

28/275

#77.400

10/12/76

Second Supplement to Memorandum 76-90

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

This supplementary memorandum analyzes the comments received since the basic Memorandum 76-90 was written. The exhibits referred to are all attached to the First Supplement to Memorandum 76-83. Some of the comments received from the Commission's consultant, Mr. Davis (Exhibit LXV--yellow), are technical in nature, and the staff plans to incorporate the technical changes in the draft where appropriate. The substantive questions raised by Mr. Davis are summarized in this memorandum. Any additional comments received between the time this supplementary memorandum is written and the time of the October meeting will be analyzed orally at the meeting.

28/276

Preliminary Part of Tentative Recommendation

Exhibit LXII (gold) makes a number of observations about the utility of having the nonprofit corporation law follow as closely as pos-

sible the business corporation law. The staff believes these are important observations and intends to incorporate them in the preliminary portion of the recommendation to the extent they are not already incorporated.

Exhibit LXVI (green--Department of Housing and Community Development) notes that an empirical study of nonprofit corporations that function in the areas of housing, community development, and economic development reveals no problems with existing nonprofit corporation law. "The problems identified did not relate to the authority, powers, restrictions, or organization of nonprofit corporations imposed by statute." The staff believes this justifies one of the basic approaches of the Commission's draft--to propose changes only in cases of a demonstrated need for change--and proposes to refer to this empirical study in the preliminary part.

28/277

#### Charitable Corporations

Exhibit LXVIX (gold) comments that "The difference in the concept, formation, operation, and management of a charitable nonprofit corporation as compared, lets say, to a mutual water company or a cooperative, is too divergent both as to the purpose and benefits to allow the same laws to apply." The staff disagrees; the bulk of nonprofit corporation law is the same for all nonprofit corporations; there may be some areas where different treatment is warranted for charitable corporations, and we have attempted to identify and provide proper rules in those areas.

28/278

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

Exhibit LXVIII (white) believes Section 5242 (along with Section 5241) is too broad. "These Sections appear to give authority to even an

assistant secretary or treasurer to bind the corporation on any transaction unless the party on the other side has actual knowledge of the lack of authority." The commentator argues that the so-called "senior officials" authorized to execute corporate instruments are often low-rank staff people or people who are acting as volunteers and have minimal involvement in a charitable corporation. "I feel these Sections are overly protective of financial and commercial operations dealing with nonprofit corporations because I think at a very minimum the people dealing with a nonprofit corporation, particularly with low-rank officers, should be required to make a reasonable inquiry as to the authority of the officers signing the document to bind the institution."

Exhibit LXXI (pink) also takes the position that there should be some authorization in writing by resolution of the board for any executive officers (other than the chairman of the board or president) to enter into binding contractual relations with third parties. The reason for this position is that "some small nonprofit corporations in California have a difficult time limiting the execution of instruments by senior executive officers on behalf of the nonprofit corporation."

The staff notes that the purpose of Section 5242 is to protect the innocent third party dealing with a corporation in his reliance on the ostensible authority of persons acting on behalf of the corporation. There is more protection to the corporation in requiring the signature of certain officials, as Section 5242 does, than under existing law in which any person who gets hold of a corporate seal can give prima facie validity to a corporate instrument.

28/279

§ 5250. Required contents of articles

Exhibit LXIII (white) adds to the observations that the law should not prohibit a statement of purposes in the articles. The staff agrees with this point and has suggested in Memorandum 76-90 some language to cure the problem.

28/280

§ 5310. Control of corporate affairs by board

Exhibit LXX (white) recommends that a provision be included in the law to permit the use of the term "trustee" interchangeably with that of "director." The law does permit this; see Section 5140 ("director" means natural person designated, elected, or appointed as a director or by any other name to act in the capacity of a director). Perhaps this could be made more clear by noting in the Comment to Section 5140 that a director may be called a trustee (or Grand Wizard, or whatever) and by referring to Section 5140 in the Comment to Section 5310.

28/281

§ 5311. Number of directors

Exhibit LXIII (white) believes that the flexibility in the number of directors provided in the draft is commendable.

28/282

§ 5312. Term of directors

Exhibit LXXI (pink) suggests that the statute make clear that the term of office of directors is until the board declares a vacancy (and he might add until the director is otherwise removed from office). The staff believes it is unnecessary to specify this in the statute--the Comment can indicate that the tenure of a director is not always certain. Moreover, regardless whether the tenure of a director is truncated, the term of office is one year.

28/283

§ 5321. Election of directors

Exhibit LXXI (pink) believes subdivision (a) should read "Directors of a nonprofit corporation shall be elected by the members at a the annual meeting of members." The reason the statute does not read thus is that the annual meeting may be waived, as the Comment notes. However, the suggested change could be made without any loss of substance since the section is prefaced by the condition "unless otherwise provided in . . . the bylaws."

§ 5331. Call of meetings

Exhibits LXIII (white) and LXXI (pink) add their voices to the commentators who believe that it is inadequate to provide merely that meetings of the board may be called by the board. Exhibit LXIII suggests permitting the chairman, president, or a specified number of members of the board, say 10 percent. Exhibit LXXI would like to see meetings called by any three directors whether they hold one-tenth of the voting power or not. As indicated in Memorandum 76-90, the staff agrees with such observations and believes they should be implemented.

§ 5336. Quorum of directors

Exhibit LXXI (pink) would like a minimum quorum of one-third imposed for the board of directors. For other comments to the same effect, see Memorandum 76-90.

§ 5362. Selection of officers

Exhibit LXXI (pink) disagrees with Section 5362(b), which permits any number of corporate offices to be held by the same person. The commentator states "Small nonprofit corporations in California generally use counter signature checks and I would like to see a provision that the president and treasurer positions not be held by the same person." The staff notes that, if a nonprofit corporation desires to require its president and treasurer to be separate persons, it may do so in its bylaws.

Exhibit LXXI also suggests that no instrument of a corporation should be signed by the same person in more than one capacity. This is a point also raised by the Commission's consultant, Mr. Davis. See discussion in Memorandum 76-90 under Section 5162. Upon further consideration, the staff agrees that the suggestion offered by Exhibit LXXI is a good one and that a provision should be added such as:

§ 5244. Execution of instruments by corporate officials

5244. Any instrument required by this division to be signed

or executed by more than one officer may not be signed or executed by the same person acting in different official capacities.

Comment. Section 5244 is new. It is intended to preclude a single person from executing instruments for which the signature of several corporate officers is required. Compare Section 5362(b) (any number of offices may be held by same person).

28/287

§ 5363. Resignation of officers

Exhibit LXIII (white) points out that "The resignation should be addressed to the chief executive officer unless he is the one resigning, in which case it should go to the next officer in line." The staff has no objection to adding a new subdivision:

(c) The resignation shall be delivered to the president unless the president is resigning, in which case it shall be delivered to the chairman of the board.

28/289

§ 5380 et seq. Indemnification of corporate agents

Exhibit LXXI (pink) suggests that subdivision (a)(2) be revised to read:

(2) ~~Another~~ A foreign or another domestic nonprofit corporation . . . .

The staff agrees that this change would more precisely convey the intent of the provision.

Exhibit LXIII (white) comments:

I think the general indemnification provisions may be overly restrictive to the point of discouraging volunteer membership of leaders of the community on public boards. I think it's one thing to require strict standards with memberships on corporations where there are oftentimes direct and indirect financial benefits, but another consideration where membership is strictly voluntary for community benefit with no financial benefit to the board member. I think the rule should be less stringent for indemnification of board members on nonprofit corporations.

The staff notes that just the opposite concern has been expressed by a number of other commentators, who fear the dispersion of charitable assets in indemnifying directors for defending against their wrongdoing. See discussion in Memorandum 76-90 on this point.

§ 5385. Authority to advance expenses

Section 5385 provides for an advance of expenses by the nonprofit corporation to a corporate agent, conditioned on the requirement that the agent repay the advance unless it is ultimately determined that the agent is entitled to indemnity. Exhibit LXXI (pink) believes the word 'ultimately' should be deleted but gives no reasons. The provision in question is drawn directly from the new business corporation law.

§ 5410 et seq. Members

Exhibit LXXI (pink) observes "No place in the Code do I find the definition of 'member', and this should be provided." The staff does not know that a useful definition of 'member' could be constructed. A member is obviously a person having voting, property, or other rights or interests in the nonprofit corporation; but defining how one becomes a member, or what his rights are, is obviously impossible since this will vary from corporation to corporation and even within a corporation.

§ 5421. Options

Exhibit LXIII (white) notes that the provision for options to purchase a membership "seems to apply more to private associations than it does public charities. Perhaps some delineation would be desirable." The staff does not know precisely what the commentator has in mind. Memberships may be treated as proprietary interests where they have some value associated with them; otherwise they will not be. The staff does not know that any other delineation is necessary.

§ 5424. Membership certificates

Exhibit LXXI (pink) would like to see "non-transferable membership" printed on membership certificates where appropriate. The Commission has considered this concept before and determined not to include such a requirement on the basis that the "certificate" would really be no more

than an "identification card," and then all identification cards would be required to carry a superfluous item of information.

As a related matter, Exhibit LXII (gold) offers the following comment:

In the interest of membership disclosure, I believe all non-profit corporations should be required to furnish to all members a summary of membership rights relating to such matters as voting, transfer, redemption, liquidation, assessment, etc. Possibly this summary could be made a part of the membership certificate and such a certificate required for all memberships.

This comment has great attraction for the staff. However, the Commission has considered this before and concluded that a member has adequate opportunity to become aware of his rights before he becomes a member of a nonprofit corporation--through examination of the bylaws, corporate literature, application forms, and the like. Nonetheless, the staff believes the Commission should give serious consideration to requiring some disclosure of rights at the time of becoming a member. This would help to allay some of the concern expressed by some of the commentators over the loss of membership rights.

405/435

§ 5441. Termination of membership

Section 5441(b) requires due notice and a reasonable opportunity to be heard before a member is expelled from a nonprofit corporation. Exhibit LXIII (white) believes this provision should be limited to members having a financial interest in the nonprofit corporation:

I think this is fine for a private nonprofit corporation in which the members have financial interests, but I think it's inapplicable to a public charity that may have thousands of members.

While the staff has sympathy for this suggestion, the staff notes that no hearing is required where the expulsion is for failure to pay dues or other obligations of memberships. The staff suggests that this exception is adequate protection for charitable corporations. Where a member is to be expelled for other reasons, even if the member has only voting or other interests and no financial interest, the staff believes that an opportunity for a hearing should be provided.



§ 5442. Effect of termination of membership

Section 5442 continues existing law by providing that rights in a nonprofit corporation terminate on death or other termination of membership unless the bylaws provide otherwise. Exhibit LXII (gold) states:

In view of the proprietary nature of many membership interests in nonprofit corporations, which the proposed legislation recognizes in many respects, I do not believe membership rights should terminate upon death unless otherwise provided in the articles or bylaws. I believe the opposite should be the case, i.e., a full right to succeed to membership rights unless otherwise specified in the articles. The new liberal rules on redemption of memberships can be used to avoid succession at death problems. On that same point, what about the community interests of a husband and wife in memberships if the community dissolves by termination of the marriage or death?

There is another comment to this same effect discussed in Memorandum 76-90. The staff reiterates that the Commission pursued the idea suggested by this commentator, attempting to provide an adequate statutory scheme for redemption of memberships on death and the like. However, the logistical problems were too great, as were the problems of attempting to appraise the "value" of memberships, and the problems faced by existing corporations which would have to amend articles or bylaws to accommodate the change in law.

405/442

§ 5443. Withdrawal of members

Section 5443 permits a member of a nonprofit corporation to surrender membership upon 30 days' written notice unless the bylaws provide a procedure. Exhibit LXIII (white) states:

A 30-day written notice requirement is onerous on a member of a public nonprofit charity in which a member has no vested interest. I think a member should be entitled to withdraw at will upon written notice. This Section modifies the present rule that a member may withdraw at will or [sic] he has no vested interest or obligation.

The staff has sympathy for this point. The 30-day figure was picked arbitrarily, and the staff believes the statute would not be hurt by deleting the 30-day provision. In fact, the statute might be improved

by its deletion since the implication of its existence is that 30 days is a reasonable length of time, and a nonprofit corporation must justify any other time period it prescribes.

405/446

§ 5560. Management of charitable property

Exhibit LXX (white) adds to the opposition to imposing the standard of care of a private trustee on directors of a charitable corporation. The commentator observes that the imposition of a trustee's duty will cause a "widespread reluctance to serve--particularly in view of the fact that in serving in such capacity most of the directors are not compensated." The staff notes that case law already imposes this duty to the extent codified in the draft. See discussion in Memorandum 76-90.

The commentator notes that he is most concerned with nonprofit hospitals and suggests his problem would be resolved by exempting from a trustee's duty those entities which are exempt from the Uniform Supervision of Trustees for Charitable Purposes Act (which exempts nonprofit hospitals). An alternative suggested by the commentator is to exempt those directors who operate a business entity as the primary function of the corporation even though it be a charitable purpose under the Internal Revenue Code.

405/448

§ 5562. Institutional trustee

Exhibit LXX (white) was unable to locate the provision in the draft continuing Corporations Code Section 10204 relating to the power of the board to delegate financial and investment decision-making authority. The provision sought for is Section 5562. To aid this and other searchers for the provision, the staff plans to add to the Comments to Section 5562 and former Section 10204 notes as to the disposition of the provision.

405/449

§ 5563. Private foundations

Exhibit LXXI (pink) suggests that the wording of Section 5563 (private foundations for purposes of the Tax Reform Act of 1969) be

revised to make the duties of a nonprofit corporation permissive rather than mandatory. The staff would be very reluctant to make any such change. We have already made one error in the rephrasing of this provision (see discussion in Memorandum 76-90), and we would not want inadvertently to impose tax liability on many nonprofit corporations by fiddling with the wording. See Exhibit XXXXVIII (gold--attached to Memorandum 76-83):

The language of Section 9501.1 should be followed very closely. It should be kept in mind that this is the language upon which the Internal Revenue Service has ruled favorably and any unnecessary tinkering with it could call into question the automatic compliance ruling for the benefit of California private foundations.

405/450

§ 5573. Dividends

Exhibit LXXI (pink) notes that Section 5573 mandates by use of the word "shall" that the trustee of a common trust fund pay periodically dividends which equal the net income of the trust. The commentator believes that any ambiguity could be cleared up by the following amendment:

5573. The trustees of a common trust fund established pursuant to this article shall pay when available periodically, not less frequently than annually, ratably among the holders of shares or beneficial certificates then outstanding, dividends which shall approximately equal, in each fiscal year, the net income of the trust.

405/453

§ 5718. Additional vote required by bylaws

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), states that he is unable to understand subdivision (b). Subdivision (b) provides that, where the bylaws require member approval for some corporate action for which member approval is not required by law, all the usual rules relating to member approval (such as notice, quorum, and the like) apply in the absence of a bylaw to the contrary. The staff believes that this provision serves an important and useful function although perhaps its intent could be spelled out a little more in the Comment.

§ 5719. Action taken by policymaking committee

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), is concerned with the meaning of the phrase "only members representative of the membership." The staff has proposed some clarifying language in Memorandum 76-90. Mr. Davis offers alternative language to the effect that "all classes effected by policies to be set by the policy-making committee shall be represented on the committee." The staff is concerned that this language might be unduly restrictive.

Mr. Davis is also troubled by subdivision (c), which attempts to clarify the effect of action taken by the policymaking committee. He suggests that the Comment be expanded to explain the statutory provisions. The staff has no objection to this proposal. He also notes that he would prefer to delete subdivisions (b) and (c) and leave all to the bylaws. The staff would be opposed to this since subdivision (c), at least, is necessary to integrate the policymaking committee provisions with other provisions of the nonprofit corporation law that are phrased in terms of action by the members rather than by their representatives.

§ 5722. Voting of membership standing in name of minor

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), suggests that language be added to the statute that a minor, upon reaching majority, cannot disaffirm a vote made as a minor. The staff does not see how an implication could be read into the statute that a minor might disaffirm an earlier vote; perhaps a note in the Comment would be sufficient. Mr. Davis likewise suggests a note in the Comment to the effect that, while a minor may exercise rights in a nonprofit corporation, this does not permit him to consume alcohol. Such a note could be added.

§ 5723. Voting of membership held by corporation

Section 5723 provides that a membership held by a corporation is voted by a person designated by the corporation. The Commission's con-

sultant, Mr. Davis (Exhibit LXV--yellow), wonders how a corporation "designates" a person--does it require a board resolution or simply oral authority given to an officer from the president? "Normally, statutes provide that the President or a Vice-President may, by virtue of his office, vote the shares of another corporation on behalf of the corporation, unless the Board of Directors has provided otherwise. This seems sensible to me."

An original draft of Section 5723 provided the scheme suggested by Mr. Davis, based on the comparable provision of the new business corporation law. The Commission determined to simplify the statute by providing simply that the corporation might designate a representative. The staff believes that it would be desirable to follow Mr. Davis' suggestion and return to the original draft, if for no other reason, for uniformity with the business corporation law. If the existing language of Section 5723 is retained, the staff suggests the adoption of Mr. Davis' idea that the person is designated "by resolution of the board" in order to make clear the authority of the designee to vote the membership.

405/468

§ 5731. Execution of proxy

Section 5731 provides that the proxy of a member may be executed by the member's attorney-in-fact placing the member's name on the proxy. The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), suggests that the statute make clear that the attorney-in-fact also sign and (presumably) indicate his status as attorney-in-fact. The staff has no objection to this clarification.

405/469

§ 5732. Form of proxy

Subdivision (d) makes clear that the rules relating to the form of proxy in Section 5732 do not preclude use of a general proxy. The comparable provision of the business corporation law, enacted this session, provides:

This section shall not apply to nor preclude the use of general proxies. As used in this section, a general proxy is one where specific proposals or directors to be voted upon as candidates are not set forth.

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), questions whether subdivision (d) in effect swallows up the other limitations in the section. It may well do so; however, the staff is not inclined to eliminate subdivision (d) since it avoids the need to solicit proxies on every vote.

405/475

§ 5733. Duration of proxy

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), sees no need to change the maximum proxy duration from seven to three years. "It is again a trap to the occasional practitioner." For other views on the duration of proxies, see Memorandum 76-90.

404/672

§ 5740. Voting agreements authorized

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), makes the following statement:

Perhaps we should consider here the fact that the 1976 tax reform act now allows 15 shareholders for Subchapter-S Corporations, and unlimited expansion when the shares pass to new shareholders by virtue of inheritance. Perhaps this same principle should be incorporated here.

The staff does not feel able to comment on this point. Perhaps Mr. Davis will be able to elaborate at the meeting.

405/757

§ 5751. Number of inspectors

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), questions the reference to inspectors appointed at "another election or vote." This language refers to mail ballot or means of voting other than at a meeting that may have been adopted by the nonprofit corporation. It is obviously impractical to poll the membership by mail to

determine whether one or three inspectors are appointed so Section 5751 provides a different rule. This could be spelled out in the Comment.

405/763

§ 5762. Jurisdiction and venue

Section 5762 provides that venue in election disputes in certain cases lies in the county "in which the election was held." The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), wonders where a mail election is held--at the place from which the ballots are mailed, the place where they are received, or the place where the majority of the members vote the ballots. The staff believes that the only choice that makes sense here is the place where the votes are received, and the Commission has so provided in Section 5760. Perhaps a cross-reference to Section 5760 could be placed in Section 5762.

405/768

§ 5910 et seq. Amendment of articles

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), would like to see the provisions relating to amendment of articles moved up into the articles chapter. Historically, the reason the amendment provisions come later in the code is that amendment of the articles is an organic corporate change, like merger, consolidation, and dissolution; it also requires a larger than normal vote of the members (like the other organic changes), and special notice provisions. There are other reasons for having a separate chapter relating to amendment and having it come later in the code: (1) This parallels the structure of the business corporation law, making it easier for practitioners to locate; (2) there are too many provisions to make this an article in a chapter; (3) there is no room left in the articles chapter; and (4) it would be a major renumbering job. For a discussion of the possibility of reorganizing the statute generally, see Memorandum 76-90.

405/770

§ 5912. Extension of corporate existence

Section 5912 permits a nonprofit corporation to amend its articles to continue its existence if "it has continuously acted as a nonprofit

corporation and conducted activity as such. The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), questions the utility of this provision:

What difference does it make if the corporation has continuously operated, and how would the Secretary of State know other than in the statement filed. This kind of thing is simply a trap since practitioners will then have to make the statement, will not know for sure whether their clients have conformed and in the final analysis I do not see that it adds anything at all since they can always re-incorporate just as easily.

405/774

§ 5920. Adoption of amendments by board and members

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), asks whether it is only the voting members who are required to approve amendments of articles. The answer is yes, by virtue of Section 5712, which states that any action required by this division to be taken by the members may only be taken by the voting members. This provision is cross-referred to under the section.

405/773

§ 6014. Certificate of resolution and approval: effect as evidence

Section 6014 gives evidentiary presumptions to a certificate of a nonprofit corporation to the effect that statutory requirements have been complied with in the case of a conveyance of corporate assets. The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), suggests that one statutory requirement--notification of the Attorney General in the case of a charitable corporation--has been omitted and should be added. The staff agrees and would add a new provision to the effect that the certificate shall state that Section 6012 has been complied with, where applicable.

405/775

§ 6124. Notice to members

Section 6124 requires notice to members of the approval of an agreement of merger or consolidation. The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), argues for deletion of this provision:



[I]t is merely an additional expense to the corporation in a case in which most instances the member will have no property interests in the transaction. The member is notified at the time of the vote on the matter and is entitled by law to find out what happened by making inquiry of the officers or directors.

Mr. Davis would make the same argument for deletion of a comparable provision requiring notice of approval of division (Section 6222). Presumably the same reasoning would apply to notice of approval of conversion of a nonprofit corporation into a business corporation (Section 14806).

405/778

§ 6141. Franchise Tax Board certificate of satisfaction

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), objects to the requirement of Section 6141 that a nonprofit corporation, before it files an agreement of merger or consolidation, must file a certificate of satisfaction of the Franchise Tax Board to the effect that all taxes imposed by the Bank and Corporation Tax Law have been paid. He says, "I do not see, by definition, how a nonprofit corporation can be subject to payment of franchise taxes." He makes the same point with respect to the certificate filed in the case of a division. See Section 6241.

The staff does not see the point. It has been the staff's understanding that nonprofit corporations are subject to the Bank and Corporation Tax Law unless an exemption is obtained and even then must file informational returns. Perhaps Mr. Davis can elaborate his point at the meeting.

405/781

§ 6142. Notice to Attorney General

There has been some discussion of the need for Section 6142, requiring notice to the Attorney General in case of a merger or consolidation. See Memorandum 76-90. The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), observes, "I think this section is an excellent idea and fills a major hole in the regulatory pattern of charitable organizations."

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

Subdivision (b) of Section 6160 permits an action by a member whose rights are affected by a merger or consolidation to rescind the merger or consolidation if it would be manifestly unfair. Sections 6260(b) and 14814(b) are comparable provisions for division and conversion. The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), argues against inclusion of these provisions:

I am philosophically opposed to subsection (b) in that I feel it raises many more problems than it solves and is an open invitation to a "strike" suit by an annoyed member. It is an overprotection of members rights, which merely suggests litigation. It is fairly evident that even absent such a statute a grossly unfair transaction will still be susceptible to court review, but I do not think we should invite it. Please seriously consider omitting it.

The reason for inclusion of subdivision (b) was to provide a remedy of some sort for a dissenting member. The draft statute does not provide for dissenter's appraisal and compensation rights; the action to rescind an unfair merger is the only remedy, although limited in nature, provided by the draft statute.

§ 6220. Approval by board and members

Section 6220 requires approval by the members of a plan of division. The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), believes that it is not clear that only the approval of the voting members is required, despite the reference to Section 5712 (an action required by this division to be taken by the members may only be taken by the voting members). He suggests that specific reference be made to the voting members. The staff believes the drafting of the section could be improved in any event and suggests the following revision:

6220. (a) The plan of division shall be approved by the board of the dividing nonprofit corporation. Upon approval, the plan shall be signed by the officers as specified in Section 5174 on behalf of the dividing nonprofit corporation.

(b) The plan of division shall be approved by the members of the dividing nonprofit corporation holding a majority of the votes

entitled to be cast thereon. The approval of the members may be given either before or after the approval of the board.

405/790

§ 6248. Effect of recording plan

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), believes this is a useful section and should be included among the merger and consolidation provisions, as it is among the division provisions. The staff notes the existence of just such a provision as Mr. Davis desires in Section 14460, which is referred to in the Comment to Section 6248. Perhaps the Comment could have added to it a reference to the subject matter of Section 14460.

405/794

§ 6411. Specific powers

Exhibit LXXI (pink) states that Section 6411 grants specific powers to a nonprofit corporation which may be contrary to federal bankruptcy law and suggests language to make sure that a nonprofit corporation may only act consistent with bankruptcy law. The staff believes this is unnecessary; our bankruptcy expert, Professor Riesenfeld, has assured us that the statute is satisfactory as drafted.

405/793

§ 6412. Filing of certificates and agreements

The Commission's consultant, Mr. Davis (Exhibit LXV--yellow), suggests that a provision be added that, where a merger, consolidation, or division is effectuated pursuant to a bankruptcy reorganization, recordation of the agreement of merger or consolidation or of the plan of division evidences record ownership in the successor corporation. The staff believes that such a provision is unnecessary since Section 6248 provides this for the plan of division and Section 14460 for the agreement of merger or consolidation, as drafted. The staff will add language to the Comment to Section 6412 to the effect that these two provisions can be utilized for the desired effect.

§ 6526. Members' right to obtain fiscal information

Section 6526 permits a member who has obtained the written authorization of five percent of the membership to require the nonprofit corporation to make available financial information relating to the nonprofit corporation. Exhibit LXII (gold) believes all nonprofit corporations should be required to furnish some form of annual financial or fiscal statement to all members at no cost. "The 5% limit proposed is elitist. The cost can be handled through membership dues or assessments. Public policy should favor greater rather than less disclosure of the affairs of all corporations.

Exhibit LXIII (white) takes the opposite view. "I think the provision for members to inspect records is overly broad for public corporations in which the member has no vested interest. We have an increasing problem of strike suits by groups thinking personal gain rather than betterment of a particular organization."

§ 6720. Voluntary dissolution by members

Section 6720 permits voluntary dissolution of a nonprofit corporation by a simple majority of the membership; this continues existing law. Exhibit LXXI (pink) believes that, because of the academic and social services provided by nonprofit corporations generally, it would be in the best interest of nonprofit corporations for the vote to be three-fourths. "In this manner, a minority of members, who may wish to continue the function, purposes, and structure of the nonprofit corporation, would be able to carry on those activities without a hindrance of the majority at the time."

The staff believes that it would be unwise to preclude a nonprofit corporation from dissolving where a majority of the members wishes to dissolve; this can create nothing but problems. There is a procedure provided whereby a minority that wishes to keep the nonprofit corporation going may buy out the memberships of the majority, thereby creating a majority that wishes to continue existence. See Sections 6740-6745. The staff believes that this statutory remedy is adequate.

§ 6740. Application of article

Section 6740 makes the provisions for avoidance of dissolution by purchase of memberships inapplicable to charitable corporations. Exhibit XXXXVII (blue--Attorney General) thinks this provision is "excellent"; however, the commentator notes that some sort of notice should be given to the Attorney General where a nonprofit corporation that is not charitable but that holds charitable assets is dispersing funds to buy up memberships. "If an organization is disposing of its assets as part of or as a prelude to a plan of dissolution or otherwise disappearing, it is our view that that should be brought to the attention of the Attorney General."

The objective sought could be accomplished by adding the following subdivision to Section 6740:

(b) A nonprofit corporation that holds assets on a charitable trust shall give written notice to the Attorney General before making any payment to members pursuant to this article.

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

The staff has received some informal comments concerning subdivision (b) of Section 6772, which requires the return of corporate assets of a dissolving subordinate body to the head or national body. The comments received were unfavorable. See discussion in Memorandum 76-90. Exhibit LXIII (white) also believes that subdivision (b) should be limited:

It has been used as a club negotiating disengagement of local chapters of large national charities from a "parent" body. I think it may be illegal if applied in such a situation. I think that a volunteer group that has raised millions of dollars from local business should not be subject to forfeiture of its assets simply because it decides to disengage from the connection of a national organization.

The commentator suggests that public charities be exempted altogether, the section limited to fraternal organizations, and even there only if all members and public contributors have notice that rights and assets

contributed may be forfeited. The staff believes the provision can be deleted altogether with a note in the Comment that a head and subordinate body may prescribe their respective property rights in the charter of the subordinate body.

405/833

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

The Commission has received a number of views concerning its attempt in Section 6773 to permit disposition of charitable assets on dissolution without court decree if the nonprofit corporation and the Attorney General agree on the disposition. See Memorandum 76-90. Exhibit XXXVII (blue--Attorney General) recommended the provision and is "delighted to see that it has been added. We feel that it is an excellent provision and should make the problems of dissolutions of charitable corporations much simpler."

Respectfully submitted,

Nathaniel Sterling  
Assistant Executive Secretary