

#77

11/24/76

Memorandum 76-103

Subject: Study 77 - Nonprofit Corporations (Preliminary Part of Recommendation)

Attached to this memorandum is a redrafted version of the preliminary part of the recommendation relating to nonprofit corporations, revised to reflect the changes made by the Commission in the tentative recommendation. Also attached as Exhibit 1 (pink) is a proposed summary of the recommendation.

Please review the recommendation and summary, and mark any editorial changes you may have, to return to the staff at the December meeting. The staff will, in addition, make a review of the recommendation and summary when it completes the process of redrafting the entire statute, to assure accuracy.

Respectfully submitted,

Nathaniel Sterling  
Assistant Executive Secretary

SUMMARY OF RECOMMENDATION

The major purpose of this recommendation is to propose a new nonprofit corporation law that is independent of the business corporation law and complete in itself. The recommendation is based on the existing General Nonprofit Corporation Law and, to a large extent, represents an adaptation of the new business corporation law. One objective of the draft is to provide a simple statute applicable to all types of nonprofit corporations with a few special provisions relating to large corporations or charitable corporations where necessary. To this end, the draft is designed to give greatest flexibility to nonprofit corporations to provide by articles or bylaws the structure most appropriate for them. The recommendation also preserves existing law and validates present practices to the extent possible but also makes a number of changes in nonprofit corporation law, some of the the more significant of which are summarized below.

Formation

Many of the formalities surrounding incorporation of a nonprofit corporation serve no purpose. The incorporation process is greatly simplified.

Corporate Powers

There is some uncertainty over the extent to which a nonprofit corporation can conduct profit-making business activities. The recommendation makes clear that a nonprofit corporation may engage in business

activities to the same extent as any other corporation, subject to the limitation that any profits be applied to the corporate purposes and not distributed to members.

#### Charitable Corporations

To assist the office of the Attorney General in enforcement of its supervisory duties over charitable corporations and charitable trusts, notice requirements are imposed on charitable corporations in the case of major corporate actions.

#### Corporate Elections

In order to assure adequate membership control over management, nonprofit corporations are required to employ fair election procedures. Among the specific requirements are that members be afforded a reasonable opportunity to nominate candidates, that candidates have a reasonable opportunity to communicate with the members, and that proxies be solicited for all candidates on an equal basis.

#### Multiple Boards of Directors

Many nonprofit corporations have honorary or advisory boards or divide the corporate authority among several boards. This arrangement is validated provided that there is a single managing board having all the residual authority of the nonprofit corporation. The liability of each board is limited to the matters delegated to it.

#### Duty of Care of Directors

The duty of care of directors of a nonprofit corporation is the same as the duty of care of directors of a business corporation. The recommendation

does not attempt to codify the additional duty of care in the management of charitable assets; this matter is left to continued case development. Provision is made for delegation of investment duties to an institutional trustee. Notwithstanding the general duties of care, a director is exonerated from liability for acts reasonably necessary to effectuate the corporate purposes of a charitable corporation or the conditions of a charitable trust.

#### Officers

Existing law requires that different persons hold the offices of president and secretary. The recommendation permits any offices to be held by one person.

#### Indemnification of Corporate Agents

The rules relating to indemnification of corporate agents are liberalized in the same manner as the new business corporation law.

#### Memberships

Existing law limits memberships to one per member. The recommendation authorizes multiple memberships; it also makes clear the authority for group memberships and memberships held by nonnatural persons. Notice and an opportunity to be heard are required prior to expulsion of members. And a procedure for resignation of members is provided in the absence of a procedure adopted by the nonprofit corporation.

#### Consent to Action Without a Meeting

The number of members required for written consent to action without a meeting is reduced to a simple majority, but the requirement that the consents be solicited from all members is retained.

### Vote Required for Member Action

Existing law is unclear concerning the vote required where a vote is by mail ballot or means other than at a meeting. The recommendation makes clear that the required vote is a majority, subject to the limitation that sufficient votes are cast to equal a quorum. For major corporate actions such as merger, consolidation, disposition of all of the corporate assets, and dissolution, the two-thirds vote requirement is reduced to a simple majority.

### Proxies

The provisions of the new business corporation law relating to the required form of proxy are adapted for nonprofit corporations. The existing seven-year maximum duration for proxies is reduced to three years unless the proxy is coupled with an interest.

### Voting Agreements

Voting agreements among members of small nonprofit corporations are validated for renewable 10-year periods. Nonprofit corporations may make provisions for other types of vote-pooling arrangements.

### Corporate Finances

A member is permitted to resign membership and thereby avoid a capital improvement assessment if resignation occurs promptly. This rule would not apply to condominiums and homeowners' associations. A new financing device, known as a subvention, which in effect is a form of subordinated debt, is authorized. The liquidity and solvency requirements of the new business corporation law are imposed on nonprofit corporations as a condition to making payments to members.

### Membership Record

The record-keeping requirements are clarified; a record of members is required only to the extent any rights or interests are dependent on it. A member is given express authority to inspect his own membership record. In addition, a member authorized by five percent of the membership may inspect the membership list, provided the inspection is for a proper purpose. A nonprofit corporation may protect the confidentiality of the membership list by providing persons seeking inspection a reasonable means of communicating with the members.

### Annual Report

Existing law does not require nonprofit corporations to make annual reports. The recommendation requires an annual report unless expressly waived by the nonprofit corporation; in case of a waiver, the nonprofit corporation must supply specified financial information upon a proper demand. The information must include a report of amounts spent for indemnification of corporate agents and in transactions in which directors might have conflicts of interest.

### Inspection of Records

A nonprofit corporation is required to keep a copy of its articles and bylaws available for inspection and must supply a copy to a member upon request (making a reasonable charge for the copy). The right is granted to a member to inspect the minutes and financial records for a purpose reasonably related to his interests as a member. The provisions of the new business corporation law relating to judicial enforcement of inspection rights are extended to nonprofit corporations.

### Derivative Actions

The right of a member of a nonprofit corporation to bring a derivative action is clarified. The requirement that the plaintiff's post security is abrogated in the case of an action brought by 50 members or 10 percent of the membership.

### Merger and Consolidation

Dissenters' rights to require repurchase of memberships in the case of a merger or consolidation are not provided, since they would violate the prohibition on distribution of corporate assets to members. Instead, dissenting members may bring a prompt action to contest the validity of an unfair or inequitable agreement of merger or consolidation.

### Division and Conversion

A new statutory procedure is provided to enable a nonprofit corporation to divide into two or more separate nonprofit corporations. A procedure is also provided to enable a nonprofit corporation to convert into a business corporation, and vice versa.

### Disposition of Assets on Dissolution

Existing law requires a court order in a proceeding to which the Attorney General is a party before a nonprofit corporation may dispose of charitable assets on dissolution. The recommendation provides a procedure to enable the disposition of charitable assets without the necessity of a court order in cases where the Attorney General waives objections to the proposed disposition.

Operative Date

The operative date is deferred for one year after enactment of the statute, and existing nonprofit corporations are given an additional period of up to one year in recognition of the possible need to make article and bylaw amendments.



## BACKGROUND

The General Nonprofit Corporation Law and special provisions in the Corporations Code and other codes<sup>1</sup> authorize and regulate the incorporation and operation of nonprofit corporations. The existing scheme has developed piecemeal and, as noted recently, "historically the orphan of corporate law, nonprofit corporations [have] suffered from undefined and poorly articulated statutes governing their organization and operation."<sup>2</sup> As an example, Section 9002 of the Corporations Code provides that the general law applicable to business corporations (General Corporation Law) applies to nonprofit corporations, "except as to matters specifically otherwise provided for in [the General Nonprofit Corporation Law]." Thus, it appears that the provisions of the General Corporation Law relating to the issuance and handling of shares should apply to nonprofit corporations, however, nonprofit corporations do not distribute profits or normally even issue stock.<sup>3</sup> The situation is further confused by other statutes that incorporate the nonprofit corporation provisions by reference<sup>4</sup> and thus require reference first to the General Nonprofit Corporation Law which in turn requires reference to the General Corporation Law.

Such confusion and ambiguity could be excused or ignored except that:

In recent decades nonprofit corporation law has taken on a new importance. . . .

Nonprofit corporations are no longer confined to the traditional category of political, religious, or social endeavor but have expanded to include community theaters, hospitals, thrift shops, conservation clubs, etc. Moreover, the tax problems, the

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1. See generally Divisions 2 and 3 of Title 1 of the Corporations Code. Other provisions are scattered throughout the codes. See, e.g., Educ. Code §§ 29017, 29013 (private educational institutions); Ins. Code § 11496 (hospital corporation).
  2. Stumpf, "Preface" to California Nonprofit Corporations at v (Cal. Cont. Ed. Bar 1969).
  3. See H. Oleck, Non-Profit Corporations, Organizations, and Associations § 6 (2d ed. 1965).
  4. See Corp. Code § 12205 (provisions relating to nonprofit corporations "apply to cooperative corporations formed under this part, except where such provisions are in conflict with those of this part").

state and local laws regulating fund-raising, the effect of various activities on the tax-exempt status, the effects of reorganization or dissolution, and many other problems are complex and difficult. Because of these reasons nonprofit corporation law has recently gained a greater vitality. [Stumpf, "Preface" to California Non-profit Corporations at v (Cal. Cont. Ed. Bar 1969).]

For these reasons,<sup>5</sup> the California Law Revision Commission was authorized in 1970 to make a study to determine whether the law relating to nonprofit corporations should be revised.<sup>6</sup> The object of the study was a comprehensive revision of the law relating to nonprofit corporations.<sup>7</sup>

The need for a new nonprofit corporation law has now become acute. The enactment of a new business corporation law<sup>8</sup> and the repeal of the old general corporation law<sup>9</sup> have left nonprofit corporations governed for the most part by a repealed body of law.<sup>10</sup> The Commission's study has generated this proposal for the revision of the law relating to nonprofit corporations.

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5. See 9 Cal. L. Revision Comm'n Reports 107-108 (1969).

6. Cal. Stats. 1970, Res. Ch. 54, at 3547.

7. Such comprehensive revisions of nonprofit corporation law have been made in recent years by New York (N.Y. Not-for-Profit Corporation Law (1970)) and Pennsylvania (Pa. Nonprofit Corporation Law of 1972). See also ALI-ABA Model Nonprofit Corporation Act (1964); H. Oleck, Proposed Uniform Non-Profit Organizations Act, in Nonprofit Corporations, Organizations, and Associations 959 (3d ed. 1974); P. Cumming, Proposals for a New Not-For-Profit Corporations Law for Canada (1973). The Commission has drawn upon these sources and statutes of other jurisdictions in the course of its study.

8. Corp. Code §§ 100-2319, as added by Cal. Stats. 1975, Ch. 682, § 7 [hereinafter referred to as "new business corporation law"].

9. Corp. Code §§ 100-6804, as repealed by Cal. Stats. 1975, Ch. 682, § 6 [hereinafter referred to as "old general corporation law"].

10. Cal. Stats. 1975, Ch. 682, § 16, provides that the old general corporation law continues to govern corporations organized under other laws to the extent applicable, but the provisions of the new business corporation law relating to permissible corporate names apply to all corporations.

## PROPOSED NONPROFIT CORPORATION LAW

### GENERAL APPROACH

Nonprofit corporations generally are governed by the old general corporation law with the exception of a handful of key provisions in the General Nonprofit Corporation Law<sup>1</sup> and statutes authorizing a few corporations of a special nature.<sup>2</sup> The concept of having nonprofit corporations generally governed by a law designed primarily for business corporations has caused difficulties in practice and should be abandoned.<sup>3</sup> In place of this scheme, the Commission recommends the adoption of a complete and self-contained nonprofit corporation law (with the exception of a number of provisions of the new business corporation law that should be uniformly applicable to corporations of every sort).<sup>4</sup> The new statute should follow the new business corporation law to the extent practicable<sup>5</sup> but should be tailored to the particular needs and practices of nonprofit corporations.<sup>6</sup>

### Need for an Independent Body of Law

The old general corporation law now applies to nonprofit corporations "except as to matters specifically otherwise provided for" in the General Nonprofit Corporation Law.<sup>7</sup> Likewise, the old general corporation law is applicable by its terms to nonprofit corporations unless "there is a special provision applicable to the corporation inconsistent with some provision" of the old general corporation law.<sup>8</sup> The enactment of a new business corporation law has not affected existing nonprofit corporation law,<sup>9</sup> which depends in large part on the old general corporation law.

1. Corp. Code §§ 9000-9802.
2. See discussion under "Conforming Revisions," infra.
3. See discussion under "Need for an Independent Body of Law," infra.
4. See discussion under "Applicability of New Business Corporation Law," infra.
5. See discussion under "Organization of New Statute," infra.
6. See discussion under "Philosophy of Nonprofit Corporation Statute," infra.
7. Corp. Code § 9002.
8. Corp. Code § 119.
9. Cal. Stats. 1975, Ch. 682, § 16.

The incorporation of the old general corporation law in the General Nonprofit Corporation Law confronts a person attempting to advise nonprofit corporations with an interpretive dilemma. Since the General Nonprofit Corporation Law contains only a few basic rules, the old general corporation law must be continually consulted for additional requirements affecting the issue under consideration. Once the relevant statute is located, the question arises whether these provisions are in fact inconsistent or otherwise specifically provided for. This question is particularly troublesome where detailed requirements of the old general corporation law are covered in a general fashion by the General Nonprofit Corporation Law.

For example, various provisions of the General Nonprofit Corporation Law relate to meetings of members in a general manner but do not state whether an annual meeting is mandatory;<sup>10</sup> the old general corporation law requires an annual meeting of shareholders.<sup>11</sup> Does the business corporations annual meeting requirement apply to nonprofit corporations, or should the absence of a specific requirement in the existing General Nonprofit Corporation Law be construed as "inconsistent" or "otherwise specifically provided for"? It required an appellate case to determine that an annual meeting is required;<sup>12</sup> and even this has been interpreted by the Attorney General as applying only in the absence of a bylaw provision to the contrary.<sup>13</sup>

The statutory overlap is more than merely inconvenient for practicing attorneys. It fosters uncertainty which is particularly harmful for nonprofit corporations because usually the small investment at stake tends to preclude clarifying litigation. Lingering uncertainty encourages legitimate claims to go unanswered and rights unprotected. Such uncertainty is also inconsistent with an important advantage normally associated with corporate status--a clear and comprehensive set of legal

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10. See, e.g., Corp. Code §§ 9401, 9600.

11. Corp. Code § 2200. "Shareholders" is defined by Section 103 to include members of a nonstock corporation.

12. See *Burnett v. Banks*, 130 Cal. App.2d 631, 279 P.2d 579 (1955).

13. 56 Ops. Cal. Atty. Gen. 317 (1973).

rules that guide the administration of the nonprofit corporation's affairs and establish the rights and liabilities of the corporation and interested persons.

Perhaps a more serious defect in the general approach of incorporation by reference is the inappropriate application of many of the old general corporation law provisions to nonprofit corporations. This awkward state of affairs results because the old general corporation law is designed primarily for business corporations.<sup>14</sup> Provisions of the old law are based, for example, on the assumption that dividends will be distributed, that stocks will be transferable or have a market value, or that the shareholders will receive the corporate assets on dissolution; they simply do not work when applied to nonprofit corporations in which the distribution of dividends is prohibited,<sup>15</sup> in which the unrestricted transfer of memberships is not ordinarily permitted,<sup>16</sup> in which the memberships have no ascertainable market value, or in which assets may go on dissolution to other nonprofit corporations.<sup>17</sup>

The Law Revision Commission recommends that the existing scheme be discontinued. In its place, a new independent and self-contained nonprofit corporation law should be enacted.<sup>18</sup> This will enable persons dealing with nonprofit corporations to have available a law that is certain in its scope and application and that deals with nonprofit corporation problems in a rational manner.

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14. This is also true of the new business corporation law, which by its terms is applicable only to business corporations and makes no endeavor to specifically bring nonprofit corporations within its scope or to generalize its provisions to cover nonprofit corporations where there is no reason to treat them differently from business corporations. See Corp. Code § 102.

15. Corp. Code § 9200.

16. Corp. Code § 9609 (bylaws may permit transfer).

17. Corp. Code § 9801 (charitable corporations).

18. A number of provisions of the new business corporation law, not relating to the internal operations of the nonprofit corporation, should be incorporated by specific reference with appropriate modification where necessary. The provisions to be incorporated by reference are ones that should be uniformly applicable to all corporations. See discussion under "Applicability of New Business Corporation Law," infra.

### Organization of New Statute

The proposed nonprofit corporation law follows generally the structure, organization, and where appropriate, the substance of the provisions of the new business corporation law. Attorneys and other persons who deal with both business corporations and nonprofit corporations will thus be able to work comfortably with both new laws. For clarity and ease of use, the proposed nonprofit corporation law shortens and simplifies many of the provisions of the new business corporation law.<sup>19</sup>

### Philosophy of New Statute

Throughout the proposed legislation run several major themes. These themes, some of which are related and some of which on occasion conflict, are outlined below.

No change should be made in existing law unless there is a demonstrable need for change. This principle will avoid unnecessary disruption in the ongoing activities of established organizations.

As a corollary of this rule, existing practice (whether or not recognized by existing law) should be accommodated in the new statute to the extent practicable. The practices that have developed where there is a need for them should be validated wherever possible.

The substance of the new business corporation law should be followed as closely as possible with adaptations necessary for the character of nonprofit corporations. There are obvious advantages to parallelism between business and nonprofit corporation laws. Persons dealing

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19. The policy of short, clear, and concise sections, initiated by the California Code Commission in its preparation of the Corporations Code in 1947, has been followed in the proposed nonprofit corporation law. The reasons for this policy have been stated as follows:

In this Code, as in other codes prepared by the [Code Commission], long sections have been divided into several short sections wherever feasible. This practice facilitates reference to particular provisions, further, when amendments are proposed, and the entire text of the section amended must be set forth in the legislative act in compliance with the republication requirement of the Constitution, the use of short sections not only minimizes the chance of unintentional change in the law through unnoticed printing errors, but also

with both types of corporations will be able to turn with facility from one law to the other; to the extent the two types of corporations are the same, they will be treated uniformly; experience and cases developed under one law may, in appropriate cases, be useful in construing the meaning of the other law.

The nonprofit corporation law should be constructed with sufficient flexibility to enable the wide variety of types of nonprofit corporations to operate efficiently within its parameters. This requires that the statute be sufficiently broad to cover the many different types of nonprofit corporations and the variety of circumstances under which they operate. To accomplish this objective, the law should be a basic organizational framework within which a nonprofit corporation may provide the structure most appropriate to it. This will avoid the need for detailed regulatory statutes for different types of nonprofit corporations. This approach also makes it unnecessary to propose provisions comparable to the close corporation provisions of the new business corporation law.

The degree of regulation imposed on nonprofit corporations should be minimal except in those cases where protection of the public or of basic member or creditor rights is of particular importance. The General Nonprofit Corporation Law imposes few regulations on nonprofit corporations. As a general rule, there is less need for strict statutory prescription of the manner of operation of internal corporate affairs of nonprofit corporations than of business corporations. Because memberships in most nonprofit corporations are not freely transferable, members ordinarily have the opportunity to be informed of their rights before joining. Because there is little financial motive for domination by management in most nonprofit corporations, members normally have sufficient control of corporate affairs.

Moreover, as a practical matter, many nonprofit corporations are substantially regulated by the tax laws. Nonprofit corporations which

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effects a substantial savings to the state in cost of typesetting, proof-reading, etc.

I. H. Ballantine & G. Sterling, California Corporation Laws § 13, at 10 (4th ed. 1976) (footnote omitted). See also Rule 8, Joint Rules of the Senate and Assembly, California Legislature.

depart too far from the basic purposes of the nonprofit corporation law in issuing memberships will be subject to regulation by the corporate securities laws. Charitable corporations are subject to the supervision of the Attorney General.

The Commission proposes no changes in the tax laws, corporate securities laws, or laws governing supervision of charitable trusts; these regulatory provisions embody policies that the Commission has not undertaken to review. The absence of recommendations by the Commission in these areas does not reflect a position that no change is needed in them. The Commission believes that a separate study, apart from the present project, is required.

The most important nonprofit corporation regulations proposed by the Commission concern the relation between the corporation and outsiders: regulation of the dissipation of corporate assets for the protection of creditors and regulation of charitable corporations for the benefit of the public. As to internal affairs, basic protections of members' voting rights, control of the board of directors, and rights of inspection are proposed to assure adequate limitations on management.

The nonprofit corporation law should provide a rule to cover the most commonly occurring internal situations absent an applicable provision in the articles or bylaws. This will eliminate the uncertainty that occurs when a nonprofit corporation fails to adopt a rule covering a basic matter. It will provide a guideline for normal practice yet still enable the nonprofit corporation to construct in its bylaws the type of organization desired.

#### FORMATION

The formation of nonprofit corporations under existing law is steeped in formalities. The formation of a nonprofit corporation requires three or more incorporators<sup>1</sup>; the articles must be signed and acknowledged by the initial directors and other persons desiring to associate in the formation of the nonprofit corporation<sup>2</sup>; the articles must be filed in the county in which the nonprofit corporation has its

1. Corp. Code § 9200.

2. Corp. Code § 9304.



principal office and in each county in which it acquires real property, as well as with the Secretary of State<sup>3</sup>, the articles must include the "specific and primary purposes" for which the nonprofit corporation is formed, the county where its principal office is located, and the names and addresses of three or more initial directors.<sup>4</sup>

These formalities serve no useful function for nonprofit corporations while complicating the incorporation process. Under the proposed law, a nonprofit corporation may be formed simply by one or more initial directors signing and filing articles with the Secretary of State.<sup>5</sup> The articles themselves need set forth only the name of the nonprofit corporation, with the name and address of at least one initial director, and a statement that it is organized under the nonprofit corporation law and may not distribute gains, profits, or dividends to members.<sup>6</sup>

In order to provide interested parties the opportunity to discover and reach persons involved in the nonprofit corporation, the proposed law requires the nonprofit corporation, within 90 days after incorporation, to file with the Secretary of State a statement listing the name and address of its principal executive officer and of either of its secretary or chief financial officer, the street address of its office, and its agent for service of process.<sup>7</sup>

In the case of a nonprofit corporation organized for charitable purposes, the proposed law would require the corporation to state in the articles that it is organized for charitable purposes and is subject to all provisions governing charitable corporations and, upon filing the articles, to send a copy to the Attorney General. This will assist the office of the Attorney General in performance of its supervisory duties over charitable corporations.

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3. Corp. Code § 9304.5.

4. Corp. Code § 9300.

5. The new business corporation law also simplifies the execution and filing requirements. See Corp. Code § 200.

6. The new business corporation law also simplifies the contents of the articles. See Corp. Code § 202.

7. This requirement is comparable to a provision of the new business corporation law. For a more full discussion, see "Applicability of New Business Corporation Law," infra.

8. See Corp. Code § 9505.

## CORPORATE POWERS

Under existing law, unless a nonprofit corporation limits its corporate powers, it generally has the necessary power and authority to administer its affairs and attain its purposes.<sup>1</sup> A self-imposed limitation in the articles is binding internally on the nonprofit corporation, and a member or the state may raise the limitation in a proceeding to enjoin ultra vires acts of the nonprofit corporation except where third parties have acquired rights thereby.<sup>2</sup>

In the case of a charitable corporation,<sup>2a</sup> however, the law should be changed to permit a limitation on the corporation's powers to be raised whether or not third parties have acquired rights thereby.<sup>3</sup> In such a case, the performance of an ultra vires contract of a charitable corporation should be enjoined only if all the parties to the contract are parties to the action and it is equitable to do so. This change in existing law will protect the public against dissipation of corporate assets through ultra vires acts of a charitable corporation and should be enforceable by a director, the Attorney General, or a person having a right of visitation.

Among the existing statutory powers of nonprofit corporations is the power to "[carry] on a business at a profit as an incident to the main purposes of the corporation."<sup>4</sup> Case law authorizes a nonprofit corporation to carry on a business for profit, however, whether or not the business is "incident" to its main purposes.<sup>5</sup> The case law should be codified, subject to the limitation that any gain or profit may be

1. Corp. Code § 501.
2. Corp. Code § 303 (old general corporation law). This provision is applicable to nonprofit corporations through Section 9002. See, e.g., Osteopathic Physicians & Surgeons v. California Medical Ass'n, 224 Cal. App.2d 378, 36 Cal. Rptr. 641 (1964).
- 2a. As used herein, "charitable corporation" means a nonprofit corporation that is organized for charitable purposes or holds assets on charitable trust.
3. This recommendation is comparable to ALI-ABA Model Nonprofit Corporation Act § 6(a).
4. Corp. Code § 9200.
5. See People ex rel. Groman v. Sinai Temple, 20 Cal. App.3d 614, 99 Cal. Rptr. 503 (1971).

## DIRECTORS

### Number and Term of Directors

Existing law requires a minimum of three directors of a nonprofit corporation.<sup>1</sup> This rule is sound except where the nonprofit corporation has fewer than three members; in such a case, fewer than three directors should be permitted.<sup>2</sup>

Existing law permits a nonprofit corporation to have a variable number of directors, with a minimum of not less than five and a maximum that does not exceed the stated minimum by more than three.<sup>3</sup> The permissible limits of variation should be expanded, with a lower minimum and the maximum of not more than twice the minimum minus one.<sup>4</sup>

Under existing law, the term of directors may be specified in the articles or bylaws.<sup>5</sup> Absent a specification in the articles or bylaws, the term of directors is one year.<sup>6</sup> The nonprofit corporation law should provide that the term is one year and until successors are elected and take office, absent a contrary provision in the articles or bylaws.

In order to assure member control over the board, a bylaw relating to the number of directors, or a bylaw affecting the term of directors, should be adopted, amended, or repealed only by the members. Existing law limits such protection to changes in the number of directors.<sup>6a</sup>

### Selection of Directors

In order to ensure members an adequate opportunity to participate in corporate management and control, a nonprofit corporation should be required to provide a reasonable means for nominating persons for elec-

1. Corp. Code §§ 9300(e) and 9500.
2. The new business corporation law makes a comparable change. See Corp. Code § 212(a).
3. Corp. Code § 9300(e).
4. The new business corporation law makes a comparable change. See Corp. Code § 212(a).
5. Corp. Code §§ 9302 and 9401(c).
6. See 56 Ops. Cal. Atty. Gen. 317 (1973).
- 6a. Corp. Code § 9400(c).

applied only to the corporate purposes and may not be distributed as gains, profits, or dividends to members. This proposal will allow a nonprofit corporation to generate income for its legitimate purposes; it also recognizes existing practice of both nonprofit corporations generally and charitable corporations in particular to engage in business activity in support of their corporate purposes. The taxability of income generated by business activities of nonprofit corporations is a separate matter with which the Commission has not dealt.

The most significant limitation on the powers of nonprofit corporations under existing law is the prohibition on distribution of gains, profits, or dividends to members.<sup>6</sup> This limitation is central to the character of nonprofit corporations and should be retained. However, the proposed statute makes clear that a nonprofit corporation may pay compensation to members for services rendered, pay debts and other obligations owed to members, purchase memberships, and confer services or other benefits on members in conformity with the purposes for which it is formed. Existing authority to distribute corporate assets (with the exception of charitable property) to members upon dissolution should be retained.<sup>7</sup>

Creditors and other members should be authorized by statute to bring an action in the name of the nonprofit corporation to recover an improper distribution to members.<sup>8</sup> Likewise, any director who authorizes the improper distribution should be liable to the nonprofit corporation for the amount improperly distributed upon action in the name of the nonprofit corporation by creditors or members.<sup>9</sup>

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6. Corp. Code § 9200.

7. Corp. Code § 9200. See discussion under "Voluntary and involuntary dissolution," infra.

8. This recommendation is comparable to a provision of the new business corporation law. See Corp. Code § 506.

9. This recommendation continues existing law. See Corp. Code §§ 823-829 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

tion as director of a nonprofit corporation and a reasonable means for nominees to communicate with the membership. Likewise, all nominees should be permitted to solicit proxies on an equal basis. The Commission recommends no specific standards for what constitutes "reasonable means" of nomination and communication; the standard may differ from corporation to corporation depending on its character, size, purposes, and the like. The existence of a statutory right to a reasonable means for nominating and communicating, however, will grant to a person seeking to test the nomination and election procedures a statutory basis which a court may rely on without having to invoke equitable or common law inherent authority.

Although the articles or bylaws may provide the manner of selection of directors,<sup>7</sup> the nonprofit corporation law should make clear that, absent a provision in the articles or bylaws, the selection is to be by election of the voting members at a meeting of the members.<sup>8</sup>

Cumulative voting in an election of directors of nonprofit corporations is not permitted unless the corporation provides for it.<sup>9</sup> This is the rule for nonprofit corporations in nearly all jurisdictions,<sup>9a</sup> and, in California, very few nonprofit corporations provide for cumulative voting. The existing law has worked well for many years with no problems. There are significant differences in the manner of selection of directors of nonprofit corporations and of business corporations (in which cumulative voting is required).<sup>9b</sup> Nonprofit corporations may select directors by appointment or by a means other than election. Directors may be elected or otherwise selected by geographic, functional, interest, or other special group selection process. Even where elected by the members generally, the directors are often not all

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7. Corp. Code §§ 9302 and 9401(a).

8. This is comparable to the normal rule for business corporations provided in the new business corporation law. See Corp. Code § 301(a).

9. Corp. Code §§ 9402(d) and 9601.

9a. See, e.g., New York Not-for-Profit Corporation Law § 617; see discussion in H. Cleck, Non-Profit Corporations, Organizations, and Associations § 168 (3d ed. 1974).

9b. Corp. Code § 703(a).

elected annually. Moreover, mail ballot and other voting techniques may make cumulative voting impractical. For these reasons, the Commission recommends no change in existing law relating to cumulative voting.

#### Multiple Boards of Directors

It is the practice of some nonprofit corporations--particularly charitable corporations--to have two or more independent boards of directors with separate authority, functions, or manner of selection. This practice should be statutorily recognized by adoption of a provision permitting multiple boards if (1) the articles or bylaws provide for them, (2) the manner of selection and authority of each board is specified, and (3) one board is designated to have all residual authority of the nonprofit corporation. All rules and liabilities applicable to corporate directors generally will apply to directors on such boards, and individual board members will be liable only for matters delegated to them. This will facilitate the practice in some nonprofit corporations of having honorary or advisory boards.

#### Committees of the Board; Advisory Committees

A nonprofit corporation may provide under existing law for the appointment and authority of executive or other committees of the board.<sup>10</sup> The new business corporation law establishes some detail concerning committees of the board, including provisions that:

(1) A committee consists of two or more directors designated by the board and serving at the pleasure of the board.

(2) The board may designate alternate committee members.

(3) The committee has all the authority of the board delegated to it, with the exception of authority with respect to certain fundamental actions which is reserved for the board as a whole.<sup>11</sup>

The Commission recommends the adoption for nonprofit corporations of this procedural detail applicable to committees. However, the proposed statute also makes clear that the articles or bylaws may specify that particular directors are to be members of particular committees. This will accommodate those nonprofit corporations whose committees are

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10. See Corp. Code § 9401(d).

11. See Corp. Code § 311.

filled by geographic, functional, interest, or other special group selection process.

The nonprofit corporation law should also recognize the practice of many nonprofit corporations to have advisory committees, often composed of persons other than directors or members, and who may be selected by persons or organizations other than directors or members. These advisory committees, however, are not empowered to exercise the corporate authority.

#### Meetings of Directors

Under existing law, the articles or bylaws of a nonprofit corporation generally govern the meetings of directors.<sup>12</sup> This basic provision should be retained, with the adoption of specific rules governing meetings of directors absent a provision in the articles or bylaws. In the interest of uniformity, the specific rules should parallel those of the new business corporation law<sup>13</sup> with two exceptions:

(1) Quorum of directors. The new business corporation law imposes minimum quorum requirements for directors;<sup>16</sup> the General Nonprofit Corporation Law permits any quorum set by the nonprofit corporation.<sup>17</sup> The greater flexibility of the General Nonprofit Corporation Law is necessary for nonprofit corporations whose directors may be persons performing a public service and often unable to attend meetings; the existing law should be retained.

(2) Acts of the board. The new business corporation law permits the corporation to require a greater than majority vote of the directors for approval of an action, but only by a provision in the articles.<sup>18</sup> A nonprofit corporation should be permitted to prescribe a greater vote in the bylaws as well. This is consistent with the general policy of

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12. See Corp. Code §§ 9401(a)-(b); 9503.

13. See Corp. Code § 307.

14. [omitted]

15. [omitted]

16. See Corp. Code § 307(a)(7).

17. See Corp. Code § 9401(b).

18. See Corp. Code § 204(a).

flexibility and the general authority for nonprofit corporations to control voting requirements in the bylaws; it will continue existing law.<sup>19</sup>

#### Provisional Directors

Existing law permits the appointment of a provisional director of a nonprofit corporation upon petition of one-third of the members in cases where there is an even number of directors and the directors are deadlocked.<sup>20</sup> A few minor changes in existing law are appropriate for nonprofit corporations:

(1) The appointment provisions should apply whether or not there is an even number of authorized directors where, for adequate reason, there is no working majority.

(2) The lesser of 50 voting members or members holding 10 percent of the voting power should be authorized to petition for a provisional director. This lowers what would be an impractically high percentage for many nonprofit corporations and is consistent with other provisions of the proposed nonprofit corporation law requiring a given number of members to initiate actions.

(3) A provisional director should not be appointed if it is shown that a majority of the members oppose the appointment.

#### Directors' Duty of Care

The new business corporation law imposes a general duty of care on directors of business corporations that is flexible and exempts a person who meets the standard of care from liability resulting from being or having been a director.<sup>21</sup> Nonprofit corporations need to attract capable persons to serve as directors, often without monetary

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19. See Corp. Code § 317 (old general corporation law), applicable to nonprofit corporations through Section 9002.

20. See Corp. Code § 819 (old general corporation law), applicable to nonprofit corporations through Section 9002. Cal. Stats. 1976, Ch. 641, § 9, added the authority to appoint a provisional director in cases where the shareholders are deadlocked. The Commission believes that this solution is inappropriate for nonprofit corporations; if the members of a nonprofit corporation are deadlocked, dissolution or division is the appropriate solution.

21. See Corp. Code § 309; Report of the Assembly Select Committee on the Revision of the Corporations Code 43 (1975).



reward. Nonprofit corporations vary widely in size and type. It is, therefore, particularly important to have a flexible duty of care which, if satisfied, immunizes directors from liability. For these reasons, the Commission recommends that the duty of care for directors of nonprofit corporations be measured by the same flexible standard applicable to directors of business corporations.<sup>21a</sup>

Where the director of a nonprofit corporation has a conflict of interest in a contract or transaction of the nonprofit corporation because of a common directorship or a financial interest, existing law provides several independent procedures for validating the contract or transaction.<sup>22</sup> The new business corporation law makes a number of changes in this scheme, including addition of a provision for validating those contracts in which a director has a "material" financial interest.<sup>23</sup> In the interest of uniformity, the Commission recommends that these provisions of the new business corporation law be followed in the proposed nonprofit corporation law.

Under existing law, a nonprofit corporation cannot make loans to directors or officers without the approval of the members.<sup>24</sup> The new business corporation law makes a number of alterations in these loan provisions, including the addition of authority to make loans pursuant to an employee benefit plan approved by the shareholders and to make travel advances without further approval of the shareholders.<sup>25</sup> Under the new business corporation law, a director who approves a loan in violation of the prohibitions is liable to the corporation in an action in the name of the corporation brought by shareholders or creditors.<sup>26</sup> In the interest of uniformity, the Commission recommends that these

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21a. This does not affect the applicable law relating to charitable corporations. See discussion under "Charitable Property," infra.

22. See Corp. Code § 320 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

23. See Corp. Code § 310.

24. See Corp. Code § 323 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

25. See Corp. Code § 315.

26. See Corp. Code § 316.

provisions of the new business corporation law be followed in the proposed nonprofit corporation law.

#### OFFICERS

Under existing law, a nonprofit corporation must have a president, vice president, secretary, and treasurer; any two or more offices may be held by the same person except those of president and secretary.<sup>1</sup> The new business corporation law requires either a chairman of the board or a president as chief executive officer and permits one person to be both president and secretary.<sup>2</sup> In the interest of uniformity, the Commission recommends that the scheme of the new business corporation law be followed.

The new business corporation law also specifies that an officer may resign at any time subject to the rights of the corporation under a contract of employment.<sup>3</sup> The Commission believes this is a useful provision for nonprofit corporations except that, to assure a nonprofit corporation an adequate opportunity to obtain a replacement for the resigning officer, resignation should be subject to any notice period (not exceeding 30 days) provided in the articles or bylaws.

#### EXECUTION OF CORPORATE INSTRUMENTS

Existing law establishes a presumption of valid execution for instruments to which the corporate seal has been affixed.<sup>1</sup> The Commission recommends that this presumption be abolished; failure to affix a corporate seal should not affect the validity of a written instrument.<sup>2</sup> More significant protection of parties dealing with a nonprofit corporation can be provided by enacting statutes, patterned after the provisions of the new business corporation law, that allow reliance upon the

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1. See Corp. Code § 821 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

2. See Corp. Code § 312(a).

3. See Corp. Code § 312(b).

1. Corp. Code § 333 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

2. This is the approach of the new General Corporation Law. See Corp. Code § 207(a).

authority of specified senior executive officers to execute any instrument on behalf of the nonprofit corporation.<sup>3</sup> While this guarantee of valid execution requires involvement of senior officers of the nonprofit corporation, it grants commensurately greater assurance to third parties than the rebuttable presumption created under existing law by use of the seal. To avoid the need for unnecessary proof that the instrument was actually signed by the officers whose purported signatures it bears, a presumption that it was signed by such officers should be created. This presumption should be one affecting the burden of producing evidence.

#### INDEMNIFICATION OF CORPORATE AGENTS

Existing law restricts the circumstances under which a nonprofit corporation may indemnify a director, officer, or employee for his expenses incurred in defending an action against him in his capacity as a corporate agent.<sup>1</sup> The practical effect of these provisions may be to force an official or employee of the nonprofit corporation who is a defendant in an action to enter into a settlement regardless of the merit of the claim.<sup>2</sup>

The new business corporation law substantially liberalizes the conditions under which corporate agents may be indemnified.<sup>3</sup> Comparable provisions should be applied to nonprofit corporations. This will provide sufficient flexibility to afford reasonable protection for directors and officers while imposing safeguards that adequately protect the corporation, its members, and the public.

#### MEMBERS

##### Multiple Memberships

Under the General Nonprofit Corporation Law, a nonprofit corporation may have such memberships and classes of membership as the articles or bylaws provide, with the classes having differing rights, privileges,

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3. See Corp. Code § 313.

1. See Corp. Code § 830 (old general corporation law), applicable to nonprofit corporations through Section 9002.

2. See Report of the Assembly Select Committee on the Revision of the Corporations Code 61 (1975).

3. See Corp. Code § 317.

and interests.<sup>1</sup> No person may hold more than one membership,<sup>2</sup> but this limitation may be rendered ineffectual by the creation of classes with voting rights proportionate to contributions made to the nonprofit corporation.<sup>3</sup> Moreover, multiple memberships may be appropriate in some nonprofit corporations, as where memberships and membership rights and obligations are based upon the ownership of subdivision lots or condominium units, where members are encouraged to acquire additional memberships of higher classes, or where membership classes are based on specified qualifications (as in a trade association) and a person may satisfy the qualifications for several classes. For these reasons, the Commission recommends that a person be permitted to hold more than one membership in a nonprofit corporation unless the articles or bylaws preclude it.

The General Nonprofit Corporation Law does not provide specific rules concerning joint and fractional memberships or memberships held in the name of groups and corporations.<sup>4</sup> Such memberships should be permitted unless the articles or bylaws preclude it.

#### Membership Certificates

Under existing law, membership in a nonprofit corporation may be evidenced by a certificate, in which case the certificate must state that the corporation is not one for profit.<sup>5</sup> The apparent reason for this statement on the certificate is to avoid the possibility of confusion with a stock certificate. The requirement of the statement is unduly broad and should be limited to those cases where the certificate is transferable and represents a property interest in the nonprofit corporation. The Commission further recommends that membership certificates be subject to recall and exchange, where appropriate, in generally the same manner as share certificates under the new business corporation

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1. See Corp. Code §§ 9402(b), 9602.

2. See Corp. Code § 9602.

3. Erickson v. Gospel Foundation of California, 43 Cal.2d 581, 275 P.2d 474 (1954).

4. See Corp. Code §§ 9402, 9601, and 9602.

5. See Corp. Code § 9607.

law.<sup>6</sup>

The Commission has considered proposals to expand the requirement of information on the membership certificate to include a statement of members' rights and interests. Such a disclosure provision is not recommended here. If necessary, it could be done more appropriately in the context of the Corporate Securities Law with general disclosure and qualification requirements.

#### Options to Purchase Memberships

Under existing law, nonprofit corporations are authorized to issue options for the purchase of memberships.<sup>7</sup> As with memberships, options should be nontransferable unless the articles or bylaws provide otherwise.

#### Consideration for Memberships

Existing law limits the types of consideration for which memberships may be issued.<sup>8</sup> The new business corporation law further narrows what constitutes acceptable consideration for the issuance of stock,<sup>9</sup> with the intent of providing for the "general protection of creditors and shareholders."<sup>10</sup> Nonprofit corporations need greater flexibility. To provide this flexibility, a nonprofit corporation should be allowed to determine (or provide the method of determining) in its articles or bylaws the acceptable consideration for the issuance of its memberships, subject to the requirement that no fraud be involved.

#### Redemption of Memberships

Both the old general corporation law<sup>11</sup> and the new business cor-

6. See Corp. Code § 422.

7. See Corp. Code §§ 1103, 1104 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

8. See Corp. Code § 1109 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

9. See Corp. Code § 409(a).

10. Report of the Assembly Select Committee on Revision of the Corporations Code 67 (1975).

11. Corp. Code §§ 1100, 1101.

poration law<sup>12</sup> authorize a business corporation to issue redeemable shares as long as the shareholder does not have the option to compel redemption. It is unclear whether nonprofit corporations may issue redeemable memberships subject to these rules.<sup>13</sup> However, provisions comparable to those of the new business corporation law are appropriate for nonprofit corporations and should be included in the proposed nonprofit corporation law.

#### Record Date for Determining Members' Rights

The authority of a nonprofit corporation to set a record date for determining the voting and other rights of members is provided by existing law, as are the rules for determining the record date where that authority is not exercised.<sup>14</sup> The new business corporation law adds provisions for business corporations for the record date of an adjourned shareholders' meeting and changes somewhat the time of the record date where none is selected by a business corporation.<sup>15</sup> In the interest of uniformity, the same rules should be adopted for nonprofit corporations except that the record date for notice of or voting at a meeting where no date is fixed by the board should be 10 days, rather than one day, prior to the meeting.

#### Transfer and Termination of Memberships

Under the General Nonprofit Corporation Law, a membership is transferable only pursuant to the articles or bylaws.<sup>16</sup> If the articles or bylaws so provide, they should also be authorized to state that a transfer is not binding on the nonprofit corporation until notice is actually

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12. Corp. Code § 402. Section 402 is intended "to clarify and increase the flexibility" of existing law. Report of the Assembly Select Committee on Revision of the Corporations Code 64 (1975).

13. Section 9002 of the Corporations Code provides that the provisions of the old general corporation law (including Sections 1100 and 1101) apply to nonprofit corporations unless specifically otherwise provided. Because Section 1100, by its own terms, is expressly applicable only to "stock corporations," the effect of Section 9002 in this case is unclear.

14. See Corp. Code §§ 2214, 2215 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

15. See Corp. Code § 701.

16. See Corp. Code § 9609.

received in a specified manner. This will enable the nonprofit corporation to maintain accurate records.

California courts have long required minimal due process for expulsion of members from nonprofit organizations.<sup>17</sup> This general principle should be codified in the nonprofit corporation law.<sup>18</sup> The courts have also required that nonprofit corporations provide members a reasonable procedure for resignation from the corporation.<sup>19</sup> The Commission recommends that, absent a procedure specified in the articles or bylaws, members be given the right to resign membership upon written notice to the nonprofit corporation. Resignation will terminate future rights and obligations of membership but not liability for prior obligations.

Under existing law, unless the articles or bylaws provide otherwise, death terminates all rights of a member in a nonprofit corporation or in its property.<sup>20</sup> Because this rule may be unduly harsh where the membership represents a substantial property interest, the Commission considered several alternative provisions regarding the effect of the death of a member. However, these provisions, while protecting the heirs of deceased members, would create additional problems that outweigh their benefits.<sup>21</sup> The Commission, therefore, recommends the

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17. See, e.g., *Cason v. Glass Bottle Blowers Ass'n*, 37 Cal.2d 134, 231 P.2d 6 (1951); *Otto v. Tailors' P. & B. Union*, 75 Cal. 308 (1888); *Taboada v. Sociedad Espanola, etc.*, 191 Cal. 187, 215 P. 673 (1923).

18. Termination of membership for nonpayment of dues or other proper financial burdens of membership normally requires only reasonable notice in order to meet due process standards, with no requirement of an opportunity to be heard. *DeMille v. American Fed'n of Radio Artists*, 31 Cal.2d 139, 187 P.2d 769, cert. denied, 333 U.S. 876 (1947).

19. See *Haynes v. Annandale Golf Club*, 4 Cal.2d 28, 47 P.2d 470 (1935).

20. See Corp. Code § 9603.

21. The chief problems are: (1) the difficulty of defining what type or magnitude of property interest should be protected; (2) the determination of the identity and the status of the deceased member's heirs during the period prior to dissolution of the nonprofit corporation (when the property interest would normally be realized); (3) the possible unfairness to other members and violation of the principle prohibiting distributions to members before dissolution inherent in any proposal that involves the forced purchase of the membership by the nonprofit corporation; (4) the difficulty of determining the value of the interest of the deceased member; and (5) the problem that might be created for the nonprofit corporation in raising the funds to pay the deceased member's heirs.

continuation of existing law, which leaves to the nonprofit corporation the authority to provide such protection in its articles or bylaws, if desired.

## MEMBERS' MEETINGS AND CONSENTS

### Annual Meeting

A nonprofit corporation is required by existing law to hold an annual meeting of members unless the bylaws provide otherwise.<sup>1</sup> This rule should be continued. The new business corporation law permits the bylaws to set the time and place of the annual meeting and provides a procedure for the members to obtain a court order requiring the corporation to hold the annual meeting where it has failed to do so.<sup>2</sup> These provisions are sound and should be applied to nonprofit corporations with the inclusion of the existing statutory meeting time if the bylaws fail to specify one.

### Special Meetings

The General Nonprofit Corporation Law provides that a special meeting of a nonprofit corporation may be called by the directors or by members holding one-tenth of the voting power.<sup>3</sup> The new business corporation law authorizes the chairman of the board and the president to call a special meeting as well.<sup>4</sup> The new nonprofit corporation law should include this additional authority.

### Quorum

Under the General Nonprofit Corporation Law, the bylaws may provide that a quorum at a meeting of members is greater or less than a majority.<sup>5</sup> The proposed nonprofit corporation law should make clear that, absent a provision in the articles or bylaws, a quorum is a majority of

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1. See Corp. Code § 2200 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002; Corp. Code § 9401(a); *Burnett v. Banks*, 130 Cal. App.2d 631, 279 P.2d 579 (1955).
  2. See Corp. Code § 600.
  3. See Corp. Code § 5600.
  4. See Corp. Code § 600(d).
  5. See Corp. Code § 9401(b).



the votes entitled to be cast at the meeting.<sup>6</sup> If a quorum is initially present, the meeting should be permitted to continue, provided any action taken is by a majority of the number required to constitute a quorum.<sup>7</sup>

#### Notice of Meetings

A nonprofit corporation may, under the General Nonprofit Corporation Law, specify the manner of giving notice of meetings of members and may dispense with notice of all regular members' meetings.<sup>8</sup> This rule is appropriate in view of the variety of types of nonprofit corporations; however, the Commission recommends that the broad authority to regulate notice of meetings be subject to a general requirement of reasonableness in order to assure adequate notice.<sup>9</sup> Absent a reasonable provision by the nonprofit corporation, the time and contents, manner of giving, and persons to whom notice is given should be the same as required in the new business corporation law.<sup>10</sup> The new business corporation law makes several improvements in the existing procedure<sup>11</sup> for validation of defectively noticed meetings, which should be adopted for use by nonprofit corporations.<sup>12</sup>

#### Consents

Existing law permits an action that may be taken at a meeting of

6. The new business corporation law quorum requirement is a majority of the shares entitled to vote except as varied in the articles. See Corp. Code § 602(a).
7. This is comparable to a provision of the new business corporation law. See Corp. Code § 602(b).
8. See Corp. Code § 9401(a).
9. The bylaws should not be permitted, however, to waive notice of certain fundamental corporate actions to be taken at a meeting. These actions include approval of a contract or transaction in which a director has a conflict of interest, amendment of the articles, sale or other disposition of all or substantially all of the corporate assets, merger, consolidation, division, conversion, voluntary dissolution, and approval of a plan of distribution on dissolution. This is comparable to a provision of the new business corporation law. See Corp. Code § 601(f).
10. Cf. Corp. Code § 601.
11. See Corp. Code §§ 2209, 2210 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.
12. See Corp. Code § 601(e). For an analysis of the changes, see Report of the Assembly Select Committee on Revision of the Corporations Code 80-81 (1975).

members to be taken instead by unanimous written consent of the members.<sup>13</sup> The new business corporation law allows action by less than unanimous written consent but requires the written consent form to provide the option of approval, disapproval, or abstention.<sup>14</sup> Since, under existing law, a nonprofit corporation may permit member action by any reasonable means, including mail, these new provisions are appropriate for inclusion in the new nonprofit corporation law<sup>15</sup> except that, to assure adequate member participation, written consents should be solicited from all members.

## VOTING OF MEMBERSHIPS

### Voting Rights

The normal rule among nonprofit corporations that each member has one vote, which may be cast at a meeting of members, is subject to modification by a nonprofit corporation, which may provide more or less than one vote per member and a manner of voting by mail or other reasonable means.<sup>1</sup> This flexibility is important to nonprofit corporations and should be retained. However, there are certain aspects of voting rights of members that require clarification. These are discussed below.

Persons entitled to take member action. A number of corporate actions require approval of the "members." Whether this requirement applies to all members, including honorary and other members having no proprietary interest in the nonprofit corporation, is unclear under existing law. In order to assure that the responsibility for basic decisions relating to the operation of the nonprofit corporation is properly delegated, the proposed nonprofit corporation law makes clear that all actions requiring the approval of the members are to be taken by the persons entitled to elect directors. The nonprofit corporation may specify additional persons whose approval is required but may not

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13. See Corp. Code § 2239 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

14. See Corp. Code §§ 603, 604.

15. See Corp. Code § 9601.

1. Corp. Code § 9601.

remove the basic decision-making authority from the persons given the power to elect the directors, except in the case of a policymaking committee, discussed below.

Action by policymaking committee of members. Existing law permits member approval of amendments to the articles of incorporation to be made by a "policymaking committee" of the members "with or without authority to represent and act for the corporation members in other matters."<sup>2</sup> The device of a policymaking committee is particularly useful in large nonprofit corporations. It enables a manageable body, the composition of which may be based on regional, population, interest, or other factors, to deliberate on behalf of the members.<sup>3</sup> The proposed statute makes clear that any action required to be taken by the members, not merely amendment of the articles, may be taken by the policymaking committee. In order to assure adequate representation, the policymaking committee should be composed solely of members who are selected by the membership to represent the membership, and the action of a member of the policymaking committee should be deemed the action of those members whom he or she represents.

Memberships held in representative capacity or by nonnatural person. The new business corporation law specifies a variety of rules for the manner of voting shares held by an administrator, executor, guardian, conservator, custodian, trustee, pledgee, minor, or corporation, or by two or more persons.<sup>4</sup> These provisions are useful and should apply to the voting of memberships in a nonprofit corporation unless the articles or bylaws provide otherwise.<sup>5</sup> In addition, the law should make

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2. See Corp. Code § 3632.5 (old general corporation law).

3. Compare Corp. Code § 12453 (district delegates in cooperative corporations).

4. See Corp. Code §§ 702-704.

5. The Commission does not recommend adoption for nonprofit corporations of the rule found in Section 702(a) that shares held by a trustee must be transferred into the name of the trustee before they may be voted by the trustee; likewise, similar provisions relating to shares held by a receiver should not be adopted. The rule in these cases should be that provided in the trustee and receivership laws generally.

clear that, absent a provision otherwise in the articles or bylaws, the manner of voting of memberships standing in the name of a partnership, association, family, or other group is the same as the manner of voting a membership that stands in the names of two or more persons.

#### Vote Required for Member Action

Existing law is silent on the vote required for many actions of nonprofit corporations. The members may generally take action by vote of a majority of a quorum at a meeting;<sup>6</sup> the vote required where the bylaws authorize a mail ballot or other reasonable voting method is not stated. The law should be clear that, in the case of such a mail ballot or other method, the required vote is a majority of the votes cast, provided the number of votes cast is the equivalent of a quorum at a meeting.<sup>7</sup>

There are a number of important corporate actions for which existing law imposes a two-thirds vote of the members; these actions include amendment of the articles, disposition of all or substantially all of the corporate assets, and voluntary dissolution. The new business corporation law reduces the vote to a majority of the shareholders.<sup>8</sup> This reduction is particularly appropriate for nonprofit corporations, in which a large voter turnout may be impossible to achieve, and should be adopted for nonprofit corporations.

The new business corporation law permits the articles of a business corporation to impose a class vote or a greater vote than would otherwise be required for approval of a corporate action.<sup>9</sup> The proposed nonprofit corporation law enables nonprofit corporations to do this in the articles or bylaws, consistent with the general rule that basic membership rights, including voting rights, may be stated in the bylaws. Any bylaw that adversely affects the voting rights of members, however, should be required to be adopted by the members.

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6. See Corp. Code § 109 and particular provisions imposing vote requirements in the old general corporation law.

7. For a discussion of quorum requirements, see "Members' Meetings and Consents," supra.

8. See Corp. Code § 152 and particular provisions imposing vote requirements in the new business corporation law.

9. See Corp. Code § 204(a)(5).

The new business corporation law lists a number of corporate actions for which the approval of a class of shareholders is required.<sup>10</sup> Many of the listed actions are inapplicable to nonprofit corporations. However, the general principle of class approval of actions harmful to the rights and interests of the class is sound and should be codified in general form in the nonprofit corporation law.

#### Proxy Voting

Proxy voting is permitted but not required by the General Nonprofit Corporation Law.<sup>11</sup> While the issue of proxy voting of memberships in nonprofit corporations has been recently litigated,<sup>12</sup> the Commission recommends no change in this permissive rule. As a practical matter, voting by proxy may be a necessity in a large nonprofit corporation in order to assure a sufficient vote to enable basic corporate actions to be taken.<sup>13</sup>

The new business corporation law requires that the form for a proxy solicited from 10 or more shareholders in a corporation having 100 or more shareholders afford an opportunity to specify a choice of approval, disapproval, or abstention with respect to the proposal for which the proxy is solicited; this does not preclude use of general proxies.<sup>14</sup> These provisions should be adopted for nonprofit corporations.

Under existing law, a proxy may be made effective for a period of up to seven years.<sup>15</sup> This period is unduly long for nonprofit corporations. A proxy in a nonprofit corporation should be effective only for a maximum of three years unless the proxy is coupled with an interest, in which case it could be made irrevocable until the interest is discharged, terminated, or otherwise satisfied.

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10. See Corp. Code § 903.

11. See Corp. Code § 9601.

12. See *Braude v. Havenner*, 38 Cal. App.3d 526, 113 Cal. Rptr. 386 (1974).

13. H. Oleck, Non-Profit Corporations, Organizations, and Associations § 175 (3d ed. 1974).

14. Corp. Code § 604.

15. See Corp. Code § 2226 (old general corporation law), applicable to nonprofit corporations through Section 9002.

### Voting Agreements

Voting agreements and voting trusts generally have little use in nonprofit corporations. However, voting agreements may have some utility in a limited class of cases, such as the small family foundation in which the family desires to maintain control. For this reason, the Commission recommends adoption of a limited voting agreement provision for nonprofit corporations, based on features of the voting agreement and voting trust provisions of the new business corporation law.<sup>16</sup>

Voting agreements should be authorized in the nonprofit equivalent of a close business corporation--a nonprofit corporation having fewer than 10 memberships. The agreement should be limited to 10 years, renewable for 10-year periods. The parties to the agreement should be permitted to transfer their memberships to a third party to vote in accordance with the terms of the agreement only if memberships in the nonprofit corporation are otherwise transferable. A copy of the voting agreement should be deposited with the nonprofit corporation and should be open to inspection by any member. These provisions should not limit the authority of a nonprofit corporation to expressly authorize other types of vote-pooling arrangements.

### Supervision of Elections

Inspectors of election may be appointed to oversee elections held at meetings of nonprofit corporations.<sup>17</sup> Because a nonprofit corporation may have elections other than at a meeting of members, the statute should be broadened to make clear that inspectors of election may be appointed for any nonprofit corporation election.

The court has broad authority to determine the validity of elections and appointments.<sup>18</sup> This authority includes the determination whether the basic election procedures are fair, equitable, and reasonable.<sup>19</sup> The broad authority of the court should be codified, but the

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16. See Corp. Code § 706.

17. Corp. Code §§ 2232, 2233 (old general corporation law), applicable to nonprofit corporations through Section 9002.

18. See Corp. Code §§ 2236-2238 (old general corporation law), applicable to nonprofit corporations through Section 9002.

19. Braude v. Havenner, 38 Cal. App.3d 526, 113 Cal. Rptr. 386 (1974).

burden of proof that the basic election procedures were unfair, inequitable, or unreasonable should be on the person challenging the procedures.

#### REQUIRED BOOKS AND RECORDS

The new business corporation law includes provisions that require a corporation to keep adequate and correct books and records of account and minutes of the proceedings of the members, board, and, to the extent they exercise the authority of the board, committees of the board.<sup>1</sup> These provisions supersede the more detailed provisions of the old general corporation law that govern nonprofit corporations.<sup>2</sup> Provisions comparable to the more general provisions of the new business corporation law should apply to nonprofit corporations.

The General Nonprofit Corporation Law requires that a nonprofit corporation keep a "membership book" containing the name and address of each member and requires that termination of any membership be recorded in the book, together with the date on which the membership ceased.<sup>3</sup> The required content of the membership record should be specified in more detail. The membership record should include the name and address of each member, the date the member became a holder of record of the membership, and, where applicable, the number and class of memberships held by each member, and a record of the termination of memberships, together with the date of termination. The membership record should be required only 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 the nonprofit corporation.

More flexible procedures for keeping the membership and fiscal records should be authorized. The nonprofit corporation should be permitted to retain the membership record and the books and records of account either in written form or in any other form capable of being converted into written form, but the minutes should be kept in written

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1. See Corp. Code § 1500.

2. See Corp. Code §§ 3000, 3001, which apply to nonprofit corporations through Section 9002.

3. See Corp. Code § 9606.

burden of proof that the basic election procedures were unfair, inequitable, or unreasonable should be on the person challenging the procedures.

#### REQUIRED BOOKS AND RECORDS

The new business corporation law includes provisions that require a corporation to keep adequate and correct books and records of account and minutes of the proceedings of the members, board, and, to the extent they exercise the authority of the board, committees of the board.<sup>1</sup> These provisions supersede the more detailed provisions of the old general corporation law that govern nonprofit corporations.<sup>2</sup> Provisions comparable to the more general provisions of the new business corporation law should apply to nonprofit corporations.

The General Nonprofit Corporation Law requires that a nonprofit corporation keep a "membership book" containing the name and address of each member and requires that termination of any membership be recorded in the book, together with the date on which the membership ceased.<sup>3</sup> The required content of the membership record should be specified in more detail. The membership record should include the name and address of each member, the date the member became a holder of record of the membership, and, where applicable, the number and class of memberships held by each member, and a record of the termination of memberships, together with the date of termination. The membership record should be required only 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 the nonprofit corporation.

More flexible procedures for keeping the membership and fiscal records should be authorized. The nonprofit corporation should be permitted to retain the membership record and the books and records of account either in written form or in any other form capable of being converted into written form, but the minutes should be kept in written

1. See Corp. Code § 1500.
2. See Corp. Code §§ 3000, 3001, which apply to nonprofit corporations through Section 9002.
3. See Corp. Code § 9606.



form. These requirements, the same in substance as those of the new business corporation law,<sup>4</sup> provide needed flexibility in maintaining accounting and membership records; while not preventing a nonprofit corporation from keeping a membership book, they would permit the use of electronic data processing equipment to maintain such a record so long as the record could be converted into written form.

#### ANNUAL REPORT; SPECIAL FINANCIAL STATEMENTS

The General Nonprofit Corporation Law provides that the bylaws of a nonprofit corporation may include provisions for the making of annual reports and financial statements to members,<sup>1</sup> but there is no requirement that a nonprofit corporation make an annual report or provide financial statements to members.<sup>2</sup>

#### Annual Report

The old general corporation law required "stock corporations" to send an annual report to the shareholders unless the bylaws expressly dispensed with such report.<sup>3</sup> The new business corporation law requires that an annual report be sent to shareholders by business corporations unless the corporation has less than 100 holders of record of its shares and expressly waives the requirement in the bylaws.<sup>4</sup> The Commission recommends that the board of a nonprofit corporation be required to present an oral or written annual report (containing specified information similar to that required by the new business corporation law) at the annual meeting of members except to the extent the articles or bylaws otherwise provide.

The annual report of a nonprofit corporation, which would cover a fiscal year ending not more than 12 months prior to the date of the

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4. See Corp. Code § 1500.

1. See Corp. Code § 9402.

2. Corp. Code § 3006 (old general corporation law) (annual reports) was limited to a "stock corporation" and Corp. Code § 3011 (old general corporation law) (financial statements) specifically excepted "nonprofit corporations." Hence, these requirements did not apply to nonprofit corporations through Corp. Code § 9002.

3. See Corp. Code § 3006.

4. See Corp. Code § 1501.

annual meeting, should show all of the following:

(1) The assets (including any held in trust) and liabilities of the nonprofit corporation as of the end of the fiscal year.

(2) The major changes in assets (including any held in trust) and liabilities during the fiscal year.

(3) The revenue or receipts of the nonprofit corporation, both unrestricted and restricted to particular purposes, during the fiscal year.

(4) The expenses or disbursements of the nonprofit corporation, for both general and restricted purposes, during the fiscal year.

In addition to this fiscal information, the annual report should also describe briefly:

(1) Any transaction during the fiscal year involving an amount in excess of \$40,000 to which the nonprofit corporation was a party and in which a director or officer of the nonprofit corporation or (if known to the nonprofit corporation) a person holding more than 10 percent of the voting power of the nonprofit corporation had a direct or indirect material interest. This requirement would not apply to compensation of officers and directors, to contracts let at a competitive bid or services rendered at prices regulated by law, or to transactions approved by the members.

(2) The amount and circumstances of indemnification or advances aggregating more than \$10,000 paid during the fiscal year to an officer or director of the nonprofit corporation except for indemnification approved by the members.

The requirement of an annual report would apply except to the extent the articles or bylaws otherwise provide. Thus, for example, the articles or bylaws could dispense entirely with the requirement of an annual report, provide for an annual report that contains different or more or less information than is required by the statute, or require that a copy of the annual report be mailed to each member. The recommended provisions will provide flexibility to meet the needs of various types of nonprofit corporations but will, at the same time, require that the articles or bylaws expressly set forth a decision to alter the statutory annual report scheme.

If the articles or bylaws dispense with the requirement of an annual report or with the inclusion of the financial information specified by statute, the members of the nonprofit corporation would be authorized to obtain that financial information by using the procedure discussed below. In addition, notwithstanding the articles or bylaws, the information concerning (1) transactions in which a director, officer, or person holding more than 10 percent of the voting power has an interest and (2) indemnification and advances to officers and directors should be required to be furnished to the voting members, whether or not the nonprofit corporation makes an annual report.

#### Special Financial Statements

The old general corporation law required a corporation to provide special financial statements upon demand of shareholders holding at least 10 percent of the number of outstanding shares<sup>5</sup> but expressly excepted nonprofit corporations from this requirement. The new business corporation law contains a comparable requirement that special financial statements be provided upon written request of holders of at least five percent of the outstanding shares of any class.<sup>6</sup>

Members of a nonprofit corporation may need to obtain fiscal information. Accordingly, the Commission recommends that provisions generally comparable to the special financial statements provisions of the new business corporation law be included in the proposed nonprofit corporation law with the following important exceptions:

(1) The nonprofit corporation should be allowed 60 days within which to prepare the requested financial statement or statements.

(2) The nonprofit corporation should be permitted to open its fiscal records to inspection as an alternative to providing the requested financial statement, as long as the records are located at an address which is within the county where the principal office of the nonprofit corporation in this state is located. This option is appropriate because a nonprofit corporation frequently will not prepare financial statements with the regularity of business corporations, and a demand for a special financial statement may thus impose an unreasonable cost on the nonprofit corporation.

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5. See Corp. Code § 3011.

6. See Corp. Code § 1501(c), (d), (e), (f), (g), and (h).

(3) Although an authorized member (one having written authorization of at least five percent of the voting power or such lesser authorization as is specified in the articles or bylaws) should be provided a copy of the requested fiscal statement or statements without charge, the nonprofit corporation should be permitted to impose a reasonable charge for providing additional copies of the statement or statements.

#### RIGHTS OF INSPECTION

The new business corporation law provisions pertaining to the right of inspection of corporate records<sup>1</sup> supersede provisions of the old general corporation law which apparently apply to nonprofit corporations.<sup>2</sup>

#### Membership Records

The new business corporation law expands the inspection rights provided by the old general corporation law by providing an absolute right to inspect the shareholder record for shareholders who have a significant ownership interest in the corporation or who, in addition to a specified ownership interest in the corporation, have instituted a proxy contest with respect to the election of directors. The new law permits a shareholder to obtain a court order postponing any previously noticed shareholders' meeting until the corporation complies with a proper request for a shareholder list; the court may award the shareholder his reasonable expenses (including attorney's fees) incurred in an action to enforce compliance with the statutory inspection rights upon a finding that the corporation's refusal was not justified.

The Commission recommends that the expanded inspection rights given shareholders by the new business corporation law also be given to members of nonprofit corporations with the following significant adjustments:

(1) An authorized member (one having written authorization of at least five percent of the voting power or such lesser authorization as is specified in the articles or bylaws) should have a statutory right to

1. See Corp. Code § 1600 et seq.

2. See Corp. Code §§ 3003-3005, apparently applicable to nonprofit corporations through Section 9002; cf. *Mooney v. Bartenders Union Local No. 284*, 48 Cal.2d 841, 313 P.2d 857 (1957).

inspect the membership record or obtain a list of voting members upon 10 days' prior written notice. But the nonprofit corporation should be permitted to protect its membership list from disclosure by adopting a provision in its articles or bylaws that provides a reasonable procedure whereby the authorized member may communicate without cost with the members to seek support for the nomination of any person or persons for election as directors, to communicate a candidate's statement for persons nominated for director, or to solicit proxies. The proposed statute includes a section specifying procedural requirements which, if included in the provisions of the articles or bylaws, are deemed to provide a reasonable procedure.<sup>3</sup> This option will provide an authorized member with a practical and economical means of communicating with other members. At the same time, it will permit a nonprofit corporation whose membership list is a valuable trade secret to protect the list from possible improper use.<sup>4</sup> It will also provide a means of preserving the right of privacy of members--a matter of some importance, for example, where the nonprofit corporation is one that advocates an unpopular cause.

(2) The court should be granted specific authority to allow the nonprofit corporation additional time (over the 10 days prescribed by statute) within which to provide its membership list to an authorized member. The court should be authorized to impose just and proper conditions for the exercise of the right to inspect the membership records or secure a membership list and to postpone a previously noticed meeting of the members or make other appropriate orders if the nonprofit corporation fails to comply with a proper demand for inspection.

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3. A bylaw that does not satisfy all of these requirements should satisfy the statute if the procedure it provides is reasonable in view of the circumstances, practices, and nature of the particular nonprofit corporation; but, if the bylaw is challenged, the burden should be on the nonprofit corporation to establish that the bylaw is reasonable under this standard.
  4. Such a bylaw would not limit the right of an individual member to inspect his or her membership record for a purpose reasonably related to such member's interests as a member, but a member demanding such an inspection should be required to state in writing under oath the purpose of the inspection and the use of the information obtained should be limited by statute to the purpose stated in the demand.

(3) A provision is included in the proposed nonprofit corporation law making the member who obtained the membership information, and any other person who used the information, liable to the nonprofit corporation for any damages resulting from the improper use of the information. This will provide protection to a nonprofit corporation whose membership list is a valuable trade secret and is used, for example, for the purpose of soliciting its members to join a competing organization. The remedy would not be exclusive. Improper use of the membership information could be enjoined or other appropriate remedies used.

#### Financial Records and Minutes

The new business corporation law<sup>5</sup> continues the substance of provisions of the old general corporation law<sup>6</sup> which authorized a shareholder to inspect the financial records and minutes for a purpose reasonably related to his interests as a shareholder. The right of a member of a nonprofit corporation to inspect the financial records and minutes for a purpose reasonably related to such member's interests as a member should be continued with several additions. In order to help assure a proper purpose, the demand for inspection should be under oath and state the purpose of the demand. This requirement is taken from the Pennsylvania Nonprofit Corporation Law.<sup>7</sup> The nonprofit corporation should have 10 business days within which to comply with the demand. This will give the nonprofit corporation time to determine whether the demand is for a proper purpose and time to schedule the inspection with a minimum disruption of its office personnel.

#### Articles and Bylaws

The General Nonprofit Corporation Law requires a nonprofit corporation to keep a book of bylaws at its principal office;<sup>8</sup> it does not specifically grant inspection rights to members. The new business corporation law requires that the bylaws of a business corporation be

5. Corp. Code § 1601.

6. Corp. Code § 3003, applicable to nonprofit corporations through Corp. Code. § 9002.

7. See Pa. Stat. Ann. tit. 15, § 7508(b) (Supp. 1976).

8. See Corp. Code § 9404.

open to inspection by the shareholders.<sup>9</sup> This requirement is a salutary one and should be extended to cover the articles as well as the bylaws of a nonprofit corporation. In addition, the nonprofit corporation should be required, upon written request, to furnish a member with a copy of the articles and bylaws and should be authorized to make a reasonable charge for furnishing the copy.

#### Director's Right of Inspection

The director's right under existing law to inspect all books, records, and documents and physical properties of the nonprofit corporation<sup>10</sup> should be continued.

#### Application to Foreign Nonprofit Corporations

The provisions relating to rights of inspection should extend to a foreign nonprofit corporation having its principal executive office in this state and to any other foreign nonprofit corporation with respect to books and records, documents, and properties actually or customarily located in this state.<sup>11</sup>

#### Judicial Enforcement

The new business corporation law<sup>12</sup> continues the substance of provisions of the old general corporation law<sup>13</sup> relating to judicial enforcement of the right of inspection and adds a new section<sup>14</sup> author-

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9. See Corp. Code § 213. If the corporation does not have an office in this state where the bylaws may be inspected, it must furnish the shareholder with a copy upon written request.
  10. See Corp. Code § 3004 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.
  11. The recommended provisions do not extend, as do some provisions of the new business corporation law, to a foreign corporation customarily holding meetings of its board in this state. On the other hand, the provisions apply with respect to all books, records, documents, and properties actually or customarily located in this state whereas some of the rights of inspection provisions of the new business corporation law are not made applicable to foreign corporations on this basis. Where the foreign corporation has its principal executive office in this state, it should be noted that the right of inspection under the Commission's recommended legislation extends to books and records kept outside the state.
  12. Corp. Code § 1603.
  13. Corp. Code § 3005, applicable to nonprofit corporations through Corp. Code § 9002.
  14. Corp. Code § 1604.

izing the court to award a shareholder his reasonable expenses (including attorney's fees) if the court finds that the failure of the corporation to comply with a proper demand for inspection was without justification.

Comparable provisions should be made applicable to nonprofit corporations except that the award of reasonable expenses (including reasonable attorney's fees) should be extended to directors who seek to enforce rights of inspection. In addition, in any proceeding to enforce an individual member's right of inspection, the member should have the burden of establishing that the inspection is for a proper purpose. These provisions will protect a nonprofit corporation against abuse of the rights of inspection and protect members against unjustified refusal to permit inspection for a proper purpose.

#### CORPORATE FINANCE

##### Financial Obligations of Members

The General Nonprofit Corporation Law grants general authority to a nonprofit corporation to provide in its articles or bylaws for the amount, terms of payment, and collection procedures for membership dues and assessments,<sup>1</sup> as well as for imposition of admission and transfer fees.<sup>2</sup> A member is liable to the nonprofit corporation for these charges as long as the corporation's own rules are followed in imposing the obligations and the payments are used for corporate purposes;<sup>3</sup> even resignation of membership after the levy of an assessment does not terminate such an obligation.<sup>4</sup>

The Commission recommends that nonprofit corporations continue to have full authority to regulate their financial relations with their members by means of provisions in the articles or bylaws. However, there should be a method for members to escape liability, by prompt resignation of membership, for assessments imposed in order to acquire

1. See Corp. Code §§ 9301, 9403, 9611.

2. See Corp. Code § 9403.

3. *DeMille v. American Fed'n of Radio Artists*, 31 Cal.2d 139, 187 P.2d 722, cert. denied, 333 U.S. 876 (1947).

4. *Cf. Locust Club v. Einstein*, 129 Pa. Super. 338, 195 A. 432 (1937) (and cases cited therein).



or construct expensive capital improvements. As the resigning member will not benefit from the future improvements, it is equitable that the member not pay the assessment. This rule should not apply to such nonprofit corporations as condominiums and homeowners' associations where the obligation to pay assessments runs with the land at law.

#### Financing Devices

The General Nonprofit Corporation Law authorizes nonprofit corporations to raise funds by incurring debt.<sup>5</sup> The Commission recommends that this authority be continued. For clarity, the payment of interest (as long as it is not measured by or contingent upon profits) or principal to members who hold debt instruments of the nonprofit corporation should be specifically authorized. In order to protect both the members and outsiders who deal with the nonprofit corporation, acceptable consideration for the issuance of debt instruments should be defined.<sup>6</sup>

The nonprofit corporation laws of both New York and Pennsylvania authorize the issuance of subvention certificates.<sup>7</sup> In brief, a subvention is a form of subordinated debt, the repayment of which is normally contingent both upon the financial health of the nonprofit corporation and upon the occurrence of some event--ideally, the completion of the project for which the funds were solicited. The subvention has been greeted in New York as a new means of obtaining subsidies for nonprofit corporations.<sup>8</sup> The Commission recommends that subvention provisions be added to California law. Specific statutory authorization of subventions should not restrict the full authority of nonprofit corporations to incur debt in such form as they find desirable.

The Commission also considered the use of another device provided by New York and Pennsylvania law--the capital contribution.<sup>9</sup> This

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5. Corp. Code § 9501.

6. This is comparable to a provision of the new business corporation law. See Corp. Code § 409(a).

7. See N.Y. Not-for-Profit Corp. Law §§ 504, 505 (McKinney 1970); Pa. Stat. Ann. tit. 15, § 7542 (Supp. 1976).

8. See Note, New York's New Not-for-Profit Corporation Law, 47 N.Y.U. L. Rev. 761, 783-784 (1972).

9. See N.Y. Not-for-Profit Corp. Law §§ 502, 503 (McKinney Supp. 1976); Pa. Stat. Ann. tit. 15, § 7541 (Supp. 1976).

consists of a required contribution from members (such as an admission fee or assessment) which may, under limited circumstances, be returned to the members by the nonprofit corporation. The Commission does not recommend adoption of capital contribution provisions since California nonprofit corporations presently have full and flexible authority to regulate this matter, and this authority is continued in the recommended legislation.

#### Partly Paid Memberships

Under existing law, nonprofit corporations are authorized to issue partly paid memberships<sup>10</sup> with the purchaser remaining liable to the nonprofit corporation for the unpaid balance of the price.<sup>11</sup> The liability to the nonprofit corporation of transferors and transferees of such partly paid memberships is regulated by statute although always subject to specific written agreement between the parties.<sup>12</sup> It is important for members to know whether memberships may be purchased on an installment basis. The Commission, therefore, recommends that existing law regarding partly paid memberships be continued with the additional requirement that authorization for issuance of memberships on a partly paid basis be set forth in the articles or bylaws.

#### Repurchase and Redemption of Memberships

The financial requirements for repurchase of shares by a business corporation are applicable to a nonprofit corporation that reacquires memberships from members.<sup>13</sup> In general, payment for the membership must be from earned or reduction surplus and may not threaten the solvency of the nonprofit corporation. The new business corporation law continues the solvency requirement; however, with the goal of "rationalizing" the

10. See Corp. Code § 1109 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.
11. Corp. Code § 1300 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.
12. See Corp. Code §§ 1301-1304 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.
13. See Corp. Code §§ 1706-1708 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002. But see H. Ballantine & G. Sterling, California Corporation Laws § 408.01, at 761 (4th ed. 1976).

restrictions and providing "meaningful protection" for creditors and investors,<sup>14</sup> the new business corporation law substitutes for the existing surplus account requirement a test based upon the earnings, net worth, and liquidity of the corporation (as disclosed by its financial statements).<sup>15</sup>

The Commission recommends application of the new financial requirements to nonprofit corporations which repurchase memberships, with some adaptation to reflect differing accounting terminology for nonprofit corporations. The repurchase should also be subject to the requirement that payments not be made pursuant to a plan to distribute to members any gains, profits, or dividends.

The specific redemption procedures (e.g., notice, time of payment) of the old general corporation law which now govern nonprofit corporations<sup>16</sup> have been continued in the new business corporation law.<sup>17</sup> Comparable provisions should be included in the new nonprofit corporation law.

#### Charitable Property

In addition to general common law powers over charitable institutions,<sup>18</sup> the Attorney General now has specific statutory authority to supervise nonprofit corporations holding assets for charitable purposes.<sup>19</sup> This authority should be continued.

Existing provisions of the Corporations Code do not impose specific duties of care upon a nonprofit corporation holding assets for charitable purposes. Case law provides that the management activities of such a nonprofit corporation, and its directors, are to be measured

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14. Report of the Assembly Select Committee on Revision of the Corporations Code 72 (1975).

15. See Corp. Code §§ 500, 501.

16. See Corp. Code §§ 1700-1703 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.

17. See Corp. Code § 509.

18. See *People v. Cogswell*, 113 Cal. 129, 45 P. 270 (1896).

19. See Corp. Code § 9505; Uniform Supervision of Trustees for Charitable Purposes Act, Govt. Code §§ 12580-12597.

against the standards applicable to private trustees.<sup>20</sup> This is a developing area of law and should be left to continuing case law evolution. The statute should make clear, however, that the directors of a charitable corporation may comply with the express purposes of the charitable trust without violating the applicable general standard of care.

Existing law saves indefinite or uncertain charitable gifts to charitable corporations and authorizes these corporations to determine the best use for such gifts.<sup>21</sup> The Commission recommends that this provision be expanded to apply to all nonprofit corporations named as recipients of indefinite or uncertain charitable gifts.

New York and Pennsylvania provide authority for nonprofit corporations to transfer for investment purposes all or part of their assets, including those held for charitable purposes, to an institutional trustee; these statutes protect the directors of the nonprofit corporation from liability arising out of the administration of the transferred assets by the trustee.<sup>22</sup> Similar provisions should be adopted for California nonprofit corporations.

#### Common Trust Funds

Existing law authorizes a nonprofit corporation organized for charitable purposes to form a common trust fund for the pooling of investment funds by the nonprofit corporation and affiliated organizations.<sup>23</sup> Certain educational institutions are also authorized to participate in such funds.<sup>24</sup> The Commission recommends continuation of these provisions.

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20. See *Lynch v. John M. Redfield Foundation*, 9 Cal. App.3d 293, 88 Cal. Rptr. 86 (1970).

21. See Corp. Code § 10206(b).

22. See N.Y. Not-for-Profit Corp. Law § 514 (McKinney Supp. 1976); Pa. Stat. Ann. tit. 15, § 7551 (Supp. 1976). Cf. Civil Code § 2290.5.

23. See Corp. Code § 10250.

24. See Corp. Code § 10251.

## AMENDMENT OF ARTICLES

Existing law specifies the amendments that may be made in the articles of a nonprofit corporation.<sup>1</sup> The new business corporation law eliminated this specification in favor of general authority to make any necessary amendments, provided the amendments would be proper if inserted in original articles filed at the time of the amendment.<sup>2</sup> This flexibility is desirable and should be extended to nonprofit corporations.

Existing law permits the adoption of amendments to the articles by a vote of two-thirds of a quorum of members<sup>3</sup> or by a vote of two-thirds of a policymaking committee created by the members.<sup>4</sup> These provisions have enabled nonprofit corporations to function efficiently, and no problems in their operation have been called to the attention of the Commission; they should be continued without change.<sup>5</sup>

The new business corporation law revises and simplifies the provisions relating to certificates of amendment and restated articles.<sup>6</sup> For uniformity, comparable provisions should apply to nonprofit corporations.

## SALES OF ASSETS

The provisions of the new business corporation law relating to sales of assets<sup>1</sup> are, with a few modifications, equally suitable for nonprofit corporations. The Commission recommends that these provisions be adapted to require that a sale, lease, or other disposition of all or substantially all of the assets of a nonprofit corporation be approved by the board in every case and approved by the members if the transac-

1. See Corp. Code §§ 3600-3602 (old general corporation law), applicable to nonprofit corporations through Corp. Code § 9002.
2. See Corp. Code § 900(a).
3. Corp. Code § 3632 (old general corporation law).
4. Corp. Code § 3632.5 (old general corporation law).
5. The concept of a policymaking committee should be expanded to apply to other areas than amendment of articles. See discussion under "Voting of Memberships," supra.
6. Corp. Code §§ 905-908 and 910.
1. Corp. Code §§ 1000-1002.

tion is not in the usual and regular course of corporate activities.<sup>2</sup> Notice of the general nature of the proposal should be given to members before member approval (other than unanimous approval) may be obtained at a meeting, whether the meeting is regular or special;<sup>3</sup> this will effectuate an earlier Commission recommendation.<sup>4</sup>

The statute should make clear that assets held on condition or on a charitable trust are subject, respectively, to the limitations in the instrument of conveyance or in the instrument creating the trust. Where any assets are subject to a charitable trust and the transaction is not in the usual and regular course of corporate activities, the nonprofit corporation should give written notice to the Attorney General before the transaction is consummated. This will facilitate performance of the Attorney General's duty to supervise charitable property.<sup>5</sup>

#### MERGER AND CONSOLIDATION

Under existing law, nonprofit corporations may merge or consolidate with other nonprofit corporations.<sup>1</sup> The new business corporation law has eliminated consolidation for business corporations on the ground that it was "outmoded"<sup>2</sup> and was seldom used.<sup>3</sup> The Commission recommends that consolidation be retained for nonprofit corporations, however,

2. See Corp. Code § 1001(a) (new business corporation law).
3. The new business corporation law contains a comparable provision. See Corp. Code § 601(a) (notice of general nature of proposal must be given if meeting is special but not annual).
4. See Recommendation and Study Relating to Notice to Shareholders of Sale of Corporate Assets, 2 Cal. L. Revision Comm'n Reports G-1 (1959).
5. See Corp. Code § 9505.
1. Corporations Code Section 9700 makes the provisions of Article 1 (commencing with Section 4100) of Chapter 3 of Part 8 of Division 1 of the old general corporation law applicable to nonprofit corporations.
2. Report of the Assembly Select Committee on the Revision of the Corporations Code 13 (1975).
3. See working papers of the State Bar Committee on Corporations, p. 37-6 (unpublished materials on file at the office of the California Law Revision Commission).

since many nonprofit corporation combinations employ the consolidation procedures in preference to merger procedures.<sup>4</sup>

A merger or consolidation is accomplished by filing an agreement of merger or consolidation, approved by the boards and members of the constituent nonprofit corporations. Under existing law and under the new business corporation law, the agreement may provide for the compensation of shareholders by the payment of money or property.<sup>5</sup> This is inappropriate for nonprofit corporations because of the basic policy against distributing gains, profits, or dividends of a nonprofit corporation except upon dissolution.<sup>6</sup>

Existing law provides for approval of the agreement by a majority of the members acting by vote or by two-thirds of the members acting by written consent, disregarding any limitations or restrictions on the voting power of a class of membership.<sup>7</sup> The Commission recommends that the requirement of two-thirds approval where members act by written consent be changed to a majority.

Where a nonprofit corporation organized for charitable purposes or holding assets on charitable trust proposes to merge or consolidate, the Attorney General should be given notice of the proposed merger or consolidation before it is effective so that the Attorney General may ensure that the charitable purposes will not be violated.

Under existing law, it appears that a member who dissents from the merger or consolidation has the right to require the nonprofit corporation to purchase his membership, assuming that the membership has a monetary value.<sup>8</sup> The Commission recommends that dissenting members not be afforded the dissenters' appraisal right granted to dissenting share-

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4. See Davis, Reorganization and Termination, in California Nonprofit Corporations § 9.17, at 325 (Cal. Cont. Ed. Bar 1969).

5. See Corp. Code §§ 4103 (old general corporation law) and 1101(d) (new business corporation law).

6. See discussion under "Corporate Powers," supra.

7. Corp. Code § 9701.

8. Corporations Code Section 9700 makes the merger and consolidation provisions of the old general corporation law applicable to nonprofit corporations without excepting the provisions of Section 4123 which provides for the compensation of dissenters.

holders. Such a right could not be applicable in the case of a non-profit corporation organized for charitable purposes. To require other types of nonprofit corporations to purchase the memberships of dissenting members would violate the policy against distribution of gains, profits, and dividends except upon dissolution<sup>9</sup> and create other problems.<sup>10</sup>

The new business corporation law eliminated the requirement that the corporation give to each shareholder notice of the approval of the agreement of merger, in favor of a provision that notice be sent to those shareholders who hold dissenting shares.<sup>11</sup> The nonprofit corporation law should retain the requirement that all members be given notice of approval; all members will thus receive timely notice for purposes of any challenge to the merger or consolidation. The notice should be given in the same manner as notice of meetings of members.

The Commission recognizes that there may be situations where valuable property rights of members are infringed by a merger or consolidation. Where these rights are limited to certain classes, they are protected by the rule that the approval of a class of members is required where an action would adversely affect the rights of the members of a class to a greater extent than members of other classes.<sup>12</sup> In addition, where a merger or consolidation would be manifestly unfair to the property rights of an individual member, the member should be permitted to bring a prompt action to enjoin or rescind the merger or consolidation. In every other case, except where an action is brought to test whether the proper vote of approval was obtained, the members should have no right to enjoin or rescind the merger or consolidation.

The new business corporation law has codified the de facto merger doctrine which gives shareholders the right of approval and dissenters' rights in corporate transactions that have the effect of a merger but

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9. See discussion under "Corporate Powers," supra.

10. See discussion under "Transfer and Termination of Memberships," supra.

11. See Corp. Code §§ 1300, 1301.

12. See discussion under "Voting of Memberships," supra.



are not formal mergers.<sup>13</sup> The Commission does not recommend the codification of the de facto merger doctrine in the proposed nonprofit corporation law. It will be an extremely rare case where a nonprofit corporation is involved in transactions covered by the doctrine.

#### DIVISION

Although existing law provides for the combination of nonprofit corporations through the devices of merger and consolidation, no provision is made for dividing into two or more independent nonprofit corporations. A nonprofit corporation may wish to divide, for example, to sever membership factions that cannot agree or to separate different types of corporate activities. The Commission recommends that a division procedure, based in part on the division provisions of the Pennsylvania Nonprofit Corporation Law of 1972,<sup>1</sup> be included in the nonprofit corporation law.

The major features of the recommended division procedure are:

(1) Any nonprofit corporation is permitted to take advantage of the division procedure.

(2) A dividing nonprofit corporation may (a) survive the division and create one or more new nonprofit corporations or (b) cease to exist and create two or more new nonprofit corporations.

(3) The dividing nonprofit corporation will be permitted to divide its assets and liabilities among the resulting nonprofit corporations as it sees fit so long as the rights of creditors are not impaired.

(4) In order to ensure that a charitable trust will not be violated by a division, the Attorney General must be given notice of a planned division by a charitable corporation.

(5) Other aspects of the recommended division procedure--including the contents of the plan of division, the manner of adoption, amendment, or abandonment of the plan, the effect of filing the plan, and the limitations on actions to enjoin or rescind a division--are analogous to the merger and consolidation procedures.<sup>2</sup>

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13. See Corp. Code §§ 181, 1200, 1201; Report of the Assembly Select Committee on the Revision of the Corporations Code 93-94 (1975).

1. Pa. Stat. Ann. tit. 15, §§ 7941-7946 (Supp. 1976).

2. See discussion under "Merger and Consolidation," supra.

CONVERSION OF NONPROFIT TO BUSINESS CORPORATION OR BUSINESS TO NON-  
PROFIT CORPORATION

Existing law provides no means whereby a nonprofit corporation may be converted into a business corporation or a business corporation may be converted into a nonprofit corporation. It may be argued that conversion of a nonprofit corporation into a business corporation permits the shareholders to receive dividends and other distributions, which were previously denied them under the nonprofit corporation law. However, this result can be achieved indirectly by dissolution and reincorporation. Consequently, the Commission recommends the enactment of conversion provisions based on the conversion provisions of the Pennsylvania Nonprofit Corporation Law of 1972.<sup>1</sup>

The significant features of the recommended conversion procedure are:

(1) A nonprofit corporation (other than a charitable corporation)<sup>2</sup> will be permitted to convert into a business corporation.

(2) A business corporation will be permitted to convert into either a charitable or noncharitable nonprofit corporation.

(3) The procedure for conversion is analogous to the merger procedure.<sup>3</sup> The conversion will be accomplished by filing a plan of conversion which has been approved by the board and the shareholders or members of the converting corporation in the same manner as is provided for the approval of mergers. Members of a converting nonprofit corporation will be given notice of the approval of the plan of conversion and will be permitted to bring an action to enjoin or rescind the conversion if the conversion would be manifestly unfair to their property rights. Dissenting shareholders of a converting business corporation will be given the same right to require the corporation to purchase their shares as dissenting shareholders have where a merger takes place under the new business corporation law.<sup>4</sup> No other action to enjoin or rescind the

1. See Pa. Stat. Ann. tit. 15, §§ 7951-7956 (Supp. 1976).

2. This limitation is not found in Pennsylvania law which permits the conversion of any nonprofit corporation, subject to the power of the court to prevent a diversion of property committed to charitable purposes. See Pa. Stat. Ann. tit. 15, §§ 7549(b), 7956(b) (Supp. 1976).

3. See discussion under "Merger and Consolidation," supra.

4. See Corp. Code § 1300 et seq.

conversion may be brought except to test whether the proper number of memberships or shares were voted in favor of the plan of conversion.

## VOLUNTARY AND INVOLUNTARY DISSOLUTION

### General Approach

The rules governing dissolution of nonprofit corporations are generally the same as those governing business corporations<sup>1</sup> with the major exceptions noted below. The Commission believes this statutory scheme is sound and recommends that the new business corporation law provisions be adapted for nonprofit corporations.

A number of provisions of the new business corporation law that are applicable both to voluntary and involuntary dissolution proceedings should be consolidated in the proposed nonprofit corporation law.

Examples of such provisions are those concerning powers of the court, limitations on corporate activities, powers of the board and officers, notice, presentation of creditors' claims, and cessation of corporate existence.<sup>2</sup> This will eliminate duplication and will result in a simpler statute.

### Disposition of Charitable Assets

Dissolution of a nonprofit corporation differs from dissolution of a business corporation principally in the special treatment accorded to charitable assets. The Commission recommends the codification of existing law that such assets be distributed on dissolution in conformity with the purposes of the charitable trust or the charitable purposes for which the nonprofit corporation was organized.<sup>3</sup> This codification will not affect the judicially developed rule that, if the dominant purpose, express or implied, of a donor cannot be carried out, the doctrine of cy

1. See Corp. Code § 9800 (nonprofit corporations wound up and dissolved in same manner as stock corporation).
2. See Corp. Code §§ 1801(c), 1802-1804, 1805(b), 1806, 1904 (powers of court); 1805(c), 1903(c) (corporate activities during winding up); 1805(b), 1903(b), 2001 (powers of board and officers); 1805(c), 1807(b), 1903(c) (notice); 1808(b), 1905(b), 2010 (cessation of corporate existence).
3. See Corp. Code § 9801; *Pacific Home v. County of Los Angeles*, 41 Cal.2d 844, 264 P.2d 539 (1953).

pres will be applied by substituting another charitable object approaching the original purpose as nearly as possible.<sup>4</sup>

The present rule requiring court proceedings for distribution of charitable assets<sup>5</sup> should be modified to allow distribution to be made without court proceedings if the Attorney General makes a written waiver of objections. This will recognize the existing practice and expedite those proceedings in which there is no problem and no need to go to court. This would not preclude a nonprofit corporation from obtaining a court order for distribution of assets even though the Attorney General has waived objections, nor would it preclude subsequent court challenge of the distribution by an interested party. The common law rule that a conditional gift be disposed of in accordance with the donor's intent if dissolution violates the condition should be codified.<sup>6</sup>

#### Grounds for Dissolution

The grounds for voluntary dissolution by the board should include that the term of existence of a nonprofit corporation formed for a limited period has expired without extension or renewal<sup>7</sup> and that the charter of a subordinate body has been surrendered to, taken away, or revoked by the head or national body granting it.<sup>8</sup> These changes will allow such nonprofit corporations to wind up without the necessity of court proceedings. In addition, the Attorney General should be authorized to bring an involuntary dissolution proceeding in the case of expiration of the term of existence. This will allow the Attorney General to enforce the termination of the corporation if necessary.

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4. See, e.g., Metropolitan Baptist Church of Richmond, Inc., v. Younger, 48 Cal. App.3d 850, 121 Cal. Rptr. 899 (1975); In re Veterans' Industries, Inc., 8 Cal. App.3d 902, 88 Cal. Rptr. 303 (1970).

5. See Corp. Code § 9801.

6. See In re Los Angeles County Pioneer Society, 40 Cal.2d 852, 257 P.2d 1, cert. denied, 346 U.S. 888 (1953).

7. Under the business corporation law, this is now a ground for involuntary, but not voluntary, dissolution. Compare Corp. Code § 1800(b)(6) with Corp. Code § 1900(b).

8. Under present law, whenever the charter of a "subordinate body" incorporated under the General Nonprofit Corporation Law "is surrendered to, taken away, or revoked by the head or national body granting it, the subordinate body shall dissolve." Corp. Code § 9802.

### Avoidance of Dissolution by Purchase

The remedy of avoidance of dissolution by purchase<sup>9</sup> should be limited to dissolutions of nonprofit corporations other than charitable and to proceedings initiated by members holding a majority of the voting power. This will eliminate the possibility of a minority commencing involuntary proceedings as a device to circumvent the prohibition against distribution of gains to members.<sup>10</sup>

In order to assure equity to all members, (1) if the nonprofit corporation elects (by vote of members excluding those initiating the dissolution proceeding) to purchase the memberships, the members who opposed such election should be allowed to require the corporation to purchase their memberships in addition to the memberships of the persons initiating the proceeding and (2) if the nonprofit corporation does not elect to purchase the memberships, any member should be authorized to make the purchase.<sup>11</sup>

### Presentation of Claims

Under the new business corporation law, notice of the commencement of proceedings for winding up is given to shareholders and creditors by mail,<sup>12</sup> and notice to creditors to present claims is given by publication.<sup>13</sup> The requirement of publication is inadequate and should not be duplicated in the nonprofit corporation law.

In order to assure adequate notice of the commencement of proceedings and notice to present claims, notice ordinarily should be given by mail with authorization for the court to prescribe a different method of notice where appropriate. The notice of commencement of proceedings should be permitted to contain a statement of the time and place for presentation of creditors' claims; if it does not do so, separate later notice to present claims should be required.

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9. See Corp. Code §§ 2000 (new business corporation law), 4658-4659 (old general corporation law).

10. See discussion under "Corporate Powers," supra.

11. Compare Corp. Code § 2000(a) (new business corporation law).

12. Corp. Code §§ 1805(c), 1903(c).

13. Corp. Code § 1807.

### Dissolution of Regulated Nonprofit Corporation

Under the Public Utilities Act,<sup>14</sup> a public utility may not dispose of its assets without the consent of the Public Utilities Commission.<sup>15</sup> And under the Insurance Code, the Insurance Commissioner may commence a proceeding to obtain control of the assets of an insolvent or delinquent insurer and to dissolve the corporation.<sup>16</sup> Consent of the appropriate regulatory agency should be obtained in these cases before dissolution proceedings under the nonprofit corporation law may be maintained.

### APPLICABILITY OF NEW BUSINESS CORPORATION LAW

The old general corporation law applied to every private corporation, profit or nonprofit, "now existing or hereafter formed," unless the corporation was expressly excepted from the operation thereof or there was a special provision applicable to the corporation inconsistent with some provision of the old general corporation law, in which case the special provision prevailed.<sup>1</sup>

The new business corporation law is limited in its application; the new law does not apply to nonprofit corporations subject to Division 2 (commencing with Section 9000) of Title 1 of the Corporations Code, to certain corporations subject to Division 3 (commencing with Section 12000) of Title 1 of the Corporations Code--chambers of commerce, boards of trade, mechanics' institutes, cooperative corporations, fish marketing associations, California job creation corporations, or business and industrial development corporations--or to corporations organized or existing under any statute of this state other than the Corporations Code, unless expressly included in a particular provision of the new business corporation law.<sup>2</sup>

14. Pub. Util. Code §§ 201-2115.

15. Pub. Util. Code § 851; Grover v. Sharp & Fellows Contracting Co., 82 Cal. App.2d 515, 186 P.2d 682 (1947); Slater v. Shell Oil Co., 39 Cal. App.2d 535, 103 P.2d 1043 (1940).

16. Ins. Code §§ 1011, 1017.

1. Corp. Code § 119.

2. Corp. Code § 102, as amended by Section 1.3 of Chapter 641 of the Statutes of 1976.

Section 16 of Chapter 682 of the Statutes of 1975 saves the old general corporation law to the extent that that law applied to corporations not covered by the new business corporation law.<sup>3</sup>

There are a number of provisions of the old general corporation law that were carried forward into the new business corporation law that the Commission believes should apply generally to all corporations, profit or nonprofit, now existing or hereafter formed. These provisions--and only these provisions--of the new business corporation law should apply to nonprofit corporations. Accordingly, the Commission recommends that the provisions, listed below, be made applicable to nonprofit corporations by specific incorporation by reference in the proposed nonprofit corporation law:

Section 105 (suit against corporation)

Section 106 (subjection of corporate property to attachment)

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3. Section 16, as amended by Section 43.5 of Chapter 641 of the Statutes of 1976, provides:

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

(b) Notwithstanding subdivision (a), subdivision (b) of Section 201 of the Corporations Code as in effect on January 1, 1977, and as subsequently amended, shall apply to all corporations.

Section 107 (issuing or putting in circulation other than lawful money)

Section 108 (fees of Secretary of State)

Section 109 (correction of instruments)

Section 110 (filing of instruments)

[Chapter 14 (commencing with Section 1400) (bankruptcy reorganizations and arrangements)]

Chapter 17 (commencing with Section 1700) (service of process on domestic corporations)

Chapter 21 (commencing with Section 2100) (excepting Sections 2108, 2109, and 2115)<sup>4</sup> and Section 191 (foreign corporations--registration of corporate name, qualification to transact intrastate business, permissible corporate name, service of process, and related provisions)

Chapter 22 (commencing with Section 2200) (excepting Sections 2200-2202) (crimes and penalties)

Other provisions of the new business corporation law also should be incorporated by reference in the proposed nonprofit corporation law with appropriate modifications or additions:

(1) Subdivision (b) (permissible corporate name) and subdivision (c) (reservation of corporate name) of Section 201 should be incorporated by reference, and the nonprofit corporation law should further provide that a nonprofit corporation shall not adopt (a) a name the use of which is prohibited by any other statute or (b) a name in which the word "charitable" or its equivalent appears unless the corporation is a nonprofit corporation organized for charitable purposes.

(2) Section 800 (shareholder derivative action) should be incorporated by reference with one important modification. In recognition of

4. The excepted sections relate to pseudo-foreign corporations, which the Commission recommends not be applied to foreign nonprofit corporations at this time. The concept presents difficult conflict of laws and other problems. See Malloran & Hammer, Section 2115 of the New California Corporation Law--The Application of California Corporation Law to Foreign Corporations, 23 U.C.L.A. L. Rev. 1282 (1976). Experience should be accumulated before a determination is made whether a similar provision is appropriate for foreign nonprofit corporations. Moreover, there is much less need for a similar provision for nonprofit corporations--there is little motivation for Californians to incorporate a nonprofit corporation in another state in an effort to avoid application of the California nonprofit corporation law.



the nonpecuniary nature of many nonprofit corporations, a provision should be included in the nonprofit corporation law to permit members to bring derivative actions without being required to furnish security where 50 members or 10 percent of the members, whichever number is smaller, join in the action. This is similar to provisions of the Pennsylvania Nonprofit Corporation Law of 1972.<sup>5</sup>

(3) Section 1502 (annual statement of officers, office, and agent for service) should be incorporated by reference, but only the following information should be required in the annual statement of a nonprofit corporation: the name and address of its chief executive officer and either its secretary or chief financial officer; the address of its principal executive office and, if that office is not located in this state, the address of its principal office in this state, if any; and a statement whether the nonprofit corporation is a nonprofit corporation organized for charitable purposes. The nonprofit corporation, like other corporations under the new business corporation law, would be required to designate in the statement an agent for service of process.

#### OPERATIVE DATE AND TRANSITION PROVISIONS

The operative date of the new nonprofit corporation law should be deferred for a period of one year following its enactment. This will permit adequate time for the law publishers to print the law and for affected persons, organizations, and agencies to become familiar with and prepare forms to implement the law.

An additional period of up to one year following the operative date should be allowed before the new law becomes applicable to nonprofit corporations formed under prior law and in existence on the operative date. Such corporations could elect to be governed by the new law at any time during the additional period. This will accommodate changes in articles and bylaws that may be necessitated by the new law. To assure that the new requirements for the contents of articles of incorporation do not force an existing nonprofit corporation to make extensive amendments solely to comply with formalities, the provisions relating to the required contents of articles should be deferred until such a time as the existing nonprofit corporations makes any amendment of its articles.

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5. Pa. Stat. Ann., tit. 15, § 7765(c) (Supp. 1976).

As a general rule, all corporate actions taken on or after the operative date are to be governed by the new nonprofit corporation law. There are a few minor exceptions to this rule, however, set out in the portion of the proposed legislation relating to "Transition Provisions." These exceptions are based largely on comparable provisions of the new business corporation law.

During the transition period, an existing nonprofit corporation should consider the following provisions in determining whether article or bylaw amendments may be necessitated by the new law:

[list of provisions to be added later which permit or require nonprofit corporations to prescribe rules in articles or bylaws that differ from existing law]

#### CONFORMING REVISIONS

A substantial number of conforming revisions--amendments, additions, and repeals--will be required to conform other laws to the enactment of the proposed nonprofit corporation law and to improve the organization of the statutes relating to nonprofit corporations. These are outlined below. Many of the conforming revisions are technical in nature. The technical revisions are explained, where necessary, in the Comments that follow the sections in the "Proposed Legislation," infra.

#### COOPERATIVE CORPORATIONS

There are three major statutes as well as a number of minor statutes under which cooperative corporations may be formed in California. Two of the major statutes--relating to agricultural cooperatives<sup>1</sup> and fish marketing cooperatives<sup>2</sup>--incorporate by reference the "General Corporation Law."<sup>3</sup> However, this reference is to the old general corporation law rather than to the new business corporation law.<sup>4</sup> Because

1. Food & Agri. Code §§ 54001-54294.
2. Corp. Code §§ 13200-13356.
3. See Corp. Code §§ 13204, 13208, 13225, 13230, 13314 (fish marketing cooperatives); Food & Agri. Code §§ 54040, 54082, 54083, 54116, 54178, 54180, 54202, 54291 (agricultural cooperatives).
4. See Cal. Stats. 1975, Ch. 682, § 16, as amended, Cal. Stats. 1976, Ch. 641, § 43.5. ("All references in any such other statute to any sections or portions of the General Corporation Law shall, until such amendment, continue to be references to Division 1 (commencing with Section 100) of Title 1 of the Corporations Code as in effect immediately prior to the effective date of this act.")

these types of cooperative corporations are governed by laws relating to business corporations, the Commission has not studied or made recommendations with respect to them.

The third major statute--the cooperative corporation law in the Corporations Code<sup>5</sup>--incorporates by reference the provisions of the General Nonprofit Corporation Law.<sup>6</sup> The statute also provides for the formation of cooperatives with shares, memberships, or both<sup>7</sup> and permits the distribution of dividends to the shareholders or members.<sup>8</sup> The proposed nonprofit corporation law covers only membership corporations and does not include provisions dealing with the issuance of shares or the payment of dividends. Accordingly, the Commission recommends that the General Nonprofit Corporation Law be continued for these cooperative corporations to the same extent it is now applicable to them. This will preserve the existing law applicable to these corporations until a study can be made and a new statute drafted that relates to them.

"Nonprofit cooperative corporations" were formed pursuant to a repealed title in the Civil Code<sup>9</sup> that differed from the cooperative corporation law in the Corporations Code in that it forbade the issuance of stock<sup>10</sup> and did not authorize the distribution of dividends to members.<sup>11</sup> The legislation enacting the new business corporation law was amended in 1976 to provide that such corporations, if they have not

5. Corp. Code §§ 12200-12956 (cooperative corporations for ultimate producers or consumers or both).
6. Corp. Code § 12205. But see Corp. Code §§ 12206 (corporation organized under other law may bring itself under cooperative corporation law by amending articles as prescribed in General Corporation Law), 12900 (cooperative corporation may amend its articles as prescribed by General Corporation Law).
7. Corp. Code § 12402.
8. Corp. Code §§ 12201, 12805.
9. Former Civil Code §§ 653t-653zd (former Title 22 of Part 4 of Division 1).
10. Former Civil Code § 653u.
11. See former Civil Code § 653zc (corporation may carry on business for profit of its members).

elected to be governed by the cooperative corporation law,<sup>12</sup> are governed by the General Nonprofit Corporation Law.<sup>13</sup> The Commission recommends that these nonprofit cooperative corporations, like those subject to the cooperative corporation law, be governed for the time being by the existing General Nonprofit Corporation Law rather than the proposed Nonprofit Corporation Law.

The Commission recommends that a general study be made of cooperative corporation law. The statutes relating to agricultural cooperatives and fish marketing cooperatives, as noted above, refer to the old general corporation law. This requires that repealed statutes be consulted to determine the law applicable to these corporations. In addition, under the Commission's recommendation, with respect to the cooperative corporation law found in the Corporations Code, it will be necessary to refer to the now existing but to be repealed General Nonprofit Corporation Law, which in turn will refer to the old general corporation law. This undesirable situation is one that should be corrected as soon as possible.

#### CORPORATIONS FOR CHARITABLE AND ELEEMOSYNARY PURPOSES

A special statute provides for the formation of corporations to receive, hold, and expend funds for charitable purposes.<sup>14</sup> The Commission recommends that this rarely used<sup>15</sup> statute be repealed. Nonprofit corporations may be formed for these purposes under the General Nonprofit Corporation Law and under the proposed nonprofit corporation law. Thus, the specific restrictions contained in the special statute<sup>16</sup> have

12. The election to be governed by the cooperative corporation law (Corp. Code §§ 12200-12956) may be made pursuant to Corp. Code § 12206.

13. Cal. Stats. 1975, Ch. 682, § 16, as amended, Cal. Stats. 1976, Ch. 641, § 43.5.

14. Corp. Code §§ 10200-10208.

15. California Nonprofit Corporations § 1.11, at 10-11 (Cal. Cont. Ed. Bar 1969); H. Ballantine & G. Sterling, California Corporation Laws § 408.02(a), at 761-762 (4th ed. 1976).

16. See, e.g., Corp. Code §§ 10200 (formation by a minimum of 25 persons), 10201(d) (board consisting of between 9 and 25 trustees), 10206(d) (no property held other than for charitable purposes), 10206(f) (prohibition against compensation of trustees).

no general application under existing practice and are easily avoided. They should not be continued. A few advantageous provisions<sup>17</sup> of the special statute should be continued in the proposed nonprofit corporation law and expanded to make them generally applicable to all corporations organized for charitable purposes. Existing corporations organized under the special statute would continue to exist under and be subject to the provisions of the proposed nonprofit corporation law.<sup>18</sup>

#### CHAMBERS OF COMMERCE, BOARDS OF TRADE, AND THE LIKE

A special statute authorizes the formation, with or without stock,<sup>19</sup> of chambers of commerce, boards of trade, mechanics' institutes, and the like.<sup>20</sup> If formed with capital stock, the corporation is subject to the old general corporation law;<sup>21</sup> if formed without capital stock, it is subject to the General Nonprofit Corporation Law.<sup>22</sup> The statute contains a number of special provisions<sup>23</sup> which are unnecessary because they largely duplicate provisions of the new business corporation law and the proposed nonprofit corporation law. The statute also contains certain restrictive provisions<sup>24</sup> which are ineffective because they may be easily evaded by forming the corporation under other laws.<sup>25</sup>

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17. See, e.g., Corp. Code §§ 10204 (power of the board to delegate financial and investment decision-making authority), 10206(b) (authority to accept funds upon a general charitable trust and to receive and use indefinite or uncertain charitable gifts).
  18. These corporations would be free from the restrictions found in Corporations Code Sections 10200-10208 unless otherwise provided in their articles or bylaws.
  19. Corp. Code § 12000.
  20. See Corp. Code §§ 12000-12006.
  21. Corp. Code § 12000. See Corp. Code § 102 (scope of new business corporation law).
  22. Corp. Code § 12000.
  23. See, e.g., Corp. Code §§ 12001 (required provisions of articles), 12002 (required provisions of bylaws), 12005 (levy of assessments).
  24. See, e.g., Corp. Code §§ 12000 (formation by 20 or more persons), 12004 (penalty for violation of bylaws not to exceed \$100).
  25. See I li. Ballantine & G. Sterling, California Corporation Laws § 428 n.4 (4th ed. 1976).

The Commission recommends that the special statute be repealed.<sup>26</sup> Any corporation existing under the special statute on the operative date of its repeal should be subject to the provisions of the proposed non-profit corporation law if the corporation is currently subject to the General Nonprofit Corporation Law, or to the provisions of the new business corporation law if the corporation is currently subject to the old general corporation law.

#### CORPORATIONS TO ADMINISTER LIBRARIES

An infrequently used special statute in the Education Code<sup>27</sup> authorizes the formation of corporations to administer libraries. These provisions should be repealed. The statute is not the exclusive authorization for the formation of nonprofit library corporations since such corporations may be formed under the General Nonprofit Corporation Law and will be able to be formed under the proposed nonprofit corporation law.<sup>28</sup> Accordingly, the apparent purpose of its restrictive and unique provisions<sup>29</sup> is easily avoided and is not being achieved. Any corporation existing under the special statute on the operative date of the proposed nonprofit corporation law should be subject to the provisions of the proposed law.

#### CORPORATIONS SOLE

The Corporations Code governs the formation and operation of a corporation sole--a corporation consisting of the presiding officer of a church in his official capacity.<sup>30</sup> The provisions relating to these

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26. For a complete statement of the proposed disposition of Corp. Code §§ 12000-12006, see the Comment to the proposed repeal of these sections in the "Proposed Legislation," infra.

27. Educ. Code §§ 28701-28712.

28. It should be noted that a corporation formed under the proposed nonprofit corporation law would be permitted to restrict its purposes and make special provisions for the governing of its affairs in the same manner as provided in the special provisions in the Education Code.

29. See, e.g., Educ. Code §§ 28702 (business not be carried on for profit), 28703 (board members subject to approval of Commissioner of Corporations), 28712 (articles subject to approval of Attorney General).

30. See Corp. Code §§ 10000-10015.

unique entities, useful for maintaining continuity of institutional property ownership, should be continued with minor technical revisions<sup>31</sup> and should be relocated in Division 3 of Title 1 of the Corporations Code which deals with corporations for specific purposes.<sup>32</sup>

#### SOCIETIES FOR THE PREVENTION OF CRUELTY TO CHILDREN OR ANIMALS

Provisions relating to societies for the prevention of cruelty to children or animals are currently located both in the Corporations Code<sup>33</sup> and in the Civil Code.<sup>34</sup> These provisions should be relocated in the Health and Safety Code with a few technical revisions to conform them to the proposed nonprofit corporation law.<sup>35</sup>

#### PORT AND TERMINAL PROTECTION AND DEVELOPMENT CORPORATIONS

The provisions governing port and terminal protection and development corporations, currently located in the Corporations Code,<sup>36</sup> should be relocated in the Harbors and Navigation Code which contains other provisions pertaining to ports. A few technical revisions should be made in these provisions to conform them to the proposed nonprofit corporation law.<sup>37</sup>

31. For example, provisions requiring the verification of the articles (Corp. Code § 10005) and the filing of articles of incorporation with a county clerk (Corp. Code § 10006) should be deleted, in conformity with the new business corporation law and the proposed nonprofit corporation law. See discussion under "Philosophy of Nonprofit Corporation Statute" and "Formation," supra.
32. It should be noted that corporations sole would not be subject to the proposed nonprofit corporation law except for the provisions authorizing participation in common trust funds.
33. See Corp. Code §§ 10400-10406.
34. See Civil Code §§ 607d-607f.
35. For example, the provision of Civil Code Section 607f, requiring that an appointment of a humane officer be attested by the seal of the corporation, should be eliminated to be consistent with the proposed abolition of the presumptive validity of instruments to which a seal has been affixed. See discussion under "Corporate Seal," supra.
36. See Corp. Code §§ 10700-10703.
37. For example, the provision of Corporations Code Section 10703, relating to incorporators, should be deleted because it is recommended that the concept of incorporators not be continued in the proposed nonprofit corporation law. See discussion under "Formation," supra.

### NONPROFIT CORPORATIONS FOR MEDICAL SERVICES

The special provisions relating to nonprofit corporations for medical services, currently located in the General Nonprofit Corporation Law,<sup>38</sup> should be relocated in the Business and Professions Code along with other provisions concerning the healing arts.<sup>39</sup>

### NONPROFIT CORPORATIONS FOR LEGAL SERVICES

The special provisions relating to nonprofit corporations for legal services, currently located in the General Nonprofit Corporation Law,<sup>40</sup> should be relocated in the Business and Professions Code along with other provisions concerning law corporations.<sup>41</sup>

### WATER COMPANIES

Various provisions concerning water companies, including nonprofit water companies, are found in what remains of the old "General Provisions Applicable to All Corporations" in the Civil Code<sup>42</sup> and in the new business corporations law.<sup>43</sup> These provisions should be relocated, without substantive change, in the Public Utilities Code where other provisions relating to water companies are compiled.<sup>44</sup>

### FEEES FOR FILING CORPORATE INSTRUMENTS

Existing law provides different fees for the filing of certain corporate instruments with the Secretary of State, depending on whether

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38. See Corp. Code §§ 9201, 9201.1.

39. See Division 2 (commencing with Section 500) of the Business and Professions Code.

40. See Corp. Code § 9201.2.

41. See Article 10 (commencing with Section 6160) of Chapter 4 of Division 3 of the Business and Professions Code.

42. See Title 1 (commencing with Section 330.24) of Part 4 of Division 1 of the Civil Code.

43. See Corp. Code §§ 602(a), 708(d).

44. See Chapter 2 (commencing with Section 2701) of Part 2 of Division 1 of the Public Utilities Code.



the corporation is a business or a nonprofit corporation.<sup>45</sup> The fee for filing articles of incorporation or agreements of merger or consolidation is \$15 for nonprofit corporations<sup>46</sup> and \$65 for business corporations.<sup>47</sup> The Commission recommends that this scheme be preserved and that the fees for filing a plan of division of a nonprofit corporation and for filing a plan of conversion of a nonprofit into a business corporation, and vice versa, be consistent therewith. Accordingly, the fee for filing a plan of division should be \$15; the fee for filing a plan of conversion of a nonprofit into a business corporation should be \$65, and the fee for filing a plan of conversion of a business into a nonprofit corporation should be \$15.

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45. See Govt. Code §§ 12200, 12201, 12202, 12205, 12210. These sections are drafted in terms of stock and nonstock corporations rather than business and nonprofit corporations.
  46. Govt. Code §§ 12200 (articles of incorporation and agreement of consolidation), 12205 (agreement of merger, fee not otherwise provided for).
  47. Govt. Code §§ 12201 (articles of incorporation and agreement of consolidation), 12202 (agreement of merger).