

## Memorandum 76-90

Subject: Study 77.400 - Nonprofit Corporations (Comments Concerning Division 2--Nonprofit Corporation Law)

This memorandum analyzes the comments received relating to the portion of the tentative recommendation containing the basic Nonprofit Corporation Law--proposed Division 2. The exhibits referred to are all attached to Memorandum 76-83. In addition to the comments set out as exhibits, this memorandum summarizes comments made by the Commission's consultant, Mr. Whitman, in a memorandum to the staff that has not been reproduced. The staff also has some substantive problems with the draft, which it raises at this time (there are additional technical and conforming changes that will be necessary before the final report is printed). Any problems that the Commission has with any portion of the draft should also be raised at this time.

30/968

Preliminary Part of Tentative Recommendation

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), makes a number of suggestions relating to the preliminary part of the tentative recommendation that explains the proposals. The staff believes these suggestions are good and plans to work them into the final draft.

043/177

Organization of Statute

Exhibit XIII (gold) believes Chapter 5 (corporate finances) is misplaced between the chapter relating to members and the chapter relating to members' meetings and consents. Corporate finance should follow all the membership chapters. Exhibit XXXIX (buff) believes that the membership chapters should precede the directors chapter; members are more important to nonprofit corporations, and this would conform to the normal organization of the bylaws. The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), offers a total reorganization of the statute.

The staff has a lot of sympathy for these points. The reason for the present organization is to parallel that of the business corporation law. However, the parallel is not as strong as originally conceived, and there are many departures. We could reorganize the statute, but at this point it would involve extensive renumbering.

30/969

#### Scope of Statute

Exhibit L (pink) feels 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." The staff observes that schools and churches are exempted from coverage of the Uniform Supervision of Trustees for Charitable Purposes Act, which apparently has prompted this comment. See Govt. Code § 12583. The staff agrees that it would not be profitable to pursue this aspect of the law; the Attorney General may wish to attempt to expand the coverage of the Uniform Supervision Act.

While the scope of the Commission's project does not include revision of the tax laws (see discussion in Memorandum 76-83), the Commission has attempted to draw its proposals so as not to affect the tax status of nonprofit corporations. Exhibit XXV (buff), a comment of the nonprofit corporations subcommittee of the State Bar Committee on Taxation, finds "no serious fault in the proposed legislation insofar as the taxation of these entities is concerned."

30/970

#### Charitable Corporations

One general problem that runs throughout the statute is the treatment of provisions that relate to nonprofit corporations "organized for charitable purposes." There are a number of such provisions, which are listed in the Comment to Section 5250. It is not clear, however, how such nonprofit corporations can be identified since charitable purposes are not defined, and the statute does not make clear whether "organized for charitable purposes" means exclusively, predominantly, or simply having one or more charitable purposes. Exhibit XVIII (buff) makes this

point; the Commission's consultant, Mr. Whitman, has also written an extensive memorandum to the staff concerning this problem. Exhibit XXXXVIII (gold) suggests that, while defining charitable purposes is inadvisable, perhaps some suggestion of their scope might be placed in a Comment.

The question of the definition of charitable purposes is one that the Commission has discussed on several occasions. Charitable purposes are not really susceptible to definition since they are broad and changing. The staff agrees that the Commission has reached the proper decision to allow charitable purposes to be defined through the development of case law; however, it would be possible to cite some of the cases giving the term a broad interpretation.

The definition of a "nonprofit corporation organized for charitable purposes," on the other hand, is susceptible to definition. As used in the statute, it is intended to mean a nonprofit corporation that is sufficiently involved in charitable activities that it should be considered as holding all its assets and receiving general donations impressed with a charitable trust. The staff suggests the addition of the following definition to the statute:

§ 5163. Nonprofit corporation organized for charitable purposes

5163. "Nonprofit corporation organized for charitable purposes" means a nonprofit corporation formed and operated predominantly or exclusively for charitable purposes.

Comment. The phrase defined in Section 5158 is used in the following provisions:

Notice to Attorney General of formation	§ 5223
Special ultra vires provision	§ 5232
Contents of articles	§ 5250
Management of charitable property	§ 5560
Attorney General supervision	§ 5564
Property received on general charitable trust	§ 5565
Common trust funds	§ 5570
Notice to Attorney General of disposition of assets	§ 6012
Notice to Attorney General of merger or consolidation	§ 6142
Division limited	§ 6210
Notice to Attorney General of division	§ 6242
Reports to Attorney General not affected	§ 6527
Purchase of memberships to avoid dissolution prohibited	§ 6740

Disposition of assets on dissolution	§ 6773
Name containing the word "charitable"	§ 14512
Conversion prohibited	§ 14801

It should be noted that the phrase "charitable purposes," as used in this section, is used in its broadest sense, it being impossible to enumerate specifically all purposes that are charitable in nature. See, e.g., discussion in Lynch v. Spilman, 67 Cal.2d 251, 431 P.2d 636, 62 Cal. Rptr. 12 (1967).

043/176

§ 5102. Scope of division

Under Section 5102, the statute applies unless there is a special statutory provision inconsistent with the statute. Exhibit XXXXI (gold) queries this provision since one of the objects of the statute is to eliminate the welter of provisions relating to nonprofit corporations. The answer to this query is that the statute does eliminate a variety of related provisions in favor of one uniform provision. However, there are a number of special provisions that relate to particular types of nonprofit corporations that are retained. For example, proxy voting and cumulative voting are prohibited in certain types of medical and legal services corporations. There is a more complete illustrative listing of special provisions of this type in the Comment.

30/972

§ 5126. Articles

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), suggests that the definition of "articles" should include plans of division and conversion and agreements of merger and consolidation. This is unnecessary since, under the Commission's statutory scheme, when any of those organic changes occur, new or amended articles are also filed.

30/973

§ 5128. Board

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), suggests that the definition of board might include "trustees." The staff believes this is unnecessary since board is defined as board of

directors, and a director (under Section 5140) is a person named as a director or "by any other name or title to act in the capacity" of a director. There should be a cross-reference to Section 5140 under Section 5128, and the staff plans to make this reference.

30/974

§ 5130. Business corporation

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), would amend Section 5130 to read:

5130. "Business corporation" means a corporation organized under the laws of this state which is other than a nonprofit corporation.

31/500

§ 5132. Bylaws

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), believes that it is improper to define bylaws to include articles. He makes the point that it is inconsistent with the provision relating to adoption of bylaws since it would make articles adoptable by the same procedure used for adopting bylaws.

The staff suggests that Mr. Davis is wrong, the definition of bylaws in Section 5132 makes quite clear that "a provision governing the procedure for adoption, amendment, or repeal of bylaws does not apply to articles." The staff believes the definition is a useful one: It eliminates the need to continually refer to "articles or bylaws" when in nearly all cases it is the bylaws that will be involved, and it encourages placement of matters governing the operation of nonprofit corporations in the bylaws rather than cluttering up the articles.

043/175

§ 5150. Financial statements and similar accounting items

Section 5150, although included among the definitions for lack of a better place, is not really a definition but a general provision. It provides that, where the nonprofit corporation statute refers to financial statements and similar accounting items, such references mean those items kept in accordance with generally accepted accounting principles.

Exhibit XIX (blue) questions the use of this requirement for nonprofit corporations, both because laymen may be involved in the operations of nonprofit corporations and because it is inappropriate to make the law depend on changes in the accounting profession.

The primary application of Section 5150 is in Section 6510 which requires a nonprofit corporation to keep adequate and correct books and records of account; Sections 6511 and 6512, which impose penalties for failure to keep the required books and records; Section 6522, which requires the annual report to contain financial information; and Section 6526, which permits members to obtain certain fiscal information.

31/501

§ 5156. New nonprofit corporation

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), asks whether this section should include a newly converted Section 14802 organization. Such inclusion would be unnecessary since the conversion provisions make no reference to a "new nonprofit corporation."

31/502

§ 5162. Officers' certificate

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), notes that, under Section 5362, any number of offices may be held by the same person; hence, the notion of having an officers' certificate signed by each of two groups of officers is empty. The staff agrees that this is a point but has no specific suggestions to offer. If the Commission desires, we could require signing by separate persons; the staff is inclined, however, to simply let the anomaly stand.

31/503

§ 5174. Signed by the officers

Whatever action is taken with respect to Section 5162 (supra) should also be taken with respect to Section 5174, which applies to many corporate instruments other than officers' certificates.

§ 5180. Verified

Section 5180 permits verification of an instrument by a declaration in writing executed "under penalty of perjury" that states the date and place of execution, whether within or without the state. Exhibit XX (gold), feels that verification under penalty of perjury should be limited to execution within this state. The commentator supports this feeling with the statement that it would conform with the general provisions of the Code of Civil Procedure and with recognized practice. The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), also makes this point, noting that, if the perjury occurs outside California, there would be no basis for prosecution in California.

The issue here is one of uniformity--whether to be uniform with the Code of Civil Procedure or with the business corporation law. The staff believes that it is desirable here to conform to the business corporation law so that there will be uniformity of procedure for verification of all corporate documents required to be verified.

In this connection, Exhibit XXXXI notes that a definition might be added to make clear that an affidavit under the nonprofit corporation law may be executed by declaration under penalty of perjury. Such a provision would read:

§ 5121. Affidavit

5121. An affidavit under this division may be made by declaration under penalty of perjury.

Comment. Section 5121 is new.

§ 5210 et seq. Organization and bylaws

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), would change the title of this chapter to "Organization, Articles, and Bylaws" or simply "Articles and Bylaws." The chapter title is drawn from the comparable title in the new business corporation law. However, the staff would have no strong objection to adding "Articles" in the existing title.

404/111

§ 5211. Incorporation of unincorporated association

Exhibit XXXI (green) suggests the following amendments to Section 5211 to resolve the question of when a member may effectively dissent from the incorporation of an unincorporated association:

"(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 non-profit 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."

The staff believes this would be a useful addition to the law. We note that the last sentence of subdivision (d) is unnecessary since Section 5160 by its terms would apply. A cross-reference to Section 5160 is sufficient.

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), notes that we have provided for dissenters' rights elsewhere, and we should provide for dissenters' rights under subdivision (d). The Commission had initially thought to provide dissenters' rights in this



situation but, after it determined not to provide dissenters' rights for other corporate reorganizations on the basis that this would be an improper distribution to members, it determined not to provide for them here.

045/213

§ 5220 et seq. Formation

Exhibit XVIII (buff) strongly agrees with the simplified incorporation procedure and the elimination of needless formality in the formation and operation of nonprofit corporations. Exhibit XXXIV (yellow) likewise approves the simplified formation provisions.

One of the simplifications made is to reduce the number of persons required to incorporate from three to one. Section 5221. Exhibit XXIX (buff) says that people are used to the concept of at least three persons incorporating; a "one man" membership corporation appears to be a contradiction in terms. Exhibit LX (buff), on the other hand, believes that one-man incorporation is "very important."

The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), suggests that Section 5221 refer to execution of articles by "one or more natural persons." While the staff believes this concept is inherent in the statute since the initial directors who execute the articles must be natural persons (Section 5140), the staff has no objection to making the suggested change.

045/052

§ 5224. Additional requirement for charitable corporations

A corporation "organized for charitable purposes" is required to deliver a copy of its articles to the Attorney General promptly upon formation. Exhibits XII (blue) and XV (pink) state that this provision would serve no purpose since the articles are already required to be sent to the Attorney General under the Uniform Supervision of Trustees for Charitable Purposes Act provisions. The Commission's consultant, Mr. Whitman, has made the same point. Exhibit XXXVII (blue--Attorney General), on the other hand, considers it "an excellent provision."

The reason for the provision is that the Registry of Charitable Trusts does not include all charitable corporations. Notable exceptions are churches, cemeteries, hospitals, and educational institutions. See Govt. Code § 12583.

Perhaps the duplicate articles problem could be solved by requiring only that a charitable corporation give notice to the Attorney General promptly upon formation. The sanction for failure to comply would be the possibility of an action by the Attorney General to dissolve the corporation under Section 14491. An alternative to this suggested by Exhibit XXXXVII is to have the Secretary of State send a copy of the articles to the Attorney General.

Exhibit XV also suggests that the Commission do something about the situation confronting a charitable corporation that must give annual reports containing approximately the same information to both the Attorney General and the Franchise Tax Board. The staff believes this suggestion has possibilities and plans to solicit the views of the state agencies involved.

043/159

§ 5230. Powers of nonprofit corporation

Exhibit XVIII (buff) notes that subdivision (b)(6) of Section 5230 authorizes payment of pensions and establishment of pension and other deferred compensation plans, but makes no reference to profit sharing plans. The commentator points out that nonprofit corporations do make profits, and implies that some have traditional "profit sharing plans." The staff agrees with this analysis, and believes that profit sharing plans should be added to (b)(6). There are other statutory limitations in the nonprofit corporation law that qualify the power to carry out profit sharing plans.

Exhibit XVI (yellow) believes subdivision (b)(7) should be expanded to make specific reference to the authority to enter into indemnity contracts subject to the limitations of Sections 5380-5389. The staff agrees that this is appropriate, and would amend Section 5230 to read:

5230. Subject to any limitations contained in the articles or provided by statute, a nonprofit corporation in carrying out its activities:

\* \* \* \* \*

(6) Pay pensions; establish and carry out pension, profit sharing, savings, thrift, and other retirement, incentive, and benefit plans, trust, and provisions for any or all of the directors, officers, and employees of the nonprofit corporation or any of its subsidiary business or nonprofit corporations.

(7) Assume obligations; enter into contracts (including contracts of guaranty or ~~suretyship~~, suretyship, or indemnity); incur liabilities; borrow and lend money and otherwise use its credit; secure any of its obligations, contracts, or liabilities by mortgage, pledge, or other encumbrance of all or part of its property, franchises, revenue, and receipts.

\* \* \* \* \*

Exhibit XXXV (green) objects to the deletion of a piece of special legislation from the powers provisions. The text of the legislation is set out in the exhibit. The staff does not believe that it is appropriate to include special legislation in the Nonprofit Corporation Law. We are attempting to ascertain the cause of this special legislation to determine whether it indicates a problem of general application of which we are unaware that should be cured by general legislation. If it appears that this is really a unique case requiring special legislation, the staff proposes to continue the provision in question as an uncodified statute.

404/959

§ 5231. Defense of ultra vires

The staff has discovered two defects in Section 5231: (1) It fails to make clear that a limitation in the articles, regardless whether it may be asserted as between a nonprofit corporation and a third party, nonetheless is internally binding on the management of the nonprofit corporation and (2) a provision extending the application of the section to foreign corporations was inadvertently omitted. These defects are easily cured by adding a new subdivision (c) and by providing that a limitation described in subdivision (a) "constitutes as between the nonprofit corporation and the members, officers, or directors, an authori-

zation to the directors and a limitation upon the actual authority of the representatives of the nonprofit corporation.

(c) The application of this section extends to a contract or conveyance made by a foreign nonprofit corporation in this state and to a conveyance by a foreign nonprofit corporation of real property situated in this state.

405/969

§ 5232. Enjoining ultra vires act of nonprofit corporation holding assets on charitable trust

This section is intended to permit an action to enjoin ultra vires acts of a nonprofit corporation in any case where the corporation holds charitable assets. The Commission's consultant, Mr. Whitman, has suggested that, since the section is intended to protect the public's interest in charitable assets, the section should be limited in its application to activities involving charitable assets and not to all corporate activities. This could be accomplished by amending Section 5232(a) to read:

(a) Notwithstanding Section 5231, where a nonprofit corporation holds ~~its~~ assets on a charitable trust or is organized for charitable purposes, a limitation described in Section 5231 may be asserted in an action to enjoin the doing or continuation of unauthorized activities that affect the charitable trust or charitable purposes by the nonprofit corporation or its officers, or both, regardless of whether third parties have acquired rights thereby.

Exhibit XXXXVII (blue--Attorney General) and the Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), suggest that some clarification is required as to the persons entitled to bring suit under this section. Mr. Davis suggests that this can be simply done by reference in the statute to an action "by any interested party"; the Comment would then refer to directors, the Attorney General, members, and donors as possible interested parties.

404/961

§ 5235. Illegal distribution; derivative action against member

Exhibit LII (green) is happy to see the increased creditor protection in this provision for a cause of action regarding improper distributions.

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), wonders why an improper distribution can be recovered only from a member who received the distribution "with knowledge of facts indicating the impropriety thereof." The simple reason is that this is the standard of the business corporation law on which Section 5235 is based. A more policy-oriented reason, we suppose, would be that the member who has received a distribution may have already spent it, and it is unfair to the member to make him responsible.

405/967

§ 5242. Instrument signed by certain officers valid absent actual knowledge of lack of authority

Exhibit XXXI (green) notes that, although the presumptive effect of the corporate seal has been replaced by a provision permitting reliance on instruments signed by certain corporate officers, Section 5242 fails to retain the presumption of prior law that those certain corporate officers are indeed the persons who signed the instrument. The staff agrees that this is a defect in the statute and proposes to amend Section 5242 as follows:

5242. An instrument in writing, including an assignment or endorsement thereof, executed or entered into between a nonprofit corporation and another person and signed by the officers as specified in Section 5174 is not :

(a) Presumed to be signed by the officers specified. This presumption is a presumption affecting the burden of producing evidence.

(b) Not invalidated by any lack of authority of the signing officers unless (subject to subdivision (b) of Section 5231) the other person has actual knowledge of the lack of authority.

043/173

§ 5250. Required contents of articles

Subdivision (b) of Section 5250 requires the articles to state that the nonprofit corporation is organized "for any lawful purposes," and provides that no further or additional statement of purposes may be made except by way of limitation or except as expressly required by law (such as tax laws). This scheme is patterned after the new business corporation law.

Exhibits XV (pink), XXVI (blue), XXXXVII (blue--Attorney General), and XXXXVIII (gold) make the point that this provision is unduly restrictive. They believe it is helpful in obtaining federal tax exemption to include a more detailed statement of purposes that may not be strictly required by law. Presumably, they would like to be able to make a statement of primary purposes without having this statement construed as a limitation on the corporate purposes.

The staff agrees with this point, and can suggest several alternative proposals to cure the problem:

- (1) The articles shall not set forth any further or additional statement with respect to the ~~purposes or~~ powers of the non-profit corporation except by way of limitation or except as required by any law . . . .
- (2) The articles shall not set forth any further or additional statement with respect to the purposes or powers of the non-profit corporation except by way of limitation (unless the articles expressly provide that the further or additional statement is not by way of limitation) or except as required by any law . . . .
- (3) The articles ~~shall not~~ may set forth any further or additional statement with respect to the purposes or powers of the non-profit corporation ~~except by way of limitation or except~~ but the further or additional statement shall be construed as a limitation on the purposes or powers unless the articles expressly provide otherwise or unless required by any law . . . .

Of these formulations, the staff prefers the third as the most direct and clear. Adoption of such a provision would also make clear the ability of a nonprofit corporation to specify in the articles the disposition of its assets on dissolution. The Comment should make clear that this continues existing law. In this connection, Exhibit XXXXVIII suggests that the Comment also make clear that merely because a nonprofit corporation specifies that its assets go to charity on dissolution does not make it charitable. The staff agrees that this would be useful.

Subdivision (c) of Section 5250 requires a nonprofit corporation that is "organized for charitable purposes" to so state in its articles. The section goes on to provide that the corporation "is subject to all provisions of the Nonprofit Corporation Law that relate to nonprofit corporations organized for charitable purposes." Exhibit XII (blue) notes that the quoted words are superfluous; the Commission's consultant, Mr. Whitman, has made the same point. The staff agrees that it

would be possible to put this language in the Comment; on the other hand, the Commission previously determined to put it in the statute on the theory that it will give the incorporators and directors a better appreciation of the consequences of declaring their corporation charitable. In fact, Exhibit XXXVIII (gold) would like to see the statute go even farther and require the articles to state that the assets of a charitable corporation are "irrevocably dedicated" to charitable purposes. This would eliminate many problems that result from the failure of fiduciaries to appreciate this and might have the incidental effect of eliminating the need to amend the articles to insert such a clause at the demand of the taxing authorities. Exhibit LIV (blue) would also like to see a requirement that the articles state that the charitable corporation is subject to the Uniform Supervision Act. This would help to eliminate some of the confusion caused by the fact that not all the law is located in the Corporations Code.

The State Board of Equalization (Exhibit XXXVIII--pink) would like to see a requirement that a charitable corporation have a statement of purposes in its articles. "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." The Commission has determined not to impose this requirement in the past on the theory that any corporation seeking a tax exemption will in fact put a statement of purposes in its articles. However, if the Commission wishes to require a charitable corporation to put a statement of purposes in the articles, this could be accomplished by amending subdivision (c) to read:

(c) If the nonprofit corporation is organized for charitable purposes, that the nonprofit corporation is organized for charitable purposes and the primary and specific purposes for which it is organized, and that it is subject to all provisions of the Nonprofit Corporation Law that relate to nonprofit corporations organized for charitable purposes.

Exhibit LXI (blue) suggests that the Commission recommend standardized forms for articles of incorporation and bylaws. The staff believes this is unnecessary. The articles are in very simplified form, and the Secretary of State will undoubtedly publish sample forms that satisfy the statute in Corporations Check List.

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), suggests a cross-reference to Section 5311, relating to the number of directors. The staff agrees that this would be useful and plans to make the reference.

494/086

§ 5260. Adoption of bylaws

Exhibit XIII (gold) was unable to locate the provision for amendment of bylaws. Section 5260 deals with amendment as well as adoption of bylaws. The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), suggests that the leadline be expanded. The staff proposes to expand the leadline to read:

§ 5260. Adoption, amendment, and repeal of bylaws

Exhibit XIII also asks whether directors could deprive a class of members of voting rights by bylaw amendment. The answer is no; see Section 5264(b). The staff proposes to add to the Comment to Section 5260 the following paragraph:

The power of the directors to adopt, amend, or repeal the bylaws may be limited by statute as well as by the articles or bylaws. See, e.g., Sections 5264(b) (bylaws adversely affecting voting rights of members may be adopted, amended, or repealed only by the members), 5311 (bylaws relating to the number of directors may be adopted, amended, or repealed only by the members).

Exhibit XV (pink) believes the wording of Section 5260 is not clear; Section 5260 states specifically that the articles or bylaws may limit the right of directors to affect bylaws; by implication the right of members may not be affected. What is the intent? The staff believes that the intent is to permit a nonprofit corporation to limit adoption of bylaws to directors if it so desires and that this is proper. The staff would amend Section 5260(b) to read:

(b) Notwithstanding subdivision (a), the articles or bylaws may restrict or eliminate the power of the members or board to adopt, amend, or repeal any or all bylaws.



§ 5261. Permitted contents of bylaws

Exhibit XIII (gold) suggests that the Comment make clear that the so-called "Constitution" of a nonprofit corporation is not the basic governing document. The staff is not familiar with the "Constitution" of a nonprofit corporation, but, if this is a document other than the articles (such as the bylaws), the staff believes that a Comment could be added to Section 5261 that "It should be noted that Section 5261 applies regardless whether the bylaws are denominated a 'constitution'."

§ 5264. Bylaws relating to voting rights

Exhibit XV (pink) notes that existing law permits proxy voting unless the nonprofit corporation expressly permits it and that Section 5264(a) appears to reverse existing law by permitting the bylaws to state whether proxy voting is allowed. The commentator believes that the apparent intent of Section 5264(a) should be embodied in the substantive provisions applicable to proxy voting so that the law would be that proxy voting is prohibited unless the nonprofit corporation expressly permits it. In support of this belief, the commentator notes that many nonprofit corporation leaders are unaware of the provision permitting proxy voting and, although in actual practice 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 the nonprofit corporation.

The staff finds this argument attractive. The result could be accomplished by amending Section 5730 to read:

5730. Unless the bylaws provide otherwise If the bylaws provide therefor, a person entitled to vote a membership on a matter may authorize another person to vote the membership on the matter by proxy.

One drawback of this scheme, however, is that there may be existing nonprofit corporations that permit proxy voting, although having nothing in their bylaws about it. The staff suspects it will be fairly rare

that a nonprofit corporation permitting proxy voting will not regulate the proxies in some way in its bylaws, however. And for those that do not, a bylaw amendment to permit proxy voting in conformity with existing practice should be relatively simple to accomplish.

404/092

§ 5266. Bylaws relating to directors, officers, and committees

Both Exhibits XXIV (green) and XXXXIV (yellow) approve the statutory scheme that permits a nonprofit corporation considerable flexibility in determining the appropriate number of directors, their terms of office, and the manner in which they are selected.

Section 5266 permits the bylaws to provide for the "qualifications" of directors; this continues existing law. Exhibit XX (gold) believes that any limitations on who may become directors "should be known to all," and consequently should be required to be set forth in the articles. The staff does not find this point particularly convincing. It is the bylaws that is the basic governing document of a nonprofit corporation and that contains much more basic matters, e.g., property and voting rights of members, than who may become directors.

404/093

§ 5267. Articles and bylaws made available to members

Section 5267 requires a nonprofit corporation to keep at its principal executive office in this state the original or a copy of its articles and bylaws as amended to date, which are open to inspection by the members during office hours. Exhibit XV (pink) states that many nonprofit corporations have no office as such, and the mailing address is the home of its president or secretary. Exhibit XV suggests that, if the nonprofit corporation does not have a regular office, a member should be permitted to request a copy of the articles and bylaws, with the nonprofit corporation imposing a reasonable charge.

The staff believes there is merit in this suggestion, and would amend Section 5267(b) to read:

(b) If the articles and bylaws are not open to inspection by the members at all reasonable times during office hours or if the

principal executive office of the nonprofit corporation is outside this state and the nonprofit corporation has no office in this state, ~~it~~ the nonprofit corporation shall upon within five days after receipt of the written request of any a member furnish to the member a copy of the articles and bylaws as amended to date.

The staff also notes that, although a nonprofit corporation may not have an "office" as such, it always has a "principal executive office" since it is required to give a street address for its principal executive office in the statement of officers and agent for service of process it files with the Secretary of State. Section 14602(a). The staff believes that this can be made more clear in the statute by adding the following definition:

§ 5165. Principal executive office

5165. "Principal executive office" means the office of the nonprofit corporation designated in the statement filed pursuant to Section 14602.

Comment. Section 5165 makes clear that the "principal executive office" of a nonprofit corporation is simply the office selected for statutory purposes by the nonprofit corporation. It need not be the principal business office of the nonprofit corporation, but it is the place where the corporate records are kept. See, e.g., Sections 5267 (articles and bylaws kept at principal executive office), 6510 (record of members kept at principal executive office).

Defined Terms:

Filed, § 5148

Cross-References:

Statement required of nonprofit corporation, § 14602

Exhibit XV makes the additional suggestion that the articles and bylaws be available to the general public. The articles, of course, are a matter of public record and are available to the general public at the Secretary of State's office. The bylaws are not a matter of public record, and the staff can see no reason that the public might have a legitimate interest in the bylaws of a nonprofit corporation. There might be some basis in the case of a charitable corporation, but there the appropriate regulatory agency in theory represents the public interest.

Exhibit XV also suggests that the nonprofit corporation make available a list of officers and directors. It notes that there is a state-

ment filed with the Secretary of State, but that there is no full listing. The Commission has previously made a determination that only the name of the chief executive officer need be made a matter of public record in the filing with the Secretary of State. Unless the Commission determines that a more full listing of directors and officers in the statement filed with the Secretary of State is desirable, it would be anomalous to require a nonprofit corporation to give any person who makes a request such a listing. The major object of requiring a filing with the Secretary of State is to provide a central public record that the public can look to for information.

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), suggests there may be some constitutional difficulties with subdivision (b) of Section 5267, which relates to nonprofit corporations having no office in this state. Mr. Davis argues that it would be unconstitutional for California to assume jurisdiction over a dispute between a member who lives outside of California and a corporation with no offices in California. The staff does not see why this would be unconstitutional --after all, it is a California corporation.

404/965

§ 5268. Provisions effective only in bylaws

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), would like to see included in the Comment the idea that a corporation may have a third level of rules--membership rules that relate to particular activities but that do not rise to the dignity of articles or bylaws. Mr. Davis states that, as a practical matter, most organizations do have such rules. The staff sees no problem with adding the following language to the Comment:

Nothing in this section is intended to preclude the adoption by a nonprofit corporation of rules relating to membership activities, such as house rules, swimming pool rules, and other rules that are not bylaws. Such rules may be adopted by a nonprofit corporation in whatever manner it provides in its bylaws.

§ 5310. Control of corporate affairs by board

Exhibit LVIK (green) warns the Commission that, in connection with the delegation of corporate management to a management company, the Commission may encounter a desire on the part of various legislators that the books and records of the management company pertaining to the nonprofit corporation be open to inspection. The commentator notes that they are not suggesting such a provision, but there has been considerable controversy in this area.

Perhaps the Comment should note that all the rules applicable to books and records of a nonprofit corporation, including inspection rights, apply to every nonprofit corporation regardless whether the board of a nonprofit corporation may have delegated management responsibilities to a management company.

31/506

§ 5311. Number of directors

Exhibit LX (buff) approves the provision permitting as few as one director of a nonprofit corporation. The commentator says:

I present the thesis that Non-Profit Corporations function most effectively as Sole Corporations, where 'too many cooks spoiling the broth' prove out multiplicity of Director's influences in governing such Non-Profit Corporations.

Exhibit LIV (blue) thinks the provision realistically recognizes that, in many situations, the subterfuge of "straw men" is resorted to in order to attain the present inflexible minimum.

404/098

§ 5312. Term of directors

The Commission's consultant, Mr. Whitman, has pointed out that Section 5312(a)(2) provides that a director serves until a successor is elected and "qualified," with no statutory meaning given to "qualified." Qualification is intended, the staff believes, to refer to the process by which a director accepts election to the board, formerly found in

Section 307, but omitted in the present draft. The staff suggests that, for purposes of clarity, the former language be continued by adding to Section 5321 a new subdivision (e):

(e) A person who is elected as director shall within 60 days after notice of election accept the office either in writing or by attending a meeting of the board, and fulfill such other requirements of qualification as the bylaws specify.

Comment. Subdivision (e) continues former Section 307(b), applicable to nonprofit corporations through former Section 9002. A director holds office until a successor is elected and qualified. Section 5312(a)(2).

The staff would add a cross-reference to this provision following Section 5312 so that the reference to qualification of directors will be clear.

404/099

#### § 5313. Initial directors

Under Section 5313(b)(2), the number of initial directors is the number named in the articles, which under Section 5250 may be as few as one. Exhibit XIX (blue) points out that, if only one is named and the one dies before executing the articles, the organizational expenses incurred will be lost. While this is true, the staff does not suggest changing the statute to require a greater number of initial directors. If more persons than the decedent were involved in the formation of the corporation, they can easily name a new initial director in the articles.

The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), believes that the Comment to this section, as well as the Comment to Section 5250, should note that the number of directors named as initial directors need not be the same as the permanent number of directors of the corporation. This accurately states the intent of the statute, and the staff will put the following language in the Comment:

The number of initial directors named in the articles may be one or more, but need not be the same as the number of directors of the nonprofit corporation.

§ 5314. Personal liability of directors

Section 5314 immunizes directors from personal liability for the corporate debts. Exhibit XI (buff) asks "Shouldn't there be some personal accountability requirement for directors?" The question evidently refers to the possibility of piercing the corporate veil in appropriate cases. The staff suggests the addition of the following sentence to the comment:

Section 5314 does not in any way affect the equitable doctrine in which the corporate entity is "disregarded" in order to fasten responsibility upon the owners who are found to be the alter ego of the corporation.

§ 5315. Multiple boards

Both Exhibits XXXIX (buff) and XXXIII (pink) express unfamiliarity with any nonprofit corporations having multiple boards.

Exhibit XX (gold) states "it is common with reference to nonprofit 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 nonprofit corporation." The staff believes that Section 5315, permitting a nonprofit corporation to have several boards, with specified authority, should be sufficient to accomplish the result desired by Exhibit XX.

The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), suggests the addition of a further provision that, if one board is designated as the "managing board," it is generally responsible to the public and the other boards are responsible only for the specific area designated to them. Presumably, Mr. Davis would revise subdivision (c) to read:

(c) The bylaws designate one board having as the "managing board." The managing board shall have all the authority of the board of directors provided in this division that is not specifically delegated to another board.

§ 5317. Vote required for board action

The Commission's consultant, Mr. Davis (Exhibit V XXVI--buff), states:

I think it would be advisable to state specifically that directors may not vote by proxy but must be present, except as provided in Section 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 the staff's opinion, the matter is not quite so simple. The various jurisdictions take divergent views toward whether proxy voting by directors is permitted. See discussion in Oleck, Non-Profit Corporations, Organizations, and Associations § 173 (3d ed. 1974). The issue is whether the director will be abrogating his duty of care by not attending and hearing discussion on an issue before casting his vote. Oleck argues for permitting proxy voting:

Grants of general proxy powers may be undesirable for trustees, or for members. But grants of specific, narrow proxy powers, limited to specific issues, seem to be reasonable. Undoubtedly, the law should permit such specific grants of authority to vote by proxy. In fact, as has been remarked, many organizations do allow proxy voting by trustees (as well as by members), with no objections and no harm done.

The writer has advised inclusion of proxy voting power in by-laws of non-profit organizations for which he has served as counsel. No case of objection or abuse, or trouble of any kind, has resulted. The organizations concerned have found the provision to be convenient. Of course, the provision should be limited, not general, in nature.

There are three ways to go: We can clarify the right to vote by proxy, we can clarify the prohibition of proxy voting, or we can remain silent. The staff is inclined to continue the Commission's present posture of silence towards the issue of proxy voting by directors; this will leave the matter to case law development. The staff believes the cases will validate proxy voting under the statute as drafted, with whatever limitations appear desirable in the context of the particular cases as they arise.



§ 5320. Nomination of directors

Section 5320 requires that the bylaws provide a reasonable means of nominating persons for election as director. The Commission's consultant, Mr. Whitman, raises the question of the consequence of failure to so provide. Exhibit III (blue) believes the provision is undesirable because it will restrict the flexibility of nonprofit corporations and because it will generate litigation over what is "reasonable."

The Commission was aware of these problems when it adopted the principle that a nonprofit corporation must provide a reasonable means of nominating people for directors. The Commission was responding to reports of abuses in large nonprofit corporations in which it was practically impossible to get a non-management candidate even nominated (let alone elected) as director. The argument the Commission found persuasive was that equitable principles require a reasonable means of nomination, as held by the courts, but the absence of a statute codifying these equitable principles necessitates appellate court battles to establish the principle. Modification of the principle will enable persons seeking to challenge the election procedure to have a clear legal basis on which to proceed. Perhaps the following language should be included in the Comment:

Section 5320 codifies the principle that a nonprofit corporation may not unreasonably restrict the right of members to nominate directors. Braude v. Havenner, 38 Cal. App.3d 526, 113 Cal. Rptr. 386 (1974). Under Section 5320, a court may find the electoral procedures of a nonprofit corporation that fails to provide a reasonable means for nominating directors unlawful and may impose such requirements as it considers reasonable. Ibid.

§ 5321. Election of directors

Existing law prohibits cumulative voting in nonprofit corporations unless the bylaws provide for it. Section 5321(c) continues this rule. Exhibit XIV (green) approves this rule, noting the significant differences between business and nonprofit corporations which militate against cumulative voting in nonprofit corporations, such as the fact that the board may be based on the representation of geographic, economic, or professional interests or expertise.

§ 5323. Declaration of vacancy by board

Among the grounds on which the board may declare the office of a director vacant is that the director has been "declared of unsound mind by an order of court." Exhibit XVI (yellow) notes that this language perpetuates an ambiguity of existing law in that, when a conservator or guardian is appointed, there is not necessarily an adjudication of mental incompetency. The commentator recommends adoption of a more objective standard such as the appointment of a conservator or guardian. The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), also notes that the term "unsound mind" is ambiguous and suggests substitution of the word "incompetent."

The staff agrees that these changes would be desirable; it is theoretically possible that a person who has a guardian or conservator appointed might nonetheless be competent to serve as director, but the staff believes this would be a rare case. The staff would add the following subdivision to Section 5323:

5323. The board may declare vacant the office of a director in any of the following cases.

(a) The director has been declared incompetent or of unsound mind by an order of the court.

\* \* \* \* \*

(d) A conservator or guardian of the person or estate of the director has been appointed.

31/507

§ 5325. Removal of directors

The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), observes that subdivision (b) permits an action for removal of directors by 10 percent of a class and suggests that this should really be 10 percent of the members unless elected by classes. This provision has troubled the staff in the past even though it is drawn from the new business corporation law. The staff thinks the provision would make more sense the way Mr. Davis suggests and would revise Section 5325(b) to read:

(b) The superior court of the proper county, in an action by 10 percent of the members, or where the director is elected by a class, by 10 percent of the members of the class, may remove a director from office for fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the nonprofit corporation.

Exhibit LXVII (blue--Attorney General) suggests that the Comment refer to any authority the Attorney General may have to seek court removal of directors of charitable corporations. The staff suggests the following language be added to the Comment:

Nothing in this section limits any authority the Attorney General may have to seek by court action the removal of a director of a nonprofit corporation organized for charitable purposes in appropriate cases.

31/500

§ 5330 et seq. Meetings of directors

Exhibit LVII (white) states, "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)."

The only problem the staff has with such a provision is the problem of notice of meetings to members. With a simplified form of notice, such as posting in the principal executive office, a right of members to attend board meetings (subject to bylaws limiting the right) could be feasible. A provision to implement this concept could read:

§ 5330.5. Members' right to attend meetings of directors

5330.5. Unless the bylaws provide otherwise:

(a) Notice of meetings of the board shall be given to the members by posting at the principal executive office of the nonprofit corporation. The notice shall be given at the same time as notice is given to directors.

(b) Meetings of the board are open to voting members of the nonprofit corporation.

Comment. Section 5330.5 is new. The right of members to attend meetings of the board is subject to limitation in the bylaws.

§ 5331. Call of meetings

The new business corporation law provides that meetings of the board may be called by the chairman of the board, by any two directors, or by the president or any vice president or secretary. The Commission considered adoption of this scheme, but determined to permit meetings of the board to be called only by the board (subject to the bylaws) on the theory that one person should not be enabled to thus control the board.

Exhibit XIII (gold) disagrees with this decision, noting that nonprofit corporations are no different from business corporations in this matter. "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." Exhibit XXIX (buff) also states, "it has been my experience that meetings are called by the president or two or more members of the board." And the Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), feels likewise.

The staff agrees with these comments, and would adopt the scheme of the business corporation law. The staff does note, however, that under the Commission's proposal a nonprofit corporation may provide for call of meetings by officers in its bylaws. Adoption of the business law rule would yield the following provision:

§ 5331. Call of meetings

5331. Meetings of the board may be called by the chairman of the board or the president or any vice president or the secretary or any two directors.

This provision would be subject to contrary provisions of the bylaws.

§ 5332. Notice of meetings

Section 5332(d) provides that a notice or waiver of notice of a meeting of the board need not specify the purpose of the meeting. This contrasts with the requirements for notice or waiver of notice of special meetings of members. Exhibit XX (gold) believes that the rule

applicable to members should apply to directors as well--the specific purpose of the meeting should be set forth. The commentator gives no specification of reasons.

404/130

§ 5336. Quorum of directors

The business corporation law permits the bylaws to lower the requirement for a quorum of directors to one-third the authorized number of directors or two (whichever is larger), unless the authorized number of directors is one, in which case a quorum is one. Section 5336 permits the bylaws to lower the quorum requirement without limit.

Exhibit K (gold) recommends that the nonprofit corporation law provide the same quorum requirements as the business corporation law. Directors are held to the same standard of care and should be expected to attend meetings. Moreover, to permit a low quorum on a large board of directors enables "a small coterie of officers to decide what the nonprofit corporation would do." Exhibit XXXVIII (gold) also believes in a minimum quorum requirement. The commentator believes no public service is done by having nonattending 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."

The staff notes that Section 5336 continues existing law as drafted. Imposition of a minimum quorum, such as that of the new business corporation law, could necessitate bylaw amendments by some existing nonprofit corporations.

31/509

§ 5339. Written consent to action without a meeting

Exhibit LXI (blue) comments, "[T]he 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."

§ 5340 et seq. Provisional directors

Exhibit XIV (white) thoroughly agrees with the Commission's proposals relating to provisional directors.

§ 5343. Rights and powers of provisional director

The Commission's consultant, Mr. Whitman, has made the following comment:

This section, like former Section 819 and new general corporation law Section 308, provides that a provisional director loses his powers when "the conditions . . . no longer exist." This is an alternative to removal by order of the court or by majority of the voting power. It seems to me that this is a very unclear standard to use. If it were deleted, a provisional director would retain his rights and powers until the court or the members decided otherwise. I think we should consider whether this isn't preferable.

The staff agrees that the phrase "until the conditions of subdivision (a) of Section 5341 no longer exist or" should be deleted.

§ 5354. Meetings of committees

Exhibit XIX (blue) believes the use of the Latin words "mutatis mutandis" should be eliminated; they serve no useful purpose. If the Commission desires to eliminate the phrase, the staff would substitute for it, "with necessary changes having been made in the language thereof."

§ 5360. Corporate officers

Exhibit XXLVIII (gold) 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. The staff notes that Section 5266 permits the bylaws to provide for, among other things, the "official designations" of officers, and the Comment to Section 5360 refers specifically to this provision. If the Commission desires to make the cross-reference statutory, this could be done by amending Section 5360 to provide that "A

nonprofit corporation shall have all of the following officers, with such titles as the bylaws provide".

404/169

§ 5361. Chief executive officer

Exhibit XXXIX (buff) notes that nonprofit corporations may be unfamiliar with the concept of a chief executive officer as opposed to a president, and so on. The staff notes that "chief executive officer" is a defined term. In order to clear up any possible confusion, the staff will make an effort to assure that, in any section in which the term is used, there is a cross-reference to Section 5361 which defines chief executive officer as the president or chairman of the board.

404/170

§ 5362. Selection of officers

Exhibit XII (blue) states that Section 5362(a) relating to service of an officer at the pleasure of the board, subject to the rights of the officer under a contract of employment, should conform to the comparable provision of the business corporation law. As the staff reads the business corporation clean-up bill (final amended version), Section 5362(a) is virtually identical to the first sentence of Section 312(b). The second sentence of Section 312(b), with which Exhibit XII is also concerned, is continued in Section 5363.

Subdivision (b) of Section 5362 states that any number of offices may be held by the same person. This changes existing law although it is the same as the new business corporation law. Exhibit XXXIX (buff) says that people accept the 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." The staff notes that Section 5362 permits the bylaws to require separate persons to hold corporate offices; the effect of subdivision (b) is simply to permit consolidation if the corporation so desires.

Exhibit LVIII (white) sees the need for permitting nonprofit corporations, particularly small nonprofit corporations, to have some means

of selecting officers other than appointment by the board. The commentator proposes 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." The staff notes that Section 5362 would permit the bylaws to do precisely this. The staff has no problem with putting the suggested language in the Comment to Section 5362.

404/171

§ 5363. Resignation of officers

Section 5363 permits the bylaws to specify a notice period (not exceeding 30 days) before the resignation of an officer becomes effective. Exhibit XXXIX (buff) disagrees with the notice provision and asks how it will be enforced. Exhibit XIV (white) sees no reason for resignation to be subject to delay: the Commission's reason--that the non-profit corporation will have an adequate opportunity to replace the officer--is no more applicable to nonprofit corporations than to business corporations.

The Commission's consultant, Mr. Davis (Exhibit XLXVI--buff), suggests that the 30-day notice period for resignation of officers parallel the 30-day notice period for resignation of directors. He would take the 30-day provision out of subdivision (a) and make the following new subdivision:

(b) The resignation is effective upon giving the notice, or after such period not exceeding 30 days as is provided in the bylaws, unless the notice specifies a later time for the effectiveness of the resignation.

404/173

§ 5370. Duty of care of directors

Section 5370 imposes a flexible standard of care on directors, based on that of the new business corporation law. Exhibits X IV (green) and LXI (blue) believe this standard is appropriate for non-profit corporations. Exhibit LII (green) states that "the enunciation of the flexible standard of care for directors may help to bring more predictability into that area."



Exhibit XI asks, "Should some provision be made for liability and removal because of failure to perform, absenteeism, and neglect of duties?" The staff agrees that Section 5370 as drafted would not impose liability for failure to perform, absenteeism, and neglect of duties. Of course, a nonprofit corporation could make these grounds for removal if it so desired. Section 5266(a). The staff believes this authority is sufficient to take care of the problem.

3/516

§ 5371. Transactions involving interested directors

Both Exhibits XXXVII (blue--Attorney General) and LIV (blue) make the argument that Section 5371, which validates transactions involving interested directors, should not be applicable to charitable corporations or nonprofit corporations holding assets on charitable trust to the extent those assets are affected by the conflict of interest. Exhibit LIV points out that the safeguard of Section 5371 (approval by the members) is not present in many charitable corporations where the directors are the members.

Section 5371 could be made subject to Section 5560 (duty of care in management of charitable property) in the same way that Section 5370 (general duty of care of directors) is subject to Section 5560. Exhibits XXXVII and LIV point out that the same arguments also apply to Sections 5372 (transactions involving common directors) and 5373 (loans to officers and directors). Whatever action the Commission takes with respect to Section 5371 should also be taken with respect to Sections 5372 and 5373.

3/941

§ 5373. Loans to directors and officers

Section 5373 prohibits loans to directors or officers of a nonprofit corporation with certain exceptions, including loans made to officers pursuant to an employee benefit plan. Exhibit XVIII (buff) believes the section should be expanded to validate "participant loans" from a qualified plan under Section 401 of the Internal Revenue Code as defined under Section 4975(d)(1) of the Internal Revenue Code. Exhibit

X (gold), on the other hand, feels the section should be eliminated altogether; it is improper and could encourage potentially wrongful conduct.

The staff believes the loan provisions serve a useful function. They are limited to situations where a loan is clearly appropriate. Exhibit LII (green) notes that "the corporate ability to advance ordinary business expenses seems to bring the code more in line with practical reality." The staff believes that Exhibit XVIII has misinterpreted the effect of Section 5373. It does not limit loans made from benefit plans, as the commentator appears to assume, but only loans by the nonprofit corporation. The staff believes that no action is necessary to achieve the result suggested by the commentator. The staff plans to add language to the Comment to make clear that Section 5373 limits only loans by a nonprofit corporation.

31/511

§ 5374. Illegal distribution or loan; derivative action against directors

Exhibit LII (green) states that "the directorial liability for improper loans is a welcome sight."

Exhibit XXXVII (blue--Attorney General) notes that Section 5374 sets forth the liability of directors for an illegal distribution and sets forth 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." The staff is at a loss to understand this comment; Section 5374 authorizes a derivative action by creditors and members to recover improper distributions from directors. It considerably expands this recovery right over former Sections 823-829, in particular eliminating the prerequisite that the illegal distribution be "willful or negligent." See former Section 825 (old General Corporation Law). Section 5374 is not intended to be limiting, but rather to expand the available remedies against directors who abuse their office. Perhaps it should be made clear in the Comment that Section 5374 supplements, and does not replace, any other available remedies.

§ 5380 et seq. Indemnification of corporate agents

Exhibits XIV (white) and LIII (green) agree with the provision for liberalized indemnification.

Exhibit XI (buff) believes the law should not authorize indemnification for attorney's fees "without limitation." See Section 5380(b). The staff believes the commentator is misreading the statute; the statute could be clarified by the following amendment:

(b) "Expenses" includes ~~without limitation~~ but is not limited to, reasonable attorney's fees and ~~any~~ expenses of establishing a right to indemnification under Section 5383 or subdivision (c) of Section 5384.

Exhibit XX (gold) believes that a foundation manager should not be indemnified for expenses incurred in defending against violations of the Tax Reform Act of 1969 because that is not "appropriate." The staff is unable to draw the same distinction drawn by Exhibit XI among the various types of actions in which a corporate agent may be involved. The staff believes the safeguards provided in Sections 5381 and 5384 are adequate: indemnification may be made only if the indemnitee acted in good faith in a manner he reasonably believed to be in the best interest of the nonprofit corporation and only if approved by the members or directors of the nonprofit corporation (excluding the vote of the person to be indemnified).

Exhibit XXXVII (blue--Attorney General) is concerned with insurance for and indemnification of directors of charitable corporations for actions which constitute a breach of 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 commentator goes on to state that it is really a problem of defining the line between permissible and impermissible indemnification.

Again, indemnification under the statute may only be made if the person to be indemnified acted "in good faith and in a manner the person reasonably believed to be in the best interests of the nonprofit corporation." Sections 5381 and 5382. In addition, indemnification is

required where the indemnitee has been successful on the merits in defense of a proceeding. Section 5353. The staff believes that this is adequate protection for charitable corporations in the case of direct indemnification. In the case of insurance, however, the staff believes there may be a legitimate problem since Section 5383 permits insurance for liability "whether or not the nonprofit corporation is authorized under this article to indemnify the person against the liability." Perhaps this section could be revised to read:

5383. (a) A nonprofit corporation may purchase and maintain insurance on behalf of a person against any liability asserted against or incurred by the person as an agent or arising out of the person's status as an agent .

(b) Except in the case of a nonprofit corporation organized for charitable purposes, this section applies whether or not the nonprofit corporation is authorized under this article to indemnify the person against the liability.

23/764

§ 5383. Insurance for corporate agents

The Commission's consultant, Mr. Davis (Exhibit XXXVI---buff), asks whether this section means that a nonprofit corporation may pay for insurance covering damages as well as expenses, as it appears to. The staff agrees that the provision is unclear. It is drawn from former Section 830(d) (old General Corporation Law), which in fact permitted insurance for any "liability or loss", including, but not limited to "judgments, fines, settlements, and expenses incurred in defense". The staff believes the words "or loss" should be reinserted in the text of the statute and plans to include the illustrative listing of "judgments, fines, settlements, and expenses incurred in defense" in the Comment.

23/765

§ 5390. Indemnification of estate of deceased agent

The Comment to this section erroneously states that no comparable provision is found in prior law. In fact, Section 830(g) of the old General Corporation Law does extend the indemnification provisions to the estate of an agent. The staff suggests that the text of Section 5390 be replaced with the text of existing law:

5390. This article applies to the estate, executor, administrator, heirs, legatees, or devisees of an agent, and the term "person" where used in this article includes the estate, executor, administrator, heirs, legatees, or devisees of the agent.

§ 5410. Members

Exhibit X (green) sees the need to permit a nonprofit corporation to have members who may hold more than one membership. This has been accomplished in Section 5410. Exhibit XII (blue) believes the presumption against nonnatural persons as members should be reversed, so that the rule is that nonnatural persons may be members unless the bylaws preclude them. The Commission had already determined to make this change at its September 1975 meeting.

Exhibit XXXIX (buff) addresses the more philosophical question of the relation of a member to the organization, and suggests adoption of a provision that a person who agrees to be a member or who pays membership dues is bound by the articles and bylaws of the corporation. The staff does not believe such a provision would be advisable: (1) It is certainly the rule absent a statutory provision that a member is bound by the rules of the organization so long as he remains a member; (2) adoption of a provision defining when a person becomes a "member" for purposes of being bound by corporate rules may unduly restrict the manner in which "members" are acquired in some types of nonprofit corporations.

§ 5420 et seq. Issuance of memberships

The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), believes there should be an initial Comment that this article does not affect corporate securities matters as to memberships. The staff agrees that this would be useful, and suggests the addition of the following language:

Comment. Article 2 (commencing with Section 5420), which relates to issuance of memberships, governs only the internal affairs of nonprofit corporations. It does not affect in any way the coverage of the Corporate Securities Law, which may in an appropriate case be applicable to the issuance of memberships in a nonprofit corporation. See, e.g., Silver Hills Country Club v. Sobieski, 55 Cal.2d 811, 361 P.2d 906, 13 Cal Rptr. 186 (1961).

§ 5422. Redeemable memberships

The tentative recommendation provides for redemption of memberships in nonprofit corporations, noting that existing law is unclear whether this is permitted, and stating that redemption is "appropriate" for nonprofit corporations. Exhibits XXXI (gold) and XXXIII (pink--State Board of Equalization) both believe strongly that it is improper for charitable corporations to make redemptions. Exhibit XXXI states "I am not in favor of any charitable nonprofit corporation in any way reimbursing or distributing to any members any part of the assets"; Exhibit XXXIII states "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." In addition, Exhibit XIV (white) believes that redeemable memberships should not be permitted whether the corporation is charitable or simply nonprofit.

The staff does believe that redeemable memberships may be a useful device for some types of nonprofit corporations, particularly in enabling them to get started. If the Commission desires to preclude its use by charitable corporations, Section 5422(a) could be amended to read:

(a) Pursuant to its bylaws, a nonprofit corporation other than a nonprofit corporation organized for charitable purposes may issue memberships or classes that are redeemable, in whole or in part.

The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), calls attention to subdivision (c) which precludes issuance of memberships redeemable at the option of the holder. He does not "understand what public policy is offended by permitting such redemption."

Subdivision (c) is drawn from the existing General Corporation Law, and the existing provision is continued in the new business corporation law. 1 Ballantine & Sterling, California Corporation Laws § 144 (footnotes omitted) states:

Among the powers of every corporation is the power, subject to the provisions of its articles, to redeem shares thereby made subject to redemption. However, compulsory redemption provisions, enforceable at the option of the shareholder, are not allowed under

the California law. The shareholder can be given no right in the articles to compel a return of his investment either in common shares or in preferred shares. Such provisions are recognized in many states as to preferred shares but are dangerous and ill-advised. Examples of the harsh working of compulsory redemption provisions may be found in the reports.

404/185

§ 5423. Partly paid memberships

Exhibits XIV (white) and XXIX (buff) approve the provision authorizing issuance of partly paid memberships. Exhibit XXIX suggests, however, that a member should have no membership rights until the membership is paid in full. The staff does not agree; this would destroy the usefulness of the provision.

404/192

§ 5424. Membership certificates

Exhibit XXIV (green) approves the distinction between membership certificates and identity cards implemented by Section 5424. The commentator suggests, however, that the section or Comment be expanded to make clear that the property interest referred to is only a "current" interest and not one contingent upon dissolution. The staff does not believe this is the intent of Section 5424; if a membership is transferable and is evidenced by a certificate that represents a property interest in the corporation of any type, Section 5424 is intended to apply.

404/286

§ 5433. Liability of transferee with knowledge

The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), notes that the parenthetical information in Section 5433 is redundant, intended only for cross-referencing purposes. The staff does not believe it should be deleted, however, since it makes the interrelation of Sections 5432 and 5433 easier to understand in what seems to us a rather complex statutory scheme.

§ 5441. Termination of membership

The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), believes there should be a specific statutory reference in Section 5441 to the notice required in the case of a termination of membership pursuant to Section 5511 (failure to pay dues). As a matter of drafting technique, the staff considers this inadvisable, the provisions of Section 5511 may change, and a general reference to the section is adequate; moreover, the Comment makes specific reference to the notice requirement of Section 5511.

39/942

§ 5442. Effect of termination of membership

Sections 5540-5543 provide the rules, absent provisions in the bylaws, for transfer and termination of membership (including withdrawal), as well as the effect on property rights of termination (including termination by death). Exhibit VIII (gold) argues at some length that members should be better protected than they are under existing law (which is generally carried forward in the proposed legislation); in fact, this writer argues that a member should have an absolute right to payment of all of his "equity" investment and repayment of all loans within 30 days of termination of membership, at a price to be set by the member.

The Commission and the staff spent significant time on this point during the drafting process, aided by an earlier letter from the same writer. A draft section protecting proprietary rights of a member upon his death was prepared and reviewed by the Commission. It was decided at that time to continue existing law, leaving such protection to the bylaws.

404/239

§ 5443. Withdrawal of members

Section 5443 permits a member to withdraw from a nonprofit corporation upon 30 days' notice unless the bylaws provide a procedure for



withdrawal. Exhibits XI. (blue), XII (pink), and XIII (green) make the point that permitting withdrawal of members in a homeowner's association could have crippling effects on the viability of such nonprofit corporations. They recommend that homeowners' associations be excepted from the provisions of Section 5443. The staff agrees with this recommendation.

Exhibit XIII makes the additional observation that Section 5443 merely provides for withdrawal on 30 days' notice absent a withdrawal procedure in the bylaws but that the section does not specify the maximum notice requirement that may be imposed by the bylaws. The commentator suggests that a statutory maximum be included. The staff believes this would be inadvisable; we cannot foresee the different circumstances of the innumerable different types of nonprofit corporations. As originally drafted, Section 5443 required the bylaws to provide a "reasonable" withdrawal procedure; the Commission deleted the "reasonable" requirement so as to avoid litigation over this very issue. In fact, of course, the bylaws are always subject to equitable requirements of reasonableness.

Exhibit XI makes the additional observation that the statute indiscriminately makes use of the terms "withdrawal," "terminate," and "surrender," causing confusion as to nuances of meaning. The commentator suggests that a single terminology be used throughout. The staff agrees with this suggestion.

As amended to accomplish the changes suggested, Section 5443 would read:

5443. (a) Unless the bylaws provide a procedure for ~~withdrawal of members~~ termination of membership by members, a member may ~~surrender~~ terminate membership upon 30 days' written notice to the nonprofit corporation. This subdivision does not apply to membership in an owners' association as defined in Section 25012.

(b) Unless the bylaws provide otherwise, ~~surrender~~ termination of membership terminates all future rights, powers, and obligations of membership, but does not terminate the members' liability for dues, assessments, fees, charges, or other obligations incurred prior to ~~surrender~~ termination.

§ 5450. Record date

Section 5450 provides for a record date for the purpose, among others, of determining an "allotment of rights." The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), believes this is not appropriate to nonprofit corporations. "I think an allotment of rights is like a stock right, which does not exist under our law." The staff believes that a nonprofit corporation may have an allotment of rights, e.g., a right to distribution of assets on dissolution. However, the staff has no strong objection to deletion of subdivision (c) since arguably subdivision (d) ("exercise rights in respect of any other lawful action") covers the same ground. If subdivision (c) of Section 5450 is deleted, subdivision (c) of Section 5452 should also be deleted.

28/766

§ 5451. Authority of board to fix record date

Section 5451 permits the board to fix a record date. Exhibit LVII (white) states that consideration should be given to allowing the record date to be set in the bylaws. The staff thinks this makes sense. Section 5451 could be amended to read:

5451. (a) The bylaws may provide, or the board may fix, in advance, the record date.

(b) The record date provided by the bylaws or fixed by the board shall be:

(1) In the case of a meeting, not more than 60 nor less than 10 days prior to the date of the meeting.

(2) In the case of any other action, not more than 60 days prior to the action.

A few conforming changes would have to be made here and there in the remainder of the record date article.

404/292

§ 5452. Record date where board does not fix date

Section 5452 provides a record date for determining members entitled to notice of and to vote at a meeting, in cases where the board

has failed to provide a record date, of "the business day next preceding the day on which notice is given." Exhibit XV (pink) believes that this provision is impractical and will handicap corporations which must do some preparation for giving notice. The commentator suggests that a period of 10 days prior to the day on which notice is given would be a more rational time period.

The staff agrees that this would be a more appropriate period for nonprofit corporations, which may in many cases fail to set record dates. The staff would amend Section 5452 to read:

5452. If no record date is fixed by the board.

(1) (a) The record date for determining members entitled to notice of or to vote at a meeting of members is the close of business on the tenth business day ~~next~~ preceding the day on which notice is given or, if no notice is ~~waived~~ required to be given, the close of business on the business day next preceding the day on which the meeting is held.

\* \* \* \* \*

§ 5512. Levy of assessments for capital improvements

Section 5512 allows a member to escape a levy of assessment for capital improvements by prompt withdrawal from membership. The Commission adopted this section because of existing case law which appears to bind a member for any assessments made before termination of membership, whether or not the member will ever benefit from the assessments.

Exhibit XI (gold) argues that this section should not be used to allow a member to withdraw a pledge which has been made to a charitable organization and relied upon by that organization. The staff does not believe that Section 5512 covers such a situation. The staff proposes to add the following sentence to the Comment to make this clear:

It should be noted that Section 5512 provides only for avoidance of certain capital improvement assessments upon withdrawal of a member; it does not affect any other obligations to which a member may be liable. Section 5443(b).

Exhibits XIX (blue), XXII (pink), XXVI (blue), and XXXI (green) all argue that this section is inappropriate in the case of a condominium or homeowners' association which is specifically set up in order to levy and collect assessments for capital improvements and maintenance of common grounds. In general, the responsibility for such assessments is set forth in a deed or declaration of covenants and restrictions recorded at the time of development of the condominium or subdivision; the nonprofit corporation is normally set up simply to administer the common area and the assessment procedure. Thus, it is arguable that Section 5512 does not in fact extinguish these liabilities which are created by recorded deeds or declarations rather than by membership in the nonprofit corporation.

However, the staff agrees with the recommendations made in these letters that this should be clarified. The staff recommends that a new subdivision (d) be added to this section to read as follows:

(d) This section does not apply to a member of an owners' association as defined in Section 25012.

§ 5520. Subventions authorized

Exhibits III (green), XI (gold), and XXXI (gold) strongly agree with the Commission recommendation that the subvention provisions not be included in the proposed legislation. They note that subventions are merely forms of debt and should be called such. Exhibit XXXI (gold) states "In my opinion the issuance of such certificates for any grant or loan to the corporation which would draw interest could be abused because it provides a loop-hole for the distribution of properties or income." Exhibits XI (buff), XXXIX (buff), and the Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), appear to approve of the subvention concept on the grounds that it will do no harm and it may add "definiteness and certainty" to the law.

The staff continues to recommend that the subvention article is unnecessary and might be interpreted as being restrictive of the financing devices available to nonprofit corporations and should, therefore, not be included in the proposed legislation. The same analysis applies to the suggestion in Exhibit XI (buff) that "capital contributions" be codified.

§ 5525. Redemption at option of holder

The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), points out that Section 5525, authorizing subventions which are redeemable at the option of the holder, is inconsistent with Section 5422(c), which specifically prohibits memberships redeemable at the holder's option. Mr. Davis recommends the deletion of Section 5422(c).

Section 5422(c) continues existing law and is comparable to the new general corporation law provisions limiting the issuance of redeemable stock. See discussion, supra. Section 5525 is taken directly from the New York law establishing the subvention concept; it is inconsistent with existing and proposed rules on redeemable memberships. The staff sees no harm in this inconsistency. If it is determined, however, to bring the two sections in harmony, the staff recommends that Section

5525 rather than Section 5422(c) be deleted; this will do less violence both to existing law and to the congruence between the new General Corporation Law and the proposed nonprofit corporation legislation.

30/946

§ 5529. Officer's certificate

Section 5529 requires that an officer's certificate, including the board resolution establishing the terms and conditions upon which subventions are to be issued, be filed with the Secretary of State. The Commission's consultant, Mr. Davis (Exhibit XCVI--buff), argues that this provision, parallel to similar requirements in the General Corporation Law, should not be included here because the articles of incorporation of a nonprofit corporation need not set forth its capitalization (as is required of a business corporation). The staff believes that Mr. Davis is correct and recommends that Section 5529 be deleted.

35/947

§ 5530. Consideration

Section 5530 specifies acceptable consideration for the issuance of debt instruments by a nonprofit corporation. Exhibit XIX (blue) argues that a corporation with charitable purposes should be empowered to issue debt instruments for any consideration it considers acceptable or for no consideration at all. The writer believes that supervision of charitable corporations by the Attorney General is enough protection to the public or its members.

This question was considered by the Commission in connection with the sections relating to valid consideration for the issuance of a membership and for subventions. At that time, the Commission determined that memberships and subventions may be issued for "such consideration as is specified in the bylaws or as is determined pursuant to authority contained in the bylaws," with the judgment of the board of directors as to the value of such consideration to be conclusive in the absence of fraud (Sections 5420 and 5521); the Commission specifically decided, however, to retain the stricter requirements of Section 5530 for indebtedness. The staff sees no reason for imposing these different require-

ments for consideration for the issuance of debt and, therefore, recommends that the language of Section 5530 be revised to follow that of Sections 5420 and 5521. As so revised, Section 5530(a) would read:

(a) Bonds or other evidences of indebtedness may be issued for such consideration as is specified in the bylaws or as is determined pursuant to authority contained in the bylaws.

30/948

§§ 5550-5552. Payments to members

Exhibit XI (buff) approves of the explicit solvency requirements of these sections.

Exhibit XI (gold) argues that a member holding a subvention should not be able to resign and thus avoid the restrictions upon payments for subvention redemptions set forth in Section 5551. The staff does not believe that these sections should be rewritten to extend their coverage to former members. If a member wishes to resign and give up the benefits of membership, he should be free of its burdens as well. It should also be noted that there are separate financial requirements for the redemption of subventions at the option of the holders, whether or not members (see Section 5525).

The Commission's consultant, Mr. Davis (Exhibit XI, XVI---buff), recommends that an exception to these sections be provided for the situation in which a payment to a member to purchase his membership is made in order to resolve a legitimate controversy between corporation and member; such language was contained in former Section 1706. Former Section 1706 allowed the use of stated capital (rather than capital surplus) for the purchase of shares in the course of a resolution of a shareholder dispute; such a purchase was still subject to the general solvency requirement of former Section 1708. In moving from the general requirement of surplus accounts to the balance sheet and liquidity criteria of new Section 500, the new General Corporation Law deleted the exception for shareholder dispute resolution. This pattern was followed in drafting Section 5551.

This proviso could be reinstated in Section 5551 by adding a subdivision (c), as follows:

(c) The payment is made to collect or compromise in good faith a debt, claim, or controversy with any member.

The staff does not see any justification for this change and recommends against the proposed addition.

30/949

§ 5560. Management of charitable property

Section 5560 codifies existing case law to the effect that the management duty of a nonprofit corporation holding charitable assets is that of the private trustee as set forth in Section 2261 of the Civil Code. Exhibit LII (green) approves this provision as a "tightening up the standard of care". Exhibit VII (white) correctly points out that this rule leaves in doubt the permissible extent of delegation of investment decisions and then recommends language specifically allowing delegation of investment decision-making to investment advisors or investment counsel with full authority to make day-to-day investment decisions, including execution of buy and sell orders.

The staff does not agree with the recommendation that directors of charitable corporations be authorized to contract with investment advisors and thus escape all responsibility for management of the assets. A limited form of this delegation is provided by Article 5 of Chapter 3 (Committees of the Board) and Section 5562 (institutional trustee).

Exhibit XVII (green) recommends language to make the standard of this section the maximum duty to be imposed on the board, citing claims by the Attorney General that directors of the charitable corporation are "insurers" of the soundness of their investment decisions. With regard to the fear that directors may become "insurers" of their investment decisions, existing case law (see the citations in Exhibit VII) provides for a liability as an insurer only in the event of violation of the trustee's duties. Perhaps a notation in the Comment that a director becomes an insurer only in the event of such a violation would be appropriate.

Exhibit XX (gold) points out that the "prudent man" rule of the Civil Code may not be appropriate for certain high-risk charitable activities, such as slum improvement investments. The staff believes



that Exhibit X has raised a valid point with regard to charities which are formed in order to invest in risky ventures which would be beyond the scope of a normal trustee's discretion. It is recommended that an exception be added to Section 5560, as follows:

(c) A nonprofit corporation and its directors shall not be liable for violation of the obligations described in subdivision (b) in carrying out the charitable purposes of the nonprofit corporation or of the donor or instrument transferring the property received for charitable purposes to the nonprofit corporation.

Exhibit XXXII (white) complains that this section does nothing to resolve an existing ambiguity in California law: whether or not the remaining portions of the Civil Code (Sections 2215-2290) applicable to trustees are also applicable to nonprofit corporation directors. The staff recommends against any further attempt to set forth the extent to which the various statutory rules and obligations of trustees are applicable to nonprofit corporations and their directors. Section 5560 codifies the only explicit decision on this point. There has been a great deal of commentary among various authorities as to the interrelationship between the duties of charitable corporation directors and private trustees with very little consensus reached.

Exhibit XLVII (blue--Attorney General), for example, argues that all of the provisions of the Civil Code relating to private trustees (Sections 2215-2290) should apply to directors of charitable corporations, claiming that existing cases (those cited in the Comment to Section 5560) establish this law. Exhibit LIV (blue) also makes the argument that reference to merely Section 2230 of the Civil Code in affect precludes application of the other trustee provisions; he would delete the specific reference to the Civil Code and leave it to case law to determine what the duties of a trustee are as applied to directors of a charitable corporation. Exhibit XLVIII (gold), on the other hand, applauds the limited nature of the incorporation of trustee rules in proposed Section 5560 and argues very strongly that the other private trustee rules are not and should not be applicable to charitable corporation directors.

The staff does not agree with the position that all the duties of a trustee are applicable to directors of charitable corporations. First,

the cases simply do not establish any further application of the Civil Code rules to charitable corporation directors than is contained in Section 5560. Second, there are significant differences between private trustees and charitable corporation directors in terms of expertise, the reasons for selection, and the scope of activities. It is the staff's belief that a large percentage of the existing directors of charitable corporations would not be able to serve if the stringent private trustee rules of the Civil Code were imposed upon them (assuming the directors were fully advised by their lawyers as to the requirements and the extent of liability involved). The staff, therefore, recommends that no further changes be made in Section 5560.

30/951

§ 5561. Indefinite purposes

Section 5561 saves indefinite charitable gifts to any nonprofit corporation, allowing the nonprofit corporation to resolve the specific manner in which the gift is to be used. Exhibit XI (buff) complains that this gives too much power to nonprofit corporations. Exhibit LIV (blue) argues that this usurps the prerogative of the courts to determine the application of the cy pres doctrine; the commentator fears that a nonprofit corporation, which may have a single director, could abuse the power even were the directors held to all the duties of trustees (which they are not).

The Commission considered this question at an earlier date when it was pointed out that existing law allows only a corporation organized specifically for charitable purposes (with a minimum nine-man board of directors) to receive and utilize such uncertain gifts. The staff recommends that the Commission's decision to expand this principle to all nonprofit corporations receiving charitable gifts be retained; the corporation will continue to hold the assets only for the charitable purposes stated and subject to the trustee's duty of Section 5560.

Exhibit XLXVII (blue---Attorney General) argues that Section 5561 (also Section 5565) should be restricted so as to allow a nonprofit corporation to receive an indefinite charitable gift or administer a general charitable trust only in a manner which is consistent with the

purposes of the nonprofit corporation. Both sections adopt existing statutory language, and the commentator's argument thus reflects dissatisfaction with existing law. The staff doubts that any nonprofit corporation could use assets in a manner inconsistent with its purposes, but there does not seem to be any obvious harm in adding to these sections a requirement that the property be utilized or held in trust "in a manner not in conflict with the purposes of the nonprofit corporation."

30/052

§ 5562. Institutional trustees

Section 5562 allows a nonprofit corporation to transfer any of its assets (including charitable assets) to an institutional trustee; this transfer relieves the directors of liability for administration of the assets. Exhibit XVI (yellow) suggests that a nonprofit corporation may require some lesser services of an institutional trustee than full management of its portfolio. The staff acknowledges the force of this suggestion and recommends language in the Comment that the provisions of Section 5562 relating to management of corporate assets do not preclude a nonprofit corporation from purchasing investment advice or other investment services.

Exhibit XXXVII (blue--Attorney General) argues that the directors of the nonprofit corporation should, after transfer of assets to an institutional trustee, still have some responsibility for monitoring the performance of the trustee. Exhibit XI (Buff) and the Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), make the same point.

When Section 5562 was drafted, the staff included in the Comment a statement that the directors retain the duty to exercise due care in the selection of the institutional trustee "and in the continuation or termination of the trust." After substantial discussion, the Commission determined to delete this language for the reason that it was unable to determine the scope of the duty thus indicated. Put very simply, this language (whether in the statute itself, as the Attorney General recommends, or in the Comment) requires some continuing review by the directors of the performance of the trustee; it does not answer the question of how often the review must occur and how wide its scope must be. The

staff has been unable to find statutory examples from other sources setting forth the extent of such a monitoring duty. The staff recommends that no change be made in Section 5562 unless the Attorney General or the other commentators are able to provide suggested language which does not suffer from this ambiguity.

Exhibit VII (white) argues that the delegation of power is too limited and should be extended to permit the nonprofit corporation to employ investment managers and delegate to them full investment authority. Exhibits XVI (yellow) and XII (blue) note that the definition of "institutional trustee" appears to exclude nationally-chartered banks which are conducting trust businesses.

The staff does not believe that Section 5562 should be extended to include investment managers. There appears to be no adequate statutory regulations concerning investment managers in the same way that there are regulations concerning institutional trustees. The staff does agree that "institutional trustee" should be defined in subdivision (a) to include national as well as state chartered banks. This can be done by amending subdivision (a) as follows:

(a) As used in this section, "institutional trustee" means an entity entitled under ~~Section~~ Sections 1500 and 1502 of the Financial Code to engage in the trust business.

Again, the staff plans to add a Comment to the effect that nothing in Section 5562 is intended to preclude a nonprofit corporation from hiring and relying on the counsel of investment advisers in appropriate cases.

Exhibit LIV (blue) makes the point that subdivision (b), as presently drafted, authorizes the transfer of assets to an institutional trustee with no restrictions or limitations except that the assets remain subject to any existing investment restrictions. The commentator correctly points out that this is intended to enable transfers for investment purposes only, not for the actual utilization of the assets for charitable purposes. Subdivision (b) should be amended, as he proposes, to read:

(b) A nonprofit corporation may transfer, by appropriate action of the board, any or all of its assets (including property

held upon a charitable trust) to an institutional trustee for pur-  
poses of investment and reinvestment , as trustee subject to any  
investment restrictions on the assets.

Exhibit LIV also notes that subdivision (c), which relieves the  
board from liability for "administration" of the assets, is objection-  
ably broad. The staff believes it is unnecessary to amend subdivision  
(c) if the change in subdivision (b) is made since the extent of the  
immunity of liability under subdivision (c) is controlled by subdivision  
(b).

Exhibit XVI (yellow) believes that subdivision (d) should be cross-  
referenced to Section 5563(b) since many charitable corporations are  
private foundations subject to the minimum payout requirements imposed  
by Section 4942 of the Internal Revenue Code. The staff will add such a  
cross-reference; it may prove helpful to someone.

405/004

#### § 5563. Private foundations

Exhibit XXLVIII (gold) points out that, in the recodification of  
Section 9501.1 as Section 5563, the staff erroneously omitted qualifying  
language relating to the Internal Revenue Code. Upon further research,  
the staff acknowledges the error; the missing language should be re-  
stored thus:

5563. (a) This section applies to a nonprofit corporation  
during any period the nonprofit corporation is deemed to be a  
'private foundation' as defined in Section 509 of the Internal  
Revenue Code of 1954, and any provision contained in its articles  
or other governing instrument inconsistent with this section or to  
the contrary thereof is without effect.

(b) A nonprofit corporation described in subdivision (a) shall  
distribute its income (and principal, if necessary) for each tax-  
able year at such time and in such manner as not to subject it to  
tax under Section 4942 of the Internal Revenue Code of 1954 (as  
modified by paragraph (3) of subsection (1) of Section 101 of the  
Tax Reform Act of 1969) .

(c) A nonprofit corporation described in subdivision (a) shall  
not do any of the following:

(1) Engage in any act of self-dealing as defined in subdivi-  
sion subsection (d) of Section 4941 of the Internal Revenue Code of  
1954 (as modified by paragraph (2) of subsection (1) of Section 101  
of the Tax Reform Act of 1969) .

(2) Retain any excess business holdings as defined in ~~subdivision~~ subsection (c) of Section 4943 of the Internal Revenue Code of 1954.

(3) Make any investments in such manner as to subject it to tax under Section 4944 of the Internal Revenue Code of 1954.

(4) Make any taxable expenditure as defined in ~~subdivision~~ subsection (d) of Section 4945 of the Internal Revenue Code of 1954 (as modified by paragraph (5) of subsection (1) of Section 191 of the Tax Reform Act of 1969) .

30/953

#### § 5564. Attorney General supervision

Exhibit XI (buff) recommends that procedures for enforcement of the duties of a charitable corporation by persons other than the Attorney General be included in this section. A review of the cases cited in the third paragraph of the Comment indicates that interested parties are able to utilize ordinary civil procedures in order to hold charitable corporations to their duties; it does not appear that any additional statutory procedures need be provided. The staff plans to cross-refer to Section 5103, making applicable the rules of civil procedure.

Exhibit XVI (yellow) recommends that charitable solicitation rules be adopted in this section as soon as they are recommended by the Attorney General. The staff suggests that we wait to see what action the Attorney General takes before we consider whether anything needs to be done by the Commission.

Exhibit XXXXI (gold) complains that the supervision of the Attorney General's office is too complicated and that some simpler method of reporting should be devised. The problems of the complexity of supervision by the Attorney General arise from the Uniform Supervision of Charitable Trustees Act (Govt. Code §§ 12580-12597). The staff will forward these comments to the Attorney General's office for appropriate action.

30/954

#### § 5570. Establishment

Section 5570 authorizes the establishment of common trust funds by a nonprofit corporation organized for charitable purposes. Exhibit XVI

(yellow) complains that the phrase "common trust fund" has an established meaning in the financial community which is different from that used in the statutes. The staff does not recommend changing the statute (which has been in effect since 1947) because of this coincidence.

30/955

§ 5572. Administration

Exhibit VII (white) argues that the trustees of the common trust fund (like the directors of a nonprofit corporation) should be entitled to delegate their investment authority. Exhibit XI (buff) complains, on the contrary, that the powers of the trustees are too broad and should be sharply limited. The staff does not recommend that the existing statute should be altered to comply with either of these suggestions; the trustees are subject to Civil Code requirements placed upon all trustees, and we are unaware of any problems having arisen with the administration of charitable common trust funds.

30/956

§ 5574. Educational institution defined

Section 5574 continues existing Section 10251(a) in defining certain "educational institutions" which are allowed to become members of nonprofit corporations in order to maintain a common trust fund. The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), states that the definition may be read as requiring that the institution maintain a "full-time" educational program and argues that this is an unnecessary requirement. While the staff does not see any indication in the language that such a reading is likely, it has no objection to addition of the phrase at the end of the sixth line of subdivision (a), "whether or not providing a full-time course of instruction."

§ 5613. Special meetings

Subdivision (b) of Section 5613 limits the matters that can be taken up at special meetings of members to those stated in the notice of meeting. Exhibit XV (pink) believes this is unduly restrictive. "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."

The staff finds itself unable to agree with this suggestion. As the commentator notes, the purpose of the restriction is to avoid surprise. The staff thinks it would be unduly harsh to require every member of a nonprofit corporation to attend every meeting called by the board merely to assure that no subject is taken up in which he has an interest.

§ 5623. Manner of giving notice

Section 5623(a) requires notice of meetings of members to be given by first-class mail or other means of written communication. Exhibit XV (pink) suggests that consideration be given to permitting use of third-class mail, in cases where it can be done without unreasonable compromise of timeliness, in light of the considerable savings to the nonprofit corporation.

The staff is in sympathy with this suggestion. We note that Section 5620(b) permits the bylaws to prescribe reasonable notice requirements; we interpret this to permit the bylaws to provide for third-class mail in cases where it would be reasonable to do so.

Exhibit XV also observes that subdivision (b) of Section 5623 "implies an obligation by the corporation to request expensive address correction service from the U.S. Postal Service." The staff notes that this was not the intent of subdivision (b), which merely advises the corporation what to do in the case of actual knowledge of an inadequate address. Perhaps the following sentence should be added to the Comment:

It should be noted that nothing in subdivision (b) is intended to require address correction service from the United States Postal Service.



5627. Validation of defectively noticed meeting

Section 5627 permits validation of actions taken at a meeting held without proper notice if a number of conditions are satisfied, one of which (subdivision (a)(2)) is that "each person" entitled to vote at the meeting sign a waiver of notice, a consent to the holding of the meeting, or an approval of the minutes. Both Exhibit XIX (blue) and the Commission's consultant, Mr. Davis (Exhibit XXCVI--buff), note that the unanimity requirement is anomalous in light of the provisions relating to written consent, which permit a simple majority of those entitled to vote to take an action without any meeting at all.

The staff agrees and suggests that Section 5627(a)(2) be amended to provide that "each person" be replaced by the phrase "a majority of the persons."

§ 5710 et seq. Voting rights

Exhibit XI (buff) comments that "Reduction of the vote for member approval from 2/3 to a majority is in keeping with current California trends."

§ 5715. When class vote required

Section 5715 requires a class vote where a "substantial property right of the class" would be adversely affected by a corporate action. The Commission's consultant, Mr. Whitman, queries "What is a 'substantial' property right?" He suggests requiring a class vote where the "action would adversely affect voting or property rights of the class." The staff believes this would be an improvement in the statute.

§ 5719. Action taken by policymaking committee

Both Exhibit XII (green) and the Commission's consultant, Mr. Whitman, note that there is considerable uncertainty and ambiguity in the requirement that the persons who serve on the policymaking committee be "representative of the membership." Exhibit XII suggests that this limitation simply be deleted; Mr. Whitman suggests that, if committee members are elected by the membership, they would then be "representative." The staff prefers Mr. Whitman's approach and would revise the relevant portion of Section 5719(b) to read:

Only members of the nonprofit corporation who are ~~representative of~~ selected by the membership to represent the membership may serve on the policymaking committee.

§ 5724. Voting of membership standing in name of two or more persons or group

Exhibit XXIX (buff) likes this provision. "Oftentimes in a homeowners associations it is necessary for either the husband or wife to vote."

§ 5730 et seq. Proxies

Exhibit XV (pink) feels that proxy voting should be precluded unless the bylaws specifically permit it. This would reverse existing law. This proposal is discussed in connection with Section 5266 (infra); whatever action the Commission takes in connection with that provision will be reflected in Section 5730.

§ 5732. Form of proxy

Exhibit XIX (blue) believes the provisions of Section 5732 relating to the form of proxy are far too complex for such nonprofit corporations as homeowners' associations. The staff disagrees with this assessment as to complexity; the form requirements are simple and easy to understand. Moreover, this is a matter on which the Legislature feels very strongly.

The staff does observe, however, that the business corporation law proxy form provisions do not apply to proxies distributed to 10 or more shareholders in a corporation having 100 or more shareholders. The nonprofit corporation law could have a similar limitation.

The staff also notes that the 1976 Legislature added a provision to the business corporation law relating to general proxies. The staff plans to conform the language of subdivision (d) to the newly enacted provisions.

§ 5733. Duration of proxy

Section 5733 would reduce the length of time a proxy may be valid (unless coupled with an interest) from seven years to three years. Exhibit XXIV (green) notes that the more frequently proxies must be solicited, the greater the expense involved. For a very large organization (having in excess of a million members), the cost of proxy solicitation each year for proxies having a three-year duration would be about \$70,000 more than for proxies having a seven-year duration. Exhibit XXIV suggests a compromise figure of five years, which would cut the

duration of proxies by two years yet only impose an additional \$20,000 annual expense for such a corporation.

Exhibit LVII (white), on the other hand, states that "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."

404/350

§ 5740 et seq. Voting agreements

Exhibit LXVIII (white) points out that many times nonprofit corporations are formed to finance municipal projects and that as part of the financing device a voting trust is created, lasting until the retirement of the bonds (e.g., a 40-year period). The commentator is concerned that the existence of Sections 5740-5745, and particularly the 10-year limit on the duration of a voting agreement, could be construed to limit the type of financing projects referred to.

The staff believes that it is not the intent of Sections 5740-5745 to limit the types of voting arrangements that a nonprofit corporation sanctions. It is intended to give the members a statutory right to pool their votes, absent a provision in the bylaws to the contrary. A nonprofit corporation should be expressly permitted in its bylaws to create any type of voting arrangements it deems appropriate. The staff suggests the addition of the following provision to clarify this matter (which the Commission's consultant, Mr. Whitman, has also noted is unclear as drafted):

§ 5746. Scope of article

5746. Nothing in this article precludes a nonprofit corporation from providing in its bylaws for a voting trust or other vote pooling agreement on such terms and conditions as it deems appropriate.

Comment. Section 5746 makes clear that the provisions of this article are not intended as the exclusive means by which votes in nonprofit corporation may be pooled, nor are they intended to limit the provisions of the bylaws of a nonprofit corporation that provide for a voting trust or other vote pooling agreement.

Defined Terms:

Bylaws, § 5132  
Vote, § 5132

Cross-References:

Permitted contents of bylaws, § 5261

§ 5745. Enforcement of voting agreements

Section 5745 precludes the court from denying specific performance of a voting agreement on equitable grounds. The staff questions the wisdom of limiting the court's equitable jurisdiction and suggests that Section 5745 be revised to read:

5745. An agreement under this article shall not be denied specific performance by a court on the ground that the remedy at law is adequate or on other grounds relating to the jurisdiction of a court of equity.

§ 5750. Appointment of inspector

Section 5750 requires the appointment of an inspector of election on the request of a member. Exhibit III (Blue) believes it is "burdensome" to require appointment of an inspector at the request of one member and recommends deletion of the provision.

The staff agrees that this is a burdensome provision. However, the staff is opposed to its deletion. Appointment of an inspector is a useful protection to the members. Perhaps Section 5750 could be revised to require appointment on request of five percent or 50 members, whichever number is less. This would still afford some protection for the members, yet would assure that an inspector is required only where there is a substantial number concerned about the running of the election.

§ 5755. Evidentiary effect of report or certificate of inspector

Section 5755 prescribes the evidentiary effect of a report or certificate of the inspector of election but does not state when a report or certificate is required. The requirements for a report and certificate are found in existing law, which apparently was omitted inadvertently from this section. The staff recommends inclusion of the following provision:

On request of the chairman of the meeting or in the case of an election or vote other than at a meeting of members, the chairman of the board, or of a person entitled to vote at the other meeting or election, the inspector of election shall make a report in writing of any challenge, question, or matter determined and execute a certificate of any fact found.

§ 5810 et seq. Members' derivative actions

Exhibit XXII (gold) does not believe that derivative actions should be permitted in charitable corporations. The commentator notes that members of charitable corporations have no interest in the corporate funds from which an action could "derive," that the members have other more specific causes of action under the statute, and that the appropriate person to bring an action in the case of a charitable corporation is the Attorney General.

Charitable corporations could be expected from the operation of the derivative action provisions by addition of the following provision:

§ 5813. Charitable corporations excepted

5813. An action under this chapter may not be brought by a member of a nonprofit corporation organized for charitable purposes.

Comment. Section 5813 is new. It precludes derivative actions in charitable corporations. It should be noted that the Attorney General has supervisory authority, including authority to bring actions, over charitable corporations. See Section 5564 and Comment thereto.

Exhibit XI (buff) is also concerned about the expense of a derivative action to a charitable corporation. The commentator suggests use of an ombudsman to resolve disputes, that being expeditious and inexpensive. If the Commission determines that charitable corporations should not be excepted from the derivative action provisions, it may desire that the staff investigate the ombudsman approach.

§ 5820 et seq. Preconditions to derivative action

Sections 5820 and 5821 impose requirements on a person bringing a derivative action to attempt to secure the desired action from the board and to inform the board of the causes of action. Exhibit XIV (green) believes these are a good balancing of the needs of minority and majority members of the nonprofit corporation. Exhibit VIII (pink) believes these sections are unnecessary, fruitless, and should be eliminated. Particularly, the commentator believes that Section 5821 (which requires the plaintiff to inform the board of the facts of the complaint or deliver a copy of the complaint) is negative in its approach and duplicates matters already covered in Section 5820.

The staff notes that these provisions are derived from comparable provisions of the business corporation law. Nonetheless, the staff tends to agree that they serve no real useful purpose. We cannot conceive that a member with a grievance would proceed to suit without having first attempted to get the desired action from the board and without having indicated the grounds of his complaint. On the other hand, the staff cannot conceive that these requirements are unduly burdensome, particularly if the member would have done what is required any way, absent a statute.

404/360

§ 5830 et seq. Security for defendant's expenses

Sections 5830-5833 are provisions enabling the defendant in a derivative action to require the plaintiff to post security for the defendant's costs. Exhibit XXIV (green) concurs with the procedure for posting security, noting that, where a shareholder in a business corporation may feel constrained about bringing an action that may affect the value of his investment, this inherent restraint is not always present for members of nonprofit corporations.

Exhibit VIII (pink), on the other hand, believes the security for costs provisions totally ignore the differences in size and scope between business and nonprofit corporations. The commentator doubts the necessity for having such provisions at all and in any case would limit them to the large corporation, i.e., one having in excess of 500 members. The commentator notes that the security provisions were designed to curb "strike" suits in the very large business-type corporations and should be limited to them.

The application of the security provisions could be limited to large corporations by adoption of the following provision:

5839. . . .

(b) If an action is brought pursuant to this chapter by a member of a nonprofit corporation having fewer than 500 voting members on the date the action was commenced, the plaintiff shall not be required to furnish security under this article for the defendant's expenses.

Comment. Subdivision (b) of Section 5839 is new. It is intended to limit the securities for costs requirements to large corporations.

Defined Terms:

Voting members, § 5134

494/361

§ 5839. Exception where action brought by stated number of plaintiffs

Section 5839 is an innovation proposed for California law by the Commission; it abrogates the security for costs requirement in derivative actions where the action is brought by 50 members or 10 percent of the voting power of the nonprofit corporation. Exhibit VIII (pink) notes that getting even 10 percent of the members in aggravated cases can be a near-impossible task. On the other hand, Exhibit XI (gold), having the small corporation in mind, feels that 10 percent is too low; 50 members is O.K., but the percentage should be 35 percent. Exhibit XIV (green), however, having in mind the large corporation, feels that 10 percent is O.K., but that 50 members out of a multitude is inadequate protection against suits having harrassment as a principal purpose.

With this diversity of comment, the staff suspects that the Commission may have hit upon a perfect compromise figure (the kind that pleases no one) and suggests that Section 5839 be left unchanged.



§ 5921. Adoption of amendments by board alone

Exhibit XXXI (gold) is opposed to permitting the directors to amend the articles to delete the names and addresses of initial directors. The commentator points out there is often jealousy among volunteers in the nonprofit corporation, and allowing the directors to remove previous directors' names serves no purpose whatsoever. Presumably the commentator would not be opposed to deleting the names and addresses of initial directors if this were done by the members in the same manner that other amendments to the articles were made.

The staff has some sympathy with this point of view. Section 5921 could be deleted altogether, we believe, without any great loss of substance to the statute.

§ 5940 et seq. Restatement of articles

Exhibit XXXI (gold) is opposed to the provisions allowing restated articles. The commentator notes that the provision for amendments permits filing the amended articles of incorporation in toto. Thus the restatement of articles provision is unnecessary.

The staff cannot agree with this point. While it is true the same result can be accomplished by setting out the whole articles as amended at the time of an amendment, a corporation may find it useful at a time when it is not amending its articles, but still would like to have restated articles. Thus the provisions for restatement of articles serve a useful, albeit limited, function.

§ 6011. Sale or transfer of all or substantially all of assets;  
approval of members

Section 6011 requires the approval of a majority of the members for disposition of all or substantially all of the corporate assets other than in the usual and regular course of the corporate activities. Subdivision (a) permits the approval of the members to be made either before or after the disposition. Exhibit XX (gold) feels that approval should be required 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." The staff notes that existing law permits the approval to be given either before or after the transaction. Long Const. Co. v. Empire Drive-In Theaters, Inc., 293 Cal. App.2d 726, 25 Cal. Rptr. 509 (1962).

Exhibit XXXVII (blue--Attorney General) notes that subdivision (a) requires member approval for the transfer of assets other than in the ordinary course of activities and poses the problem that many charitable corporations have no members. He suggests that the Attorney General approve the transaction on behalf of the beneficiaries. The staff believes requiring Attorney General approval is unnecessary; the Attorney General is notified pursuant to Section 6012 and can take appropriate action if there is a violation of the trust.

In the drafting of Section 6011 the following provision, drawn from the comparable provisions of the new business corporation law, was inadvertently omitted:

(c) Notwithstanding subdivision (a), a nonprofit corporation may not sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of its corporate assets to a subsidiary or to another nonprofit corporation having a common parent with the nonprofit corporation, unless the principal terms of the transaction are approved by the members of the subsidiary or other nonprofit corporation by at least 90 percent of the votes entitled to be cast thereon.

Comment. Subdivision (c) is derived from Section 1001(d) (General Corporation Law), but applies to all transfers or dispositions of all or substantially all of the corporate property, and not merely to sales. Subdivision (c) applies to both transactions under subdivision (a) and under Section 6751(c)(7) (powers of board on dissolution).

§ 6012. Notice to Attorney General required in certain cases

Section 6012 requires a charitable corporation to give notice to the Attorney General in the case of a disposition of all or substantially all of its corporate assets other than in the ordinary course of its activities. Subdivision (b) adds the condition that the notice only needs to be given if the transaction is "for less than fair and adequate consideration." The Commission's consultant, Mr. Whitman, believes this condition should be deleted-- How often is a nonprofit corporation going to admit in a notice to the Attorney General that it has sold substantially all of its assets for 'less than fair and adequate consideration'?"

The staff thinks this is a good point, and recommends the deletion of subdivision (b). A representative of the Attorney General's office has informed us orally that whether the transaction is for less than fair and adequate consideration is the ultimate issue in the bulk of the cases in which they become involved in litigation--to permit the nonprofit corporation to characterize the transaction is to defeat the purpose of the whole provision.

Exhibits XXXLVII (blue--Attorney General) and XXXLVIII (gold) are both concerned with the paperwork that will be generated by the requirement that notice be given to the Attorney General. They believe that the provision should be further refined so that the Attorney General receives notice only in appropriate cases. The staff does not know how this can be done. Exhibit XXXLVII suggests that maybe a provision requiring notice in case of dissolution will be adequate; the staff notes, however, that the prime reason for Section 6012 is to catch the "de facto dissolution." Exhibit XXXLVIII suggests that it might be limited to situations where there is self-dealing, e.g., transfer to a director or a director's relative. The staff believes that this is too limited for full protection of the public's interest in what may be substantial charitable assets.

Exhibit XXXLVIII is also concerned that Section 6012 may be applied to such actions as the family foundation that turns its assets over annually. The staff does not believe that Section 6012 would apply to

this situation since the annual turnover would be in the "usual and regular course of the activities of the nonprofit corporation." Perhaps this should be spelled out, using the illustration just given, in the Comment.

Exhibit XVIII (buff) believes that Section 6012 should contain an exception for a private foundation that is winding up pursuant to Section 507(b) of the Internal Revenue Code. "Attorney General surveillance 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." The staff does not agree--the Attorney General is charged with supervision of all aspects of the charitable trust, not merely those aspects that concern the Internal Revenue Service, and a simple notice to the Attorney General of disposition of assets would not unduly complicate a transaction.

§ 6110. Merger or consolidation authorized

Exhibit XXXXVIII (gold) observes that existing law does not preclude the merger of a nonprofit corporation, even one for charitable purposes, with a business corporation and suggests that 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."

As drafted, Section 6110 provides only for mergers between nonprofit corporations. The reason for limiting the merger provisions is not one of policy, but one of drafting--a nonprofit-business corporation merger statute would be rather complex, particularly in integrating dissenters' rights provisions and the like. A nonprofit corporation (other than a corporation organized for charitable purposes) can convert into a business corporation, however. And once the conversion occurs, merger with another business corporation would, of course, be possible. This is an indirect way of accomplishing what Exhibit XXXXVIII suggests be accomplished directly.

§ 6142. Notice to Attorney General

Section 6142 requires a charitable corporation to send to the Attorney General a copy of any agreement of merger before the agreement is filed. Exhibit XII (blue) notes that this duplicates an existing filing requirement. Exhibit XXXXVII (blue--Attorney General), however, thinks this is "an excellent provision." As stated in the discussion of Section 5224 (supra) the jurisdiction of the Attorney General under the Uniform Supervision Act is not complete. Perhaps the problem can be resolved by requiring, rather than a copy of the agreement, notice in all cases.

Exhibit XII also queries the need for sending a copy of the agreement to the Attorney General before it is filed. The reason for the requirement is to give the Attorney General an opportunity to investigate before the merger is effectuated. The staff believes that this requirement could be eliminated, however, since there is no time limit

and the agreement might be delivered to the Attorney General on the day it is filed.

Exhibit XX (gold) suggests that a time limit be imposed within which the Attorney General must object to a merger. The staff does not believe this is advisable. It may take time to investigate and collect facts; the Attorney General can and should intervene at any time if there has been an improper transaction involving charitable assets. See discussion under Section 6160 (infra).

045/193

§ 6160. Action to test validity of, or enjoin or rescind, merger or consolidation

Section 6160 permits an action to enjoin or rescind a merger or consolidation that is "manifestly unfair" to the property rights of a member or class. The Commission's consultant, Mr. Whitman, objects to use of the term "manifestly." The staff agrees that it should be deleted; it is simply a litigation factor and has no manifest meaning.

Exhibit XXXVII (blue--Attorney General) objects to the 60-day statute of limitations for challenging a merger, as applied to the Attorney General. A 60-day statute for the Attorney General "is wholly unreasonable." Subdivision (c) could be amended to provide:

(c) ~~No~~ An action to enjoin or rescind a merger or consolidation, other than an action by the Attorney General, may not be commenced more than 60 days after the effective date of the merger or consolidation.

406/230

§ 6146. Effect on bequest, devise, gift, etc.

Section 6146 states that any bequest to a constituent nonprofit corporation which "is to take effect" after merger or consolidation inures to the surviving corporation. Exhibit XVIII (buff) points out that the quoted language might be construed as suggesting an element of intent on the part of the testator. This suggestion could be eliminated by referring simply to a bequest which "takes effect" after merger or consolidation.

This change is agreeable to the staff. A similar change should be made in a parallel provision, Section 6245 (division).

§ 6210. Division of nonprofit corporation authorized

Subdivision (a) of Section 6210 is a new provision authorizing division of nonprofit corporations. Exhibit XXXIX (buff) states "This is a novel idea and a good one."

Subdivision (b) limits division so that a nonprofit corporation organized exclusively for charitable purposes may only divide so as to form nonprofit corporations exclusively organized for charitable purposes. The Commission's consultant, Mr. Whitman, asks why the coverage of this provision does not include corporations with mixed charitable and noncharitable purposes or a nonprofit corporation with noncharitable purposes that holds property on a charitable trust. The staff agrees that subdivision (b) is a little peculiar in its coverage; the general rule is that charitable property remains subject to the charitable purposes for which it is held, regardless of the transformations of the corporation holding it. The staff would simply delete subdivision (b) and state the general rule in the Comment. This would also satisfy the request of Exhibit XXXXVII (blue--Attorney General) that the Comment make clear that the device of division cannot be used to divert charitable assets from their charitable purposes. A similar Comment belongs in the merger chapter.

§ 6242. Notice to Attorney General

Section 6242 provides for notice to the Attorney General in case of a division of a nonprofit corporation organized for charitable purposes or holding assets on a charitable trust. Exhibit XXXXVII (blue--Attorney General) considers this "an excellent provision."

Exhibit XX (gold) believes there should be a time limit during which the Attorney General must object to any division. The staff believes such a provision would be unwise. See discussion in connection with Sections 6142 (merger), 6160 (merger), and 6260 (division).

§ 6260. Action to test validity of division or to enjoin or rescind  
division

Exhibit XXXXVII (blue--Attorney General) believes that the 60-day statute of limitations for bringing an action affecting the division is inappropriate for actions by the Attorney General. Subdivision (c) could be revised to read:

(c) No An action to enjoin or rescind a division , other than  
an action by the Attorney General, may not be commenced more than  
60 days after the effective date of the division.



§ 6510. Required books and records

Exhibit XI (buff) makes the general observation with regard to the Commission's proposals to liberalize record requirements that "Allowing more flexible procedures for keeping membership and fiscal records is sound business practice."

Subdivision (a)(2) requires that minutes of committees of the board of directors be kept. Exhibit XXIV (green) questions this requirement, noting that it is appropriate where a committee is exercising board authority, but not where the committee has no decision-making authority or where the committee is merely making recommendations to the board after the study of a subject. The commentator notes that it is common among nonprofit corporations to have numerous committees of the board not exercising board authority in order to assure member participation.

The result desired by the commentator could be achieved by amendment of Section 6510(a)(2) to read:

(a) A nonprofit corporation shall keep:

\* \* \* \* \*

(2) Minutes of the proceedings of members, the board, and (to the extent they exercise the authority of the board) committees of the board.

Subdivision (b) requires a fairly detailed record of members "to the extent that such a record is necessary to determine the members entitled to vote, to share in the distribution of assets on dissolution, or otherwise to participate" in the affairs of a nonprofit corporation. Exhibit XXXIX (buff) notes that "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." The staff agrees with this observation but suggests that the existence of subdivision (b) will force nonprofit corporations to keep better track of who its members are.

§ 6512. Failure to keep records or provide financial statements

Section 6512 provides penalties for failure to keep records or provide financial statements. Exhibit XXXXVII (blue--Attorney General)

suggests that reference be made in the Comment to Government Code Section 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." The following language could be added to the Comment:

Nothing in this section limits the authority of the Attorney General to enforce the duties of the directors of nonprofit corporations organized for charitable purposes under authority of Government Code Sections 12580-12597 or other statutory or common law authority.

406/234

§ 6520. Annual report required unless bylaws otherwise provide

Exhibit XVIII (buff) notes that existing law does not require an annual report and that adopting a provision such as Section 6520 which requires an annual report unless the bylaws provide otherwise will simply have the effect of requiring a large number of existing nonprofit corporations to amend their bylaws. The commentator suggests that existing nonprofit corporations be excused from compliance with Section 6520.

The Commission considered this possibility at the September 1976 meeting and determined to make Section 6520 applicable to all corporations, but to defer the operative date for an additional year for existing nonprofit corporations in order to permit sufficient time for the existing nonprofit corporations to comply.

406/205

§ 6524. Member's right to examine copy of annual report

Section 6524 gives a member the right to obtain a copy of or to inspect the annual report. Exhibit XV (pink) suggests that the right to examination should include the right to make extracts or copy. The staff notes that the draft statute provides this right for inspection under Chapter 16. See Section 6610. The staff recommends, in accordance with the commentator's suggestion, that Section 6610 be expanded to provide:

6610. (a) Inspection under this ~~chapter~~ division may be made in person or by agent or attorney.

(b) The right of inspection under this division includes the right to copy and make extracts.

There should be a cross-reference to this section under Section 6524.

Exhibit XV also suggests that the right to copy and make extracts should not extend to those cases where it would be impracticable to do so and that a fee for duplication of the record should be authorized. The staff notes that, in the case of data not available in written form, Section 6611 requires the nonprofit corporation to make the data available at its expense. Whether a fee should be charged for providing a copy in lieu of permitting inspection by the member is handled in the draft on a case-by-case basis.

968/705

§ 6526. Members' right to obtain fiscal information

Exhibit XIV (white) agrees with the concept of this section that the financial statements normally prepared by a nonprofit corporation should be available to the members.

Subdivision (a) is defective in failing to define "authorized member" as a person having the written authorization of five percent of the voting power, "or such lesser authorization as is specified in the bylaws." Adoption of the quoted language would make the definition of authorized member in Section 6526 the same as that in Section 6620.

Subdivision (f) permits a nonprofit corporation to open its books for inspection in lieu of providing requested financial statements. Exhibit XI (buff) states that this provision is "good."

§ 6610 et seq. Rights of inspection

Exhibit XI (buff) states that "expanded inspection rights" and "stating procedures" is good.

Exhibit LVII (white) notes that rights of inspection are granted, in Sections 6622 and 6630, for example, "during usual business hours." The commentator observes that many small nonprofit corporations have no regular hours. See also discussion under Section 5267, supra (inspection of bylaws). Exhibit LVII suggests that "at a reasonable time of day" might be substituted for "usual business hours."

Exhibit LVII also suggests that the requirement that the records be available for inspection be satisfied if the records are available at members' meetings held eleven or more times per year.

The staff believes there is merit to these points and will draft language accordingly.

14/905

§ 6620 et seq. Membership records

Sections 6620-6628 provide a scheme for inspection of the membership list and membership records of a nonprofit corporation, with provisions for maintaining the confidentiality of the list. Exhibit XV (pink) states that this scheme is "very well thought out. An organization can lose valuable good will if through release of its membership list its members suffer loss of privacy and become caught in crossfire of various factions." Exhibit XXXIX (buff) also agrees with this scheme but makes the point that, if there is any cost of making an inspection, the members making the inspection should assume reasonable costs. The draft in fact already accomplishes this. See Section 6623(b).

Exhibit XXIV (green), on the other hand, believes that the provisions do not supply adequate protection to the membership list. The commentator notes that the only valid reason for giving access to the membership list is to assure the member can communicate with other members in connection with the nomination and election process. To this end, the commentator suggests that Sections 6620-6628 be replaced with a provision requiring a nonprofit corporation to provide an adequate means

of communication by members and leaving it to the discretion of the directors of the nonprofit corporation how that mandate is satisfied 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. A statutory requirement that the procedure be reasonable would assure court supervision in appropriate cases.

The staff finds this argument attractive. While it is true that the Commission has attempted to work out a specific statutory scheme with reasonable standards for communicating with members, this scheme has inherent problems which are raised below in connection with particular sections. A general statutory mandate such as that described by Exhibit XXIV would enable the flexibility required by the different types of nonprofit corporations while eliminating the types of problems created by the specific statutory scheme.

The staff has mixed feelings about this issue. On the one hand, we feel that the detailed scheme worked out by the Commission is feasible and makes rights clear. On the other hand, a general provision requiring the corporation to provide a reasonable means of communication has the virtues of simplicity and flexibility. The staff suggests that the Commission work through the particular problems raised below in connection with Sections 6620-6628 before coming to a decision on this issue.

10/367

§ 6622. Member's right to inspect membership record

Section 6622 permits a member of a nonprofit corporation, upon five days' notice to the corporation, to inspect the record of members for a purpose reasonably related to his interests as a member.

Exhibits XXIII (yellow) and XXIV (green) suggest that the five-day notice period should be increased to 10 days in order to permit the nonprofit corporation to petition for judicial supervision as provided in Section 6624. 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."

The reason the commentators feel that judicial relief might become necessary is expressed in Exhibit XXIII--"We see within the provisions

of Section 6622 the seeds of unjustified expense to and harrassment 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 commentator suggests that the statute make clear that inspection must be for a proper purpose.

Exhibit XXIII also suggests that, if a corporation is able to provide a member with a reasonable and appropriate alternative to inspection that will satisfy the purpose of the inspection, it should be permitted to do so.

As amended to effectuate these suggestions, Section 6622 would read:

6622. (a) Except as provided in subdivision (b), a member has the right to inspect the membership record during usual business hours upon ~~five~~ 10 business days' prior written demand upon the nonprofit corporation for a proper purpose reasonably related to the member's interests as a member. The written demand shall be under oath and shall state the purpose of the inspection.

(b) A nonprofit corporation may satisfy a demand for inspection under subdivision (a) by any reasonable means that adequately satisfies the purpose of the inspection.

(c) The use of the information obtained pursuant to this section shall be limited to the purpose stated in the demand.

404/282

§ 6623. Authorized member's right to inspect or obtain membership list

This section provides a right to obtain a membership list upon five days' demand. Exhibits XXIII (yellow) and XXIV (green) make the same argument for extending the demand period here to 10 days as for Section 6622 (discussed supra).

31/524

§ 6624. Judicial supervision

Section 6624 permits court supervision over the procedures for inspection of the membership record and membership list provided in Sections 6622 and 6623. One facet of the supervision, found in subdivision (b), permits the court to postpone any previously noticed meeting

of members for a period not exceeding any delay in compliance with an inspection request by a member.

Exhibit XXIII (yellow) questions the utility of this provision. It may be impossible to arrange adequate substitute meeting facilities on short notice; requiring a delay may do more harm than good. The commentator believes the provision should be deleted altogether or at the very least postponement of an annual meeting should not be allowed after the meeting has already been noticed. The precise language proposed by Exhibit XXIII is, "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."

10/171

§ 6626. Requirements for bylaw deemed to satisfy requirements of  
Section 6625

Section 6625 permits a nonprofit corporation to avoid the obligation of making its membership list available for inspection if the corporation adopts bylaws providing reasonable means of communication among members. Section 6626 prescribes standards, which if followed, will satisfy the reasonable means requirement; these standards are not intended as minimum but as a maximum. Exhibit XXIV (green) is concerned that a court will read the standards as a minimum and require bylaws to satisfy that standard, notwithstanding directions to the contrary in Section 6625(c).

Exhibit VI (gold) directs the Commission's attention to a particular portion of Section 6626--subdivision (b)(3)--which requires the bylaws to provide "a procedure to permit any nominee to communicate to the voting members a candidate's statement for the nominee." The commentator notes that some corporations permit candidate nominations from the floor at an annual meeting and, in such cases, it would be inappropriate to have the meeting continued until the candidate has had the opportunity to communicate his candidate's statement to the voting membership. This problem could be cured by amendment of subdivision (b)(3) to require the bylaws to provide:

(3) A procedure to permit any a nominee who has been nominated a reasonable time prior to the election to communicate to the voting members a candidate's statement for the nominee.

10/172

§ 6628. Authority of court not limited

Section 6628 permits the court to modify the legal requirements relating to inspection of membership lists and communicating with members. Exhibit XXIV (green) is concerned that this provision will permit the court to impose procedures that "are totally different from those set out in the statute," which will generate uncertainty, the commentator is particularly concerned that a court may impose a lesser percentage or number of members than the five percent required by Section 6620 for inspection of the membership list, thereby leaving the statutory protection "speculative at best."

Exhibit VI (gold) is likewise concerned with this problem. The commentator notes that "Section [6628] 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." The commentator suggests that a court might lower the number of members required below the five-percent level in any case where the number of members required is large simply because of the size. The commentator believes that there should be some other unfairness or inequity required before the court is permitted to lower the five-percent requirement. The commentator would amend Section 6628 to add the following provision:

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.

10/173

§ 6630. Inspection of financial records and minutes

In drafting Section 6630, the staff inadvertently omitted a provision extending the right of inspection to subsidiaries of the nonprofit corporation. Subdivision (c) should be added to read:



(c) The right of inspection created by this section extends to the financial records and minutes of a subsidiary of a nonprofit corporation subject to this section.

10/174

§ 6640. Director's right of inspection

In drafting Section 6640, the staff inadvertently omitted a provision extending the right of inspection by directors to subsidiaries of the nonprofit corporation. Subdivision (b) should be added to read:

(b) The right of inspection created by this section extends to books, records, documents, and physical properties of a subsidiary of a nonprofit corporation subject to this section.

18/529

§ 6652. Recovery of reasonable expenses by member or director

Section 6652 permits recovery of expenses incurred in obtaining inspection of corporate records if the expense was incurred as a result of a corporate denial of inspection rights that was arbitrary and completely without justification. The Commission's consultant, Mr. Whitman, comments:

My reaction to the "arbitrary and completely without justification" standard of this Section is that the statute might as well be deleted. If we intend to allow a recovery of expenses in some situations, rather than constructing a hollow statutory right, the words "arbitrary and completely" should be deleted.

§ 6710 et seq. Dissolution

Exhibit XVI (yellow) suggests that it would be helpful to provide 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.

The staff does not see why the provisions of Chapter 17 relating to dissolution and distribution of assets do not provide adequate and specific guidelines for termination and distribution of assets to another corporation.

Exhibit XX (gold) suggests that notice should be given to the Attorney General where dissolution of a corporation involves a charitable trust. The Commission has previously considered such a suggestion and has tentatively determined to generalize the notice provision in Section 6012, requiring notice to the Attorney General in case of any transfer of charitable assets not in the usual and regular course of the activities of the nonprofit corporation. The staff believes the interrelation of the sections could be made more clear and plans to add a Comment at the beginning of Chapter 17, stating:

Where a nonprofit corporation organized for charitable purposes or holding assets on a charitable trust dissolves, notice to the Attorney General may be required under Section 6012.

30/958

§ 6710. Persons who may commence action

Among the persons authorized to commence an action for involuntary dissolution is a member of a nonprofit corporation that is a subordinate body if the charter of the subordinate body has been surrendered to, taken away, or revoked by the head or national body. Exhibit XXXII (buff), "with some experience in disputes between nationals and their locals", is concerned with this provision which would permit just one

voting member to bring the action. The staff suggests that this provision be deleted; there is adequate authority in Section 6721 for the board to commence voluntary dissolution where the charter of a subordinate body has been revoked by the national.

30/959

§ 6711. Grounds for dissolution action

There should be added to Section 6711 the following subdivision, which is in existing law but which was inadvertently omitted in the compilation of Section 6711:

(j) The liquidation is reasonably necessary for the protection of the rights or interests of a substantial number of the members or of the complaining members.

405/384

§ 6741. Avoidance of dissolution by purchase

Section 6741 permits avoidance of dissolution by purchase of memberships in cases of dissolution initiated by persons holding a majority of the voting power. The Commission's consultant, Mr. Davis (Exhibit XXXXVI--buff), does not understand the intent of this restriction. "To me this does not make sense as written."

The purpose of this limitation, as stated in the Comment, is to "minimize the possibility of a minority commencing involuntary dissolution proceedings as a means of circumventing the general prohibition against distribution of gains, profits, or dividends to members."

30/960

§ 6750. Cessation of corporate activities; exceptions

Subdivision (b) of Section 6750 requires that a corporation cease activities when the term of its existence expires. This provision, which was recommended by the staff, is not in existing law. Upon further consideration, the staff believes it should be deleted. It can only create problems of validity of corporate acts and is inconsistent with provisions elsewhere in the statute that impliedly sanction the continuation of activities despite the expiration of the term of existence. See Section 5912 (amendment of articles to continue corporate existence).

§ 6772. Return of assets held on condition or by subordinate body

Subdivision (b) of Section 6772 requires that proceeds held by a subordinate body be redelivered to the national body upon revocation of the charter of the subordinate body by the national body. The Commission queried the policy of this provision and specifically requested comments concerning it. The Commission received only two comments, both informally, concerning this provision. One commentator found the subdivision troublesome and could envision possible abuses, particularly if an assessment had been levied on the members of the subordinate body prior to dissolution; would they remain liable to the national body? Would they continue to receive the benefits that the subordinate body would have provided? The other commentator felt that the rule is a bad one--many subordinate bodies are rather independent and have substantial assets that the national organization has no interest in and should have no right to. This commentator felt the only situation where the provision should have any application is where the national body is a California corporation and the subordinate body is incorporated in another state which has no orderly procedure for distribution of assets on dissolution.

The staff believes that subdivision (b) could probably be repealed. The staff suspects that, in many cases, the charter of the subordinate body will specify the disposition of assets on dissolution so that the existence or nonexistence of a California law on the point will have little effect.

§ 6773. Disposition of assets held on trust or by charitable corporation

Exhibit XIV (white) concurs with the provisions proposed by the Commission for disposition of charitable assets. Exhibit XVIII (buff) suggests that Section 6773 cover more than just charitable corporations but also other types of corporations which, though not organized for charitable purposes, may have solicited funds from the general public. The staff notes that any charitable funds held by a noncharitable corporation are impressed with a charitable trust, and Section 6773 would in

fact cover those funds. Perhaps this should be made more clear in the Comment by deletion of the reference to assets received on "express" trust.

Subdivision (a) of Section 6773 requires disposition of assets "in conformity with the purposes of the charitable trust or the charitable purposes for which the nonprofit corporation was organized." Both Exhibits XXVI (blue) and XXXXIII (pink) were troubled by the interrelation of subdivision (a) with Section 6772(a), which requires that assets received on condition be disposed of according to the requirements of the condition imposed. They suggest that the interrelation be made clear by statute rather than by Comment. The staff agrees and would preface subdivision (a) of Section 6773 with the phrase "Except as provided in Section 6772, . . . ."

The Commission's consultant, Mr. Whitman, questions the requirement of subdivision (a) of Section 6773 that all assets of a nonprofit corporation organized for charitable purposes must be disposed of in accordance with the purposes of the nonprofit corporation. He suggests that, under existing law, it would be possible for a charitable corporation to hold some noncharitable assets, e.g., assets given to it expressly for noncharitable purposes, that the courts would not hold to be impressed with a charitable trust. While Mr. Whitman's argument has some force if "organized for charitable purposes" is undefined, the staff suggests that, if the phrase is defined as proposed supra (predominately or exclusively for charitable purposes), it would be proper to subject all the corporate assets of a nonprofit corporation organized for charitable purposes to the provisions of subdivision (a).

Subdivisions (b) and (c) of Section 6773 are an attempt to require court supervision of the disposition of charitable assets, as in existing law, but to excuse the necessity to go to court in cases where the dissolving corporation and the Attorney General are in agreement and no other interested persons object. Both Exhibits XVIII (buff) and LI (yellow) believe that subdivisions (b) and (c) do not adequately accomplish these objectives. Exhibit LI suggests that subdivision (b) not require that the Attorney General be a party, but only that the Attorney General has an opportunity to become a party. The staff is sympathetic to this point of view but sees no need to change the proposed statute--

the corporation need simply join the Attorney General as a party and whether or not the Attorney General makes an appearance is up to the Attorney General. This could be made clear in the Comment.

Exhibit XVIII would exempt small charitable corporations from going to court altogether. The Commission has considered this possibility in the past but has determined that, to preclude abuse, the small corporation might merely obtain a waiver from the Attorney General and avoid court proceedings under subdivision (c). The Commission's consultant, Mr. Davis (Exhibit XXXVI--buff), however, would change the rule altogether. "I do not believe that one superior court judge should have that authority, when the board of directors and the A.G. both agree upon a matter, even if third parties object." Exhibit LI, on the other hand, thinks it desirable to have a court proceeding in every case regardless of the Attorney General's opinion. The staff believes that on balance the Commission has a sound recommendation.

30/964

§ 6776. Plan of distribution of securities or assets in kind

Section 6776 is a rather special provision relating to distribution of assets in kind to memberships having liquidation preferences in lieu of the stated preference. It requires special approval of a plan of distribution with special notice requirements. It has its use primarily in business corporations.

The staff believes that, even though we have satisfactorily adapted the provision for nonprofit corporations, the provision is a very narrow one, is extremely remote, has little practical chance of ever being applied to a nonprofit corporation, and should be deleted. This will have the incidental effect of greatly simplifying other portions of the statute as well in which special provisions are necessitated by Section 6776.

30/965

§ 6784. Effect of order discharging directors or other persons appointed to conduct the winding up (new)

In drafting the dissolution provisions, the staff inadvertently

omitted the following provision, which is found in the new business corporation law:

§ 6784. Effect of order discharging directors or other persons appointed to conduct the winding up

6784. Upon the making of the order pursuant to subdivisions (d) and (e) of Section 6780, the directors or other persons appointed to conduct the winding up are thereby discharged from their duties and liabilities except with respect to completion of the winding up, if necessary.

Comment. Section 6784 is the same in substance as subdivision (b) of Section 1808 (General Corporation Law).

30/966

§ 6810 et seq. Transition provisions

There were several comments directed to the transition provisions, which were not included in the tentative recommendation, but with respect to which the Commission solicited comments. Exhibit VIII (pink) considered the transition provisions important but gave no specific suggestions. The staff sent the commentator a copy of the staff memorandum relating to transition provisions prepared for the September 1976 Commission meeting but has received no further response.

Exhibits XXXII (buff), LI (yellow), and LVIX (green) suggest the need for a moratorium or grandfather clause for the application of the new law to existing nonprofit corporations. The Commission determined at its September meeting that a two-year delay in the operative date for existing nonprofit corporations should provide adequate time for compliance with the new law.

405/386

§ 6900. Curative provision (new)

Exhibit XXXXVIII (gold) states:

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 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.

The staff believes that this suggestion has considerable merit; however, drafting an adequate provision presents a number of difficulties, in particular limiting the kinds of corporate acts which are validated. If the Commission agrees with the suggestion, the staff will devote some resources to drawing up an adequate curative provision; any suggestions by the Commission at the meeting will be appreciated.

Respectfully submitted,

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Assistant Executive Secretary