

#77.400

11/19/76

Memorandum 76-100

Subject: Study 77.400 - Nonprofit Corporations (Review of Comments on Division 4--Redrafted Provisions)

This memorandum presents for Commission review those provisions that the Commission requested the staff return after redrafting, plus a few additional provisions of which the staff believes further Commission review at this time would be most beneficial.

Application of Statute to Religious Corporations

The Commission has determined to include a provision that recognizes the constitutional limitations on statutes relating to religious corporations. Such a provision could read:

This division does not apply to a nonprofit corporation organized for religious purposes to the extent that such application is prohibited by the Constitution of the United States or the State of California.

Comment. This section recognizes that the First Amendment to the U.S. Constitution may limit the extent to which the state may regulate religious organizations where ecclesiastical matters are concerned. See, e.g., Serbian Eastern Orthodox Diocese for the United States & Canada v. Milivojevich, 96 S. Ct. 2372 (1976). See also Cal. Const., Art. I, § 4 (religious freedom).

§ 5211. Incorporation of unincorporated associations

The Commission requested that a subdivision be added to the effect that nothing in the provisions authorizing incorporation of an unincorporated association affects any rights a dissenter may have in the property of the association, with a Comment noting that the rights of dissenting members are determined by the applicable law under the circumstances of the particular case. Such a provision would read:

(e) Nothing in this section affects the rights, if any, of a person described in subdivision (d) in the assets of the association.

Comment. Subdivision (e) is new. It makes clear that the authority contained in Section 5211 for incorporation of an unincorporated association should not be deemed to preclude dissenters from obtaining a share of the assets of the association where they

have the right to do so. The rights of dissenters are determined not by this section, but by other applicable law under the circumstances of the particular case and the particular agreement of association.

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

The Commission has determined to add to Section 5232 a new subdivision (c) that specifies the persons authorized to enjoin the ultra vires activities of a charitable corporation regardless whether third parties have acquired rights thereby:

(c) An action may be brought under this section by the Attorney General, a director, or a person having the right of visitation.

The staff has done further research on the "right of visitation." The following analysis was prepared by Mr. Murphy.

Under English canon law, the founder of a private charity had a "right of visitation"--a right to inspect and regulate the charity. Phillips v. Bury, 91 Eng. Rep. 900, 902-903 (1694); Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 660 (1819); see 2 J. Perry, A Treatise on the Law of Trusts and Trustees § 742, at 1270 (7th ed. 1929); C. Zollmann, American Law of Charities § 603, at 418 (1924). If the charity is incorporated, the corporate charter may vest the visitorial powers in the trustees or may retain such power in the founder. See Trustees of Dartmouth College v. Woodward, *supra* at 675; C. Zollmann, *supra* § 604, at 419-420. Where the founding gift is made not by a single donor but by many people, administrative expediency requires that the rule not be applied, and the persons who have thus contributed have no visitorial power. See C. Zollmann, *supra* § 605, at 420-421.

However, the right of visitation has "found little, if any, recognition in recent times." 15 Am. Jur.2d Charities § 113, at 120 (1964). But see, e.g., Coffee v. William Marsh Rice University, 403 S.W.2d 340, 347 (Tex. 1966) (express reservation of visitorial power by founder in trust instrument). No California cases dealing with the power of visitation have been found.

In the United States jurisdictions, there is a split of authority as to whether the founder of a charitable trust or his heirs have standing to sue to enforce the trust or to prevent misuse or diversion of

charitable assets. See 15 Am. Jur.2d Charities § 123, at 130 (1964); Annot., 124 A.L.R. 1237, 1241-1242 (1940); Annot., 62 A.L.R. 881, 897-900 (1929). According to the majority rule, the founder or his heirs do not have standing, except where the gift is conditional or ineffective, or there is a clear reservation of a right to terminate or revoke it. 15 Am. Jur.2d, supra. This is the rule adopted by the Restatement of Trusts. Restatement (Second) of Trusts § 391, Comment e (1959).

California follows the majority rule and holds that the creator of a trust who retains no reversionary interest has no standing to compel proper execution of the trust except as a relator. O'Hara v. Grand Lodge, Independent Order of Grand Templars, 213 Cal. 131, 139, 2 P.2d 21, 24 (1931); 12 Cal. Jur.3d Charities § 51, at 159 (1974). As a relator, the creator of the trust can maintain such an action only with the consent of the Attorney General. 3 B. Witkin, California Procedure, Pleading § 123(c), at 1794 (2d ed. 1971).

Although the Attorney General has primary responsibility for the enforcement of charitable trusts in California, this responsibility is not vested in him exclusively. 12 Cal. Jur.3d, supra § 51, at 158. An action to enforce a charitable trust may be maintained by anyone who has "some definite interest in the property--he must be a trustee, or a cestui [beneficiary], or have some reversionary interest in the trust property." O'Hara v. Grand Lodge, Independent Order of Grand Templars, supra at 140, 2 P.2d at 24. Accord, Holt v. College of Osteopathic Physicians & Surgeons, 61 Cal.2d 750, 752-757, 394 P.2d 932, 934-937, 40 Cal. Rptr. 244, 246-249 (1964) (minority trustees); 12 Cal. Jur.3d, supra § 51, at 158-159.

Thus Section 5232 (enjoining ultra vires act affecting charitable trust) as drafted differs from trust law by giving standing to the founder of a charitable trust (assuming the California courts will recognize the visitorial power) and by not giving standing to beneficiaries of the trust. This should pose no problem so long as Section 5232 is not construed to limit trust law principles. To ensure this, the staff recommends that the Comment to Section 5232 be revised to read:

Comment. Section 5232 is new. For a comparable provision, see ALI-ABA Model Nonprofit Corporation Act § 6(a). See also Holt v. College of Osteopathic Physicians & Surgeons, 61 Cal.2d 750, 394 P.2d 932, 40 Cal. Rptr. 244 (1964).

The remedies provided by Section 5232 supplement those of Section 5231. A "right of visitation" may be possessed by the founding donor to inspect and regulate the trust. See Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819); 15 Am. Jur.2d Charities § 113, at 120 (1964).

Nothing in Section 5232 limits the law of trusts as to standing to sue to enforce a trust or to prevent misuse or diversion of charitable assets. See, e.g., O'Hara v. Grand Lodge, Independent Order of Grand Templars, 213 Cal. 131, 140, 2 P.2d 21, 24 (1931) (action to enforce trust may be maintained by anyone who has "some definite interest in the property"); accord, Holt v. College of Osteopathic Physicians & Surgeons, *supra*. Nor does Section 5232 limit rights provided by any other statute.

§ 5250. Required contents of articles

The Commission reversed the presumption of Section 5250 so that any statement of purposes or powers in the articles is not deemed a limitation on the general right to exercise any purposes or powers unless the articles expressly state that a limitation is intended. The staff believes this should be made more clear in the statute and proposes to make two sections that cover this matter: (1) a section prescribing the required contents of the articles; and (2) a section describing the effect of putting statements of purposes or powers in the articles.

§ 5250. Required contents of articles

5250. The articles shall state:

(a) The name of the nonprofit corporation.

(b) That the nonprofit corporation is organized pursuant to the Nonprofit Corporation Law and that the nonprofit corporation shall not distribute gains, profits, or dividends to members except to the extent permitted by the Nonprofit Corporation Law.

(c) In the case of a nonprofit corporation organized for charitable purposes, that the nonprofit corporation is organized for charitable purposes and is subject to all provisions of the Nonprofit Corporation Law that relate to nonprofit corporations organized for charitable purposes.

(d) In the case of original articles, the names and addresses of one or more persons who are to act in the capacity of initial directors.

§ 5250.5. Statement in articles concerning purposes and powers

5250.5. (a) The articles need not include any statement with respect to the purposes or powers of the nonprofit corporation.

(b) Unless the articles include a provision limiting the purposes for which the nonprofit corporation is formed, the nonprofit corporation may engage in any activity in which a nonprofit corporation formed under this division may engage.

(c) Unless the articles include a provision limiting the powers which the nonprofit corporation may exercise, the nonprofit corporation may exercise all the powers a nonprofit corporation formed under this division may exercise.

(d) If the articles include a provision with respect to the purposes or powers of the nonprofit corporation, the provision shall not be construed as a limitation on the purposes or powers of the nonprofit corporation unless the articles expressly so provide.

(e) A provision limiting the purposes for which the nonprofit corporation is formed or the powers which the nonprofit corporation may exercise or both is not effective unless expressly provided in the articles.

§ 5315. Multiple boards

The Commission adopted provisions specifying the responsibility of each board for matters delegated to it and directed the staff to further refine the multiple board provisions. The staff believes the following provision is adequate:

5315. (a) A nonprofit corporation may have multiple boards of directors if all of the following conditions are satisfied:

(1) The articles or bylaws provide for multiple boards.

(2) The articles or bylaws specify the manner of selection and delegate the authority of each board.

(3) The articles or bylaws designate one managing board, however named, that has all the authority of the board of directors provided in this division that is not specifically delegated to another board.

(b) The liability of each board other than the managing board is limited to the matters delegated to it by the articles or bylaws.

(c) The liability of the managing board extends to all matters not specifically delegated to another board.

Comment. Section 5315 recognizes the practice of some nonprofit corporations to have more than one board of directors, with a division of authority. No comparable provision was found in prior law.

Under Section 5315, each board is responsible for those matters delegated to it. The matters delegated may vary with the type of board. An honorary board, for example, may have no duties or only advisory duties. In such a case, the liability of directors will vary accordingly.

§ 5320. Nomination of directors

The Commission adopted requirements for reasonable nomination and election procedures for candidates for director of a nonprofit corporation. The staff suggests that these requirements be stated as follows:

§ 5321. Nomination and election procedures for directors

5321. The articles or bylaws shall provide reasonable nomination and election procedures for directors, which procedures shall include:

(a) A reasonable means of nominating persons for election as directors.

(b) A reasonable opportunity for a nominee to communicate with voting members the qualifications of the nominee and the reasons for the nominee's candidacy.

(c) If proxy voting is permitted, an equal opportunity for all nominees to solicit proxies.

Comment. Section 5321 is new. It codifies the principle that a nonprofit corporation may not unreasonably restrict the right of members to nominate and elect directors. Braude v. Havenner, 38 Cal. App.3d 526, 113 Cal. Rptr. 386 (1974).

Section 5321 requires a nonprofit corporation to provide reasonable nomination and election procedures, but permits the nonprofit corporation to prescribe procedures appropriate to its particular circumstances. Section 5321 is not intended to preclude any manner of selection of directors of a nonprofit corporation that is reasonable, such as through a representative body. See, e.g., Section 5719 (action taken by policymaking committee).

Under Section 5321, if a court finds that the nomination and election procedures of a nonprofit corporation are inadequate or unreasonable, it may impose such requirements as it considers adequate and reasonable. Braude v. Havenner, supra.

§ 5410. Members

The staff was directed to prepare a definition of "member" drawing upon the following concepts: (1) A member is a person who has rights or interests in the nonprofit corporation; (2) the rights or interests of a member are those prescribed in the articles and bylaws; (3) a member may be described in the articles or bylaws by any other means. The objective of these concepts is to fill a logical hiatus in the statute while not affecting the substantive meaning of those provisions in which "members" are referred to.

The staff believes the following provision satisfies these objectives:

§ 5155. Member

5155. "Member" means a person, however named, for whom the articles or bylaws provide property, voting, or other rights or interests in the nonprofit corporation.

Comment. Section 5155 supersedes former Section 104. It makes clear that the articles and bylaws determine who are members and what their membership interests are. A nonprofit corporation may call its members by any name it chooses.

Defined Terms:

Articles, § 5126

Person, § 18

§ 5560. Management of charitable property

The Commission determined to delete from the statute the reference to the trustee's duty of a director in the management of charitable assets and to replace the reference with exculpatory language for carrying out the charitable purposes. The Comment is to note that the statute does not address the question of the director's duty concerning charitable assets.

Here is a redrafted version of Section 5560 in accordance with these decisions.

5560. (a) As used in this section, "property received for charitable purposes" means both of the following:

(1) All property received for charitable purposes by a nonprofit corporation.

(2) Unless the donor or instrument transferring the property provides otherwise, all property received by a nonprofit corporation organized for charitable purposes.

(b) In acquiring, purchasing, investing, reinvesting, exchanging, selling, and otherwise managing property received for charitable purposes, a nonprofit corporation and its directors are not liable for either of the following:

(1) An action reasonably required to comply with the terms of a transfer of property for charitable purposes to the nonprofit corporation.

(2) An action reasonably required to carry out the charitable purposes of the nonprofit corporation.

Comment. Section 5560 is new. It makes clear that, regardless of the duty of care generally imposed on directors of a nonprofit corporation in the management of charitable property, the directors and the nonprofit corporation may comply with the charitable purposes even though such compliance might otherwise violate

the duty of care. Section 5560 does not prescribe the duty of care of directors in the management of charitable property; this is a matter left to case law development. See, e.g., Lynch v. John M. Redfield Foundation, 9 Cal. App.3d 293, 88 Cal. Rptr. 86 (1970). For the duty of care of directors generally (other than in the management of charitable assets), see Section 5370.

§ 5632. Number of consents required

The Commission requested that the number of consents required for action by written consent be clarified. In connection with this request, the staff notes that the Commission revised the consent provisions to require that written consents of all voting members be solicited in order for action by written consent to be effective. With this revision, Section 5632 can now be eliminated and a reference made in Section 5713(a)(2) (vote required if approval is by mail or other reasonable means provided in the bylaws) to approval by written consent.

§ 6110. Merger or consolidation authorized

The Commission deleted subdivision (b), providing that the bylaws may not prohibit a merger or consolidation authorized by the merger chapter, subject to further staff research on the need for the provision. Further research reveals that the provision was adopted in 1971 as Section 9703 of the General Nonprofit Corporation Law; it was taken from Section 4107 of the old General Corporation Law, which allowed the articles to require a larger vote for merger but did not allow the articles to preclude merger altogether. The provision served no useful purpose since the articles can impose a unanimous vote requirement and since the general rule is that the articles may not limit a statutory right anyway. The provision was omitted from the new business corporation law.

The staff believes that the Commission's decision to delete Section 6110(b) is sound and is consistent with the new business corporation law. However, if the Commission's intent is to in fact permit the articles or bylaws to preclude merger or consolidation, this would have to be done specifically by statute. The staff recommends against such a statutory provision since the same result can be accomplished by adoption of a high or unanimous approval requirement in the articles or bylaws.

§ 6142. Notice to Attorney General

The staff was directed to consider whether a provision should be added to the effect that nothing in the merger chapter should be construed as limiting the power of the Attorney General over charitable corporations. The staff believes such a provision is unnecessary since Section 6142 expressly requires notice of the merger agreement to be given to the Attorney General, and the Comment states that it is intended to help implement the Uniform Supervision of Trustees act. To place a statement in the merger chapter to the effect that nothing in the chapter is intended to limit the Attorney General's authority could have an adverse effect by implication in other areas of the statute.

§ 6410. Bankruptcy reorganizations and arrangements

The Commission determined to delete the provisions relating to bankruptcy reorganizations and arrangements. The staff has contacted the Secretary of State's office to determine what effect deletion would have on the operation of that office. Mr. Holden of that office indicated that they receive filings under the bankruptcy provisions on the average of once a month (mainly involving business corporations). He felt that the provisions were helpful, have worked well with federal law, and would not like to see them deleted. There could be real problems, if the provisions are deleted, where there is a question of compliance with state law after the bankruptcy court loses jurisdiction.

The staff agrees with this assessment and believes deletion of the provisions will serve no useful purpose; deletion can do no good and can only create problems. The staff would substitute for Sections 6410-6415 the following provision:

5528. The following provisions of the General Corporation Law apply to a nonprofit corporation:

* * * * *

(1) Chapter 14 (commencing with Section 1400) of Division 1 (bankruptcy reorganizations and arrangements).

§ 6624. Judicial supervision

The staff was directed to provide more flexibility for the court in devising appropriate orders for compliance with the inspection of membership records provisions. This could be accomplished by revising Section 6624 to read:

6624. Upon the filing of a verified petition and after a hearing, notice of which shall be given to such persons and in such manner as the court may direct, the superior court of the proper county may, for good cause shown, make such orders and decrees as may be just and proper under the circumstances of the case to enable compliance with this article, including but not limited to:

(a) Allowing the nonprofit corporation additional time to comply.

(b) Postponing or recessing a meeting of members.

(c) Imposing conditions for the exercise of inspection rights, including imposing reasonable restrictions on the purposes for which the information may be used.

Comment. Section 6624 permits either the nonprofit corporation or an authorized member to seek court supervision of inspection rights under this article. See also Section 6650(a) (power of court to impose just and proper conditions where member seeks to enforce inspection rights). For a comparable provision, see Section 1600(b) (General Corporation Law).

It should be noted that postponement of a meeting under subdivision (b) in case of a failure to comply with Section 6623 may be made only after an authorized member has made a "proper" demand under Section 6623, including payment or tender of the specified charge. The court should postpone a previously noticed meeting only in extreme cases.

Defined Terms:

Proper county, § 5166

Verified, § 5180

Cross-References:

Recovery of reasonable expenses by member, § 6652

Transition Provisions

The Commission determined to defer the provisions relating to required contents of the articles (Section 5250) until such a time as the nonprofit corporation amends its articles. A draft to implement this decision is set out below.

§ 6813.5. Application of division to articles of incorporation

6813.5. Prior law governs the required contents of the articles of an existing nonprofit corporation unless and until the nonprofit corporation files any amendment of articles on or after the operative date, and thereafter Section 5250 applies.

Comment. Section 6813.5 defers the application of Section 5250 (required contents of articles) until the articles are amended on or after the operative date. Unlike Section 2303 (General Corporation Law), Section 6813.5 does not defer indefinitely (until the corporation specifically elects to be governed by them) the provisions relating to required contents of articles. For the prior law, see former Section 9300 (Cal. Stats. 1971, Ch. 940, § 1).

Defined Terms:

Articles, § 5126
Existing nonprofit corporation, § 6810
Operative date, § 6810
Prior law, § 6810

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary