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STATUTORY TRENDS IN THE LAW OF NONPROFIT ORGANIZATIONS: CALIFORNIA, HERE WE COME!*

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Introduction

Nonprofit organizations[1] have been the neglected stepchildren[2] of modern organization law. The law historically has given nonprofit organizations, like Cinderellas, the hand-me-downs of their half-siblings, the business organizations. This pattern, however, is changing. Recent growth in the economic power of nonprofit organizations,[3] as

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[1] Statutory formulations contain diverse definitions of the term "nonprofit organization." Broadly defined, a nonprofit organization is one that is not operated for the personal financial benefit of its members. Thus, a nonprofit organization may not pay dividends to its members. Members may, however, extract benefits from nonprofit organizations. For instance, employee-members of such organizations often receive substantial compensation for their services. Moreover, members of certain noncharitable nonprofit organizations (such as automobile clubs) may receive part of the corporations' assets upon dissolution in addition to other benefits of membership. *See* Ellman, *On Developing a Law of Nonprofit Corporations,* 1979 Ariz. St. L.J. 153, 154.

[2] Lesher, *The Non-Profit Corporation—A Neglected Stepchild Comes of Age,* 22 Bus. Law. 951 (1967).

[3] The membership rolls of nonprofit organizations have swelled in recent years. A recent report of about 240 religious institutions noted a total of over 131 million members. *See* Oleck, *Nature of Nonprofit Organizations in 1979,* 10 U. Tol. L. Rev. 962, 965 (1979). The wealth of nonprofit organizations is similarly staggering. American Association of Fund-Raising Counsel statistics reveal that contributions in 1980 totaled $47.7 billion, compared with $19.2 billion in 1970. *Id.* at 967; "Gifts to Nonprofit Groups Rise to a Record but Lag Behind Inflation," N.Y. Times, Apr. 27, 1981, § B, at 1, col. 1.

well as the ascendency of the nonprofit organization as an important alternative form of commercial enterprise,[4] have spawned significant legislation in the field.[5]

This Article traces the historical development of nonprofit organization law in view of the traditional dominance of business organization law. Next, general principles for the ideal nonprofit corporation statute are outlined. The Article then discusses and evaluates the major nonprofit organization statutes: the ABA Model Non-Profit Corporation Act,[6] the Delaware General Corporation Law,[7] the New York Not-for-Profit Corporation Law,[8] Professor Howard L. Oleck's proposed Uniform Nonprofit Organizations Act,[9] and the recent California Nonprofit Corporation Law.[10] Despite their shortcomings, these statutes represent considerable progress in the development of a coherent body of law that deals specifically with the unique and varied problems of nonprofit organizations.

I

Historical Development of Nonprofit and Business Organizations

Business corporations have not always occupied the center of organization law. Unincorporated nonprofit organizations prevailed centuries before the development of business organizations. Indeed, business organizations originally patterned themselves after such nonprofit groups as public, religious, charitable, and educational unincorporated and incorporated organizations.[11]

Early common law recognized three types of nonprofit organizations: unincorporated nonprofit associations, charitable trusts, and

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4 *See* Ellman, *supra* note 1 at 153-54 (discussing ascendency of nonprofit corporations that perform services for their members, but shun the profit form, such as Educational Testing Service and Master Charge).

5 *See generally* H. Oleck, Nonprofit Corporations, Organizations, and Associations 54-62 (4th ed. 1980) [hereinafter cited as Oleck Draft]. Professor Oleck notes that "[e]very state provides some system of basic classifications of nonprofit organizations. Some . . . are elaborate and precise, while some are so rudimentary as to be of little practical value." *Id.* at 44.

6 ABA-ALI Model Non-Profit Corp. Act (1964).

7 Del. Code Ann. tit. 8, §§ 101-398 (1975 & Supp. 1980).

8 N.Y. Not-for-Profit Corp. Law §§ 101-1515 (McKinney 1970 & Supp. 1981) [hereinafter cited as N-PCL]. This Article discusses the New York statute in the most detail to indicate those subjects a comprehensive nonprofit corporation statute should cover. Only the unique aspects of the other statutes are discussed in detail.

9 Oleck Draft, *supra* note 5, at 1187-1221.

10 Cal. Corp. Code §§ 5000-10,846 (West Supp. 1981).

11 *See* H. Henn, Handbook of the Law of Corporations and Other Business Enterprises 13-14 (2d. 1970).

nonprofit corporations. Early courts applied the law governing nonprofit organizations to the commercial enterprises that subsequently developed. Consequently, emerging commercial organizations such as joint stock companies, Massachusetts or business trusts, and business or stock corporations were subject to similar rules.[12] Unincorporated organizations were governed primarily by agency law and, by analogy, partnership principles; trusts were governed by the law of trusts—both areas rich in fiduciary concepts. With little statutory support, courts applied analogous legal and equitable principles to incorporated organizations. Nonprofit corporations originally obtained special charters from the Crown or successive sovereign powers such as the state legislatures in the United States. This special legislation provided the foundation upon which business corporation charters and general incorporation statutes were later based.[13]

II

PRECEDENCE OF BUSINESS ORGANIZATION LAW

The industrial revolution precipitated the development of business organizations, which soon dominated the economy and have since preoccupied organization law.[14] Courts routinely have decided cases involving nonprofit groups on common law and equitable principles originally developed to solve the problems of business organizations.[15] The organized bar has nurtured the law of business organizations at the state and federal levels. Practicing lawyers and bar associations have litigated business organization issues and have drafted and lobbied for business legislation.[16] With the exception of Professor Oleck, law teachers have demonstrated little interest in nonprofit organizations. Law schools infrequently offer courses on the subject, and the relevant legal literature is largely confined to the tax

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[12] Large overseas trading companies also developed in the sixteenth and seventeenth centuries. Many of these were organized as joint stock companies and were closely linked to their national governments. *See id.* at 14-16.

[13] *See generally id.* at 13-18.

[14] General incorporation enabling statutes replaced the special charter incorporation procedures. These general incorporation statutes became more lenient as states competed for local business incorporations. *Id.* at 19-20. *See* notes 70-75 and accompanying text *infra.* Business organization legislation has covered partnerships, limited partnerships, and business corporations. *See, e.g.,* UNIFORM PARTNERSHIP ACT; UNIFORM LIMITED PARTNERSHIP ACT; REVISED UNIFORM LIMITED PARTNERSHIP ACT; ABA-ALI MODEL BUS. CORP. ACT (1978).

[15] *See, e.g.,* Stern v. Lucy Webb, 381 F. Supp. 1003 (D.D.C. 1974) (applying business corporation rules on director self-dealing to charitable corporation).

[16] For a discussion of the widespread influence of the Model Business Corporation Act, see notes 33-35 and accompanying text *infra.*

aspects of nonprofit organizations and constitutional issues of church and state that arise in connection with religious nonprofit institutions.

Nonprofit corporations currently are regulated by myriad statutory formulations. Some jurisdictions, for example, have general corporation statutes, governing both profit and nonprofit corporations, which contain a few sections applicable only to nonprofit corporations.[17] Other jurisdictions have enacted separate business corporation and nonprofit corporation statutes.[18] Still other statutory formulations are so scattered as to defy classification. Statutory and decisional treatment of unincorporated nonprofit groups in many jurisdictions is far from satisfactory.[19]

III

Ideal Nonprofit Corporation Statute

Nonprofit corporation statutes generally should resemble business corporation statutes inasmuch as they both govern the formation, financial and management structures, operation, regulation, and dissolution of corporations. The ideal nonprofit corporation statute, however, should be modified where appropriate to reflect the essential differences between nonprofit and profit organizations.[20]

A. *Drafting Considerations*

Because the motives behind corporate organization range from pure altruism to unabashed cupidity, drafters of nonprofit corporation statutes should understand thoroughly the purposes of nonprofit corporations. Thus, they should have similar backgrounds, experiences, and attitudes as organizers of nonprofit corporations. One statute covering both profit and nonprofit corporations can hardly satisfy such needs; nor can separate business corporation and nonprofit corporation statutes if drafted under the same sponsorship.[21]

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[17] *See, e.g.*, Del. Code Ann. tit. 8, §§ 101-398 (1975 & Supp. 1980).

[18] *See, e.g.*, Cal. Corp. Code §§ 100-2319 (West 1977 & Supp. 1981) (business corporations); *id.* §§ 5000-10,846 (nonprofit corporations); N.Y. Bus. Corp. Law §§ 101-2001 (McKinney 1963 & Supp. 1981) (business corporations); N-PCL, *supra* note 8, §§ 101-1515 (nonprofit corporations); ABA-ALI Model Bus. Corp. Act (1978); ABA-ALI Model Non-Profit Corp. Act (1964).

[19] *See* Payne, *Unincorporated Associations Trends*, in ABA-ALI, Trends in Nonprofit Organizations Law 31 (1977).

[20] *See* notes 87-90 and accompanying text *infra*.

[21] The ABA Corporate Laws Committee was responsible for both the Model Non-Profit Corporation Act and the Model Business Corporation Act. *See Preface* to ABA-ALI Model Non-Profit Corp. Act at vii-viii (1964); *Foreword* to ABA-ALI Model Bus. Corp. Act (1978).

Furthermore, statutory treatment of nonprofit corporations should reflect the fact that even nonprofit corporations vary in their degree of altruism. Nonprofit organizations may be created for mutual benefit, public benefit, religious purposes, or countless other reasons. To accommodate best such varying purposes, the ideal nonprofit corporation statute should be flexible with respect to financing, membership, duties and liabilities of the board of directors, external supervision, and distribution of assets upon dissolution of the organization. Thus, a nonprofit corporation statute should provide for some general classification of nonprofit corporations in accordance with corporate purposes.[22]

Although incorporated and unincorporated nonprofit organizations may have similar purposes, traditional thinking treats the former as a fictitious legal entity or person and the latter as an aggregate of persons. One statute covering both types of organizations would require considerable delineation of the legal principles that govern the unincorporated nonprofit organization. A preferable alternative would be a Uniform Unincorporated Nonprofit Association Act, under the sponsorship of the National Commissioners on Uniform State Laws.[23]

B. *Desiderata*

What, then, are the desiderata of a nonprofit corporation statute? Permissible corporate purposes should be nonpecuniary and nonbusiness, and there should be no opportunity for amending, merging, consolidating, or otherwise amalgamating for other purposes.[24] Cor-

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22 *See* notes 241-45 and accompanying text *infra.* Professor Henry B. Hansmann recently criticized statutory attempts to classify nonprofit corporations according to corporate purposes. *See* Hansmann, *Reforming Nonprofit Corporation Law,* 129 U. PA. L. REV. 497, 580-94 (1981). Professor Hansmann correctly points out that the classification schemes contain various ambiguities regarding the criteria for classification. These ambiguities, however, have posed few practical problems. Nonprofit incorporators have generally been able to identify the classification which suits their corporate purposes. The N-PCL, for example, has been in place for eleven years and there are no siguificant cases involving disputes over classification of a nonprofit corporation. Professor Hansmann's main concern is that such ambiguities will permit evasion of the rule against distributions to members. 129 U. PA. L. REV. at 580-94. He proposes a unitary nonprofit statute with rigid prohibitions on distributions to members. Mutual benefit organizations would be required to form under the statute governing cooperative corporations. *Id.* The proposal presents significant economic and practical problems in view of the number of mutual benefit groups currently using the nonprofit corporation form. His approach would also require reform of cooperative statutes. It would be preferable to deal with this problem by modifying provisions dealing with distributions and dissolution. *See, e.g.,* notes 169-72 *infra.*

23 The Uniform Partnership, Uniform Limited Partnership, and Revised Uniform Limited Partnership Acts are not very helpful for unincorporated nonprofit organizations. For a discussion of this problem see notes 185-92 and accompanying text *infra.*

24 *See* notes 165-68 and accompanying text *infra.*

poration statutes should be enabling, thus permitting incorporation without excessive regulation. Yet some governmental supervision of both unincorporated and incorporated nonprofit organizations is essential. These needs may be addressed in one statute or through enabling legislation applicable only to nonprofit corporations and supervisory legislation applicable to all nonprofit organizations.[25]

Membership and board of directors provisions should reflect varying organizational purposes.[26] The statute governing nonprofit organizations should allow different classes of members, institutional members, and no members, with provision for performance of member functions by others in the latter situation.[27] In addition, there must be adequate provision for the selection of directors, express delineation of their management functions and duties, and limits on self-dealing and compensation. Where management other than by the board of directors is desirable, the statute should permit delegation of authority to committees and alternate managing bodies.

The degree of internal stewardship and governmental regulation, including attorney general supervision, also should vary depending on corporate purpose. Member derivative actions, similar actions by directors, officers, and others, and intracorporate procedures may provide adequate internal stewardship.[28] Governmental regulation should not be unduly burdensome and should be performed by as few governmental bodies as possible.[29] Judicial regulation should be limited to the traditional visitatorial power of courts of equity in addition to the judicial functions commonly associated with the resolution of legal disputes.

Provisions pertaining to the administration of assets should be consistent with the conditions and limitations applicable to donated assets, whether from public or private sources. Upon dissolution, and after satisfaction of all creditors' claims, net assets should be distributed according to applicable conditions and limitations, including the *cy pres* doctrine.[30] The disposition of any remaining assets should depend on the stated organizational purposes and the principle against profits inuring to the benefit of members, as set forth in the articles of incorporation under the controlling statute.[31]

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25 *See* notes 185-92 and accompanying text *infra*.
26 *See* notes 141-43 and accompanying text *infra*.
27 *See* notes 199-200 and accompanying text *infra*.
28 *See* notes 267-74 and accompanying text *infra*.
29 *See* notes 257-66 and accompanying text *infra*.
30 *See* notes 133-40 and accompanying text *infra*.
31 *See* notes 48-52, 169-72 and accompanying text *infra*.

A nonprofit corporation conducting activities within a state should not be able to circumvent the state's nonprofit corporation laws simply by incorporating in another jurisdiction. In such situations, the corporation should be required to qualify as a foreign corporation before it can commence in-state activities. The statute also should provide for assimilation so that foreign corporations with substantial local contacts are subject to certain provisions applicable to domestic nonprofit corporations.[32]

IV

ABA Model Non-Profit Corporation Act

The American Bar Association Corporate Laws Committee has drafted model acts dealing separately with profit and nonprofit corporations. The two model acts, the Model Business Corporation Act[33] and the Model Non-Profit Corporation Act,[34] reflect the prevailing concern for business corporations.

The Corporate Laws Committee first published the Model Business Corporation Act in 1950. The Act subsequently was revised every few years and has undergone annual revision since 1973. The Model Business Corporation Act has attracted considerable attention from the corporate bar and different versions of it have been substantially adopted in one-quarter of American jurisdictions.[35]

The Model Non-Profit Corporation Act[36] first appeared in 1952 under the same auspices as the Model Business Corporation Act. A newly created Committee on Non-Profit Corporations revised the Act in 1957 and again in 1965.[37] The Model Non-Profit Corporation Act "follows as closely as permitted by the difference in subject matter the corresponding provisions of the Model Business Corporation Act as supplemented and modified by the 1964 Addendum."[38] In contrast to the Model Business Corporation Act's frequent revisions, the Model Non-Profit Corporation Act remains substantially unchanged since it was first published. Although many of the changes made to the Model Business Corporation Act are equally germane to nonprofit

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[32] *See* notes 173-180 and accompanying text *infra*.

[33] ABA-ALI Model Bus. Corp. Act (1978).

[34] ABA-ALI Model Non-Profit Corp. Act (1964). The ABA currently is revising the Model Non-Profit Corporation Act, but the text of the revision is unavailable.

[35] *See* Model Bus. Corp. Act. Ann. (West Supp. 1977).

[36] ABA-ALI Model Non-Profit Corp. Act (1964).

[37] *See* Oleck Draft, *supra* note 5, at 1189.

[38] *Preface* to ABA-ALI Model Non-Profit Corp. Act at vii-viii (1964).

corporations,[39] the Model Non-Profit Corporation Act has not incorporated them.

The principal strengths of the Model Non-Profit Corporation Act lie in its organization and well-drafted sections, modeled after its business corporation predecessor. Although permissible corporate purposes are broadly defined,[40] the Act does not contain a classification scheme. No distinction is made among mutual benefit, public benefit, and religious corporations despite their different financial and management structures and need for varying degrees of internal and external supervision.[41]

The Act, which defines a nonprofit corporation as "a corporation no part of the income or profit of which is distributable to its members, directors or officers,"[42] prohibits the issuance of stock or dividends.[43] There may be one or more classes of members or no members.[44] The articles of incorporation or bylaws set standards for the election of directors.[45] The Act provides that the board of directors manage corporate affairs but contains no express provision for alternative arrangements allowing greater membership control.[46] The Act also requires foreign nonprofit corporations to qualify before conducting local activities.[47]

Upon dissolution of the corporation and satisfaction of creditors' claims, the Act provides for distribution of assets as follows: (1) return to the donor of assets held on condition requiring return;[48] (2) transfer of assets subject to limitations permitting their use only for specific nonprofit purposes to another nonprofit organization having a purpose similar to that of the dissolving corporation;[49] (3) distribution to

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[39] *See, e.g.*, ABA-ALI Model Bus. Corp. Act § 35 (1978) (duties of directors revised in 1974).

[40] ABA-ALI Model Non-Profit Corp. Act § 4 (1964) states:

> Corporations may be organized under this Act for any lawful purpose or purposes, including, without being limited to, any one or more of the following purposes: charitable; benevolent; eleemosynary; educational; civic; patriotic; political; religious; social; fraternal; literary; cultural; athletic; scientific; agricultural; horticultural; animal husbandry; and professional, commercial, industrial or trade association; but labor unions, cooperative organizations, and organizations subject to any of the provisions of the insurance laws of this State may not be organized under this Act.

[41] *See* notes 246-66 and accompanying text *infra*. The Model Business Corporation Act, on which the Model Non-Profit Corporation Act is based, intends that other statutes will regulate the corporation's activities. *Preface* to ABA-ALI Model Bus. Corp. Act at xi (1953).

[42] ABA-ALI Model Non-Profit Corp. Act § 2(c) (1964).

[43] *Id.* § 26.

[44] *Id.* § 11.

[45] *Id.* § 18.

[46] *Id.* § 17.

[47] *Id.* § 63.

[48] *Id.* § 46(b).

[49] *Id.* § 46(c).

the dissolving corporation's members or others as provided for in its articles of incorporation or bylaws;[50] or (4) distribution to such persons or organizations as the plan of distribution specifies.[51] The dissolving corporation may thus distribute net assets resulting from accumulated income or profits to its members, directors, or officers upon dissolution despite the no-dividend requirement, because such distributions are not "deemed to be a dividend or a distribution of income or profit."[52]

In sum, the Model Non-Profit Corporation Act lacks the necessary classification scheme, does not sufficiently provide for more active membership role in management, and may allow improper distribution of income upon dissolution of the nonprofit corporation. Furthermore, the Act contains no provision for continuous governmental supervision,[53] director and officer liability,[54] and member derivative actions.[55]

V

Delaware General Corporation Law

Delaware's General Corporation Law of 1899, as revised in 1967, governs both nonprofit and profit corporations.[56] Drafted to encourage business incorporations in Delaware, the statute applies to any corporation formed "to conduct or promote any lawful business or purposes."[57] Moreover, the use of the term "conduct of affairs" instead of "transacting business" or "management of business" makes the statute easily applicable to nonprofit corporations.[58]

The Delaware statute provides no classification scheme for the various types of nonprofit corporations although it does contain special provisions that apply to private foundations[59] and the conferment of academic or honorary degrees.[60] Although most provisions of the statute refer to stockholders as such, specific provisions exist that permit the certificate of incorporation to control member activity.[61]

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[50] *Id.* § 46(d).
[51] *Id.* § 46(e).
[52] *Id.* § 26.
[53] *See* notes 257-66 and accompanying text *infra*.
[54] *See* notes 141-56 and accompanying text *infra*.
[55] *See* notes 267-79 and accompanying text *infra*.
[56] Del. Code Ann. tit. 8, §§ 101-398 (1975 & Supp. 1980).
[57] *Id.* § 101(b).
[58] *Id.* § 141.
[59] *Id.* § 127.
[60] *Id.* § 125.
[61] *Id.* § 102(b)(1).

Members may adopt, repeal, or amend bylaws.[62] In addition, the law provides for members' voting rights,[63] quorum requirements,[64] proxies,[65] appraisal rights (equating members with stockholders of business corporations),[66] dissolution of nonprofit corporations,[67] and renewal and amendment of certificates of incorporation of religious, charitable, educational, and other nonprofit corporations.[68] The statute expressly authorizes mergers and consolidations of profit and nonprofit corporations.[69]

In other respects, this most permissive of state corporation statutes[70] applies without distinction to nonprofit corporations. The Delaware statute permits nonprofit corporations, like business corporations, to operate with only one director[71] and the board of directors manages the corporation except as otherwise provided in the certificate of incorporation.[72] The statute also provides for liberal fringe benefits for directors and employees,[73] as well as indemnification of directors and officers for liability arising out of their good faith actions on behalf of the corporation.[74]

The 1967 revision of the original statute contributed little with respect to nonprofit corporations. Indeed, the public policy underlying the revision, legislatively mandated in 1963, was "to maintain a favorable business climate and to encourage corporations to make Delaware their domicile."[75] Similarly, the revision commentaries, "in the interest of brevity," made no attempt to call attention to provisions of the law applicable only to nonprofit corporations.

The Delaware statute not only relies excessively on provisions tailored to business corporations; it omits important features as well. The statute fails to define a statutory standard of care for directors and officers, and there is no provision for member derivative actions except in the procedural rules. Therefore, common law and equitable

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[62] *Id.* § 109(a).
[63] *Id.* § 215(c).
[64] *Id.*
[65] *Id.*
[66] *Id.* § 262.
[67] *Id.* § 276.
[68] *Id.* § 313.
[69] *Id.* §§ 254-258.
[70] *See* H. HENN, *supra* note 11, at 624 & n.51.
[71] DEL. CODE ANN. tit. 8, § 141(b) (1974 & Supp. 1980).
[72] *Id.* § 141(a).
[73] *See id.* § 122(15), (16).
[74] *Id.* § 145.
[75] 54 Del. Laws ch. 218, at 724 (1963).

principles govern such matters. Furthermore, no mechanism exists for continuous supervision of nonprofit corporations. Clearly, Delaware provides less than an ideal climate for nonprofit corporations.

VI

NEW YORK NOT-FOR-PROFIT CORPORATION LAW OF 1970

New York enacted its Not-for-Profit Corporation Law[76] (N-PCL) in 1969, and the law became effective on September 1, 1970. Typical of the dominance of business corporation law, the N-PCL was the last phase of a seventeen-year legislative program to update the state's corporation statutes.[77]

A. *Statutory Structure*

The N-PCL was designed to parallel the New York Business Corporation Law (BCL)[78] as closely as the subject matter permitted.[79] The N-PCL superseded the Membership Corporations Law and replaced the General Corporation Law[80] as the supporting statute for the Religious Corporations Law,[81] the Benevolent Orders Law,[82] and the Education Law,[83] which the legislature retained with little change.[84]

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[76] N-PCL, *supra* note 8, §§ 101-1515. New York chose the unique phrase "not-for-profit" because the legislators believed the term "nonprofit" might be misconstrued to include unprofitable business corporations. JOINT LEGISLATIVE COMMITTEE TO STUDY REVISION OF CORPORATION LAWS, EXPLANATORY MEMORANDA ON NOT-FOR-PROFIT CORPORATION LAW ix (McKinney 1970) [hereinafter cited as JOINT COMMITTEE MEMORANDA]. There is little basis for the drafters' concern. Those familiar with the subject matter recognize readily the term "nonprofit" and distinguish nonprofit corporations from unprofitable business corporations. Later drafters have not followed the New York terminology.

[77] *Foreword* to JOINT COMMITTEE MEMORANDA, *supra* note 76, at vii. The same joint committee responsible for the revised Business Corporation Law of 1963 drafted the N-PCL. Although the joint committee relied on various consultants and advisory committees with expertise in nonprofit corporations, it may have been preferable to delegate the drafting to a separate committee. *See* note 21 and accompanying text *supra*.

[78] N.Y. BUS. CORP. LAW §§ 1-2001 (McKinney 1963 & Supp. 1980).

[79] *See* notes 87-90 and accompanying text *infra*.

[80] *Foreword* to JOINT COMMITTEE MEMORANDA, *supra* note 76, at vii.

[81] N.Y. RELIG. CORP. LAW §§ 2-b(1), (3) (McKinney Supp. 1980).

[82] N.Y. BEN. ORD. LAW § 1-a (McKinney Supp. 1980).

[83] N.Y. EDUC. LAW § 216-a (McKinney 1972 & Supp. 1980); N-PCL § 103(a) (McKinney Supp. 1980).

[84] Prior to the 1970 legislation, New York classified corporations into three groups: (1) public, (2) stock, and (3) non-stock. The statute further classified a non-stock corporation as either a religious corporation, a membership corporation, or any corporation other than a stock or public corporation. *See* N.Y. GEN. CORP. LAW §§ 2, 3 (McKinney 1943).

New York currently classifies corporations as: (1) public; (2) corporations formed other than for profit; and (3) corporations formed for profit.[85] Corporations formed other than for profit are further classified as: (1) religious corporations; (2) education corporations; (3) cooperative corporations; (4) not-for-profit corporations; and (5) any other nonpublic corporation that is formed other than for profit.[86]

The Joint Legislative Committee drafted the N-PCL using the Business Corporation Law as a structural model.[87] The committee desired both to draw upon the drafting expertise reflected in the BCL and related business organization statutes and to enact a modern statutory scheme governing nonprofit corporations. Special provisions were, of course, included to address the special problems of nonprofit corporations.[88] The organizational similarity between the two laws facilitates use of the N-PCL by those already familiar with the slightly older BCL.

For similar pragmatic reasons, the drafters of the N-PCL also borrowed many definitions from the BCL.[89] Again, it makes sense to provide consistency between the two laws when the subject matter, and indeed the terms employed, are identical. The N-PCL's similarity to the BCL therefore meets the criterion for the ideal formulation that calls for similarity except when the nonprofit form mandates otherwise.[90]

B. *Recognition of Nonprofit Diversity*

The N-PCL defines a not-for-profit corporation as a corporation "(1) formed . . . exclusively for a purpose or purposes, not for pecuniary profit or financial gain, . . . and (2) no part of the assets, income or profits of which is distributable to, or enures to the benefit of, its members, directors or officers except to the extent permitted under this statute."[91] Thus, a not-for-profit corporation must have a not-

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[85] N.Y. GEN. CONSTR. LAW § 65 (McKinney Supp. 1980).

[86] *Id.*

[87] The N-PCL is divided into 14 articles. The first 13 articles deal with the same subject matter as the corresponding articles of the BCL. The drafters borrowed the substance and language of the BCL where appropriate. *See, e.g.*, N-PCL, *supra* note 8, § 619 (adopts verbatim language of BCL § 620(a) concerning voting agreements).

[88] *See, e.g.*, N-PCL, *supra* note 8, § 202 (substantially adopts BCL provision regarding corporate powers, with modification to accommodate nonprofit purposes). *See* JOINT COMMITTEE MEMORANDA, *supra* note 76, at xii.

[89] *See, e.g.*, N-PCL, *supra* note 8, § 102(a)(6) (borrowing definition of director from N.Y. BUS. CORP. LAW § 102(a)(5) (McKinney 1963)).

[90] *See* note 20 and accompanying text *supra*.

[91] N-PCL, *supra* note 8, § 102(a)(5).

for-profit purpose or purposes[92] and no flow-through of assets or income to its members, directors, or officers.[93] The N-PCL divides not-for-profit corporations into four types—A, B, C, and D—[94] reflecting the different purposes of nonprofit corporations. This classification scheme[95] permits separate statutory treatment as necessitated by considerations of public policy.

To accommodate the special needs of certain kinds of not-for-profit corporations, the last article of the N-PCL pertains to eleven specified subtypes.[96] The N-PCL consolidated these provisions from the superseded Membership Corporations Law[97] without change in form or substance.[98] The N-PCL thus strives to recognize the diversity of nonprofit corporations through its classification scheme. It is

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[92] *See* JOINT COMMITTEE MEMORANDA, *supra* note 76, at x. Section 204 of the N-PCL, however, permits activities that result in financial gain to the corporation so long as the corporation uses such profits to further its valid nonprofit purpose.

[93] Members of not-for-profit corporations may, however, receive certain assets of the corporation upon dissolution. *See* N-PCL, *supra* note 8, § 1005(a)(3)(B), (b)(3). *See* notes 169-72 and accompanying text *infra.*

[94] N-PCL, *supra* note 8, § 201.

[95] Section 201(b) provides:

> A corporation, of a type and for a purpose or purposes as follows, may be formed under this chapter, provided consents required under any other statute of this state have been obtained:
>
> Type A—A not-for-profit corporation of this type may be formed for any lawful non-business purpose or purposes including, but not limited to, any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, animal husbandry, and for a professional, commercial, industrial, trade or service association.
>
> Type B—A not-for-profit corporation of this type may be formed for any one or more of the following non-business purposes: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals.
>
> Type C—A not-for-profit corporation of this type may be formed for any lawful business purpose to achieve a lawful public or quasi-public objective.
>
> Type D—A not-for-profit corporation of this type may be formed under this chapter when such formation is authorized by any other corporate law of this state for any business or non-business, or pecuniary or non-pecuniary, purpose or purposes specified by such other law, whether such purpose or purposes are also within types A, B, C above or otherwise.

Id. Corporations must file a certificate of type with the Secretary of State. *Id.* § 113. The Type A corporation resembles California's mutual benefit corporation; the Type B corporation resembles California's public benefit and religious corporations. *See* notes 241-45 and accompanying text *infra.*

[96] N-PCL, *supra* note 8, §§ 1401-1411 (cemetery corporations, fire corporations, corporations for the prevention of cruelty, Christian associations, soldiers' monument corporations, medical societies, alumni corporations, historical societies, agricultural and horticultural corporations, boards of trade/chamber of commerce, and local development corporations).

[97] N.Y. MEMB. CORP. LAW §§ 1-236 (McKinney 1941 & Supp. 1962).

[98] JOINT COMMITTEE MEMORANDA, *supra* note 76, at xxvii.

difficult to evaluate the efficacy of the scheme, however, because the N-PCL covers all types of not-for-profit corporations in one statute.[99]

C. *Supervisory Features*

The N-PCL retains the requirements of judicial and administrative approval previously contained in the Membership Corporations Law.[100] The N-PCL consolidates all such consents, except that judicial approval is no longer required for the formation of mutual benefit corporations (Type A).[101]

The role of judicial approval in the formation of not-for-profit corporations is questionable. The judge presumably evaluates the community's need for the corporation, but perhaps this is not a proper judicial function. The law provides for ample supervision during formation without judicial approval.[102] Furthermore, the new statute includes reporting requirements[103] and grants the Attorney General supervisory powers[104] to assure continuous supervision of not-for-profit corporations. The judicial approval provision is burdensome and probably results in more supervision than the ideal formulation requires.

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[99] For a discussion of the California method, which employs separate statutes, see notes 241-45 and accompanying text *infra*.

[100] The New York Membership Corporations Law contained an array of judicial and administrative approval and consent requirements regarding the formation of membership corporations. A nonprofit corporation whose mission was to provide services, or solicit contributions for such purpose, in areas subject to state regulation, was required to obtain two approvals. It first needed the approval of a justice of the state supreme court in the appropriate district. It was then necessary to obtain approval from the appropriate state or local agency or body, such as the public health council in cases involving hospitals. *See* N.Y. MEMB. CORP. LAW §§ 10, 11 (McKinney 1941) (repealed 1970); N.Y. GEN. CORP. LAW § 9 (McKinney 1943) (repealed 1973); N.Y. SOC. SERV. LAW § 460-a (McKinney Supp. 1980).

[101] N-PCL, *supra* note 8, § 404(a). *See also id.* § 970 (requiring judicial approval of certain mergers).

[102] The administrative bodies in the substantive field of the corporate applicant are surely in a better position to evaluate the need for additional corporations in the field. The required filings with the Secretary of State assure that the corporation observes all formalities. *See id.* §§ 401-405.

[103] The N-PCL provides that a corporation for which state money has been appropriated must have on file with the state comptroller a report stating its purposes, financial condition, and operations before state funds can be disbursed. *Id.* § 518. The law further requires the board of directors of all corporations to issue a comprehensive annual report to members containing detailed financial, operational, and membership information. *Id.* § 519.

[104] *See, e.g., id.* § 720 (detailing actions by Attorney General). *See* notes 153-54 and accompanying text *infra*. The N-PCL also grants justices of the state supreme courts visitatorial power to inspect Type B and Type C corporations. N-PCL, *supra* note 8, § 114.

D. *Members and Member Voting*

Not-for-profit corporations may have one or more classes of members as provided for in the certificate of incorporation or bylaws.[105] A corporation formed for charitable purposes (Type B) need not have any members.[106]

The Membership Corporations Law required a quorum of one-third of the membership to transact business at a meeting.[107] The new law states that the basic quorum requirement is the number of members "entitled to cast a majority of the total number of votes entitled to be cast thereat . . . ."[108] The certificate of incorporation or bylaws may, however, provide for a smaller quorum of not less than the number of members entitled to cast one hundred votes or ten percent of the votes entitled to be cast, whichever is less.[109]

The N-PCL requires a plurality vote to elect directors and a majority vote to transact other business.[110] The certificate of incorporation or bylaws, however, may require a greater vote[111] than otherwise required to transact any business or a specified item of business.[112] Amendments to the certificate of incorporation or bylaws that relate to greater-than-normal quorum or voting requirements require a vote of two-thirds of the members entitled to vote thereon, or such greater proportion as may be prescribed specifically by the certificate or bylaws.[113] Members may cast their votes pursuant to signed voting agreements.[114]

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[105] N-PCL, *supra* note 8, § 601(a).

[106] *Id.* This recognizes the existence of charitable foundations that have no membership and are run by a self-perpetuating board of directors. *See* JOINT COMMITTEE MEMORANDA, *supra* note 76, at xvi.

[107] N.Y. MEMB. CORP. LAW § 20 (McKinney 1941) (repealed 1970).

[108] N-PCL, *supra* note 8, § 608(a).

[109] *Id.* § 608(b). The 100-vote quorum accommodates the very large membership corporations whose members may not be interested in attending meetings. The N-PCL also provides for action by members without a meeting by unanimous written consent. *Id.* § 614.

[110] *Id.* § 613.

[111] *Id.* § 615(a)(1).

[112] *Id.* § 615(a)(2).

[113] *Id.* § 615(b). The certificate of incorporation or bylaws also may provide for class voting. *Id.* § 616. *See also id.* § 709 (greater-than-normal quorum and voting applicable to directors' meetings).

[114] *Id.* § 619. When combined with an irrevocable proxy, members may utilize a self-enforceable pooling arrangement. Section 609(a)(6)(E) authorizes irrevocable proxies in connection with voting agreements. These provisions obviate the need for voting trusts; thus the statute does not authorize them. *See id.* § 619, LEGISLATIVE STUDIES AND REPORTS at 229 (McKinney 1970).

E. *Board of Directors*

One aim of the N-PCL was to promote strong boards of directors in not-for-profit corporations.[115] The certificate of incorporation or bylaws may provide for the election or appointment of alternate directors, who may then exercise the rights of absent directors at board meetings.[116] This provision is preferable to proxy voting by directors because the alternate director can better represent his constituency by attendance at board meetings.[117]

A majority of directors generally constitutes a quorum for transacting business.[118] The board generally may act by a majority vote of the directors present at the meeting,[119] but the statute also authorizes greater-than-normal quorum and voting requirements.[120]

Although the N-PCL was purportedly to promote a strong board of directors, it allows sterilization of the board by stipulation in the certificate of incorporation.[121] In addition, the statute permits delegation of the board's authority to executive committees with certain specific exceptions.[122]

The N-PCL provisions regarding members' and directors' roles in managing the not-for-profit corporation are both comprehensive and flexible. The norm is majority rule and management by the board of directors, but the flexible quorum requirements and sterilization option allow for a more active membership role in running the corporation whenever permissible or desirable.

F. *Corporate Finance*

Not-for-profit corporations in New York, as elsewhere, are financed by a variety of sources, including the government, the business community, the public, and membership fees. A modern nonprofit corporation statute must allow flexible methods of financing while preventing abuse of the nonprofit form.

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[115] *See* JOINT COMMITTEE MEMORANDA, *supra* note 76, at xviii. *See also* N-PCL, *supra* note 8, § 701 (vesting management authority in board of directors).

[116] N-PCL, *supra* note 8, § 703.

[117] *See* notes 212-13 and accompanying text *infra*.

[118] N-PCL, *supra* note 8, § 707.

[119] *Id.* § 708(d).

[120] *Id.* § 709.

[121] "Except as otherwise provided in the certificate of incorporation, a corporation shall be managed by its board of directors." *Id.* § 701(a). If the certificate of incorporation vests management authority in non-board members, such persons are subject to the same liabilities as are directors. *Id.* § 701(b).

[122] *Id.* § 712.

Under the N-PCL, not-for-profit corporations may not issue shares or certificates therefor.[123] Members may make capital contributions of money, property, or services, but not of promises of future services or payments.[124] Capital contributions are redeemable only upon dissolution, or, if specified in the certificate of incorporation, at the option of the corporation for a specified amount not to exceed the initial capital contribution.[125]

The subvention, a new method of financing not-for-profit corporations, resembles a debt agreement. The certificate of incorporation may authorize the board of directors to accept subventions by resolution and issue certificates therefor.[126] Subventions may be accepted from both members and nonmembers, and must consist of money or property actually received or expended for the corporation's benefit.[127] The board resolution would set a fixed or contingent "periodic payment" from corporate assets—quasi-interest— at a percentage of the original subvention value, not to exceed two-thirds of the maximum interest rate allowed under the usury law.[128] The board resolution may provide for whole or partial redemption of subventions at any price not to exceed the original value of the subvention plus accrued periodic payments.[129] The resolution also may grant subvention holders the right to require redemption after a designated period or upon occurrence of a specified contingency, such as nonpayment of the periodic payment for a specified time, provided such redemption would not impair the corporation's operations or injure its other creditors.[130] Claims of subvention holders are subordinated to claims of creditors upon dissolution of the corporation.[131]

Although flexible financing provisions are desirable, the utility of the subvention remains to be seen. Conventional debt, capital contribution, and charitable contribution procedures probably can achieve similar results.[132]

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[123] *Id.* § 801.
[124] *Id.* § 502(a), (b), (c).
[125] *Id.* § 502(e).
[126] *Id.* § 504.
[127] *Id.* § 504(b).
[128] *Id.* § 504(d).
[129] *Id.* § 504(e).
[130] *Id.* § 504(f). Thus, the board may give the subvention certain characteristics of preferred shares.
[131] *Id.* § 504(g).
[132] *See id.* §§ 502, 506, 513.

G. *Donated Funds*

Corporation law principles, rather than trust principles,[133] govern the administration of funds donated for specific charitable purposes.[134] Assets donated to not-for-profit corporations become the property of the corporation even if transferred by a trust instrument.[135] The donation does not create an express trust.[136] The board of directors, however, must apply the assets received to the purposes specified in the gift instrument and follow specific instructions as to the administration of the assets.[137] Because the law authorizes virtually all otherwise lawful investments,[138] directors are afforded wide latitude in the administration and investment of donated funds.

Upon dissolution, the not-for-profit corporation must distribute those assets held for a specific purpose to another organization with similar purposes.[139] The N-PCL thus effectuates the presumed intent of the donor while allowing flexibility in the administration of donated funds.[140]

H. *Duties and Liabilities of Directors and Officers*

The ideal nonprofit corporation statute should provide comprehensive treatment of directors' and officers' duties and liabilities, thereby facilitating internal stewardship by members and directors. Although some statutes leave this area to judicial development,[141] the

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133 *See* Oleck Draft, *supra* note 5, at 763-64.

134 *See* N-PCL, *supra* note 8, § 513, Legislative Studies and Reports at 162.

135 *Id.* § 513(a). This is always true of Type B corporations (charitable, educational, religious, scientific, literary, cultural or prevention of cruelty purposes). With regard to other not-for-profit corporations, this section may be superseded by law or by amendment to the certificate of incorporation. *Id.*

136 *Id.*

137 *Id.* § 513(b). In addition, if a gift donated for a specific purpose consists of appreciable property, the board may expend any appreciation thereof for the prescribed purposes, unless prohibited by the donor in the gift instrument. *Id.* § 513(c), (d).

138 *Id.* § 512. Of course, the powers of directors are always subject to the duty of care requirements of the statute. *See* notes 142-45 and accompanying text *infra.*

139 N-PCL, *supra* note 8, § 1005(a)(3)(A). For a discussion of dissolution priorities, see notes 169-72 and accompanying text *infra.*

140 The N-PCL codifies the *cy pres* doctrine. *See id.* § 1005, Legislative Studies and Reports at 426. The *cy pres* doctrine requires that the presumed intent of the donor control distribution of donated funds upon dissolution, rather than allowing distribution to the state or members. Under the doctrine, the organization holds the assets in trust for specific purposes. The transfer of the assets to a corporation with similar purposes is thus consistent with the trustee's duty under the gift. *See* Henn & Pfeifer, *Nonprofit Groups: Factors Influencing Choice of Form,* 11 Wake Forest L. Rev. 181, 199 (1975).

141 *See, e.g.,* ABA-ALI Model Non-Profit Corp. Act (1964).

N-PCL sets forth a detailed statutory scheme. Directors and officers must adhere to the "prudent director" standard: "Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions."[142] Directors and officers may rely in good faith on financial statements represented as correct by the president or officer in charge of the accounts or by reports of independent auditors.[143]

The N-PCL's prudent director standard resembles that contained in the BCL.[144] Legislative studies of the N-PCL reveal the intent to create a duty "flexible enough to meet the many differing circumstances of the various types of non-profit corporations."[145]

Directors voting for or concurring in certain proscribed corporate actions are jointly and severally liable to the corporation.[146] Such proscribed actions include improper distributions,[147] periodic payments or redemptions with respect to outstanding subventions,[148] and loans.[149] Directors held liable for such violations may obtain contribution from other directors who have voted for or concurred in the action.[150] Directors who are sued may avoid liability by proving that they discharged their statutory duties.[151]

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[142] N-PCL, *supra* note 8, § 717(a).

[143] *Id.* § 717(b).

[144] N.Y. Bus. Corp. Law § 717 (McKinney Supp. 1980). The legislature amended the BCL provision in 1977 to apply only to directors and to expand and particularize the reliance defense. *See id.* Officers are held to a good faith standard. *Id.* § 715(h).

[145] N-PCL, *supra* note 8, § 717, Legislative Studies and Reports at 297. The N-PCL does not explicitly state to whom the director owes the duty, but does provide an action for violation of the duty. *See* notes 152-64 and accompanying text *infra.*

The "prudent person" test, which requires the director or officer to exercise the degree of care a prudent person would exercise in the management of his own affairs, is far more rigid. For a discussion of the difference between the prudent person test and the prudent director test, see Selheimer v. Manganese Corp. of Am., 423 Pa. 563, 224 A.2d 634 (1966), wherein the court applied the prudent person test under a 1933 Pennsylvania statute. The Pennsylvania statute was amended in 1968 to adopt the prudent director standard. Pa. Stat. Ann. tit. 15 § 1408 (Purdon 1981). For a discussion of the "trustee" standard, see notes 203-11 and accompanying text *infra.*

[146] N-PCL, *supra* note 8, § 719(a).

[147] *Id.* § 719(a)(1).

[148] *Id.* § 719(a)(2), (3).

[149] *Id.* § 719(a)(5). Section 716 prohibits corporate loans to directors and officers of the corporation or to organizations or entities in which a director or officer has a substantial financial interest. This prohibition does not include loans made through purchase of bonds or debentures customarily sold in public offerings, or through deposit of funds in a bank. Directors or officers participating in or authorizing a proscribed loan violate their statutory duties, but the borrower must still repay the obligation.

[150] *Id.* § 719(c).

[151] *Id.* § 719(e).

The statute also authorizes specific remedies for certain director and officer misconduct.[152] The attorney general, the corporation, judgment creditors, and various other parties[153] may bring an action against directors and officers for statutory violations.[154] The N-PCL expressly authorizes indemnification of officers, directors, and other personnel[155] and empowers the corporation to purchase insurance covering possible indemnification.[156]

I. *Member Derivative Actions*

Five percent or more of any class of members, holders of capital certificates, or owners of a beneficial interest therein may bring an action in the right of a domestic or foreign corporation to procure a judgment in the corporation's favor.[157] The plaintiff must be a member, holder, or owner when the complaint is filed.[158] The complaint must set forth with particularity prior efforts by the plaintiff to secure the initiation of the action by the board of directors, or reasons for not having made such efforts.[159] Analogous New York case law probably would bar the derivative action if a disinterested quorum or committee of directors exercises its business judgment and determines that

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[152] *Id.* § 720, authorizes actions

(1) To compel accounting regarding director or officer failure to perform duties in the management and disposition of corporate assets, or for waste or conversion of assets;

(2) To set aside the unlawful conveyance, transfer, or assignment of assets where the transferee knew of its unlawfulness;

(3) To enjoin the proposed unlawful conveyance, transfer, or assignment of assets.

[153] *Id.* § 720(b), (c).

[154] *See* notes 146-51 and accompanying text *supra.*

[155] *Id.* §§ 721-726, 202(a)(12).

[156] *Id.* § 727.

[157] *Id.* § 623(a). The N-PCL adopted the five percent rule in lieu of the BCL provision requiring security for expenses in derivative actions. *See* N.Y. Bus. Corp. Law § 627 (McKinney 1963).

[158] N-PCL, *supra* note 8, § 623(b). The N-PCL dropped the BCL's contemporaneous share ownership requirement because the five percent rule makes it unlikely that an interest would be acquired solely to initiate a derivative action. *See* N.Y. Bus. Corp. Law § 626(b) (McKinney 1963); N-PCL, *supra* note 8, § 623(b), Legislative Studies and Reports at 237.

[159] *See* N-PCL, *supra* note 8, § 623(c). The N-PCL does not provide for demand on members. The demand rule regarding the board is similar to that contained in the BCL, and cases interpreting the BCL may apply by analogy. *See* Woodley v. Butler, 101 Misc. 2d 670, 673, 421 N.Y.S.2d 797, 800 (Sup. Ct. 1979), *appeal dismissed,* 75 A.D.2d 756, 428 N.Y.S.2d 999 (1980). Demand might be unnecessary if plaintiff shows, for example, that the demand would be futile because the complaint implicates a majority of the board.

the maintenance of the action is against the best interests of the corporation.[160]

A derivative action cannot be discontinued, compromised, or settled without court approval.[161] Proceeds from such actions accrue to the corporation after deduction of any court award to the plaintiffs or claimants of reasonable expenses, including attorneys' fees.[162]

The five percent rule is an overly burdensome prerequisite for the initiation of member derivative actions.[163] In conjunction with the business judgment rule embodied in the demand requirement,[164] the five percent rule is likely to stifle many meritorious actions.

J. *Merger and Consolidation of Not-for-Profit Corporations with Business Corporations*

In addition to its broad authorization of mergers and consolidations between not-for-profit corporations,[165] the N-PCL permits merger or consolidation of domestic or foreign mutual benefit or public purpose not-for-profit corporations (Type A and Type C) with domestic or foreign business corporations.[166] Given the complexity of the provision,[167] it may be preferable to require dissolution when a not-for-profit corporation seeks to change its purpose from nonprofit to profit.[168]

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160 *See* Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600 (1980). In the context of nonprofit corporations, the rule would be more aptly termed the "best judgment rule."

161 N-PCL, *supra* note 8, § 623(d).

162 *Id.* § 623(e). Proceeds of a judgment rendered solely for the compensation of injured members or beneficial owners, however, accrue to such members or owners and are limited to actual losses. *Id.*

163 *See* notes 267-79 and accompanying text *infra* (discussion of the preferable California rule).

164 *See* note 160 and accompanying text *supra.*

165 N-PCL, *supra* note 8, § 901. Mergers and consolidations involving a Type B or Type C constituent corporation require judicial approval. *Id.* § 907.

166 *Id.* § 908.

167 In addition to the general procedures set forth in § 902, the merger or consolidation must be consistent with New York law as well as the law of any other jurisdiction in which a constituent corporation is incorporated. *Id.* § 908(a). The plan of merger must explicitly describe the method of converting members' interests into shares, bonds, or securities of the surviving or consolidated corporation. *Id.* § 908(c). The plan must also specify the cash or consideration to be paid for shares or other interests of members in any constituent corporation. *Id.* Pursuant to § 907, judicial approval is required when a constituent corporation is, or would be if formed under the N-PCL, a public purpose corporation (Type C). *Id.* § 908(f). If any constituent or consolidated corporation requires an administrative consent under section 404, the corporation must obtain such consent before filing the certificate of merger. *Id.* § 909.

168 *Cf.* notes 226-28 and accompanying text *infra* (discussion of applicable OLECK DRAFT provisions). Specific legislation could permit urban development not-for-profit corporations to become business corporations and thus satisfy the apparently narrow goal of the provision. *See* N-PCL, *supra* note 8, § 908, LEGISLATIVE STUDIES AND REPORTS at 417.

K. *Dissolution*

Creditors enjoy priority in both judicial and nonjudicial dissolutions of not-for-profit corporations.[169] The dissolving corporation must distribute assets held for a Type B charitable purpose to a domestic or foreign corporation with similar purposes.[170] Otherwise, the dissolving corporation must distribute its assets to holders of subvention certificates, holders of capital certificates, and members, in that order.[171] Distributions to members upon dissolution are exempt from the general prohibition against distributions of any part of the income or profit of a not-for-profit corporation to members, directors, or officers.[172]

L. *Application to Foreign Corporations*

A nonprofit corporation statute should regnlate foreign nonprofit corporations that conduct local activities.[173] Under the N-PCL, a foreign not-for-profit corporation may not conduct activities in New York unless authorized.[174] Once authorized, a foreign corporation may conduct any activities that are lawful under both the law of New York and the law of the jurisdiction of its incorporation.[175] An unauthorized corporation conducting activities in New York may not maintain an action in New York until it has been authorized and has paid all accrued taxes, fees, and penalties.[176]

The statutory liabilities of directors and officers of domestic corporations apply equally to directors and officers of foreign corporations conducting activities in New York.[177] In addition, certain provisions governing member derivative actions, exclusive indemnification authority, and mergers or consolidations apply to foreign corporations.[178] Certain authorized foreign corporations conducting most of

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[169] N-PCL, *supra* note 8, § 1005(a)(3).

[170] *Id.* § 1005(a)(3)(A).

[171] *Id.* § 1005(b). *See id.* §§ 504(c), 502(e).

[172] *Id.* § 102(a)(5).

[173] *See* note 32 and accompanying text *supra.*

[174] N-PCL, *supra* note 8, § 1301(a). *See id.* §§ 1304, 1305 for authorization procedures.

[175] *Id.* § 1301(a). ABA-ALI MODEL BUS. CORP. ACT § 99 (1966 version) (now § 106) greatly influenced the drafters of the N-PCL. Both statutes contain a list of activities not constituting the "conduct of activities." *See* N-PCL, *supra* note 8, § 1301, LEGISLATIVE STUDIES AND REPORTS at 554.

[176] N-PCL, *supra* note 8, § 1313(a). An unauthorized corporation may, however, defend any action brought against it in New York. *Id.* § 1313(b).

[177] *Id.* § 1318. Directors and officers are liable for substantive statutory violations under § 719 (except § 719(a)(4)) and misconduct under § 720. *Id. See* notes 142-52 and accompanying text *supra.*

[178] N-PCL, *supra* note 8, § 1320, referring to § 623 (derivative actions), §§ 721-27 (indemnification), and § 906 (merger or consolidation).

their activities outside New York are exempt, however, from the substantive requirements outlined above.[179]

The N-PCL thus assimilates many foreign nonprofit corporations by subjecting them to the substantive statutory provisions applicable to domestic corporations. This permits more meaningful regulation and is far more effective than a simple qualification requirement.[180]

M. *Summary*

The New York N-PCL approaches the ideal in the areas of classification, governmental supervision, membership role, duties and liabilities of directors and officers, and qualification and assimilation of foreign nonprofit corporations. Improvements can be made, however, by further differentiating the types of corporations, deleting judicial approval requirements, relaxing the limitations on member derivative actions, and disallowing mergers or consolidations converting nonprofit corporations into business corporations.

VII

OLECK DRAFT OF PROPOSED UNIFORM NONPROFIT ORGANIZATIONS ACT (1980 REVISION)

A. *Statutory Structure*

Dissatisfaction with certain aspects of the ABA Model Non-Profit Corporation Act inspired Professor Oleck's proposed uniform Nonprofit Organizations Act (Oleck Draft).[181] The Oleck Draft, however, was intended neither to be comprehensive in coverage nor to compete with the ABA's formulation. Rather, Professor Oleck offered

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179 Section 1321 of the N-PCL exempts the following corporations:

(1) Type A corporations where their principal activities, the greater part of their property, and two thirds of their members are located outside the state;

(2) Type B corporations where their principal activities, the greater part of their property, and more than 90 percent of their revenue is derived from outside the state;

(3) Type C corporations where their principal activities, the greater part of their property, and more than 50 percent of their revenue over the last three years originated from outside the state.

180 *See* note 32 and accompanying text *supra.*

181 OLECK DRAFT, *supra* note 5, at 1187-1221. Professor Oleck, for example, disapproves of the ABA-ALI Model Non-Profit Corporation Act's failure to include adequate provision for governmental supervision. *Id.* at 1189. The Model Act left governmental supervision to other statutes. *See* note 41 *supra.* For a discussion of the Model Act, see notes 33-55 and accompanying text *supra.*

his draft as an alternative to certain provisions contained in the Model Act.[182]

The Oleck Draft rests on the premise that nonprofit organizations spring from voluntarism and are therefore fundamentally different from business organizations "though they can benefit from the laws and procedures developed for and by the latter."[183] A paramount drafting concern was to provide for reasonable supervision by the public authorities that grant privileges and support to nonprofit organizations, on the ground that all nonprofit organizations are affected with a public interest.[184]

B. *Application to Unincorporated Associations*

The Oleck Draft applies to unincorporated associations as well as corporations.[185] It characterizes unincorporated nonprofit associations as "partnerships not-for-profit"[186] and requires such partnerships to file their articles of association with the state licensing commission.[187] The Oleck Draft, however, requires all nonprofit organizations to incorporate with the exception of those non-"public benefit" organizations having fewer than seven members that operate within a single county.[188]

Although good reasons exist for applying the Oleck Draft to unincorporated groups,[189] the proposed methodology raises more questions than it answers. First, unincorporated nonprofit organizations are deemed partnerships not-for-profit. Yet all of the states except Georgia and Louisiana have adopted the Uniform Partnership Act,[190] which defines a partnership as an association of two or more persons carrying on business for profit.[191] This definition is the

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182 OLECK DRAFT, *supra* note 5, at 1189.

183 *Id.*

184 *See id.; id.* § 4(b), at 1191.

185 *Id.* § 3, at 1191. Unincorporated organizations would also be subject to all general and special corporation and association statutes of the state, except where inconsistent with the Oleck Draft. *Id.* § 4(a), at 1191.

186 *Id.* § 10, at 1193.

187 *Id.* § 12, at 1193. The licensing commission is discussed at notes 214-20 and accompanying text *infra.*

188 OLECK DRAFT, *supra* note 5, § 6, at 1191-92.

189 As a general proposition, it makes sense to draft the proposed act to apply to unincorporated nonprofit associations. Surely some statutory provisions addressing problems of public benefit groups should apply to both incorporated and unincorporated groups. For example, a formulation of the *cy pres* doctrine might apply upon dissolution of any public benefit organization. *See* notes 133-40 and accompanying text *supra.*

190 UNIFORM PARTNERSHIP ACT §§ 1-45.

191 *Id.* § 6(1). Georgia and Louisiana define partnership in similar terms. GA. CODE ANN. § 75-101 (West 1935); LA. CIV. CODE ANN. art. 2801 (West Supp. 1981).

cornerstone of modern partnership law. The Oleck Draft's imposition, in a single provision, of a complex business-for-profit statute accompanied by decades of judicial gloss, upon all types of unincorporated nonprofit groups boggles the mind.[192]

Second, the requirement that all nonprofit organizations incorporate,[193] save for small, local membership groups, is also questionable. This provision would increase costs for many unincorporated groups. The rule presumably is designed to subject these groups to the regulations applicable to corporations. Indeed, the substantive provisions of the Oleck Draft are addressed primarily to corporations, with occasional reference to "organizations" or "associations." The Draft might instead have included a special chapter containing substantive and supervisory provisions applicable only to unincorporated groups. Such a scheme could have accommodated the problems germane to unincorporated associations, preserved flexibility in choice of form of nonprofit organization, and reduced costs for the smaller associations that might have wished to avoid incorporation.

C. *Recognition of Nonprofit Diversity; Duration; Members*

The Oleck Draft's principal classification scheme distinguishes between organizations not for pecuniary profit and organizations that benefit the general public through charitable work.[194] Corporate purposes and activities may not confer direct or indirect pecuniary profit to members or officers, other than reasonable compensation for work or services performed in their capacities as agents or employees.[195]

Duration is perpetual unless the articles of incorporation or association or another statute specifies a shorter period.[196] "Charitable organizations" and "charitable trusts (foundations)" have twenty-five year[197] and ten year maximum durations, respectively, unless the licensing commission approves a longer term.[198]

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[192] Indeed, having a business association statute apply to a nonprofit association is inconsistent with Professor Oleck's basic approach. The Oleck Draft also includes a questionable provision that deems organizers and promoters of nonprofit corporations joint venturers until the filing of the certificate of incorporation. OLECK DRAFT, *supra* note 5, § 16, at 1193. Principles of agency law might be better suited to control the activities of organizers and promoters.

[193] *See* note 188 and accompanying text *supra*.

[194] OLECK DRAFT, *supra* note 5.

[195] *Id.* § 1, at 1190.

[196] *Id.* § 13, at 1193.

[197] *Id.* § 14, at 1193.

[198] *Id.* § 15, at 1193.

Membership provisions are flexible, permitting organizations with no members as well as those with institutional members.[199] If an organization has no members, its directors are "taken to be members."[200] Quorum and voting requirements are left to the bylaws,[201] and proxy voting by members is permitted unless otherwise provided in the articles of incorporation or bylaws.[202]

D. *Board of Directors*

The Oleck Draft gives directors "the status of trustees except as that status is limited by law, the charter, or bylaws."[203] Management authority is vested in the board of directors,[204] and "fundamental changes in corporate purposes or methods" require decision by the general membership.[205] Although executive or other committees are authorized,[206] directors may not abdicate their authority to anyone.[207] They may, however, vote by proxy on simple matters requiring either a yes or no vote.[208] The board must present a detailed report at the annual meeting and file this report with the licensing commission.[209]

The trustee status of directors raises many questions, notwithstanding the public interest in nonprofit organizations. Under the trust concept, legal title to the assets vests in the trustees, and the equitable interests vest in passive beneficiaries. This division of interests in assets is inconsistent with the corporate form and generates unnecessary complications and confusion.[210] More important, the trustee standard is excessively demanding for most directors of nonprofit organizations. Trustees are subject to the highest standards of

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199 *See id.* §§ 37, 39, at 1200.

200 *Id.* § 37, at 1200. Directors in organizations with no members must distinguish between acting *qua* directors and acting *qua* members. Directors could bring derivative actions if the state allowed equitable member derivative actions.

201 *Id.* § 43(d), at 1201.

202 *Id.* § 43(a), at 1201.

203 *Id.* § 57, at 1206.

204 *Id.* § 63, at 1206.

205 *Id.*

206 *Id.* § 69(a), at 1209.

207 *Id.* § 58, at 1206.

208 *Id.* § 50, at 1205.

209 *Id.* § 64(a), at 1206-07. The Oleck Draft requires a verified report containing detailed financial, operational, and membership information.

210 Moreover, the trust concept perpetuates outdated decisional law applying trust principles to nonprofit corporations. This would continue the confusion that resulted from the application of inconsistent legal principles to nonprofit corporations. *See* notes 11-13 and accompanying text *supra*.

care and fiduciary conduct. Directors of nonprofit organizations often have other full-time positions and perform their directors' duties as an avocational community service. Subjecting them to the trustee standard might discourage such service. Of course, directors should have a duty of care, but the "prudent director" test is more realistic and more flexible than the trustee standard.[211] The trustee concept is a vestige of the law of charitable trusts and is inappropriate for nonprofit corporations.

The prohibition of a director's abdication of authority should be assessed in view of the authorization of executive and other committees and director voting by proxy, both of which reduce the impact of the nonabdication rule. Proxy voting by directors is questionable. Directors are supposed to attend meetings and exercise their collective judgment in the best interests of the organization.[212] The Oleck Draft recognizes this by requiring meetings and by allowing proxy voting only on "specific questions calling for a simple affirmative or negative vote."[213] In the final analysis, however, even the most complicated resolutions can be phrased to require a yes or no vote.

E. *Supervisory Features*

The Oleck Draft provides for a five person licensing commission whose members are appointed by the governor for staggered five year terms.[214] The commission must include "one member of the political party other than that to which the Governor belongs," a woman, a trained sociologist, and a member of the bar.[215] The commission is charged with regnlating nonprofit organizations, including the examination and approval of every certificate of incorporation and amendment thereto.[216] The commission is also responsible for supervising special activities of nonprofit organizations "affected with a direct public interest,"[217] authorizing all solicitations of public support, licensing solicitors, and promulgating rules to effectuate these purposes.[218]

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[211] *See* notes 142-45 and accompanying text *supra*. The Oleck Draft also prohibits transactions in which a director is interested unless authorized by the certificate of incorporation, bylaws, or a two-thirds vote of the board of directors. OLECK DRAFT, *supra* note 5, § 64(b), at 1207.

[212] For a discussion of New York's alternate director approach, see notes 115-17 and accompanying text *supra*.

[213] OLECK DRAFT, *supra* note 5, § 50, at 1205.

[214] *Id.* § 7(a), at 1192.

[215] *Id.*

[216] *Id.* § 7(b), at 1192. The Oleck Draft also contains some unnecessary, anachronistic boilerplate requirements for incorporation. For example, the provision that requires five incorporators to form a corporation. *See id.* § 27(a), at 1198.

[217] *Id.* § 7(c), at 1192.

[218] *Id.* § 7(d), (e), at 1192.

One may well question the superimposition of a licensing commission on the current administrative and judicial framework.[219] Perhaps greater consideration should be given to setting forth statutory standards of conduct and relying on judicial visitatorial powers, Attorney General intervention, and self-regulation by members and directors.[220]

Adhering to his premise,[221] Professor Oleck has included ample provision for judicial and administrative supervision of nonprofit organizations. The licensing commission has overseer functions that continue from incorporation to dissolution.[222] Other provisions for judicial and administrative supervision,[223] combined with the disclosure and reporting requirements,[224] allow for comprehensive supervision of the activities of nonprofit organizations.[225]

F. *Prohibition of Charitable Corporation's Becoming Noncharitable Corporation*

The Oleck Draft, while permitting mergers and consolidations between nonprofit corporations and amendments to corporate charters,[226] properly prohibits a charitable corporation from amending its articles of incorporation to become a noncharitable corporation.[227] If a charitable corporation desires to change its basic purpose, it should

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219 The commission might contribute expertise and diverse views to the supervision of nonprofit corporations. This is the apparent intent of the provision requiring the governor to appoint diverse types of individuals to the commission. *See* note 215 and accompanying text *supra*. It is doubtful, however, that a five member commission would possess expertise in all or even most of the fields in which nonprofit organizations operate. Where administrative approval is required for incorporation, the licensing commission's work largely will duplicate the efforts of state agencies. Clearly, the state agencies involved will possess more expertise and thus will be better suited to supervise nonprofit corporations in their substantive fields. Moreover, the Office of the Secretary of State can monitor nonprofit corporate formalities just as it does with business corporations. *See, e.g.*, OLECK DRAFT, *supra* note 5, § 27(a), at 1198 (requires filing of articles of incorporation with Secretary of State).

220 The commission might be able to supervise membership organizations to protect the rights and investments of members. Surely, however, comprehensive provision for director and officer liability coupled with a provision allowing member derivative actions would accomplish the same end. *See* notes 141-64 and accompanying text *supra*. The latter course avoids the cost of an expanded bureaucracy. Moreover, the process is familiar to the courts and legislatures because of their experience with similar business corporation statutes.

221 *See* notes 183-84 and accompanying text *supra*.

222 OLECK DRAFT, *supra* note 5, §§ 7, 87, at 1192, 1216.

223 *See id.* § 90, at 1219 (Attorney General involuntary dissolution procedure); § 27(d), at 1198-99 (administrative approval requirements for incorporation).

224 *See* note 209 and accompanying text *supra*.

225 *But see* discussion of licensing commission at notes 214-20 and accompanying text *supra*.

226 OLECK DRAFT, *supra* note 5, § 78, at 1214-16.

227 *Id.*

dissolve, subject to the *cy pres* provisions, for the protection of its donors, creditors, members, beneficiaries, and the general public.[228]

G. *Application to Foreign Organizations*

The Oleck Draft requires that foreign nonprofit corporations and associations register with the Secretary of State and obtain approval from the licensing commission before commencing local activities.[229] Failure to register bars the organization from instituting any legal action in the state, but the organization may cure this incapacity pursuant to commission rules.[230] This approach has the commendable advantage of applying consistent requirements regardless of whether the organization is incorporated, and whether it is incorporated within or without the state. The Draft, however, requires only qualification and does not apply to foreign organizations the substantive statutory provisions applicable to domestic organizations.[231]

H. *Summary*

In formulating an ideal nonprofit organization statute, state legislators should consider Professor Oleck's application of substantive regulation to unincorporated associations. With some modifications, the Oleck provisions would plug a major gap in current regulatory schemes. On the other hand, the suggestion that all directors be held to a trustee standard of care must be considered with caution. Finally, the licensing commission proposal is probably an example of bureaucratic overkill.

VIII

CALIFORNIA NONPROFIT CORPORATION LAW OF 1980

In many respects, the California Nonprofit Corporation Law (NCL)[232] approaches the ideal nonprofit corporation statute. Its

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[228] *Id.* § 88, at 1218-19. Upon dissolution, net assets (after provision for creditors) are divided "among the members or persons entitled thereto," except that property legally required to be used for particular or charitable purposes must be transferred, by court order, to another corporation or association to be used to best accomplish the general purposes for which the dissolved corporation was formed or for which the property is legally required to be used. *Id.* § 88(e), at 1218-19. *But see* note 261 and accompanying text *infra*.

[229] OLECK DRAFT, *supra* note 5, §§ 81, 82, at 1216.

[230] *Id.* § 84, at 1216.

[231] For a discussion of the preferable New York rule, see notes 174-80 and accompanying text *supra*.

[232] CAL. CORP. CODE §§ 5000-10,846 (West Supp. 1981).

drafters made a major effort to fashion legislation that would accommodate the needs of the various types of nonprofit organizations. Because the new law has already spawned much legal comment,[233] what follows is an abbreviated analysis, highlighting the unique aspects of the statute and comparing it with some of the formulations previously discussed.

A. *Statutory Structure*

The California Corporations Code[234] contains the law applicable to business corporations (the General Corporation Law),[235] nonprofit corporations,[236] partnerships,[237] and unincorporated associations.[238] The Nonprofit Corporation Law, which is organizationally similar to the General Corporation Law (GCL), is a separate, self-contained statute within the Corporations Code. Although there is little incorporation by reference,[239] many of the provisions contained in the NCL are similar or identical to counterparts contained in the GCL.[240]

B. *Recognition of Nonprofit Diversity*

The most innovative feature of the NCL is its division of nonprofit corporations by organizational purpose—public benefit,[241] mutual benefit,[242] and religious.[243] Although there is similarity among the parts, specific provisions vary according to the needs of the different types of corporations.

California's classification scheme allows the state to deal more effectively with the diversity of nonprofit corporations. The separate

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[233] *See* OLECK DRAFT, *supra* note 5; Ellman, *supra* note 1; Fryer & Haglund, *New California Nonprofit Corporation Law: A Unique Approach,* 7 PEPPERDINE L. REV. 1 (1979); Hone, *California's New Nonprofit Corporation Law—An Introduction and Conceptual Background,* 13 U.S.F. L. REV. 733 (1979).

[234] CAL. CORP. CODE §§ 1-35,302 (West 1977 & Supp. 1981).

[235] *Id.* §§ 100-2,319.

[236] *Id.* §§ 5,000-10,846.

[237] *Id.* §§ 15,001-15,700.

[238] *Id.* §§ 20,000-24,007.

[239] *But see id.* § 6910 (incorporates GCL provisions regarding foreign corporations into NCL chapter covering public benefit corporations).

[240] *See, e.g., id.* § 7710 (allowing member derivative actions in mutual benefit corporations).

[241] *Id.* § 5060. A public benefit corporation must further a public or charitable purpose. *Id.* § 5111.

[242] *Id.* § 5059. A mutual benefit corporation can operate for any lawful purpose that does not contemplate the distribution of gain, profits, or dividends to members, except upon dissolution. *Id.* § 7110.

[243] *Id.* § 5061. This Article will not consider separately the provisions regarding religious corporations.

statutory treatment of religious corporations, for example, accommodates the first amendment problems associated with regulation of religious institutions. In addition, the separate statutes are easier to work with than a conglomerate statute with alternative provisions.[244] The effectiveness of the scheme ultimately depends on the rationale and effectiveness of the differences among the statutes of the NCL.[245] Some of the differences are considered below.

C. *Board of Directors*

The NCL holds directors of both public benefit and mutual benefit corporations to the prudent director standard of care.[246] Arguably, directors of public benefit corporations should be held to a stricter standard of care than directors of mutual benefit corporations,[247] but the prudent director test seems flexible enough to deal with both types of corporations.[248]

The NCL also contains a provision applicable to public benefit corporations that regulates self-dealing transactions[249] and is stricter than its GCL counterpart. Any self-dealing transaction must be (1) approved by a disinterested majority of the board, (2) fair to the corporation, (3) for the corporation's benefit, and (4) the most advantageous arrangement reasonably obtainable under the circumstances.[250] The NCL's strict self-dealing provision for public benefit corporations supplements the general duty of care imposed upon all

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[244] The classification scheme may raise problems regarding incorporation of mixed purpose nonprofit corporations. Commentators have suggested the use of a primary purpose test to classify such corporations. *See* Fryer & Haglund, *supra* note 233, at 9. *Cf.* CAL. CORP. CODE § 9111 (West Supp. 1981) (applies primary purpose test to religious corporations).

[245] An example of differing provisions among the parts of the statute is the definition of the key term "distribution." As applied to mutual benefit corporations, distribution does not include the selling or furnishing of goods or services to members. *See* CAL. CORP. CODE § 5049 (West Supp. 1981). Thus, the statute's prohibition of distributions to members, *see id.* § 5410, permits normal mutual benefit corporation activities.

[246] For a discussion of the prudent director standard, see notes 142-45 and accompanying text *supra.*

[247] For example, a more demanding standard is arguably necessary for public benefit corporations because they have no self-interested members to police the board's activities, and because they involve public interests.

[248] *See* notes 142-45 and accompanying text *supra.* The NCL preserves the existing case law regarding duties and liabilities of directors of religious corporations. *See* CAL. CORP. CODE § 9240 (West Supp. 1981); Fryer & Haglund, *supra* note 233, at 30.

[249] Self-dealing transactions are transactions to which the corporation is a party and in which one or more directors has a "material financial interest." CAL. CORP. CODE § 5233 (West Supp. 1981).

[250] *Id.* § 5233(d)(2).

directors.[251] The NCL subjects the directors of mutual benefit corporations to the same standard imposed by the GCL.[252]

In addition to the self-dealing provision, the NCL restricts the composition of the board of directors of public benefit corporations. No more than forty-nine percent of the corporation's board members may be "interested persons."[253] "Interested persons" include directors compensated by the corporation for full or part time services rendered during the previous twelve months, and their relatives.[254]

This provision is unique and its goal is obvious; however, it significantly burdens the freedom of public benefit corporations to choose directors. The NCL already comprehensively regulates self-dealing transactions in public benefit corporations[255] and provides for ample Attorney General supervision.[256] Perhaps composition requirements are better left to articles of incorporation or bylaws.

D. *Supervisory Features*

The California statute provides for extensive Attorney General supervision of public benefit corporations. The statute recognizes that members have no personal interest in such corporations and therefore have little incentive to monitor the corporation's activities.[257] Here, the California statute properly determines the degree of supervision according to the type of nonprofit corporation involved. Public benefit corporations are "subject at all times to examination by the Attorney General."[258] Voluntary[259] and involuntary dissolution[260] are also both subject to such supervision. The NCL also requires that the

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[251] In addition, the NCL allows boards of directors of all three types of corporations to delegate authority to committees; however, ultimate responsibility for direction of the corporation's affairs rests with the board. *Id.* §§ 5210, 7210, 9210. The GCL authorizes full delegation of authority. *See id.* § 311. *See* Fryer & Haglund, *supra* note 233, at 31.

[252] *Id.* § 7233. *See also id.* § 310 (GCL provision).

[253] Cal. Corp. Code § 5227(a) (West Supp. 1981).

[254] *Id.* § 5227(b)(1), (b)(2). Receiving reasonable compensation for services as a director does not render one an interested person within the statute. *Id.*

[255] *See* notes 249-52 and accompanying text *supra*. *See also* Cal. Corp. Code § 6322 (West Supp. 1981) (requiring annual statement of corporate transactions with interested persons). There are alternative methods for dealing with an interested board. For example, the Oleck Draft requires authorization of directors' salaries, as director or officer, by a two-thirds vote of the board. Oleck Draft, *supra* note 5, § 64(b), at 1207.

[256] *See* notes 257-66 and accompanying text *infra*.

[257] *See* Hone, *supra* note 233, at 741.

[258] Cal. Corp. Code § 5250 (West Supp. 1981).

[259] *See id.* § 6611.

[260] *See id.* §§ 6510, 6511.

corporation disclose to the Attorney General information concerning such extraordinary matters as mergers[261] and transfers of substantially all of the corporation's assets.[262]

Mutual benefit corporations are subject to considerably less supervision because the statute anticipates that an interested membership will exercise vigilance in corporate affairs.[263] The Attorney General has supervisory powers over such a corporation only with respect to assets held in charitable trust[264] and petitions for involuntary dissolution.[265] In the case of religious corporations, the supervisory power of the Attorney General is defined narrowly to avoid first amendment problems.[266]

E. *Member Derivative Actions*

The NCL adopts derivative action rules similar to those governing business corporations in the GCL.[267] The NCL authorizes members of both public benefit[268] and mutual benefit corporations[269] to bring derivative actions, but retains the GCL's demand requirement,[270] contemporaneous membership rule,[271] and allowance of defendants' motion to furnish security for litigation expenses[272] on the grounds that either the action will not benefit the corporation or its members[273] or that the moving party, if not the corporation, was unconnected with the challenged transaction.[274] A court cannot grant a motion to require security if the action is brought by one hundred members[275] or some other authorized number thereof.[276]

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[261] *See id.* § 6010. The merger of a public benefit corporation with a non-"public benefit" corporation requires written approval of the Attorney General. *Id.* § 6010(a). An outright prohibition of such mergers would be preferable. *See* notes 226-28 and accompanying text *supra.*

[262] CAL. CORP. CODE § 5913 (West Supp. 1981).

[263] *Cf.* note 257 and accompanying text *supra.*

[264] CAL. CORP. CODE § 7240 (West Supp. 1981) (corporation holding assets in charitable trust subject at all times to examination by Attorney General). *See also id.* § 8510(e) (dissolution of corporation holding assets in charitable trust).

[265] *See id.* § 8511.

[266] *Id.* § 9230. *See* Hone, *supra* note 233, at 743-44.

[267] CAL. CORP. CODE § 800 (West 1977).

[268] *Id.* § 5710 (West Supp. 1981).

[269] *Id.* § 7710.

[270] *Id.* §§ 5710(b)(2), 7710(b)(2).

[271] *Id.* §§ 5710(b)(1), 7710(b)(1).

[272] "Security" includes reasonable expenses and attorneys' fees as determined by the court. *Id.* §§ 5710(d), 7710(d).

[273] *Id.* §§ 5710(c)(1), 7710(c)(1).

[274] *Id.* §§ 5710(c)(2), 7710(c)(2).

[275] *Id.* §§ 5710(a), 7710(a).

[276] *See id.* § 5036 (defines authorized number). In corporations without members, directors have all the rights otherwise vested in members and therefore may bring a derivative action. *See*

The NCL strikes a sound balance between the need to allow member derivative actions and the need to prevent frivolous or strike suits. The contemporaneous membership requirement and the security provision protect corporations from meritless suits without unnecessarily discouraging members from asserting meritorious claims.[277] The NCL formulation is therefore preferable to New York's five percent requirement,[278] which can easily discourage plaintiffs with valid complaints. In addition, the NCL augments its derivative action provisions by granting members extensive inspection rights,[279] which allow discovery of misconduct and membership information, thereby facilitating joinder of enough members to avoid a defendant's motion for security.

F. *Application to Foreign Corporations*

California requires foreign nonprofit corporations to qualify before conducting intrastate activities.[280] The NCL, however, does not provide for assimilation of foreign corporations that conduct substantial intrastate activity.[281] Although the GCL assimilation provisions are quite complex,[282] and therefore burdensome, it may be desirable to apply them to foreign nonprofit corporations that conduct substantial activity in the state.[283]

G. *California, Here We Come!*

The California statute, which is the most progressive legislation of its kind to date, should provide helpful guidance for other states revising their nonprofit corporation statutes. Above all, its classification scheme provides a framework whereby legislators can draft a

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id. § 5310(b), 7310(b)(2). This method is preferable to the Oleck provision making such directors "members." *See* note 200 *supra.*

[277] Business corporation statutes frequently use this technique. *See* H. HENN, *supra* note 11, at 761-86. The California rule is unique in that it allows directors as well as corporate defendants to move for security-for-expenses. *Id.* at 781.

[278] *See* notes 157-64 and accompanying text *supra.*

[279] *See* CAL. CORP. CODE §§ 6330, 8330 (members' inspection rights), 6333, 8333 (inspection of accounting books and minutes), 5160, 7160 (inspection of articles of incorporation and bylaws) (West Supp. 1981).

[280] *See id.* §§ 6910, 8910.

[281] The GCL has a comprehensive assimilation provision in its "pseudo foreign corporation" subchapter. *See id.* §§ 2101-2115 (West 1977). Although the NCL incorporates the GCL subchapter by reference, it excludes several important assimilation sections. *Id.* §§ 6910, 8910 (West Supp. 1981).

[282] *See* CAL. CORP. CODE § 2115 (West 1977).

[283] *See* notes 173-80 and accompanying text *supra.*

statute that is sensitive to the varying needs of corporations with fundamentally different purposes and structures. One must, however, consider the following questions when evaluating the California statute.

First, should the nonprofit statute concern itself with unincorporated groups? For example, the NCL supervisory features applicable to public benefit corporations might be equally desirable with respect to unincorporated public benefit associations.[284] There are no legal obstacles to such an extension of supervisory power. Moreover, the application of substantive features of the nonprofit corporation law to unincorporated groups seems preferable to Professor Oleck's solution requiring incorporation of all charitable organizations.[285]

Second, how closely should the nonprofit corporation law mirror the business corporation law? Because formalities often serve identical functions, a degree of similarity is desirable. Beyond formalities the business corporation law is helpful only if its provisions are suitable to nonprofit corporations. California's experience with business corporation provisions governing member derivative actions is an example.[286] Nevertheless, there is good reason to question seriously each provision of the public benefit corporation law that mirrors its GCL counterpart because the purposes of the two types of corporations are so different. Of course, the mutual benefit corporation's greater similarity to the profit corporation suggests that provisions of the GCL may be more safely applied to mutual benefit corporation statutes.

Finally, how should the ideal statute provide for adequate governmental supervision without imposing excessive administrative burdens on both the state and the nonprofit corporation? California's Attorney General supervision[287] is a good compromise and is preferable to both New York's judicial approval scheme[288] and Professor Oleck's licensing commission.[289] Nevertheless, the inspection rights and reporting requirements of the NCL[290] might prove excessively burdensome for nonprofit corporations. Attention to these and other questions will aid state drafters in following the California statute.

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[284] The fundamental reason to supervise public benefit corporations is their lack of a vigilant, motivated membership. *See* note 247 *supra*. Because this problem also exists for unincorporated public benefit associations, governmental supervision would be appropriate.

[285] *See* note 193 and accompanying text *supra*.

[286] *See* notes 267-79 and accompanying text *supra*.

[287] *See* notes 257-66 and accompanying text *supra*.

[288] *See* notes 100-04 and accompanying text *supra*.

[289] *See* notes 214-25 and accompanying text *supra*. The licensing commission would not only increase the state government's budget, but also would increase costs for nonprofit corporations by virtue of the filing requirements.

[290] *See* CAL. CORP. CODE §§ 6320-6324 (West Supp. 1981) (required records and reports to directors and members); note 279 *supra* (inspection rights).

CONCLUSION

In the Cinderella story, the glass slipper fits only Cinderella. In the world of nonprofit organizations, legislators must accommodate a wide range of human altruistic activity, requiring glass slippers of various sizes, styles, and lasts for proper fit. Within the proper statutory framework, flexibility will ultimately come from appropriate provisions contained in the articles of incorporation and association, the bylaws, and the actions of members, directors, and officers.

California, here we come!