

## First Supplement to Memorandum 76-42

Subject: Study 77.50 - Nonprofit Corporations (Corporate Finance)

At its May meeting, the Commission began consideration of the staff draft of Chapter 5 (Corporate Finance) attached to Memorandum 76-42. Pursuant to direction of the Commission, the first three sections of Chapter 5 (and the Comments thereto) have been revised. The revised sections are attached to this memorandum.

Discussion of Individual Sections

§ 5500. Levy of dues and assessments

This section was tentatively approved at the February 1976 meeting. At the May meeting, it was suggested that the Comment contain some reference to the requirements of due process for the termination of a membership; this material is in the fifth paragraph of the Comment.

Some question was expressed as to whether a nonprofit corporation could "automatically" forfeit a membership for the failure to pay dues or assessments without the requirement of an opportunity to be heard. The only California case on this issue states that, unlike expulsion on other grounds, termination for this reason requires only reasonable notice. DeHille v. American Fed'n of Radio Artists, 31 Cal.2d 139, cert. denied, 333 U.S. 876 (1947). This pattern is also followed in Pennsylvania. Compare Pa. Stat. Ann., Tit. 15, § 7545(c) (termination of membership for failure to pay dues or assessments, upon reasonable notice), with § 7767(b) (expulsion from membership except pursuant to Section 7545 requires notice, trial, and conviction).

When the Commission considered draft Section 5510 (capital contributions), the staff was directed to consider addition to Section 5500 of authority to impose fees or contribution requirements upon admission to membership. This has been done in subdivision (c) of the attached draft section. It should be noted that authority for bylaws relating to admission fees is contained in Section 5262 (tentatively approved, February 1976) which continues a portion of existing Section 9403.

§ 5501. Levy of assessments

In response to Commission direction, the first paragraph of the Comment now contains a reference to existing law giving the nonprofit corporation wide discretion in the matter of imposing assessments. As long as the capital contribution concept is limited to the imposition of financial requirements at the time of admission to membership (by the suggested amendment to subdivision (c) of draft Section 5500 and the nonadoption of Article 2, or by amendment to draft Section 5510 and enactment of Article 2), no extension of Section 5501 to cover capital contributions will be necessary.

§ 5502. Replacement of lost, stolen, or destroyed instruments

This section was tentatively approved (as Section 5504) and renumbered. The staff has not discovered any gloss on the term "lawful successor" (from existing Section 2487) in any cases or other authorities.

Article 6. Payments to Members

§ 5555. Protection of liquidation preference

When reviewing the provisions of Chapter 5 of the new General Corporation Law, the staff determined that Section 502 of that chapter should be included in the General Nonprofit Corporation Law. Section 5555 prohibits the redemption or repurchase of memberships if the resulting net worth of the nonprofit corporation would be less than the liquidation preference of any other outstanding class of memberships.

Respectfully submitted,

Peter A. Whitman  
Staff Attorney

Tentatively Approved  
February 1976  
Renumbered May 1976  
Staff revision June 1976

## CHAPTER 5. CORPORATE FINANCE

### Article 1. General Provisions

#### § 5500. Levy of dues and assessments

5500. (a) The bylaws may authorize dues or assessments or both to be levied upon all members or classes of membership alike, or in different amounts or proportions or upon a different basis upon different members or classes of membership and may exempt some members or classes of membership from either dues or assessments or both.

(b) The bylaws may fix the amount and method of collection of dues or assessments or both, or may authorize the board of directors to fix the amount thereof from time to time, and make them payable at such times or intervals and upon such notice and by such methods as the directors may prescribe.

(c) The bylaws may provide for fees or other required contributions upon admission to membership, the amount of the fees or contributions, and the time and manner of payment.

(d) The bylaws may fix the amount and method of collection of charges owed to the nonprofit corporation.

(e) Dues, assessments, fees and contributions upon admission, or charges, or all of them, may be made enforceable by action or by sale or forfeiture of membership, or both, upon reasonable notice.

Comment. Section 5500 augments Sections 5261(d) (liability of members to dues and assessments) and 5410 (authority of nonprofit corporations to levy dues and assessments).

Subdivision (a) continues the substance of the third sentence of former Section 9301.

Subdivision (b) continues the substance of the fourth sentence of former Section 9301.

Subdivisions (c) and (d) are new.

Subdivision (e) continues the substance of the last sentence of former Section 9301 with the addition of provisions for the collection of admission fees and charges owed to the nonprofit corporation in the manner of dues or assessments. There is a general requirement of due process when a member is expelled or significant membership rights are affected by a nonprofit corporation. See Section 5441; Cason v. Glass Bottle Blowers Ass'n, 37 Cal.2d 134, \_\_\_\_ P.2d \_\_\_\_, \_\_\_\_ Cal. Rptr. \_\_\_\_ (1951); Ascherman v. San Francisco Medical Soc'y, 39 Cal. App.3d 623, \_\_\_\_ Cal. Rptr. \_\_\_\_ (1974). However, the termination of membership because of the failure to pay a legal assessment or other membership obligation, or in other such circumstances involving undisputed facts, does not require a hearing. DeMille v. American Fed'n of Radio Artists, 31 Cal.2d 139, \_\_\_\_ P.2d \_\_\_\_, \_\_\_\_ Cal. Rptr. \_\_\_\_, cert. denied, 333 U.S. 876 (1947).

968/978

§ 5501

Tentatively Approved  
May 1976

§ 5501. Levy of assessments

5501. (a) This section applies where a nonprofit corporation levies an assessment upon its members or any class of members in an amount in excess of three times the annual dues or regularly recurring annual assessment, whichever is greater, fixed for such members or class of members.

(b) A nonprofit corporation shall give written notice of an assessment described in subdivision (a) to each member subject to the assessment by mailing a copy of the articles, bylaw, or resolution of the

board fixing the amount and terms of the assessment to the member at the address of the member appearing on the books of the nonprofit corporation for the purpose of notice.

(c) Each member subject to an assessment described in subdivision (a) may withdraw from membership by delivering to the nonprofit corporation at its principal executive office written notice of withdrawal within a period of 15 days from the giving of written notice of assessment by the nonprofit corporation pursuant to subdivision (b). The withdrawal shall be upon the same terms and conditions established by the nonprofit corporation for withdrawal from membership in the absence of such an assessment and, upon withdrawal, the withdrawing member shall not be liable for such assessment.

Comment. Section 5501 is new. Existing law leaves the amount and manner of levying assessments to the discretion of the nonprofit organization, subject only to the requirements that the organization's own procedures be followed and that the funds so raised be used for proper purposes. See former Section 9301 (General Nonprofit Corporation Law); DeMille v. American Fed'n of Radio Artists, 31 Cal.2d 139, \_\_\_\_ P.2d \_\_\_\_, \_\_\_\_ Cal. Rptr. \_\_\_\_, cert. denied, 333 U.S. 876 (1947). Resignation of membership is not necessarily an effective means to escape liability for an assessment. See Locust Club v. Einstein, 129 Pa. Super. 336, 195 A. 432 (1937)(and cases cited therein).

Section 5501 protects a member from liability for extraordinary assessments, typically for major property, construction, or program additions by the nonprofit corporation. The limitation stated in subdivision (a) provides the nonprofit corporation with the opportunity to fix assessments in amounts bearing some reasonable relationship to annually recurring financial burdens of membership (such as for unexpected operating deficits) without the requirement that members be allowed to escape liability by withdrawal. The binding nature of assessments below the limitation is appropriate because the amount involved will necessarily be within the member's concept of the general financial consequences of membership.

This section does not prohibit a nonprofit corporation from adopting a bylaw restricting the right of a former member, after exercising his withdrawal right, to rejoin the organization. A nonprofit corporation may regulate admission to membership (Sections 5410, 5411), termination (Sections 5441 and 5442), and withdrawal (Section 5443).

968/979

§ 5502

Tentatively Approved  
May 1976

Renumbered May 1976

§ 5502. Replacement of lost, stolen, or destroyed instruments

5502. (a) This section applies to a membership, capital, or subscription certificate, or a bond or other evidence of indebtedness which was issued by the nonprofit corporation or by any nonprofit corporation of which it is the lawful successor and which is alleged to have been lost, stolen, or destroyed.

(b) A nonprofit corporation may issue a new instrument to replace an instrument described in subdivision (a) and may require the owner of the instrument described in subdivision (a) or the owner's legal representative to give the nonprofit corporation a bond (or other adequate security) sufficient to indemnify it against any claim that may be made against it (including any expense or liability) on account of the alleged loss, theft, or destruction of the instrument described in subdivision (a) or the issuance of the new instrument.

(c) If the nonprofit corporation refuses to replace an instrument described in subdivision (a), the owner of the instrument or the owner's legal representative may bring an action to require the nonprofit corporation to replace the instrument, subject to the following procedure:

(1) The action shall be brought in the superior court of the proper county.

(2) The court shall make an order requiring the nonprofit corporation to issue and deliver to the plaintiff a replacement instrument if the court is satisfied that (i) the plaintiff is the lawful owner of the instrument described in the complaint, (ii) the instrument has been lost, stolen, or destroyed, and (iii) no sufficient cause has been shown why a replacement instrument should not be issued.

(3) In its order, the court shall direct that, prior to the issuance and delivery to the plaintiff of the new instrument, the plaintiff give the nonprofit corporation such a bond (or other adequate security) as to the court appears sufficient to indemnify the nonprofit corporation against any claim that may be made against it (including any expense or liability) on account of the loss, theft, or destruction of the instrument described in subdivision (a) or the issuance of the new instrument.

Comment. Section 5502 is the same in substance as Section 419 (General Corporation Law). It continues the provisions of former Sections 2481-2485.

405/348

§ 5555

Staff draft June 1976

§ 5555. Protection of liquidation preference

5555. Neither a nonprofit corporation nor any of its subsidiaries shall make any payments pursuant to this article to members holding any class of memberships which are junior to outstanding memberships of any other class with respect to distribution of assets on liquidation if,

after giving effect thereto, the excess of its assets (exclusive of goodwill, capitalized research and development expenses, and deferred charges) over its liabilities (not including deferred taxes, deferred income, and other deferred credits) would be less than the liquidation preference of all memberships having a preference on liquidation over the class to which payment is made.

Comment. Section 5555 is the same in substance as Section 502 (General Corporation Law).