in view of the fact that lawyers frequently perform legal work for small nonprofit corporations without compensation, and following formation, many small nonprofit corporations are operated by laymen without the benefit of legal counsel in day-to-day operations."), XXVI ("I have revieved your draft . . . of the proposed new California Non-Profit Corporation Law (Parts I and II). On the whole I think it is very well drafted. It is to be hoped that the legislature will adopt the new law."), XXVII ("heartily endorse the approach"), XXIX ("I have read the tentative recommendation of the Commission and express my approval. The comprehensive coverage of the new statute will give non-profit corporations and their advisors clear guidance, with a single codification, in the law governing the organization and operation of such corporations."), XXXI ("Preliminarily, we would like to express our appreciation of the Commission's general approach in the organization of the Draft, and our wholehearted support of the concept of establishing a complete and self-contained nonprofit corporation law"), XXXIII ("I am in total agreement with the specific approach of a comprehensive non-profit law complete in itself. The references in the current law to the business corporation law creates no end of problems for nonprofit corporations."), XXXV ("The recommended restructuring of the code basically to provide a separate section devoted to nonprofit corporation law appears to us to have considerable merit."), XXXVI ("I think the basic

approach in the tentative draft proposing comprehensive, complete non-profit law which alleviates the necessity of flipping through every other code book is a noteworthy and a valiant undertaking and one which has long since been overdue."), XXXVIII ("ERC approves the basic approach of the tentative draft and commends the California Law Review Commission for the fine effort."), XXXIX ("General Approach--Agree--I have been asked to incorporate the National Wool Growers Association. It has operated for 100 years as an association. It was somewhat embarrassing to respond to a member in Texas who wanted a copy of the California Non Profit Law!"), XXXXIII ("I am favorably impressed with the format, the substance and the wording employed."), XXXXIV ("The problems raised in your report with respect to the lack of continuity of the general corporate law provisions and the nonprofit provisions have caused many hours of wasted time in developing articles of incorporation. There is no question that a comprehensive nonprofit corporation law will be extremely helpful to lawyers working with this type of organization. . . . I wholeheartedly concur with the concept and recommend that the two parts, part I--New Division 2: Nonprofit Corporation Law and part II--Proposed Legislation, New Division 4: Divisions Applicable to Corporations, generally be recommended by your commission."), XXXXVI ("the Commission has successfully achieved its desire to simplify the nonprofit corporation statute and to fill in the many new, needed provisions in what was an incomplete and hopelessly obsolete law."), XXXXVII ("approach is excellent and desirable"), XXXXVIII ("Overall, I am very impressed with the quality of the Commission's work and I think that the basic approach is sound."), XXXXIX ("I am in accordance with the approach of the Law Revision Commission, and particularly its attempts to simplify the law relating to nonprofit corporations and to formulate the provisions relating to this body of law in one consecutive set of code sections. Although a number of non-profit corporations are formed where the clients can pay substantial fees for the legal work involved, particularly in the municipal financing area and in connection with the formation of special corporations in connection with real estate developments, a number of corporations must be formed by every attorney virtually as a public service. Any steps which make it easier for the lawyer to carry out this latter function of public service in a competent manner without a great expenditure of time and effort will be of benefit to the Bar, since it will encourage

a number of attorneys to engage in this activity who otherwise would not be able to perform such public service. I hope these comments may be helfpful, and congratulate the Commission on its noble effort in this area."), LI ("like the approach of having a Nonprofit Corporation Law which is complete in itself"), LII ("I can state that I approve your approach in producing a self-contained set of codes relating only to nonprofit corporations. This should be a boon to practitioners in that the location of the pertinent law and the interpretation of it will be greatly simplified."), LIV ("I strongly support what your Letter of Transmittal, July 23, 1976, refers to as 'The basic approach of the tentative draft' and the recommendation of the Commission that there be adopted" para. 1) A new and self-contained nonprofit law that is ' . . . complete in itself and does not require reference over to the business corporation law. . .', and para. 2) A new Division 4 to Title 1 of the Corporations Code that would set for provisions applicable to all types of corporations."), LV ("When the new profit corporation law goes into effect, we will have two corporation laws in effect because the old one stays in effect for the parts of it that are incorporated into the non-profit law. Obviously, the next logical step is the one you have taken - to make a new separate non-profit law. Both are very different in purpose, organizaton and operation and should be provided for entirely separately with the exception of those common mechanical matters that you have provided for in the new Division 4. With this revision, then these provisions not only can be used more easily and intelligently, but also they will be more easily amended to correct future problems for specific problems of either profit or non-profit"), LVII ("First, you solicit comments on the basic approach of the tentative draft--a comprehensive nonprofit corporation law, complete in itself, and the addition of a new Division 4 to Title 1 of the Corporations Code. I heartily endorse this approach."), LVIII ("I am very much in favor of a comprehensive nonprofit corporation law which is complete in itself. Where there are provisions of the law which are applicable to both profit and nonprofit corporations I favor a compilation of such provisions in a separate division of the Corporation Code. The reasons for this preference is not only the facility for research and analysis, but the improved quality of advice which might be rendered where one is not faced with the procedural task of referring to several volumes of several codes in order to ascertain the law relating to a particular problem of a client; the ease of research will

reduce the cost to the client and assist in providing a more accurate response to the particular situation, a better service at a lower cost with less possibility of confusion and error."), LVIX ("We think the basic approach of a comprehensive and complete nonprofit corporation law deserves support. We think the Commission's draft is excellent.").

Comments expressing concern about Division 4. Four of the writers expressed concern about Division 4. Division 4 was considered to be "quite sound" in Exhibit XVIII but the writer suggests that the division "should be expanded" to add additional provisions common to business and nonprofit corporations. Later in this memorandum, the staff suggests one additional provision for Division 4.

In Exhibit XXXVII, the writer states that a division containing provisions that cover both profit and nonprofit corporations may be a "good idea"; if the provisions "turn out to be the same, of course I can see one [division] serving for both. But, normally, matters of great departure develop over the years and we might have substantial difference in the proposed separate [division] between the two types of corporations . . . ." There is merit to this point; the Commission should include in Division 4 only those provisions that are extremely unlikely to require separate development for profit and nonprofit and other types of corporations over the years.

One writer (Exhibit XXXXI) objects to Division 4 on the basis that it is inconsistent with the objective of having a nonprofit corporation law that is complete in itself. "It would have been preferable to have the non-profit corporation law really complete not requiring any reference to any other part of the corporation law." The writer also suggests that all special statutory provisions applicable to nonprofit corporations should be included in the new nonprofit corporation law.

Mr. Holden of the office of the Secretary of State (Exhibit LIII) objects to Division 4 on the ground he expressed in his prior letter (previously considered by the Commission) "that a consideration of that subject is entirely premature and unwise."

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Scheme of Tentative Draft

The scheme of the tentative draft is to take certain provisions of general application that do not relate to the internal affairs of corporations

and to compile those provisions in Division 4 to be applicable to all corporations. Accordingly, a person interested in business corporations under Division 1 will need Division 1 and Division 4. A person interested in nonprofit corporations under Division 2 will need Division 2 and Division 4. A person interested in a corporation formed under a special law will need that special law and Division 4.

In determining which provisions should be included in Division 4, the staff took a conservative approach. We compiled in Division 4 only those provisions which are of the type that should apply to all corporations and are not likely to require modification for particular types of corporations. We were influenced, too, by the convenience to the person who was seeking to find the provision in determining whether to compile the provision in the nonprofit corporation law or in Division 4. We selected provisions for Division 4 that did not relate to the internal affairs of the corporation so that both the business corporation law and the nonprofit corporation law would be complete in themselves. We were influenced by whether uniform provisions on the particular subject matter were needed and by whether there was a danger of having inconsistent provisions dealing with the subject matter in various corporation statutes if a uniform statute were not enacted. If the subject matter was one where different statutes might reasonably be expected to develop for different types of corporations, we did not include the provision in Division 4.

The situation can best be illustrated by an example. Take, for example, Section 14452, which provides:

> 14452. A corporation shall, as a condition of its existence as a corporation, be subject to the provisions of the Code of Civil Procedure authorizing the attachment of property.

As drafted, this provision will apply to all corporations, unless the corporation is expressly excepted from the operation thereof or there is a special provision applicable to the corporation inconsistent with Section 14452, in which case the special provision applies. See Section 14450. A plaintiff who has a cause of action against a corporation and wants to attach corporate property can refer to one section--Section 14452--and need not determine which statute the particular corporation whose property is sought to be attached is incorporated under.

What is the existing situation? With respect to corporations governed by the new General Corporation Law, Section 106 provides:

> 106. Any corporation heretofore or hereafter formed under this division shall, as a condition of its existence as a corporation, be subject to the provisions of the Code of Civil Procedure authorizing the attachment of corporate property.

Section 106 does not apply to corporations which are not governed by the new General Corporation Law; such corporations continued to be covered by the repealed provision of the old General Corporation Law, specifically Section 126.1, which provides:

> 126.1. Any corporation heretofore or hereafter formed under this division shall, as a condition of its existence as a corporation, be subject to the provisions of the Code of Civil Procedure authorizing the attachment of corporate property.

If Section 14452 were taken from Division 4 and inserted into the new nonprofit corporation law, we will have a provision covering corporations formed under the new General Corporation Law, a similar provision covering corporations formed under the old General Corporation Law, a different provision covering nonprofit corporations covered by the new nonprofit corporation law, and no provision at all covering corporations formed under the cooperative corporation law or other divisions of the Corporations Code or under special statutes in other codes. If a provision covering attachment is to be duplicated in each statute providing for the formation of corporations, the comparable provision of each statute will have to be amended if the need for amendment of the provision arises. A more significant problem is that a plaintiff who seeks to attach corporate property will be faced with the task of identifying the particular statutory provision that applies to the particular corporation whose property he seeks to attach. We think this is clearly the type of situation where one general provision should apply to all corporations and the provision is best compiled in a division that applies by its terms to all corporations.

We believe that the same case can be made for the other provisions that are compiled in Division 4. In a separate portion of this memorandum, we go through each chapter of Division 4 pointing up the considerations that are relevant to whether the provisions of that chapter should be duplicated in the various statutes authorizing the formation of corporations or should be compiled in Division 4.

The State Bar Committee on Corporations discussed Division 4 and, as previously noted, disapproved the concept of Division 4. Several members of the committee advanced reasons at the meeting for this disapproval. Mr. Holden (office of Secretary of State, see Exhibit LIII attached) stated that he believes that it is premature to approve Division 4. Instead, he would wait until the nonprofit corporation law is enacted (with the provisions in Division 4 included in the nonprofit corporation law) and then determine whether some of those provisions can be combined with provisions in Division 1 to provide provisions applying to all corporations. Perhaps he would wait to make this decision until the study of cooperatives and the other corporations not formed under the new General Corporation Law has been made. The staff believes that a decision can be made now as to which of the provisions in Division 4 should apply to all corporations. In this connection, it should be noted that the provisions of the old General Corporation Law, which would be superseded by Division 4, did apply to all corporations but many improvements have been made and defects eliminated in these old General Corporation Law provisions in drafting the new General Corporation Law. Division 4 makes the new perfected provisions generally applicable.

The second reason given at the State Bar Committee meeting was that the new General Corportion Law should be a self-sufficient body of law for business corporations. This reason has considerable merit, especially insofar as the internal operation of corporations is concerned. However, when matters such as attachment of property or service of process on corporations, and the like, are concerned, the staff believes that it would be better to have a division applicable to corporations generally than it would be to duplicate the provisions in each corporation statute in order that each statute be complete in itself. In this connection, it should be noted that the persons commenting on our draft were strongly of the view that we need a nonprofit corporation law that is complete in itself but, at the same time, there was almost unanimous approval of our basic approach which is to compile certain general provisions in a new division applicable to all corporations.

Another concern expressed at the meeting of the State Bar Committee was that, if the provisions proposed to be compiled in Division 4 were compiled in that division and made applicable to all corporations, there is a danger that inappropriate amendments will be made to the general

provisions to deal with the problems of particular types of corporations--such as cooperatives. Given the nature of the provisions compiled in Division 4, the staff believes that such amendments are unlikely and, if justified in rare instances, are managable. By way of contrast, consider the problem of amendments if the provisions in Division 4 are to be duplicated in each of the statutes relating to the formation of corporations. Each time a defect is discovered in one of the sections, amendments to all comparable sections in the various corporate statutes will be required if the sections are to be kept uniform. The likelihood of unintended lack of uniformity resulting from a corrective amendment to one but not all of the sections is a significantly greater danger, we believe, than inappropriate amendments to the general provisions if they are compiled in Division 4.

In conclusion, the staff believes that a sound decision on whether to retain Division 4 can be made only if the alternatives are considered with respect to each chapter of Division 4. An analysis of each chapter is set out in a subsequent portion of this memorandum.

There is another significant benefit of collecting in Division 4 general provisions that do not relate to the internal operation of the corporation. The old General Corporation Law will continue for many years to apply to a substantial number of corporations, including cooperatives, mutual savings banks, savings and loan associations, private educational corporations, and so on. Defects in the old General Corporation Law will continue to exist with respect to these corporations. These defects will no longer continue to exist to the extent that some of the provisions of the old General Corporation Law--those which will be superseded by provisions of the new Division 4--can be made no longer applicable to corporations not under the new General Corporation Law. To accomplish this objective, the staff recommends that the Commission add to the bill to be introduced to effectuate the recommendations with respect to Division 4, the following section:

15/906

APPLICATION OF OLD GENERAL CORPORATION LAW

Cal. Stats. 1975, Ch. 682, § 16, as amended, Cal. Stats. 1976, Ch. ___, § 43.5 (amended). Continued effectiveness of repealed General Corporation Law

SEC. ___. Section 16 of Chapter 682 of the Statutes of 1975, as amended by Section 43.5 of Chapter ___ [AB 2849] of the Statutes of 1976, is amended to read:

Sec. 16. (a) Section 119 of the Corporations Code as in effect ~~immediately prior to the effective date of this act~~ on December 31, 1976 , to the extent that it makes applicable the General Corporation Law to private corporations organized under other laws, shall continue in effect notwithstanding its repeal by the provisions ~~hereof~~ of Chapter 682 of the Statutes of 1975 ; but it shall refer to the provisions of Division 1 (commencing with Section 100) of Title 1 of the Corporations Code as in effect ~~immediately prior to the effective date of this act~~ on December 31, 1976 , unless and until the provisions of any other statute permitting the incorporation of private corporations shall be amended to incorporate by reference in such other statute specific sections or portions of Division 1 (commencing with Section 100) of Title 1 of the Corporations Code as ~~amended hereby~~ enacted by Chapter 682 of the Statutes of 1975 . All references in any such other statute to any sections or portions of the General Corporation Law shall, until such amendment, continue to be references to Division 1 (commencing with Section 100) of Title 1 of the Corporations Code as in effect ~~immediately prior to the effective date of this act~~ on December 31, 1976 . ~~Nonprofit cooperative corporations organized pursuant to Title 22 of Part 4 of Division First of the Civil Code prior to August 14, 1931 which have not elected to be governed by Part 2 (commencing with Section 12200) of Division 3 of Title 1 of the Corporations Code pursuant to Section 12206 of the Corporations Code, and existing as nonprofit cooperative corporations on January 1, 1977, shall be governed on and after such date by the General Nonprofit Corporation Law.~~

(b) Notwithstanding subdivision (a), ~~subdivision (b) of Section 201 of the Corporations Code as in effect on January 1, 1977, and as subsequently amended, shall apply to all corporations~~ Division 4 (commencing with Section 14400) of Title 1 of the Corporations Code as in effect on January 1, 1979, and as subsequently amended, shall apply to every private corporation as provided in Section 14450 of the Corporations Code, and the following provisions of Division 1 (commencing with Section 100) of Title 1 of the Corporations Code as in effect on December 31, 1976, no longer apply to any private corporation: Sections 123, 124, 126, 126.1, 127, 128, 129, 309, 310, 313, 832, 1307, 1308, 1309, 1511, 2240, 3001.1 3019, 3020, 3021, 3022, 3300, 3301, 3301.1, 3301.2, 3301.3, 3301.5, 3301.6, 3301.7, 3301.8, 3302, 3303, and 4122; Article 3 (commencing with Section 4690) of Chapter 1 of Part 9; Sections 6302, 6303, 6304; Part 11 (commencing with Section 6200) .

(c) Subdivision (a) does not apply to corporations to which the Nonprofit Corporation Law (Division 2 (commencing with Section 5000) of Title 1 of the Corporations Code) applies.

Comment. The first two sentences of subdivision (a) of Section 16 of Chapter 682 of the Statutes of 1975, as amended, are amended to eliminate any ambiguity in the references to the 1975 legislation and pertinent dates. The third sentence is continued in Corporations Code Section 12206.

Subdivision (b) is amended to delete the reference to subdivision (b) of Section 201 of the Corporations Code which is repealed and recodifie as Sections 14510 through 14515 of the Corporations Code, to make clear that subdivision (a) does not limit the scope of Section 14450 of the

Corporations Code, and to repeal for all purposes those provisions of old General Corporations Law (as in effect on December 31, 1976) which are superseded by the provisions of new Division 4 of Title 1 of the Corporations Code.

Subdivision (c) is added to make clear that nonprofit corporations are no longer governed by the old General Corporation Law. See Corp. Code § 5102 (scope of division) and Comment thereto.

Note. The operative date of this amendment is January 1, 1979.

404/401

Analysis of Division 4

Chapter 1 - Definitions and General Provisions (commencing on page 419)

Article 1 consists of definitions. These definitions are relevant only with respect to the substantive provisions which use the defined terms. Hence, Article 1 involves no policy issues as to the content of Division 4.

Article 2 consists of miscellaneous general provisions. These provisions are analyzed in some detail below because a careful analysis of the provisions will, we believe, give the Commission a feeling for the reason why Division 4 is needed.

The first substantive provision is Section 14451 (suit against corporation). As drafted, this provision will apply to all corporations unless the corporation is expressly excepted from the operation thereof or there is a special provision applicable to the corporation inconsistent with Section 14451, in which case the special provision prevails. See Section 14450. A plaintiff who has a cause of action against a corporation or association can refer to one section--Section 14451--and need not determine what statute the particular corporation he is going to sue is incorporated under.

What is the existing situation? With respect to corporations governed by the new General Corporation Law, Section 105 provides:

> 105. A corporation or association may be sued as provided in the Code of Civil Procedure.

With respect to corporations not covered by the new General Corporation Law, such corporations continue to be covered by the repealed provisions of the old General Corporation Law, specifically Section 128, which provides:

128. A corporation or association may be sued as provided in Section 395.5 of the Code of Civil Procedure.

If Section 14451 is taken from Division 4 and inserted into the new nonprofit corporation law, we will have three differently phrased provisions covering exactly the same situation, will have established the pattern of repeating a similar provision in each special corporation act, and will cause the plaintiff who has an action against a corporation the burden of determining which provision applies.

Section 14452 (attachment of corporate property) was previously discussed in this memorandum. Section 14453 (issuance of money) is a general provision that is compiled in the Corporations Code merely because there is no better code in which to compile the provision. Section 14454 (federal corporations) is a general provision that should not be limited to corporations formed under Division 1 and it would be undesirable to duplicate the provision in various statutes authorizing the formation of corporations.

Section 14455 (information to assessor) also deals with a matter that should be covered by one general provision. Certainly it would be an aid to the assessor to have one general provision requiring the corporation to furnish requested information, rather than having to search out the specific provision that applies to the particular corporation from which the information is sought. There is also a risk that there will not be a comparable provision applicable to the particular special corporation if there is no general provision.

Section 14456 (reserving the right to amend or repeal all statutes relating to corporations) also should be a general provision. It should not be necessary to insert in each bill that affects corporations such a provision.

The collection of the various provisions (Sections 14457, 14458, 14459, 14460, 14461, and two additional provisions to be recommended for addition by the staff in a separate memorandum) relating to the evidentiary effect of certain corporate instruments or documents in one general statute applicable to all corporations should be a substantial aid to the attorney who seeks to offer such an instrument or document in evidence. Having general provisions in a chapter applicable to all corporations--rather than having specific provisions in each statute applicable to corporations--will avoid the need to search out the provision applicable

to the particular corporation and will result in a uniform set of provisions that will minimize the need for amendment of numerous provisions should the amendment of one of the general provisions prove to be necessary.

Article 3 contains provisions relating to enforcement by the Attorney General. Section 14490 relates to enforcement of certain statutory provisions by the Attorney General. This section could be duplicated in Division 1 and Division 2, but the staff recommends that it be retained in Division 4 because it fills out Article 3 and avoids the need for unnecessary duplication. If the language used in this section requires amendment, it would be easier to amend one section than two (which would be the case if the section were duplicated). In addition, there is a likelihood that the section may be expanded when the study of cooperative corporations is completed. Section 14491 (action by Attorney General to dissolve corporation) is clearly a general section that should apply to all corporations and should not be duplicated in each corporation statute. Section 14492 is a companion section to Section 14491 and should be retained in Division 4 for that reason.

Chapter 2 - Corporate Name (page 439)

The provisions of the new General Corporation Law relating to corporate name (Section 201) now apply to all corporations. Chapter 2 places these provisions in Division 4 which applies to all corporations. The existing situation is one that will be a trap to an unwary lawyer. Section 102 of the new General Corporation Law limits the scope of Division 1, but an obscure provision in an uncodified section (Section 16 of Chapter 682 as amended by Section 43.5 of the 1976 corrective bill) adds the following provision:

> (b) Notwithstanding subdivision (a), subdivision (b) of Section 201 [compiled as Sections 14510, 14511, 14512, and 14515 in Division 4] of the Corporations Code as in effect on January 1, 1977, and as subsequently amended, shall apply to all corporations.

The provision quoted above is defective in that it fails to recognize that special provisions relating to corporate names are found in various special statutes relating to corporations. More significant, however, is the trap for the unwary lawyer who must be aware of an obscure provision in an uncodified section to know that the provision of the new General Corporation Law applicable to corporate names applies to all corporations.

Since the decision already has been made to apply the corporate name provisions to all corporations, the policy issue is whether it is better to handle the matter as it is now handled as outlined above or to compile the corporate name provisions in Division 4 which is a division that will apply to all corporations.

Chapter 3 - Filing of Instruments; Certificates of Correction (page 447)

Chapter 3 proposes to enact a uniform set of provisions relating to the date of filing, delayed effective date, extending credit for filing, correction of instruments, and record of process served on Secretary of State. The staff believes that the need for a uniform statute covering these matters is clear. The existing situation--one set of provisions covering corporations under the old General Corporation Law (with defects uncorrected) and another set covering the corporations under the new General Corporation Law would be made even worse if a third set of provisions were added for corporations under the new nonprofit corporation law. If any defect is discovered in the statutes, amendments would be required in each of the comparable statutes. Moreover, we believe that it will be many years before all corporations will be removed from coverage of the old General Corporation Law, and the attorney who is seeking to file an instrument with a delayed effective date or to correct an instrument will face a confusing array of statutes unless a single uniform statue is enacted.

Chapter 4 - Service of Process of Domestic Corporations

Chapter 4 proposes to enact a uniform alternative method of serving all types of domestic corporations. The staff believes that the need for a uniform statute covering this matter is clear. First, one uniform statute avoids the need for a lawyer who seeks to serve a corporation to search for the particular statute that applies to the particular corporation. He need not determine whether the corporation is under the new General Corporation Law, the old General Corporation Law, or some other statute. He would have this task if provisions comparable to Chapter 4 were to be duplicated in Division 1, Division 2, and in special statutes relating to corporations. The uniform statute will also result in a uniform procedure for handling service on all corporations.

The single statute applicable to all corporations will also result in simplification of Code of Civil Procedure Section 416.10, which is

proposed on page 530 to be amended to conform to the new scheme. See that amendment. In place of the simplification made possible by the enactment of Division 4 in Section 416.10, if Division 4 were not enacted, it would be necessary to keep Section 416.10 as it is and add additional references to at least three more sections in subdivision (a) and to at least four more sections in subdivision (d). If the same policy of repeating the service of process provisions in other special statutes were adopted, additional references would have to be inserted in Code of Civil Procedure Section 416.10. The result would be to create a research task of some magnitude for the lawyer who seeks to find the appropriate statute providing the alternative method of service for the particular type of corporation. Note that the enactment of Division 4 will permit the deletion of the reference to the old repealed General Corporation Law from Section 416.10.

Chapter 5 - Statement Identifying Officers, Office, and Agent for Service

Chapter 5 provides a uniform statute governing the annual statement identifying officers, office, and agent for service. The Commission's draft has accommodated the needs of nonprofit corporations within the framework of the uniform statute.

What is the existing scheme? Corporations formed under the new General Corporation Law are governed by the provisions of that statute relating to the annual statement. Corporations that are governed by the old repealed General Corporation Law are governed by a different set of provisions that require different information, different filing times, and so on. If a third statute were incorporated into the nonprofit corporation law, there would be three different statutes dealing with the same problem--providing a filing to serve as a source of information as to the officers and address of the corporation and requiring (or under the old General Corporation Law permitting)the designation of an agent for service of process. We do not know how the Secretary of State plans to assist corporations under the old and new General Corporation Laws to comply with the varying time and contents requirements of those laws. However, the absence of a uniform statutory procedure will certainly be a cause of confusion to those attorneys who are required to prepare the statements on behalf of their client corporations. The uniform

statute proposed in Division 4 will do much to eliminate this confusion and is a much needed improvement that should be enacted as soon as possible.

Chapter 8 - Conversion (commencing at page 477)

This chapter (which provides a procedure for converting a business corporation into a nonprofit corporation or a nonprofit corporation into a business corporation) would appear more appropriately compiled in Division 4 than in Division 1 or Division 2. The Commission could develop two different procedures--one for converting a business corporation into a nonprofit corporation (compiled in Division 1) and another for converting a nonprofit corporation into a business corporation (compiled in Division 2), but the staff recommends against this alternative. We believe that the provisions in Chapter 3 should be retained in Division 4.

Chapter 9 - Foreign Corporations (commencing at page 489)

Chapter 9 containes a uniform statute applicable to foreign corporations that are not otherwise subject to Calfornia law. The chapter provides for the filing of an informational statement and designation of an agent for service, requirements concerning the name of a foreign corporation doing business in California, and provisions relating to service of process on a foreign corporation. The chapter applies to all corporations.

What is the existing scheme? It is difficult to determine whether the provisions of the new General Corporation Law relating to qualification of foreign corporations apply to all foreign corporations. The savings provision (uncodified Section 16 of Chapter 682 of the Statutes of 1975) may preserve the provisions of the old General Corporation Law for some foreign corporations, but this may not be the intent of the savings provision although literally the savings clause would preserve these provisions of the old General Corporation Law.

In any case, the requirements that a foreign corporation doing business in California (which includes a nonprofit corporation which conducts sufficient activities in California, cooperatives and other types of corporations which are not of the type formed under Division 1) should be covered by a general uniform statute. The provisions of the

statute do not relate to the internal affairs of the corporation since the corporation is a foreign corporation that is not subject to Division 1 or Division 2 or some other statute. Hence, it is appropriate to compile these provisions in Division 4 where they will be more readily discovered by a lawyer for a foreign corporation seeking to comply with the California requirements. The only reasonable alternative--to make the new General Corporation Law provisions apply to every type of corporation, profit, nonprofit, cooperative, and so on--is not an attractive one.

Chapter 10 - Crimes (commencing at page 511)

There is a need for a comprehensive statute relating to crimes. It would be possible to duplicate the provisions relating to crimes in each statute. However, whenever a section is discovered to be in need of amendment, it would then be necessary to find and amend all comparable sections. The criminal provisions of Division 4 apply to all corporations. This will avoid the problem that the prosecutor would have in attempting to find the particular statute applicable to the particular corporation if no general provisions on crimes were provided. Also, there appears to be a need for a study and improvement of these provisions, and this task would be greatly aided by the existence of a uniform statute.

Additional Provisions for Division 4

One commentator suggested that consideration be given to including additional provisions in Division 4 with the view to having uniform provisions and avoiding unnecessary duplication. The staff has given consideration to this suggestion. We do not want to include in Division 4 any provisions that are an integral part of the basic corporation statute applying to a particular type of corporation. There is, however, on area where the statute might be compiled in Division 4 without disturbing the structure of Divisions 1 and 2. We recommend that Chapter 14 (Sections 1400-1403) of the new General Corporation Law and Chapter 14 (Sections 6410-6415), relating to bankruptcy reorganizations and arrangements, be consolidated and compiled in Division 4 and be made applicable to all corporations. These chapters can easily be severed from the divisions in which they are now found, and it would appear that a uniform statute--applying to all corporations--would be desirable on this matter.

Respectfully submitted,

John H. DeMoully
Executive Secretary

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Memorandum 76-83

EXHIBIT I

LAW OFFICES OF
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AND
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August 6, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Gentlemen:

The Recorder, a San Francisco lawyers' newspaper, on July 30, 1976, made reference to the proposed new non-profit corporation statute.

I am one of the attorneys for Franklin Savings and Loan Association, a California Mutual Corporation. There are only a few such savings and loan corporations in California.

California's mutual savings and loan associations are nonprofit in one sense, but are corporations organized for profit in another. The reason for this is that the earnings of this type of corporation redound to the advantage of the depositors, but the depositors do not receive any moneys from the corporation except the interest which is paid to them on their deposits.

A California mutual savings and loan association is unlike such organizations as a Chamber of Commerce, a social club or a fraternal society, so that in one way, this type of corporation is nonprofit, but, nevertheless, does obtain profits when lending money, but nobody ever gets the profits except the corporation, itself. They become a part of the capital.

I do not want to get involved in the preparation of the new nonprofit corporations statute, but thought it would be advisable for me to write to you, calling your attention to the foregoing facts.

Yours very truly,

WALTER A. DOLD

WAD:hg

STATE OF CALIFORNIA EDMUND G. BROWN JR., Governor

CALIFORNIA LAW REVISION COMMISSION
STANFORD LAW SCHOOL
STANFORD, CALIFORNIA 94305
(415) 497-1731

August 10, 1976

Walter A. Dold, Esq.
681 Market Street
San Francisco, California 94105

Dear Mr. Dold:

In the course of determining the scope of its "Tentative Recommendation Relating to Nonprofit Corporation Law," the Law Revision Commission had occasion to consider the sort of problem you raise concerning mutual savings and loan associations in your letter of August 6. It was our tentative conclusion that mutual savings and loan associations--like credit unions, consumer cooperatives, agricultural cooperatives, mutual water companies, and mutual insurance companies--should be governed by the business corporation law rather than the nonprofit corporation law, at least until a complete study of this entire area can be undertaken by an appropriate group.

It appears to the Commission's staff that, for the time being, mutual savings and loan associations are governed by the Savings and Loan Law (Fin. Code § 5000 et seq.) which in turn incorporates the General Corporation Law where it is not inconsistent with the Financial Code provisions. (See Fin. Code §§ 5001, 5057, 5500, 5512.5, 7616, 8400, 9206, 9214, 9216.) It also appears that the existing General Corporation Law will continue to apply to savings and loan associations, including mutuals, even after the new General Corporation Law becomes operative on January 1, 1977. (See Cal. Stats. 1975, Ch. 682, § 16, as proposed to be amended by Assembly Bill 2849, § 43.5 (1975-76 Regular Session, as amended in Senate, June 15, 1976).)

In the introductory portion of its tentative recommendation, the Commission has recommended that a general study of the law relating to cooperative corporations be made. Otherwise, such corporations will continue to be governed by a repealed law. The law relating to mutual savings and loan associations might very well be a part of such a study. In any event, as presently structured, the Commission's proposed Nonprofit Corporation Law would not govern mutual savings and loan associations.

We appreciate your writing to us to call attention to the situation with respect to mutual savings and loan associations. Your observations

concerning the nature of their operations will, I am sure, be helpful to the Commission.

Sincerely,

John H. DeMoully
Executive Secretary

JHD:aj

Memorandum 76-93

EXHIBIT II

CHAMBERS OF
The Superior Court
LOS ANGELES, CALIFORNIA 90012
THOMAS C. YAGER, JUDGE
[PRIVATE]

August 4, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
School of Law
Stanford, California 94305

Dear Mr. DeMoully:

The California Law Revision Commission's tentative recommendations relating to non-profit corporation law, Parts I and II have been received and reviewed by me.

As the president of a Corporation Sole, I am particularly interested in the portions relating thereto.

The proposed changes appear to be an improvement. The cross references to the general corporation law and the non-profit corporation law appear to be useful.

Thank you and congratulations on your good work.

Sincerely,

THOMAS C. YAGER

TCY/cm

Memorandum 76-83

EXHIBIT III

WAKE FOREST UNIVERSITY SCHOOL OF LAW
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August 10, 1976

Mr. John N. McLaurin (Chairman)
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Nonprofit Corporation Law
(Tentative Recommendations)

Dear Mr. McLaurin:

The proposed legislation obviously involved great efforts and hard thought. All in all it probably is the best statute ever proposed on this subject, and I congratulate the Commission members on the achievement.

Yet, there are items in the Recommendations that seem to me to be unwise:

For example, in "Chapter 10. Crimes" the §§ 14900 to 14902 provisions of a maximum of punishment of $1000 or one year in jail for deliberate use of even charitable status for larceny by trick (fraud) continue the old view that white collar crime is a mere gentleman's peccadillo, while theft of an automobile tire by a youth may be a major felony. This is grotesque in an era of destruction of faith in law and justice by the supposed protectors of democracy and of government by law. How far can fraudulent privilege go? To the point where a dictatorship (or communism) becomes the only remedy?

Fraudulent record tricks are punishable (§ 14904) by 10 years in state prison or one year in county jail or $500 fine. This belongs in a New Yorker magazine "How's that again?" section.

And so on, and on. A "slap on the wrist" philosophy of criminal law, for sanctimonious white collar swindlers.

In §§ 14490 et seq. the Attorney General is given permission to (i.e., "may") get into legal actions against malefactors in nonprofit corporations. No expectation of real action is likely, except in politically advantageous or notoriously vicious situations -- as

long has been the reality as to attorney general work in this country. Why not make the law require action in proper cases? And why not make the Secretary of State's "Corporation Division" do the job it should do, by requiring that office to bird-dog abuses of corporate status; and the Tax Office too perhaps!

I am troubled, too, by the oblique provisions for an equivalent of the "subventions" and stock-investment devices copied from the New York and Pennsylvania provisions. Why not just let a lender be a lender, without cloaking him with the mantle of "public benefactor" when all he is doing is getting profit for himself!

Nevertheless, I commend the proposed statutes.

Sincerely,

Howard L. Oleck

Howard L. Oleck
Professor of Law

HLO:a

Memorandum 76-82

EXHIBIT IV

Superior Court of California

San Francisco

CLAYTON W. HORN, JUDGE
Ret'd.

August 16, 1976

California Law Revision Commission
Stanford Law School
Stanford, Ca 94305

Gentlemen: Re: Non-profit corps.

I have reviewed the proposed revision material of the law covering non-profit corporations. The staff has prepared an excellent proposal; compliments are in order. I have no suggestions or criticism and believe the enactment will be of assistance to the legal profession.

One query? Non-profit associations appear to be omitted, altho they are in the present law. Suggest that this subject be reviewed and covered in the revision.

Sincerely yours,

Clayton W. Horn

45 Graystone Tr.
San Francisco, Ca 94114
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Memorandum 76-93

EXHIBIT V

NATIONAL AUTOMOBILE CLUB

GENE HALLIBURTON
PRESIDENT

August 17, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
School of Law
Stanford, California 94305

Dear Mr. DeMoully:

We have reviewed the tentative recommendation relative to the proposed legislation revising nonprofit corporation law and, in our considered opinion, this proposal is to be commended.

The National Automobile Club supports the concepts of this new legislation, which we think would be meaningful in its simplification of these laws, and which would be beneficial in this area of corporate law and in the public interest.

As we interpret the new legislation, we would urge passage of this legislation and hope our endorsement is timely and helpful.

Sincerely,

Gene Halliburton
President

GH:ab

Memorandum 76-83

EXHIBIT VI

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August
19th
1976

Law Revision Commission
Stanford Law School
Stanford, CA 94305

Attention: Mr. John DeMoully
Secretary

Dear Mr. DeMoully:

The attention of the Commission is respectfully directed to Section 6621 of the proposed non-profit law subdivision (c)(3) which provides in substance that a by-law adopted pursuant to Section 6621 shall include among other procedures:

> "(3) a procedure to permit any nominee to communicate to the voting members a candidate's statement for the nominee."

Many non-profit corporations, including several represented by the undersigned, have informal and non-restrictive procedures for the nomination of a person to the Board of Directors. Thus, many non-profit corporations allow nominations to be made from the floor at the time of the membership meeting. If a nomination is made at the time of the membership meeting, the person so nominated becomes a nominee. Would subdivision (3) then give that nominee the right to have the membership meeting continued until he has had an opportunity to communicate his candidate's statement to the voting membership? Taking subdivision (3) literally, it would seem that this would be so. I question whether this is intended by the Commission.

I also have a concern with Section 6624 which is entitled "Authority of Court not limited." Prior Section 6620 provides that an "authorized member" means a member having the written authorization of at least five percent of the voting power or such lesser authorization as is specified

in the by-laws. Presumably, the Commission has determined that five percent of the voting power is appropriate and proper. For corporations with a substantial number of voting members (i.e. Fedco with 700,000 voting members), this requires a relatively large number of written authorizations for a person to qualify as an "authorized member" under Section 6620. As I understand it, this was intended by the Commission. It should not be easy to take over the Board of Directors of a going successful company either non-profit or stock. Fedco sells a substantial amount of merchandise to its members ($200,000,000 per year). It is a successful enterprise. Fedco has exactly the same needs and requirements of any stock company that is engaged in the merchandising business. Among these needs are continuity of management and political stability. No company that is engaged in a highly competitive business, whether it is non-profit or a stock company, can exist, least of all do a very good job for its members, if it has hanging over its head the knife of an easy take-over by outsiders who may have no special complaint, but would just like to supplant the Directors and management of a successful business.

Section 6624 as it is now written seems to be an invitation to a trial court to vitiate the five percent requirement of section 6620 and to allow a court, if it so desires, to set a figure so low that the take-over of a non-profit corporation becomes an invitation to those who wish to take over a company just to take it over. Section 6624 seems to give the court unlimited authority to reduce the 35,000 written authorizations that might be required in the case of Fedco to qualify as an authorized member to 350 signatures or even 35. Is it the intent of the Commission to allow the court to reduce the requirement of 35,000 signatures to 50 or 100 signatures without any evidence of unfairness or inequity? In short, if the five percent figure as specified under section 6620 involves a large number of persons, is this fact alone sufficient to justify the court reducing the percentage required under section 6620 to any figure within the uncontrolled discretion of the court? I suggest to the Commission that if the five percent requirement specifically designated in Section 6620 is proper and appropriate before one can be an "authorized member", then there should be something more by way of unfairness or inequity, before

a court should have the power under section 6624 to reduce the five percent figure specified under section 6620.

May I make the following suggestion. I would propose that the period after the word "corporation" at the end of subdivision (a) of section 6624 be changed to a semi-colon, and the following language should be added:

> "provided, however, that the number of written authorizations required to constitute a member as an "authorized member" under Section 6620, of itself and however large, shall not be considered a circumstance rendering the procedures for nomination and election of directors unfair and inequitable under the provisions of this section."

Very truly yours,

Edward L. Butterworth

ELB:kg

Memorandum 76-83

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RAYMOND R. HAILS
1880-1959

August 20, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Nonprofit Corporation Law--
July, 1976 Tentative Recommendation

Gentlemen:

We have reviewed your July 26, 1976 tentative recommendation relating to the Nonprofit Corporation Law of the State of California. Several aspects of the recommendation raise in our minds considerable room for doubt on the future methods to be used in organizing the investment activities of nonprofit corporations. Our question is as follows:

> May a charitable nonprofit corporation delegate to outside investment counsel (registered investment advisers under the Investment Advisers Act of 1940, as amended) the sole authority to execute buy and sell orders for the nonprofit corporation's charitable funds without such counsel's obtaining any advance approval from a committee of the nonprofit corporation as to the specific buy or sell transactions?

This question assumes that the nonprofit corporation has provided to the outside investment counsel general investment guidelines and objectives, and that a committee of the board of directors diligently monitors the performance of investment counsel.

We believe that the answer to the foregoing question may be negative, both under existing law and your 1976 tentative recommendation. We will outline our concerns in respect to your tentative recommendations:

1. Under your proposed Section 5560, the nonprofit corporation and its directors, in managing property received for charitable purposes, are to "be subject to the obligations of a trustee set forth in Section 2261 of the Civil Code."

This is stated to be a codification of the rule of Lynch v. John M. Redfield Foundation, 9 Cal. App. 3d 293 (1970).

2. As to the ability of private trustees to delegate their duties to make investments, the basic California Civil Code sections contain no direct provisions. Civ. Code, §§2258-2289. (However, see below regarding the 1973 enactment in the Civil Code of the Uniform Management of Institutional Funds Act.) Rather, two cases have laid down the rules that the trustee's duty of making investments cannot be delegated to another and that the trustee must exercise his own independent discretion and judgment in the investment of trust funds. See 49 Cal. Jur. 2d, Trusts §210 (1959).

First is Martin v. Bank of America, 4 Cal. App. 2d 431 (1935). There, the bank defendant was the trustee of a private trust created in 1927. During the subsequent depression, the bank placed defaulted bonds in the hands of a protective committee. Those bondholders who did not participate in the protective committee received a thirty-nine percent recovery, while the trust and other participants in the protective committee lost the entire value of their bonds. The trial court entered judgment for the plaintiff trust beneficiary for monetary damages suffered. The district court of appeal affirmed, stating that the defendant bank, without any authority under the governing trust instrument, had relinquished possession and control of the trust assets by placing the bonds with the protective committee and that the investment responsibility is fundamental and cannot be delegated by a trustee. The appellate court used the following language:

> "'If a trustee enters into any arrangement with reference to trust funds which surrenders or limits his control over them, he becomes a guarantor of the fund, irrespective of his motive or whether his surrender of control was the cause of the loss of the fund. In such case, in the event of loss, the court will not enter upon an inquiry whether the loss is due to such abdication of control.' (Gaver v. Early, 191 Cal. 123, 126 [215 Pac. 394, 395]. See, also, 26 R. C. L. 1281, sec. 131.)
>
> "This is not a case of an active trust in which the trustee is vested with plenary powers and the trust agreement nowhere directly or by inference permits

> a surrender of control and direction to another. (44 L. R. A. (N. S.) 873, note.) 'The making of investments is fundamental, and not merely administrative, in administering the trust; consequently, in accordance with the general rule, the making of investments cannot be delegated by the trustee to another.' (65 C. J. 797, sec. 672.) The advice of its attorney cannot shield defendant from responsibility. (Estate of Halbert, 48 Cal. 627.)" 4 Cal. App. 2d at pp. 435-436.

Second is Estate of Talbot, 141 Cal. App. 2d 309 (1956). There, a bank was administering a trust which held substantial amounts of common stocks. In 1951, one of the several trust income beneficiaries recommended to the trustee that the common stocks be sold, and that the proceeds after the payment of capital gains taxes be invested in bonds. After giving some internal management consideration to the request, the bank sold certain of the common stocks, paid capital gains taxes, and invested the remainder in tax exempt securities. Another of the income beneficiaries objected to this action on the part of the trustee when the latter filed its court accounting. The trial court ruled that the trustee had failed to exercise its independent judgment, and ordered the payment of damages. The bank appealed. The question before the district court of appeal was whether the evidence supported the finding that the trustee had failed to exercise its independent judgment. The evidence was found to be sufficient, and the following rules were stated:

> "This statute, enacted in 1943 to replace the old statutory list of trust investments, embodies the so-called 'prudent man rule' first adopted by the Massachusetts courts, and later by many other states. There can be no doubt that, under this section, and pursuant to general law applicable to trustees, the trustee, even where given broad discretionary power of investment, must exercise its independent discretion and judgment in reference to the investment of trust funds. No serious contention is made to the contrary. The trial court has found that in making the sales and purchases here involved the trustee did not exercise its independent judgment but acted upon the advice and judgment of Frederick C. Talbot, and upon his assurance that the other income beneficiaries would consent. The question presented is whether that finding is

> supported by any substantial evidence or by any reasonable inference therefrom. If there is any substantial evidence, or any reasonable inference from the evidence that supports this finding, it is binding on us, regardless of conflicts." 141 Cal. App. 2d at p. 317.

Thus, under the prudent man rule, the trust must exercise its independent discretion and judgment with respect to the investment of trust funds. The trustee cannot act upon the advice and judgment of a beneficiary.

3. In 1973, and as an adjunct to the Civil Code provisions on private trustees, the Uniform Management of Institutional Funds Act was adopted for the benefit of educational institutions of collegiate grade. Civ. Code, §2290.12. In the legislative declaration in support of this legislation, it was categorized as a "pilot study for a limited period of time [automatically expiring in 1979]" allowing "expanded investment and expenditure policies by a limited class of reputable, substantially endowed educational institutions." Cal. Stats. 1973, c. 950, §§2 - 4, p. 1789. The purposes of the act were to give recognition to investment programs taking long-term appreciation into account in investing for the highest rate of overall return consistent with safety and to permit the appropriation for current use under specified circumstances of the realized and unrealized appreciation of the funds. Ibid. The main provisions deal with the expenditure of appreciation for current use, broadened forms of investments, release of restrictions in grant instruments, etc. However, of especial importance to the problem here under consideration is Civil Code Section 2290.5, regarding the delegation of authority by the governing board of such an educational institution:

> "Except as otherwise provided by the applicable gift instrument or by applicable law relating to governmental institutions or funds, the governing board may (1) delegate to its committees, officers or employees of the institution or the fund, or agents, including investment counsel, the authority to act in place of the board in investment and reinvestment of institutional funds, (2) contract with independent investment advisors, investment counsel or managers, banks, or trust companies, so to act, and (3) authorize the payment of compensation for investment advisory or management services." Civ. Code, §2290.5.

This is a broad ranging authorization for delegation by the governing board to others "to act in place of the board in investment and reinvestment of institutional funds." Those on whom such broad delegation may be conferred are "agents (including investment counsel)." This is an express legislative recognition of delegation of investment management to outside investment counsel.

4. Under your proposed Section 5562, nonprofit corporations can transfer their investment holdings in trust to an "institutional trustee" (one authorized to do a trust business) for investment management. The nonprofit corporation's board of directors is thereafter relieved of liability for administration of the assets. Also, under your Section 5570, nonprofit corporations can establish common trust funds for investments. For that purpose, the trustees of the common trust funds can "employ an investment adviser or advisers, define their duties, and fix their compensation," as provided in your Section 5572. This last section is not explicit as to whether the trustees of the common trust funds can actually delegate to such advisers the actual buy and sell decisions. As trustees, they may be subject to the rules prohibiting private type trustees from delegation of their responsibilities. Perhaps the advisers can advise, but perhaps the final decisions must be actually made by the trustees.

5. Sections 5562 (institutional trustees) and 5570 (common trust funds) offer no solutions to the nonprofit corporation which desires to administer its own investments through outside investment counsel. Rather, such a nonprofit corporation must look to other general provisions found in your recommendation. Your Section 5310 states the general power of the board of directors to direct its activities and affairs. Subsection (b) of that section provides for delegation of the board's management powers even to a management company:

> "(b) The board may delegate the management of the day-to-day operations of the activities of the nonprofit corporation to a management company or other person provided that the activities and affairs of the nonprofit corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board."

Perhaps the employment of investment counsel is in the nature of delegation to a "management company." Perhaps the execution of "buy" and "sell" orders for the nonprofit

corporation's portfolio, including its charitable funds, is merely "day-to-day operations of the activities of the nonprofit corporation" within the meaning of Section 5310.

6. Under your proposed Section 5353, a committee of the board may, by a board resolution or bylaw, be given all of the authority of the board itself. This would appear to allow the nonprofit corporation to totally delegate the investment responsibility to a single committee of its board.

7. When your new proposals are all taken together, the question of whether an outside investment counselor can make buy or sell orders on its own authority for charitable funds appears to remain unresolved. Subsection (b) of Section 5310 appears to empower the board, subject to its ultimate responsibility for direction, to engage management companies for day-to-day operations. This might cover the employment of investment counsel to finally decide on particular transactions without specific board or board committee approval. Cutting the other direction is Section 5560 which mandates the prudent man rule. The case law implementing the prudent man rule stands against investment delegation by private trustees. Again, when the legislature in the Uniform Management of Institutional Funds Act wanted to permit investment counsel to act in place of the board on investments and reinvestments, it employed specific language to that effect. Civ. Code, §2290.5. The exact delegation of authority language there used is instructive in its exactness: ". . . the governing board may (1) delegate to its committees, officers or employees of the institution or the fund, or agents, including investment counsel, the authority to act in place of the board in investment and reinvestment of institutional funds. . ."

The problem which we pose with respect to the use of outside investment counsel has practical importance. The investment realities for large nonprofit corporations having substantial investment holdings are as follows:

--The board of directors is made up of prominent community leaders, who are individually busy in their businesses or the practices of their professions. They attend monthly meetings of the full board of directors. They are also assigned to committees of the board.

--The board has a specific committee on investments. Those board members sitting on the

committee include those personally active in the investment business and finance.

--The committee conceives as its function the setting of basic investment policy and the review of performance of the investment adviser selected to implement such policy. Both functions are in addition subject to overall full board review.

--The board investment committee is then confronted with the practical problem of day-to-day buy or sell transactions for the portfolio. The investment counsel has frequent proposals for specific transactions. It is not possible to convene the investment committee to pass formally on each transaction. The members cannot make time available for weekly or more frequent meetings. Also, investment transactions often require quick action.

--The board members serving on the investment committee do not want to be placed in the position of second-guessing investment counsel on specific transactions. Those with experience in the investment field believe that investment counsel should be able to act independently on investment transactions for a period of time (subject to overall investment guidelines), and then counsel's performance should be subject to review for the period on the basis of the results of counsel's transactions.

In reviewing your recommendation, we have drawn the following conclusions on the investment management provisions incorporated therein:

(a) Section 5562 is too limited an approach to the delegation of the investment responsibility. It only treats the deposit of the investment assets in trust with a financial institution authorized to do a trust business such as a bank.

(b) Sections 5570 and 5572 regarding the administration of common trust funds are also a limited approach. While the trustees of the common trust funds are allowed to employ investment advisers, define their duties, and fix their compensation, it is nowhere stated in your proposals to what degree the trustees of common funds can place

reliance on such advisers. Perhaps those trustees must make all final decisions on transactions so that they can come safely within the case law prohibiting investment delegation by trustees.

(c) Under Section 5560, the prudent man rule is applied to nonprofit corporations and their directors on all their direct investment operations. This brings in to play the cases prohibiting investment delegation. It is not clear that Section 5310 permitting delegation of "day-to-day operation of the activities of the nonprofit corporation to a management company or other person" overcomes these cases. Also, the board, when it acts directly, has no specific provision permitting it to engage investment advisers as is expressly permitted for trustees of common trust funds. See Section 5572 of your proposals.

(d) To resolve these problems, we would suggest that a new provision be added to Section 5560 allowing nonprofit corporations:

> (i) To contract with independent investment advisers, investment counsel or managers, banks, or trust companies to make day-to-day investment decisions, including the execution of buy and sell orders, on their own authority; and
>
> (ii) To pay compensation for such investment advisory and management services.

This would be subject to the board's continuing obligations to exercise prudence in selecting such advisers and in establishing overall investment policy and guidelines to govern such advisers. In short, we are suggesting an addition which would blend into Section 5560 the provisions of your proposed Section 5310 and existing Civil Code Sections 2290.5 and 2290.6.

We are hopeful that you will give further consideration to the problems of investment management for nonprofit corporations. The case law prohibiting investment delegation by private trustees must be adjusted by this new legislation for nonprofit corporations. The latter must be able to delegate the responsibility for day-to-day transactions, such as buy and sell orders. This can be accomplished as suggested above. This would not be inconsistent with the board of directors or its committee on investment still retaining overall responsibility.

Thank you for considering these comments.

Very truly yours,

John F. Bradley
of
BURRIS, LAGERLOF, SWIFT & SENECAL

JFB:ka

Memorandum 76-83 EXHIBIT VIII

LAW OFFICES
KENNETH N. DELLAMATER
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213

TELEPHONE
348-2711

August 23, 1976

California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Re: Nonprofit Corporation Law
Tentative Recommendations

Gentlemen:

Thank you for your letter of July 21, and for considering our comments.

Enclosed are some of our thoughts and suggestions concerning the proposed revision.

Your Tentative Recommendation indicates exhaustive and excellent legal research, but perhaps minimal contact with the actual workings of nonprofit corporate clubs and associations.

It seems to be patterned very largely on ordinary corporate law. It fails to take into account the vast difference between the diverse human elements and management make-up of each. One is profit motivated, orderly, methodical, well managed (if it is to survive) and on the job five toseven days per week. The other is social or recreation motivated, usually run on a part time basis, poorly managed (if at all), and on the job perhaps three to ten days per month.

For the most part nonprofit corporations are drastically smaller than profit corporations. They are notorious for their poor administration, their poor business acuman, and their penchant for sentimental, emotional and self-serving decisions. They are equally famous for their cliques, their factions, their "sets", and their self-serving groups.

Accordingly, the individual member of a nonprofit corporation needs much more protection under law than in the case of the well managed profit corporation, particularly the public, profit corporation.

We consider "debt" membership financing instead of "equity" membership financing to be thoroughly unfair to the members.

The security for costs and attorneys fees provision appears to us to be an elephant's cloak used for a mouse.

It is our firm belief that your basic approach should be directed much more toward the protection of individual members. The present draft places far too many burdens and obstacles on the member, who actually has no other recourse with which to protect himself.

We consider the transitional provisions important.

We have not had sufficient time to analyze all proposed sections. Therefore, we confine our comments to those enclosed herewith.

Our comments do not relate to charitable nonprofit corporations. All equities in those go to the charities. Moreover, they are under the supervision of the State Attorney General.

We compliment you, and each of you, on your dedicated efforts on behalf of the improvement and up-dating of California law.

Yours very truly,

Kenneth N. Dellamater

KENNETH N. DELLAMATER

KND:mf
Encl.

NON PROFIT CORPORATION LAW

Tentative Recommendation

Comments by Kenneth N. Dellamater;
Member of the State Bar of California

I

TERMINATION OF MEMBERSHIPS
(Sections 5441, 5442, 5553, pages 25-26)

These sections fail to recognize the difference between members' property and equity rights, as distinguished from their social, club-activity, and loan rights and interests.

In every instance under these sections the burden and expense of protecting his interests rests on the member, and the proposed law furnishes nothing whatever to delineate his rights. In fact, the frequent references to "By laws" consistently leaves the whole matter wide open to both equitable and inequitable board action, even though the member paid his money years before he saw or heard of the by-laws. The odds and obstacles which the member must overcome to protect himself seem very great indeed.

Case precedent is of very little merit because of the vague and inadequate California law heretofore. We would hope that the new code is intended to overcome and correct bad case law, as well as bad statutory law.

The gravaman of the error in the Tentative Recommendation is to ignore a member's property and equity interests. Memberships may cost from one to several thousand dollars. In many instances clubs deteriorate and fail miserably in their performance. If a member withdraws because he is dissatisfied with club performance, or if he refuses to pay arbitrary dues or assessments because of unsatisfactory performance, he is terminated and his equity cut off.

Those who profit from the termination in many instances are the board members and their controlling supporters - the very ones responsible for the unsatisfactory performance. In most such instances the club can't even return the terminated member's initial investment until 10-20 or 30 years later.

In many of these cases, while the board and its supporters preside over a failing and deteriorating club, they observe tremendous increases in the fair market value of the club's real property. Then by attrition the unhappy and dissatisfied members drop out one by one setting the stage for dissolution and great equity gains for the board members and their supporters who presided over the club's demise.

This situation is compounded by providing "debt" rather than "equity" financing for memberships.

The cash contribution for a membership should definitely entitle the member to an "equity" interest rather than a mere "debt" obligation. After a person becomes a member and owns an "equity" interest, then he should have complete freedom of choice as to whether or not he wishes to loan money to the club.

Not only do those in control literally force members out by bad club performance, but having terminated the member the debt obligation on its face may not be due and payable until the year 2010. So the board and its supporters having eliminated 40% to 80% of the members, sell the property at great gains, dissolve the corporation, pay the debt obligations, and enjoy all of the quity spoils for themselves.

It is no answer to say that a member may sue to correct this. Not only can he not afford such a burden, but if all damaged members sue as a class they must suffer the added burden of securing the club and its directors against costs, expenses and even attorneys fees.

The Tentative Recommendation would sanction, fortify and permit just such an injustice. All could be avoided and corrected by distinguishing and separating the member's property and equity rights and interests on the one hand, and his social and club activity rights and his loans and debt paper on the other.

It is our firm belief that every club should be compelled by law to pay every member in full for his equity and loans within 30 days after his termination or withdrawal. Otherwise, the club terminates him and then uses his money free of charge for the next 10 or 20 years.

In our judgment the member should retain all property and equity rights and interests until he has been repaid in full. And having withdrawn or terminated as to his social and club activities, he should have the option as to when, how, and at what price he wishes to sell or transfer his property and equity rights and interests.

Nor is it any answer to contend that one doesn't join a club to make money. That is true. Nevertheless, where money, and property and equity are concerned, honesty and fairness must prevail. And that can be accomplished only when the law adequately protects money, property and equity regardless of what its setting might be.

The above facts are not hypothetical. They are from actual cases, except that the members could not afford the burden of suing. They took their beating and walked away. Their burden of suit was infinitely greater than their prospects for gain or break-even.

II

MEMBERS' DERIVATIVE ACTIONS

(Sections 5810 et seq.)

We believe that Sec. 5821 is not only totally negative in its approach, but it places an undue burden on the complaining member. Moreover, it is already covered by Sec. 5820.

It totally ignores the attorney man-hours and the legal expense required even before there is a lawsuit. To ask any attorney to draft a letter demand is one thing, but to ask him to draft and set out "each cause of action" even before there is a lawsuit is something entirely different, and much more expensive.

Even worse is the necessity of drafting and submitting a complaint even before there is an action on file. In no other phase of law will you find such a requirement. This is part of the remnants of the '40s and '50s hysteria and propaganda about stockholders derivative actions.

It is completely negative in that it assumes that a demand letter would be entirely fruitless in every single case, thus necessitating the furnishing of a complaint even before you had an action on file.

These sections should be eliminated.

III

SECURITY FOR COSTS AND ATTORNEYS

FEES (Section 5830-5839)

The above sections totally ignore the size and scope differences between the multi-million dollar public corporation for profit, and the private non-profit corporations. We doubt the necessity, or indeed the advisability, of having these sections at all.

In any event they should not be applicable to nonprofit corporations having 500 members, or less, which covers about 99% of them. Such members, individually or by group, should be permitted an ordinary civil class action with none of the restrictions which apply to derivative suits involving public profit corporations.

Human nature being as it is, to "avoid involvement", getting even 10% of the members in aggrevated cases, can be a near-impossible task. They prefer to take their loss and walk away, even when they don't have unnecessary legal obstructions.

The "strike suit" arguments which fostered derivative action security procedures in the 1940s has no application at all. The club or corporate size is so small in 99.9% of the cases that a "strike suit" purpose is just plainly out of the question - as it really is in substantially all big suits.

There is just not enough involved to even think in such terms.

Nor is there enough involved for a strict "class action" to pay even reasonable contingent fees for attorneys. Class actions in this particular area of the law are virtually out of the question as a practical matter. And the individual member cannot afford to pay straight-hourly-fees for the hundreds of attorney-man-hours and legal expertise required by such cases.

We doubt that you will find a single nonprofit corporate derivative action in the annals of California law. With the members' prospects for substantial recovery or gain virtually minimal, the security for costs burden would almost certainly prohibit any such member's action. They would be compelled to suffer all of their losses and hopefully forget it.

If a few members wish to file a class action just to get their club straightened out, why should they be burdened and obstructed by all of the expense and barriers of the laws made solely for derivative actions in the

multi-million dollar public, profit corporation suit.

Private clubs, and associations and nonprofit corporations are notorious for their poor administration, their poor business acumen, and their sentimental, emotional, and self-serving decisions. This is a known red flag of major proportions. Why should the individual member not be given greater protection under law in such circumstances.

We suggest that the tone and nature of the nonprofit corporation law follow more closely the fair and equitable principles enunciated by the eminent Chief Justice Trainor in Jones v. Ahmanson (1969) 1 Cal. 3rd 93, 108-109, 111.

DELLAMATER
August 23, 1976

Memorandum 76-93

EXHIBIT IX

DEPARTMENT OF THE MARSHAL
MUNICIPAL COURT OF CALIFORNIA
County of San Diego
WILLIAM F. HOWELL, MARSHAL

August 24, 1976

John N. McLaurin, Chairman
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Dear Mr. McLaurin,

At the request of the Marshal's Department in San Diego County and the Marshals Association of California, I have carefully looked over your tentative recommendation relating to the Non-Profit Corporation Law, dated July 26, 1976.

There are many sections therein beyond our general interest and knowledge, so specific comments would be invalid. We do wish to say that all areas which appear to effect the Department and the Association are clearly put and considerably easier to understand (and thus easier to comply with) than before.

We appreciate, and thank you for, this input opportunity. This time, however, the input will consist only of a hearty "well done!" to the members and staff of the Commission for their efforts.

Very truly yours,

William F. Howell, Marshal

By James S. Carroll, Deputy
Research & Development Officer

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Memorandum 76-83

EXHIBIT X

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August 24, 1976

California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Re: Proposed General Nonprofit Corporation Law

Ladies and Gentlemen:

The present nonprofit corporation law of the State of California provides that no member shall hold more than one membership. Sections 9301 and 9601. Many associations of owners at condominium projects and single family lot subdivisions are nonprofit corporations. In such corporations the developer is required by the California Department of Real Estate to pay the assessments on lots held by it, and is entitled to one vote in the association for each lot owned by it. In such developments, a membership in the association is appurtenant to each lot. Therefore, the developer, or a purchaser who purchases more than one lot, holds more than one membership in the association.

Perhaps in drafting the new nonprofit corporation law the dichotomy between the law as it now stands and its application in the real world can be resolved.

Sincerely yours,

MORLEY, SMITH & BURK LAW CORPORATION

By _____
John Rogers Burk

JRB:bcm

EXHIBIT XI

COPY OF LETTER

Wanda Underhill
2079 Market Street, No. 27
San Francisco, California 94114
August 29, 1976

To: California Law Revision Commission
From: Wanda Underhill
Re: Nonprofit Corporation Law

The basic approach of the Commission, i.e., a nonprofit corporation law which is complete in itself is good; it will contribute to economy of time and money.

The substance and wording used by the draftsmen (drafters) complies with current legal usage and the standards set by the California Code Commission.

Dickerson, Reed. Legislative Drafting. Bodyon, Little, Brown, 1954.
Report of the California Code Commission for the Year 1947-1948. Appendix G. "Drafting Rules and Principles for the use of the California Code Commission Draftsmen."

Page 28. Subvention Certificates

Are "a form of subordinated debt, the repayment of which is normally contingent on the financial health of nonprofit corporations and on the occurrence of some event (i.e., completion of the projects for which funds are solicited)."

Wouldn't statutory recognition of the subvention concept through codification add formality, definiteness, and certainty to the law?

Cross-Reference: P. 199. Art. 2. Subventions.

Page 28. Capital Contribution

Also, would codification of this device be in keeping with modern legal trends?

Page 29. Repurchase and Redemption of Memberships

The new "solvency test" in the new law is good because it sets up specific standards and it eliminates generalities.

Page 30. Charitable Property

Paragraph 4. Re: Accountability.

If the directors of a nonprofit corporation transfer for investment purposes all or part of their assets, including those held for charitable purposes, to an institutional trustee, why shouldn't the directors of the nonprofit corporation be held liable for their actions and judgment?

Does the recommendation to adopt this or a similar provision for California reflect the intent of our legislators?

Page 35. Vote Required for Member Action

Reduction of the vote for member approval from 2/3 to a majority is in keeping with current California trends.

Page 38. Required Books and Records

Allowing more flexible procedures for keeping membership and fiscal records is sound business practice.

Page 42. Membership Records

Expanded inspection rights to shareholders and stating procedures is good.

Page 132. § 5314. Personal Liability of Directors

"A director is not personally liable for the debts, liabilities, or obligations of the nonprofit corporation."

Shouldn't there be some personal accountability requirement for directors?

Page 156. § 5370. Duty of Care of Directors

"(c) A person who performs the duties of a director . . . shall have no liability. . . . "

Should some provision be made for liability and removal because of failure to perform, absenteeism, and neglect of duties?

Page 163. Article 8. Indemnification of Corporate Agents

"§ 5380. Definitions

(b) "Expenses" includes without limitation attorney's fees and any expenses of establishing a right to indemnification. . . ."

Parker v. Matthews Civ. A. No. 75-0812, April 1, 1976. 411 F. Supp. 1059 (1976). Re: "Reasonable attorney's fees."

The range of attorney's fees cited in this case was from $50.00 to $75.00 per hour.

Since we are dealing with a nonprofit corporation law, and with corporations organized for charitable purposes rather than business and profit, some corporations will have limited budgets and prudent philosophies. Attorney's fees and expenses without limitation would inhibit and limit activities of charitable nonprofit corporations which should have legislative encouragement.

Page 214. Article 6. Charitable Property

"§ 5561. Indefinite Purposes

No bequest, devise, gift, or transfer of property for a charitable purpose to a nonprofit corporation is invalid because of indefiniteness or uncertainty as to the purpose or the beneficiaries, but to the extent to which such indefiniteness or uncertainty exists, it shall be resolved by the nonprofit corporation in the manner that, in its judgement, is most consonant with the purpose of the donor and most conducive to the public welfare.

"Comment. . . . This section establishes the principle that charitable gifts shall not fail because of uncertainty as to the donors' intentions and the authority of a nonprofit corporation to resolve any such ambiguities. Charitable purposes are not defined by statute but are left to judicial development."

Doesn't this section give too much power to the nonprofit corporation in resolving ambiguities?

Contract law requires a valid contract to be free from mistake and ambiguity.

Perhaps a statutory definition of "charitable purpose" would add clarity to this section.

Establishing the principle that charitable gifts shall not fail because of uncertainty as to the donors' intentions, and giving authority to the nonprofit corporation to resolve ambiguities suggests the establishment of a dangerous legal precedent.

Page 217. § 5564. Attorney General Supervision

"Comment. [Paragraph 3.]

Interested individuals other than the Attorney General may also have standing to compel proper utilization of charitable property held by a nonprofit corporation."

Would it be helpful to outline specific steps, or procedure?

Page 220. § 5572. Administration

"The trustees of a common trust fund . . . may do all of the following . . . ."

What about restrictions and restraints; prompt removal for failure to exercise prudent judgment for the good of the trust.

Page 274. Article 3. Security for Defendants Expenses

"§ 5830. Motion for Security

In an action [against an officer or director of a nonprofit corporation, the] defendant may move the court for an order requiring plaintiff to furnish security for reasonable expenses (including reasonable attorney's fees)."

To avoid expensive litigation, but to insure expeditious handling of complaints, could an alternate method be provided where the corporation is a nonprofit, charitable corporation, such as an ombudsman or impartial person or group.

American Bar Association. A Model Ombudsman Statute for State Governments, February 1974.

ABA. Section of Adm. Law, Ombudsman Comm. The Ombudsman, N.D. Bibliog.

- - - - - - - - - . Development Report. July 1, 1973 - June 30, 1974.

Page 356. § 6526. Members' Right to Obtain Fiscal Information

(f) "Open for inspection" - good.

Page 469. § 14603. Designation of Agent for Service

The new law makes the designation of an agent for service mandatory rather than permissive.

An excellent requirement which will facilitate communication and accessibility.

And also,

Page 475. § 14611. Qualification of Corporation as Agent for Service

Improves communication and availability.

Page 587. Division 15. Societies for the Prevention of Cruelty to Children and Animals

This division is probably one of the most important parts of the new code. The subject deserves all the attention and legislative wisdom that we can supply.

Moving sections from the Civil Code to this one, give the division more continuity and makes it a complete entity.

Let us hope that Division 15 will attract the attention of individuals and groups who will use the new nonprofit corporation law for charitable purposes, and select children and animals as the objects of their charity.

/s/ Wanda Underhill

COPY OF LETTER

Sept. 4, 1976

To: California Law Revision Commission

From: Wanda Underhill

Re: New Nonprofit Corporation Law--Additional Comments

Page 214. Article 6. Charitable Property

§ 5561. Indefinite purposes

Couldn't this section be declared "void for vagueness"?

Page. 558. Part ~~2~~ 1 Corporations Sole

§ 10003. Articles (amended)

The rules, regulations, or discipline of the religious denomination, society, or church will no longer be required to state the county in this state where the principal office for the transaction of business is located.

Is this intended to reduce record keeping and increase efficiency?

Page 559. § 10006. Filing articles with county clerk (repealed)

If corporations sole are no longer required to file a copy of their articles of incorporation with the county clerk, would a local agency have to obtain the information from the Secretary of State, or will the Secretary of State automatically transmit copies of the articles to the counties as they are filed?

/s/ Wanda Underhill

Memorandum 76-82

EXHIBIT VII

LAW OFFICES OF

PILLSBURY, MADISON & SUTRO

STANDARD OIL BUILDING

225 BUSH STREET

SAN FRANCISCO, CALIFORNIA

MAIL ADDRESS: P.O. BOX 7880, SAN FRANCISCO, CA 94120

TELEPHONE (415) 983-1000

WRITER'S DIRECT DIAL NUMBER

983-1361

TELEX 34043

CABLE ADDRESS "EVANS"

TELECOPIER: TEL. (415) 398-2096

September 2, 1976

Nonprofit Corporation Law

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
School of Law
Stanford, CA 94305

Dear Mr. DeMoully:

We have reviewed the tentative recommendation relating to the Nonprofit Corporation Law of the California Law Revision Commission dated July 26, 1976 and have the following comments listed by section number:

Section 5224. Additional requirement for charitable corporations

Pursuant to Section 12585 of the Government Code and Section 300 of the California Administrative Code, Title 11, corporations formed for charitable purposes are required to file with the Attorney General copies of their articles of incorporation within six months from the date of incorporation. This requirement is satisfied by filing the registration Form CT-1 provided by the Attorney General. We see no reason to require an additional filing at the time of incorporation, since the Attorney General will not be provided with any significant new information by obtaining a copy of the articles of incorporation at the time of incorporation.

Section 5250. Required contents of articles

The words "and is subject to all provisions of the Nonprofit Corporation Law that relate to nonprofit corporations organized for charitable purposes" appear superfluous.

Section 5320. Nomination of directors

Requiring that the by-laws specify a reasonable means of nominating persons for election of directors seems

undesirable. In many nonprofit corporations the nominating procedures are informal and may vary somewhat from year to year. Requiring a specific means of nominating directors will result in many nonprofit corporations not complying either with the statute or their by-laws. This will raise unnecessary questions concerning the authority of the board of directors to act. In addition, with certain kinds of nonprofit corporations there could be questions as to what constitutes a reasonable means of nominating directors, e.g., religious organizations where the directors may be nominated by a religious superior or other official. We recommend that the section either be stricken or the word "shall" changed to "may."

Section 5362. Selection of officers

We believe that subdivision (a) is not the same as provided in the so-called clean-up law which amends Section 312 of the new General Corporation Law. The latter provides that "any officer may resign at any time upon written notice to the corporation without prejudice to the rights, if any, of the corporation under any contract to which the officer is a party." Section 5362 provides that officers "serve at the pleasure of the board, subject to the rights, if any, of an officer under a contract of employment." [emphasis added] This latter clause could be interpreted as meaning that the corporation could not terminate the position of the employee as an officer for the term of the employment contract. We do not believe this result is desired or intended. The section should be revised to conform to the wording of Section 312 of the General Corporation Law by striking the words "subject to the rights, if any, of an officer under a contract of employment."

Section 5410. Members

We believe that the rule should be that any person, including corporations, should be permitted to be a member of the nonprofit corporation unless the by-laws provide otherwise. We believe this can be achieved by revising subdivision (a) to read: "Any person may be a member of a nonprofit corporation." The words "If the bylaws provide for members other than natural persons" should be stricken from subdivision (c).

Section 5562. Institutional trustee

This section defines "institutional trustee" as an entity entitled under Section 1500 of the Financial Code to

engage in the trust business. This would not appear to apply to national banks and should be revised to refer to an entity "entitled under Sections 1500 or 1502 of the Financial Code to engage in the trust business."

Section 5750. Appointment of Inspector

We believe that it is burdensome to require the chairman of a nonprofit corporation to appoint an inspector of election at the request of any member. We recommend that the clause "and on the request of a person entitled to vote at the meeting or other election or vote shall" be deleted from subdivision (b). We recognize that this clause does appear in Section 707 of the new General Corporation Law, but we believe that carrying this protection through to nonprofit corporations is unnecessary.

Section 6142. Notice to Attorney General

We see no reason to require a copy of the agreement of merger to be sent to the Attorney General before the agreement is filed. Pursuant to Section 12586 of the Government Code, a copy of the merger agreement must be filed with the Periodic Report to the Attorney General. Therefore, like Section 5224, this appears to duplicate an existing filing requirement without purpose.

Yours very truly,

Robert B. Sullivan

Memorandum 76-83

EXHIBIT XIII

HOPKINS & CARLEY
A PROFESSIONAL CORPORATION
ATTORNEYS AT LAW
101 PARK CENTER PLAZA-SUITE 1000
SAN JOSE, CALIFORNIA 95113
(408) 286-9800

CABLE: HOPKINS

PALO ALTO OFFICE:
525 UNIVERSITY AVENUE
(415) 322-2111

LEON A. CARLEY
JOHN F. HOPKINS
FRANCIS M. SMALL, JR.
THOMAS S. JORDAN, JR.
DAVID W. MITCHELL
SHERWOOD M. SULLIVAN
BRUCE N. MUNRO
LIONEL M. ALLAN
STEPHEN H. PETTIGREW
THOMAS G. PERKINS
GARTH E. PICKETT

September 1, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
School of Law
Stanford, California 94305

Dear Mr. DeMoully:

Recently you asked for comments on the tentative recommendation of the California Law Revision Commission on a non-profit corporation law. I have gone over the voluminous materials which you sent me, with particular attention to the background and summary, and I offer the following comments for your consideration:

1. I think that the overall approach of the Commission and its consultant is excellent. The non-profit law has been confusing for years and the adoption of a new general corporation law has made it imperative that something be done about the non-profit law. I am delighted to see that this is being done at this time, and I hope that the Legislature will be able to move promptly on the Commission's recommendations.

2. To me, the policy of simplification is paramount. There are many small non-profit corporations in this state who either receive no legal advice at all or receive free legal advice. Many attorneys - and I am afraid that at times I have fallen into this category myself - are not as careful as they should be in the advice rendered to the non-profit corporations. Therefore, a clear, concise statute with a minimum number of cross-references is necessary.

3. On page 10 of the background summary, it is stated that:

> "The Commission proposes no significant changes in tax laws, corporate securities laws, or laws governing supervision of charitable trusts; these regulatory provisions embody policies that the Commission has not undertaken to review."

I would respectfully suggest that some of these policies need the review of the Commission and corrective legislation. Many laymen, if not lawyers, believe that if an organization is non-profit it can sell anything without paying sales tax and is exempt from property tax. The property tax situation is particularly confusing, as most County Assessors make a distinction between investment property and property used by a non-profit corporation. The property tax law is generally administered by the Board of Equalization on behalf of all counties, and I have personally found its administration to be very arbitrary and difficult. Particularly in the areas of sales and property taxes, it seems to me that some simplification and clarification should be sought.

4. In the summary, under Meetings of Directors, on page 18, it is stated that the call of meetings by officers is not appropriate for non-profit corporations, since the directors are the body charged with the governance of the non-profit corporation. I disagree with your consultant on this point. This is no different from an ordinary Board of Directors of a business corporation, which is also charged with governance of the corporation. It seems to me that meetings should be able to be called by officers if the By-Laws so provide. I do not know how the directors could call a meeting unless they called the meeting at a previous meeting or by unanimous action without a meeting. It seems to me that the only practical way is for officers to call the meeting with the directors also having the right to call a special meeting.

In the very next paragraph it is stated that the existing corporation law permits any quorum set by the non-

profit corporation. Again, I am not certain that I agree with your consultant on the recommendation that this should remain the same. Certainly, it should not be on the ground that the directors may be persons performing public service and often unable to attend meetings. As I understand the Statute, directors are going to be held to more or less the same standard as they would be if they were directors of a business corporation; and it does seem to me that they should therefore be expected to attend meetings and that the quorum requirements should be no different than those required for a business corporation. I was once a member of the Board of a non-profit agency with no quorum requirement to speak of and which had 180 directors. In addition to the 180 directors it had 180 alternates. A different group of thirty directors attended every meeting, and that enabled a small coterie of officers to decide what the non-profit corporation would do since no director had any continuity. This type of organization should be discouraged by the law, in my opinion.

5. No mention is made of the so-called "Constitution" of a non-profit corporation. There are many non-profit corporations that think their Constitution is their basic document. I think it would be helpful if the comment on the law made it clear that that was not the case.

Turning to the Statute itself, I have only two comments for your consideration in an otherwise excellently drafted Statute. They are as follows:

1. I do not understand why corporate finance is included in Chapter 5, between Chapter 4 on Members and Chapter 6 on Members' Meetings and Consents. It seems to me that a better order would be would be to have the chapter on corporate finance follow all members' chapters, so that it would come after the present Chapter 8.

2. I could not find a provision which clearly set forth how By-Laws could be amended. Amendments to Articles are set forth in Chapter 9, and there are provisions on voting on By-Law amendments by members. Where does it say

what By-Laws can be amended by directors and what can be amended by members? For example, could the directors deprive a certain class of members of the right to vote by a By-Law amendment?

I hope you will find these brief comments useful in your consideration.

Sincerely,

HOPKINS & CARLEY

David W. Mitchell

DWM:js

cc: G. Gervaise Davis, III, Esq.,

EXHIBIT XIV

JON B. SHASTID
ATTORNEY AT LAW

TELEPHONE 209 521-3822

P. O. BOX 1130
MODESTO, CALIFORNIA 95353

September 9, 1976

California Law Revision Commission
Stanford Law School
Stanford CA 94305

Gentlemen:

This is in answer to your request for a review of the tentative draft of the non-profit corporation law.

Non-profit corporations are an increasingly important segment of corporate law. I thoroughly concur with the concept that the non-profit corporation law should be complete in itself. I think the basic approach of the tentative draft is excellent.

All comments below refer to Part I.

At page 9, I concur that the business corporation law should be followed as closely as possible. I do not believe that "experience and cases developed under one law may be useful in construing the meaning of the other law." This goes too far in trying to draw parallels between completely differing types of corporations.

At page 19, I thoroughly agree with the recommendation on the provisional directors.

At page 21, I see no reason for resignation as an officer of a non-profit corporation to be subject to a time delay. There is no more need for a non-profit corporation to have an "adequate opportunity to obtain an officer to replace a resigning officer", than there is for a profit corporation so to do.

At page 22, I agree with the provision for liberalized indemnification.

At page 24, I am uncertain why non-profit corporations should be permitted to issue redeemable memberships. A business corporation may issue redeemable stock, but this is preferred stock, not common. I see no similarity between redeemable memberships and redeemable preferred stock. I thus feel non-profit corporations should not have the power to issue redeemable memberships, unless there is some other reason of which I am not aware.

At page 25, I concur as to the provision for partly-paid memberships, if they are authorized.

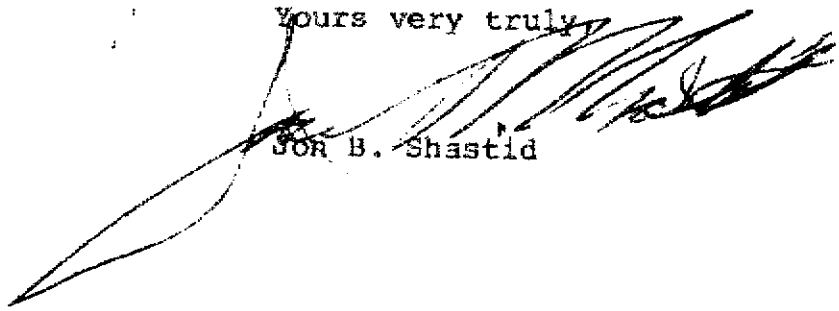
At page 41, I think the financial statements normally prepared should be available to the member. I concur that a special statement need not be prepared, but the regular financial statements -- or if nothing else, a copy of the tax returns filed with the federal and state governments -- should be available.

At page 55, I concur with the codification of cy pres. I also agree with the dissolution provisions on pages 55 and 56.

At page 66, I do not understand why non-profit cooperative corporations should be governed for the time being by the existing general non-profit corporation law.

This revision is an enormous task and I think the committee overall has done a thorough job.

Yours very truly,



JOR B. Shastid

A

Memorandum 76-83

EXHIBIT XV

San Francisco Planning and Urban Renewal Association
NEIGHBORHOOD SERVICES OFFICE
414 Clement Street, Room 5
San Francisco, California 94118
Phone: 387-0123

Roger W. Hurlbert, Neighborhood Services Advisor

September 9, 1976

Hon. John N. McLaurin, Chairman
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Chairman McLaurin:

We were very pleased to have received a draft copy of your tentative recommendations relating to the nonprofit corporation law and wish to take this opportunity to make comments.

Our office provides administrative services and consultation in a variety of matters to various nonprofit organizations composed of those who live, work or own property in specific geographical areas and whose general purpose is to combat neighborhood deterioration. These comments therefore are from the perspective of how the proposed changes will affect or improve operations rather than from a legal point of view. They are the comments of the writer and not those officially of this organization.

By way of background, most of these organizations serviced by us are small (membership averaging 200, and assets and gross receipts seldom exceeding $5,000 per year). These groups usually have no employees, the officers change annually with about a 50% turnover, and the membership is drawn from a cross-section of the population. These groups often were formed during some sort of crisis affecting their area. Individuals usually become members of these organization based upon direct mail invitations; receipt of dues automatically enrolls a member. These are organizations which cannot compel anyone to join and exercise no authority. Their articles of incorporation and by-laws are often hastily drawn, almost always by persons without legal training or orientation. The most common occurance is to copy portions of by-laws from similar, existing organizations and to use stock forms of articles of incorporation from common reference sources, including those published by the Secretary of State, Franchise Tax Board, or Internal Revenue Service. Occasionally, organizers may seek out model by-laws in law library reference books. Some groups which were organized many years ago, we have found, are unaware that they have at some time in the past incorporated.

In general, I support the idea of a separate nonprofit corporation code and am appreciative of the basic thrust of the commission's work. Specific comments and suggestions follow, related to the sections indicated.

Sincerely,

Roger W. Hurlbert
Neighborhood Services Advisor

5224. This provision would serve no purpose. I do not believe the Attorney General is interested in building a duplicate file simply of articles. It is interested in having newly-formed charitable nonpforit organizations register with the Registry of Charitable Trusts. Registration requires more documents and information than simply furnishing a copy of the articles. (See form attached). Rather, the AG desires copies of the federal tax exemption letter, advice as to the federal employer number, and names and addresses of officers and directors. Much of this information is usually not available until 30 days or longer after filing of the articles. If the intent is to call attention to Government Code provisions which require registration, perhaps those could be stated instead in the new nonprofit corporation code, or a provision inserted that the corporation would automatically dissolve unless registration were accomplished 120 days from the date of filing of the articles. Present practice appears to be that the AG sends its "Notice to Register" to new nonprofit charitable corporations (based upon receiving a copy of the Franchise Tax Board exemption letter) 30 days or more after the articles are filed. NOTE: The Commission should be concerned that nonprofit corporations organized for charitable purposes must make annual reports to two different state agencies (AG and FTB), both requiring approximately the same information. Consolidation of reporting requirements and supervision responsibility would undoubtedly save the state money, improve regulation of charities by combining personnel now in two departments, and relieve the organizations of an administrative burden.

5250. Nonprofit corporations should not be restricted from making additional statements in their articles with regard to purposes. Prompt and uncomplicated

action on federal tax exemption applications is insured when the articles contain legally accepted phrases which specify certain educational and charitable purposes, such as "lessening the burdens of government" or "instructing the public in subjects useful to the individual and beneficial to the community." If organizations are prohibited from making such statements of purpose in their articles, it is believed that many will be handicapped in gaining federal tax exemption.

5260. (a) The wording is not clear. Is the power of the members to amend or repeal bylaws always one which they have?

5264. (a)(1) Appears to leave a choice as to whether or not proxy voting is allowed. This conflicts with proposed Sec. 5730 which provides that there is proxy voting unless specifically precluded, continuing present law in this regard. However, in my view, proxy voting should be prohibited unless expressly authorized, reversing present law. Many nonprofit corporation leaders are unaware of this provision and although in actual pratice most deny proxy voting, their articles or bylaws contain no such prohibition. Proxy voting is considered to be an extraordinary matter, and thus should be expressly provided for by an organization.

5627. (a) Many (perhaps most) nonprofit corporations have no office as such. Instead, its mailing address is usually the home of its president or secretary. Frequently it has no employees. Therefore, there is no office and no office hours at which or during which bylaws or articles could be inspected. Articles of course can be inspected or obtained by mail from the Secretary of State, and the same as to bylaws on file with Franchise Tax Board. However, (a) should include the mechanism in (b) whereby a member may request in writing these documents. A reasonable length of time (not to exceed five business days) should be imposed within which to answer the request, and a reasonable charge (not to exceed fifty cents for the first page and ten cents thereafter) should be authorized. There is no reason

why the general public ("any person") should not be able to request and receive articles and bylaws. The same provisions should be extended to rights of any person to obtain a list of the officers and directors of a nonprofit corporation. True, these are to be filed in the Secretary of State's office, but delays can occur, and that office at present uses abbreviated forms which do not provide for a full listing, even of officers.

5452. (1) A time period of 10 days should be fixed by law as the record date if the board fixes no other time. To make the record date the day before notice is to be given is impractical and this provision will unknowingly handicap an organization which through oversight fails to fix a record date. Even in the smallest of organizations the mechanical processes of giving of notice (addressing of envelopes, etc.) is started well before the day before they are dispatched. In those organizations where membership is automatic upon receipt of dues, and where dues are received by a different person than the one who mails notices, impossibilities also exist in adhering to "next-day" requirements for notice.

5613. (b) Continuing to preclude the transaction of business at a special meeting other than that included in the notice is unduly restrictive, unless such a provision is also extended to regular meetings. If the purpose is to avoid surprise, then all meetings should be covered. This can serve to handicap an organization which requires only an annual meeting, but in actual practice calls meetings at various times throughout the year, at the direction of the board.

5623. Third class mail should be authorized to be used to give notice of a meeting of the members when it can be done without unreasonable compromise of timeliness. The savings to a charitable organization of 1,000 members which uses third class instead of first class mail would be $110.00 per meeting, no small item when charities are under increasing pressure to reduce administrative costs. When

substantially all of the members live in one city, there should be no difference in arrival of a first class or a third class letter when both are mailed at the same time. Also, (b) implies an obligation by the corporation to request expensive address correction service from the U.S. Postal Service. Sound organizational management practices may indicate this, but in some organizations a member who moves may be presumed to have lost membership eligibility. In any event, is it not the responsibility of the member to provide the organization with his current address?

5730. I have previously commented on proxies and wish those comments to apply here.

6524. This section, and all others which permit a member to examine a particular document, should as a matter of right (not alternately at the corporation's option) allow the member to make extracts and/or to receive an exact copy, unless impracticable to do so. (Similar to Government Code provisions related to public records). A fee for duplication of the record should be authorized.

6620+. The procedures, and the alternates which still permit an organization to maintain its mailing list confidential, are very well thought out. An organization can loose valuable good will if through release of its membership list its members suffer loss of privacy and become caught in crossfire of various factions.

PART II

14510. Present law provides that the name of a suspended corporation becomes immediately available for use by another corporation. Perhaps this should be changed. In any event, I believe the law should be amended so as to require the Secretary of State to advise a representative of a proposed corporation that while a particular name is legally available, it had been in use previously by a corporation now suspended. The Secretary of State maintains two separate name files--"active" and "inactive", (dissolved, suspended, term expired, etc). Problems can be created when a corporation which has been suspended continues to transact business under the name of the suspended corporation, and new incorporators form an entirely different corporation using that name, unknowingly. This definitely tends to mislead the public, although usually unintentionally. This situation is particularly important to nonprofit corporations where the circumstances under which many operate cause them to be suspended by the Franchise Tax Board because they fail to file information returns. Often, these returns are completed by doing nothing more than placing and "X" in one box, but the penalty for non-filing is suspension. A substantial percentage of active nonprofit organizations have been suspended for that reason; many are unaware of their status because correspondence has not reached them or because they falsely believe that a similar form filed elsewhere (with the Attorney General, for example) suffices. Although they can regain their good standing status relatively easily, they may find their corporate name taken, perhaps unknowingly, because the Secretary of State in practice checks only the "active" file in granting name availability. The "new" corporation then experiences confusion with the "old" suspended corporation, the public may be baffled and misled, and the "old" corporation must adopt a new name.

14535. If a purpose of these proposed revisions is to consolidate into one section as much of the law as possible regarding nonprofit organizations, consideration should be given to transferring the fee schedule to the Corporation Code.

14602. Nonprofit organizations should also be required to disclose directors. They, too, have effects, positive and negative, on the public, and the public has a right to know who controls all corporations. (The "Comment" is not entirely correct. Nonprofit corporations must now file a statement every fifth year, and every time there is a change of officers).

14607. The mailing of a form three months prior to the date due is too far in advance. Less efficient people will tend to lose it. Others will fill it out immediately, giving information current on the date of receipt, rather than current as of the date due, in cases where an elections were to take place between the time the form is received and the due date. The statement does not call for extensive information which takes time to develop, as in an income tax blank.

14610. The penalty which Section 25936, Revenue and Taxation Code, sets forth for the failure of a corporation to file a statement of officers is $250.00, and the section states that "such penalty shall be a final assessment." This is much too severe to impose upon a nonprofit corporation. The dollar amount would be a substantial percentage of the annual income of many nonprofit organizations. Compared to other authorized and actual penalties for far more serious crimes by individuals or organizations, such a penalty is excessive. There appears to be no provision in Section 25936 whereby for good cause the assessment may be waived. There are many reasons why a nonprofit corporation would not file a statement, primarily the mechanical and educational problems involved in becoming informed of the law and obtaining a copy of the prescribed form. The experience of the Franchise Tax Board is a parallel here. Prior to 1970, nonprofit organizations at

the time of incorporation were assured in writing by the FTB that they need submit no annual return unless their income exceeded $25,000. That year, the law was changed to require an annual return regardless. FTB, using the last known addresses available to it for those which previously required no reports, attempted to mail forms. Many were not received because of problems cited in comments on previous sections, such as absence of a permanent office, phone book listing, employees, etc. Many corporations were then suspended. However, those suspended may be brought into good standing by payment of a $10.00 fee and submission of the missing returns. Such a procedure and a penalty (more a processing fee for extra expense caused the state) is one more in line with the failure to file a statement of officers by a nonprofit corporation.

NOTE: It is also noted (page 72 of the background materials to Part I) that the commission's tentative recommendation is to increase the fee for the filing of a nonprofit corporation's statements of officers to $5.00.

In recommending changes or no changes in this and various fees, the commission does not indicate whether or not it is in possession of information regarding the adequacy of the present fees to cover the costs of the services rendered by the Secretary of State and whether or not the legislative history indicates that the filing services are to be provided on a self-supporting basis. The Legislature took specific action about 1971 to require that statements of officers of nonprofit corporations be filed without a $3.00 fee, which had been in effect until that time. That action and that of allowing nonprofit organizations eligible to file the simplified exempt organization information return with the Franchise Tax Board (Form 199B) without fee would indicate a legislative intent to waive minor filing fees for nonprofit corporations.

Memorandum 76-83

EXHIBIT XVI

SECURITY PACIFIC NATIONAL BANK

HEAD OFFICE TRUST DEPARTMENT, 333 SOUTH HOPE STREET, LOS ANGELES, CALIFORNIA

MAILING ADDRESS: P. O. BOX 2498, TERMINAL ANNEX, LOS ANGELES, CALIFORNIA 90051

September 10, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Attention: John M. McLaurin, Chairman

Re: Tentative Recommendations -
Nonprofit Corporation Law

Dear Mr. McLaurin:

Security Pacific National Bank, in its trust activities is not involved in the formation or operation of nonprofit corporations except to the extent that the Trust Department can provide services to a nonprofit corporation in the area of investment management and/or advice and bookkeeping or record-keeping services by way of an agency or custodial relationship. We also serve as trustee for employee pension and profit-sharing accounts of nonprofit corporations.

Existing Section 10,204 of the Corporations Code authorizes a charitable corporation organized under Section 10,200 to delegate the control, management and investing of property held for the purpose of income to one or more trust companies or banks authorized to conduct a trust or banking business in California. The Secretary of State has taken the position that Section 10,204 is not available to a corporation formed under the General Nonprofit Corporation Law notwithstanding the corporate charter authorizes the Directors to delegate such responsibilities to a bank or trust company.

Proposed Section 5,000 and following merges the former General Nonprofit Corporation Law and Charitable Corporations Law. Article 6, Section 5560, deals with management of charitable property. Subparagraph (b) of Section 5562 provides that a nonprofit corporation may transfer any or all of its assets (including property held upon a charitable trust) to an institutional trustee. "Institutional Trustee" is defined in §5562(a) to mean "an entity entitled under Section 1500 of the Financial Code to engage in trust business.

The restrictive definition of an "institutional trustee" for purposes of the Nonprofit Corporation Code may have the effect of limiting such "institutional trustees" to state chartered banks and exclude national banks operating trust departments in California because national banks secure authority to act in a fiduciary capacity by grant of such authority under Section 92(a) of Title 12, USC by the Comptroller of the Currency. It is, therefore, recommended that Section 5562(a) be expanded by adding the following after the word "business" in the third line of Section 5562(a): "or a national bank authorized by the U.S. Comptroller of the Currency to transact trust business in California."

Since "institutional trustees" have a variety of services available to nonprofit and/or charitable corporations, it is recommended that these various services be made available to nonprofit corporations in keeping with the needs of the nonprofit or charitable corporations. Some nonprofit or charitable corporations may require the complete services of an institutional trustee in the management of investment portfolios and others only a part of such services. The nonprofit corporation should be authorized to purchase from an institutional trustee full investment management and/or investment advice without asset management or in the alternative the authority to purchase agency or custodial services and retain the power to direct investments and engage independent investment advice.

Paragraph (c) of Section 5562 would, of course, not be appropriate if the institutional trustee is furnishing only custodial services and does not have investment responsibilities.

Paragraph (d) of Section 5562 should be referenced to paragraph (b) of Section 5563. Many charitable corporations are private foundations subject to the minimum payout requirements imposed by Section 4942 of the Internal Revenue Code.

Section 5564 provides for Attorney General supervision of nonprofit corporations holding property in a charitable trust or where the corporation is organized for charitable purposes. It is recommended that consideration be given to incorporating proposed charitable solicitation legislation at Section 5564 if the Attorney General's Task Force to Study Proposed Legislation on Charitable Solicitation recommends the enactment of such legislation.

In this regard, it is recommended that the state supervision of charitable solicitation be deemed to preempt city and county regulation of charitable solicitation to avoid the necessity of multiple licensing where a publicly supported charitable

organization makes a statewide or countywide solicitation for funds. This preemption of county and state supervision and authority should probably be effective only as to charitable corporations that qualify as "publicly supported" charitable organizations and are so classified by the Internal Revenue Service. Charitable corporations that qualify under the Internal Revenue Code as "community foundations" should, in any event, be freed from local licensing requirements as to solicitation of funds.

Section 5570 of the proposed nonprofit corporation law continues existing Section 10,250 of the Corporations Code permitting a nonprofit corporation organized for charitable purposes to establish one or more "common trust funds".

The use of the term "common trust fund" for the pooled investment fund of a nonprofit corporation is questionnable since the words "common trust fund" are accepted in the trust industry as making reference to a common trust fund defined in Section 584 of the Internal Revenue Code and Regulation 9.18 of the Comptroller of the Currency. A common trust fund is defined in the Internal Revenue Code and the Comptroller's Regulation as a fund maintained by a bank. This comment also has application to Section 5575.

In reviewing Chapter 11 of the proposed legislation, it is suggested that consideration be given to providing special provisions for terminating private foundations into publicly supported charitable organizations. The Tax Reform Act of 1969 imposed many restrictions and imposed severe penalties for certain acts of managers and fiduciaries of private foundations. The solution to the Tax Reform Act problems in many private foundations is termination as authorized by the 1969 Act by distributing all assets to a publicly supported charitable organization. Specific guidelines for such terminations and "pour-overs" would be helpful.

Section 5230(b)(7) does not tract with Section 5389. There is no express authority in Section 5230 to enter into contracts of indemnity. Section 5389(b) permits indemnification of persons described in subsection (a) under a contract "enforceable to the extent permitted by applicable law other than this article." ERISA does not expressly authorize contracts of indemnity between an employer and fiduciaries of an employee benefit plan, it merely is generally conceded that such contracts are not prohibited.

We suggest that there be added to Section 5230(b)(7) the authority to enter into indemnity contracts, subject to the limitations provided in Article 8.

Section 5323(a) perpetuates an ambiguity which exists under existing law. Prior to the 1957 enactment of the conservatorship law (Probate Code §1701 et seq.), appointment of a guardian of person or estate of an individual constituted an adjudication of mental incompetancy. Likewise, an order placing an individual under the jurisdiction of the Department of Mental Health constituted an adjudication of mental incompetency.

Under the conservatorship law, the appointment of a conservator of person or estate does not of itself constitute an adjudication of mental incompetency unless there is an express finding that the conservatee is mentally incompetent.

Similarly, the Lanterman-Petris-Short Act (Welfare & Inst. Code §5350 et seq.) has created comparable uncertainty in psychiatric proceedings.

We suggest that the new law adopt a more objective standard such as is utilized in Civil Code Section 2281(1)(c) (appointment of a guardian or conservator of person or estate). Welfare & Inst. Code Section 5350 et seq., provides for appointment of a conservator of person or estate of a person gravely disabled due to menta disorder or chronic alcoholism.

Generally, the recommendations for the rewrite and consolidation of the nonprofit corporation law into the 17 chapters is well done and is a big step toward simplification and clarification of the law.

Sincerely,

Robert L. Sorgenfrei

Robert L. Sorgenfrei
Vice President and
Trust Counsel

RLS:aw

Memorandum 76-83

EXHIBIT XVII

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A. T. PROCOPIO
1900-1974

September 10, 1976

California Law Review Commission
Stanford Law School
Stanford, California 94305

Dear Sirs:

The Tentative Recommendation relating to Nonprofit Corporation Law, Part I and Part II, has been reviewed by me. I am impressed by its comprehensive nature and thoroughness in scope and coverage. Particularly pleasing is the use, wherever appropriate, of self-executing provisions, not necessarily requiring the assistance of counsel.

Your attention is directed to proposed Section 5560(b) imposing investment responsibility upon the director of a nonprofit charitable corporation equivalent to that of a trustee, i.e. a "prudent investor." This codification of court law is salutory, indeed. However, based upon personal experiences in representing such directors against claims made by the California Attorney-General, I do not think the statute "goes far enough".

The Attorney-General's office has consistently negotiated from the standpoint that such directors are "insurers". In such negotiations the AG's office has admitted that to date the courts have imposed a "prudent investor" standard, but the A.G. argues that it is time for the courts to impose strict liability on such directors and to make them "insurers" of the charitable funds they hold on trust.

Section 5560(b) as proposed, could be interpreted as "minimum" standard only. In order not to discourage persons from serving on charitable boards, they should also be

aware of their "maximum" liability, and that maximum should not be strict, i.e. a 100% insurer.

Please consider some additional wording to Section 5560(b), perhaps similar to the following:

> "A greater obligation than as said trustee, shall not be imposed on the non-profit corporation or its directors unless clear and convincing circumstances show that it or they expressly assumed a greater obligation than as said trustee."

Sincerely,

RJB/pmh

ROBERT JAMES BERTON, of
Procopio, Cory, Hargreaves
and Savitch

Memorandum 76-89

EXHIBIT XVIII

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September 10, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Tentative Recommendation Relating to the Non Profit Corporation Law

Ladies & Gentlemen:

I have reviewed the tentative recommendation for legislation revising the California Non Profit Corporation Law. I have the following comments:

1. I agree that a separate, independent statute governing California non profit corporations is desirable, although I do not necessarily agree with the statement made at page five of the recommendation to the effect that the existing law has not worked well in practice.

2. I strongly agree with the simplified incorporation procedure and I agree generally with the philosophy that would eliminate needless formality in the formation and operation of non profit corporations.

3. I believe that it is quite sound to establish a separate Section of the Corporations Code for provisions that are applicable both to business corporations and non profit corporations. Indeed, I believe that this segment of the Code should be expanded to the extent possible in order to avoid needless duplication, with a resulting decrease in the cost of reproducing a complete Corporations Code. The comments in the tentative recommendation, following many of the Code Sections, indicate that the Section is substantially the same as a corresponding Section affecting profit corporations. Many of these Sections, it seems to me, could be moved out of the separate divisions and combined into a single Section in the common division. While such a procedure may necessitate additional cross referencing and may be confusing in some instances, it would result in a significant reduction in the use of resources.

4. A number of Sections in the recommendation refer to

corporations formed "for charitable purposes," and it is noted in the text in a number of places (e.g. page 407) that "Charitable purposes are not defined by Statute but are left to judicial development." This procedure may create unacceptable uncertainty for the Administrator of a non profit corporation. He must decide whether the corporation is obligated to send a copy of its Articles to the Attorney General (§5224) and whether to notice the Attorney General in the event of certain other actions such as a disposition of substantially all assets (§6012). Furthermore, the Articles of Incorporation under §5250 must specifically reflect the fact that the corporation is organized for charitable purposes. The Administrator or his attorney oughtn't to be faced with a task of legal research in order to answer these questions; the definition of charitable purposes ought to be determinable from a reading of the Statute.

I also wonder whether the charitable purposes concept is appropriate everywhere it is used. For example, §6773 prohibits a distribution to members on disolution of a corporation organized for charitable purposes. This prohibition, perhaps, ought to apply in circumstances other than the disolution of a corporation organized strictly for charitable purposes. A civic league, formed for public, though not necessarily charitable purposes, ought not to be permitted to distribute its assets to its members upon disolution, particularly, if it has solicited funds from the general public.

5. Section 5230(b)(6) specifically authorizes the payment of pensions and the establishment of pension and other deferred Compensation plans. No specific reference is made to Profit Sharing Plans, perhaps, because of the traditional notion that "non profit corporations" do not have profits. The omission appears to be unnecessary in light of §5233 authorizing gainful business activity. Furthermore, the omission is confusing since it is almost certainly not intended to prohibit traditional "Profit Sharing Plans," and, furthermore, the clause specifically authorizes Savings and Thrift Plans which are normally treated as Profit Sharing Plans under the provisions of §401 of the Internal Revenue Code.

6. Section 5373 prohibits loans to Directors or Officers of a non profit corporation with certain exceptions, including loans made to officers pursuant to an Employee Benefit Plan. I believe that the Section ought to have a specific provision to validate "Participant Loans" from Plans qualified under §401 of the Internal Revenue Code, as such loans are defined under §4975(d)(1) of that Code. I think that such a clarifying provision is necessary because the provisions of §5373(b) ought not to be applicable to such loans

and, at the same time, a qualified Plan could probably not make the kind of loan that is contemplated by §5373(b) because such a loan would constitute a prohibited transaction.

7. Section 6012 requires notification to the Attorney General whenever a non profit corporation organized for charitable purposes transfers all or substantially all of its assets for less than a full consideration. I believe that this Section should contain an exception for a private foundation that is winding up and distributing its assets to public charities pursuant to §507(b) of the Internal Revenue Code. Attorney General surveilance of transactions of this nature is not necessary, and the additional requirement of notification to the Attorney General will only needlessly complicate what is already an unduly complex procedure.

8. Section 6146 states that any bequest to a constituant non profit corporation "which is to take effect" after merger or consolidation inures to the surviving corporation. The quoted language may create a problem since it seems to suggest an element of intention on the part of the testator. Would it not be more direct and more clear merely to provide that any bequest "which takes effect or remains payable" after merger inures to the benefit of the surviving corporaton. The same comment would apply to §6245.

9. Sections 6520 et. seq. deal with the requirement of an Annual Report. It seems to me that these Sections should apply to existing corporations so as to require an annual report only if the By-Laws of such corporation so provide. Otherwise, it will be necessary for practitioners to contact the large number of corporations to provide for an Amendment of their By-Laws in order to avoid a requirement that is not now applicable.

10. Section 6773(b) seems to require a court decree in connection with the disolution of any charitable organization. This procedure is certainly not currently followed, at least with small charitable foundations. The imposition of such a requirement is not justifiable because it would not add any substantial protection to the attainment of charitable purposes, but it would add to the cost of disolving small charitable corporations. The net result would be an increase in the income of lawyers and a decrease in the amount of assets going for charitable purposes.

I extend my compliments to those who have been and are still

in this project. I hope that my comments will prove of some value.

Sincerely yours,

Albert J. Fink

AJF:an

Memorandum 76-83

EXHIBIT XIX

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September 13, 1976

The California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Draft Nonprofit Corporation Law

Gentlemen:

The following are my comments regarding the draft nonprofit corporation law dated July 26, 1976.

I am not in a position to comment upon all aspects of the draft. I have used the current nonprofit corporation law in my practice in connection with two types of organizations: small tax-exempt organizations and homeowner associations. Accordingly, I shall limit my comments to the effect of your draft upon such organizations.

The nonprofit corporation is a useful form of organization for small public and private charities or other tax-exempt organizations. Generally these organizations have self-perpetuating boards of directors and are designed to function in limited areas. Examples are a veterinary medical research clinic, an art education foundation and a conservation group which I have organized. These organizations have a great need for simple procedures.

The homeowners associations are either condominium management associations or associations which manage common area or recreational facilities for a group of single-family detached dwellings. In both instances, membership in the corporation is dependent upon ownership of real property and is not severable from ownership of such property. The boards of directors of such associations generally are laymen who will not understand great complexity.

The draft nonprofit corporation law is, on the whole, a worthwhile effort. However, there are a number of minor flaws and one very serious flaw which should be remedied. The one most significant flaw is in Section 5512, which permits a member subject to a capital improvement assessment to withdraw from membership. Such a provision is wholly inappropriate for a homeowners association for reasons which will be discussed below.

My comments regarding the draft are as follows:

1. Section 5150.

The adoption of a statute incorporating generally accepted accounting principles into the statute has been debated at great length in connection with the new Corporation Law. The debate should not be repeated here. However, I do not believe that those concepts will be well understood by laymen who will operate their corporations without benefit of sophisticated counsel or accountants. In addition, I question the wisdom of permitting the accounting profession to effect amendments to the nonprofit corporation law by the mere act of changing their accounting principles rather than through the normal legislative process.

2. Section 5313.

If only a single person is named as initial director and that person dies before the corporation is organized, it would seem that the corporation cannot be organized and the organizational expenses incurred will be lost.

3. Section 5354.

The use of the Latin words "mutatis mutandis" should be eliminated. Statutes should be written in the English language since that is the language spoken and understood by the majority of the people in this State. The Legislature, in its wisdom, may determine to provide translations for the benefit of minorities in such languages as Chinese and Spanish, but the sprinkling of Latin words in statutes serves no useful purpose. The draftsmen of Section 5354 must have recognized the confusion introduced by the use of Latin words because they found it necessary to explain the meaning of the phrase in the Comment.

4. Section 5443.

Where a homeowners association uses a nonprofit corporation as its vehicle for organization, individual members should not be permitted to withdraw. Recorded declarations of covenants, conditions and restrictions tie membership in the association to ownership of the affected parcels of real property. The declarations do not permit the owners of real property to withdraw from association membership except in the event of disposition of the property. Permitting withdrawal from the corporation merely will create confusion.

It would not be sufficient merely to permit the bylaws to contain a provision prohibiting withdrawal. It would be difficult, and in some cases nearly impossible as a practical matter, to amend the bylaws of existing homeowners associations.

A special provision in Section 5443 should be included making the section inapplicable to situations where recorded declarations of convenants, conditions and restrictions provide a different rule.

5. Section 5512.

This section brings into sharper focus the problem raised by Section 5443. A homeowner or condominium owner whose property is subject to capital improvement assessments should not be permitted to escape liability by withdrawing from the association. The other members must be presumed to have purchased their condominiums or homes in reliance upon a structure which would force all owners to bear the costs of operation or improvements equally or proportionately. If Section 5512 is designed only to permit the owners to escape personal liability, and is not designed to free their property from liens imposed by capital improvement assessments, such a distinction should be made clear in the statute. The distinction is probably meaningless, however, because the recorded declarations for many associations currently impose some form of personal liability on owners for assessments. For the foregoing reasons, I would recommend that Section 5512 either be deleted or that a special exception be made for homeowners and condominium owners associations.

6. Section 5530.

This section, which restricts the issuance of evidences of indebtedness, should not apply to a corporation which is organized for charitable purposes. A charity might determine to make distributions in the form of interest-bearing obligations. Such obligations might be issued without consideration or for a consideration consisting of a change of position by the recipient not involving any of the items of consideration specified in Section 5530(a)(1) through (6). As long as the corporation is performing its charitable functions to the satisfaction of the Attorney General, no restrictions such as those found in Section 5530 should be necessary.

7. Section 5627 and Section 5631.

It would appear that Section 5627 and 5631 are inconsistent with each other. If an action may be taken by written consent without a meeting and without prior notice by less than all of the persons entitled to vote, then there is no reason to require a higher number of persons to sign a waiver of notice, a consent to the holding of the meeting or an approval of the minutes of the meeting.

8. Section 5732.

The provisions of Section 5732 relating to the form of proxy may be appropriate for a profit-making corporation. They are, however, far too complex for homeowners associations.

The following are my comments on proposed New Division Four of the Corporations Code:

1. Section 14602.

Most homeowners associations change their officers every year, and sometimes more often. An annual filing requirement would be less burdensome upon such corporations then the provisions of Section 14602. The same would be true for small charities.

2. Section 14610.

The $250 penalty provided in Section 25936 of the Revenue and Taxation Code is an unnecessary burden imposed upon small charities. The penalty, as a practical matter, will fall only upon those persons who would have been charitable beneficiaries had the $250 been available for distribution.

This letter should not be construed as a general criticism of the draft. On the whole, the draft provisions would seem to provide an excellent substitute for the existing nonprofit corporation law. The authors of the draft should be congratulated for their fine work.

Very truly yours,

Fred B. Weil

FBW/caj

For BROAD, KHOURIE & SCHULZ,
Professional Corporation

EXHIBIT XX

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September 13, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Comments on Tentative Recommendation for Non-Profit Corporation Law

Gentlemen:

I have had an opportunity to review the proposed Non-Profit Corporation Law and have a number of comments with reference thereto. As a general matter, I think that the idea of a basic, self-contained Non-Profit Corporation Law is an important step forward in this area. At the present time, I have several clients who are all non-profit corporations. One is a cemetery corporation whose basic organization is found in the Health and Safety Code. Private foundations and social clubs are found in the Corporations Code. Finally, I represent a church organization which is governed under the Corporate Sole Provisions. I hope that no matter what happens with reference to the recommendations, that the concept of a specific body of law relating to all non-profit corporations is put into effect by the California legislature.

I have a number of specific comments, and some may overlap into various different code sections. I will cite the specific code section where the comment came to mind.

1. Section 5180(a)(2). I feel that any verification executed "under penalty of perjury" should be limited to executions occurring within the state. This would make it conform with the provisions of the Code of Civil Procedure and the recognized practice that verification of a document executed outside the State of California must be done before a Notary Public.

2. Section 5320 Series. At some stage in the matter of directors, there should be recognition given to some unusual practices in non-profit corporations. Sometimes you will find that directors must have specific characteristics; e.g., an attorney, a banker, a resident of a specific county, holder of a particular office such as President of the Mechanics Institute, etc. In other instances, you will find directors who must be appointed by a specific person, normally by the presiding judge of the court, or maybe the Board of Directors of a corporation. These limitations should be known to all, and I would suggest that it be required that any such limitation in connection with the Board of Directors be set forth in the Articles of Incorporation of a non-profit corporation rather than in the bylaws.

As another matter involving directors, it is common with reference to non-profit corporations to have honorary directors. I think that there should be some recognition of this category of directors who may not vote and you may not wish to include for purposes of determining a quorum, but who you do want to have as a "director" of the non-profit corporation.

3. Section 5332(d). In connection with the director's special meeting notice or waiver, I feel that the specific purpose of the special meeting should be set forth. You will note that in Section 5613 and 5622 where the special meeting of members is provided for that the specific item to be discussed at the special meeting must be set forth. I feel that the same holds true for the directors.

4. Section 5373 I feel should be eliminated. I think that the matter of loans to directors or officers of profit corporations is questionable enough; but for a non-profit corporation, I think that the same is improper and, indeed, could encourage potentially wrongful conduct. No non-profit corporation should be in the position of making a guarantee or lending money to an officer or director.

5. With reference to the indemnification of corporate agents, Section 5380 and following, I think that there are some real problems. For example, in the private foundation, what about the foundation managers where there are violations of the Tax Reform Act of 1969? There are some violations where there is no direct benefit to the foundation manager, for example, failure to pay out sufficient sums of money during the year or excess business holdings in the investment portfolio, as well as ones involving self-dealing. I think that the way the Section 5380 et. seg. reads now, any foundation manager could be fully indemnified by the non-profit corporation, including civil penalties from the Internal Revenue Service, and I do not feel that such is appropriate.

6. Section 5512. I do not feel that a person should be allowed to withdraw his pledge for a capital improvement matter. Normally, these pledges are taken to the bank or some lender who in good faith and based upon the pledges presented to it makes a loan. I realize that in some instances pressure can be brought to bear to sign pledges and that second thoughts about signing a pledge for capital improvement may lead to a desire to withdraw. However, I feel that where there has been obligations incurred in good faith by third parties based upon the pledges, that there should not be this permission. Insofar as a pledge to operating expenses, I feel that the procedure set forth of permitting a withdrawal as an absolute matter of right under certain circumstances is appropriate.

7. I agree with the Law Revision Commission with reference to Section 5520 on the following regulating authority for subvention. I still think that there should be some protection in those areas where, like church bonds, there may be pressure, particularly upon unsophisticated people as to subvention and other indebtednesses of the church.

8. In connection with Section 5550 and following, what are you going to do about the member who resigns from the organization to avoid the limitations on the payments to him as member such as set forth in Section 5551? I think that when a perso

is a member at the time that he obtains the certificate, that he should not be able to improve his position by a quick resignation or withdrawal.

9. Section 5360. With reference to the duties of the trustee for investment purposes, I think some recognition must be given, particularly in connection with subparagraph (b) about those organizations which are formed for high-risk purposes, such as upgrading slum property, investing in struggling minority businesses, etc. As investments, these obviously would be against the Prudent Man Rule, but where it is the specific purpose of the organization to make these types of investments, there should be some relief.

10. Section 5839. I feel that the 10 percent figure is much too small. Many times members of an organization are the Board of Directors, and this means that one person could institute such proceedings. I think that 50 members are a good limit, but the percentage test should be increased to 35 percent. You must remember that this is only to avoid the furnishing of security as an absolute requirement. It would still be up to the directors of the non-profit corporation to go into court to establish no reasonable possibility of benefit. I think that if you are going to be able to institute proceedings and avoid the possibility of such a motion requiring security, that there ought to be a goodly number of people involved rather than just one disgruntled person.

11. Section 6011. I feel that where there is a sale or transfer of all or substantially all of the assets, the members should approve it before the transaction. A meeting can be held in ten days' time and you can post notice for unknown members, so I don't think that this is too much of a hardship. On something as important as this, prior approval should be required.

12. In Sections 6142 and 6242, I think that there should be a stated time period for the Attorney General to decide to object before the transaction is completed. The way that the section is written now, it is left a little uncertain as to what would happen if somewhere down the line the Attorney General decided to interpose an objection.

13. In connection with Section 6700 involving voluntary dissolution, I think that notice should be given to the Attorney General where there is a charitable trust involved.

14. In connection with the permissible corporate name, I think that where the organization is, or impliedly is, a chapter or subsidiary of a national body, such as fraternities or lodges or a local chapter of a heart association, cancer society, etc., that the Articles of Incorporation must be filed by a member of the national body or with the consent of the national body, and further that any use of the name is with the consent of the national body. I think there could be well meaning and unintentional efforts to file Articles which contain a name similar to a national body in order to show some similarity of purpose. A deliberate matter can be done to assist in fund raising efforts.

I appreciate your letting me review the proposed recommendations and would be very happy to discuss any of these or other items in greater detail if you desire.

I also would like to be kept advised of what happens to the Non-Profit Corporation Law and its submission to the legislature.

Sincerely yours,

Philip M. Jelley

PMJ:dgd

Memorandum 76-83

EXHIBIT XXI

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September 13, 1976

California Law Revision Commission
Stanford Law School
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Gentlemen:

Thank you very much for having given me the opportunity to review your Tentative Recommendation relating to Nonprofit Corporation Law. I have read the material through and in this cursory reading discovered no significant defects. Due to unexpected illness and unanticipated obligations I have not had an opportunity to study the recommendation in the manner I had hoped I would. It will be the end of November before I have some free time again, but if you will still accept comments after that time, please let me know as soon as possible and I will set aside that time for a deeper review of the work.

Very truly yours,

Kenneth James Arnold

Kenneth James Arnold

Memorandum 76-83

EXHIBIT XXII

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September 14, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Comment on Proposed Nonprofit Corporation Law

Gentlemen:

This comment has been prepared by us on behalf of Mission Viejo Company ("MVC") which is a large-scale land developer based primarily in Orange County, California. In connection with its real estate developments, MVC has formed a number of homeowners' associations in the form of nonprofit corporations. Based upon its substantial experience with such corporations, MVC has asked us to comment on certain relevant sections of California's proposed Nonprofit Corporation Law ("Act").

In reviewing Sections 5443 and 5512 of the Act it would appear that the Law Revision Commission has not given consideration to the needs of homeowners' associations in the form of nonprofit corporations. Although homeowners' associations sometimes take the form of unincorporated associations, nonprofit corporations are generally preferred since they create limited liability in the members and there are clear statutory provisions governing their structure and operations. Indeed, it is extremely difficult to obtain a Final Subdivision Public Report from the California Department of Real Estate unless a proposed homeowners association is, or will be, incorporated. Therefore, it is important that the Nonprofit Corporation Law of this state provide an appropriate means by which homeowners' associations may function effectively through the use of the corporate form.

Sections 5443 and 5512 of the Act provide that members of nonprofit corporations shall have rights to withdraw from membership under certain circumstances. Such withdrawal rights may be a useful device in nonprofit corporations formed by clubs,

charities or similar groups but homeowners' associations, on the other hand, are an integral part of a system of deed restrictions and private government by which the subject real property is managed. Due to the nature of this system, the statutory provisions for withdrawal rights as presently drafted would have drastically adverse consequences for all homeowners' associations organized as nonprofit corporations and for all future similar developments.

The Conditions, Covenants and Restrictions ("CC&R's") of a real estate development create property rights and corresponding obligations in the form of reciprocal servitudes in the common areas and the individual lots. These rights and obligations include general assessments for maintenance of the common areas, architectural controls and use restrictions over the real property subject to the CC&R's. The CC&R's also create management and enforcement mechanisms so that the real property subject to the CC&R's can be effectively governed. When a homeowner purchases a lot covered by the CC&R's, he becomes subject to the obligations and vested with the rights created by the CC&R's. It is never contemplated in drafting CC&R's that a member be able to withdraw from the obligations imposed by the CC&R's, since such withdrawal would destroy the governmental function of the CC&R's and deprive other owners of certain of their property rights.

As in any other type of governmental structure, homeowners' associations can function effectively only if all of the people within the jurisdiction are bound by the same laws. In the setting of homeowners' associations, the applicable laws are the CC&R's. The management of the association must be able to enforce the lot restrictions uniformly and assure that those who benefit from the common areas and use restrictions of the subdivision are the ones who pay for the maintenance and management of the association property. Members cannot be permitted to withdraw from homeowners' associations if such associations are to remain a viable method of private land management.

In order to establish the governmental structure, the CC&R's typically provide that all owners automatically become members of a homeowners' association, which frequently is organized as a nonprofit corporation. In such cases, Sections 5443 and 5512 would presumably govern such a homeowners' association. It is not clear, however, what effect those Sections would have on the system of private government created by a typical set of CC&R's.

Since the Act governs only membership in the nonprofit corporation, it is likely to be construed to have no effect on the CC&R's. In this event, a member could withdraw from the association, but his lot would still be subject to all restrictions in the CC&R's and to all liens created to enforce the assessments. Withdrawal would only serve to deprive the member of rights to vote and to participate in the management of the Association. In such a case, withdrawal rights would serve no purpose.

If the withdrawal rights of Sections 5443 and 5512 were construed to permit an owner to withdraw from the system of private government created by the CC&R's, the result would be devastating. Individual owners could unilaterally exempt themselves from their obligations under the CC&R's. Surely a statute designed to govern nonprofit corporations should not permit the possibility of an interpretation that would destroy recognized property rights like those created in CC&R's. Such an interpretation, while unlikely, would be possible until litigation settled whether the Act was intended to destroy such property rights and whether such a statutory provision was constitutional.

Nevertheless, until it becomes clear that owners could not escape from the burdens placed upon them by the CC&R's through the withdrawal rights of Sections 5443 and 5512, careful lawyers may avoid use of the corporate form for homeowners' associations. Such a course would, however, have risks such as the exposure of the individual members of the associations to the risks of unlimited liability; the developer would also run the risk of such liability. This result could substantially retard the growth of planned developments in this state. Further, the uncertainty in the law would almost surely result in costly litigation for existing homeowners' associations already organized in the corporate form.

Since Sections 5443 and 5512 may serve a valuable purpose for most nonprofit corporations, we do not propose that these sections be deleted. The needs of homeowners' associations will be adequately served by their exclusion from these sections. The following language is proposed as amendments to the Act.

PROPOSED ADDITIONAL DEFINITIONS:

Owners' Association. "Owners' association" means a nonprofit corporation created to own or lease the commonly owned lots, parcels or areas referred to in clause (a) of Section [definition of real estate development], or to provide management, maintenance, preservation or control

of either such lots, parcels or areas or of the separately owned lots, parcels or areas, or both, or any portion of or interest in them, if the shares or certificates of membership therein are transferable only by transfer of the separately owned lots, parcels or areas in a real estate development. Such shares of stock or memberships shall be considered interests in a real estate development.

Real Estate Development. "Real estate development" means a development (a) which consists or will consist of separately owned lots, parcels or areas with either or both of the following features: (1) one or more additional contiguous or noncontiguous lots, parcels or areas owned in common by the owners of the separately owned lots, parcels or areas, or (2) mutual, common, or reciprocal interests in or restrictions upon all or portions of such separately owned lots, parcels, or areas; and (b) in which the several owners of the separately owned lots, parcels or areas have rights, directly or indirectly, to the beneficial use and enjoyment of the lots, parcels, or areas owned in common, or any one or more of them or portions thereof or interests therein, or of the interests or restrictions referred to in clause (a) above, or both. The estate in a separately or commonly owned lot, parcel, or area may be an estate of inheritance or perpetual estate, an estate for life, or an estate for years. The common ownership of the lots, parcels or areas of the enjoyment of the interests or restrictions referred to in clause (a) above or both may be through ownership of shares of stock or memberships in an owners' association or otherwise.

COMMENT

The definitions of "owners' association" and "real estate development" are added to the definitional section in order to streamline the changes needed in the substantive text. It will also result in added convenience in drafting any subsequent amendments to the Act involving owners' associations or real estate developments. The definition of "owners' association" is taken from Corporation Code 25012 and a similar counterpart in the Subdivided Lands Act, Business and Professions Code 11003.1. The proposed definition has been changed from Corporation Code 25012 only by deleting reference to unincorporated associations. The definition of "real estate development" is taken from the Corporation Code 25015 and a similar counterpart in Business and Professions Code 11003.1.

The use of these definitions has two advantages. First, it makes the Corporations Code consistent in its use of terms. It would only serve to confuse if the same terms were defined differently within the same code. Secondly, it ties the Nonprofit Corporation Law to the Subdivided Lands Act. Owners' associations have characteristics which subject them to the dual authority of the Corporations Code and the Real Estate Law section of the Business and Professions Code. It is important, therefore, that the definitional terms used in these acts use the same language.

PROPOSED AMENDMENT TO §5443:

5443(b). Notwithstanding the provisions of subsection (a) above, unless the bylaws of an owners' association provide otherwise, a member of an owners' association may withdraw from membership therein only by transfer of the lot, parcel or area from which such membership in the owners' association is derived.

COMMENT

MVC does not have knowledge of the organizational requirements of nonprofit corporations formed for purposes other than owners' associations. Therefore, the proposed amendment to Section 5443 provides specific authorization for the traditional practice of owners' associations throughout the State of California. The proposed amendment is intended to be drafted in a manner which does as little violence as possible to the original section, while providing the means for owners' associations to govern their affairs effectively.

PROPOSED AMENDMENT TO §5512(c)*

(c) Any member, other than a member of an owners' association, subject to a capital improvement assessment may withdraw from membership by delivering to the nonprofit corporation at its principal executive office written notice of withdrawal within a period of 15 days from giving of written notice of assessment by the nonprofit corporation pursuant to subdivision (b). The withdrawal shall be upon the same terms and conditions established by the nonprofit

*(Proposed amendments are underlined.)

corporation for withdrawal from membership in the absence of such an assessment and upon withdrawal from membership in a nonprofit corporation other than an owners' association, the withdrawing member shall not be liable for such assessment.

COMMENT

The CC&R's of most homeowners' associations continue the homeowners' personal liability for payment of outstanding assessments after the sale of the home. The result of this practice is a negotiated off-set in the purchase price of the home. We believe the last sentence of §5512(c) as presently written could be construed to relieve the homeowner of personal liability after the sale is completed. The proposed amendment is intended to resolve this problem.

There is one additional problem with Section 5443. We raise it here since it is only tangentially relevant to the homeowners' association problem. Although the section states that the bylaws must provide for withdrawal of members, it does not specify what requirements for withdrawal will satisfy the section. The Comment states that the section codifies the holding in Haynes v. Annandale Golf Club which merely holds that a nonprofit corporation may not hold its members in perpetuity. The suggestion of Haynes, followed in Associated Press v. Emmett, 45 F. Supp. 907, 918 (S.D. Cal. 1942), is that restrictions on withdrawal will be upheld if reasonable. In the Associated Press case, the Court found that a bylaw provision allowing withdrawal two years after giving notice to the corporation is not unreasonable. However, even with the guidelines of this case, there is a considerable period of uncertainty between the two-year period of Associated Press and the thirty-day period of Section 5443(a). We believe the section would be improved if the maximum notice period which the bylaws could require was included in the Act.

This comment has been directed solely at Section 5443 and Section 5512 of the Act, as these impact so severely on the activities of MVC. We have not had time to carefully scrutinize the entire proposal and therefore cannot comment further at this time. However, if the Law Revision Commission would consider extending the comment period, we would be better able to analyze

the proposal and to comment intelligently on its strengths and weaknesses.

We thank the Commission for this opportunity to comment on the Act. We hope that our analysis of the effect of the Act upon homeowners' associations within this state will enable the Commission to find the satisfactory solution to the problems we foresee.

Very truly yours,

McKENNA & FITTING

McKenna & Fitting

California State Automobile Association

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EXECUTIVE OFFICES

September 14, 1976

California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Attention: John DeMoully, Esq., Executive Secretary

Gentlemen:

Having had opportunity to confer with the staff of the Automobile Club of Southern California regarding their comments on the Commission's tentative Recommendation relating to Nonprofit Corporation Law, the staff of the California State Automobile Association concurs and joins therein. We will not, therefore, repeat what has been well expressed.

Wishing to detract neither from our wholehearted agreement with Mr. Nida's observations concerning simplification of Chapter 16, nor our continuing concern for the protection of the membership list from abuse, we see within the provisions of Section 6622 the seeds of unjustified expense to and harassment of a large membership organization. A series of demands, ostensibly bona fide and appearing to be reasonably related to the member's interests as a member, would not be difficult to frame.

The comment to Section 6622, and the text of Section 6650(a), both recognize that a demand for inspection must be for a proper purpose, as well as being reasonably related to the member's interests as a member. The text of Section 6622, however, simply recites the reasonable relationship test. We suggest inclusion of the proper purpose test within the statutory text itself.

We suggest, too, that a corporation which can or does afford a reasonable and appropriate alternative to inspection--one which will satisfy the purpose which the member seeks to achieve by inspection--should be permitted to provide it in lieu of the considerable cost of producing its then current list of, for instance, 1.5 million members.

Concerning the five-day notice requirements, we feel that ten days is about the minimum reasonably required to analyze a demand, determine its propriety, and either comply in a proper case, or draft and file for judicial relief, calendar and serve, should that become necessary.

Finally, we question the utility of the postponement provision of Section 6624(b). It can be impossible to "hire a hall," so to speak, on short notice. Imposition of the sanction on short notice could do a great deal more harm than good. We suggest its deletion. If, however, it is felt that subdivision (b) should be retained, we suggest that it read as follows:

> (b) Postponing any previously noticed meeting of members if the nonprofit corporation has failed to comply with a proper demand under Section 6623 within the time limits prescribed either in that section or in an order made pursuant to subdivision (a), but any such postponement shall not exceed a period equal to the period of delay by the nonprofit corporation and provided, however, that no such postponement shall be made of the annual meeting of a nonprofit corporation unless demand is made prior to the giving of notice under the provisions of Article 2, Chapter 6 of this Code. This remedy is in addition to any other legal or equitable remedies to which the authorized member may be entitled.

We thank the Commission for this opportunity to comment.

Sincerely,

Wells A. Hutchins

WAH/kp

EXHIBIT XXIV

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September 14, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Nonprofit Corporation Law

Gentlemen:

Pursuant to the Law Revision Commission's request of July 26, the staff of the Automobile Club of Southern California has reviewed the Commission's Tentative Recommendation relating to the Nonprofit Corporation Law and submits the following comments on the current draft.

1. General Approach

The Club supports the general approach taken by the Commission in drafting a complete and self-contained nonprofit corporation law. We believe this approach will facilitate the use and understanding of the statutes applicable to nonprofit corporations by both lawyers and laymen. This is particularly important in view of the fact that lawyers frequently perform legal work for small nonprofit corporations without compensation, and following formation, many small nonprofit corporations are operated by laymen without the benefit of legal counsel in day-to-day operations.

In drafting a "complete" nonprofit law, however, we believe it is important to distinguish between completeness as to the basic needs of all nonprofit corporations, vis-a-vis protection of members, creditors and the public, and the desire to regulate particular aspects of the operations of some nonprofit corporations. The Nonprofit Corporation Law should provide the basic statutory structure for forming, operating, and dissolving nonprofit corporations applicable across the board to all, consistent with the philosophical framework which the Commission adopted and which is set forth at pages nine through ten of the Tentative Recommendation. Many nonprofit corporation are regulated by extensive statutory provisions in other codes, which we believe is appropriate. Attempts to write regulatory statutes to resolve perceived problems in some types of nonprofit corporations may have unintended adverse consequences for the thousands of nonprofit corporations not identified as a part of that problem.

We believe the Commission has generally made the desired distinction throughout the draft; however, we respectfully submit that the Commission has ventured unnecessarily into the regulatory area in its drafting of Chapter 16 (Rights of Inspection) upon which we comment more completely below.

2. Philosophy of Draft

We wholeheartedly support the "Philosophy of New Statute" set forth at pages nine and ten. Again, we believe the Commission has followed this philosophy in drafting the new law, with the exception noted above. In Chapter 16, changes are proposed in the law which appear to be designed to regulate specific nonprofit corporations, yet which will apply to all. The need for change in this area is questionable, since the courts have found the necessary authority in existing law to propose and impose changes deemed desirable. These changes vary from both the existing law and the new General Corporation Law. With the exception of Chapter 16, however, it is our view that the draft is a successful implementation of these desirable themes.

3. Directors' Duty of Care

The Commission is quite correct in pointing out at pages nineteen and twenty that nonprofit corporations must be able to attract competent people of the highest integrity to serve as directors, frequently without compensation. One aspect of this problem is to assure that the director has the means at hand to avoid, by his conduct, the imposition of liability for such conduct, unless it clearly violates a standard of care suitable to the situation.

The new General Corporations Law provides a flexible and realistic standard upon which the performance of a director can be judged, and which can be used by a director in guiding his or her conduct to assure avoidance of liability by reason of being or having served as a director. We believe adoption of this standard in Section 5370 of the Nonprofit Corporation Law draft is appropriate.

4. Membership Certificates and Cards

Many nonprofit corporations issue membership cards as a means of establishing the identity of a person as a member. The question has occasionally arisen as to whether such cards are membership certificates in law, thus requiring certain disclosures to avoid public confusion. Because of the size of such cards, the public's perception of what they represent, and their utility in performing the identification function, we are wholly supportive of the Commission's proposed distinction between cards and certificates.

To fully accomplish the Commission's purposes set forth at page twenty-three, however, we recommend that Section 5424(b) be revised to clarify that the "property interest" contemplated is a current property interest, and not one contingent upon dissolution of the nonprofit corporation. Alternatively, this clarification could be included in the comment at Page 179.

5. Proxy Voting

In a large nonprofit corporation such as the Automobile Club (which has over 1.3 million voting members), proxy voting is a necessity if adequate member participation is to be assured at a cost tolerable to the membership as a whole. We believe the Commission appropriately provided for the use of proxies, and more specifically, the use of general proxies.

We recognize that, of necessity, the selection of a maximum period of time for the validity of a proxy must be somewhat arbitrary. Although we can concur that the duration of 7 years in existing law may be too long, we also question whether the proposed reduction to 3 years might not be too short a period of time. In our view, this question really becomes one of cost to the membership and, within a reasonable statutory framework, this decision of duration should be left up to the nonprofit corporation. Perhaps five years is a reasonable compromise, since abuses based on the duration of revocable proxies have not, to our knowledge, been identified. The cost factors for a large organization are significant, however, and our analysis shows the following annual costs attributable to soliciting proxies for the durations shown:

3 years	$162,849
5 years	$114,514
7 years	$ 93,799

6. Cumulative Voting

We concur with the Commission's decision to permit the nonprofit corporation to determine whether or not cumulative voting is necessary, desirable, or even practical for that particular organization. In this context it should be noted that there are significant differences between business corporations (where ownership of multiple shares is the rule) and nonprofit corporations (where single memberships are the rule). Also, nonprofit corporations may wish to assure representation on the board of directors of geographic, economic, or professional interests or expertise which may be essential to fulfilling that organization's purposes, and which might be compromised by requiring in all cases the application of cumulative voting.

7. Derivative Actions

We concur with the Commission that it is desirable to provide for a procedure requiring posting of security for defendants' expenses in derivative actions against nonprofit corporations. Where a shareholder in a business corporation may feel constrained from instituting unfounded legal action which may affect the value of his investment, for most members of nonprofit corporations no such inherent constraint exists. The procedures provided by the Commission in Article 2, (commencing with Section 5820), and Article 3, (commencing with Section 5830), of Chapter 8 appear to us to balance appropriately the needs of the minority against the needs of the majority members of a nonprofit corporation.

We believe, however, that the Commission may wish to review the effect of Section 5839, which appears to emasculate the carefully-drafted protections which precede it. Section 5839 provides that no security for defendants' expenses need be posted if an action is brought by at least 50 voting members or members holding at least 10 percent of the voting power. We believe the percentage requirement is the more appropriate "test"; a fifty member "test" in an organization exceeding one million members (or even ten thousand members) provides inadequate protection against suits having harassment as a principal purpose.

8. Records and Reports

We question the broad requirement in Section 6510(a)(2) that minutes be required of committees of the board of directors. Generally, committees of the board are not decision-making bodies, but merely make recommendations to the board after studying or analyzing a subject. We agree that decisions of the board itself should be subject to the requirement that minutes be maintained, and, in recognition of the broader authority which a board would have under Section 5353 to delegate its authority to a committee, we would concur that minutes be required for committees to the extent they exercise board authority. Nevertheless, a blanket requirement that all committees maintain minutes seems unnecessary and may be overly burdensome in organizations which utilize numerous committees having no decision-making authority to assure member involvement.

9. Rights of Inspection

We have commented previously to the Commission on the very troublesome problems involved in balancing a member's interest in having or inspecting the organization's membership list and the fact that in many organizations that list is a trade secret and perhaps the organization's most valuable asset.

In adopting the provision of the General Corporation Law permitting shareholders holding 5 percent of the shares to obtain a copy of a shareholders list, we wish to point out that such a list does not have the same value to the business corporation or its competitors that a membership list may have to a nonprofit corporation, its competitors (if any), and a wide variety of commercial interests which might use such a list.

We believe that Chapter 16, although recognizing this problem, fails to satisfactorily resolve it.

Chapter 16 assumes protection by appearing to require five percent of the voting power as a precondition to the right to inspect the list. (Sections 6620, 6623) However, Section 6628 permits a court to impose a lesser percentage or number of members, leaving such protection speculative at best.

The Commission has provided in Section 6624(c) that a court may impose reasonable restrictions on the purposes for which the membership list may be used, and has provided in Section 6627 liability for damages for improper use of the information, in further recognition of the potential for abusing the list.

The Commission has also provided in Section 6625 for the nonprofit corporation to elect to adopt a reasonable procedure to permit authorized members to communicate with the voting members for nomination and election purposes, and thus void the member's right to the membership list. We believe that this highlights the real problem and that the Commission should focus on this problem rather than concentrate on the membership list itself.

The only reason advanced for giving the member access to the membership list is to assure the member can communicate with other members in connection with the nomination and election process. If this is in fact the problem, and we believe it is, then the solution would appear to be a simple requirement that the nonprofit corporation adopt reasonable procedures permitting a member to communicate with other members to seek support for nomination or election, or for the purpose of soliciting proxies.

Obviously, an organization could comply with this requirement by providing a member with a membership list when that is consistent with the organization's concerns. The method of compliance, however, should be left to the discretion of the board of directors to accomplish, since the board has the responsibility to all members for protection of the membership list and for controlling costs involved in adopting other available procedures. The statutory requirement that the procedure be reasonable assures court supervision in appropriate cases.

This would permit a much-simplified statute, and would provide these further benefits to nonprofit corporations and their members.

1. Assure protection of the membership list.

2. Avoid the possibility that a court will assume that the detailed nomination and election procedures set forth in Section 6626 as "safe haven" standards are not intended to be interpreted as the legislatively-approved "reasonable" standard for nomination and election procedures adopted pursuant to Section 5320.

3. Avoid the uncertainty which will result from the broad discretion granted a court in Section 6628 "to prescribe such procedures as the court determines are necessary for the fair and equitable nomination and election of directors in view of the circumstances, practices, and nature of the particular nonprofit corporation", even though such procedures are totally different from those set out in the statute.

In the event the Commission does not agree on the revision suggested here, we suggest that the 5 day notice for member inspection of the membership record, and the 5 day period for providing a member with a membership list, respectively set forth in Sections 6622 and 6623, be increased to 10 days to permit the nonprofit corporation to petition for the judicial supervision provided for in Section 6624. This seems to be a more realistic time frame in which to successfully involve the courts.

10. Number, Term and Selection of Directors

We concur with the Commission that the statutory framework should provide a nonprofit corporation with considerable flexibility in determining the appropriate number of directors, their terms of office, and the manner in which they are selected.

Although the Commission states at page 15 that it "...recommends no specific standards for what constitutes 'reasonable means';..." as we pointed out in our comments about Chapter 16, we believe that a court may well conclude that the Legislature has adopted the detailed procedures set forth in Section 6626 as the standard of reasonableness. Our suggestion for revising Chapter 16 would eliminate this risk.

We very much appreciate having the opportunity to comment on the Commission's effort to date. Should the Commission or the staff wish additional clarification of any comment, we will be very pleased to cooperate.

Sincerely,

Robert H. Nida

RHN:jvs

Memorandum 76-83

EXHIBIT XXV

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September 14, 1976

John H. DeMoully, Esq.
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Draft of Non-Profit Corporation Law

Dear Mr. DeMoully:

Our committee met yesterday and reviewed our respective reactions to the draft of the new Non-Profit Corporation Law. Our reactions were as follows:

1. The approach taken--a separate and independent non-profit corporation law--is desirable and meets with the unanimous approval of our Committee.

2. The idea of combining sections that deal with provisions equally appropriate to non-profit and profit corporations was also desirable.

In short, our Committee completely and enthusiastically endorses the approach taken in this legislative draft.

There are a number of specific reactions to various provisions of the draft, and Committee members will put these reactions in writing and have them to me by the 25th of September. I, in turn, will put them together and see to it that a collective effort reaches you by October 1st.

Finally, somewhat in the nature of a liason arrangement, Mr. Dick, the San Francisco representative of our

Committee, attended the meeting of the Corporate Committee yesterday in the Bay Area.

Very sincerely yours,

Kenneth C. Eliasberg

KENNETH C. ELIASBERG

KCE/cr

cc: Warren J. Abbott, Esq.
James M. Cowley, Esq.
Brett R. Dick, Esq.
William B. Eades, Esq.
Leslie S. Klinger, Esq.
Robert C. Kopple, Esq.

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September 30, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Revision of Non-Profit Corporation Law

Dear Mr. DeMoully:

As per our conversation of this date, enclosed are the comments of Messrs. Cowley and Abbott of my Committee. Mr. Klinger's comments are enroute to me, and I shall forward them as soon as they are in my hands. Mr. Dick and I, who have addressed the non-profit corporation primarily from a tax point of view, find no serious fault in the proposed legislation insofar as the taxation of these entities is concerned.

As I previously indicated, all of us are very much in favor of the approach that you have taken (i.e., isolating the non-profit corporation and separately dealing with it) and are very appreciative of, and impressed by, the monumental effort that you have made.

I am certain that there are a number of minor problems that will surface as this legislation becomes a more concrete possibility, but, for present purposes, I feel that the enclosed comments are adequate and all that we could come up with given the time limitations that we, as private practitioners, operate under.

If you have any reaction to our comments, or if we can provide any additional information, please do not hesitate to call on me. Unless I hear from you, I

shall assume that we are to take no action until the proposed legislation moves closer to becoming a reality.

Very sincerely yours,

Kenneth C. Eliasberg

KENNETH C. ELIASBERG

KCE/cr
Enclosures

cc: Robert C. Kopple, Esq., Chairman
Executive Committee, Taxation Section
State Bar of California
William B. Eades, Esq., State Bar of California
Warren J. Abbott, Esq.
James M. Cowley, Esq.
Brett R. Dick, Esq.
Leslie S. Klinger, Esq.

...orandum 76-83

EXHIBIT XXVI

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September 13, 1976

California Law Revision Committee
Stanford Law School
Stanford, California 94305

Re: Non-Profit Corporation Law

Gentlemen:

I have reviewed your draft dated July 26, 1976, of the proposed new California Non-Profit Corporation Law (Parts I and II). On the whole I think it is very well drafted. It is to be hoped that the legislature will adopt the new law.

I have only a few comments as follows:

1. Section 5250. It seems to me that a non-profit corporation which desires to qualify for federal income tax exemption and exemption under California Revenue and Taxation Code should be permitted to state its purposes in more detail. For example, a non-profit corporation could state that it was organized for charitable purposes and this probably would meet the requirements of the Internal Revenue Code and regulations thereunder. Nevertheless, I feel it is desirable (although not mandatory) in forming a corporation designed to qualify as tax-exempt under Internal Revenue Code Section 501(c)(3) to state the purposes in more detail. For example, if I were forming a non-profit corporation which was going to operate a hospital which would admit charity patients, I feel it would be easier to obtain a tax-exempt ruling from the Internal Revenue Service if the articles stated that the purpose of the corporation was to operate a hospital which would admit patients unable to pay. While such a statement of purposes probably is not required by the Internal Revenue Code or the regulations thereunder, I am of the opinion that it would be beneficial to include such a statement in order to obtain the tax-exempt ruling.

Accordingly, I would like to see Section 5250 permit additional statements with respect to the purposes where it would be desirable although not necessarily required in obtaining tax-exempt status.

Also, it is not clear to me whether the articles of incorporation may contain a provision requiring that the assets be distributed to a named organization upon dissolution. I have found it desirable both in carrying out the intent of the creators of the organization and also in obtaining a tax-exempt ruling to provide for example in the case of a charitable foundation that upon dissolution the assets are to be distributed to a named organization which itself is a charitable organization. Again, while this may not be required by the Internal Revenue Code or the regulations thereunder, it is helpful in obtaining a tax-exempt ruling if the articles of incorporation provide that upon dissolution the assets are to be distributed either to a certain named organization which itself is tax-exempt or alternatively if the articles provide that the assets are to be distributed to one or more other organizations which are themselves the type described in certain specified Internal Revenue Code Sections.

2. Section 5512. I am uncertain as to how this section would operate with respect to a condominium association which is incorporated as a non-profit corporation. In reading the section, it appears to me that if the condominium association made an assessment for capital improvements to improve the common area, an owner of a condominium could simply withdraw as a member of the condominium association and not have to pay the assessment. The owner, however, would continue to own a condominium and would presumably benefit from the improvements made to the common area even though he was not required to pay the assessment. This seems to me to be unfair. I would therefore recommend a provision indicating that an owner of a condominium could not escape assessment merely by withdrawing as a member of the condominium association if such owner continued to own his condominium.

3. Sections 6772 and 6773. It is not clear to me how these sections would work in a situation where a non-profit corporation organized for charitable purposes is required by its articles of incorporation to transfer the assets to another charitable organization which is named in the articles of incorporation. It would appear that this would be covered by Section 6772(a) and that such a transfer could be made without a court order or without a waiver by the attorney general. On the other hand, Section 6773 seems to indicate that the assets could be distributed to the named organization only upon court order or following waiver by the attorney general. The comments to Section 6773 state that Section 6773 applies only where the assets are not held on condition requiring return, transfer or conveyance. However, Section 6773 does not so provide. It seems to me that Section 6773 should expressly state that it is not applicable in a case covered by Section 6772.

I appreciate your having afforded me the opportunity to review the proposed new law. I hope that my comments will be of some help to you in formulating the final draft to be submitted to the legislature.

Very truly yours,

IRVING M. GRANT

IMG:rs

Memorandum 76-83

EXHIBIT XXVII

WILLIAM DRYDEN SOMMER
24A KEARNY STREET
SAN FRANCISCO, CA 94108

September 14, 1976

California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Gentlemen:

I am an attorney who has considerable contact with non-profit corporations. I have had a chance to briefly review your tentative recommendation relating to non-profit corporation law, and heartily endorse the approach and suggestions made therein.

Very truly yours,

William D. Sommer

Memorandum 76-83

EXHIBIT XXVIII

ORRICK, HERRINGTON, ROWLEY & SUTCLIFFE
COUNSELORS AND ATTORNEYS AT LAW
ELEVENTH FLOOR
600 MONTGOMERY STREET
SAN FRANCISCO, CALIFORNIA 94111
TELEPHONE 392-1122
AREA CODE 415
CABLE "ORRICK"
TELEX 34-0870

September 15, 1976

California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Re: Comments on Tentative Recommendation Relating to Nonprofit Corporation Law

Gentlemen:

We hereby submit written comments on the tentative recommendation of the California Law Revision Commission relating to the proposed new nonprofit corporation law, dated July 26, 1976.

Numerous cities, counties, school districts and other special districts in California have for many years used nonprofit corporations to issue bonds to finance public projects (such as schools, public buildings, public parking garages and transportation facilities, for example) which are constructed or acquired by a nonprofit corporation and leased by the nonprofit corporation to the political subdivision for a rental sufficient to pay the principal and interest on the bonds of the nonprofit corporation when due. The usual nonprofit corporation financing has three or five members and the corporation's sole purpose is financing the construction or acquisition of needed public improvements.

Typically, as part of the financing transaction, all of the nonprofit corporation's membership certificates are assigned by the members of the corporation to a bank as trustee and held in trust in accordance with a declaration of trust. The declaration of trust provides that the bank trustee shall vote the membership certificates of the corporation under the terms of the declaration of trust, for the purposes of providing further security to the holders of the corporation's bonds and to insure that all assets of the corporation shall vest in the political subdivision upon retirement of the bonds.

Although the proposed new nonprofit corporation law is not entirely clear on the matter, it is possible that proposed Corporations Code sections 5740-5745, dealing with voting agreements, would prevent the members of a nonprofit corporation formed to finance the construction or acquisition of a public project from permanently vesting membership voting control in a bank trustee for the benefit of the political subdivision and the holders of the corporation's bonds. Proposed section 5741 would limit the duration of a voting agreement to a period of not exceeding ten years, whereas the nonprofit corporation financing of needed public improvements is accomplished through the issuance of bonds having terms of up to 40 years. We are aware of no reason why a voting trust of membership certificates for the term of the bond issue would be inappropriate or improper under these circumstances, and urge that the 10 year restriction be dropped from proposed section 5741.

We would be pleased to supply you with any further information on this subject that you may desire.

Very truly yours,

Thomas R. Shearer, Jr.

Thomas R. Shearer, Jr.

Memorandum 76-83

EXHIBIT XXIX

LAW OFFICES OF
KERNER, COLANGELO & IMLAY
680 MARKET STREET
SAN FRANCISCO 94104
(415) 986-1520

FRANCIS KERNER
MARVIN J. COLANGELO
ALEXANDER R. IMLAY
H. STANTON ORSER
JAMES D. HOBBS
CARL HOWARD

September 17, 1976

Mr. John A. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

In re: New General Non-Profit Corporation Law

Dear Mr. DeMoully:

Please forgive my tardiness in re comments on the above proposed legislation.

I have read the tentative recommendation of the Commission and express my approval. The comprehensive coverage of the new statute will give non-profit corporations and their advisors clear guidance, with a single codification, in the law governing the organization and operation of such corporations.

I wish to compliment the Commission's Chief Consultant, G. Gervaise Davis III. I had the pleasure of working with him in the preparation of the CEB California Non-Profit Corporations book. He's a very talented lawyer and the thoroughness of his work leaves little room for improvement.

I also wish to thank you for your courteous reply to Frank Kerner, Esq. of our office regarding his expression of interest in a revision of the law relating to agricultural cooperatives. Frank Kerner is a leading authority in this field of cooperative law and would render valuable assistance to your Commission or any other group which decides to undertake some action in this matter.

Kindest regards.

Sincerely,

Carl Howard

Carl Howard

CH:jb

EXHIBIT XXX

ORRICK, HERRINGTON, ROWLEY & SUTCLIFFE
COUNSELORS AND ATTORNEYS AT LAW
ELEVENTH FLOOR
600 MONTGOMERY STREET
SAN FRANCISCO, CALIFORNIA 94111
TELEPHONE (415) 392-1122

CABLE ...
TELEX ...

September 21, 1976

Thomas E. Stanton, Jr., Esq.
Johnson and Stanton
221 Sansome Street
San Francisco, California 94104

Dear Mr. Stanton:

Thank you for attending the September 13 meeting of the State Bar Committee on Corporations. We appreciated hearing from you and Mr. Sterling and hope that the discussion provided some insight into the views and procedures of our Committee.

The tentative draft of the new Nonprofit Corporation Law distributed by the California Law Revision Commission constitutes an important step forward in the program to improve California law governing nonprofit corporations. Certainly it represents the major contribution thus far. However, our Committee unanimously concluded at the September 13 meeting that additional study and debate of major policy and substantive issues is highly desirable. Accordingly, our Committee recommends that your tentative draft be referred to the Assembly Select Committee on Nonprofit Corporations for further study, to enable all interested groups, including the Commission, the Select Committee and our Committee, to focus their joint efforts upon the development of the best possible bill for presentation to the Legislature.

For the reasons indicated at the meeting, our Committee is opposed to Division 4 of the Commission's tentative recommendation, and feels that the definitions and general provisions presently contained in the General Corporation Law should be retained in such Law. To the extent that such provisions are appropriate for nonprofit corporations, they may be incorporated by reference or repeated with appropriate modification.

The foregoing is a brief summary of the action taken at the September 13 meeting of our Committee. I will be happy to discuss any questions which you may have, and invite your comments and suggestions.

Kindest regards.

Yours very truly,

Walter G. Olson

WALTER G. OLSON

cc: John H. DeMoully
Nathaniel Sterling
William B. Eades
R. Bradbury Clark
Carl A. Leonard

Memorandum 76-82

EXHIBIT XXXI

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OF COUNSEL
DENNIS E. CARPENTER

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PLEASE REPLY TO:
Newport Beach

September 20, 1976

File No. 10263

California Law Revision Commission
c/o School of Law
Stanford University
Palo Alto, California 94305

Attn: Mr. John H. DeMoully
Executive Secretary

Re: Proposed California Nonprofit Corporation Law

Gentlemen:

In response to the solicitation of the California Law Revision Commission, we are enclosing our comments with regard to the tentative draft of the proposed California Nonprofit Corporation Law ("Draft"). Preliminarily, we would like to express our appreciation of the Commission's general approach in the organization of the Draft, and our wholehearted support of the concept of establishing a complete and self-contained nonprofit corporation law.

Because a significant portion of our real estate practice involves the representation of builders of residential housing, our contact with the existing California Nonprofit Corporation Law ("Existing Law") is predominantly related to the formation of nonprofit homeowners associations, as defined in Section 11003.1 of the California Business and Professions Code, which own, operate and maintain common area facilities in condominium projects and planned unit developments. Consequently, our specific comments are primarily directed to the expected impact of the Draft on the operation and management of such homeowners associations. For your convenience, our comments are organized according to the specific Draft Sections involved, but consider the comments of the Commission contained in its tentative recommendation.

Sections 5240 & 5242 -- Corporate Seal. The Commission recommends the abolition of the presumption of valid execution for instruments to which the corporate seal has been affixed, which presumption is contained in Section 833 of the Existing Law. Although we concur in the general approach of the Draft which would permit reliance upon the authority of specified senior executive officers to execute any instrument on behalf of nonprofit corporations, we would suggest that as a practical matter "more significant protection of parties dealing with a nonprofit corporation" can be provided by retaining, to some extent, the presumption regarding the identity of such officers which is presently afforded by Existing Law.

Reliance upon the authority of specified senior executive officers to execute instruments on behalf of the corporation is justified only insofar as reliance upon the identity of such signatories as "senior executive officers" is justified. In this regard, Section 833 of the Existing Law provides, in part, that the existence of what purports to be the corporate seal on a written instrument is prima facie evidence that such instrument was "duly executed and signed by persons who were officers or agents of the corporation...." Thus, Section 833 affords a rebuttable presumption regarding the identity of signatories of instruments bearing the corporate seal as corporate officers, and we suggest that this aspect of the Existing Law be retained in order to facilitate reliance upon the provisions of Section 5242 of the Draft.

Section 5443 -- Withdrawal of Members. In the context of the nonprofit homeowners association, it is absolutely vital that assessments and other membership obligations continue for so long as an individual owns property in the development. The equity of such an arrangement is especially apparent in the context of the condominium project or planned unit development where the value of a member's privately owned residence is enhanced by the value of the association-managed common areas. This intrinsic benefit to the homeowner-member is recognized by Sections 2188.3 and 2188.5 of the California Revenue and Taxation Code. These Sections basically provide that association-maintained common areas need not be assessed separately because the value of the common areas is reflected in the value of the individual homes.

In order to provide continuity of assessment obligations, the By-Laws of nonprofit homeowners associations, and the Declaration of Restrictions applicable to subdivision projects, typically provide that a homeowner remains a member, with all attendant obligations, until such time as his ownership of property within the project ceases. Furthermore, membership obligations may not be terminated by a member's waiver of membership rights, including the use and enjoyment of common areas.

Section 5443(a) of the Draft states that unless the By-Laws provide a "procedure" for withdrawal of members, a member may "surrender" membership upon thirty (30) days' written notice to the nonprofit corporation. Section 5443(b) further provides, in part, that unless the By-Laws provide otherwise, "surrender" of membership "terminates" all future rights, powers, and obligations of membership. It is unclear from the language of Section 5443 as to whether the "surrender" of a membership constitutes a "termination" of such membership or is merely a prelude to such termination. This ambiguity is compounded by the fact that Sections 5541 and 5542 refer only to the procedure for terminating a membership in the nonprofit corporation, and not to surrendering a membership.

Assuming that the "surrender" of a membership constitutes the "termination" of membership in a nonprofit corporation, Section 5443 refers to the establishment of a "procedure" in the By-Laws for the withdrawal of members and, in the absence of such procedure, a right in the members to surrender membership upon thirty (30) days' written notice. The use of the word "procedure" in Section 5443(a), when read in conjunction with the thirty (30) day provision, seems to imply that a withdrawal "procedure" consists merely of a mechanism for giving notice of a member's intentions to terminate his membership and that such termination may be effectuated as a matter of right within a finite period of time either established in the By-Laws or as set forth in Section 5443(a). As previously noted, termination of membership in a nonprofit homeowners association must be conditioned upon a member no longer owning property in the development. Since it is justifiable to condition termination of membership upon the conveyance of the member's residence, the implication raised by Section 5443(a) that termination of membership may be accomplished within a finite period of time appears inconsistent with the concept of a nonprofit homeowners association. Consequently, we would suggest that Section 5443 be amended to read as follows:

§ 5443 Termination by Members.
(a) Unless the By-Laws provide otherwise, a member may terminate membership upon thirty (30) days' written notice to the nonprofit corporation."

"(b) Unless the By-Laws provide otherwise, termination of membership terminates all future rights, powers, and obligations of membership...."

The foregoing changes would remove the confusion created by the apparent interchangeable use of words such as "terminate", "withdrawal" and "surrender" and provide certainty in the absence of a By-Law provision, while retaining the flexibility necessary to the particular needs and practices of various types of nonprofit corporations.

Section 5512 -- Capital Improvement Assessments. The Commission recommends implementation of a method by which members, by prompt resignation of membership, may escape liability for assessments imposed in order to acquire or construct capital improvements. The Commission's justification for this provision is that a resigning member will not benefit from future improvements and it is thereby equitable that such member not be required to pay capital improvement assessments.

In the case of a nonprofit homeowners association, the association is authorized to levy capital improvement assessments which shall be charged to individual members in accordance with the By-Laws of the association. Prompt payment of such assessments is a necessary incident to orderly management and operation of the association. As previously noted, homeowners association memberships and assessment obligations are generally terminated as to a member only at such time as the member's ownership of property within the project ceases. Consequently, a member may ordinarily terminate his membership and avoid payment of a capital improvement assessment only by the prior sale of his residence. In the event that a member desires to sell his residence and a capital improvement assessment has been levied prior to such sale, such member will presumably enjoy the benefits of these future improvements in the increased resale value of his home. Furthermore, provisions for the proration of homeowners association assessments are quite common in sales escrow instructions for

residential property. Consequently, there is little justification for a homeowners association member not paying capital improvement assessments or installments of such assessments merely because of an intent to terminate his membership by selling his home.

In addition to the foregoing, Section 5512(c) appears to be formulated on the basis of a finite period of time between a member's giving notice of his intent to terminate his membership and the effect of such termination. As previously noted, membership in a homeowners association is not terminable except upon the member's no longer owning any property in the development. Consequently, the 15-day notice provison of Section 5512(c) appears inappropriate in the context of the nonprofit homeowners association. A homeowner-member should not be entitled to absolve himself from liability for improvement assessments merely by giving notice within fifteen (15) days of the assessment of his intent to terminate his membership when it may take months to obtain a buyer for his residence and consummate the sale.

In view of the foregoing, we suggest that Section 5512(c) be amended to read as follows:

> (c) Unless the By-Laws provide otherwise, any member subject to a capital improvement assessment may terminate his membership by delivering to the nonprofit corporation at its principal executive office written notice of such termination within a period of fifteen (15) days from the giving of written notice of assessment by the nonprofit corporation pursuant to subdivision (b). Such termination shall be upon the same terms and conditions established by the nonprofit corporation for termination from membership in the absence of such an assessment, and, unless the By-Laws provide otherwise, upon such termination, the terminating member shall not be liable for such assessment.

Alternatively, a specific provision might be inserted in Section 5512(c) which would render that Section inapplicable to any "Owners association", as that term is defined in Section 11003.1 of the California Business and Professions Code.

Section 5719 -- Action by Policymaking Committee. Section 5719 of the Draft authorizes the establishment of a policymaking committee which, within the limits of, and in accordance with the procedures set forth in the By-Laws of the nonprofit corporation, may take any action which would ordinarily be required to be taken by the individual members.

The second sentence of Section 5719(b) specifically provides that "only members of the nonprofit corporation who are representative of the membership" may serve on the policymaking committee. The tentative recommendation explains that this restriction is included in order to assure adequate representation. However, it is unclear as to whether the second sentence of Section 5719(b) is intended to distinguish between "members" and members who are "representative of the membership." Because of the lack of any enumerated standards in Section 5719(b) for distinguishing between "members" and "representative members" and the difficulty which would be involved in fairly and sufficiently establishing such critera, we believe that both the intended and favored interpretation of the second sentence of Section 5719(b) is one which does not distinguish between "members" and "representative members." Consequently, it is suggested that the second sentence of Section 5719(b) be amended so as to provide that "only members of the nonprofit corporation may serve on the policymaking committee."

We hope that the foregoing comments and suggestions will be helpful in the formulation of the final draft of the new California Nonprofit Corporation Law. Please provide us with a copy of any changes which are made in the Draft prior to the Commission's recommendation to the California Legislature.

Very truly yours,

F. Scott Jackson of
FULOP, ROLSTON, BURNS & McKittrick

FSJ:ja

FULOP, ROLSTON, BURNS & McKITTRICK
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September 23, 1976

OF COUNSEL
DENNIS E. CARPENTER

CABLE: FULBRICK
NEWPORT BEACH FAX (714) 541-7354
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PLEASE REPLY TO:
Newport Beach
File No. 10263

California Law Revision Commission
c/o School of Law
Stanford University
Palo Alto, California 94305

Attn: Mr. John H. DeMoully
Executive Secretary

Re: Proposed California Nonprofit Corporation Law

Gentlemen:

This letter supplements our letter dated September 20, 1976, wherein we submitted to the Commission our comments with regard to the tentative draft of the proposed California Nonprofit Corporation Law ("Draft"). In this regard, we would like to draw the Commission's attention to Section 5211 of the Draft relating to the incorporation of unincorporated associations.

Section 5211 of the Draft provides that a nonprofit corporation may be formed for the purpose of incorporating an existing unincorporated association or organization. More specifically, Section 5211(d) provides that the members of such an unincorporated association are members of the nonprofit corporation so created "unless they file their dissent in writing with the secretary" of such nonprofit corporation. Although subdivision (d) of Section 5211 is a virtual carry-over from Section 9604 of the existing California Nonprofit Corporation Law, neither of these sections resolves the question of when a member may effectively dissent from the incorporation of an unincorporated association of which he is a member. Therefore, we would suggest that Sections 5211 (c)&(d) of the Draft be amended to provide as follows:

"(c) The articles shall be signed by the presiding officer or acting presiding officer and the secretary or clerk or similar officer of the association or by at least a majority of its governing board or body, and there shall be attached thereto the affidavit of the signing officers or governing board or body that the association has (1) duly authorized its incorporation, (2) given written notice to each member of the association of such authorization, and (3) has authorized the officers or governing board or body to execute the articles."

"(d) The members of the association are members of the nonprofit corporation so created unless they file their dissent in writing with the secretary thereof within fifteen (15) days of the giving of the notice of authorization to incorporate required to be given pursuant to subsection (c) of this section. For purposes of this subsection (d) a notice of authorization to incorporate shall be deemed to be given at the time specified in Section 5160 of this Division."

We again wish to express our approval and support of the concept of establishing a complete and self-contained nonprofit corporation law and we hope that the foregoing comment and suggestion will be helpful in the formulation of the final draft of the new California Nonprofit Corporation Law which is to be submitted to the California Legislature. Again, please provide us with a copy of any changes which are made in the Draft prior to the Commission's recommendation to the Legislature.

Very truly yours,

F. Scott Jackson of
FULOP, ROLSTON, BURNS & McKITTRICK

FSJ:ja

Memorandum 76-83

EXHIBIT XXXII

[illegible] LONG (1887-1953)
[illegible] LEVIT
[illegible] B. LEVIT
[illegible] HARRISON
[illegible] HOCK
[illegible] M. MOLTZEN
[illegible] D. WILLMARTH
[illegible] L. MALLEN
[illegible] M. LACHOWICZ
H. PAUL BRESLIN
WALTER S. WEISS
KEITH C. HUGHES
[illegible] A. PARKINSON
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RICHARD S. WOLF
A. KIRK McKENZIE
HARRY M. SNYDER
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ALAN H. LAZAR
WILLIAM R. JACKSON
BARRY ZALMA
MYRON S. MEISEL
ALLEN LEE MICHEL
WILLIAM H. LEVIT
IRVING G. BREYER
LLOYD E. GRAYBIEL
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LOS ANGELES
1900 AVENUE OF THE
LOS ANGELES, CALIFORNIA [illegible] 7
(213) 879-[illegible]

22 September 1976

John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Dear Mr. DeMoully:

I have reviewed the tentative draft of the new General Nonprofit Corporation Law, Parts I and II, and the excellent analysis of the proposed revision My experience lies mainly in the health and welfare areas. I can forsee considerable amendment of Bylaws, and probably the Articles of Incorporation. This is a first impression statement, but if true, there should be some compliance moratorium for existing corporations.

With some experience in disputes between nationals and their locals I am concerned with Section 6710(3) which would permit just one voting member to bring action for dissolution.

With these minor suggestions, I think the tentative draft is entitled to high commendation.

Sincerely yours,

Lloyd Graybiel

Lloyd E. Graybiel

LEG:srd

Memorandum 76-83

EXHIBIT XXXIII

LAW OFFICES
JENNINGS, GARTLAND AND TILLY
WORLD TRADE CENTER
SAN FRANCISCO 94111

JOHN PAUL JENNINGS
EUGENE L. GARTLAND
JOHN VICTOR TILLY
JOHN P. HEMMING, JR.
JEFFREY R. WALSH

TELEPHONE 781-1854
AREA CODE 415

September 23, 1976

John H. DeMoully, Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Re: Tentative Recommendation Relating to Nonprofit Corporation Law

Dear Mr. DeMoully:

Responding to your letter of September 22, 1976, I have reviewed the Tentative Recommendation Relating to Nonprofit Corporation Law. I am in total agreement with the specific approach of a comprehensive nonprofit law complete in itself. The references in the current law to the business corporation law creates no end of problems for nonprofit corporations.

I have no problem with the detailed provisions of the draft as far as I can tell. Based on my fairly limited experience, they are quite workable.

Thank you very much for sending me the copy of the draft. I wish you success.

Very truly yours,

John Paul Jennings

JPJ/qt

cc: Bill Cleveland, CNA, Sacto
cc: Marie Hill, CNA, SF

EXHIBIT XXXIV

Save-the-Redwoods Lea...

114 SANSOME STREET, ROOM 605, SAN FRANCISCO, CALIFORNIA 94104
TELEPHONE (415) 362-2352

September 24, 1976

Mr. John H. DeMoully, Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

In reply to your letter of September 22, 1976, our legal counsel, Mr. Robert W. Jasperson, has carefully reviewed the copy of the California Law Review Commission's Tentative Recommendation Relating to Nonprofit Corporat Law.

We believe your recommendations to be good and well-researched and proposed. I'm sure that the results of your excellent efforts will simplify the law and improve its uniform application with respect to all nonprofit corporations.

Sincerely,

John B. Dewitt

JBD/pw

Memo 76-83

EXHIBIT XXXV

2323 Homestead Road, P.O. Box 2, Santa Cl
247-1200 From North Co

September 27, 1976

ed Way
nta Clara County

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

We appreciate the opportunity of receiving and reviewing the Tentative Recommendation Relating to Nonprofit Corporation Law. Our principal purpose in requesting the copy is to seek guidance on an extensive amendment of our bylaws which is in process. The document will be of great assistance in this regard.

Unfortunately, we do not have the technical expertise in house to offer meaningful comments on the text. The recommended restructuring of the code basically to provide a separate section devoted to nonprofit corporation law appears to us to have considerable merit.

Many thanks for your prompt cooperation in furnishing us with a copy of the Recommendations.

Sincerely,

Thomas T. Vais
Executive Director

TTV:os

EXHIBIT XXXVI

Keith E. Abbott
Attorney at Law
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Menlo Park, California 94025
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New Address:
P.O. Box 7187
Menlo Park, CA 94025
Telephone: 854-7216

September 28, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Tentative Recommendation Relating to
Nonprofit Corporation Law

Dear Mr. DeMoully:

I apologize for not having forwarded comments to the California Law Revision Commission prior to this time. I have reviewed the tentative recommendation relating to your nonprofit corporation law, and as you are aware, it is a voluminous undertaking. I think the basic approach in the tentative draft proposing comprehensive, complete nonprofit law which alleviates the necessity of flipping through every other code book is a noteworthy and a valiant undertaking and one which has long since been overdue.

My initial impression of the law once it is put into a complete package leaves me with questions whether or not it will not cause a proliferation of nonprofit corporations which use the membership vehicle to rekindle a new wave of land marketing schemes. Due to certain features of the nonprofit corporation law a great number of the fiduciary and legal strictures seem to be not nearly severe enough.

I certainly appreciate receiving the commission reports and count them as an important portion of my law library.

Very truly yours,

Keith E. Abbott

KEA:jp

Memorandum 76-83

SUITE 307

EXHIBIT XXXVII

(415) 362-7807

LAW OFFICES
JEROME SAPIRO
HUMBOLDT BANK BUILDING,
785 MARKET STREET
SAN FRANCISCO 94103

September 28, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Attn: John H. DeMoully
Executive Secretary

Dear Mr. DeMoully:

First, let me thank you for the advance copies of the California Law Revision Commission's tentative recommendation relating to non-profit corporation law.

I have used the same and made reference to same in by-laws committee meetings of the French Hospital.

Being a members' rights thinking person, I am particularly impressed with the emphasis that is placed in your proposed draft on preservation of members' rights and control of the Board of Directors to assure adequate limitations on management. It has helped in our discussions.

However, I note that non-profit corporations for medical services are recommended to be relocated in the Business and Professions Code with other provisions concerning the healing arts. Such corporations are now subject to control of the Corporations Commissioner under the Knox Keane Act, and it does appear that the said Commissioner thus is in a foreign field and will become involved in much duplication of reporting, investigating and clearing.

The basic approach of the tentative draft and your intendment is excellent. The use of another separate volume relative to formation of corporations and procedures which may concern both profit and non-profit corporations may be a good idea. However, there are some of us who still believe that if we can go to one source to obtain all of our non-profit corporation law, including substantive, organizational and procedural phases contained in one volume or set of volumes, it will

expedite our research efforts. If provisions for organization and procedures of both profit and non-profit corporations turn out to be the same, of course I can see one volume serving for both. But, normally, matters of great departure develop over the years and we might have substantial difference in the proposed separate volume between the two types of corporations concerning their organizational and procedural matters.

Be assured that I do appreciate your work and recognize its merit. It has been very helpful.

Very truly yours,

Jerome Sapiro

JS/ir

Economic Resources Corporation

September 27, 1976

Mr. John M. McLaurin
Chairman
California Law Revision Commission
Stanford Law School
Stanford, CA. 94305

Dear Mr. McLaurin:

Economic Resources Corporation (ERC) is a private non-profit California corporation whose purpose is to develop a viable economic base in South Central Los Angeles.

ERC has examined the basic contents of the tentative recommendation in relation to non-profit corporation law and concur with the Commission that the existing General Non-profit Corporation Law is inadequate for governing non-profit corporations. Consequently, resolution of many issues concerning non-profit corporations require constant referral to the old general corporation law.

Additionally, in our own case, we have found many rules referring to such matters as formation, corporate powers, corporate seal, director selection/tenure, etc., to be serving no useful function or unduly limiting the activities of the corporation.

The proposed new non-profit corporation laws and the proposed legislation have long been overdue. ERC approves the basic approach of the tentative draft and commends the California Law Review Commission for the fine effort. Maybe now we can refer to the (new) non-profit corporation laws in general and the general business laws in case of "exceptions", instead of vice versa.

Sincerely,

C. Robert Kemp

C. Robert Kemp
President

cc: John H. DeMoully

11633 South Alameda Street • Los Angeles, California 90059 • Telephone (213) 564-4521

EXHIBIT XXIX

LAW OFFICES
OF
CHARLES A. RUMMEL
2558 TELEGRAPH AVENUE
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September 27, 1976

TELEPHONE
(415) 841-3531

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stan Law School
Stanford, California 94305

RE: Tentative Recommendation Relating to Nonprofit Corporation Law

Dear Mr. Dermoully:

With vacation and certain pressing work in the office behind me I am now able to devote sometime to the task I volunteered to assume regarding the above subject.

By way of background and your evaluation of the comments to follow, I was General Counsel of the California Farm Bureau Federation for 25 years, I was Secretary of a Home Owners Association, Session Member of the First United Presbyterian Church of Oakland, I have been a number of years a board member of the San Francisco Bay Area Council of Boy Scouts, drafter of the bylaws of the Hastings College of the Law Alumni Association and the 1066 Foundation. I have been a member of the Exempt Committee of the Section on Non Profit Corporations of the American Bar Association.

This experience has given me a background of understanding of non profit corporations and the people problems relating to them I have had time to review the 71 pages consisting of the Tentative Recommendations. I will start with page 5 and state my agreement or disagreement and any reasons for the latter of communicates to the former.

GENERAL APRROACH

Agree - I have been asked to incorporate the National Wool Growers Association. It has operated for 100 years as an association. It was somewhat embarrasing to respond to a member in Texas who wanted a copy of the California Non Profit Law!

NEED FOR AN INDEPENDENT BODY OF LAW

Agree

ORGANIZATION OF NEW STATUE

Disagree - Disagree is perhaps too strong a word. However, the

bylaws of a large number of non profit corporations start with the member portions first and this is followed by the board of directors section. The members are the important part of a non profit corporation. It seems that the provisions relating to them should come prior to provisions dealing with directors.

FORMATION

Disagree - Again my comments deal with my own background. People are used to the concept of at least three persons who will be interested enough in shouldering a load of others. The concept of a "one man" membership corporation is odd. There appears to be some substance to the venture if more than one is involved.

Probably more important than the number of incorporators would be a provision in the articles that each person who joins the organization and agrees in writing to be a member or who pays dues is bound by the articles and the bylaws as they exist or as they may be amended.

In my experience the question always arises as to what is the relation of an individual to the organization and how was it established. Perhaps there could be a rebuttable presumption that the payment of dues establishes the membership relationship and the committments intended by the provisions of the articles and bylaws.

I note your reference to the "principal executive officer" at the top of page 12. I would stay with someone who is an elected officer. The concept of the PEO is understood in profit corporations but it is an uncertain element in most non profit corporations. When people get together they usually understand the concept of a president, a vice president, a secretary and a treasurer.

CORPORATE POWERS

Agree

CORPORATE SEAL

Agree

DIRECTORS

Agree

SELECTION OF DIRECTORS

Agree

MULTIPLE BOARDS OF DIRECTORS

I am not familiar with this program.

COMMITTEES OF THE BOARD; Advisory Committees

Agree

MEETINGS OF DIRECTORS

Disagree(1) While 9503 governs except in the case of a bylaw provision, it has been my experience that meetings are called by the president or two or more members of the board.

(2) agree

(3) agree

PROVISIONAL DIRECTORS

This is a new concept and one I have not experienced.

DUTY OF CARE OF DIRECTORS

Agree

OFFICERS

Disagree - I would stay with the core officers. Again people understand these terms. They accept this idea that there should be some division between the president who runs the organization and a secretary who keeps the records. They dislike one man rule particularly. If the president keeps the records and the money. It is otherwise in a profit corporation.

I disagree also with the concept of notice in order to resign. How would this be enforced?

INDEMNIFICATION OF CORPORATE AGENTS

Agree

MEMBERS

Agree

MULTIPLE MEMBERSHIPS

I again suggest, however, a rebuttal presumption that the payment of dues constitutes memberships.

GROUPS, CORPORATE, JOINT & FRACTIONAL MEMBERSHIPS

Agree

MEMBERSHIP CERTIFICATE

Agree

OPTIONS TO PURCHASE MEMBERSHIPS

Agree

CONSIDERATION FOR MEMBERSHIPS

Agree

REDEMPTION OF MEMBERSHIPS

Agree

PARTLY PAID MEMBERSHIPS

Agree - I would suggest, however that until paid for, the member would not have membership privileges.

RECORD DATE

Agree

TRANSFER AND TERMINATION OF MEMBERSHIPS

Agree

CORPORATE FINANCE

Agree

FINANCIAL OBLIGATIONS OF MEMBERS

Agree

FINANCING DEVICES

Agree - I like the subvention idea.

REPURCHASE AND REDEMPTION OF MEMBERSHIPS

Agree

CHARITABLE PROPERTY

I have no depth of experience in this subject.

COMMON TRUST FUNDS

I have no depth of experience in this subject.

VOTING OF MEMBERSHIPS

Agree - I like the emphasis in the last two of the paragraphs headed "Membership held In Representative Capacity or By Natural Person". Oftentimes in a home owners association it is necessary for either the husband or wife to vote.

VOTE REQUIRED BY MEMBERSHIP ACTION

Agree

PROXY VOTING

Agree

VOTING AGREEMENTS

Agreed

SUPERVISION OF ELECTIONS

Agree

REQUIRED BOOKS AND RECORDS

Agree - The tie down concepts are good. However, it is extremely difficult to determine who are members in the first place and unless there is actual resignation or a presumption to fall back on.

ANNUAL REPORT; SPECIAL FINANCIAL STATEMENTS

Agree

SPECIAL FINANCIAL STATEMENTS

I don't quite understand the "waiver" in the last part of(1)

RIGHTS OF INSPECTION

Agree

MEMBERSHIP RECORDS

Agree - However, if there is any cost of making the inspection, the members making the inspection should assume reasonable costs.

FINANCIAL RECORDS AND MINUTES

Agree

DIRECTOR'S RIGHT OF INSPECTION

Agree

APPLICATION TO FOREIGN NONPROFIT CORPORATIONS

Agree

JUDICIAL ENFORCEMENT

Agree

MEMBERS' DERIVATIVE ACTIONS

Agree

AMENDMENT OF ARTICLES

Agree

SALES OF ASSETS

Agree

MERGER AND CONSOLIDATION

Agree

DIVISION

Agree - This is a novel idea and a good one.

BANKRUPTCY REORGANIZATIONS AND ARRANGEMENTS

Agree

VOLUNTARY AND INVOLUNTARY DISSOLUTION

Agree and to all subheadings

PSEUDO-FOREIGN CORPORATIONS

Agree

CONVERSION OF NONPROFIT TO BUSINESS CORPORATION OR BUSINESS TO NONPROFIT CORPORATION

Agree -

I agree with the recommendations on page 59,60, 61 and 62. However, on page 63, I do again point out that there is a lack of understanding and a lack of tenure to the person who is a chief executive officer. There is permanence and understanding of a president.

7/

I agree to the balance of the recommendations on page 63, 64, 65, 66, 67,68, 69, 70 and 71.

It is evident that someone has done a great deal of work on the subject of non profit corporations which is long over due. If I can be of further help to you, please let me know. I regret that my comments are somewhat tardy.

Yours truly,

Charles A. Rummel

CHARLES A. RUMMEL

CAR/llm

Memorandum 76-83

EXHIBIT XXXX

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September 28, 1976

John H. DeMoully
California Law Revision
Committee
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

This letter will acknowledge receipt of your letter dated September 22, 1976 regarding the "Tentative Recommendation Relating to Nonprofit Corporation Law."

This office presently serves as general counsel for an international church as well as a college with a theological major which trains ministers. Now, we have served as counsel for the Church in one capacity or other for over a period of eighteen years.

Unfortunately, I have only had sufficient time to give a cursory review of said recommendations. It was my extreme desire to be more definitive in my remarks. Perhaps, the following will suffice to at least bring the particular matter in mind to your attention. If, therefore, you deem the matter worthy of further consideration, I will be more than pleased to find time to cooperate in any way I can to further delineate potential problem areas.

First of all, my concern is for churches incorporated under general provisions of the proposed law, not under the corporate sole provisions.

I am of the opinion that there are certain rights that the law attempts to vest in church members that, although the same may be permissible regarding general nonprofit corporations, the same would be in violation of the First Amendment to the United States Constitution, and others, as applied to members of a church. In other words, I believe that there are certain parameters that the U.S. Supreme Court has placed beyond the bounds of inquiry in authority of the states, and that the provisions of the recommended law transgresses these limitations.

The derivative provision comes to mind, as well as the provisions of disfellowshipping of members, as well as the rights to information regarding church assets. Howbeit true that certain other provisions in the law permit a restriction upon these particular rights of members, still the same question would be applicable should a church fail to include the restrictions or not draft them broadly enough.

If you agree that even the generality of the foregoing has merit, then I would ask the question: "Would it not be advisable to include some type of exemption in the new law for churches and some type of favorable clause in the repeal of the old law for churches until further consideration of the question can be had?"

If I may be of aid in organizing a committee of persons interested in the subject, I will be more than pleased to do so.

The committee's view of the foregoing would be appreciated, and you may feel free to call collect.

Very sincerely yours,

Ralph K. Helge

RKH:sp

EXHIBIT XXXI

GEORGE B. WHITE
ATTORNEY AT LAW
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[illegible] MARKET STREET
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(415) 621-[illegible]

September 29, 1976

John A. DeMoully, Esq.
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Dear Mr. DeMoully:

This is to acknowledge your letter of September 22, 1976, regarding comments on Tentative Recommendation Relating To Non-Profit Corporation Law. I read the tentative draft in detail and did not want to make any comments because any criticism of the result of six years of hard work on the part of the commission, in my opinion, would be unwarranted in view of the fact that the commission has a great deal of information which, of course, I would be unable to review.

I agree with the basic approach of a comprehensive, non-profit corporation law which is complete in itself and does not require reference over to the business corporation law. However, it seems to be inconsistent with this purpose to have new Division 4 to title I which would still apply to non-profit corporations as well as to business corporations. This would still require reference over to Division 4 hence the non-profit corporation law would not be "complete in itself."

It would have been preferable to have the non-profit corporation law really complete not requiring any reference to any other part of the corporation law.

The following comments are made as to certain sections because probably I do not completely understand their significance;

On page 81, section 5102(b), I do not understand why there could be "special statutory provision applicable to a non-profit corporation" in any other law. I understood the object of this draft is that all special statutory provisions applicable to non-profit corporations shall be in this law for non-profit corporations.

I notice on page 102, section 5211(c), reference is made to an "affidavit." This also occurs in some other sections therefore it may be advisable to give a definition of "affidavit" as including declaration under penalty of perjury which is now a common practice.

Page 199, section 5520: the term "subventions" ought to be defined. This term does not appear in Black's Law Dictionary, nor in Corpus

Juris. If this is a loan it should be described as such. If it is a grant then there is no reason for issuing any certificates. In my opinion this is very vague and would not be understood by the average person dealing with non-profit corporations. This is even more evident when you consider page 203, section 5529, "Officer's Certificate," which originally was adopted from section 401(a) General Corporation Law, which latter I was unable to find in the 1977 Corporation Code. The former section 1102 has no reference to "subventions." If subvention merely means loans to the corporation then it should be called as loans. At any rate this whole section on subventions makes no sense to me. I am glad to note the commission does not as yet intend to include Article 2 in the final draft. In my opinion the issuance of such certificates for any grant or loan to the corporation which would draw an interest could be abused because it provides a loop-hole for the distribution of properties or income.

Page 209: I have difficulty in understanding why there is a combination of charitable foundations and foundations with redeemable membership. Of course I understand there may be certain clubs, social clubs and otherwise, in which membership would be transferable and have value but it has nothing to do with charitable foundations where memberships could not be made redeemable. Once the dues are paid it should become irrevocably the property of the charitable foundations. It may be advisable to handle charitable foundations in a separate article, separately and independently of membership non-profit corporations where the memberships are redeemable or where members may be entitled to distribution in liquidation. Certainly section 5554 would not be applicable to a charitable foundation which expressly must provide that the assets will not be distributed to the members. Probably this could be remedied by stating in section 5550 that or in the title of Article 5 that this is limited to certain type of non-profit corporations. I appreciate that Article 6 is on charitable "property" but I believe it should apply to charitable corporations irrespective of whether the property is a charitable trust or not. In other words I am not in favor of any charitable non-profit corporation in any way reimbursing or distributing to any members any part of the assets, whether it is a charitable property or not.

Page 270: I am very much in favor of supervision by the attorney general's office. I wish that some way it could be codified that the attorney general's office should provide a less complex method of supervision, especially of reporting on the part of small charitable foundations. These reports and the multiplication of them become so burdensome that I am advising many small non-profit charitable foundations in my office to dissolve and hand their funds over to some large public foundation.

Page 271, chapter 8, "Members' Derivative Actions:" I do not believe that members of a charitable foundation or a charitable non-profit corporation should be entitled to "derivative" action. This will be proper in non-profit corporations where the members have such financial interest in the non-profit corporation that they would be entitled to some return of their investment or

capital, but it certainly should not be allowed for a non-profit corporation for charitable purposes. From my experience non-profit corporations handling charitable trusts usually rely on volunteers as members whose membership is not transferable and whose dues or contribution are not returnable. In such foundations there is always a group which disagrees with the majority and such controversy sometimes takes on quite acrimonious character. In such a case the particular volunteers who do not agree with the objects of the majority of the members of the corporation simply could resign and join another non-profit corporation more to their liking but they should not be allowed to start a "derivative" action. From what would such right of action "derive" when the members have no financial interest whatever in the funds of the foundation. Furthermore other sections of your draft provide for the attorney general to commence action against any non-profit corporation having a charitable trust or fund and it would be sufficient if a member simply complained and let the attorney general start such action. Other provisions of your draft provide for actions against directors and officers who mishandle funds etc. and those actions should be sufficient. The mere fact that a judge can require a cost bond up to $50,000 from the plaintiff would not suffice and would not protect the small charitable foundation from disturbing its activities or from practical bankruptcy in case of such litigation. I am against derivative action unless it is limited to such non-profit corporations wherein the members are permitted to have financial interest in the funds of the non-profit corporation.

Page 286: I am positively against section 5921 where a new board can delete the name and address of an initial director from the articles of incorporation. That poor initial director may have been the soul and the founder of the whole organization. In my experience jealousy between volunteers running such foundations is frequently such that if some successor was advised that it can be done, it would result in continuous amendments of the articles of incorporation to remove previous directors' names and this provision serves no purpose whatever. If the corporation was incorporated by "dummies" there is no reason to remove their names and substitute others. The choice was taken when the original articles were filed and should remain as is.

I was always against the provision of "Restatement of Articles," (page 291, 292). There is no reason to adopt it. There are provisions made for amendment of articles whenever necessary and there is absolutely no reason whatever why this should be a restated article of incorporation. The provision for amendments permits filing the amended articles of incorporation in toto. Just because such provision was in the general corporation law does not justify that this privilege should be granted to non-profit corporations.

On page 462, you again mention "affidavit," in section 14582. My previous comment applies.

Page 482: I do not believe that non-profit corporations should be allowed conversion to a business corporation. It is true

that charitable non-profit corporations cannot do it, but I do not think that any one of them should be allowed to do it. They should re-incorporate.

On page 483, section 14807, naturally there might be some dissenting share-holders entitled to have their dissenting shares repurchased. But I do not understand why that should not be limited again to certain types of non-profit corporations so that it would not give the idea to some non-profit corporations for charitable purposes that dissenting members would be entitled to any consideration or reimbursement.

In general, I am in agreement of a separate provision for non-profit corporations so that no reference is necessary to the general corporation laws, and please understand I appreciate your efforts and I am submitting these comments so as to show that I read the draft.

Sincerely yours,

GEORGE B. WHITE

GBW:jc

Memorandum 76-83

EXHIBIT XXXXII

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GARTH L. SCALLON
GEORGE BABYE
MALCOLM S. WEINTRAUB
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(1928-1958)
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September 29, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re: Tentative Recommendation Relating to Non-Profit Corporation Law ("Recommendation")

Dear Mr. DeMoully:

I wish to thank you for supplying me with a copy of the Recommendation referred to above. At the same time, I wish to apologize for not having responded prior to September 15, 1976.

As I indicated in my letter of June 24, 1976, I am not generally knowledgeable of the existing General Non-profit corporation law with one minor exception: I have dealt with the law relating to the duty owed by directors of a non-profit corporation holding assets on charitable trust; while I have perused the entire Recommendation, my comments will be restricted to this relatively limited area.

My examination of the Recommendation does reveal an ambiguity of considerable proportions; and, in my opinion, this ambiguity is one which exists in the present California law.

The specific question which I believe is not adequately answered in the Recommendation is: Is a director of a California non-profit corporation holding assets on a charitable trust subject to the duties of trustees prescribed in Division 3, Part 4, Title 8 of the California Civil Code (CC §§2215-2290.12)? At this point, you are no doubt thinking that, in fact, this question has been expressly confronted and disposed of by the Recommendation in the Background (pp. 19-20) and in proposed Corp. Code §5560 (and the comment thereto). However, proposed Corp. Code §5560 is based upon the case of Lynch v. John M. Redfield Foundation (1970) 9 C.A.3d 293, and an examination of that case and of the authority relied upon therein reveals the ambiguity with which I am concerned.

The holding of Redfield is simply that a director of a charitable corporation is bound by the prudent-investor rule codified in CC §2261; the case is quiet on the question of whether other of the Civil Code trust provisions also apply to directors of a charitable corporation. In fact, there is language in Redfield which might be construed to mean that all of the Civil Code provisions apply to such directors. The language to which I am referring is found in Redfield on Page 298:

> "From the standpoint of sound legal practice the only technique to be employed by a charitable corporation in California in the performance of their duties is that of compliance of strict trust principles. It should be noted that, while directors of charitable corporations are exempt from personal liability for the debts, liabilities or obligations of the corporation, they are not immune from personal liability for their own fraud, bad faith, negligent acts or other breaches of duty. (26 So. Cal. L. Rev. 80, 85, cited in Holt v. College of Osteopathic Physicians & Surgeons, supra, 61 Cal. 2nd at p. 757.)." (Emphasis mine).

It seems queer to me that the court in Redfield should cite Holt for the proposition that strict trust principles be applied to directors of charitable corporations, for there is considerable language in Holt to the effect that there are different legal duties owed by the director of a charitable corporation and by the trustee of a charitable trust (which trustee is undoubtedly bound by all of the Civil Code trust provisions):

> "It is true that trustees of a charitable corporation do not have all the attributes of a trustee of a charitable trust. They do not hold legal title to corporate property (See Corp. Code §10206, Subd. (d)) and they are not individually liable for corporate liabilities (Corp. Code, §9504). The individual trustees in either case, however, are the ones solely responsible for administering the trust assets (Corp. Code, §10205), and in both cases they are fiduciaries in performing their trust duties." Holt, supra, at p. 756.

One area in which this ambiguity is manifested is the area of interested transactions, i.e., transactions between a charitable corporation and one of its directors. Under present law, a director of a charitable corporation is bound by the provisions of Corp. Code §820 through the incorporating provisions of Corp. Code §9002; however, is such a director also bound by the strict provisions of CC §§2230 and 2235? This question has not been resolved by the cases; nor does the Recommendation appear to resolve it. Under the Recommendation, the director of a non-profit corporation is bound by the provisions of proposed Corp. Code §5371; but, is the director of a charitable non-profit corporation also bound by the provisions of CC §§2230 and 2235?

It appears from certain portions of the Recommendation (that portion of the Background cited above and the comment to proposed Corp. Code §5560) that the Law Revision Commission is proposing application of the same fiduciary standards to directors of business corporations and to directors of non-profit (including charitable) corporations (with, of course, the one exception that directors of charitable corporations are also bound by the provisions of CC §2261). I applaud this approach. However, to make it clear that this is what is intended, I recommend that the Recommendation explicitly deal with the other Civil Code trust provisions which conflict with the duties of corporate directors in general.

Please do not hesitate to contact me if you should have any questions about my comments.

Kindest regards,

Jeffery H. Speich

JHS:cad

Memorandum 76-83

EXHIBIT XXXXIII

STATE OF CALIFORNIA
STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 1799, SACRAMENTO, CALIFORNIA 95808)

(916) 445-4588

September 29, 1976

California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Attention: Mr. John H. DeMoully
Executive Secretary

Dear Mr. DeMoully:

I have read all of Part I of the *Tentative Recommendation Relating to Nonprofit Corporation Law* and those portions of Part II that relate to charitable corporations. I am favorably impressed with the format, the substance and the wording employed.

In working on claims for property tax exemption we are constantly required to remind general practitioners of the difference between nonprofit corporations and those organized for charitable purposes. The draft makes the distinction most clear. I would suggest, however, that charitable corporations be required to have a statement of purposes in their articles (Section 5250). This would not only be helpful to the officers in charge of corporate affairs, and to potential donors but also to taxing agencies that rely on the contents of the articles in deciding initial eligibility. I believe the Sec. 5250 comment reference to other sections of the proposed code relating to charitable corporations will be of great assistance and would be worthwhile if used in other codes.

1. Page 16, last paragraph indicates that it is the practice of some nonprofit corporations -- particularly charitable corporations -- to have more than one independent board of directors. In 13 years of working with such corporations I have never encountered one with multiple boards of directors.

2. Page 29 -- I do not believe redemption of memberships should be allowed by charitable corporations. I don't believe a requirement that such redemptions are allowable if not made pursuant to a plan to distribute gains, profits or dividends will provide the protection hoped for.

3. Table of contents omits Section 5560.

4. Sections 6772 and 6773 appear to be somewhat in conflict. Assets donated to a charitable corporation should not be subject to return on dissolution or otherwise. Second sentence to footnote section 6773 seems to indicate that section 6772 may apply in some instances.

These comments are obviously brief but the thoroughness of the recommendations leaves little to say other than to verbally applaud your efforts.

Very truly yours,

J. J. Delaney
Assistant Chief Counsel

JJD:rl

Memorandum 76-83

EXHIBIT XXXXIV

ASSOCIATED GENERAL CONTRACTORS OF CALIFORNIA

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SKILL · RESPONSIBILITY · INTEGRITY

September 29, 1976

REPLY TO:

State of California
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Attn: John H. DeMoully, Executive Secretary

Re: Tentative Recommendation Relating to Nonprofit Corporation Law

Gentlemen:

Pursuant to your request I have reviewed the above referenced report and have the following comments:

This office has been involved in preparing Articles of Incorporation for nonprofit organizations on at least six different occasions. The problems raised in your report with respect to the lack of continuity of the general corporate law provisions and the nonprofit provisions have caused many hours of wasted time in developing articles of incorporation.

There is no question that a comprehensive nonprofit corporation law will be extremely helpful to lawyers working with this type of organization. The simplified method for formation of a nonprofit corporation is a necessary requirement considering the essential differences between a profit making and nonprofit corporation.

The provisions setting forth corporate powers will help clarify a confusing area of the law with respect to the purposes of the corporation and the method of disposal of assets after dissolution.

The provisions with respect to the directors and the number and term and selection of directors is clear and concise and is cognizant of the problems of small nonprofit corporations and will help it become feasible for smaller organizations to develop nonprofit corporations.

-continued-

In conclusion, having reviewed the major provisions of the nonprofit corporation law, I wholeheartedly concur with the concept and recommend that the two parts, part I - New Division 2: Nonprofit Corporation Law and part II - Proposed Legislation, New Division 4: Divisions Applicable to Corporations, generally be recommended by your commission.

Very truly yours,

Lawrence H. Kay

Lawrence H. Kay
Counsel

LHK/jb

cc: Thomas Stanton

Memorandum 76-83

Exhibit XXXXV

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JOHN J. BRANDLIN, JR.
JOHN D. CRAIG

September 27, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Re : Proposed Non Profit Corporation Law

Gentlemen :

In reviewing the proposed changes to the Non Profit Corporation Law it came to our attention that an important provision of Section 9501 has not been included in Section 5230 relating to the powers of a non profit corporation.

That provision is subsection (g) which reads as follows :

> " Pay the reasonable value of services rendered in this state to the nonprofit corporation before January 1, 1975, and not previously paid , by any person who performed such services on a full time basis under the direction of a religious organization in connection with the religious tenets of the organization. Such person shall have relied solely on the religious organization for his or her financial support for a minimum of five years. A payment shall not be made if such person or religious organization waives the payment or receipt of compensation for such services in writing. Payment may be made to such religious organization to reimburse it for maintenance of any person who rendered such services and to assist it in providing future support and maintenance ; however, payment shall not be made from any funds or assets acquired with funds donated by or traceable to gifts made to the nonprofit corporation by any person, or - ganization , or governmental agency other than the members , immediate families of members and affiliated religious organizations of the religious organization under whose directions the services were performed. "

Subsection (g) was added in 1974. This provision was passed unanimously in both the Assembly and Senate and is necessary for the protection of persons who have given of their services in the past and whose future support is dubious under present case law.

This most proper provision should be included as a power of a nonprofit corporation which would not otherwise be covered by statuatory or case law , as it is merely the continuation of the unanimously adopted rule in California. Accordingly, we urge that it be included in Section 5230 of the proposed legislation.

Yours very truly,

Brandlin & McAllister

J. J. Brandlin

JJB:vl

Memorandum 73-86

EXHIBIT XXXXVI

LAW OFFICES

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September 28, 1976

John H. DeMoully
Executive Secretary
CALIFORNIA LAW REVISION COMMISSION
Stanford Law School
Stanford, Calif. 94305

RE: Consultant Report on Tentative Recommendation

Dear John:

As I indicated to you and Nat, I have gotten behind in dictating the notes that I made to the Review of the tentative recommendation and I am forwarding the material in two pieces, the enclosed material relating to the initial discussion and the first half or so of the law. I will be forwarding the remaining material later this week or early next week. I hope that it does not unduly inconvenience you.

I would be very pleased to discuss it with you at your offices or by phone prior to the October meeting of the Commission, the agenda for which I just recently received.

Very truly yours,

G. Gervaise Davis III

3:dm
encl.: Consultant's Comments

CONSULTANT'S COMMENTS ON LAW REVISION

TENTATIVE RECOMMENDATION CONCERNING

NON-PROFIT CORPORATION LAW

GENERAL COMMENTS CONCERNING RECOMMENDATIONS

As a general comment, I believe that the Commission has successfully achieved its desire to simplify the non-profit corporation statute and to fill in the many new, needed provisions in what was an incomplete and hopelessly obsolete law. I am also humbled at the reference to me as your consultant in the introduction since I realize that the work was done by your staff and that all I have really done is comment from place to place on areas in which I felt things were needed or in which improvements might be made. The remaining comments of this first section relate to your introductory material which describes the proposed legislation, and I have simply referred to the introduction by its page numbers.

COMMENTS ON BACKGROUND MATERIAL, BY REFERENCE TO PAGE NUMBERS

Page 8. The reference at the end of the page to breaking up of the sections of the business corporation law is important, and although I know you do not want to twist anyone's tail, the point should be made even more strongly.

Page 9. The last major point on the page concerning the all-encompassing provisions should emphasize even more strongly that the basic theory of the non-profit corporation law is a deliberate design aimed at allowing nearly anything to be done under the form of a non-profit corporation, unless it is

specifically modified or prohibited by the Articles or By-Laws, or if prohibited by law. We need to make the point that the Commission had the alternative of establishing a whole series of different types of non-profit corporations with restrictive provisions relating to each, the pattern vaguely followed in the past; or it had the choice of designing a basic organizational statute with governing provisions applicable to everything with only a few restrictive provisions inserted as to various classes. I do not believe that this material makes that point strongly enough. It should emphasize a concerted effort on the part of the Commission to eliminate separate sets of non-profit corporation laws for different types, such as we now have.

Page 10. I would like to see the comments specifically state, not only as you now do, that the Commission proposes no changes in the tax laws, corporate securities laws or laws governing charitable trusts, but more specifically that you have opted to accept these laws as they are, notwithstanding the fact that some changes need to be made. I believe it imperative for you to state that the Commission is aware of the need for someone to reconsider the crazy quilt of the present tax laws, and perhaps to examine the scheme of regulation of securities for non-profit corporations and the regulation by the Attorney General. However, the Commission was not assigned this job and therefore prepared the law on the premise that if it was general enough it would work with subsequent changes in these other areas. In other words, make the flat statement that because you accepted the other laws as they are, does not necessarily mean

the Commission agreed with them or that they should not be studied. If you do not do these things someone is bound to point out that the Commission failed to consider certain tax aspects of things and should have recommended changes in the tax laws.

Page 13. In the center of this page is a statement concerning recognition of practices of charitable and non-profit corporations to engage in business activities in support of their purposes. I think you should make clear here that the broadening of corporate powers to engage in business was not intended to affect the tax laws which may or may not tax such activities, depending upon where they fall within the tax laws. Point out that the taxability of such business acitivity is a separate and unrelated tax question not dealt with here.

Page 18. On Item (1) on this page, and subsequently with respect to the particular sections, I find, upon reflection, that I cannot agree with the decision we made permitting only the directors to call meetings of the directors. This is contrary to the general practice throughout the United States as to business corporations, and because of the broadening of the statute we have done, I think it is unnecessarily restrictive and counterproductive to insist that the meetings be called by directors. Most charitable corporations in fact, have an executive director or president who actually runs the business, who should, at least, have the authority to call a board of directors meeting. Furthermore, one of the problems often is that the directors cannot be rounded up readily so that an officer has to call a meeting in order to get more directors. I

urge that this section be reconsidered carefully because I think it is a mistake not to conform it to the business corporation law. At a minimum the president, or the vice president if the president is absent, should have the authority to call the board into session.

Page 54. In the matter of court approval of distribution of charitable assets where there is a question of where assets should go, I feel, upon reflection, that it is important the Commission seriously consider overruling the Veterans' Industries, Inc. case. This case holds, as I understand it, that one superior court judge has the right to make the decision and that neither the board of directors nor the Attorney General has that final authority. I do not believe one superior court judge should have that authority, when the board of directors and the A.G. both can agree upon a matter, even if third parties object as they did in that case. Perhaps this can be discussed at the next meeting. This comment has reference, I believe to §6773. In short, I would urge that you statutorily overrule the Veterans' Industries case when it comes to third party objections where the board of directors and the A.G. are in agreement.

Page 56. I do not believe I understand the intent of §6740 and its restriction to proceedings initiated by members holding a majority of the voting power. To me this does not make sense as written.

Page 63. I continue to respectfully disagree with the Commission on the decision that the non-profit corporation be required to file a statement of officers only once every five years. The problem with a non-profit corporation is that the officers and directors tend to change far more rapidly then they do for business corporations. Furthermore, I cannot agree that administrative duties like this are performed by volunteers without compensation and that therefore people dealing with the corporation should not have adequate information. I personally have spent hours trying to get accurate information about non-profit corporations that I represent as a legal counsel, only to find that the only information anyone has as to who the current officers are is on the last report filed with someone. In fact it is only the request for this report that generates activity which causes people to determine who the officers are, which is constructive internally as well as to third parties. It is not a serious burden, the cost is very little, and the benefit to the general public is substantial. You could even waive the filing fee if you are concerned about cost.

Page 69. I see no reason to continue the anachronistic provisions for the corporation sole, presently found in old corporations codes §§10000-10015. This can be accomplished simply by the provisions of our new law allowing one person to serve as the sole director of the corporation. I do not think you would get any particular opposition from the church either, as long as some transitional provision could be made merely requiring them to elect to come under the new law.

Page 70. I don't understand why a special law has to be considered for SPCAs since the non-profit corporation law quite adequately covers it. As far as I can tell from reading the sections, the new non-profit corporation law permits them to do everything they have always wanted to do and presently do.

In the event that you do continue the SPCA and other special sections I would suggest that all the sections on special corporations should be indexed and cross referenced by a special section in Part 2 of the statute telling where they went so that inexperienced persons can find them by references that pop up in the non-profit corporation law. In other words, if agricultural cooperatives are found somewhere else, or the SPCA are elsewhere, one section of cross references should be included in the basic statute so that they will show up in the non-profit corporation index when people look for them. Similar provisions are now placed in the Internal Revenue Code which, while exasperating at the time, are very helpful since otherwise one has no reference in the law and does not know where to look.

Page 71. I believe that the filing fee for Articles at $15.00 is unrealistically low, and that it should be raised to at least $25.00, and a similar provision made with that of the business corporations whereby for that price the filing party receives three free certified copies. This has simplified writing of checks and determination of filing fees, and I suspect has resulted in fewer Articles being returned for the wrong filing fees. Please consider this relation to the business corporation filing fee as a serious and important suggestion,

since it would also make a slightly higher filing fee more palatable.

GENERAL ORGANIZATION - ORANGE PAGES

I believe, on re-thinking some of the ideas on organization, including one suggested in David Mitchell's letter, that a move of the corporate finance sections might be logical, as well as some other changes. I would also suggest that the name of Chapter 2 be changed to "Articles and By-Laws". Realizing that it is a monumental task to renumber some of your proposed sections, I do think that you could logically divide things into the following order under which the first four relate to organization and directors, the next six relate to the members, and the last seven relate to functional changes and finance. I would order them as follows:

Chapter 1. GENERAL PROVISIONS

Chapter 2. ARTICLES AND BYLAWS

Chapter 3. AMENDING ARTICLES

Chapter 4. DIRECTORS

Chapter 5. MEMBERS

Chapter 6. MEMBERSHIP MEETINGS

Chapter 7. VOTING OF MEMBERSHIPS

Chapter 8. RIGHTS OF INSPECTION

Chapter 9. MEMBERS' DERIVATIVE ACTIONS

Chapter 10. RECORDS

Chapter 11. CORPORATE FINANCE

Chapter 12. SALE OF ASSETS

Chapter 13. MERGERS

Chapter 14. DIVISION

Chapter 15. DISSOLUTION

Chapter 16. RESERVED

COMMENTS ON SPECIFIC SECTIONS

The following comments refer to the section which commences the paragraph:

§ 5126. Should not this definition include a reference to "Plan of Division" under 6211, a "Plan of Conversion" under 14802 and maybe to "Agreements of Merger or Consolidation" under §6111 and §6113.

§ 5128. Should not this definition include references to boards of trustees, impliedly authorized by §5250 and §5251.

§ 5130. I would insert the words "which is" between the words "state" and "other" on the second line of this definition.

§ 5132. I continue to believe that reference to bylaws as including articles is a logical inconsistency. This definition is confusing and inconsistent with §5260 on adoption, since by this definition under §5260 the same procedure for adopting bylaws can be used for adopting articles. I believe §5261 and §5268 make clear what you intend by this definition and does not create the confusion that the definition does.

§ 5156. Would this section not also include a newly converted §14802 organization?

§ 5162. I wonder how you reconcile this definition when by subsequent provisions you have eliminated the requirement that the president and the secretary cannot be the same, as under the old corporation law. It seems to me that in this event the

certificate definition becomes meaningless since then the same person signs twice. That is not logical to me.

§ 5174. I would raise the same question that I did under the preceding section.

§ 5180(a)(2). I question, under this law and the general corporation law the validity of a declaration under penalty of perjury outside the State of California. My understanding of the constitutional difficulty is that if the act or crime occurs outside the State the State of California would have no basis for prosecution of the party even if they were a California resident.

Chapter 2. I would change the title to "Organization, Articles and Bylaws" or simply "Articles and Bylaws".

§ 5211(d). It appears to me under this section that there are no provisions to protect the rights, property and otherwise, of dissenting association members upon incorporation. We have carefully provided for the rights of dissenting members in other instances, but here where a person owns an interest in an association his interest may be dragged into the corporation without his consent, and under subsection (d) all you have provided is that they need not be a member if they dissent. We have not provided what happens to his property rights in the association's property, and whether or not he is to be compensated. He should have some rights beyond objection.

§ 5221. I do not believe we have defined "persons" in this statute, while other codes include corporations and other entities as persons. This does not appear to be appropriate here. It raises the question of whether or not a corporation

could be a director since it is legally a person. Perhaps this can be solved by adding reference to the requirement that the articles be executed by "one or more natural persons".

§ 5232(a). It appears to me that we have not made clear who may assert this right -- anyone, or merely interested parties, or how the court is to determine who has standing to sue under this code section. I would suggest we could make this clear if we extend the principle of the Holt case from directors to "any interested party" or some other language setting up some sort of basis for the court determining who has standing to sue. As written, it leaves me with the impression that the directors and the A.G. are the only ones who have authority, whereas I think members of an organization set up for charitable purposes should have this right to bring such an action. I believe this is a critical question that has not been addressed by the Commission unless I have missed the other limitations on this, in which case there should be a cross reference.

§ 5235. I do not understand why the requirement that a member must be responsible only if he receives a prohibited distribution "with knowledge of facts". This is not a criminal act so notice is not necessary, the law assuming that all parties have knowledge of civil statutes.

§ 5250. I think we need here a cross reference to §5311 specifying information on the number of directors. Merely reading §5250 does not answer the quesion of the number of persons who can serve as initial directors, even though subparagraph (d) refers to one or more.

§ 5260. I would suggest changing the title to "Adoption and Amendment of Bylaws".

§ 5267(b). I would suggest some constitutional difficulties with this section since I do not believe that the California courts would have authority unless the request was made by a member who was either a California resident or who had some contact with California. Otherwise, you have the situation in which a member in New York might bring suit in California against a Texas non-profit corporation citing this section. Application of that section in such a case, would, as far as I am concerned, be an unconstitutional assertion of California's jurisdiction.

§ 5268. I would like to see inclusion in the comment the idea that a corporation may still have a third level of rules -- membership rules that relate to particular activities, such as house rules, swimming pool rules, or other rules which do not rise to the level of charters or constitutions. As a practical matter most organizations do, and the question always rises as to whether such rules are in effect bylaws. I know we had a considerable discussion of this but I do not recall how it was solved and I do not think this section solves it as written.

CHAPTER 3

§ 5313. In my comment to §5250 I perhaps did not make clear that as I understand our statute the articles can name a small number of initial directors, but also set a larger number. This allows quick incorporation and yet no harm to anyone else. Both this section and §5250, or the notes thereto, should make clear our intent to do so. In such case the articles would state, for

example, "the initial directors are X, Y and Z, but the number of directors to serve unless changed by the Bylaws is 11". In this way the corporation can be set up promptly and other directors appointed later.

§ 5315. As you know this section relates to the discussion I had with the Commission and a section which I never got around to drafting because I found some difficulties in drafting it. Perhaps we could go from the fine provisions here to a further provision stating that if one group is designated as the "managing board of directors", that it is generally responsible to the public and the other boards of directors are responsible only for the specific area which is part of their designated board. For example, the investment board, or the membership solicitation board. These people then would by statute not have general responsbility or liability to the public for the conduct of the corporation, but only as to the area that was assigned to them. This would not affect much change in §5315 but I think would improve it and make some clear answers to questions that have never been answered before.

§ 5323. The term "unsound mind" seems ambiguous to me, and I believe notwithstanding the use of the language in the business corporation law it would be better to change the word to "incompetent", which includes physical condition as well as mental.

§ 5325(b). The reference to members of "a class" seems ambiguous in that it could mean that if you have two classes 10% of one is enough for the suit. Doesn't this section really mean 10% of the members in general, unless elected by classes, and in such case then 10% of each class. In any event, it is not clear to me when I read it what is meant by it.

§ 5331. As I commented previously, I think the president should be able to call a board meeting, and even the acting vice president in absence of the president should have this authority. I recognize that under §5330 bylaws can provide otherwise, but this is an unnecessary bylaw and I can't see any reason, as commented earlier, why the principal operating officer should not have the authority to call the board of directors to a meeting.

§ 5339. Following this section I think it would be advisable to state specifically that directors may not vote by proxy but must be present, except as provided in §5338. I think corporation law generally has always held that directors cannot vote by proxy but it would be easy to include it somewhere in one of these two or three sections.

§ 5363(a). With respect to the resignation of officers, I think the language of this should be exactly the same as §5324 for consistency, including adding subparagraph (a) on 30 days as a separate paragraph and making paragraph (b) subsection (c).

§ 5388. Does this section mean that a corporation may pay for insurance covering damages as well as expenses, as it appears to? Most of these statutes on indemnity are aimed at compensating for expenses, but not paying the damages. We should

be certain what we mean here.

CHAPTER 4

§ 5420 et seq. The first comment should clearly indicate that this article does not purport to pass on corporate securities matters nor to change existing law such as it is as to securities, i.e. the Silver Hills case or the corporate securities statutes. This is especially so since many of these rules offend the present law and rules on non-profit corporations subject to corporate securities laws. This ties to my earlier comment to the effect that we should make the point again that we are not passing upon the wisdom of existing law as to securities regulation, only providing for the organizational rules, and that someone else may wish to look at the corporate securities laws as they exist now.

§ 5422(c). I do not understand what public policy is offended by permitting such redemption, especially if you included a provision referencing it to not paying out things to members that would make the company insolvent.

§ 5433. The information in the parentheses in the center of the section seems redundant since §5432 says the same thing.

§ 5441. Either here or in §5511 the statute should make clear that, even in case of termination of forfeiture, notice is required even if no hearing is. I realize the comments state this but the code section in §5441 leaves the impression that not even notice is required.

§ 5450(c) and § 5454. I do not understand what a "allotment of rights" is and think it should be omitted since this type of thing is not appropriate to non-profit corporations. I think an allotment of rights is like a stock right, which does not exist under our law.

CHAPTER 5

§ 5520 - § 5529. I see no harm in including this in the final proposed law as long as you note, as you do, that it does not appear to be limited under California law now, but that you want to make clear it can be done. It does seem to me, however, that §5525 is inconsistent with §5422(c) in policy at least. I would still omit §5422(c).

§ 5529. I do not understand the necessity of filing in California. There is nothing in the articles about capitalization so I see no need for such a filing, which simply makes unnecessary filings. This has application in business corporation laws but not in non-profit corporation laws.

§ 5550. Even with the reference in the comment, I think you should specifically cross reference to §5532 on debt generally.

§ 5551. I think it is a mistake to omit the old provision about making payments to settle disputes with members such as the old corporation law had. This applies to the guy who is raising hell because he does not like some things being done, and the corporation should have a chance to buy him out as long as a creditor is not harmed by it, even though it may make it more difficult to make payments generally. The old law was used in a number of instances and prevented long litigation that would

otherwise have insued.

§ 5562(c). I know this matter was discussed by the Commission on a number of occasions, but I still think this is poor language as to the duty of a director. Even though the comment discusses it, it is dangerous because many people do not read the comments and there should be further language in subsection (c) that says "provided that the services of the institutional trustee are monitored from time to time by the board". The comment relates only to the duty of care in selecting the trustee, whereas the trustee might well have left for Mexico after selection, and after a number of years of service. In this case I cannot believe that the board would be insulated from liability

§ 5574. I do not know what "conducting private school instruction" means. This could be a serious problem because the implication is that you have to offer full classes during all of the usual hours in order to qualify. On the other hand, there are a number of schools that are specific in nature and supplement the public school system at a high school or elementary level, such as remedial reading schools, speech defect schools, hearing defect schools and schools for the physically handicapped. All of these schools clearly are charitable in nature, or at least are required to be under this section. They should be entitled to the benefits of §5575, and would not be under the previous definition now in the statute. This is not an idle problem since I have previously represented several entities where this same definition has presented a problem in other

areas.

CHAPTER 6

§ 5627(a)(2). Requiring each person to "sign a waiver", seems totally inconsistent with §5632 which allows a simple majority consent without notice. Subsection (2) here should be changed to the same number of people as set forth in §5632. My point is that §5627 requires unanimous consent while §5632 requires only a majority. Of the two I would prefer §5632's resolution.

(Balance of Comments to Follow.)

Memorandum 76-83

EVELLE J. YOUNGER
ATTORNEY GENERAL

(213) 736-2304

EXHIBIT XXXXVII
STATE OF CALIFORNIA

OFFICE OF THE ATTORNEY GENERAL

Department of Justice

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LOS ANGELES, CALIFORNIA 90010

September 22, 1976

Kenneth C. Eliasberg, Esquire
Suite 770 Wells Fargo Bank Building
433 North Camden Drive
Beverly Hills, California 90210

Re: Draft of Non-Profit Corporation Law

Dear Ken:

As requested by you, here are my comments on the tentative recommendation of California Law Commission revision relating to the non-profit corporation law:

1. The approach is excellent and desirable, namely that of a separate and independent non-profit corporation law.

2. Proposed section 5224 provides that upon the formation of a non-profit corporation organized for charitable purposes the incorporators shall send a copy of the articles to the Attorney General. We consider that an excellent provision and as we discussed at our meeting, if it would be administratively easier for the Secretary of State to send the copy, that would be satisfactory with us.

3. Section 5232. Perhaps the comments to this section should make reference to the fact that the Attorney General (and perhaps others) is an appropriate person to bring an action pursuant to this section.

4. Section 5250(b) may well be interpreted to prohibit the listing of specific charitable purposes for which the organization is formed. This would seem to be undesirable.

5. Section 5329 sets forth provisions for removal of directors. It would be appropriate to indicate in the comments that nothing in that section detracts from whatever authority the Attorney General may already have to seek court removal of directors of charitable corporations.

6. Section 5370 sets forth the duty of care of directors and then it makes it subject to Section 5560. In our view Section 5560 is inadequate. We are of the opinion that the Redfield, Speilman and other cases make it quite clear that directors of a charitable organization or corporation or directors of non-profit corporations holding charitable assets have the duties and obligations of ordinary trustees in relation to those assets. Section 5560 only incorporates Section 2261 of the Civil Code, the so-called prudent man rule. In our view, if any reference is to be made to the Civil Code it should incorporate all the obligations as set forth in Civil Code Sections 2228 through 2229 as well as any common law obligations of trustees. I recognize that this position is not universally accepted, but it is in our view well established and may be an area of basic fundamental disagreement within the committee on any recommendations as to this law.

7. Section 5371 authorizes certain transactions involving interests of directors. In our view, if those transactions involve directors of a charitable corporation or of a non-profit corporation holding charitable assets (and relating to those assets) under the present law such transactions are void unless approved by the beneficiaries of the trust through their representatives, the Attorney General. Section 5371 attempts to change the law as set forth in Holt, Redfield, and other cases, most notably People v. Larkin, a recent United States District Court, Northern District of California case. We have the same problem with Section 5372, and we can see no cogent arguments for changing the law. Again, the same problem exists in Section 5373, loans to directors and officers, if they involve a charitable corporation or charitable assets of a non-profit corporation.

8. Section 5374 sets forth the liability for directors for an illegal distribution, and sets forth several limitations on that liability. If this is intended to apply to charitable assets or the assets of a charitable

corporation, it is a severe erosion of existing law, and we will be opposed. I would recommend that such assets be specifically exempted from the section.

9. Article 8 commencing with section 5380 sets forth rules for indemnification of corporate agents. This is an area as far as charitable assets are concerned where we have some unresolved disagreements with many attorneys representing charitable organizations, but I think the problem can be resolved. We have no objection to directors (or trustees for that matter) being indemnified for such matters as automobile accidents and the like. Where we draw the line is using charitable assets to indemnify or to pay for the insurance of indemnification of a trustee or director who fails to do his duty. If the director of a charitable corporation performs an act which constitutes a breach of trust, we are opposed to his being indemnified from charitable assets either directly or indirectly through insurance. The problem may be in defining the line between permissable and non-permissable indemnification.

10. Section 5561 authorizes the directors to make certain an indefinite or uncertain purpose of a gift. The language is such that it might be construed to allow that decision by the directors to go beyond the purposes set forth in the articles. The section is apparently designed to attempt by other than court action to resolve some ambiguity as to a donor's intent. Some clarification is needed to limit such actions by the directors to the purposes of the corporation.

11. Section 5562 authorizes the use of institutional trustees. The comment indicates that the use of institutional trustees does not relieve the directors from their duty to exercise care in the selection of institutional trustee, but it does relieve the directors of their obligations in relation to the results attained by the institutional trustees. This is a specific change in law, since trustees cannot delegate their responsibilities with total absolution. It is however an area where the law should perhaps be modernized, and we suggest the possibility of requiring some degree of supervision over the institutional trustees even if non-negligently selected in the beginning.

12. Section 5565. The comments as to Section 5561 also applicable to Section 5565. If there is any chance that the directors could make use of charitable

assets beyond the purposes set forth in corporation's articles, we feel the language should be changed to make sure that cannot happen.

13. Section 6011 prohibits disposing of substantially all of the corporations assets without approval and certain other conditions. In the alternative this would approve the approval of the members. Since there are generally no members to a non-profit charitable organization other than the directors, it might be appropriate to require Attorney General approval on behalf of the beneficiaries in the case where charitable organization or charitable assets when the alternative of approval by members of subdivision a(2) is used.

14. Section 6012. Notice to the Attorney General. This requires notice to the Attorney General in certain Section 6011 dispositions when specific conditions are met. As we discussed at our subcommittee meeting, giving written notice to the Attorney General under these circumstances may well not solve anything. Any prudent counsel is going to advise that the corporation give notice even if not absolutely required by Section 6012. Therefore there may well be an inundation of notices to the Attorney General. Moreover, Section 6012 does not provide for a review period by the Attorney General or any other delay. One example cited was a non-profit charitable corporation that owns a building which constitutes a major if not sole asset of the corporation. Under this section, counsel would undoubtedly advise the corporation give the Attorney General notice prior to the sale of that building even though the corporation proposed to remain active as a charity. It may well be that such notice to the Attorney General could not serve any great public purpose. If the corporation was, however, going to disolve, then under other sections of the proposed law, notice of dissolution should be given to the Attorney General, who could then examine the books and records to determine what disposition had been made of the assets. My suggestion is that some further thought be given to this section to perhaps devise some mechanism whereby the public interest is served yet neither the Attorney General nor the corporations are bogged down in paper work.

15. Section 6142 requires notice to the Attorney General of agreement of merger or consolidation if one of the non-profit corporations holds assets on charitable trusts or is organized for charitable purposes. We think

that this is an excellent provision. We note, however, that Section 6160 provides a 60-day statute of limitations to challenge a merger. We think that Section 6160 should be amended to specifically exclude any action brought by the Attorney General, or as a bare minimum, the comments to that section should indicate that it is not applicable to actions brought by the Attorney General in the performance of his duties of supervision of charitable organizations holding charitable assets. A 60-day statute of limitations from the Attorney General is wholly unreasonable.

16. Section 6242 provides a similar notice to the Attorney General in the case of a division of a non-profit corporation organized for charitable purposes or for holding charitable assets. As with 6142 we consider this an excellent provision but also as with 6160 we feel that a statute of limitations of sections 6260 should specifically exclude the Attorney General or as a bare minimum that the comments thereto should indicate that the Attorney General is not covered by that statute.

Note, in dealing with both the mergers and the division sections, we are assuming that it would be impermissable under either article for a charitable corporation or a non-profit corporation holding charitable assets to use either devise to avoid any legal restraints on the use of any assets held for charity by the mechanism of merger or division. It might be appropriate in the comments as to both articles that some statement be made that neither article authorizes any non-profit corporation organized for charitable purposes or holding charitable assets to change the use previously authorized to be made of those assets.

17. Section 6512 provides penalty for failure to keep records or provide financial statements. The comments make reference to, among other items, section 14490 enforcement by the Attorney General. We would suggest adding to that, reference to the Government Code Sections 12580 et seq. and other Attorney General common law powers. This would make it clear that the statute is not designed to cut down on any existing authority the Attorney General has in reference to enforcement of the duties of the directors of a charitable corporation.

18. Section 6740, et seq. Article 4 provides a mechanism of avoiding dissolution by purchase, and then Section 6740 specifically exempts non-profit corporations

Memorandum 76-63

EXHIBIT XXXVIII

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September 27, 1976

Kenneth C. Eliasberg, Esq.
Suite 770
Wells Fargo Bank Building
433 North Camden Drive
Beverly Hills, California 90210

Re: Revision of Nonprofit Corporation Law

Dear Ken:

The following is a summary of my comments on Part I of the California Law Revision Commission's Tentative Recommendation Relating to Nonprofit Corporation Law (the "Law").

1. General. Overall, I am very impressed with the quality of the Commission's work and I think that the basic approach is sound. My specific comments go mainly to problems I have encountered in practice which might indicate a need for clarification in the Law.

2. Curative Provision. I would like to see included in the Law a general curative provision covering procedural irregularities in the operation of nonprofit corporations. Many nonprofit corporations are small and cannot afford, or do not realize the need for, legal advice. Even the boards of some sizeable organizations make mistakes from time to time. These can lead to fundamental questions--such as whether the present board is validly constituted. I think it would be helpful to provide that, after some period of time, prior defective actions cannot be exploited--either by third parties or by factions in an internal dispute.

3. Scope of "Charitable". While I would be very skeptical about an attempt to define the word "charitable," I would like to see some indication in the Comments (not in

the Law) that the term is being used in its broad sense--i.e., that it includes, without limitation, religious, educational, scientific, literary, testing for public safety, prevention of cruelty to children or animals and other similar purposes.

It is my understanding that the mere presence in the articles of a nonprofit corporation of a dissolution clause (not an irrevocable dedication clause)--providing that upon the dissolution of a corporation which otherwise is not charitable the remaining assets will be distributed to a charitable organization--does not make that corporation "charitable" within the meaning of the Law. I understand that the Attorney General's office shares this view and I would like to see it clarified in the Law.

4. Purpose Clause. I am troubled by the elimination of the requirement of a specific purpose clause. While I realize that it may be possible to write a specific purpose clause by way of limitation, I suspect that the practical effect of Section 5250(b) would be to discourage nonprofit corporations from disclosing their distinctive purposes in their articles. Corporations engaged in charitable activities ordinarily do not hold themselves out to the public simply as all-purpose charitable organizations. When they receive contributions, the assets received are subject to an implied trust, the terms of which are found largely in the purpose clause of the articles (in the absence of specific limitations imposed by the donor). I think that neutering the articles of incorporation of nonprofit corporations is likely to lead to litigation about the limitations, or lack thereof, on contributions. A purpose clause would also help to distinguish among the numerous of types of nonprofit corporations. Unlike business corporations, nonprofit corporations are subdivided into many distinct classifications for tax purposes. It is important to reflect those distinctions in the articles to satisfy the "organizational" requirements of the tax laws.

5. Irrevocable Dedication Clause. Problems in the administration of the affairs of corporations for charitable purposes can result from the failure of fiduciaries to understand that the assets are irrevocably dedicated to charitable purposes. I think that Section 5250(c) leaves too much unsaid and will not have the prophylactic effect of an irrevocable dedication clause. Moreover, the fact that

an irrevocable dedication clause will be required by the Internal Revenue Service, the Franchise Tax Board and the county tax assessor suggests the wisdom of requiring it in the articles of any nonprofit corporation organized for charitable purposes if for no other reason than avoiding unnecessary amending of articles.

6. Quorum. I believe that there should be a minimum quorum requirement for all nonprofit corporations. Page 18 of the Commission's summary states the reason for having no minimum quorum for nonprofit corporations as follows:

> "The greater flexibility of existing nonprofit corporation law is necessary for nonprofit corporations whose directors may be persons performing a public service and often unable to attend meetings; the existing law should be retained."

I strongly disagree. I have seen situations in which the majority of the directors never attend. I do not believe they are performing a public service by purporting to act as directors but not doing so. Moreover, I have seen problems arise from the lack of attention by such purported directors. Small inbred groups--perhaps even just an executive director--are saddled with more responsibility, control and opportunity for abuse than they want or should have. I believe the public interest would be better served by discouraging the practice of lightly making supporters directors-in-name-only. If they are not going to accept and discharge fiduciary responsibility, such persons should be on advisory committees, not the board of directors.

7. Officer Titles. In Section 5360, I would like to see a provision authorizing the corporation's bylaws to use terms other than those listed and to provide that they are the equivalent of those offices listed for all purposes under the Law.

8. Identification Statements. I think there is a problem with the approach of current law and Section 14602 of the Law. In practice many changes of chief executive

officers are not reported because no one thinks about it. I suspect there would be far better compliance if this were simply made an annual filing requirement and the form came in the mail.

9. Private Foundation "Governing Instrument" Provisions. In rewriting existing Section 9501.1 (new Section 5563), the Commission made a technical error. In referring to sections of the Internal Revenue Code, it omitted all parenthetical references to the savings provisions of the Tax Reform Act of 1969. Those provisions are not obsolete by any means. Many of them are permanent and others have lives of 10 to 20 years after 1969. Thus Section 5563 would prohibit many acts which are proper and important for private foundations and which Congress expressly permitted. The language of Section 9501.1 should be followed very closely. It should be kept in mind that this is the language upon which the Internal Revenue Service has ruled favorably and any unnecessary tinkering with it could call into question the automatic compliance ruling for the benefit of California private foundations.

10. Merger with Business Corporation. Existing corporate law does not preclude the merger of a nonprofit corporation, even one for charitable purposes, with a business corporation. (The Charitable Trust Division of the Attorney General's office undoubtedly would object to such a merger involving a charitable organization.) There could be some clarification of this point in the Law. Probably the rule should be that such a merger is permissible for nonprofit corporations other than those holding assets for charitable purposes.

11. Dispositions of Substantially All Assets. The approach of Section 6021 seems unduly broad. It will, in effect, compel notice to the Attorney General in nearly every case that might possibly come within its terms; no one is going to take a chance on fair market value. Having to deal with the Attorney General's office can easily mean a six-month delay. The underlying rationale for this provision seems to be prevention of self-dealing. If so, it should be narrowed, if retained, to require such notice only if the person to whom the assets are being transferred is a fiduciary or related to or affiliated with a fiduciary.

Also, is this section intended to cover the gift by a foundation of a substantial portion of its assets in any one year to another charitable organization? Some family foundations do this every year (being replenished each year with fresh contributions from the family). I do not see any reason why this situation should be covered.

12. Fiduciary Duties. This is an important question and one that is not settled under existing law. I am very much in agreement with the approach taken in the Law (Sections 5370-74 and Section 5560)--as I understand it. I take it that the reference to Section 5560 in Section 5370 merely subjects the fiduciaries of a nonprofit corporation for charitable purposes to the prudent man rule of Civil Code Section 2261 with respect to investment decisions--not to the other provisions of the Civil Code defining the duties of a private trustee. I believe that the Charitable Trust Division of the Attorney General's office will press for the private trustee rules in toto, but I feel strongly that most substantial charitable organizations would be damaged by the application of the private trustee rules,* and that few, if any, additional abuses would be prevented.

The private trustee rules were designed primarily for private trusts, in which the tasks undertaken by the trustee do not encompass such things as raising funds or running a substantial institution, such as a hospital or a school (which, however charitable, must have many operational aspects of a business if it is to operate efficiently and survive).

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* The Attorney General's office will contend that case law already establishes that the private trust rules apply to corporations for charitable purposes. I disagree; the cases cited for this proposition will not stand close examination. Lynch v. John M. Redfield Foundation, 9 Cal. App. 3d 293, 88 Cal. Rptr. 86 (1970), is authority only for the prudent man rule of Section 2261; moreover, the same result could have been reached under the corporate fiduciary rules. There are some rather sweeping statements in other cases, but I believe they are dicta.

Universities, hospitals, etc., do their best to persuade large donors, lawyers, bankers, accountants and the like to serve on their boards of directors because they derive substantial benefits from such service. The private trustee rules would prohibit these institutions from entering into any subsequent transactions with these individuals or their firms without advance permission of the Attorney General's office. This would discourage charitable remainder gifts by donor-directors, provision of services at minimum rates by law and accounting firms and provision of banking services--such as favorable "community service" types of loans by banks and other financial institutions. To require prior Attorney General approval of any such transaction--despite approval of a disinterested majority of the board after full disclosure--would merely create a large new bureaucracy. The inevitable tendency, in addition to the added cost and delay, would be toward the substitution of a government agent's judgment for that of a board of directors, and a corresponding weakening of private charitable enterprises.

I believe that the disclosure approach of the Law affords adequate protection against abuse. I cannot think of an "abuse" which I have observed which would not have violated the provisions of the Law as proposed.

If the highly arbitrary and restrictive private trustee rules are to be applied at all, they should be limited to organizations which are similar to private trusts--i.e., non-operating foundations with small boards of directors. (This distinction is already recognized in the Internal Revenue Code as a result of the Tax Reform Act of 1969).

Also, I believe that numerous transactions which are permissible even for private foundations under the Tax Reform Act (and, accordingly, existing Section 9501.1) would be prohibited by the strict application of the private trustee rules of the Civil Code.

If there are any significant changes in the approach of the Law to fiduciary duties, I would like to have an opportunity to comment at length on such changes. I fear that there is a natural tendency toward excess zeal in this area--i.e., charity is sacred and its agents can never be holy enough--which must be kept in check to avoid imposing impractical and costly impediments on charitable organizations.

Very truly yours,

James M. Cowley

cc: Warren J. Abbott, Esq.
Leslie R. Klinger, Esq.
Brett R. Dick, Esq.

Memorandum 76-83

EXHIBIT XXXIX

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September 28, 1976

IN REPLY PLEASE REFER TO

John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

In response to your letter of September 22, 1976 requesting comments on the Law Revision Commission's tentative recommendations relative to non-profit corporation law, the following comments are offered.

As a preliminary matter, I have not had an opportunity to review the tentative draft in detail. However, in accordance with your suggestion that comments on the basic approach of the tentative draft be made, this letter is intended to serve that purpose.

I am in accordance with the approach of the Law Revision Commission, and particularly its attempts to simplify the law relating to non-profit corporations and to formulate the provisions relating to this body of law in one consecutive set of code sections. Although a number of non-profit corporations are formed where the clients can pay substantial fees for the legal work involved, particularly in the municipal financing area and in connection with the formation of special corporations in connection with real estate developments, a number of corporations must be formed by every attorney virtually as a public service. Any steps which make it easier for the lawyer to carry out this latter function of public service in a competent manner without a great expenditure of time and effort will be of benefit to the Bar, since it will encourage a number of attorneys to engage in this activity who otherwise would not be able to perform such public service.

Additionally, a number of people who are interested in forming non-profit corporations for various public service activities are really unsophisticated as to the intricacies of operating a non-profit corporation, and the clarification set forth in the proposed revision should aid them in operating the corporation, once formed. Probably in the future pamphlets will be issued by the State containing the applicable code sections relating to non-profit corporations, so that in the future such corporations will have a readily available set of code sections to utilize in conducting their operations.

The goals you have in mind, however, may be frustrated to some extent by the separation of the general provisions relating to non-profit corporations from other provisions equally important to such corporations which are contained in the general corporation code which is Part II of these recommendations. I wonder if it wouldn't be possible to include a code section in Part I which says in effect, "The law pertaining to the following topics is contained in the general corporation code" and then list the major topics that are contained in Part II, such as Corporate Name, Filing of Instruments, Service of Process, etc. This would lead the unsophisticated members of the general public who are attempting to operate a non-profit women's club, for example, to know that they should look to some other provision of the law concerning certain subjects.

Another problem exists in your proposed Section 14450 of Part II (and perhaps the same type of language occurs elsewhere). I refer to language such as "The provisions of this division apply to every corporation, profit or nonprofit, stock or nonstock, now existing or hereafter formed unless:

. . .

(b) There is a special provision applicable to the corporation inconsistent with some provision of this division, in which case the special provision prevails."

There is considerable difference between the saying "A general provision applies unless a special provision exists" and saying "A general provision prevails unless a special provision is inconsistent with the general provision." Inconsistency lies in the eyes of the beholder, and it is this type of language which leads to litigation and a requirement that a court determine whether inconsistency exists or not. A legislative enactment should be clear on its face and not invite litigation over its meaning.

I hope these comments may be helpful, and congratulate the Commission on a noble effort in this area.

Sincerely,

Homer L. McCormick, Jr.

HLM:ehe

Memorandum 76-83

EXHIBIT I

REDKEN® LABORATORIES, INC.
14771 Calla Street, Van Nuys, California 91411 • Phone (213) 781-4824

September 30, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Dear Mr. DeMoully:

I requested a copy of the proposed code relating to nonprofit corporations because of some prior working experience with a private school and a farmers cooperative association. Although not deeply concerned with incorporation and organization matters, I did become aware of some shortcomings in the law. I would like to see the cooperative association law taken out of the Agricultural Code and made more comprehensive. Other than that element, you have addressed my concerns.

As your analysis points out, the policing of the nonprofit organization creates a difficult balance, and the tax laws are one source of control. But, I must admit that I still feel that some nonprofit organizations, particularly schools and churches, need more control. I do not recommend the Law Revision Commission take on that battle at this time.

You are to be complimented on your efforts.

Sincerely yours,

JOHN S. MURRAY
Counsel - Corporate Affairs

JSM:jlh

Memorandum 76-83 EXHIBIT II

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October 1, 1976

John H. DeMoully, Esq.
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

Thank you for your letter of September 22nd. My apologies for not having responded earlier to your request for comments on the Tentative Recommendation Relating to Nonprofit Corporation Law.

In general, I like the draft and, while I have not found time to go through it in detailed analysis, it does seem to me that it is a substantial improvement on the present law. I do like the approach of having a Nonprofit Corporation Law which is complete in itself.

However, I have two small problems, one quite specific and the other of more general application:

(1) Section 6773(b) would provide that distribution of assets of a charitable corporation be pursuant to a decree in proceedings "to which the Attorney General is a party." We have had difficulty, under the present law, in having the Attorney General actually become a party to such a proceeding. I would, therefore, prefer that the sentence be changed to refer to proceedings "of which the Attorney General has been given notice and to which the Attorney General has an opportunity to become a party." Furthermore, I am not sure that paragraph (c) should allow distribution without court order if the Attorney General waives objections. I appreciate the desirability of having the Attorney General as the supervising agency for charitable trusts and corporations. However, I think it desirable to have a court proceeding with opportunity to interested parties to make objection before assets are actually turned over to another charitable organization.

(2) I was not, in my general review of the new law, able to satisfy myself as to exactly how it is to apply to existing corporations. For example, the provisions as to what should be contained in the Articles are different from the present ones, and many corporations will not satisfy the new law. Is there to be a grandfather clause, or a period during which each nonprofit corporation must make necessary changes?

Very truly yours,

Gordon M. Weber

Memorandum 76-83

EXHIBIT LII

LAW OFFICES OF
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SAN FRANCISCO
YUKON 2-1078

JOSEPH G. JUE

October 1, 1976

John H. DeMoully
Executive Secretary
CALIFORNIA LAW REVISION COMMISSION
Stanford Law School
Stanford, CA 94305

Dear Mr. DeMoully:

I appreciate the opportunity afforded me by the Commission to review the Proposed Nonprofit Corporation Law.

Although I received it so late as to preclude detailed study, I can state that I approve of your approach in producing a self-contained set of codes relating only to nonprofit corporations. This should be a boon to practitioners in that the location of the pertinent law and the interpretation of it will be greatly simplified.

I am happy to see that you have responded to the problem of the need for increased creditor protection in the provision for a cause of action regarding improper distributions. Additionally, the tightening up of the standard of care regarding management and directors who manage or hold charitable assets, as well as the directorial liability for improper loans is a welcome sight (although perhaps not to those who would abuse their positions of trust).

The enunciation of the flexible standard of care for directors may help to bring more predictability into that area, while the provisions for indemnification of corporate agents and the corporate ability to advance ordinary business expenses seems to bring the code more in line with practical reality.

All in all, it seems to me to be a fine effort on the part of all who were involved.

Very truly yours,

John D. Nelson, J.D.
(Awaiting Bar Results)

JDN/vmr

EXHIBIT LIII

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September 30, 1976

California Law Revision Commission
Stanford Law School
Stanford, California 94305

Attention Mr. John H. DeMoully, Executive Secretary

Dear Mr. DeMoully:

This is in reply to your letter of September 22 requesting the views of this office on the tentative draft with respect to nonprofit corporations.

No change has occurred since our letter of June 10 and therefore we must reiterate what was set forth in that letter. In other words, it seems best to allow the two studies to proceed on their own course so that our comments would not tend to inhibit the exploration of imaginative alternatives from either study.

With respect to the proposed Division 4, we repeat the views expressed earlier, namely, that a consideration of that subject is entirely premature and unwise. Consideration should not be given to such subject until after a new law with respect to nonprofit corporations has been completely enacted. Only at that point could consideration be given to the question of whether there are certain provisions common to all corporations which should be set forth in a separate division.

Very truly yours,

BILL HOLDEN
Staff Counsel

BH:ng

Memorandum 76-83

EXHIBIT LIV

WALLACE HOWLAND
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SAN FRANCISCO, CALIFORNIA 94109

(415) 775-7700

October 4, 1976.

California Law Revision Commission.
Stanford Law School,
Stanford, Calif. 94305.

Gentlemen,

Herewith are my comments and suggestions concerning the Commission's "Tentative Recommendation relating to NONPROFIT CORPORATION LAW".

First, let me say that while my experience in this field has been extensive, it has been limited almost entirely to nonprofit corporations organized for charitable purposes (herein referred to as "charitable corporations", after Govt. Code § 12582.1)

From 1959 until 1971, as Assistant Attorney General of California, I directed the exercise of the Attorney General's supervision of the affairs of trustees, corporate and individual, holding property for charitable purposes. This included the establishment of the California Registry of Charitable Trusts; the drafting and advocacy of legislation in this field, both state and federal; and directing the statewide work of the Attorney General's legal staff in the enforcement of charitable trusts. In 1969 I was the spokesman for the National Association of Attorneys General before the Congress in the drafting and advocating of the provisions of the Tax Reform Act of 1969 that relate to private foundations.

I strongly support what your Letter of Transmittal, July 23, 1976, refers to as "The basic approach of the tentative draft" and the recommendation of the Commission that there be adopted"

1) A new and self-contained nonprofit corporation law that is "...complete in itself and does not require reference over to the business corporation law...", and

2) A new Division 4 to Title I of the Corporations Code that would set forth provisions applicable to all types of corporation.

The reasons giving rise to the need for such an independent body of nonprofit corporation law are cogently stated in the Tentative Recommendation (herein cited as TR). I would only add that the point, well taken, that provisions entirely proper when applied to profit-making business corporations "...are inappropriate for nonprofit corporations..." has no more forceful application than to the subject of self-dealing by directors of charitable corporations.

The following comments are set forth topically. Unless otherwise stated, section and page references are to the numbered sections and pages of the Tentative Recommendation dated July 26, 1976.

§5560. Management of Charitable Property.

Important from my viewpoint is §5560(b). It provides:

> "§5560(b). In acquiring, purchasing, investing, reinvesting, exchanging, selling and otherwise managing property received for charitable purposes, a nonprofit corporation and its directors shall be subject to the obligations of a trustee set forth in section 2261 of the Civil Code."

The Commission's comment (TR p.214) states:

> "Section 5560 codifies the existing case law that the management duty of a nonprofit corporation holding charitable assets is that of the private trustee..."

The Commission's purpose in this respect would be better served by the deletion from §5560 of the limiting words "...set forth in section 2261 of the Civil Code."

That would leave it to otherwise applicable law to determine just what the duties and obligations of a private trustee are. I heartily support such a position. As the draft now stands, taken in context with other TR provisions discussed below, I submit that the specific reference to Civil Code §2261 comprises words of limitation that would free directors of charitable corporations from prohibitions and restrictions imposed upon them by present law. Unintended this result may be, but to me it is undeniable. Explanation follows.

There is literally no action corporation directors could take with respect to charitable assets that it not embodied in the words of §5560 with its catch-all phrase "otherwise managing property". And, in a new and comprehensive nonprofit corporation law, the only obligation of a trustee that §5560 would impose upon them is to abide the well-known standard of the prudent man investment rule.

In present law, the provisions of Civil Code §2261 are taken in pari materia with the other sections of the Civil Code that lay severe strictures and prohibitions upon the conduct of a trustee. Pertinent here is §2230 which flatly prohibits a trustee from taking part in any transaction concerning trust property in which he has an interest, present or contingent, adverse to his beneficiary. The stated exceptions to this prohibition require court approval of the contemplated transaction, thus removing it from any "prudent man" standard for its accomplishment. And so it has been held that it is unlawful per se for a trustee having a power to sell trust property to purchase it for himself. Neither good faith nor lack of injury to the beneficiary (cf. "just and reasonable" to the corporation) is a defense. Differding v. Pallagh, 121 Cal.App. 1 (1932); Rest. Trusts §§ 170, 206.

In this context, the Civil Code obviously applies the prudent man standard of §2261 only to situations to which §2230 does not apply, i.e., where the trustee has no interest adverse to that of the trust beneficiaries.

The question arises: what future application can Civil Code §2230 have upon a self-dealing director of a nonprofit charitable corporation in his capacity as trustee of the charitable assets? I submit §5560 would be a bar to any such application. It would be a later and specific enactment dealing with the same subject matter, i.e., "managing property" dedicated to charitable purposes. It would be contained in a comprehensive new law, said to be "complete in itself", governing nonprofit corporations and their directors. And it would have selectively chosen and taken from its context in the Civil Code one - and only one - provision establishing a standard for the conduct of directors managing charitable assets. Rejecting the prohibitions of Civil Code §2230 by its exclusion, §5560 would actually authorize self-dealing with charitable assets under the standard of the prudent man.

In this important respect the Tentative Recommendation would make a major change in substantive law in an express override of presently applicable case and statute law. To this, I respectfully but strenuously object.

Recommendation: Delete from §5560 its concluding words: "...set forth in section 2261 of the Civil Code."

§5371. Transactions involving interest directors.

The Problem: When applied to a charitable corporation, disclosure of self-dealing by a director is not the protection to the beneficiaries of the corporation's endeavors that it is in the case of a stock corporation organized for profit.

Comment: Consistent with the results I have attributed to §5560 are the provisions of §5371. The latter embody the philosophy of the law of business corporation. More than any other provision of the Tentative Recommendation, §5371 emphasizes the truth of the Commission's comment (TR P.7):

> "...many of the old general corporation law provisions that clearly are applicable to forprofit corporations are inappropriate for nonprofit corporations."

§5371 directly evolves from former §820 of the General Corporation Law. It relies upon disclosure of self-dealing by a corporate director as a sufficient protection of the ultimate beneficiaries of the corporate business, i.e., the stockholders. Applied to a stock corporation, one can hardly quarrel with the rationale. Even in the case of a small, closely held family type of business corporation in which the officers and directors comprise the entire list of stockholders, approval of a self-dealing transaction can affect only the interests of those who vote for and approve it.

On the other hand, self-dealing by a director of a charitable corporation simply has nothing in common with the above.

1) The beneficiaries of the charitable corporation are presently unidentifiable. Moreover, they are voiceless as to corporation transactions. Disclosure to them of a director's self-dealing is impossible; and, if it were not, it would be of no avail.

2) §5371(b)(1) provides that where disclosure is made to the members of the corporation, their approval in good faith and exclusion of the interested director from voting is all that is required. But members of a charitable corporation, by definition, are not beneficiaries of the corporate activities as are "members" (read: "stockholders") of a business corporation. This difference in the structure and the benaficial interests in the two types of corporation is both basic and irreconcilable.

3) In a substantial number of all nonprofit corporations and in a substantial proportion of those that are charitable, the voting membership is synonymous with the corporate directorship. This aspect of nonprofit corporations is of

moment in considering §5371(c)(1) and (2).

It is there provided that where disclosure of self-dealing is made to the board of directors, rather than to the members, it must also be shown that the transaction is "just and reasonable as to the nonprofit corporation at the time it was...approved..." The burden of making such showing is upon the person asserting the validity of the transaction.

The question arises: In the frequent situation where the directors and the members of a charitable corporation are one and the same, is a self-dealing disclosed to those individuals qua directors under subsection (b)(2)? Or qua members under the easier test provided in (b)(1)?

Parenthetically, the question is not academic. In effect, §5412 provides that, unless otherwise stated in the bylaws, the directors are the members for purposes of nonprofit corporation law and shall exercise all of their rights and powers.

The inadequacy of disclosure to other directors or to members of a charitable corporation as the test of self dealing by a director can be shown another way.

Analysis was made of the more than 4,000 corporations registered with the California Registry of Charitable Trusts in 1965. Of these some twenty percent (20%) authorized and had only the legal minimum of three (3) directors. Many of these, the exact number unknown, were family-type private foundations in which the founder named the directors to a self-perpetuating board. In such cases, it stretches credulity to believe that self-dealing disclosed to such a board would result in protection of the interests of the charitable beneficiaries.

The Tentative Recommendation aggravates this situation by §5311. That would permit a nonprofit charitable corporation to have only one director, provided only that the corporation had only one voting member. This would be, in legal reality, a "one-man corporation".

If the founder-member-director of such a one-man charitable corporation should have second thoughts about his dedication of assets to charitable purposes (from which he undoubbedly derived tax benefits) and initiated a self-dealing transaction, it is ridiculous to even suggest that disclosure to himself or requiring him to find that his own intended transaction is "just and Reasonable" as to the corporation serves any purpose. I cannot imagine a situation to which the classic phrase Reductioab absurdum is more applicable.

Recommendation: Consistently with my recommendation on §5560, I would like to see §5371 amended to make it not applicable to non profit corporations organized for charitable purposes.

§5373. Loans to directors and officers.

Comment: This is another provision that I think requires a distinction to be made between charitable corporations and non profit corporations organized for non-charitable purposes.

Subsection (a) provides that a loan or obligation guaranty made to a director needs only approval by the "members". Again, we must consider the many instances where the members are the directors. The practical effect of §5373(a) in such cases would be to authorize a loan of trust property to a trustee upon the approval of his co-trustees. And, again, we must consider the effect of action taken pursuant to §5311: the reality of a "one-man corporation" wherein the lone director lends charitable trust funds to himself upon his own approval as the sole voting member of the corporation!

In §5373(a), as in the self-dealing situation of §5371, all that is required is approval by the members. That is to say, there is no test required as to the effect of the transaction upon the corporate assets (and, hence, upon the beneficiaries of the corporate endeavors). The members are not required to judge the transaction either by the standard of the prudent man or by whether it is just and reasonable as to the corporation.

The reason and justification for this is, of course, the fundamental fact that in a non-charitable, nonprofit corporation the members are the sole and ultimate beneficiaries of the corporate activity. Even though they may not receive gains, profits or dividends during the life of the corporation, upon its dissolution they will share its residual assets as provided by law. Their self-interest is undeniable and the law justifiably assumes they will act in their own self-interest.

None of this reasoning has any application to a charitable corporation whose members cannot lawfully have any beneficial interest in the corporate assets. And when the reason fails, so should the rule.

§5311. Number of directors.

I have already referred to this section. It would permit a charitable corporation to be governed by a single director in any case where the corporation had only one voting member. As noted in the Commission's comment (TR p.130), this is a change from the presently required minimum of three (3) directors.

Comment: I have no objection to the provision. Indeed, I think it realistically recognizes that in many situations the subterfuge of "straw men" is resorted to in order to attain the present inflexible minimum.

§5311 does put the spotlight squarely on the application to charitable corporations of §§5560, 5371 and 5373 discussed above. It emphasizes the need I feel to amend these sections in order to make effective the Commission's purpose to recognize present case law holding that a director of a charitable corporation is subject to all the fiduciary obligations of a private trustee.

* * * *

There follow comments on sections of the Tentative Recommendations that are not directly interrelated.

§5250. Required contents of articles.

The Problem: There is public need for the articles of a charitable corporation to set forth that it is subject to the Government Code provisions that comprise the Uniform Supervision of Trustees for Charitable Purposes Act (herein, "the Uniform Act").

Comment: The fact that the laws governing a charitable nonprofit corporation are not all in the Corporations Code has caused some confusion and inconvenience. For some it has resulted in ignorance of the law. The function of §5250 is obviously to require that articles be expressly informative about major limitations the law puts upon nonprofit corporations in general and, in particular, those whose purposes are charitable. It would be very helpful if §5250(c) were amended to read:

"(c). If the nonprofit corporation is organized for charitable purposes, that the nonprofit corporation is organized for charitable purposes and is subject to all provisions of the Nonprofit Corporation Law that relate to nonprofit corporations organized for charitable purposes and is subject to Article 7 (beginning with section 12580) of Chapter 6 of Part 2 of Division 3 of Title 2 of the Government Code (Uniform Supervision of Trustees for Charitable Purposes Act).

At present this admonition is contained in the Commission's comment on §14512 of the proposed new Division 4, relating to misleading names for all types of corporations. It deserves to be set forth expressly in the articles of incorporation.

§5561. Indefinite purposes.

The Problem: This section would confer upon a charitable corporation authorized to be governed by a single director certain powers now exercised by California courts under the doctrine of cy pres. This would be a change in substantive law for which I find no warrant.

Comment: This is, in effect, another departure of the Tentative Recommendations from present case law to the effect that directors of charitable corporations are subject to the fiduciary obligations of private trustees.

In my judgment and experience, no private trustee would presume to "resolve in its [his] judgment" and without court approval questions of "indefiniteness or uncertainty as to the purposes or beneficiaries" of the charitable assets committed to his care. Under present law, that judgment is reserved to the courts.

§5561 derives from former Corp. Code §10206(b), found in Part 3 of Division 2, "Corporations for Charitable or Eleemosynary Purposes" which is to be repealed.

A prime requirement of Part 3 (and probably the reason why only some 70 of the more than 4,000 charitable corporations existing in California in 1964 were organized under this Part) is that the corporation have a board of not less than 9 directors. (§10201(d)). In my view, it is one thing for a 9-man board of directors, acting as a board, to be given the limited power of cy pres by §10206(b). There is always safety in numbers. It is quite another for such authority to be given to what is literally a "one-man corporation". Thus, the combined effect of §§5561 and 5211 would permit a sole private trustee of charitable assets to assume authority now reserved to the courts simply as a result of his incorporation. I just don't "buy" it.

§5562. Institutional trustee.

The Problem: Transfer of charitable assets to an institutional trustee (as defined) should be limited to transfers for purposes of investment only. The language of the present draft is too broad. Further, as written, it would permit a nonprofit charitable corporation to avoid its present obligation to submit annual financial reports to the Attorney General by the simple expedient of transferring all its assets to an institutional trustee exempt from such reporting requirement. (Govt. Code §12586).

Comment: On first reading I thought §5562 dealt only with the transfer of charitable assets to an "institutional trustee" for purposes of investment. I would support such authority. There readily comes to mind the administrative efficiency of the highly commendable "community foundation" type of charitable organization (e.g., the San Francisco Foundation). The assets of such organizations are held and controlled for investment purposes only by banks and other qualified financial institutions; but full control and resulting responsibility for all other administrative functions (e.g., disbursement of income to charitable beneficiaries) are retained. Subsection (d) implies that this is the intended purpose of §5562.

I would support §5562, if it were amended to read:

> "(b) A nonprofit corporation may transfer, by appropriate action of the board, any or all of its assets (including property held on a charitable trust) to and institutional trustee, as trustee, for purposes of investment and reinvestment, subject to any investment restrictions on the assets.
>
> "(c) Upon the transfer, the board is relieved of all liability for the ~~administration~~ investment or reinvestment of the assets for as long as the assets are ~~administered~~ invested by the institutional trustee."

In context the word "administration" is objectionably broad.

If I am wrong in my interpretation of the intent of §5562, if it is intended to authorize the transfer of all the assets of a charitable corporation for all administrative purposes, then other and serious grounds for objection exist. This would be tantamount to a complete substitution of trustees without court approval - and without the prior notice to the Attorney General and an opportunity to be heard that would presently be the case. For such a development I find no warrant.

§6011. Sale or transfer of all or substantially all of assets, etc. AND

§6012. Notice to Attorney General required in certain cases.

The Problem: The conditions for giving notice to the Attorney General provided in §6012, which relates exclusively to charitable corporations, are too restrictive. Subsections (b) and (c) should be stated disjunctively, not conjunctively as at present.

Comment: As written, §6012 requires that charitable corporations give notice to the Attorney General only if the transaction is both

(b) for less than fair compensation and
(c) not in the usual and regular course of the corporation's activities.

It is submitted that in either event the charitable corporation should be required to give notice of the impending transaction. Either event would warrant protective or preventive action with such probability that transfershould not be permited without scrutiny by the Attorney General.

Once the horse is out of the stable, it is difficult, expensive, time-consuming and sometimes impossible to get him back in. Ordinarily, a charitable corporation would dispose of substantially all of its assets only in contemplation of dissolution.

Distribution of assets upon dissolution requires notice to the Attorney General (§6773). This latter safeguard should not be thwarted by a disposition of assets without notice before dissolution, if the circumstances of either (b) or (c) are present.

Technically, the present text of §6012 is mis-structured.

Subsection (a) limits the notice requirement to charitable corporations. It thus controls the application of the entire section by excluding from its operation all other types of non-profit corporations, regardless of circumstances.

As a matter of drafting, the limitation to charitable corporations should be placed in the opening sentence of §6012 and the present subsection (a) eliminated.

This done, the transactions now listed in (b) and (c) should be listed as alternative, and not conjunctive, conditions.

§14601. Statement identifying directors, officers, and office

The Problem: Technical

Comment: §14601(a)(6) requires a statement of the general type of business activity of the nonprofit corporation. Applied to a non profit corporation, the word "business" seems inappropriate.

Further, the subsection parenthetically lists as examples of such (nonprofit ?) "business" the following: Manufacturers of aircraft, wholesale liquor distributors, retain department stores.

Recommendation: Delete the word "business" and either delete or revise the examples given.

§14602. Statement required of nonprofit corporations.

The Problem: §14602 would require reporting the name and address of only one individual holding office in the corporation, viz: chief executive officer. At least two names should be required.

Comment: In the past, the Attorney General has been put to considerable public expense in identifying and locating individuals responsible for the operations of certain types of nonprofit corporations, particularly some of those engaged in the public solicitation of funds for allegedly charitable purposes.

There are numerous instances where the principal office of the corporation and the residence of its chief executive officer (president, usually) are identical. When he moves, all identification of record is lost. This situation will be aggravated in the future by reason of the operation of §5311 in authorizing, literally, a "one-man corporation".

Recommendation: The 5-year period between required reports should be shortened to three (3) years, at least in the case of nonprofit corporations organized for charitable purposes. Further, the name and address of the treasurer or other chief financial officer should be required in addition to that of the chief executive officer.

* * * *

So ends my comments and suggestions. I hope they will prove helpful. I have enjoyed their preparation and trust that if I can be of further assistance to the work of the Commision, you will ask.

Sincerely yours,

Wallace Howland.

Wallace Howland.

Memorandum 76-83

EXHIBIT LV

JAMES H. FLANAGAN, JR.
ATTORNEY
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(209) 299-0391

October 4, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

In Re: Non Profit Corporations

Dear John:

I'm sorry I was tardy in replying. I have not yet had the time to review your tentative draft in detail, but the basic approach is excellent.

When the new profit corporation law goes into effect, we will have two corporation laws in effect because the old one stays in effect for the parts of it that are incorporated into the non-profit law. Obviously, the next logical step is the one you have taken - to make a new separate non-profit law. Both are very different in purpose, organization, and operation and should be provided for entirely separately with the exception of those common mechanical matters that you have provided for in the new Division 4.

With this revision, then these provisions not only can be used more easily and intelligently, but also they will be more easily amended to correct future problems for specific problems of either profit or non-profit.

Good job.

Sincerely,

Jim Flanagan, Jr.

JF:dll

Memorandum 76-83

EXHIBIT LVI

STATE OF CALIFORNIA — EDMUND G. BROWN JR., Governor

DEPARTMENT OF REAL ESTATE
714 P Street
Sacramento, CA 95814
(916) 445-6112

October 4, 1976

Mr. John H. DeMoully
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

I regret that I have not found the time to do more than cursorily go through the Tentative Recommendation Relating to Nonprofit Corporation Law. On that examination alone, however, I am convinced that the basic approach toward a comprehensive nonprofit corporation law is a good one.

I will do my utmost to furnish you with more detailed comments in the near future even though I realize that that will be somewhat less advantageous than if the comments were submitted prior to October 5.

My apologies for not getting to this task before the deadline date.

Sincerely,

W. Jerome Thomas
Chief Legal Officer

WJT/pk

EXHIBIT LVII

29 September 1976

California Law Revision Commission
Stanford Law School
Stanford, CA 93405

Re: CLRC Nonprofit Corporation Law Recommendation

Gentlemen:

Your Mr. DeMoully recently wrote me to advise that my comments on the above were still welcome even though the initial deadline had passed. The press of business had prevented me from writing earlier but I have now had a chance to review your Tentative Recommendation.

I speak from experince, past and present, on the Boards of two California nonprofit corporations, one of which I serve as President.

First, you solicit comments on the basic approach of the tentative draft--a comprehensive nonprofit corporation law, complete in itself, and the addition of a new Division 4 to Title 1 of the Corporations Code. I heartily endorse this approach. Furthermore, I strongly endorse the four themes listed under "Philosophy of New Statute," on pages 9 and 10, and am of the opinion that, in general, a good job has been done in achieving these goals.

I have only the following specific objections, based on a cursory inspection of the proposed legislation:

Officers: (Sec. 5360 et seq.)

I am aware of one nonprofit corporation which was advised by counsel that the present Corporations Code forbade its then practice of having the officers selected directly by the members and thereafter serving as ex officio directors. The procedure of having officers selected by the directors and serving at their pleasure may be suitable for business corporations and large nonprofit corporations, but many small nonprofit corporations (including both of those on whose Boards I serve) find the other procedure quite satisfactory. I propose language to the effect that "Nothing in this Division prohibits the bylaws from providing that officers are chosen by the members for specific terms and that officers serve ex officio as directors."

Members: (Record Date, Sec. 5450 et seq.)

Consideration should be given to allowing the record date to be set in the bylaws

Voting: (Sec. 5733(b))

The proposed reduction from seven to three years is commendable, but I would urge further reduction, to two or (preferably) one year, in line with the concern about excessive separation of ownership from control stated on p. 37.

Inspection Rights: (Secs. 6622, 6630)

Giving members the right to inspect records "during usual business hours" may be satisfactory for business corporations or large nonprofit corporations, but small nonprofit corporations are typically manned by volunteers who can only work for the corporation outside of "usual business hours." I would suggest substituting "at a reasonable time of day" for "usual business hours."

I would also suggest a total exemption for corporations which routinely make the records available to members for inspection at members' meetings, where these are held eleven or more times per year.

Directors' Meetings: (Secs. 5330 et seq.)

Some consideration should be given to a provision that members have a right to attend meetings of directors, unless the bylaws provide otherwise (a kind of "Sunshine

Law" for nonprofit corporations).

Fee for Filing Statement: (Gov.C. Sec. 12210)

I am strongly opposed to the deletion of the exemption of nonstock/nonprofit corporations from this fee. This conflicts with the "philosophy" (p. 9) that no change should be made in existing law unless there is a demonstrable need for change. It is stated (p. 63) that the "same fee that applies to other corporations filing a statement should apply to nonprofit corporations." But the differential concept is preserved elsewhere, and reasonably so (Gov.C. Secs. 12202, 12203.7).

In closing, let me say that I hope my comments are of some help; I only regret I could not have made an exhaustive inspection of the proposed legislation and given further suggestions.

Very truly yours,

David G. Cameron

David G. Cameron
P. O. Box 24328
Los Angeles, CA 90024

Memorandum 76-83

Steven J. Malamuth
ATTORNEY AT LAW

EXHIBIT LVIII

~~1260 W. Taylor St., Ste. #2~~
~~SAN JOSE, CA 95126~~

2930 Lake Shore Avenue # 402
Oakland, CA. 94610
(415) 444-0345

California Law Revision Commission
Stanford Law School
Stanford, CA. 94305

Re.: Tenative Recommendation Relating to Nonprofit Corporation Law (July 26, 1976).

Dear Mr. DeMoully:

As you can see I have moved my office to Oakland.

Unfortunately the entire month of September had to be spent in New York on a combination of business and personal activities which arose quite unexpectedly. The net result is that I have not been able to complete a detailed review of the proposed legislation.

I am very much in favor of a comprehensive nonprofit corporation law which is complete in itself. Where there are provisions of the law which are applicable to both profit and nonprofit corporations I favor a compilation of such provisions is a separate division of the Corporation Code. The reasons for this preference is not only the facility for research and analysis, but the improved quality of advice which might be rendered where one is not faced with the procedural task of refering to several volumes of several codes in order to ascertain the law relating to a particular problem of a client; the ease of research will reduce the cost to the client and assist in providing a more accurate response to a particular situation, a better service at a lower cost with less possibility of confusion and error.

Most all of my work deals with nonprofit corporations. Your keeping me advised of future developments in the law relating to such entities would be very much appreciated.

Although a detailed review of the proposed legislation will not be rendered timely, I shall continue to review the draft and when finished my conclusions and reasons therefore will be sent to the Commission.

Sincerely,

Steven J. Malamuth

Steven J. Malamuth

Memorandum 76-63

EXHIBIT LVIX

HOWARD HASSARD
JOSEPH S. ROGERS
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HARTLEY F. HEART
(1901-1964)
GUS L. BARATY
(1910-1966)
ALAN L. BONNINGTON
(1945-1972)

October 4, 1976

Mr. John H. DeMoully,
Executive Secretary
California Law Revision Commission
Stanford Law School
Stanford, California 94305

Dear Mr. DeMoully:

We very much appreciate the opportunity to review the Commission's Tentative Recommendation Relating to Nonprofit Corporation Law. It is our impression that the Commission has done a superb job.

We are particularly interested in the subject because we are counsel to the California Medical Association. While CMA itself is unincorporated, numerous component societies are incorporated. Additionally, organized medicine has formed a multitude of nonprofit corporations to carry out specific tasks. We think the basic approach of a comprehensive and complete nonprofit corporation law deserves support. We think the Commission's draft is excellent.

It is imperative that affected organizations have sufficient time after the effective date of the Act to make necessary bylaw changes. In many instances, these changes can only be made at the Annual Meeting of the corporation. For example, medical societies will want to protect themselves against members who wish to obtain membership lists for commercial exploitation, by adopting the alternative bylaw provisions specified in Section 6625.

With respect to Section 5310, which recognizes the Board's right to delegate the management of the day-to-day operation of the corporation to a management company, you may encounter a desire on the part of various legislators that the books and records of a management company pertaining to the corporation be open to inspection. We are not suggesting such a provision, but there has been considerable controversy in this area, particularly with respect to certain "prepaid health plans" which were organized as nonprofit corporations. This specific problem has been resolved in the Knox-Keene Act, dealing with entities of this nature, but these concerns may now be felt more generally.

We are also attorneys for California Physicians' Service, doing business as "Blue Shield of California." The corporation was originally organized by the California Medical Association pursuant to Corporations Code Section 9201. We have historically opposed any tampering with Section 9201. However, we think that your approach, which is to add a new article and Section 700 to the Business and Professions Code, probably makes more sense than retaining this provision in the Corporations Code. We believe that Blue Shield will support this change.

Sincerely yours,

David E. Willett

DEW/yb

cc: Mr. Willis W. Babb
Mr. Michael Ganahl
Howard Hassard, Esq.

Memorandum 76-83

EXHIBIT IX

312 South Detroit Street #4
Los Angeles, Calif.
90033
Sept. 30, 1976

Dear Sir: Be friendly,

Please forgive my delay in responding to you on the Calif. Non-Profit Corporation Code Revisions, as I did not notice the initial deadline of Sept. 15, 1976

I have read the Non-Profit Corp. Code Revisions carefully, and my sole comment is that the Change to Jurisdiction of such corporations by ~~one~~ Director is very important. Present Title Three Non-Profit Corporations function most effectively at "Sole Corporations," where "too many cooks spoil the broth" & one out-weighs of Director's influence governing such Non-Profit Corporations.

The draft is quite comprehensive and if accepted and become law, it will demonstrate its feasibility in California Corporate Control.

Thank you for your confidence in my efforts of this solicitation, and please continue.

Yours very cordially,

Marcus D. Gale, C.C.C., Ph.D.

Memorandum 76-83

EXHIBIT LXI

ARTHUR W. SIMON
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October 4, 1976

California Law Revision Commission
Stanford Law School
Stanford, CA 94305

Att: John H. DeMoully, Executive Secretary

Dear Sir:

I apologize for sending in this reply at the last minute. Only through sheer force of will was I able, during the last few days, to devote sufficient time to complete the review requested.

I can find no areas of the proposed new Non-profit Corporation Code with which I disagree. I especially wish to support the general recognition which the Code would give to directors of charitable corporations being volunteers. The limited nature of their responsibility is well reflected in the proposed revision. Also, the liberalized provisions permitting action by the corporation by consent of the Directors, the obtaining of such consents and the number required should make the management of charitable corporations' affairs considerably more convenient.

If it would be appropriate, may I suggest that the Commission, in its final report to the Legislature, also make recommendations for standardized forms of articles of incorporation and by-laws for non-profit corporations? I should imagine that if such were easily incorporated into an Appendix of the Code the Secretary of State would find proposed articles acceptable in many more instances.

I hope that this is of some value. If you would like to have the draft Code returned to you, please inform me; otherwise, I shall place them in my library for future reference. Thank you for providing me this opportunity.

Cordially,

Arthur W. Simon

AWS/lp