

#77.400

15/327

11/5/76

Second Supplement to Memorandum 76-91

Subject: Study 77.400 - Nonprofit Corporations (Disposition of Provisions of Former Division 4)

At the last meeting, it was decided to incorporate the provisions of Division 4 (Provisions Applicable to Corporations Generally) into Division 2 (Nonprofit Corporation Law). In Memorandum 76-98, the staff reported that we had concluded that Division 2 should not include the provisions relating to the qualification of foreign nonprofit corporations to transact intrastate business in California. Instead, we concluded that the provisions of the General Corporation Law now apply to all foreign corporations and should continue to do so. Some technical amendments are needed in the General Corporation Law provisions relating to this matter.

The staff has started the actual drafting necessary to incorporate the remainder of Division 4 into Division 2. We have reached the conclusion that this choice of alternatives would be our third choice. A better choice, we believe, would be to make general the provisions of the General Corporation Law insofar as they deal with the matters that were covered in Division 4. This will give us a uniform statute covering each of these matters. The disadvantage, of course, is that the provisions of Division 4--which did not deal with the internal affairs of the nonprofit corporation--will not be included in the nonprofit corporation law itself and, in that sense, the law will not be complete. On balance, all members of the staff are strongly of the view that retaining the concept of general statutory provisions in the General Corporation Law for the particular matters formerly covered in Division 4 is a sound and highly desirable alternative to duplicating these provisions in Division 2.

Some provisions of the General Corporation Law already appear to have application to all corporations--business, nonprofit, cooperative, and the like. The remaining provisions which were proposed to be included in Division 4 could be made applicable to all corporations (or to all corporations under Title 1 of the Corporations Code) by a series of

minor amendments. No wholesale redrafting of the General Corporation Law provisions would be required.

We believe that the State Bar Committee on Corporations would look favorably on our proposal to generalize the provisions we had proposed to compile in Division 4. If we took this course of action, it would greatly simplify drafting the nonprofit corporation law itself since we would not have to go through the provisions formerly contained in Division 4 and redraft them to delete provisions that would not be appropriate for nonprofit corporations. We could use what we now have in our Division 2 and would need only to reorganize that material.

Our suggestion can best be understood in light of the following background concerning the scheme of the General Corporation Law. The General Corporation Law (Section 167) defines "domestic corporation" to mean "a corporation formed under the laws of this state." Note that this definition does not limit the scope of a provision in which "domestic corporation" is used to a corporation formed under Division 1 (General Corporation Law). "Foreign corporation" is defined in the General Corporation Law (Section 171) to mean "any corporation other than a domestic corporation." Accordingly, when the phrase "domestic or foreign corporation" is used in the General Corporation Law, unless the context otherwise requires, the provision applies to all corporations of every type.

The section of the General Corporation Law (Section 102) which describes the applicability of Division 1 is difficult to understand but, as we understand the section, Division 1 applies to corporations formed under Division 1 and "to any other corporation only to the extent expressly included in a particular provision of this division." Accordingly, if the words "domestic corporation" are used in a section, unless the context otherwise requires, it would appear that the section includes all corporations formed under the laws of this state. We do not know how carefully the words "domestic corporations" were used in drafting the new General Corporation Law, and we believe that a review of those provisions that apply or should apply to all corporations would be useful. We would expect that the State Bar Committee would be more than willing to cooperate with the Commission in this effort to avoid duplication of these provisions in the nonprofit corporation law.

The situation under the General Corporation Law can best be illustrated by several examples. Chapter 17 of the General Corporation Law relates to service of process and provides an alternative manner for serving process upon "domestic corporations." An examination of this chapter discloses that no amendments are needed since (in view of the definition of "domestic corporation") the chapter now applies to all corporations, including nonprofit corporations. Other sections could be given general application by a simple amendment. For example, Section 106 could be given general application by amending it as follows:

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

Section 105 could be given general application by amending it as follows:

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

Section 109, relating to certificates of correction, could be expanded to include nonprofit corporations by amending the preliminary portion of the section as follows:

109. Any agreement, certificate or other instrument relating to a domestic or foreign corporation filed pursuant to the provisions of this ~~division~~ title [or as an alternative "this division or Division 2"] may be corrected

Other technical amendments in Section 109 might be required.

If the Commission adopted the scheme suggested by the staff, we suggest that a section along the following lines be included in the nonprofit corporation law itself:

The following provisions of the General Corporation Law apply to the nonprofit corporations to which this division applies:

- (a) Section 105 (suit against corporation).
- (b) Section 106 (subjection of corporate property to attachment).
- (c) Section 107 (issuing money).
- (d) Section 108 (fees of Secretary of State).
- (e) Section 109 (certificates of correction).
- (f) Section 110 (filing of instruments).
- [etc.]

Although this proposal would lose the benefit of splitting long sections into short sections, an offsetting benefit is that the Commission will probably encounter objection to splitting up the sections from the State Bar Committee on Corporations.

In addition to the provisions we had planned to compile in Division 4, the staff suggests that Chapter 8 of the General Corporation Law (Shareholder Derivative Actions) be expanded to apply to nonprofit corporations. This section already is a general statute in the sense that it applies to derivative actions by members of unincorporated associations. Only a few amendments would be needed to make the broader application of the section to all corporations clear, and the Commission's addition (dealing with cases when the security requirement does not apply) could be added to Chapter 8, such addition to apply only to nonprofit corporations under Division 2. We make this suggestion because we believe Chapter 8 already is a general statute with broader application than just to business corporations and because we view the section as providing a remedy that need not be included in the nonprofit corporation law to make the nonprofit corporation law complete in itself as far as the internal operations of the nonprofit corporation are concerned.

We would also not duplicate Chapter 14 (bankruptcy reorganizations and arrangements) in the nonprofit corporation law. This chapter applies to any "domestic corporation" so it now applies to nonprofit corporations, but we would need to check the chapter to be sure that its terminology was adequate to cover nonprofit corporations. We think that this chapter will be so seldom used by nonprofit corporations that it would not be desirable to duplicate it in the nonprofit corporation law.

Although provisions prescribing the evidentiary effect to be given to certain corporate documents and instruments were formerly included in Division 4, we plan to incorporate these provisions into the nonprofit corporation law.

The staff believes that the suggested scheme will provide many of the benefits of Division 4, that the suggested scheme is one that will appeal to the State Bar Committee on Corporations, and that the suggested scheme will provide a sound basis for future revision of the cooperative corporation law (whether or not the Commission undertakes

that project) and the ultimate elimination of the saving of the former General Corporation Law for corporations not formed under Division 1. The alternative of duplicating the provisions formerly in Division 4 in Division 2 would create two bodies of substantially identical law and would require amendments to each comparable provision when one is found to be defective. Moreover, there is a substantial risk of inadvertent error in redrafting the general provisions to include only those portions that would have application to nonprofit corporations, and this would be required if the provisions were to be duplicated in Division 2.

As the staff has previously stated, we do not believe that the provisions we propose to generalize in the General Corporation Law are provisions relating to the internal operation of nonprofit corporations. To some extent, the nonprofit corporation law will not be complete in itself, but the incompleteness will not be a significant problem as it is under existing law.

Respectfully submitted,

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