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Dismembering Civil Society: The Social Cost of Internally Undemocratic Nonprofits

Dana Brakman Reiser

Brooklyn Law School, dana.brakman@brooklaw.edu

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Dismembering Civil Society: The Social Cost of Internally Undemocratic Nonprofits

For today's nonprofits, internal democracy is optional. Most states' laws provide that a nonprofit may choose democracy, or it may opt for a self-perpetuating and omnipotent board of directors. Under the democratic structure, the nonprofit's founders opt to empower a group of individual members¹ to elect a board of directors and approve other major corporate decisions. Alternatively, the founders may deem such democracy impractical and opt instead for a structure under which directors reappoint themselves and/or appoint their successors, and directors

* Assistant Professor of Law, Brooklyn Law School; J.D., Harvard Law School; B.A., University of Pennsylvania. I am indebted to the Brooklyn Law School Summer Research Program and the able research assistance of George Barry, Michelle Gitlitz, Marisa McCormick, and Liesel Riedel Polan. I appreciate the comments and suggestions of Debra Bechtel, Gregg Behr, Anita Brakman, Evelyn Brody, James Fanto, Marion Fremont-Smith, David Hammack, Joan Heminway, Ted Janger, Faith Kahn, Roberta Karmel, Robert Katz, Claire Kelly, Jason Mazzone, Dan Medwed, Linda McClain, Debra Pickett, Arthur Pinto, Jeff Reiser, Tony Sebok, Mark Sidel, Norman Silber, and Larry Solan. I am grateful for the comments and suggestions I received in presenting prior versions of this Article at the 2003 Annual Conference of the Association for Research on Nonprofit Organizations and Voluntary Action, the Sixth Annual Conference on Law, Culture, and the Humanities and the Brooklyn Law School Brown Bag Series. Any remaining errors are, of course, my own.

¹ See, e.g., REVISED MODEL NONPROFIT CORP. ACT §§ 1.40(21), 7.21 (1987) [hereinafter RMNCA]. Nonprofit organizations may offer donors "memberships" without voting rights, typically in exchange for a particular monetary contribution level. Under nonprofit corporate statutes, however, "members" are defined by their rights to vote, at least as a matter of default rules. See, e.g., GA. CODE ANN. § 14-3-610 (2001) (providing that members shall have the right to elect directors, and may have other voting rights as provided by the bylaws or articles of incorporation); N.D. CENT. CODE § 10-33-57(4) (2001) (stating that "[m]embers are entitled to vote and have equal rights and preferences except to the extent that the articles or bylaws have fixed or limited the rights and preferences of members or different classes of members or provide for nonvoting members"). Future references to "members" denote only these statutorily-empowered voting members.

alone approve organic changes to the organization. While this legislative position of “optionality” may seem neutral, it actually can lead to a bias against democratic governance. Today, self-perpetuating boards are the norm and members are rare, particularly among charitable or public benefit nonprofits.²

Nonprofits avoid internal democracy because doing so is practical. Governance with members is time-consuming and cumbersome to manage. Moreover, nonprofit founders correctly perceive that members are unlikely to prevent the high-profile lapses in accountability that have plagued the nonprofit sector. This insight explains, in large part, legislatures’ willingness to endorse optionality—even in a political climate in which nonprofit scandals are highly publicized and derided. If members are ineffective monitors and membership adds costs, why bother with democratic governance? Indeed, for these reasons, a self-perpetuating board is the most appropriate governance structure for many nonprofits. However, the fixation on accountability as the sole motivator of governance has prevented legislators and commentators from perceiving the real social cost of optionality.

This sole focus on accountability ignores the nonprofit sector’s role in constructing and maintaining civil society. Civil society is that realm of institutions between the individual and the state, including charities, public advocacy organizations, churches, and bridge clubs.³ These organizations overlap substantially with the nonprofit sector. Theorists who have examined civil society argue that participation in these institutions enhances our political democracy in two ways. It offers opportunities for participants to build norms of reciprocity and cooperation—also called social

² See Evelyn Brody, *Entrance, Voice, and Exit: The Constitutional Bounds of the Right of Association*, 35 U.C. DAVIS L. REV. 821, 860 (2002) (noting that “the typical nonprofit organization is a corporation that lacks members with power to vote for the board or on policy issues.”); Geoffrey A. Manne, *Agency Costs and the Oversight of Charitable Organizations*, 1999 WIS. L. REV. 227, 250 (1999) (“Charitable nonprofits, however, rarely have members.”).

³ The term “civil society” resists all but the loosest definitions and is used in a wide range of contexts. Several good descriptions of the various uses of the term are available. See JOHN EHRENBERG, *CIVIL SOCIETY: THE CRITICAL HISTORY OF AN IDEA passim* (1999); JON VAN TIL, *GROWING CIVIL SOCIETY: FROM NONPROFIT SECTOR TO THIRD SPACE* 14-17 (2000); Don E. Eberly, *The Meaning, Origins, and Applications of Civil Society*, in *THE ESSENTIAL CIVIL SOCIETY READER* 5-15 (Don E. Eberly ed., 2000); Robert C. Post & Nancy L. Rosenblum, *Introduction to CIVIL SOCIETY AND GOVERNMENT* 1-8 (Nancy L. Rosenblum & Robert C. Post eds., 2002); Miriam Galston, *Civic Renewal and the Regulation of Non-profits* 6-75, available at <http://ssrn.com/abstract=445500>.

capital.⁴ Participation also trains citizens in those practical skills necessary to participate more actively and ably in the political arena; in other words, these institutions teach civic skills.⁵

Institutions that are internally democratic are more capable of and effective at building social capital and teaching civic skills. Thus, a trend away from governance with members reduces nonprofits' ability to perform these essential societal services, imposing social costs. Furthermore, the weakening of nonprofits' role in constituting civil society in turn threatens the reputation of the nonprofit sector and the support it receives. Nonprofits' ability to enhance our political democracy is one of the principal reasons advanced in support of its receipt of various financial, political, and social advantages. Any reduction in nonprofits' capacity to play this role undermines the legitimacy of this support.

This Article will, therefore, explore the history of optionality and consider carefully the costs and benefits of a trend away from members to individual nonprofits, the nonprofit sector, and society in general. Because the nonprofit sector encompasses groups with a wide range of missions, legal forms, and compositions, Part I will introduce the nonprofit corporation and its governance structures. Part II will then explore the legislative history of state statutory provisions regarding membership and will relate the story of the adoption of optionality in various jurisdictions. In addition to considering the types of statutory language that different legislatures used to effect this change, this Part will identify the motivations behind its widespread legislative endorsement. As will be shown, legislators and law reformers sought to offer nonprofits greater flexibility in internal governance in order to reduce nonprofits' administrative costs and to facilitate their participation in sophisticated transactions.

In Parts III and IV, this Article will pursue several potential arguments in favor of governance with members. Part III will address the potential benefits of members for individual nonprofits by considering the roles that members realistically can play in nonprofit governance and whether members, through their per-

⁴ See ROBERT D. PUTNAM, *BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY* 336-49 (2000) [hereinafter PUTNAM, *BOWLING ALONE*]; ROBERT D. PUTNAM, *MAKING DEMOCRACY WORK: CIVIC TRADITIONS IN MODERN ITALY 183-85* (1993) [hereinafter PUTNAM, *MAKING DEMOCRACY WORK*].

⁵ See SIDNEY VERBA ET AL., *VOICE AND EQUALITY: CIVIC VOLUNTARISM IN AMERICAN POLITICS* 304-33, 369-90 (1995); GABRIEL A. ALMOND & SIDNEY VERBA, *THE CIVIC CULTURE* 300-22 (1963).

formance of these roles, will make individual nonprofits more efficient and/or more accountable. Ultimately, Part III will conclude that the benefits of membership are uncertain because serious obstacles reduce members' ability to make efficient decisions, to monitor other corporate actors, and to hold them accountable. When these uncertain benefits are balanced against the clear reduction in costs of administration and transacting offered by a self-perpetuating board, it is understandable that legislators have chosen to permit either structure. The same comparison predicts that individual nonprofit founders and their counsel will choose the self-perpetuating board route, bearing out the trend in favor of this option.

However, Part IV will argue that the aggregation of these individual decisions into a general trend away from governance with members results in societal costs. It will draw on literature describing the existence and importance of civil society to show this effect. This Part will begin with an outline of the concept of civil society, focusing on civil society theorists' claims that civil society supports and strengthens political democracy, principally by offering opportunities for citizen-training and social capital construction. It then will argue that the decline in membership roles diminishes the nonprofit sector's ability to provide these democracy-enhancing opportunities. Furthermore, Part IV will assert that a reduction in the capacity of the nonprofit sector to constitute civil society threatens both its privileged position in contemporary American society and the legitimacy of the advantages it enjoys.

Finally, Part V will raise various potential responses to allay the social costs arising from the trend away from members. These include a spectrum of dramatic and modest possibilities. A draconian (and deeply problematic) response would mandate voting membership governance structures for all nonprofits. A somewhat less severe, but still substantial, remedy would use governance structure as a factor in a classification system, imposing differing benefits and restrictions on nonprofits that provide different societal benefits. The most modest type of response would be purely educational—to broadcast the message that the nonprofit sector exists and enjoys advantages for a wide range of reasons. In essence, the rhetoric of the nonprofit sector might be made more complex, in order to match the reality of its various components.

In sum, this Article will argue that the significant social costs of a trend away from members derive from the trend's impact on nonprofits' contributions to civil society—rather than the impact on individual nonprofit organizations—and it will suggest several potential responses to mitigate these costs. Each of the responses sketched here is only a beginning of the work required to grapple with the social costs of optionality, but it is an important first step.

I

A NONPROFIT PRIMER

Nonprofit organizations form to address any number of goals or missions. For example, nonprofit labor unions form, at least primarily, in order to obtain gains through collective bargaining. Nonprofit environmental groups form to promote conservation, raise awareness about ecological issues, and perhaps engage in political activity.⁶ Nonprofit theater companies form to present avant-garde productions or to fill some other need that is underserved by the commercial theater community. Universities form to engage in education and research, as well as to provide a place for academics to make their contributions to society's discourse. Of course, the list could go on.⁷ The diversity of the nonprofit sector is important background to the role the sector plays in contemporary American society.

A. *Basic Forms and Frameworks*

In order to understand the impact of optionality, it is necessary to have a foundation in the legal theory and legal forms of nonprofit organizations. The various types of nonprofits share at least one overarching legal framework: nonprofits are legally prohibited from distributing their earnings to insiders. While

⁶ Political activities are not always accepted as an appropriate part of nonprofit programming. For example, significant political activity will jeopardize a charitable nonprofit entity's eligibility for federal tax-exemption. See 26 U.S.C. § 501(c)(3) (2000); 26 C.F.R. § 1.501(c)(3)-1(c)(3) (2002).

⁷ This is not to suggest that the nonprofit sector should be taken lightly. The sector plays a significant role in American society and its economy. In the mid-1990s, the nonprofit sector included 1.6 million organizations, earned revenues equal to just under 9% of the gross domestic product of the United States, and provided jobs to approximately 7% of the domestic workforce. See Lester M. Salamon, *Scope and Structure: The Anatomy of America's Nonprofit Sector*, in *THE NATURE OF THE NONPROFIT SECTOR* 23-24 (J. Steven Ott ed., 2001).

nonprofits may earn profits and use those profits to produce more and/or better goods or services, they may not distribute profits to their directors, officers, or members.⁸ This prohibition is known in the nonprofit legal literature as the “nondistributional constraint.”⁹ The nondistributional constraint has been a foundational concept for some of the most popular contemporary theories explaining the existence of the nonprofit sector and the behavior of nonprofit organizations.¹⁰

Nonprofit organizations can be organized as nonprofit corporations, charitable trusts, or unincorporated associations.¹¹ This Article, however, will concentrate its civil society critique on corporate nonprofits, as they are by far the most common legal form for nonprofits¹² and because charitable trusts do not utilize membership structures in governance.¹³ The formation of a nonprofit corporation resembles, but is not identical to, that of its for-profit corporate cousins. A nonprofit corporation is formed when one or more incorporators files articles of incorporation with an appropriate state official.¹⁴ The articles of incorporation state the

⁸ See, e.g., RMNCA §§ 13.01, 1.40(10) (prohibiting nonprofit corporations from making payments to their “members, directors, or officers”); CAL. CORP. CODE §§ 5410, 5049 (West 2002) (prohibiting distributions to members of nonprofit corporations); see also Henry Hansmann, *Economic Theories of Nonprofit Organization*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 28 (Walter W. Powell ed., 1987) (describing this general limitation). Limited exceptions to this rule for mutual benefit nonprofits are considered *infra* notes 40-42 and accompanying text.

⁹ See Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980) (coining the term “nondistributional constraint” to describe this prohibition and identifying its role in an economic rationale for the nonprofit sector).

¹⁰ See James Douglas, *Political Theories of Nonprofit Organization*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK, *supra* note 8, at 43-44; Hansmann, *supra* note 8, at 27-29; J. Steven Ott, *Economic and Political Theories of the Nonprofit Sector*, in THE NATURE OF THE NONPROFIT SECTOR, *supra* note 7, at 179-87. The idea of the nondistributional constraint has been most influential in economic theories of the nonprofit sector, particularly in describing the nonprofit form of organization as a response to market failures. This and the other principal strain of rationales for the nonprofit sector, which concentrate more on the political and social underpinnings of the sector, will be examined later. See *infra* Part IV.C.

¹¹ See MARILYN E. PHELAN, NONPROFIT ENTERPRISES: CORPORATIONS, TRUSTS, AND ASSOCIATIONS § 1:03 (2000).

¹² See James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 EMORY L.J. 617, 619, 636-39 (1985) (noting the prevalence of the corporate form and describing the general issues involved in selecting a legal form of organization).

¹³ Therefore, references to nonprofits in the balance of this Article refer to the subset of nonprofits organized as nonprofit corporations.

¹⁴ See, e.g., RMNCA § 2.01-03; N.Y. NOT-FOR-PROFIT CORP. LAW § 403 (McKinney 2002); CAL. CORP. CODE § 5133 (West 2002). Although the RMNCA has not

purposes of the nonprofit corporation and provide for its governance structure in general terms. The nonprofit corporation's by-laws provide a more detailed description of these topics.

B. Directors and Their Duties

Nonprofit corporations are managed by or under the direction of a board of directors.¹⁵ Again, these directors play a role similar to those in a for-profit corporation. They monitor the management of the nonprofit and its senior employees. They also make decisions regarding the high-level direction of the organization and approve its major transactions. Nonprofit directors are guided in their supervisory roles by their fiduciary duties of care and loyalty to the nonprofit. Although some commentators have called for stricter, trustee-like standards of fiduciary obligation to apply to the conduct of nonprofit corporate directors, or have recalled with nostalgia a time when this was the case, modern courts typically apply the same standard of fiduciary obligation to nonprofit directors as they apply to directors of business corporations.¹⁶ In the words of the Revised Model Nonprofit Corporation Act (RMNCA), a nonprofit director "shall discharge his or her duties as a director . . . (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the director reasonably believes to be in the best interests of the corporation."¹⁷

As is the case in for-profit corporate law, the duty of loyalty is effectively the primary constraint on the actions of nonprofit directors.¹⁸ The idea of the duty of loyalty is simple: a director

yet been widely adopted in its entirety, for brevity, I will refer to its provisions when they are exemplary of typical state law.

¹⁵ Although many nonprofits refer to their board members as trustees, relevant statutory frameworks typically term these actors "directors." See, e.g., RMNCA § 8.01 et seq. (requiring nonprofit corporations to empower a board of directors and setting forth their powers, duties, standards of conduct, etc.).

¹⁶ See, e.g., *Stern v. Lucy Webb Hayes Nat'l. Training Sch. Deaconesses & Missionaries*, 381 F. Supp. 1003, 1013 (D.D.C. 1974); see also PHELAN, *supra* note 11, § 4:09; Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 644 (1998); *Developments in the Law—Nonprofit Corporations*, 105 HARV. L. REV. 1578, 1593-94 (1992).

¹⁷ RMNCA § 8.30(a).

¹⁸ See Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1440 (1998) ("Legal disputes involving nonprofit fiduciaries generally deal with breaches of the duty of *loyalty* rather than of the duty of *care*.").

must perform his or her directorial duties to further the interests of the nonprofit, rather than his or her personal interests.¹⁹ This duty of loyalty concept is used by courts to regulate and punish self-dealing, fraud, taking of corporate opportunities, misappropriation of assets, and similar transgressions by nonprofit directors.²⁰ However, generic conceptions of loyalty and judicial rhetoric about honor and fealty are not the only tools that courts have to evaluate and address potential breaches of loyalty. Most state nonprofit statutes also provide procedural mechanisms for nonprofits to pre-validate transactions in which directors have a conflict of interest.²¹ Such pre-validation might be secured by a vote of disinterested directors or a committee of disinterested directors, attorney general approval, or both.

The duty of care demands that a nonprofit director pay attention to his or her directorial duties and utilize ordinary prudence and skill in performing those duties.²² The potential for liability under the duty of care is limited by the application of the business judgment rule to decisions of nonprofit directors.²³ This rule states that so long as directors make a decision in good faith, with the rational belief that the decision is in the best interest of the nonprofit, with due care, and without a conflict of interest, courts will not challenge the substance of the directorial decision.²⁴ With the protection of the business judgment rule available, the practical impact of the duty of care standard is limited to prohibiting the use of dummy directors, who serve in name only, and providing potential liability for wildly unjustifiable board decisions.²⁵

¹⁹ See Daniel L. Kurtz & Paula B. Green, *Liabilities and Duties of Nonprofit Directors and Officers*, in NEW YORK UNIVERSITY SIXTEENTH CONFERENCE ON TAX PLANNING FOR THE CHARITABLE SECTOR § 11.02[2], at 11-12 (1988).

²⁰ See Goldschmid, *supra* note 16, at 646.

²¹ See MARION R. FREMONT-SMITH, GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION (forthcoming from Belknap Press May 2004) (manuscript at Ch. 4, 30-41, on file with author); see also Deborah A. DeMott, *Self-Dealing Transactions in Nonprofit Corporations*, 59 BROOK. L. REV. 131, 137-39 (1993) (describing the RMNCA's use of the pre-validation technique).

²² Goldschmid, *supra* note 16, at 641.

²³ See Michael W. Peregrine & James R. Schwartz, *The Business Judgment Rule and Other Protections for the Conduct of Not-for-Profit Directors*, 33 J. HEALTH L. 455 (2000).

²⁴ See *id.* at 456.

²⁵ In addition, many states have enacted legislation allowing nonprofits to limit the monetary liability of their directors for violations of the duty of care by amending their articles of incorporation. See Brody, *supra* note 18, at 1453-55, 1454 nn.247-48 (describing the origins of this trend in Delaware law and its migration to

In the nonprofit context, a director's fiduciary obligations also contain the idea of a duty of obedience to the law and, more importantly, to the mission of the nonprofit for which he or she serves.²⁶ This mission can be identified through the nonprofits' expression of its purposes in its articles of incorporation. Although the duty of obedience to mission can appropriately be characterized as nebulous,²⁷ it is nonetheless important. The concept has been described as limiting the ability of directors acting alone to change the fundamental purposes of an organization.²⁸

C. Members

At this point in the description of nonprofit corporate governance, those readers familiar with the business corporation may be expecting a discussion of shareholders or some group similar to shareholders. The nondistributional constraint rules out the potential for shareholders in the sense of holders of shares of equity in the firm, to whom residual earnings will be allocated. However, even in business corporations, shareholders are not merely ticket holders in some great corporate lottery. Their equity comes with control rights as well.²⁹ Shareholders are entitled to vote for directors and on a handful of other major corporate de-

other states and an alternative provision of the RMNCA). Statutory immunity often further reduces the risk to volunteer directors of (at least financial) consequences from violations of the duty of care.

²⁶ See JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS* 230-32 (2d ed. 2000); Kurtz & Green, *supra* note 19, at 11-12; Jill S. Manny, *Governance Issues for Non-Profit Religious Organizations*, 40 *CATH. LAW.* 1, 20 (2000).

²⁷ See Manny, *supra* note 26, at 20. Although commentators have at times disputed whether the duty of obedience to mission is a separate duty, *see infra* note 117 and accompanying text, for present purposes, location of the concept is not dispositive.

²⁸ See *Manhattan Eye, Ear & Throat Hosp. v. Spitzer*, 715 N.Y.S.2d 575, 593 (Sup. Ct. 1999) (explaining that although financial circumstances may make it appropriate, in some cases, for a nonprofit to dispose of all of its assets and assume a new mission, "the duty of obedience . . . mandates that a Board, in the first instance, seek to preserve its original mission."); *see also* FISHMAN & SCHWARZ, *supra* note 26, at 231 (citing use of the obedience concept by courts in at least three cases: *Queen of Angels Hosp. v. Younger*, 66 Cal. App. 3d 359 (1977), *Brown v. Mem'l Nat'l Home Found.*, 162 Cal. App. 2d 513 (1958), and *Att'y Gen. v. Hahnemann Hosp.*, 397 Mass. 820 (1986)).

²⁹ Of course, whether and to what extent shareholders have real control has long remained an open (and controversial) question. *See* ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION & PRIVATE PROPERTY* 112-16 (1968).

cisions.³⁰ If nonprofits do not have equity contributors to hold these rights, who, if anyone, does hold these control rights? If a nonprofit has members, they do.

To some degree, the role of members depends on the type of nonprofit corporation in which they are (or could be) involved. Here, the classification system first used by the drafters of the California nonprofit corporation statute³¹ and further developed by the RMNCA is helpful.³² This system separates the universe of nonprofit corporations into religious corporations, public benefit corporations, and mutual benefit corporations. The RMNCA designates “[a]ny corporation . . . organized primarily or exclusively for religious purposes” as a religious corporation.³³ It is easy to anticipate the types of nonprofits that organize as religious corporations: places of worship and their auxiliary and umbrella organizations. A public benefit corporation is defined by the RMNCA as any non-religious corporation that is exempt from taxation under section 501(c)(3) of the federal Internal Revenue Code³⁴ or that is “organized for a public or charitable

³⁰ See, e.g., DEL. CODE ANN. tit. 8, §§ 211(b), 251(c) (2000) (requiring shareholders to vote to elect directors and approve mergers). For-profit shareholders also possess various rights of exit and voice they can use to exert influence on their corporations. See ALBERT O. HIRSCHMAN, EXIT, VOICE, & LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES 4 (1970) (originating the terms “exit” and “voice” as strategies for dissatisfied participants in various contexts). They can exit by selling their shares and they can exercise their voice through derivative suits or shareholder proposals in public corporations. None of these specific options is available in a nonprofit. There are no equity positions for members to sell, no proxy structures within which to voice objections to corporate policy, and standing to sue nonprofit directors is highly restricted. There may be other ways for nonprofit members to exit—simply through ending either their involvement with or their financial support of the organization—or to exercise their voice—by speaking up as concerned supporters of the organization. However, this Article will focus on voting, as it is the only consistent, legal right of control conferred upon members by statutory default mechanisms of nonprofit governance.

³¹ See CAL. CORP. CODE §§ 5111, 7111, 9111 (West 2002). Michael C. Hone served as reporter for both the California revision of its nonprofit corporate statute and the drafting of the RMNCA. Michael C. Hone, University of San Francisco School of Law Faculty Page, available at http://www.usfca.edu/html/fac3_hone.html (last visited Nov. 19, 2003).

³² See RMNCA § 17.07; see also Michael C. Hone, *Aristotle and Lyndon Baines Johnson: Thirteen Ways of Looking at Blackbirds and Nonprofit Corporations—The American Bar Association’s Revised Model Nonprofit Corporation Act*, 39 CASE W. RES. L. REV. 751, 758-63 (1988-89) (describing the classification approach of the RMNCA drafters, and their use of and intended improvements upon the California classification approach).

³³ RMNCA § 17.07(2).

³⁴ § 17.07(3).

purpose and that upon dissolution must distribute its assets to a public benefit corporation,” the federal or state government, or to a section 501(c)(3) tax-exempt entity.³⁵ Due to the requirement that public benefit organizations either qualify for tax exemption or have public/charitable purposes and distribute their assets on dissolution to tax-exempt or charitable entities, the organizations that can organize as public benefit corporations are prototypical charitable nonprofits. These include large and small educational, health care, social service, community, and arts organizations. Finally, mutual benefit corporations are those nonprofit corporations that qualify for neither the religious nor the public benefit mold.³⁶ Groups that typically fit the “mutual benefit” moniker include social clubs, trade associations, and fraternal organizations.³⁷

Public benefit and religious nonprofits are subject to stricter supervision by the government than are mutual benefits. A public benefit or religious nonprofit must notify the attorney general of any plan of merger or dissolution, and of the transfer of assets outside the regular course of business or as part of a planned dissolution.³⁸ These types of nonprofits also must secure governmental approval for certain types of transactions.³⁹ These notification or consent requirements do not apply to mutual benefit nonprofits.

For present purposes, the most important difference between public benefit or religious nonprofits on the one hand, and mutual benefit nonprofits on the other, is that mutual benefits may make distributions of their assets to their members upon dissolution.⁴⁰ Unlike a public benefit nonprofit, which may, by definition, transfer its assets only to other public benefit nonprofits or governmental or tax-exempt entities when it dissolves, a mutual benefit corporation may cash out its members upon dissolution.⁴¹ The RMNCA also permits mutual benefits to repurchase memberships prior to dissolution.⁴² This difference is important here

³⁵ § 17.07(4).

³⁶ See § 17.07(5).

³⁷ Michael C. Hone, *Introduction to REVISED MODEL NONPROFIT CORPORATION ACT: OFFICIAL TEXT WITH OFFICIAL COMMENTS AND STATUTORY CROSS-REFERENCES* xxviii (1988) [hereinafter RMNCA, OFFICIAL TEXT].

³⁸ See RMNCA §§ 11.02(b), 12.02(g), 14.03 (a), (b).

³⁹ See § 11.02(a).

⁴⁰ See §§ 13.02, 14.06.

⁴¹ See RMNCA §§ 13.01, 13.02 cmt.; CAL. CORP. CODE § 8717 (West 2002).

⁴² RMNCA § 13.02; see also CAL. CORP. CODE §§ 7320, 7410-14 (West 2002) (per-

because it means that members in mutual benefit nonprofits play a role much like that played by for-profit shareholders. As capital contributors and potential recipients of distributions, members in mutual benefits have a financial incentive to participate in their organizations. Likewise, mutual benefit nonprofits have financial incentives to empower their members. Thus, members continue to play a role in mutual benefit nonprofits today, whereas members in public benefit nonprofits have become increasingly rare.

With regard to the relationship between the nonprofit corporation and its members, religious nonprofits typically are bound by the rules applicable to public benefit nonprofits, but they are granted some additional flexibility.⁴³ However, the special constitutional issues raised by religious nonprofits, due to their religious character, require separate study.⁴⁴ Therefore, the balance of this Article will confine its consideration to the role of nonprofit members in public benefit nonprofits.⁴⁵

Finally, even among public benefit nonprofits, the concept of membership need not be entirely static. Nonprofit corporate statutes do define the voting rights of members as a matter of default, and statutes adopting optionality typically require nonprofits to state in their articles of incorporation whether or not they have opted to use members.⁴⁶ But such statutes generally also permit individual nonprofits to vary member rights from

mitting transfer of memberships in mutual benefit nonprofit corporations if the articles or bylaws so provide and allowing purchase or redemption of memberships by such corporations).

⁴³ See RMNCA, OFFICIAL TEXT, *supra* note 37, at xxix-xxx.

⁴⁴ See, e.g., Ira Mark Ellman, *Driven from the Tribunal: Judicial Resolution of Internal Church Disputes*, 69 CAL. L. REV. 1378 (1981) (noting and analyzing the constitutional issues raised when courts become involved in resolving internal church disputes).

⁴⁵ Future references to “nonprofits” thus denote public benefit nonprofits, unless otherwise stated. This Article also will not address the one area in which membership governance structures actually are on the rise—nonprofit parent-subsidiary structures. In these structures, a parent nonprofit corporation is the sole member of another, subsidiary nonprofit corporation. I have dealt with these structures elsewhere. See Dana Brakman Reiser, *Decision-Makers Without Duties: Defining the Duties of Parent Corporations Acting as Sole Corporate Members in Nonprofit Health Care Systems*, 53 RUTGERS L. REV. 979 (2001).

⁴⁶ See, e.g., RMNCA § 2.02(a)(5) (requiring each nonprofit to state whether or not it will have members in its articles of incorporation); TEX. REV. CIV. STAT. ANN. art. 1396, § 2.08(C) (Vernon 2001) (providing that “[i]f the corporation is to have no members, that fact shall be set forth in the articles of incorporation.”).

these default positions.⁴⁷ Nonprofits who take advantage of this flexibility might create multiple classes of members, some with and some without voting rights, or might limit the actions on which their members will be entitled to vote to some subset of the default categories. This permissive structure allows for endless permutations of the member concept by individual nonprofits sufficiently sophisticated to draft their organic documents to overcome the statutory defaults. In keeping with its design to critique the impact of optionality, however, this Article will limit its analysis to the two “off the rack” governance options modern nonprofit corporate statutes provide—the use of members with rights to vote on directors and in limited other transactional contexts and the use of a self-perpetuating board.

II

STATE LEGISLATURES ADOPT OPTIONALITY

Guided by model statutes, over the past several decades most state legislatures have adopted express statements of optionality. At one time, state nonprofit corporation acts often operated on the assumption that a voting membership governance structure would be used.⁴⁸ This is not to say that all states historically required members or assumed that all nonprofits would use them.⁴⁹

⁴⁷ See, e.g., RMNCA § 6.10 (providing that all members shall have the same voting rights and obligations, except as otherwise authorized by the corporation’s articles of incorporation or bylaws); R.I. GEN. LAWS § 7-6-15 (2001) (stating that if a corporation opts to have more than one class of members, the rights of the members of each class, *inter alia*, shall be stated in the corporation’s articles of incorporation or bylaws).

⁴⁸ See, e.g., ALASKA COMP. LAWS § 36-4-4 to -5 (1949) (superseded) (describing the voting rights of members and requiring a vote of members in order for a nonprofit corporation to acquire property, with no exception for nonprofits without members); MISS. CODE ANN. § 5326 (1942) (superseded) (requiring stockholders to elect directors and stating that “such directors or managers shall not be elected in any other manner” in a general corporation statute that also governed nonprofit corporations); N.Y. MEMBERSHIP CORP. LAW § 10 (1902) (superseded) (providing for the election of directors by members); see also N.J. STAT. ANN. § 15:1-7 (West 1982) (repealed 1983) (requiring members to approve various actions of a nonprofit corporation and providing no alternative mechanism, although § 15:2-1 states that members are not required); S.D. CODIFIED LAWS § 11.1402 (Michie 1939) (superseded) (requiring members for a nonprofit to incorporate and to elect directors).

⁴⁹ The Missouri statute, for example, has specifically permitted self-perpetuating boards since at least 1953. See MO. ANN. STAT. § 355.105 (West 1993) (enacted 1953) (repealed 1995) (“[n]o corporation shall be required to have members, and in lieu of members, may provide only for a self-perpetuating board of directors.”). Some relatively early state statutes that required members also provided for direc-

However, at least in part because early nonprofit statutes often were crafted as analogues to for-profit corporate statutes,⁵⁰ the assumption that members would play a role analogous to shareholders was frequent.

Soon after the American Bar Association's adoption of the Model Nonprofit Corporation Act ("MNCA") in 1964,⁵¹ these assumptions began to weaken. The MNCA provision on members states: "A corporation may have one or more classes of members or may have no members."⁵² Although the MNCA drafters did not offer any explanation for this provision,⁵³ as states adopted the MNCA, statutory predispositions in favor of a voting membership structure started to disappear.⁵⁴ In 1979, a subcommittee of the American Bar Association's Business Law

tors to act as members, in the absence of a separate membership. *See, e.g.*, LA. REV. STAT. ANN. § 12.126 (West 1951) (enacted 1948).

⁵⁰ *See, e.g.*, COMMITTEE ON CORPORATE LAWS OF THE AMERICAN BAR ASSOCIATION, MODEL NONPROFIT CORPORATION ACT viii (1964) [hereinafter ABA COMMITTEE, MNCA TEXT] (describing the attempt of the drafters to have the Model Nonprofit Corporation Act "closely parallel . . . the provisions of the Model Business Corporation Act"); REPORT OF THE NONPROFIT LAW REVISION COMMISSION COMMITTEE, N.J. STATE BAR ASS'N, XII, XV (1980) (noting the New Jersey Business Corporation Act as one of two main statutory sources used by the Committee in developing a new nonprofit corporate statute).

In many states, the adoption of a nonprofit corporation statute was an afterthought, and sometimes a much belated one. *See, e.g.*, Hawaii Nonprofit Corporation Act, HAW. REV. STAT. § 415B-1 to -159 (enacted 1985) (repealed 2001) (enacting the state's first nonprofit corporation statute; previously, the general corporation statute governed nonprofit corporations in Hawaii); Nevada A.B. 655 Revised Law Governing Corporations and Similar Organizations, 1991 Nev. Stat. 422 (enacted 1991) (enacting the state's first comprehensive nonprofit corporation statute). Often, close attention has not been paid to the details necessary to appropriately revise a general corporation statute for use as a nonprofit statute. Therefore, these statutes are rarely models of clarity. *See* NORMAN I. SILBER, A CORPORATE FORM OF FREEDOM 18-25 (2001) (relating the history of various nonprofit incorporation statutes).

⁵¹ *See* ABA COMMITTEE, MNCA TEXT, *supra* note 50, at vii-x (describing the publication of the 1964 MNCA as an update of a 1952 Model Act, published by the ABA Committee on Corporate Laws of the Section of Corporation, Banking and Business).

⁵² MODEL NONPROFIT CORPORATION ACT § 11 (1964) [hereinafter MNCA].

⁵³ *See* ABA COMMITTEE, MNCA TEXT, *supra* note 50, at § 11 (offering no official commentary on this section). The preface to the MNCA does mention that the Act is generally intended as an "enabling statute" and notes that the Model Act is intended, at least in part, "to simplify the transaction of affairs . . ." *See id.* at ix.

⁵⁴ *See, e.g.*, S.D. CODIFIED LAWS § 47-23-1 (Michie 2002) (enacted 1965) (adopting MNCA language in revision of statute that formerly required members); ALASKA STAT. § 10.20.051 (Michie 2001) (enacted 1968) (adopting MNCA language in revision of statute that formerly presumed the existence of members); *see also* Maurice R. Franks, Note, *Iowa: The Model Nonprofit Corporation Act Applied*, 17

Section commenced a complete revision of the MNCA.⁵⁵ This process culminated in 1987 with the publication of the RMNCA, which included a resounding endorsement of optionality.⁵⁶ The RMNCA states simply: “A corporation is not required to have members.”⁵⁷ As this statute began to be adopted in states around the country, it was clear that optionality was to become— if it was not already—the standard legislative position.⁵⁸

Today, state nonprofit corporation statutes in thirty-seven states and the District of Columbia explicitly adopt optionality.⁵⁹ Twenty of those jurisdictions do so by the precise provision of the MNCA,⁶⁰ eighteen use the RMNCA’s language.⁶¹ Nine addi-

DRAKE L. REV. 107, 107 (1967) (noting the complete or substantial adoption of the MNCA, which endorses optionality, in twelve jurisdictions within one year).

⁵⁵ See RMNCA, OFFICIAL TEXT, *supra* note 37, at xix.

⁵⁶ See RMNCA § 6.03.

⁵⁷ *Id.*

⁵⁸ See, e.g., IND. CODE ANN. § 23-17-2-17 (Michie 2002) (enacted 1991) (adopting RMNCA language in revision of nonprofit corporation statute that formerly had required members, at least in name).

Many states have enacted statutes based on model legislation quite swiftly and without fanfare. See, e.g., GA. CODE ANN. § 14-3-603 (2001) (effective July 1, 1991) (adopting a revised statute based on the RMNCA after only a couple of months of review and hearings); HAW. REV. STAT. ANN. §§ 414D-83 (effective July 2, 2002) (similar history); see also S.B. 1284, H.R. Floor Comments, at 5, 256-59 (Conn. 1959) (Mr. August of Avon noting that the bill to revise the state nonprofit corporation statute along MNCA lines would pass the House and Senate “with so little comment.”).

⁵⁹ See ALA. CODE § 10-3A-26 (2002); ALASKA STAT. § 10.20.051 (Michie 2001); ARIZ. REV. STAT. ANN. § 10-3603 (West 2002); ARK. CODE ANN. § 4-33-603 (Michie 2002); COLO. REV. STAT. § 7-126-101 (2001); CONN. GEN. STAT. § 33-1055 (2001); D.C. CODE ANN. § 29-301.12 (2002); FLA. STAT. ch. 617.0601 (2001); GA. CODE ANN. § 14-3-603 (2001); HAW. REV. STAT. ANN. § 414D-83 (2001); IDAHO CODE § 30-3-36 (Michie 2002); 805 ILL. COMP. STAT. 105/107.03 (2002); IND. CODE ANN. § 23-17-7-3 (Michie 2002); IOWA CODE ANN. § 504A.11 (West 2002); KY. REV. STAT. ANN. § 273.187 (Michie 2001); ME. REV. STAT. ANN. tit. 13-B, § 402 (West 2001); MINN. STAT. ANN. § 317A.401 (West 2001); MISS. CODE ANN. § 79-11-175 (2001); MO. ANN. STAT. § 355.181 (West 2001); MONT. CODE ANN. § 35-2-512 (2001); NEB. REV. STAT. § 21-1940 (2001); NEV. REV. STAT. ANN. § 82.231 (Michie 2001); N.M. STAT. ANN. § 53-8-11 (Michie 2001); N.C. GEN. STAT. § 55A-6-01 (2001); N.D. CENT. CODE § 10-33-57 (2001); OR. REV. STAT. § 65.137 (2001); R.I. GEN. LAWS § 7-6-15 (2001); S.C. CODE ANN. § 33-31-603 (Law. Co-op. 2001); S.D. CODIFIED LAWS § 47-23-1 (Michie 2002); TENN. CODE ANN. § 48-56-103 (2001); TEX. REV. CIV. STAT. ANN. art. 1396 § 2.08 (Vernon 2001); UTAH CODE ANN. § 16-6a-601 (2001); VT. STAT. ANN. tit. 11B, § 6.03 (2001); VA. CODE ANN. § 13.1-837 (Michie 2002); WASH. REV. CODE ANN. § 24.03.065 (West 2002); W. VA. CODE § 31-1-137 (2001) (repealed 2002); WIS. STAT. ANN. § 181.0603 (West 2001); WYO. STAT. ANN. § 17-19-603 (Michie 2002).

⁶⁰ See ALA. CODE § 10-3A-26 (2002); ALASKA STAT. § 10.20.051 (Michie 2001); CONN. GEN. STAT. § 33-1055 (2001); D.C. CODE ANN. § 29-301.12 (2002); FLA.

tional jurisdictions have formulated unique statutory language and provisions regarding members, but their endorsement of optionality is clear.⁶² New York's statute offers an example of this individuality. It classifies nonprofit corporations into four categories, lettered A through D. The statute requires those nonprofits other than Type B to have members.⁶³ But, Type B covers most of the field of charitable or public benefit nonprofits, including those "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."⁶⁴ For these Type B nonprofits, membership is

STAT. ch. 617.0601 (2001); 805 ILL. COMP. STAT. 105/107.03 (2002); IOWA CODE ANN. § 504A.11 (West 2002); KY. REV. STAT. ANN. § 273.187 (Michie 2001); ME. REV. STAT. ANN. tit. 13-B, § 402 (West 2001); MINN. STAT. ANN. § 317A.401 (West 2001); NEV. REV. STAT. ANN. § 82.231 (Michie 2001); N.M. STAT. ANN. § 53-8-11 (Michie 2001); N.C. GEN. STAT. § 55A-6-01 (2001); N.D. CENT. CODE § 10-33-57 (2001); R.I. GEN. LAWS § 7-6-15 (2001); S.D. CODIFIED LAWS § 47-23-1 (Michie 2002); TEX. REV. CIV. STAT. ANN. art. 1396 § 2.08 (Vernon 2001); VA. CODE ANN. § 13.1-837 (Michie 2002); WASH. REV. CODE ANN. § 24.03.065 (West 2002); W. VA. CODE § 31-1-137 (2001) (repealed 2002).

⁶¹ See ARK. CODE ANN. § 4-28-210 (Michie 2001); ARIZ. REV. STAT. ANN. § 10-3603 (West 2002); COLO. REV. STAT. § 7-126-101 (2001); GA. CODE ANN. § 14-3-603 (2001); HAW. REV. STAT. ANN. § 414D-83 (2001); IDAHO CODE § 30-3-36 (Michie 2002); IND. CODE ANN. § 23-17-7-3 (Michie 2002); MISS. CODE ANN. § 79-11-175 (2001); MO. ANN. STAT. § 355.181 (West 2001); MONT. CODE ANN. § 35-2-512 (2001); NEB. REV. STAT. § 21-1940 (2001); OR. REV. STAT. § 65.137 (2001); S.C. CODE ANN. § 33-31-603 (Law. Co-op. 2001); TENN. CODE ANN. § 48-56-103 (2001); UTAH CODE ANN. § 16-6a-601 (2001); VT. STAT. ANN. tit. 11B, § 6.03 (2001); WIS. STAT. ANN. § 181.0603 (West 2001); WYO. STAT. ANN. § 17-19-603 (Michie 2002).

⁶² See CAL. CORP. CODE §§ 5310, 7310, 10810, 10830 (West 2002); LA. REV. STAT. ANN. § 12:217 (West 2002); MD. CODE ANN., CORPS. & ASS'NS § 5-204 (2002); MASS. GEN. LAWS ANN. ch. 180, § 3 (West 2002); MICH. COMP. LAWS ANN. § 450.2302 (West 2002); N.J. STAT. ANN. § 15A:2-8 (West 2002); N.Y. NOT-FOR-PROFIT CORP. § 601 (McKinney 2002); OHIO REV. CODE ANN. § 1702.14 (West 2002); 15 PA. CONS. STAT. ANN. § 5751 (West 2002).

⁶³ N.Y. NOT-FOR-PROFIT CORP. § 601 (McKinney 2002).

⁶⁴ § 201(b) (outlining the purposes for which various types of not-for-profit corporations can be formed).

Type A, C and D corporations are described as follows:

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 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

optional.⁶⁵

The various state legislatures tend to cite one or more of the same rationales for their endorsement of optionality. Some explain that optionality is an improvement because it will ease the operations of nonprofits. Others assert that optionality will provide nonprofits with additional flexibility in their governance. Finally, many note an absence of clear benefits from a voting membership structure in the first place, and therefore explain that such a costly extravagance should not be forced upon nonprofits wholesale.

The first rationale, that making members optional will ease nonprofit administration, is a response to truly practical concerns. It falls to each nonprofit itself to keep track of its members.⁶⁶ Members, unlike shareholders, do not have their personal financial interests bound up in the future of the corporation and have little incentive to keep the corporation informed of their whereabouts. Particularly under broad definitions of membership, the practical cost of maintaining an updated member list can itself be quite high.⁶⁷

A potentially even greater practical cost of governance with members arises when a nonprofit must find and produce its members for a vote. Member votes on the election of directors are fairly predictable; they generally will occur at annual meet-

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.; see also Fishman, *supra* note 12, at 660 n.230 (describing purposes of Type A, B, C, and D corporations).

⁶⁵ N.Y. NOT-FOR-PROFIT CORP. § 601 (McKinney 2002). Another common method of establishing optionality among these states is to provide a requirement of members, but to permit directors to act in lieu of members in various situations. See, e.g., OHIO REV. CODE ANN. § 1702.14 (West 2002) (“Where neither the articles nor the regulations provide for members thereof as such, or where a corporation has in fact no members other than the directors, the directors shall, for the purposes of any statute or rule of law relating to corporations, be taken to be the members of such corporation, and they shall have all the rights and privileges of members. . .”).

⁶⁶ See, e.g., RMNCA § 1.40(21) (requiring a nonprofit corporation to define its membership in its organic documents); MNCA § 11 (similar).

⁶⁷ See Letter from Connie Cheney, Legislative Representative of the United Way of California, to Alfred H. Song, State Senator (Aug. 7, 1978) (on file with author) (describing the problem faced by many United Way groups and other nonprofits “which define as members all those who make a contribution. These members have the right to vote for the Board of Directors However, the names and addresses of all these members are not known, would be expensive to collect, and in some cases would not be obtainable . . .”).

ings.⁶⁸ However, as nonprofits become more sophisticated players in various industries, additional member votes can more often become necessary—and necessary quickly. Members often must vote on amendments to the articles of incorporation, on mergers, and on sales or transfers of all or substantially all assets.⁶⁹ State nonprofit corporation statutes may even require supermajority member votes to approve these actions.⁷⁰ When membership definitions are broad, obtaining the attendance of a quorum of members, let alone a majority or supermajority of the membership often necessary to pass a measure, can become an obstacle to otherwise beneficial transactions.⁷¹ If nonprofits can use a self-perpetuating board, they can act without a member vote, thereby easing operations generally and specifically fostering participation in sophisticated transactions.⁷²

This cost of voting membership structures has been made clear to state legislatures, particularly by the nonprofit trade association groups and bar associations that advised the adoption of statutory provisions endorsing optionality.⁷³ For example, in

⁶⁸ See, e.g., RMNCA §§ 7.01, 8.04 (providing for annual member meetings and election of directors at those meetings, respectively).

⁶⁹ See, e.g., §§ 10.03, 10.21, 11.03, 12.02, 14.02.

⁷⁰ See, e.g., MASS. GEN. LAWS ANN. ch. 180 §§ 7, 8A, 10, 11A (West 2002) (requiring that two-thirds of a nonprofit's membership vote in favor to amend the articles of incorporation or to approve a sale of all or substantially all assets, merger or consolidation, or dissolution).

⁷¹ See, e.g., *Hearing on H.B. 741 Before the House Comm. on Bus. & Econ. Dev.*, 52d Leg. Reg. Sess. 1, 19-23 (Mont. Feb. 18, 1991) (on file with author) (Testimony of Attorney Bob Murdo stating that “[i]f there is a problem with the existing articles of incorporation or the by-laws, the non-profit corporation is not certain how to get hold of all its members, there is no format [] to make certain the activities you plan at that meeting will be authorized.”); Comments of John T. Knox, Chairman, California Assembly Select Committee on Revision of the Nonprofit Corporations Code 5 (1978) (on file with author) (“[N]onprofit and nonstock corporations are sometimes unable to conduct their affairs because they cannot raise a quorum [or] do not know who their members or participants are . . .”).

⁷² A few statutes anticipate the difficulty of obtaining member approval and provide for governmental approval of certain transactions in lieu of a member vote. See, e.g., MASS. GEN. LAWS ANN. ch. 180, § 7A (West 2002) (permitting secretary of state approval for amendments to articles of incorporation and approvals of mergers or consolidations, when member vote or other usual statutory requirements cannot be met). However, securing this governmental approval still will be more costly than proceeding with a transaction solely on the approval of a self-perpetuating board.

⁷³ See, e.g., Letter from Connie Cheney, *supra* note 67 (explaining the practical costs attendant to membership requirements); Governing Council of the Corporate and Securities Section of the Idaho State Bar, Summary of the Proposed New Idaho Nonprofit Corporation Act 2 (Idaho Mar. 15, 1993) (on file with author) (explaining

New Jersey, the report of the Nonprofit Law Revision Commission mentioned these practical issues.⁷⁴ The report explained the statute's recognition of nonprofits without members as a response to the following:

The identity of some or all of the members at any one time may often be unknown. Records may not be kept. There may be no listing of members as one would find of shareholders in the stock book or a stock transfer book of a business corporation. These differences and other incidents . . . were considered and dealt with in the Act.⁷⁵

Presumably, attorneys counsel their clients to opt for self-perpetuating board structures for these same reasons.

The second rationale offered by drafters of legislation endorsing optionality is that it will increase the flexibility and autonomy of nonprofits in selecting their governance structures.⁷⁶ By clarifying that a voting membership structure is only one option, modern nonprofit statutes offer a range of governance possibilities.⁷⁷ The move to express statements of optionality can be seen in this way as part of a general trend toward increasing the flexibility that nonprofits have to structure their own affairs.⁷⁸ In

that, due in part to the then-current act's membership requirement, "many nonprofit organizations find it inconvenient to operate within the requirements of the existing act and simply ignore them.")

⁷⁴ See Report of the New Jersey Nonprofit L. Revision Comm., xv (N.J. Sept. 23, 1980) (on file with author).

⁷⁵ See *id.*

⁷⁶ See, e.g., *Concerning the Colorado Revised Nonprofit Corporation Act: Hearing on S.B. 97-91 Before the House Comm. on Bus. Aff. and Lab.*, First Regular Session, 61st General Assembly (Colo. 1997) (on file with author) (prepared statement of Senator Doug Linkhart and Representative Tambor Williams) ("[The Bill] provides flexibility so that each nonprofit corporation may structure its own governance . . ."); *Hearing on Secretary of State Corporate Study and A.B. 655*, 66th Leg. (Nev. 1991) (prepared testimony of John P. Fowler in support of Nevada A.B. 655) (on file with author) (explaining that "[t]he new law permits many different structures," two of which are a voting membership structure and a self-perpetuating board structure.).

⁷⁷ A few statutes make this range of options explicit, such as Michigan's specification of a "directorship corporation" as a separate form of nonprofit corporation, identifiable by its use of a self-perpetuating board structure. See MICH. COMP. LAWS ANN. §§ 450.2302, 450.2305 (West 2002).

⁷⁸ See, e.g., RMNCA, OFFICIAL TEXT, *supra* note 37, at xxxii-xxxiii (describing as one of the important aspects of the revised act the fact that it "facilitates choices between different organizational structures."); *Hearing on H.B. 741*, *supra* note 71, at Exhibit 12A (prepared testimony of Professor Steven C. Bahls, Chair of the State Bar of Montana Corporate Law Revision Committee) (explaining optionality as part of an overall attempt to increase flexibility: "The proposal specifically allows self-perpetuating boards, . . . makes it easier to call and hold meetings, makes it

Massachusetts, for example, a proposal by the Boston Bar Association for the revision of its nonprofit corporation law would permit nonprofits with members and directors to reallocate the typical member decisions to directors and vice versa, again in an attempt to increase flexibility.⁷⁹ As noted earlier, the world of nonprofits is quite diverse. Allowing for flexibility in governance structures is one way to help a single statute to continue to regulate them all.⁸⁰ However, statements by advocates and legislatures that optional membership allows for greater flexibility also might be interpreted as merely more politically palatable descriptions of the need to ease nonprofits' practical operations, as described earlier.

Finally, some legislatures and, most notably, the drafters of the RMNCA, have described a lack of real benefits from governance with members. In the introduction to the official text of the RMNCA, Reporter Michael Hone describes members' lack of a "personal economic incentive to monitor corporate activities and prevent abuses" as contributing to the need for attorney general oversight of nonprofits.⁸¹ These feelings were echoed in a report by the Montana State Bar Association Corporate Law Revision Committee to the state legislature.⁸² The bar committee explained that "[b]ecause members of public benefit corporations have little economic interest in their corporations, they usually do not carefully monitor activities to prevent corporate abuse."⁸³ The lack of faith in members as monitors is clear from these

easier to structure an organization with delegates, allows more flexibility in methods of choosing directors, allows directors['] meetings to be held by phone and generally simplifies corporatc governance.") (section citations omitted). This desire for flexibility can be seen as part of a larger trend favoring flexibility in governance in corporate law generally.

⁷⁹ See Richard C. Allen, *Bar Association Task Force Review of C. 180 for Possible Amendment*, in NONPROFIT LAW CONFERENCE 50 (Mass. Continuing Legal Education ed., 2001).

⁸⁰ See RAYMOND G. MCGUIRE, *THE LAW REGULATING NON-STOCK CORPORATIONS IN MAINE: PROPOSALS FOR CHANGE § 402 cmt.* (1976) (prepared for the Corporate Section of the Maine State Bar Association) (on file with author) ("Given the diversity of organizations eligible for incorporation under [the new state nonprofit corporation] Act, sections regulating the internal affairs of such groups must be as flexible as possible.").

⁸¹ RMNCA, OFFICIAL TEXT, *supra* note 37, at xxvi.

⁸² See *Hearing on H.B. 741*, *supra* note 71, at 19 & Exhibits 12-12A (prepared testimony of Professor Steven C. Bahls, Chair of the State Bar of Montana Corporate Law Revision Committee).

⁸³ *Id.* at 4, Exhibit 12A.

statements.⁸⁴

The trend is now essentially complete. The reigning model act forcefully adopts optionality. Forty-six jurisdictions have endorsed optionality for nonprofits incorporated within their borders. The remaining state nonprofit corporation acts, which have not yet enunciated the optionality position, almost certainly will be brought into line the next time their respective state legislatures consider revising them. Optionality is here to stay.

III

MEMBERS AND INDIVIDUAL NONPROFITS

As outlined above, state legislatures have reached near unanimous agreement that nonprofits should have the ability to choose between internally democratic governance with members and governance without them. But what are the benefits and costs of governance with members to individual nonprofits? What role, if any, can members practically be expected to play in nonprofit governance? Members play two distinct, but related, roles—as ultimate decision-makers and as monitors/enforcers of nonprofit directors and managers. In deciding whether to include members in their governance structures, nonprofit incorporators and their counsel weigh the benefits that members provide by performing these roles against the costs of governance with members.⁸⁵ This Part seeks to explain why, in considering this balance, nonprofits consistently opt out of governance with members.

Before moving headlong into the search for potential rationales for using members, it is important to note that the issues considered in this Part exist on the level of individual nonprofits. I rely on them only in order to address whether and why individual nonprofits adopt or reject governance with members. Presumably, in making this determination, nonprofit founders and their counsel focus on whether using members will improve the

⁸⁴ The obstacles to effective monitoring by nonprofit members will be explored in depth in Part III.C *infra*.

⁸⁵ Mark E. Warren suggests that various other factors, relating to a nonprofit's strategic plans and purposes, also may impact a nonprofit's choice of governance structure. See MARK E. WARREN, *DEMOCRACY AND ASSOCIATION* 95 (2001) (noting that while sometimes a democratic structure may be selected because it is uniquely suited to the organization's purposes, in other cases such a structure may be chosen to satisfy an organization's independent desire to cultivate organizational loyalty or merely to allow for division of labor).

individual nonprofit in question, without much attention to the impact their chosen governance structure may have on the world outside their particular nonprofit. The latter concern will be addressed by Part IV's review of the benefits of membership for society at large.

A. *Members as Decision-Makers*

In a nonprofit with members, members act as decision-makers when they vote to elect directors or to approve or reject major corporate decisions. In a nonprofit without members, directors make these decisions alone. If members can make, on balance, "better" decisions on these questions for a particular nonprofit, this should be a benefit that thoughtful nonprofit founders consider in selecting a governance structure. The prototypical for-profit corporate governance structure using voting shareholders can be explained in part on these grounds: shareholder voting leads to more efficient decisions.⁸⁶ In a for-profit corporation,

⁸⁶ FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 67-68 (1991); Frank H. Easterbrook & Daniel R. Fischel, *Shareholder Voting Rights and the Exercise of Voice: Voting in Corporate Law*, in *FOUNDATIONS OF CORPORATE LAW* 195, 196 (Roberta Romano ed., 1993).

For-profit corporations use voting shareholders to enhance efficiency in other respects as well. Voting shareholders play an essential part in establishing an efficient capital structure. See WILLIAM A. KLEIN & JOHN C. COFFEE, JR., *BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPALS* 361 (8th ed. 2002). The choice of whether and to what extent to use equity in financing a for-profit corporation is one closely tied to increasing the efficiency of the firm—lowering its cost of capital and thereby raising the overall value of its securities. Although many for-profit corporations rely on other sources of capital, principally borrowing, equity financing based on sales of shares of common stock remains a significant means of raising the capital needed by for-profit ventures. See ROBERT C. HIGGINS, *ANALYSIS FOR FINANCIAL MANAGEMENT* 150-60 (5th ed. 1998) (describing bonds, common stock, and preferred stock as the "more popular security types").

Granting shareholders control rights in the corporation in exchange for their investment also can be seen as a decision linked to efficient capital generation. Allocating voting power to common shareholders is a relatively inexpensive way to entice investors to purchase equity shares, which do not offer a guaranteed return. The combination of risk, return, and control offered by common stock makes it an attractive product for many consumers in the securities market, and sales of common stock enable corporations to raise the capital they require at a satisfactory cost.

The use of voting shareholders in for-profit corporate governance also enhances efficiency by enabling the market for corporate control. EASTERBROOK & FISCHEL, *supra* at 70-71; Easterbrook & Fischel, *supra* at 197; see also STEPHEN M. BAINBRIDGE, *CORPORATION LAW AND ECONOMICS* 617-20 (2002) (canvassing arguments regarding the market for corporate control). Voting shares are the currency in this market. Those wishing to take over a target corporation can do so by purchasing a number of shares sufficient to exert control over directors and management and implement their plan. This kind of competition for control of corporations arguably

efficiency can be measured by return on invested capital.⁸⁷ As equity investors and residual claimants, shareholders' preferences will be most closely aligned with those of the corporation. So, allocating to them the dispositive voice in ultimate firm decisions will stimulate efficient firm decision-making, at least at the margins.⁸⁸

If members are likewise the corporate actors whose preferences are aligned most closely with those of the nonprofit, governance with members may similarly promote efficient decision-making in nonprofits. Making this determination requires consideration of what it means to make good or "efficient" decisions in the nonprofit context. Return on invested capital cannot be conveniently relied upon as the appropriate metric. Nonprofits do not have equity investors, and their insiders are precluded by law from receiving distributions of any return on capital. A more appropriate definition of efficiency might be something akin to mission maximization:⁸⁹ achieving the nonprofit's mission to the greatest possible extent (the nonprofit's return) through the ex-

improves the overall efficiency of for-profit firms in the market. See BAINBRIDGE, *supra* at 617-20 and sources cited therein.

However, neither the efficient capital structure nor the efficient market for corporate control rationale translates well to the nonprofit context. Nonprofits do not, and indeed cannot, offer members the status of residual claimants and raise capital on the promise of a return on investment if residual earnings are available. The nondistributional constraint expressly forbids the distribution of residual earnings to members. See *supra* Part I.A. Federal tax law also prohibits and punishes attempts to provide a financial return on investment to members of tax-exempt nonprofits. See 26 U.S.C. § 501(c)(3) (2000) (exempting from taxation only those organizations that meet other exemption criteria and "no part of the net earnings of which inures to the benefit of any private shareholder or individual"). Therefore, although the groups of members and patrons or donors may overlap, a voting membership cannot be a vehicle for efficiently raising equity capital.

Membership also cannot be justified as a mechanism to smooth transactions in nonprofit corporate control. Memberships in public benefit nonprofits are not transferrable. See, e.g., RMNCA §§ 13.01-02. More importantly, however, there is no significant market for the control of nonprofits. This is in part because, in order to devote a target's resources to changed purposes, acquiring management often would have to overcome a charitable trust imposed on them. See *infra* note 108.

⁸⁷ HIGGINS, *supra* note 86, at 38, 52-54 (describing return on equity ("ROE") as a measure of firm efficiency and noting that return on invested capital is a metric superior to ROE).

⁸⁸ EASTERBROOK & FISCHEL, *supra* note 86, at 67-68; Easterbrook & Fischel, *supra* note 86, at 196.

⁸⁹ Cf. Goldschmid, *supra* note 16, at 641 ("For-profit directors and officers are principally concerned about long-term profit maximization. While nonprofit directors and officers keep economic matters in mind, they are principally concerned about the effective performance of the nonprofit's mission.").

penditure of its financial and other resources, as contributed by donors, volunteers, consumers, members, and the general public (the nonprofit's capital).

Members should vote to promote the nonprofit's mission if membership criteria are designed to identify individuals with a commitment to that mission. Each nonprofit establishes the requirements for individuals to be admitted as its members in its articles or bylaws. Examples of such criteria include admission as members of: those who have made any monetary contribution to the nonprofit⁹⁰ or a monetary donation of a certain (often nominal) level during a particular period;⁹¹ those who volunteer time to the nonprofit's activities;⁹² those who attend annual meetings;⁹³ or those who adhere to the nonprofit's purposes.⁹⁴ Nonprofits with members identified and admitted based upon their demonstrated commitment to the organization may presume that these members will vote to maximize mission achievement.⁹⁵ Therefore, allocating to such members the responsibility to elect directors and approve major organic decisions should promote efficiency in this sense.

⁹⁰ See, e.g., Peking University Alumni Association of Southern California, *available at* <http://www.pku.org/newsarchive/news45.txt> (explaining the status of a member as one who, "in the past two years . . . made any monetary contribution to [the] Association[,] . . . paid fees to attend any activities organized or sponsored by [the] Association," or "made any donations for any charity event or organization through [the] Association").

⁹¹ See, e.g., Bylaws of Different Spokes Seattle, *available at* <http://www.teamseattle.org/spokes/bylaws.htm> ("Membership is open to everyone and shall become effective upon receipt of annual dues [of \$15-\$20] and a completed membership form."); Seattle Community Network Association Membership Levels, *available at* <http://www.scn.org/scna/membership.html> (listing donation levels required to become a voting member starting at \$25 per year).

⁹² See, e.g., Assistance League of Austin, TX, Membership, *available at* <http://www.alaustin.org/membership.htm> (requiring voting members to volunteer at least ninety hours per year).

⁹³ See, e.g., Colorado Family Support Council, Bylaws, Article IV, *available at* <http://www.childsupport.state.co.us/Bylaws04.htm> (making membership available to, inter alia, any individual "actively engaged in the field of family support in the State of Colorado, who attend[s] annual meetings of the Corporation").

⁹⁴ See, e.g., North End Community Health Center, Bylaws, Article III (on file with author) ("The members of the Corporation shall be those persons of the community who adhere to the purposes of this corporation.").

⁹⁵ Even this claim may require some relaxation because members' preferences may not be monolithic or single-peaked. In the for-profit context, shareholders can be assumed to make efficient decisions through voting because their preferences should align smoothly with profit-maximization. See EASTERBROOK & FISCHEL, *supra* note 86, at 69-70; Easterbrook & Fischel, *supra* note 86, at 197. Without the easy metric of money, nonprofit members' preferences may appear less uniform.

B. Members as Monitors/Enforcers

The second major member role in governance is to monitor the performance and enforce the obligations of nonprofit fiduciaries. The question of how to improve the accountability of these nonprofit decision-makers, generally directors, officers, and managers, is a central question in the legal study of nonprofit organizations.⁹⁶ Failures in the accountability of nonprofit directors and managers for the funds and the mission of their organizations are a chronic problem in the nonprofit arena.⁹⁷ Commentators have attributed these failures in large part to inadequate governmental enforcement of fiduciary obligations against nonprofit directors and officers by state attorneys general⁹⁸ and the limited standing for non-governmental parties to challenge nonprofit decisions in court.⁹⁹ Perhaps a voting membership is an unrecognized mechanism for filling this accountability gap.

At the inception of a nonprofit, accountability should not be an issue. When a nonprofit is first founded, assuming that its incorporators become its initial directors and control it, its activities should match precisely the mission that the nonprofit was founded to pursue.¹⁰⁰ Presumably, the incorporators found the nonprofit in order to serve some formerly unserved purpose they desire—be that providing a venue for exhibitions they demand and that are not otherwise put on, taking care of the needy in a way that matches their viewpoint on how to constitute a just society, or contributing to the upkeep of a neighborhood. As initial directors, self-interest¹⁰¹ should compel the founders to direct the

⁹⁶ See Brody, *supra* note 18, at 1405; Evelyn Brody, *Agents without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457 (1996); Henry B. Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 497, 500 (1981).

⁹⁷ Brody, *supra* note 18, at 1405.

⁹⁸ See Marion Fremont-Smith, *Trends in Accountability and Regulation of Nonprofits*, in *THE FUTURE OF THE NONPROFIT SECTOR* 75-77 (Virginia A. Hodgkinson & Richard W. Lyman eds., 1989); Hansmann, *supra* note 96, at 606-08; Kenneth L. Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433, 434 (1960).

⁹⁹ See Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 J. CORP. L. 655, 657 (1998); Avner Ben-Ner & Theresa Van Hoomissen, *The Governance of Nonprofit Organizations: Law and Public Policy*, 4 NONPROFIT MGMT. & LEADERSHIP 393, 394 (1994).

¹⁰⁰ See Ben-Ner & Van Hoomissen, *supra* note 99, at 403-04.

¹⁰¹ This concept of self-interest includes the idea that altruism may be a self-interested goal.

nonprofit to pursue precisely the activities they desired in founding it. In legal terms, if the initial founders serve as the board, they act as both agents and principals in the fledgling nonprofit. With identical agents and principals, there will be little potential for a gap in agents' accountability, and there is little need to monitor them.¹⁰²

Once this initial moment passes, as the organization grows, there will no longer be complete overlap between those who control the nonprofit and those who benefit from it.¹⁰³ The directors remain the agents of the nonprofit and are required to serve it with care and loyalty. However, once the organization passes its embryonic stages, these agents become responsible to a dispersed set of principals—the nonprofit's adherents—or to no identifiable principal at all.¹⁰⁴ Directors must be monitored to ensure that they comply with their obligations. And, when failures of compliance occur, enforcement mechanisms must be applied to correct them.¹⁰⁵

¹⁰² Avner Ben-Ner and Theresa Van Hoomissen, both economists, describe the same situation in economic terms. See Ben-Ner & Van Hoomissen, *supra* note 99, at 401-03. The incorporators who form a nonprofit can be seen as individuals who experience a demand for an unavailable mix of products and/or services. See *id.* at 401-02. These demanders of output expend resources forming a nonprofit and performing services for it in order to obtain the output they demand. See *id.* Therefore, control by these incorporators should ensure that the nonprofit's output will track demand. See *id.* at 402-03.

¹⁰³ This overlap arguably will remain larger in a nonprofit with members than in one without them. The use of members in governance expands the group of individuals who benefit from or feel a part of the organization *and* are empowered with some control over its decisions. Still, even under the most inclusive definition of "member," it is extremely unlikely that these groups will be completely identical.

¹⁰⁴ See Brody, *supra* note 96, at 465. In the case of a nonprofit with members, members will make up only an identifiable subset of this class of adherents. In a nonprofit without members, however, the organization's adherents will be even more difficult to identify.

¹⁰⁵ The potential for accountability problems to arise again can be explained in economic terms. See Ben-Ner & Van Hoomissen, *supra* note 99, at 403-06. Ben-Ner and Van Hoomissen explain that if an organization is successful and its board remains the only control group, the control group ultimately will be made up of only a subset of those who demand provision of goods and services by the nonprofit. See *id.* at 404. Furthermore, nonstakeholders may join the board of directors for reasons other than to ensure the fulfillment of a demand for the organization's nonprofit output, such as for status. If so, this squeezes out additional positions of control that could be held by stakeholders. They identify this as the problem of stakeholders who should take part in controlling the organization, but fail to do so. See *id.* at 404-05. In addition, Ben-Ner and Van Hoomissen see an additional control gap in that directors may fail to exercise control sufficiently. They may shirk their duties and attempt to free-ride on the work of others. See *id.* at 405-06.

Two important kinds of substantive accountability problems affecting nonprofit organizations are failures of financial integrity and mission creep.¹⁰⁶ Nonprofits' financial accountability problems have been well-documented and much lamented.¹⁰⁷ Without effective monitoring and enforcement, nonprofit directors can engage in opportunistic behavior ranging from the diversion of corporate opportunities, to the taking of excessive compensation or perquisites, to the outright looting of corporate coffers. Of course, directors' duty of loyalty prohibits these opportunistic lapses, and charitable trust law restricts the actions that directors may take, at least regarding the use of donated, and particularly donor-restricted, funds.¹⁰⁸ However, unless there is effective monitoring and enforcement of these legalities, their prohibitions are toothless.

Neither directors nor attorneys general are optimal enforcers of nonprofit directors' fiduciary obligations. A director can bring an action charging a fellow director with fiduciary breach on the

¹⁰⁶ See Peter Swords, *The Form 990 as an Accountability Tool for 501(c)(3) Nonprofits*, 51 TAX LAW. 571, 571-74 (1998) (identifying these two strains of nonprofit accountability concerns and referring to them as "negative" and "positive" accountability); Ben-Ner & Van Hoomissen, *supra* note 99, at 406 (asserting that a lack of sufficient participation in the control of a nonprofit creates the potential for financial misconduct and results in a mismatch between what most stakeholders would demand from the organization and the organization's actions).

Another important strain of accountability of concern to nonprofits is organizational accountability, their responsibility to govern themselves in accordance with the internal rules of order they have adopted. See Dana Brakman Reiser, *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability 10-13* (2004) (unpublished manuscript, on file with author). This process-oriented component of nonprofit accountability relies on a nonprofit's fiduciaries to comply with the legal norms the organization has adopted for its own governance, and has few, if any, implications for members. Therefore, it will not be addressed in detail here.

¹⁰⁷ See, e.g., JOHN S. GLASER, *THE UNITED WAY SCANDAL: AN INSIDER'S ACCOUNT OF WHAT WENT WRONG AND WHY passim* (1994); Felicity Barringer, *Charity Boards Learn to Be Skeptical*, N.Y. TIMES, Apr. 19, 1992, at A10 (discussing how United Way's board failed to catch extensive financial manipulations by the organization's president, resulting in increased skepticism regarding effective management by nonprofit boards); George Judson, *Inquiry Faults Trustees' Acts at Adelphi U.*, N.Y. TIMES, Apr. 18, 1996, at B1 (trustees of Adelphi University failed to prevent "extraordinary personal spending" by its president); see also Brody, *supra* note 18, at 1401-14, 1443-58 (using the Adelphi scandal to illustrate how "the law struggles to ensure that charity fiduciaries carry out their duties."); DeMott, *supra* note 21, at 133-34 (discussing the United Way scandal as example of self-dealing by nonprofit directors).

¹⁰⁸ Brody, *supra* note 18, at 1465-67 (explaining that, when donations are made to a charitable organization for a particular purpose, those assets typically are impressed with a charitable trust).

basis of questionable financial activities. However, the group dynamics of boards of directors make individual directors less than ideal monitors and enforcers of the duties of their colleagues or of staff members.¹⁰⁹ In order to challenge the actions of a fellow director, a director will have to break ranks and accuse his colleague of a breach of fiduciary obligation, and he must be prepared to show that his own conduct is not similarly suspect.

State attorneys general also have long been known to have inadequate resources to oversee and enforce the financial accountability of nonprofit fiduciaries.¹¹⁰ In order to root out financial lapses of nonprofit directors, attorneys general need detailed financial information regarding the nonprofit's operations. They may not have access to this information.¹¹¹ Even if they can and do obtain such information, attorneys general need the internal resources to analyze it for misconduct and the political will to prosecute potential offenders, who may be highly-connected individuals or pillars of their communities. Despite the persistence of high-profile scandals of director and officer misconduct in nonprofits, these obstacles make enforcement of financial breaches of loyalty or charitable trust law still relatively infrequent¹¹² and reserved for the most egregious violations.¹¹³

¹⁰⁹ See DeMott, *supra* note 21, at 141 (remarking that “[n]onprofit boardrooms seem to be inhospitable venues for challenges to the opinions of fellow directors and the internal and external experts the directors may retain.”); *c.f.* James A. Fanto, *Whistleblowing and the Monitoring Board: Countering Corporate Inner Circles* 21-25 (2003) (unpublished manuscript, on file with author) (arguing that group pressures felt by directors of for-profit corporations help to explain the recent failures in board monitoring brought to light in the Enron and other corporate scandals).

¹¹⁰ MARION R. FREMONT-SMITH, *FOUNDATIONS AND GOVERNMENT* 233-41, 440-41 (1965); Hansmann, *supra* note 96, at 600-01.

¹¹¹ Many states require nonprofits to file only their annual reports with state officials. See PHELAN, *supra* note 11, §§ 2.23, 6.01 (2000); see also SILBER, *supra* note 50, at 146-51 (describing the “anemic” disclosure obligations imposed on modern nonprofits).

¹¹² DeMott, *supra* note 21, at 139. Duty of care violations are even harder to find and prosecute for all of these reasons. In addition, even prosecuted duty of care claims face extremely low odds of success, as directors may claim the protection of the business judgment rule and may be insulated by various liability shields. Brody, *supra* note 18, at 1413, 1424.

¹¹³ Grantmakers and other donors also may play a role in policing the financial accountability of nonprofits. Foundations that make grants to nonprofits engage in various types of assessment of their grantees. See Paul N. Ylvisaker, *Foundations and Nonprofit Organizations*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK*, *supra* note 8, at 365-66. However, individual donors' ability to legally challenge violations of their intent is limited by the general unavailability of donor standing. See Atkinson, *supra* note 99, at 664-69; *but cf.* Mark Sidel, *Law, Philan-*

A second serious type of substantive accountability problem is mission creep. Mission creep occurs when the direction of a nonprofit strays from its established mission—when its activities diverge from those desired by the individuals and institutions who support it.¹¹⁴ Some commentators identify this problem as a breach of the directors' duty of obedience to the mission of the organization;¹¹⁵ it can also be seen as akin to ultra vires activities;¹¹⁶ or it can be described as a violation of the duty of loyalty or care.¹¹⁷ Regardless of how it is described, the problem of accountability to mission is a central concern of nonprofit governance; unfortunately, it also is difficult to police.

Again, in the absence of members, the agents of enforcement against mission creep are directors themselves and state attorneys general.¹¹⁸ Directors may be reticent to charge their colleagues with a lack of fealty to their organization's mission.¹¹⁹ Furthermore, directors are part of the group that shapes the very mission that requires protecting. As such, it may be difficult for individual directors to differentiate between the mission of their nonprofit and the actions directors take on its behalf.¹²⁰ State

thropy and Social Class: Variance Power and the Battle for American Giving, 36 U.C. DAVIS L. REV. 1145, 1199-1201 (2003) (noting an emerging judicial tendency toward granting donors greater power to enforce intent in contributions to community foundations).

¹¹⁴ Ben-Ner and Van Hoomissen's economic account focuses on this problem: "When organizations come to be run by managers and just a few stakeholders, one result may be the provision of a different product, price, quantity, and quality mix than most stakeholders would like." Ben-Ner & Van Hoomissen, *supra* note 99, at 406.

¹¹⁵ Daniel L. Kurtz, *Safeguarding the Mission: The Duties and Liabilities of Officers and Directors of Nonprofit Organizations*, C726 ALI-ABA 15, 17-18 (1992); Kurtz & Green, *supra* note 19, § 11.02[3] at 11-15.

¹¹⁶ See *Queen of Angels Hosp. v. Younger*, 136 Cal. Rptr. 36 (Cal. App. 2 Dist. 1977).

¹¹⁷ See *FREMONT-SMITH*, *supra* note 21, at ch. 4, 41-42 (describing obedience to mission as falling within duty of loyalty); Goldschmid, *supra* note 16, at 641 (commenting that obedience can be seen as part of the duty of care).

¹¹⁸ Although grantmakers may have some real capacity to monitor mission accountability by contract, see *supra* note 113, the general public is not granted standing to challenge the actions of nonprofit directors. See Atkinson, *supra* note 99, at 657. In some states and in certain circumstances, standing may be available to members or some class of beneficiaries. See, e.g., RMNCA § 6.30 (providing for member derivative suits under certain circumstances); *Jones v. Grant*, 344 So. 2d 1210 (Ala. 1977) (allowing a suit by beneficiaries with a special interest). Member enforcement will be addressed in more detail below. See *infra* Part III.C.

¹¹⁹ DeMott, *supra* note 21, at 141.

¹²⁰ See IRVING L. JANIS, *VICTIMS OF GROUPTHINK* 8-9 (1972) (describing this kind of confusion as a result of the group dynamic of "groupthink").

attorneys general face the same informational, resource, and political problems in policing directors' compliance with the missions of their nonprofits as are raised when they are asked to police nonprofit financial accountability. They almost certainly lack resources and often will lack political resolve. Moreover, there are practical limits and political perils in tasking governmental officials with enforcing loyalty to nonprofit mission. This enforcement power might lend itself too easily to abuse for political gain,¹²¹ and its overzealous use might chill the activities of the sector.¹²²

Given the serious risks of failures in nonprofit accountability, when selecting a structure of internal governance, responsible nonprofit incorporators and their counsel should consider the impact of their choice on accountability. In considering whether or not to utilize governance with members, incorporators and their counsel need to consider whether the presence of members as additional monitors and enforcers can measurably improve accountability. The specific monitoring powers of members, as defined by current statutes, take two main forms. Members may be able to conduct some monitoring through review of the information they receive in order to carry out their decision-making function. In the course of director elections and member votes to approve major corporate life events, members may receive oral or written reports on their nonprofit's activities, or they may participate in or observe debates on transactional alternatives. Members also may monitor other corporate actors through review of various disclosures to which they are entitled, sometimes as a matter of course, but more typically upon request.

¹²¹ Perhaps a state attorney general in favor of conservation of a historic neighborhood could use a mission creep challenge to weaken and divide the local business development council or chamber of commerce, which might instead favor increased development of the area. See also Mark Sidel, *The Nonprofit Sector and the New State Activism*, 100 MICH. L. REV. 1312, 1334 (2002) (raising more general concerns about a revival of activism by state attorneys general in their oversight of the nonprofit sector); Evelyn Brody, *Whose Public?: Parochialism and Paternalism in State Charity Law Enforcement* (forthcoming 79 IND. L.J.) (analyzing and critiquing the role that state parochialism plays in setting the enforcement priorities of attorneys general) (manuscript 31-49, on file with author).

¹²² See Joel L. Fleishman, *Public Trust in Not-for-Profit Organizations and the Need for Regulatory Reform*, in PHILANTHROPY AND THE NONPROFIT SECTOR IN A CHANGING AMERICA 188-91 (C.T. Clotfelter and T. Erlich eds., 1999) (arguing that "any governmental intrusion into the functioning of bona fide not-for-profit organizations beyond the requirements of the law would be likely to chill the free functioning of the sector.").

The enforcement powers of members are largely channeled through their decision-making function as well. Members who perceive the need for changes in corporate direction or personnel must enforce their demands through voting in director elections or member approval situations. In those states that grant standing to members, members also can challenge directorial, managerial, or organizational misconduct through litigation.

C. Obstacles to Member Performance

Unfortunately, collective action problems and information asymmetries prevent members from fulfilling their potential as efficient decision-makers and as monitors and enforcers of non-profit accountability. Collective action problems arise when, although it is in the interest of the group for each individual to participate, individuals making the decision whether or not to participate rationally choose not to do so. This is precisely the situation faced by members. Furthermore, members lack direct access to corporate information and often must rely on directors to provide them with any information they require. This informational disadvantage, combined with their serious collective action problems, limits members' ability to perform their roles effectively.

Decisions by members will be most efficient, in the sense that they most likely will align outcomes with the mission of the non-profit, if all members participate.¹²³ However, individual members often will make the individually rational choice not to expend the time and energy necessary to do so or to do so effectively. The only incentives members have to participate are the social incentives¹²⁴ that may be provided by participating in the nonprofit and the concern for the nonprofit's mission that prompted their involvement in the first place.¹²⁵ Also, participation in the decision-making process will impose costs on individual members. Each member must wield his or her vote together with his or her fellow members to oust failing directors and elect promising new ones. Since votes will be cast and tallied collec-

¹²³ A mission-maximizing outcome also might be reached by obtaining the votes of a random sample of members with proportional representation of various viewpoints. But, spontaneous generation of this type of proportional participation seems highly unlikely.

¹²⁴ See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* 60-64 (1971).

¹²⁵ Unlike for-profit shareholders, members do not have a financial incentive to become involved in the governance of their corporations.

tively, an individual member's vote may have an insignificant impact on the final outcome. As one link in this expansive chain, an individual member rationally may choose not to expend the energy required to exercise his or her right to vote at all; or a member may opt to conserve participatory resources by reflexively approving whatever slate the directors offer.

Moreover, in order to vote effectively, an individual member also must expend resources to inform his or her vote. This requires a member to collect a substantial amount of information, process it, and decide how to cast his or her vote. In director elections, members must collect the information necessary to predict the future potential conduct of the candidates. In votes on major transactions, members must obtain data enabling them to weigh alternative courses of corporate action. Individual members rationally may choose not to expend the necessary resources to collect and analyze the information needed to use their vote effectively and/or they may attempt to free-ride on the work of their fellow members. If too many members fail to act or attempt to free-ride, the information gathered and processed will be insufficient to enable efficient decisions. Taken together, these factors suggest that there often will be low rates of informed member participation; this hinders members' ability to make efficient (mission-maximizing) decisions when called on to do so by their nonprofits.

The empowerment of members also is unlikely to improve the financial accountability of nonprofits significantly, due to a combination of informational and collective action problems. Like attorneys general, members often lack detailed financial information regarding the activities of their nonprofits, and they lack the resources with which to analyze such information even if it is provided. Free-rider problems compound these informational obstacles. Members often have statutory rights to inspect the books and records of their nonprofits.¹²⁶ However, in order to collect and process the data required to evaluate fiduciaries' compliance and to enforce their obligations through voting, members will have to overcome the coordination problems that hinder their performance as decision-makers.

It is in the interest of all members, and of the nonprofit generally, for each member to participate in monitoring the actions of

¹²⁶ See, e.g., RMNCA § 16.02; CAL. CORP. CODE § 6333 (West 2002); NEB. REV. STAT. ANN. § 21-19, 166 (Michie 2002); N.M. STAT. ANN. § 53-8-28 (Michie 2001).

directors and managers, tracking the finances and dealings of the nonprofit. To do so effectively, each member must monitor the actions of each director, assess the potential for financial shenanigans posed by each potential director, and enforce against violations by voting out or suing fiduciaries who act outside of bounds. The costs in time and money of using litigation to police nonprofit fiduciaries dwarf the outlays required to participate through voting. Therefore, if it seems infeasible to count upon members effectively to enforce the fiduciary obligations of nonprofit directors through voting, it is even more far-fetched to rely upon them for consistent enforcement through litigation.¹²⁷ With these serious obstacles, members surely are no panacea for addressing the financial accountability problems of nonprofits.¹²⁸

On the other hand, members have some clear advantages as monitors of mission accountability. Members, as voluntary participants in the nonprofits with which they affiliate, choose to expend their energies and resources as part of a nonprofit because of their dedication to its mission. They are the demanders of the nonprofit's outputs; their commitment, in essence, defines the nonprofit's mission.¹²⁹ However, as they are outside of the more regular direction of and decision-making for the nonprofit, they are less likely than directors to become co-opted by forces seeking to deviate from its mission. Therefore, members may be uniquely situated to evaluate whether mission creep is occurring.

Unfortunately, the same information and coordination problems that hinder members' efforts to monitor and enforce financial accountability also make it difficult for members to detect and enforce against mission creep. Although members can more easily evaluate the information necessary to determine adherence to their nonprofit's mission than financial information,

¹²⁷ Unlike in the for-profit derivative suit area, contingency-fee attorneys cannot be counted upon to collect the claims of nonprofit members. See Arthur R. Pinto, *Corporate Governance: Monitoring the Board of Directors in American Corporations*, 46 AM. J. COMP. L. 317, 340-42 (1998) (describing how contingency-fees can overcome collective action problems in for-profit shareholder derivative suits). This problem may be yet more severe in the mission accountability area, where even successful suits often conclude with non-monetary judgments.

¹²⁸ Cf. Ira Mark Ellman, *Another Theory of Nonprofit Corporations*, 80 MICH. L. REV. 999, 1007-08 (1982) (arguing the inadequacy of members to scrutinize self-dealing transactions of nonprofit directors in the ratification context, as "members have no financial interest at stake to motivate their scrutiny.").

¹²⁹ Ben-Ner & Van Hoomissen, *supra* note 99, at 398-99 (demand-side stakeholders are the "consumers, customers, donors, and sponsors" of the goods and services of the nonprofit).

they still face difficulties in obtaining this information, and their power to monitor and enforce mission accountability remains principally housed in their right to vote. Again, individual members overwhelmingly may decide it is not worth their individual effort to seek out this information, choosing instead to free-ride on the presumed monitoring actions of other corporate actors or regulators. They may make the same calculation when deciding whether or not to monitor and enforce through voting, and opt out. If too many individual members make this rational individual decision, members will be unable to improve the mission accountability of a nonprofit over the level that director and attorney general enforcement alone can provide.

Avner Ben-Ner and Theresa Van Hoomissen have argued that the empowerment of a group of member-like “stakeholders” would indeed improve accountability.¹³⁰ Ben-Ner and Van Hoomissen attempt to deal with some of the obstacles presented here by fashioning the stakeholder concept as more formal than membership, and by granting to stakeholders somewhat greater powers than members possess under current statutes.¹³¹ But, even these advocates of a member-type constituency to enhance accountability recognize that neither members nor stakeholders are likely to be consistent and comprehensive monitors and enforcers of nonprofit performance and fiduciary obligation. Therefore, in addition to creating the formal stakeholder status, Ben-Ner and Van Hoomissen propose that each state establish an Office for Nonprofit Organizations (ONO) to regulate and assist nonprofits in working with their stakeholders.¹³² The ONO

¹³⁰ See *id.* at 408.

¹³¹ See *id.* at 408-09. Their stakeholders have four major characteristics. First, stakeholder status would be formal. Individuals and organizations seeking stakeholder status would apply for this status by signing a statement of agreement with the nonprofit’s mission and submitting proof of contributions to the nonprofit, be they financial donations or contributions of time. Each formal stakeholder would be granted a number of votes proportionate to the value of his or her contribution to the organization. *Id.* Second, stakeholders would have legal standing to sue the nonprofit for breaches of fiduciary duty by directors or officers, or for failure to follow the requirements of state nonprofit law, the articles, or the bylaws. *Id.* Third, stakeholders would vote in periodic elections for a board of directors, on “radical change[s] in the objectives of the organization,” and to recall the board. See *id.* at 410-11. Finally, each nonprofit would be required to adopt a statement of mission and stakeholders would be entitled to receive an annual report including information relating the nonprofit’s progress toward achieving that mission. Ben-Ner and Van Hoomissen also contemplate that stakeholders would receive or be entitled to obtain other financial and programmatic documentation. See *id.* at 411.

¹³² See *id.* at 409-11.

would help to identify stakeholders and encourage their involvement, would disseminate information to stakeholders, and would provide guidance for them. Perhaps the ONO's most important role is as a backstop for stakeholders who fail to perform their duties. If too few individuals or organizations apply to serve as stakeholders in a particular nonprofit or vote in stakeholder elections, Ben-Ner and Van Hoomissen assign to the ONO the responsibility for voting in their stead.

As these and other commentators advocating reforms of the nonprofit sector realize, the accountability of the nonprofit sector can be improved significantly only by improving enforcement.¹³³ Due to the serious informational and collective action problems plaguing them, members' voting and litigation mechanisms are ill-suited to enforce financial or mission accountability on a consistent basis. Increased governmental involvement and oversight, such as that envisioned by the ONO, is one solution. If public oversight cannot be improved, the nonprofit sector itself needs to develop new and creative governance structures that include more powerful enforcement mechanisms in order to improve accountability from within. These innovations may well provide governance roles—nominating, voting, monitoring—for some class of participants other than directors. But members alone, as currently empowered by statutory default rules, simply

¹³³ Some reformers suggest statutory or regulatory reforms to improve enforcement. See, e.g., Atkinson, *supra* note 99, at 660 (calling for increased standing to enforce the fiduciary obligations of nonprofits); James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 272 (2003) (proposing the establishment of citizen advisory commissions to assist attorneys general in their oversight of charities by receiving and reviewing complaints regarding the activities of charities, their fiduciaries and employees); Fleishman, *supra* note 122, at 188-91 (advancing the idea that an independent federal agency should be created to deal with all aspects of nonprofit regulation); Hansmann, *supra* note 96, at 568-73, 606-22 (advocating a comprehensive statutory reform program, including, inter alia, heightened standards for nonprofit fiduciaries, broadened standing to litigate the alleged violations of nonprofit fiduciaries, and enhanced disclosure obligations); Karst, *supra* note 98, at 476-83 (proposing the establishment of a new state regulatory agency to supervise charities, including monitoring and investigation of fiduciaries and enforcement of their obligations).

Others advocate harnessing non-governmental means in order to increase the enforcement capacity directed at the nonprofit sector. See, e.g., Fishman, *supra* note 12, at 678-83 (suggesting, among other reforms, that nonprofit boards ought to be bifurcated into management and monitoring roles); Fleishman, *supra* note 122, at 186-87 (advocating the creation of self-monitoring institutions within the nonprofit sector, in order to complement governmental enforcement); Manne, *supra* note 2, at 252-65 (proposing the establishment of for-profit monitoring entities with standing to sue to enforce the fiduciary obligations of nonprofit directors).

cannot be relied upon consistently to solve nonprofits' accountability problems.

D. *The Costs of Members*

While the benefits of governance with members are limited and uncertain, the costs of such a democratic internal governance structure are substantial and definite. These include, *inter alia*, the administrative costs of identifying members, maintaining current membership lists, holding meetings, obtaining a quorum for such meetings and the required majorities necessary to elect directors and pass other measures, and providing materials necessary to inform membership voting.¹³⁴ Further, a voting membership structure imposes costs on transactions by forcing both a board and a membership decision on certain significant corporate actions—typically, amendments of the articles of incorporation, merger, sale of all or substantially all assets, and dissolution.¹³⁵ These costs can be avoided entirely through use of a self-perpetuating board.

E. *Summary*

Certainly it is initially unsettling to realize that private-regarding for-profit corporations are required to have more democratic internal governance structures than are supposedly public-regarding public benefit nonprofit corporations.¹³⁶ However, if

¹³⁴ See *supra* Part II.

¹³⁵ See *supra* Part II.

¹³⁶ Superficially, it appears that nonprofits are less internally democratic than for-profit corporations. However, on closer inspection, one finds that the opportunities for real democracy in for-profit corporations—in terms of shareholder participation, voice, and control—are also quite slim. See ROBERT A.G. MONKS & NELL MINOW, *WATCHING THE WATCHERS: CORPORATE GOVERNANCE FOR THE 21ST CENTURY* 197 (1996) (“[M]ost observers will agree that the electoral process has not been an effective mechanism for assuring that directors represent the interests of shareholders.”). Along with management, for-profit directors wield almost complete practical control in modern publicly-owned corporations. See ROBERT CHARLES CLARK, *CORPORATE LAW* § 1.2.4 (1986); JAMES D. COX ET AL., *CORPORATIONS* § 9.1 (1997). Therefore, the lack of mandated internal democracy, which initially appears to be a point of distinction between the nonprofit and for-profit sectors, actually may be a distinction without a difference.

Thus, the removal of the obstacle of members may, in substance, merely be another way in which nonprofits are becoming more and more similar to for-profit corporations. See HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 245 (1996) (explaining the circumstances in which the distinctions between the nonprofit and for-profit forms begin to dissipate); Brody, *Agents without Principals*, *supra* note 96, at 535-36 (summarizing arguments that the application of economics, management

members are unlikely consistently to play a significant role in increasing a nonprofit's efficiency and accountability, and a membership structure will impose costs, nonprofits understandably favor self-perpetuating boards. In fact, if the individuals deciding which structure to utilize make their decisions considering only an intra-firm cost-benefit analysis, they will reach the same conclusions as did state legislators considering optionality. The concrete costs of members and their dubious benefits often, if not invariably, will justify the establishment of a self-perpetuating board. By just this reasonable, well-intentioned calculus, optionality predicts a systematic bias against internal democracy in nonprofits.

IV

MEMBERS AND POLITICAL DEMOCRACY

Part III makes clear that assigning an active governance role to members offers relatively little in terms of improving the efficiency or accountability of individual nonprofits. However, nonprofits hardly operate in a vacuum. Perhaps members are valuable because nonprofits must be internally democratic in order to perform valuable functions entrusted to them by society. This Part will look to scholarly work regarding the role of nonprofits in constituting civil society in order to suggest just such a societal-level rationale for governance with members. It is important to recognize that this is a separate question from those relating to the efficiency of nonprofit firms and the accountability of their directors, officers, and managers. Rather, this Part posits that a lack of internal democracy in nonprofits compromises the nonprofit sector's ability to fill the role it is presumed to play in enhancing political democracy and the experience of democracy by citizens.¹³⁷ This Part also will argue that this rationale for governance with members is linked to the legitimacy of the nonprofit

theory, organizational psychology, and sociology all demonstrate that nonprofit and for-profit firms are more similar than they are different); Evelyn Brody, *Institutional Dissonance in the Nonprofit Sector*, 41 VILL. L. REV. 433, 441 (1996) (arguing that the nonprofit and for-profit forms increasingly have converged).

¹³⁷ Nonprofit corporate law is not the only legal framework that impacts nonprofits' ability to contribute to civil society. The requirements and limitations imposed on tax-exempt nonprofits by federal tax law also affect their capacity to constitute and improve civil society. See Galston, *supra* note 3, at 143-225 (providing a comprehensive analysis of the interaction between federal tax law and various types of civil society concerns).

sector, especially its legitimacy as a recipient of society's largesse and the general esteem in which it is held.

A. *The Impact of Civil Society*

In order to evaluate whether members make nonprofits more legitimate from this perspective, I turn to the work of a group of political theorists who have put great faith in the role of nonprofit organizations in society.¹³⁸ Loosely, this area can be termed the civil society literature or civil society theory. These theorists argue that citizens' participation in intermediate organizations—groups smaller than government but larger than individual families—enhances our political democracy.¹³⁹ Taken as a group, these intermediate organizations constitute "civil society."¹⁴⁰ The overlap of the categories of intermediate organizations and nonprofit organizations is substantial.¹⁴¹

A vibrant civil society certainly should make a polity a more

¹³⁸ See Eberly, *supra* note 3, at 10 ("Civil society theorists generally do not separate their interest in social institutions from concerns relating to the democratic state, but rather see the latter as dependent upon the former for health and vitality."). Although this work has not focused solely on the American experience, *see, e.g.*, PUTNAM, MAKING DEMOCRACY WORK, *supra* note 4, at 121-62 (describing the impact of civil society in Italy), this Article will concentrate on the question of internal democracy in American nonprofits, and leave a comparative inquiry to future research.

¹³⁹ A segment of this group of theorists includes the family as an institution of civil society. See Mary Ann Glendon, *Introduction: Forgotten Questions*, in SEEDBEDS OF VIRTUE 2 (Mary Ann Glendon & David Blankenhorn eds., 1995) (pointing to the family as the "first and foremost" institution relied upon to build the characteristics and competencies necessary for robust democratic citizenship); *see also* Martha Albertson Fineman, *The Family in Civil Society*, 75 CHI.-KENT L. REV. 531 (2000) (describing and critiquing civil society theorists' claims regarding the family). For present purposes, I will consider the family as an institution on the outside of civil society, though perhaps one involved in the formative project of preparing children for their roles as citizens.

¹⁴⁰ Putnam prefers the term "civic community" and others use alternative terminology as well. PUTNAM, MAKING DEMOCRACY WORK, *supra* note 4, at 87. For clarity, and in order to fit with the general trend of this literature, this Article will refer to "civil society."

¹⁴¹ Intermediate organizations are variously referred to in the literature as voluntary associations, private associations, public associations, civic associations, and by several other names. Whatever the appellation, the idea and the impact for purposes of this Article are the same. A significant portion of intermediate organizations are nonprofits. See Barbara K. Bucholtz, *Reflections on the Role of Nonprofit Associations in a Representative Democracy*, 7 CORNELL J.L. & PUB. POL'Y 555, 558 (1998) (stating that the nonprofit "sector encompasses all voluntary associations that comprise what is generally called 'civil society'"). Due to its concentration on nonprofit legal issues, this Article will forego consideration of the potential role in civil society of for-profit corporations and other institutions outside the nonprofit sector.

interesting and active place to live, but these theorists argue that civil society is to be encouraged for more than its own sake: civil society is a democracy-enhancing institution.¹⁴² In presenting this claim, civil society theorists build on the idea of intermediate organizations as mediating structures. In modern society, the structures of the state are too complex for individuals to navigate alone and are too enormous for individuals to have meaningful relationships with them.¹⁴³ Community and civic groups, religious groups, mutual aid societies, and educational institutions are structures that can mediate between the private sphere of individual life and the vast state.¹⁴⁴ The size and anonymity of the state likewise prevents it from playing a significant role in training its citizens to overcome self-interest, to work collectively with one another, and to use their voices to secure change. Nonprofits provide an environment in which these norms can be inculcated and this citizen-training can occur.

Nonprofits enable and enhance political democracy in two distinct but related ways. They offer opportunities for their participants to build norms of reciprocity and cooperation—to generate social capital.¹⁴⁵ Nonprofits also train their participants to be better, more active, and more able citizens by teaching civic skills.¹⁴⁶ Where nonprofits and civil society thrive, these necessary preconditions for the success of democratic governance—social capital and civic skills—will exist as well.

1. *Generating Social Capital*

Robert Putnam's *Making Democracy Work*¹⁴⁷ is perhaps the seminal modern work on the democracy-enhancing effects of

¹⁴² PETER L. BERGER & RICHARD JOHN NEUHAUS, *TO EMPOWER PEOPLE* 6 (1977) ("Mediating structures are essential for a vital democratic society."); Eberly, *supra* note 3, at 10; PUTNAM, *MAKING DEMOCRACY WORK*, *supra* note 4, at 89-90; PUTNAM, *BOWLING ALONE*, *supra* note 4, at 288-89; ALEXIS DE TOCQUEVILLE, *DEMOCRACY IN AMERICA* 513-14 (George Lawrence trans. & J.P. Mayer ed., 1969).

¹⁴³ See BERGER & NEUHAUS, *supra* note 142, at 2-3.

¹⁴⁴ See *id.* at 2-3, 34-40 (describing the role of voluntary associations as "mediating structures").

¹⁴⁵ See PUTNAM, *BOWLING ALONE*, *supra* note 4, at 338-49; PUTNAM, *MAKING DEMOCRACY WORK*, *supra* note 4, at 89-116. The term "social capital" is adapted from James Coleman's concept. See PUTNAM, *MAKING DEMOCRACY WORK*, *supra* note 4, at 167 (citing JAMES S. COLEMAN, *FOUNDATIONS OF SOCIAL THEORY* 300 (1990)).

¹⁴⁶ See ALMOND & VERBA, *supra* note 5, at 300-01; VERBA ET AL., *supra* note 5, at 17-18, 311-12.

¹⁴⁷ PUTNAM, *MAKING DEMOCRACY WORK*, *supra* note 4.

civil society's contributions to social capital. Putnam conducted extensive empirical research into the effectiveness of democratic regional governments created in Italy in the 1970s and 1980s.¹⁴⁸ He found that in regions with a rich history of intermediate organizations and strong civil society, these experiments in democracy were quite successful.¹⁴⁹ In contrast, in regions without a tradition of engagement in civil society, the new democratic regional governments struggled.¹⁵⁰ Furthermore, the existence of civil society accounted for the differential success across regions that other variations, such as access to educational or economic resources, failed to explain.¹⁵¹

Putnam asserts the following causal relationship: strong civil society builds social capital, and social capital propels the success of democratic government. For successful political democracy, citizens must vote, they must believe that others will vote, and they must express their preferences through various non-voting mechanisms. In essence, they must be willing to participate in their own governance. However, this necessary level of individual participation is beset by potential collective action problems. Effective democratic governance is a public good; if produced, it will be enjoyed by all citizens regardless of their individual contributions to it. Yet, if each citizen makes the individually rational choice not to contribute his or her energy to this effort and attempts to free-ride on the assumed contributions of others to the project of governance, it will be under-produced. Putnam sees participation in civil society as a means to create social capital, the sense of interconnectedness between people that allows them to overcome the collective action problems that threaten individual participation in government.¹⁵²

¹⁴⁸ *Id.* at 63-73 (describing the study therein reported and analyzed). Putnam used data on twelve indicators of government performance, ranging from the stability of cabinet selection to the number of day care centers established, to determine the relative success of various regional governments.

¹⁴⁹ *Id.* at 83-116.

¹⁵⁰ *Id.* at 86-87.

¹⁵¹ *Id.* at 83-120. Although each region used identical governance structures and had equivalent resources to expend, regions in the north consistently outperformed regions in the south on virtually all of Putnam's indicators.

¹⁵² *See id.* at 167. Putnam, of course, is not the first to recognize that soft or social solutions can be employed to resolve collective action problems. *See, e.g.*, RUSSELL HARDIN, *COLLECTIVE ACTION* 122-24 (1982); OLSON, *supra* note 124, at 51-52; TODD SANDLER, *COLLECTIVE ACTION: THEORY AND APPLICATIONS* 58-60 (1992). Indeed, at the outset of Putnam's exposition of social capital's contribution to solving the collective action problems inherent in democratic self-government, he notes

Putnam's idea of social capital includes three interrelated ideas: trust, networks, and norms of reciprocity. Trust is an essential element in solving any collective action problem, from establishing a community rose garden to securing a representative national government. For an individual to agree to participate in any collective endeavor, she must trust that her fellows will participate as well, without attempting to free-ride on her contribution. Trust too, explains Putnam, is a moral resource, one in which the "supply increases rather than decreases through use and which become[s] depleted if *not* used."¹⁵³ Communities with a greater supply of trust will be more successful in their efforts at democratic governance because the project of democratic governance requires cooperation that would be too expensive to secure through monitoring or contract. Trust makes this cooperation possible.¹⁵⁴

But how does participation in intermediate organizations build trust? For Putnam, the key mechanisms are the networks of civic engagement that intermediate organizations encourage and the norms of generalized reciprocity that these networks foster.¹⁵⁵ By bringing individuals together to pursue a common goal, intermediate organizations create opportunities for interpersonal communication and the building of relationships. Particularly, intermediate organizations can create horizontal networks, characterized by interactions in which the participants are relative equals.¹⁵⁶ These are the opposite of vertical networks, in which some participants are dependent on the control of others.¹⁵⁷ Horizontal networks, like Putnam's networks of civic engagement, increase interconnectedness among individuals, provide information about individuals and the opportunity to transmit that information. They also, perhaps most importantly, inculcate generalized norms of reciprocity.¹⁵⁸ "The denser such networks in a community, the more likely that its citizens will be able to coop-

that a focus on such solutions is becoming more common. See PUTNAM, MAKING DEMOCRACY WORK, *supra* note 4, at 167.

¹⁵³ PUTNAM, MAKING DEMOCRACY WORK, *supra* note 4, at 170 (italics in original) (using Albert Hirschman's term and adapting his definition).

¹⁵⁴ For an exploration of the richly textured interconnection between trust and economic development, see FRANCIS FUKUYAMA, TRUST: THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY (1995).

¹⁵⁵ See PUTNAM, MAKING DEMOCRACY WORK, *supra* note 4, at 171.

¹⁵⁶ See *id.* at 173.

¹⁵⁷ See *id.* at 173-74.

¹⁵⁸ See *id.* at 173.

erate for mutual benefit.”¹⁵⁹

Networks of civic engagement generate cooperative norms by repeating interactions among individuals. For example, consider a member of a nonprofit community economic development association. As a member, she attends the association's annual meetings, as well as some of the various fora and community service programs it sponsors. Each time she attends a member meeting, she sees other members and establishes relationships with them. Through their interactions within the association, as well as potential interactions outside, the association's members build information about each others' interests and conduct. These interactions also provide information about members' expectations, which foster the development of norms of acceptable behavior, such as a reciprocity norm. Members who coordinate the association's community service programs learn that they can depend upon the participation of others and will be more willing to participate when called upon by the association's telephone fund-raising drive chairman.

Repeated interactions also raise the costs of shirking. Suppose that one year on the evening of the annual member meeting, our hypothetical member is tired and would rather go home and relax than attend the meeting to elect new directors and debate new initiatives for the group. Because the network at issue is horizontal, a hierarchy will not force her to attend and there may be no vertically-imposed penalty. However, because of her repeated interactions with other members, her failure to attend still may be costly to her. If she foregoes attendance, many of the members she usually sees at annual meetings will question her absence later, especially if they fail to reach a quorum and cannot conduct business, or if a measure she is known to support is narrowly defeated. She may have trouble motivating other members to attend events she organizes. Or, she simply may lose the confidence of some of her fellow members, and they may not invite her to social gatherings outside the association, may not recommend her for professional opportunities they encounter, etc. This is particularly true if attendance at annual meetings has developed into a strong group norm, as is likely if it is important to the group's future. Furthermore, the network of the association provides a mode for transmitting information about our hypothetical member's questionable commitment, extending the

¹⁵⁹ *Id.*

costs of shirking beyond those immediately affected by it. By raising the costs of non-participation, the norms and networks Putnam identifies can stimulate cooperative behavior.¹⁶⁰

Successful collaborations also build a history of collective action on which members can draw in other social contexts. When nonprofits provide an opportunity for individuals to work together as equals to achieve some small-scale goal, they build trust among their participants. Horizontal interactions inculcate generalized norms of trust and reciprocity that facilitate social interaction outside of these organizations. Trust is a public good with spillover effects; when individuals build trust through their participation in nonprofits, they increase the supply of trust for the broader community.

Thus, our hypothetical community economic development association member may be willing not only to help another member to raise funds for the association, but also to help another member to make an important business connection. Although our member's concerns about being a "sucker" previously may have kept her from contributing financially to a mutual aid society, the experience of successful collective action in the community economic development association can contribute to the development of a generalized sense of reciprocity and trust that may lead her to participate in that venture as well. By creating networks of civic engagement, nonprofits build norms of reciprocity and social trust within communities that are foundational to successful political democracy.

In 2000, Putnam enlarged his argument to critique what he perceived as the decline of civil society and its effects in modern America.¹⁶¹ Again, the concept of social capital is key. In this later work, Putnam reports a study of social capital in the United

¹⁶⁰ This insight also can be articulated in the language of game theory. In a single iteration of the Prisoner's Dilemma, defection is the dominant strategy—the strategy an individualistic player rationally will pursue. However, if the game is to be played over infinite or indefinite iterations, cooperative strategies, such as tit-for-tat, become dominant. See SANDLER, *supra* note 152, at 79-93.

¹⁶¹ PUTNAM, BOWLING ALONE, *supra* note 4. Scholars have begun to conduct empirical studies to test Putnam's assertions, with mixed success. Compare, e.g., J.L. Sullivan & J.E. Transue, *The Psychological Underpinnings of Democracy*, 50 ANN. REV. PSYCHOL. 625, 646-48 (1999) (reporting some initial successes and calling for additional research), with, e.g., Dora L. Costa & Matthew Kahn, *Under-standing the Decline in Social Capital, 1952-1998*, National Bureau of Economic Research Working Paper no. W8295 (May 2001), available at <http://www.nber.org/papers/w8295> (presenting data suggesting that the decline in social capital claimed by Putnam and others has been overstated).

States, particularly participation in private, voluntary groups of various types. Although Putnam cites several unfortunate consequences of the decline of participation in these groups,¹⁶² the most salient to the argument here is the effect its drain on social capital has on the health of American political democracy.¹⁶³ To summarize, he argues “that the health of our *public* institutions depends, at least in part, on widespread participation in *private* voluntary groups—those networks of civic engagement that embody social capital.”¹⁶⁴

2. *Teaching Civic Skills*

In addition to building up the stock of social capital, participation in intermediate organizations provides participants with opportunities to learn civic skills, the specific and general skills of democratic citizenship. The possession of civic skills is necessary for citizens to participate in politics, and it is particularly important for citizens to participate effectively.¹⁶⁵

Citizens who can speak or write well or who are comfortable organizing and taking part in meetings are likely to be more effective when they get involved in politics. Those who possess civic skills should find political activity less daunting and costly and, therefore, should be more likely to take part. Furthermore, these capacities allow participants to use inputs of time and money more effectively, making them more productive when they are active.¹⁶⁶

The most elementary civic skill is the command of language, in both spoken and written forms. These basic language skills generally are acquired outside of the nonprofit sphere, through formal education at school and informal education within the family. However, more specialized civic skills that build upon

¹⁶² PUTNAM, *BOWLING ALONE*, *supra* note 4, at 326-35 (linking the decline of civil society with poor health, depression, lower marriage rates, and higher death rates).

¹⁶³ *Id.* at 287-95. Putnam is not alone in his lament of lost social capital. *See, e.g.*, FUKUYAMA, *supra* note 154, at 10-12 (noting this loss and arguing that, although the United States is still living off of an accumulated store of social trust, its continuing attrition poses a threat to the nation's future economic prosperity).

¹⁶⁴ PUTNAM, *BOWLING ALONE*, *supra* note 4, at 336 (italics in original).

¹⁶⁵ *See* VERBA ET AL., *supra* note 5, at 304-20 (identifying time, money, and civic skills as the necessary resources for political participation). The other building blocks of political participation identified by Verba, Schlozman, and Brady—engagement with political issues and involvement with recruitment networks that draw one into politics—also are intertwined with participation in civil society. *See id.* at 269-75.

¹⁶⁶ *Id.* at 304.

the ability to speak and write clearly—how to write letters, how to speak in meetings, how to propose changes in the law—can be learned through participation in the nonprofit organizations that make up civil society.

Nonprofits—even nonpolitical ones—offer participants opportunities to gain the civic skills needed to participate in democratic governance. A tenor in the community choir learns to write a more effective argument by preparing a request to extend the choir's use of rehearsal space. Hospital volunteers learn organizational and fund-raising skills through their efforts to secure donors to build a new clinic. Participants on all sides of a debate over how best to leverage the efforts of a community beautification organization learn presentation and communication skills. Research bears out the existence of opportunities to acquire civic skills through participation in nonprofits.¹⁶⁷

These opportunities to increase civic competency translate into more skillful participation in political life outside the organization in which the skills initially are acquired. In their cross-cultural study of citizens in five countries, Gabriel Almond and Sidney Verba conclude that

[m]embership in an organization, political or not, appears . . . to be related to an increase in the political competence and activity of the individual. The member, in contrast with the nonmember, appears to approximate more closely what we have called the democratic citizen. He is competent, active, and open with his opinions.¹⁶⁸

Moreover, participation in nonprofits has a cumulative effect on political competence. Civic skills and political activity in-

¹⁶⁷ Verba, Schlozman, and Brady found that a significant number and range of opportunities to acquire civic skills were available to individuals who participated in nonpolitical organizations and religious institutions. *See id.* at 311-13. These researchers report that 39% of those surveyed who participated in nonpolitical institutions and 32% of those who participated in religious organizations had an opportunity within the last six months to attend a meeting at which decisions were made, and significant percentages had the opportunity to plan such meetings (19%, 17%), write letters (20%, 12%), and make a speech or presentation (19%, 18%). *Id.*

Surely, nonprofits are not the only fora in which these skills can be gleaned. An even higher percentage of respondents who were employed reported having one of these civic skill-building experiences at work. *See id.* at 312. This finding has interesting implications for future research regarding whether the workplace may be an appropriate institution through which to build civil society, either in place of or as a complement to the contributions of nonprofits.

¹⁶⁸ ALMOND & VERBA, *supra* note 5, at 310.

crease with increased levels of participation, again even within nonpolitical nonprofits.¹⁶⁹ Those who participate in more than one such organization gain additional political competence.¹⁷⁰ Studies also correlate participation in multiple and cross-cutting voluntary associations with increased levels of tolerance of difference.¹⁷¹ When individuals belong to several groups with diverse compositions and varying goals, individual attitudes tend to moderate as a result of this interaction. This further increases the ability of a population to work collectively. In these diverse and meaningful ways, participation in nonprofits works to enhance political democracy.

3. *The Limits of Civil Society Theory*

Despite their enthusiasm, civil society theorists do not argue that a vibrant sphere of civil society is a cure-all. First, active participation in intermediate organizations enhances only a certain vision of democracy, namely a deliberative democracy fueled by personal involvement by citizens.¹⁷² As in-person participation in intermediate organizations has diminished over the past few decades, the social capital and citizen-training that intermediate organizations can provide has been reduced correlatively. The more professionalized and issue-focused kind of democracy by plebiscite that exists in the United States today may be a result of this reduction in social capital¹⁷³ and civic skills, and it certainly reinforces this effect.¹⁷⁴ For supporters of deliberative, participatory democracy, this is an unfortunate trend; indeed,

¹⁶⁹ See *id.* at 318 (noting that “active membership in an organization has a greater impact on political competence than does passive membership”).

¹⁷⁰ See *id.* at 320.

¹⁷¹ See AREND LIJPHART, *DEMOCRACY IN PLURAL SOCIETIES* 10-11 (1977) (defining cross-cutting associations as “groups with diverse interests and outlooks” and reporting the value of these associations in increasing tolerance). Significant membership by citizens in cross-cutting associations also makes an important contribution to stability and commitment to a society’s “rules of the game.” DAVID B. TRUMAN, *THE GOVERNMENTAL PROCESS* 512-24 (1971).

¹⁷² Putnam’s position also has been criticized as non-neutral in other respects. See, e.g., Stephen Macedo, *The Constitution, Civic Virtue, and Civil Society: Social Capital as Substantive Morality*, 69 *FORDHAM L. REV.* 1573, 1575-78, 1586-91 (2001) (arguing that Putnam’s argument inherently favors associations that produce more social capital and other democracy-enhancing effects, and therefore inherently will favor certain types of religious groups over others, in tension with constitutional imperatives).

¹⁷³ See PUTNAM, *BOWLING ALONE*, *supra* note 4, at 341-43.

¹⁷⁴ THEDA SKOCPOL, *DIMINISHED DEMOCRACY: FROM MEMBERSHIP TO MANAGEMENT IN AMERICAN CIVIC LIFE* 288-93 (2003).

they call for renewed participation in intermediate organizations as part of the way back to a more participatory political democracy.¹⁷⁵ Still, a revitalization of civil society will only improve the environment for a certain type of heavily personal, deliberative democracy.

Moreover, even this more measured version of the claim that civil society is key to enabling political democracy has been criticized as being overstated. It may underemphasize the impact of other institutions on the effectiveness of democracy in a particular polity. Civil society theorists have been faulted for relying on an overly simplistic model of society, particularly for failing to perceive the important contribution of markets in shaping civil society.¹⁷⁶ Furthermore, American governmental actors and institutions have been crucial in fostering the growth of civil society. In essence, some argue that the civil society theorists' claim is backwards; perhaps it is the improvement of our political democracy that is the prerequisite for repairing civil society.¹⁷⁷

[T]he sort of civil society Putnam describes might strengthen any regime's effectiveness; after all, northern Italy has seen monarchist, fascist, republican, socialist, and communist governments. Civil society may be linked to institutional capability in general rather than to any particular state formation, a possibility obscured by Putnam's failure to consider how it is constituted by politics and economics.¹⁷⁸

¹⁷⁵ *Id.* at 291-92. Skocpol summarizes her points as follows:

Over the past third of a century, the old civic America has been bypassed and shoved to the side by a gaggle of professionally dominated advocacy groups and nonprofit institutions *rarely attached to memberships worthy of the name*. Ideals of shared citizenship and possibilities for democratic leverage have been compromised in the process. Since the 1960s, many good things have happened in America. New voices are now heard, and there have been invaluable gains in equality and liberty. But, vital links in the nation's associational life have frayed, and we may need to find creative ways to repair those links if America is to avoid becoming a country of [detached spectators.]

There cannot be any going back to the civic world we have lost, but we Americans can and should look for ways to re-create the best of our civic past in new forms suited to a renewed democratic future.

Id. at 7 (emphasis added).

¹⁷⁶ See WARREN, *supra* note 85, at 31-34 (discussing Tocqueville's use of a "simple bipolar model of state-civil society relations").

¹⁷⁷ See EHRENBERG, *supra* note 3, at 230-32 (1999); Theda Skocpol, *Unsolved Mysteries: The Tocqueville Files*, THE AMERICAN PROSPECT, March 1, 1996-April 1, 1996, 6, available at <http://www.prospect.org/print/V7/25/25-cnt2.html>.

¹⁷⁸ EHRENBERG, *supra* note 3, at 231.

Still others argue that the moral content of association is uncertain.¹⁷⁹ Although participation in associations does cultivate norms of cooperation among participants, this cooperative impact is felt by the full range of associations and may not evidence any direct connection between the ability to cooperate and the success of political democracy.¹⁸⁰ “Unquestionably, [reciprocity] is a vital element of personal development, but it has no special affinity to liberal democracy. Cooperation is a universal requisite of social order, and it hardly bears mentioning that it carries no normative implication. Cooperation enables the worst as well as the best social actions”¹⁸¹

These criticisms notwithstanding, civil society theorists still make a persuasive argument that civil society and participation in the intermediate organizations that constitute civil society can enhance at least some version of political democracy. If this is the case, then perhaps nonprofits’ contributions to civil society provide a rationale for governance with members.

B. *Members and Civil Society*

Even if we accept civil society theory’s description of the role that intermediate organizations, including nonprofits, can play in a democracy, it remains to be seen whether its assertions provide a larger, societal-level rationale for governance with members. Is there a link between a nonprofit’s internal governance structure and its ability to build social capital and to train citizens to participate actively in political democracy? To forge this link, one must compare the experiences of non-director participants in nonprofits with members versus those in nonprofits with self-perpetuating boards.

Consider the potential for each type of nonprofit to teach civic skills. Nonprofits with and without members provide opportunities for directors to participate at a very intense level. Directors manage or direct the management of a nonprofit by attending and participating in meetings, obtaining and analyzing information necessary to make decisions allocated to them, and overseeing the actions of organizational managers, if any. These roles

¹⁷⁹ See, e.g., NANCY L. ROSENBLUM, *MEMBERSHIP AND MORALS: THE PERSONAL USES OF PLURALISM IN AMERICA* 50-61 (1998).

¹⁸⁰ See *id.* at 59.

¹⁸¹ *Id.* Mark Warren expands on this theme by creating a typology of associations, sketching out the sorts of associations that will serve to enhance democracy and those that will not. See WARREN, *supra* note 85, at 91-93, 134-205.

offer a variety of citizen-training opportunities to directors: to engage in group decision-making, to debate corporate decisions on major issues, and to compromise toward collectively beneficial outcomes. Directors can then employ this training in other contexts, including active participation as citizens.

In a nonprofit with members, members also are offered citizen-training opportunities. Members participate at least annually, when they vote for directors, and perhaps also on other occasions, when significant changes to the organization are anticipated.¹⁸² They can exercise their voice in controlling the organization when they participate in meetings; they may debate the issues presented, propose alternatives, and vote for their preferred outcome. In nonprofits with members, there are opportunities for participation in governance on two distinct levels, the director level and the member level. Participation on each level requires participants to expend different degrees of resources, but both offer some civic skills training.

In a nonprofit without members, directors are the only individuals with a function in governance. Of course, membership is not a prerequisite to participation. In nonprofits without members, donors or volunteers may play a crucial role in the viability of the organization, providing financing or a workforce. However, only the directors are required to be given an opportunity to debate and reach group decisions. The only mechanism of control available to non-director participants is their ability to terminate their support for and involvement with the nonprofit—they have no legal right of voice, only a practical right of exit. Thus, opportunities for citizen-training in internally undemocratic nonprofits are limited.

The link between using members in governance and the potential for social capital creation is more subtle. As described above, nonprofits contribute to the formation and maintenance of social capital by offering opportunities for horizontal interactions among their participants.¹⁸³ These interactions, in turn, build the generalized trust, civic networks, and norms of reciprocity that enable political democracy. A governance structure

¹⁸² Depending upon how members are defined in its articles or bylaws, a nonprofit also may have non-member donors or volunteers, who do not participate in governance, but rather participate only by donating money or by offering their time, respectively.

¹⁸³ See *supra* Part IV.A.1.

that includes members requires a nonprofit to provide opportunities for these interactions to occur among members—for example, at meetings to elect directors and approve major organic changes.¹⁸⁴ These venues provide a chance for formal and informal horizontal interactions. Under the default rules for member meetings, each member is equally entitled to exercise his or her voice in any discussion period and each member has an equal vote. In addition to these formal activities, members can discuss informally the activities and decisions of their nonprofits, as well as topics outside the scope of the organization.

Of course, the member meetings necessitated by a voting membership structure are not the only opportunities for horizontal interaction that a nonprofit can offer. A nonprofit without members may sponsor volunteer activities, fund-raising events, performances, or tournaments, and it may create myriad other situations in which those who support its mission can come together. All of these situations may present opportunities for individuals to meet one another and build trust, a sense of common interest that would support reciprocity, and networks of connections. However, many of these situations will be opportunities for spectatorship, rather than participation, in which interaction is less likely to develop and when it does is less likely to result in trust, reciprocity, or network building.¹⁸⁵ Moreover, even if nonprofits with self-perpetuating boards do offer opportunities for horizontal interactions that build social capital, governance with members structurally requires at least one more such opportunity annually. Therefore, both in offering civic skills training and in the potential for generating social capital, internally democratic nonprofits are equipped to outperform those with self-perpetuating boards.

¹⁸⁴ This potential for member interaction may be limited by the extent to which members may and do vote by proxy. Currently, most state nonprofit corporation statutes permit members to vote by proxy. See, e.g., VA. CODE ANN. § 13.1-847 (Michie 2002) (permitting members to vote by proxy “unless the articles of incorporation or bylaws otherwise provide”). However, even if some member votes are cast by proxy, the potential for wider citizen-training and social capital construction is still greater in a nonprofit with members than in one without them. Voting by proxy provides some civic training in the skills of selecting a candidate and voting. And, even if nonprofits with members permit proxy voting, they still must hold member meetings, which some members may attend in person.

¹⁸⁵ See Theda Skocpol, *Advocates without Members: The Recent Transformation of American Civic Life*, in CIVIC ENGAGEMENT IN AMERICAN DEMOCRACY 498-504 (Theda Skocpol & Morris P. Fiorina eds., 1999).

There is a key difference between the civil society benefits that members produce through their own participation and the benefits members can generate as decision-makers, and as monitors and enforcers. The latter are more difficult to achieve than the former. While the information asymmetry and collective action problems described in Part III(C) make members' ability to guard or govern their organizations questionable, these constraints do not have a comparable impact on the societal benefits of membership. These obstacles may keep the level and consistency of member participation below some optimal level; but, more widespread and intense participation is required for members consistently to enhance a nonprofit's efficiency and accountability than is required for them to achieve civil society gains. In other words, from a civil society perspective, any involvement by members is beneficial.

In order for members to make efficient decisions and hold directors accountable for financial or mission-based violations of fiduciary duty, members must have access to and the capacity and desire to process fairly comprehensive information regarding the board's actions and reasonable alternatives to those actions. They also must reliably articulate their preferences among competing courses of directorial conduct through their votes, by using the information they obtain to nominate and elect a board to fit their preferences. Even then, these voting decisions are group decisions, subject to the coordination problems group decisions entail. If charged through their voting role with the responsibility to steer the corporation efficiently and to hold directors accountable, individual members may feel unable to achieve these objectives on their own. Thus, they may choose to avoid the role rather than embracing it, compounding the collective action problems inherent in using membership as an accountability device. Participation once annually by attending a meeting and casting a vote will be insufficient to achieve significant gains in decision-making efficiency and directorial and managerial accountability.

In contrast, for members to learn civic skills and produce social capital, they need only to accept opportunities to observe and participate in democratic governance processes and to interact with other members as equals. Granted, a given individual may obtain proportionally greater civic skills training if she participates more intensely. However, nonprofits can successfully edu-

cate citizens even through less intense training experiences.¹⁸⁶ In terms of building social capital, some evidence suggests that less intense, though meaningful, participation in associations can create broad civic networks and strong norms of generalized reciprocity.¹⁸⁷ Therefore, participation, even once annually, by attending a meeting and casting a vote can contribute to the democracy-enhancing role assigned to nonprofits by civil society theorists. Additionally, if the voting roles of members are cast as an integral part of the democratic functioning of the nonprofit in question—rather than as an accountability device—the social incentives that can overcome collective action problems¹⁸⁸ can be harnessed to improve the level and intensity of members' participation.¹⁸⁹

C. *Members and the Legitimacy of the Nonprofit Sector*

The trend away from members also threatens the legitimacy of the nonprofit sector and the advantages it receives. The inhabitants of the nonprofit sector, and particularly charitable and public benefit nonprofits, are granted significant advantages under American law and receive a demonstrable "halo effect" merely by their designation as nonprofits. At the core of the rhetoric supporting the halo effect and the preferential treatment the sec-

¹⁸⁶ See ALMOND & VERBA, *supra* note 5, at 318. The survey evidence relied upon by Verba, Scholzman, and Brady asked respondents about limited civic training experiences. The survey asked if the respondent had, in the last six months, "written a letter," "gone to a meeting," "planned or chaired a meeting," or "given a presentation or speech." VERBA ET AL., *supra* note 5, at 311.

¹⁸⁷ See Mark S. Granovetter, *The Strength of Weak Ties*, 78 AM. J. SOC. 1360 (1973). Of course, this evidence could be used to advance arguments against members as well, on the theory that weak ties available without a voting membership structure will generate sufficient social capital.

¹⁸⁸ See OLSON, *supra* note 124, at 60-64.

¹⁸⁹ The norms of reciprocity and networks of relationships fostered by participation as a member could track back into gains in efficiency and accountability. These norms and networks lay the groundwork for solving the collective action problems that stymie members in their internal governance roles, in the same way that they build their capacity to overcome the collective action problems basic to political participation. However, social capital will not be a total solution to the problems of members as an effective part of organizational governance. Less intense participation is required for members to produce civil society gains than to overcome their coordination problems as decision-makers and monitors. Social capital simply may be unable consistently to produce the intense levels of participation required for effective decision-making and monitoring. Further, in addition to their coordination problems, serious informational asymmetries block members from being effective decision-makers or monitors and a lack of enforcement mechanisms hinders their ability to police other nonprofit actors.

tor receives is the idea that a vibrant nonprofit sector benefits the greater society and its citizens. These benefits include those inherent in constituting civil society—citizen-training and the generation of social capital. If, by their structural decisions, nonprofits lose much of their ability to constitute this democracy-enhancing sphere of civil society, the legitimacy of their privileged position is undermined.¹⁹⁰

Of course, theoretical rationales for the existence of the nonprofit sector, as well as the advantages that nonprofits receive, are not limited to nonprofits' contributions to the creation of a democracy-enhancing sphere of civil society. The existence of some nonprofits and some of the advantages they receive can be justified on economic grounds. Chief among these economic accounts are those of Henry Hansmann, whose contributions have revolutionized legal scholarship concerning nonprofits.¹⁹¹ As noted above, Hansmann identified the nondistributional constraint as the defining characteristic of a nonprofit organization¹⁹² and he used this characteristic to explain the existence of nonprofits as a response to market failures, particularly "contract failures."¹⁹³ In a contract failure situation, consumers cannot compare goods and services offered to them, cannot clearly contract for provision of those goods or services, and/or cannot adequately evaluate the quality of goods or services received, without incurring unreasonable costs.¹⁹⁴ In these situations, consumers will be more willing to purchase the relevant goods and services from a nonprofit, because the nondistributional constraint eliminates the potential for nonprofit managers to cheat consumers for personal gain.¹⁹⁵ These conditions are prevalent in various industries in which nonprofits are common: where consumers are separated from the recipients of the goods pro-

¹⁹⁰ Legitimacy here refers to the fairness of the legal and political decision to advantage nonprofits financially, socially, and politically in various ways. The invocation of this concept is not intended to intimate that the trend away from members is a force in any more general political delegitimization.

¹⁹¹ See generally Hansmann, *supra* note 9; Hansmann, *supra* note 96; Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 *YALE L.J.* 54 (1981).

¹⁹² Hansmann, *supra* note 9, at 838.

¹⁹³ See *id.* at 843-45.

¹⁹⁴ See *id.* at 843.

¹⁹⁵ See *id.* at 844-45. Of course, this assumes that the nondistributional constraint is effectively enforced, such that nonprofit managers and directors are unable to draw out personal gains via excessive salaries, perquisites, self-dealing transactions, or other means.

vided, as in the humanitarian aid area; when consumers purchase complex services of which they are poor evaluators, such as healthcare and education; and in the context of public goods, in which “[t]here is no observable connection between the amount of the individual’s contribution and the quality”¹⁹⁶ or quantity of the good provided.¹⁹⁷ Although various refinements on and alternatives to Hansmann’s conception of the economic underpinnings of the nonprofit sector followed his initial articulation,¹⁹⁸

¹⁹⁶ *Id.* at 851.

¹⁹⁷ *See id.* at 845-73. Of course, the classic solution to the problem of public goods is government. However, government also may fail to produce public goods optimally, due to constraints of majority decision-making, the fact that governments must provide goods on a uniform and universal basis, and the constraints of time, knowledge, and size on governmental providers. *See* Douglas, *supra* note 10, at 43-44; Dennis R. Young, *Government Failure Theory, in THE NATURE OF THE NON-PROFIT SECTOR*, *supra* note 7, at 190-91. Nonprofits are not bound by the majoritarian and categorical constraints under which government must operate. *See* Douglas, *supra*, 43-44. Therefore, economists see utility in nonprofit production because it is able to fill needs unmet by both government and the for-profit sector.

¹⁹⁸ Hansmann himself refined and expanded upon his arguments regarding the rationale for and role of nonprofits just a year after his influential 1980 Yale article. *See* Hansmann, *supra* note 96. In this piece, inter alia, Hansmann argues in favor of strict, trust-like fiduciary standards for directors and officers of nonprofit corporations, in order to police the nondistributional constraint more effectively.

Ira Mark Ellman challenges Hansmann’s model as deceptively simple. *See* Ellman, *supra* note 128. He argues that the nondistributional constraint and the strict standards of fiduciary behavior that Hansmann advocates to enforce this constraint only explain the success of nonprofit firms that rely on donations. *Id.* at 1000. The nondistributional constraint can provide donors with some measure of protection from thieving managers and thus provides donation-driven nonprofits with a fundraising advantage. *Id.* at 1005-06. However, Ellman is unmoved by the contract failure problem and nondistributional constraint solution in the context of nonprofits that offer customers real goods and services, rather than solicit donations. He argues that enforcement of strict fiduciary standards on these nonprofits by their customers would be destructive. *Id.* at 1007-08. Further, Ellman asserts that the rationale for mutual benefit nonprofits also is not contract failure, but a desire by the consumers of a good or service produced primarily or exclusively for themselves to maintain control over the means of production. *Id.* at 1011-12.

Rob Atkinson also finds Hansmann’s economic explanation lacking, in that it fails to account for the pervasive influence of altruism on the existence of the nonprofit sector, and particularly as a rationale for the tax benefits received by many nonprofits. *See* Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 616-25 (1990); *see also* Daniel Shaviro, *Assessing the “Contract Failure” Explanation for Nonprofit Organizations and Their Tax-Exempt Status*, 41 N.Y.L. SCH. L. REV. 1001 (1997) (arguing that understanding the nonprofit sector and tax exemption requires one to focus not only on economics, but also on the charitable nature of the sector’s activities).

For a review of various contributions to the project of constructing an economic rationale for nonprofit organizations, see generally ESTELLE JAMES & SUSAN ROSE ACKERMAN, *THE NONPROFIT ENTERPRISE IN MARKET ECONOMICS* 19-30 (1986) and

this theory has remained the principal economic rationale for nonprofits cited by legal academics for over two decades.¹⁹⁹

The articulation of an economic rationale for nonprofit organizations has been highly influential, but there is another acknowledged thread running through the explanations of the nonprofit sector and the advantages it receives.²⁰⁰ Indeed, if the primary rationale for the existence of nonprofits and for granting advantages to them is their ability to solve market failures, for-profit firms ought to be able to apply for the same advantages on a showing that they too can solve market failures (rather than going out of business due to them). The various political and social theories of the nonprofit sector provide additional rationales for supporting the nonprofit sector.²⁰¹ These ideas forge the link between the contributions of nonprofits as illuminated by civil soci-

MICHAEL O'NEILL, *NONPROFIT NATION: A NEW LOOK AT THE THIRD AMERICA* 48-51 (2002).

¹⁹⁹ Hansmann also employs economic reasoning to explain one of the major advantages extended to many nonprofit organizations—exemption from corporate income taxation under federal law. See Hansmann, *supra* note 191. Essentially, Hansmann argues that tax exemption exists as a subsidy to allow for capital formation and is appropriate, at least for those nonprofits that, due to contract failure, will better serve consumers than for-profit or government entities. See *id.* at 69-71. This argument posits that without tax exemption, nonprofits would be unable or less able to raise capital than other types of firms. They do not have sufficient access to capital because they cannot sell equity, donations are uncertain, debt financing is unavailable to finance one-hundred percent of the capital needs of any firm, and lenders are particularly conservative with nonprofits. See *id.* at 72-73. Nonprofits cannot rely on consumers who desire nonprofit production of goods and services susceptible to contract failure to support their capital needs, because those consumers suffer from free-rider problems. See *id.* Thus, tax exemption bolsters the only remaining potential source of capital available to nonprofits—retained earnings. Rather than taxing retained earnings, nonprofits (at least those nonprofits that qualify for tax exemption) can accumulate these earnings to use for expansion and other purposes. See *id.* at 73-74.

Of course, Hansmann's is neither the first nor the only rationale proposed for exemption. See Boris I. Bittker & George K. Rahtert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 *YALE L.J.* 299, 330-48 (1976) (arguing that the rationale for exempting a subset of nonprofit organizations from federal income taxation is the inability of the tax law to accurately measure a nonprofit's income); Evelyn Brody, *Of Sovereignty and Subsidy*, 23 *J. CORP. L.* 585 (1998) (describing a rationale for exemption based in ideas of sovereignty); Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 *OHIO ST. L.J.* 1379, 1381-90 (1991) (articulating a rationale for exemption using public financial support as a signal of desert).

²⁰⁰ See LESTER M. SALAMON, *AMERICA'S NONPROFIT SECTOR: A PRIMER* 14 (2d ed. 1999); Bucholtz, *supra* note 141; Douglas, *supra* note 10, at 43.

²⁰¹ See, e.g., FISHMAN & SCHWARZ, *supra* note 26, at 48-49 (canvassing these political and social theories); Douglas, *supra* note 10, at 43 (similar); see also O'NEILL, *supra* note 198, at 35-52 (describing theories of the nonprofit sector articulated in a

ety theory and the rationale for the existence of a legally-distinct and preferentially-treated nonprofit sector.

Alexis de Tocqueville, the first to articulate the political and social role of the American nonprofit sector,²⁰² did not view the sector primarily as a means to solve problems of production, but as a means to enable democracy and the emotional and intellectual capacities a democratic state required. Reporting on his nineteenth century tour of the United States, Tocqueville noted the phenomenon of its myriad associations, observing that

Americans of all ages, all stations of life . . . are forever forming associations. . . . In every case, at the head of any new undertaking, where in France you would find the government or in England some territorial magnate, in the United States you are sure to find an association.²⁰³

Tocqueville linked this tendency to form associations with the level of democracy possible in a polity.

For Tocqueville, the link between associations and democracy resided in the fact that individual citizens have little power in a democracy. Unless they learn to work together voluntarily, they cannot achieve change or obtain other societal goals.²⁰⁴ Tocqueville recognized the difficulties involved in creating and maintaining associations—essentially the collective action problem that must be overcome in doing so. But, he did not favor a then-current approach to solving these problems, namely the enlargement of the state.²⁰⁵ He feared that if the state were forced to grow to handle every issue that an association might be formed

wide range of disciplines, including economics, political theory, and sociology, as well as history and anthropology).

²⁰² Earlier theorists identified the important role intermediate organizations can play in creating civil society and strengthening democracy in other societies and polities. See EHRENBERG, *supra* note 3, at 3-27, 160-69 (tracing the concept of civil society to ancient times and the Tocquevillian concept of civil society to roots in Rousseau and Montesquieu).

²⁰³ TOCQUEVILLE, *supra* note 142, at 513. Max Weber had a similar reaction at the end of the nineteenth century, noting that “American democracy . . . did not constitute a formless sand heap of individuals, but rather a buzzing complex of strictly exclusive, yet voluntary associations.” MAX WEBER, *The Protestant Sects and the Spirit of Capitalism*, in FROM MAX WEBER: ESSAYS IN SOCIOLOGY 310 (H.H. Gerth & C. Wright Mills eds. and trans., 1946).

²⁰⁴ TOCQUEVILLE, *supra* note 142, at 514 (“[A]mong democratic peoples all the citizens are independent and weak. They can do hardly anything for themselves, and none of them is in a position to force his fellows to help him. They would all therefore find themselves helpless if they did not learn to help each other voluntarily.”).

²⁰⁵ See EHRENBERG, *supra* note 3, at 161, 163, 166-67. This state-centered solution

to undertake, it would endanger the “morals and intelligence of a democratic people.”²⁰⁶ Tocqueville disfavored government solutions imposed externally, as they could not renew feelings and ideas and they could not enlarge the heart.²⁰⁷

Tocqueville also appreciated the role of associations in combating the anomie felt by citizens of a large state, who are unable to experience democracy or citizenship solely through their relationship with the state. These experiences instead could be found through participation in associations.²⁰⁸ He further credited participation in private associations with forging the community values and innovation common to nineteenth century America, arguing that they achieved these goals by requiring men to undertake reciprocal action.²⁰⁹ Thus, in this early conception, the rationale for the nonprofit sector included its contribution to constituting civil society and thereby fostering political democracy.

Modern social and political theorists articulating a rationale for the nonprofit sector continue to build on this theme. In addition to underscoring the economic role the nonprofit sector plays by providing necessary services, Lester Salamon identifies three interrelated social and political functions of nonprofit organizations in America.²¹⁰ First, he explicitly credits the nonprofit sector’s contribution in building social capital, noting its vital role in “the development and sustenance of a sense of community, which is required to . . . make it possible for both a market system *and a democratic polity* to operate.”²¹¹ Second, Salamon points out that the nonprofit sector functions to exemplify and guard the fundamental national value placed on contributing to the public good, which he argues in turn fosters pluralism, diversity, and freedom.²¹² The third social/political role of the non-

can be traced back at least to the work of Thomas Hobbes. See THOMAS HOBBS, *THE LEVIATHAN* (Richard Tuck ed., Cambridge Univ. Press 1991) (1651).

²⁰⁶ TOCQUEVILLE, *supra* note 142, at 515.

²⁰⁷ *Id.* Here, Putnam is clearly a descendant of Tocqueville. Putnam argues that civil society creates the social capital required for robust participation in democratic governance, a task to which the Leviathan of the state is inapt.

²⁰⁸ In this vein, Berger and Neuhaus can be seen to draw on Tocqueville. See BERGER & NEUHAUS, *supra* note 142, at 3, 34-36.

²⁰⁹ TOCQUEVILLE, *supra* note 142, at 515-16.

²¹⁰ See Lester M. Salamon, *Holding the Center: America’s Nonprofit Sector at a Crossroads*, Report for the Nathan Cummings Foundation 2-4 (on file with author).

²¹¹ *Id.* at 4 (emphasis added).

²¹² See *id.* at 2.

profit sector Salamon identifies is in defining societal problems and in providing mechanisms for advocacy regarding their solutions; again, this role is tied to the support of democracy and pluralism.²¹³ Barbara Bucholtz also cites a trio of contributions by the nonprofit sector to democracy: “teach[ing] the skills of self-government,” “inculcat[ing] the habits of tolerance and civility,” and “mediat[ing] the space between the individual and the other two sectors of society,” government and the market.²¹⁴ The roles of nonprofit organizations in fostering democracy also figure prominently in David Horton Smith’s comprehensive account of the contributions of the voluntary sector²¹⁵ and in Jon Van Til’s exposition on the “building blocks for the third sector.”²¹⁶

If nonprofits took on a central role in constituting civil society only as an historical accident, then a reduction in their ability to play this role might only suggest that other institutions should be sought out to play it.²¹⁷ However, history is not the only reason that the organizations relied upon to constitute civil society typically are nonprofits. Rather, this role is one of the fundamental reasons for the existence of the nonprofit sector, and nonprofits’ contributions to civil society and American democracy are an important reason for their favored treatment. To the extent that the preferences received by the nonprofit sector are based on the expectation that nonprofits will play this role in enhancing democracy, the trend away from members leaves nonprofits open to the criticism that they are receiving something for nothing. Eventually, this may add to the already serious difficulties the nonprofit sector has encountered with its declining reputation.²¹⁸

V

RESPONSES

Thus far, this Article has attempted to compute the costs of

²¹³ *Id.* at 3.

²¹⁴ Bucholtz, *supra* note 141, at 556.

²¹⁵ See David Horton Smith, *The Impact of the Volunteer Sector on Society*, in *THE NONPROFIT ORGANIZATION: ESSENTIAL READINGS* 347-55 (David L. Gies et al. eds., 1990).

²¹⁶ VAN TIL, *supra* note 3, at 3-17.

²¹⁷ See Cynthia L. Estlund, *Working Together: The Workplace, Civil Society, and the Law*, 89 *GEO. L.J.* 1, 1-7 (2000) (describing the potential of the workplace to play a part in the constitution of civil society); cf. DAVID SCIULLI, *CORPORATE POWER IN CIVIL SOCIETY* ch. 1 (2001) (exploring the impact of changes in corporate law on civil society).

²¹⁸ See *supra* note 107.

optionality. It asserts that due to the uncertain and limited benefits that governance with members will provide to individual nonprofits, and the certain and substantial administrative and transactional costs this structure will impose, a trend away from members costs individual nonprofit firms little. Although voting members in a particular nonprofit at a particular time may make efficient decisions and/or may impose accountability on other corporate actors, informational and coordination problems prevent members from doing so consistently. However, optionality and a trend away from members will impose serious costs at the societal level, by reducing the capacity of the nonprofit sector to play a role in enabling political democracy and by weakening the nonprofit sector's claims for preferential perception and treatment. This final Part begins the work of evaluating potential responses to this critique. Although there is more work to be done in order to address the impact of a trend away from members, this Part presents—in general form—three categories of reforms intended to cover the range of likely responses.

A. Mandating Membership

The most draconian response would be to mandate that all nonprofits employ governance with members. To do so, jurisdictions would amend their nonprofit corporation statutes to require members, at least for the public benefit nonprofit corporations addressed here. Some timeline would be established for implementation of this new requirement by the affected nonprofits, who would amend their articles and/or bylaws accordingly. This would be a significant legislative and administrative undertaking for states, affected nonprofits, and their counsel.

Even if the burden of making and implementing such a legislative change could be met, this solution would be a damaging overreaction. Real dangers to civil society and to the reputation of the nonprofit sector can be linked to a general trend away from members. But, all nonprofits need not be forced to adopt voting membership structures in order to stem this tide. The maintenance of some core group of nonprofits capable of playing the role of democracy-enabling intermediate organizations should provide sufficient opportunities to train citizens and produce social capital. Thus, a mandatory membership requirement, as members are currently defined, simply would go too far.

Moreover, forcing all nonprofits to use members would result in sufficient intra-firm costs such that many institutions would choose other forms of organization to avoid these burdens. Of course, many considerations go into the decision of how legally to organize a particular endeavor: its goals, the constraints the legal form will impose on its controlling actors, how the organization will be perceived, and whether it would benefit from income and property tax exemption and/or qualification for tax-deductible contributions. However, if all nonprofit corporations were forced to obtain member approvals in order to engage in complex transactions, the same attorneys who now counsel against using members might advise newly forming institutions to consider alternatives to nonprofit incorporation. A membership requirement thus might prompt a resurgence in charitable trusts or unincorporated nonprofit associations. Further, institutions that typically form as nonprofit corporations today might consider for-profit incorporation if members were mandated. For those institutions that rely little on contributions²¹⁹ and tax exemption²²⁰ and operate in mixed industries, the cost of mandatory membership might tip the balance toward for-profit incorporation, as obtaining shareholder approvals is comparatively simple.²²¹

The costs of a mandatory membership requirement for all nonprofits could be limited by redefining the default roles of members.²²² For example, rather than vesting members with the power to approve major organic decisions in addition to electing directors, a requirement of members could be premised on membership solely as the electorate for directors. Such a pared-down

²¹⁹ See Virginia Ann Hodgkinson & Murray S. Weitzman, *Overview of the Nonprofit Sector*, in *THE NATURE OF THE NONPROFIT SECTOR*, *supra* note 7, at 26, 34; Salamon, *supra* note 7, at 26, 34.

²²⁰ If an institution does not anticipate earning significant net income, federal corporate income tax exemption alone loses its value. If it does not own or anticipate owning significant property, state property tax exemption likewise may be no substantial benefit.

²²¹ Of course, the shrinkage of the nonprofit sector would not uniformly be received with dismay. See *infra* notes 228-31 and accompanying text.

²²² As noted above, significant flexibility in designing member roles is already available if a nonprofit drafts its articles or bylaws around statutory default rules. See *supra* notes 46-47 and accompanying text. However, perhaps limiting the default responsibilities of members would change the internal cost-benefit calculation reached by a significant percentage of nonprofits in considering their governance options. If so, a change in the default rules themselves could be beneficial and should be considered.

role for members would remove the inconvenience of membership approvals in complex transactions. At the same time, this solution would maintain some of the civil society benefits of membership by requiring at least annual member participation. The annual member meeting would continue to be an opportunity for members to gain skills as citizens and to meet and work with their fellow members, thereby building social capital. It also would retain for members a position from which they might hold directors accountable, to the extent and in those instances in which they are capable of doing so.

Although the establishment of mandatory membership is a possible response to the concerns raised here, it is unlikely to be adopted, even with membership reconceptualized in a more limited form. Any legislation regarding nonprofit governance is low on the list of state legislative priorities and generally requires patience and persistence to enact.²²³ After over fifty years of model acts and legislative amendments, the states essentially have completed the task of adopting optionality as suggested to them by leaders of the nonprofit sector and the bar. Even if legislators were convinced of the dangers to civil society posed by a trend away from members, they would be unlikely immediately and independently to take up the project of reversing optionality wholesale. Since the costs created by a trend away from members exist at the societal level, rather than the level of individual nonprofit firms, nonprofits and their representatives also are unlikely to press for such a change.

Moreover, mandatory membership inappropriately treats the nonprofit sector as homogeneous. As noted above, while one of the societal benefits of the nonprofit sector is its contribution to creating civil society, nonprofits serve many other laudable goals. The nonprofit sector fills various gaps left in society by the operation of the market and the government.²²⁴ Forcing all nonprofits into the role of civil society-creating intermediate organizations would undermine their potential to offer solutions to a larger variety of societal problems.²²⁵

²²³ See Elizabeth A. Moody, *The Who, What, and How of the Revised Model Nonprofit Corporation Act*, 16 N. KY. L. REV. 251, 252-53 (1989).

²²⁴ See *infra* Part IV.C.

²²⁵ Requiring the nonprofit sector to establish the same level of political/democratic constraints that exist in the public sector also may result in a loss of the flexibility and innovation on which the nonprofit sector thrives and which is often noted as one of its major contributions to the economy and society. See, e.g., Douglas,

B. *Classifying the Sector*

Alternatively, the social costs produced by optionality could be mitigated by embracing, and in fact codifying, the variety within the nonprofit sector. This response would establish a regulatory taxonomy of nonprofits based at least in part on governance. Nonprofits with and without members could be treated differently, based on their differing contributions to civil society and to a lesser extent their differential ability to make mission-maximizing decisions and to self-monitor. This approach would respect the differential contributions of various types of nonprofits.²²⁶ These differences in treatment could halt and perhaps partially reverse the trend away from members.

Commentators often have explored the heterogeneity of nonprofit organizations and have suggested the potential for regulation to be more narrowly tailored to match the distinct benefits each category of nonprofits provides to society.²²⁷ Jon Van Til has advanced what is perhaps the most aggressive of these agendas for reform.²²⁸ Van Til contemplates "sweating down" the nonprofit sector by removing from the purview of the sector and from eligibility for governmental largesse those nonprofits that operate essentially commercially.²²⁹ This process would confine membership in the sector and eligibility for governmental bene-

supra note 10, at 43; Brody, *supra* note 2, at 860-65; Fishman, *supra* note 12, at 644; *see also* ROSENBLUM, *supra* note 179, at 13 ("[W]e may be reluctant to say that the imperative to produce a certain character or range of characters should govern the organization of social or political life. Or that laws should require us to embrace liberal democratic principles or exhibit moral dispositions in every aspect of our own lives.").

²²⁶ Of course, future work would be required to determine the differential contributions of various nonprofits and to select the advantages to confer upon nonprofits that provide particular benefits.

²²⁷ *See, e.g.,* Laura B. Chisolm, *Accountability of Nonprofit Organizations and Those Who Control Them: The Legal Framework*, 6 *NONPROFIT MGMT. & LEADERSHIP* 141, 152 (1995) ("Both diversity and accountability are better served by structuring the legal rules so as to allow and encourage formation and development of a variety of institutions . . ."); Atkinson, *supra* note 99, at 698-99 (quoting Chisolm and responding "Amen").

Evelyn Brody has argued that the diversity of nonprofit governance models is itself of societal value. Due to the variety of nonprofit governance structures, each potential participant can choose to affiliate with a nonprofit that is more or less democratically governed. Indeed, she argues that a nonprofit's choice of governance model is itself a form of organizational expression. *See* Brody, *supra* note 2, at 863-64.

²²⁸ *See* VAN TIL, *supra* note 3, at 191-214.

²²⁹ *See id.* at 196-203.

fits to those nonprofits that are “substantially voluntary and citizen-driven in mission and process.”²³⁰ For Van Til, it is only by removing much of the overpopulation of the current nonprofit sector that the vitality of its core service and advocacy organizations can be maintained and the preferences they receive can be justified.²³¹

Although Van Til’s is the most dramatic proposition, advocates of more incremental reforms also rely on differentiating among nonprofits in crafting statutory and regulatory schemes. In order to reflect “the realities of much of the charitable sector,” one such reformer suggests that a class of close nonprofit corporations ought to be established for small nonprofits with assets beneath some moderately low level.²³² This class of close nonprofit corporations would be lightly regulated, solely by state and federal tax authorities, in order to allow attorney general supervision to focus on larger and more complex organizations, where attention to corporate formalities and complex regulatory schema might be more significant.²³³ Even Hansmann, who argues for a “unitary and rigorous” nonprofit corporation law,²³⁴ appreciates the utility of more sensitive regulation. In order for a given category of nonprofits to qualify for tax exemption under his preferred criteria, contract failure problems must be shown to make nonprofit production more efficient than for-profit production in the relevant industry.²³⁵ Even the differing contributions of varying types of nonprofits to the enhancement of civil society and democracy might be charted.²³⁶ Building on these sugges-

²³⁰ See *id.* at 198-200 tbls.1-3, 202-03. Van Til suggests three slightly different frameworks for drawing the distinctions between commercial and mission-focused nonprofits. See *id.* at 201-02 (discussing frameworks focusing on commitment to mission, service provision, and contribution to civil society).

²³¹ See *id.* at 203 (“A lean third sector, consisting only of organizations true to principles of voluntary citizen-driven service and advocacy, would merit both the public privileges and the reputation it must continue to earn.”); see also Angela M. Eikenberry & Jodie Drapal Kluver, *The Marketization of the Nonprofit Sector: Civil Society at Risk*, PUB. ADMIN. REV. 10-19 (forthcoming article on file with author) (noting the lack of democratic contributions made by increasingly market-motivated nonprofits).

²³² Fishman, *supra* note 12, at 666-68.

²³³ See *id.* at 667-68.

²³⁴ See Hansmann, *supra* note 96, at 622-23.

²³⁵ See Hansmann, *supra* note 191, at 86-89. Furthermore, he contemplates a continuing role for the concept of charity, in order to demarcate the class of nonprofits that are perceived to provide public goods and for whom tax-deductible contributions are an appropriate subsidy. See Hansmann, *supra* note 96, at 623.

²³⁶ See WARREN, *supra* note 85, at 39-40. In his work classifying associations by

tions for a more nuanced understanding of the diversity of the nonprofit sector and sensitivity to differing nonprofits' contributions, a more complex taxonomy of nonprofits could be created and used in regulating and apportioning benefits to them.

One rejoinder to this response would assert that the nonprofit sector already is subject to this kind of classification when different regulation is applied to public benefit and mutual benefit nonprofits. This argument might further suggest that mutual benefit nonprofits, which typically have members and may be explicitly required to have them, can perform the nonprofit sector's role in constituting civil society. Therefore, a response targeted to encourage internal democracy in public benefit nonprofits is unnecessary. However, the classification of a nonprofit as public benefit or mutual benefit depends on purpose, not on governance structure.²³⁷ Thus, this existing distinction may fail to capture differences in governance. A nonprofit regulatory system that accounts for governance will more sensitively apportion societal benefits to nonprofits that play a role in constituting civil society, in ways that the current public/mutual benefit distinction cannot.

In a regulatory system sensitive to issues of governance, mutual benefit nonprofits that are structured to offer their members opportunities to build civic skills and social capital could qualify for tax and other benefits accorded to public benefit nonprofits as compensation for this democracy-enhancing role.²³⁸ However, such a system also would apportion advantages to public benefit nonprofits that structure themselves to benefit society in these

their contributions to democracy, Mark E. Warren notes that both "thick" associations (characterized by strong face-to-face contact by members) and "thin" ones can significantly, although distinctly, enhance democracy. *See id.* Associations characterized by member-to-member contact will have important democratic effects as "shared purposes achieved by voluntary attachments are . . . the intrinsically democratic way to relate normative purposes and collective action." *Id.* at 39. But thin associations, like Washington-based advocacy and professional groups, can better serve other democracy-enhancing purposes, like "underwriting public dialogue." *Id.* at 40.

²³⁷ Compare RMNCA § 17.07 (3)-(4) (designating as public benefit those non-religious nonprofits that qualify for federal tax exemption under § 501(c)(3), that are charitable, benevolent, or are formed for charitable or public purposes, and are required to distribute their assets to another such organization on dissolution), *with id.* § 17.07(5) (using mutual benefit as a catchall category for those nonprofits that fit neither this definition nor the definition of a religious nonprofit).

²³⁸ *Cf. Ellman, supra* note 128, at 1031, 1037-42 (discussing the benefits of narrowing the concept of mutual benefits and confining mutual benefit treatment more thoughtfully).

ways. In a public benefit nonprofit, social capital generation and civic skill-building occur as part of the organization's broader public-regarding activities. This may allow public benefit nonprofits to promote democracy in different or more positive ways than is possible for mutual benefit nonprofits.²³⁹ A regulatory taxonomy based in part on governance structure could use governance as a metric for contributions to civil society, and it could reward nonprofits for these contributions regardless of their public benefit or mutual benefit purposes.

Like mandatory membership, a classification response would require legislative amendments. The first and most formal legislative change required would be to establish or solidify subcategories of nonprofits and the differences in treatment accorded to them. Most state nonprofit corporation acts already envision two variants of nonprofit governance—with and without members. They already provide different approval requirements for various corporate actions based on whether or not a nonprofit has members.²⁴⁰ States also generally require nonprofits to state whether or not they have members in their articles of incorporation.²⁴¹ For ease of drafting, legislatures might create special terminology designating those differences. Or, legislators might prefer to continue using alternative language, providing that those nonprofits with members may do X, while those nonprofits without members may not do X or may do Y or must do Z.

But the classification proposed here also would reach farther and parcel out differential benefits and burdens to nonprofits, in part based on whether their governance structure included a role for members. Many of the major benefits offered to nonprofits are provided under federal tax law. These benefits, including the

It may be possible to link the current, relatively limited set of benefits accorded to mutual benefit nonprofits under federal tax law to this contribution. However, such an analysis is beyond the scope of this Article.

²³⁹ See WARREN, *supra* note 85, at 78 (explaining that “not all associations have the same potential to reproduce every aspect of the public sphere”). For example, public benefit nonprofits may be more likely to produce bridging social capital, by forming inclusive networks across various social groups, while mutual benefit nonprofits may be more likely to produce bonding social capital, forming instead exclusive networks of homogeneous individuals. See PUTNAM, *BOWLING ALONE*, *supra* note 4, at 22-23.

²⁴⁰ See, e.g., RMNCA § 11.03 (providing alternative decision-making mechanisms depending on whether a nonprofit has members); NEV. REV. STAT. ANN. § 82.436 (Michie 2001) (providing two alternative procedures for sale of assets depending on whether a nonprofit has members).

²⁴¹ See *supra* note 46.

exemption of corporate income from taxation and the deductibility of contributions, are already differentially offered to nonprofits. This differentiation depends not on the governance regime utilized by a particular nonprofit, but rather upon its purposes and the level of financial support it receives from the public.²⁴² The federal government may wish to add governance structure to the features it considers in affording tax benefits to nonprofits.²⁴³

Even if the federal government does not make such changes, states too could play a role in inducing a resurgence of voting membership structures through differential regulation. Property tax exemption is one of the foremost areas of state (and local) regulation of and beneficence to nonprofits.²⁴⁴ Each state issues its own requirements for real and/or personal property owned and used by a nonprofit to be exempt from property taxation.²⁴⁵

²⁴² Nonprofits that meet the Internal Revenue Code's requirements of organization and operation "exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition . . . or for the prevention of cruelty to children or animals" qualify for broad exemption from federal corporate income tax, provided that they comply with the nondistributional constraint and do not engage in political campaigning or a substantial amount of lobbying. See 26 U.S.C. § 501(c)(3) (2000). For the most part, this same group is eligible to receive tax-deductible contributions. See *id.* § 170(c). The extent of these exemption and deductibility benefits is more limited for the subgroup of exempt entities that are deemed "private foundations," see *id.* § 509(a), and private foundations are more heavily regulated, see *id.* § 4940-46. In short, a private foundation is a § 501(c)(3) exempt entity that cannot show a prescribed level of public support, either through its receipt of individual donations, its receipts for services rendered, or its affiliation with another non-private foundation, § 501(c)(3) exempt entity. See *id.* § 509.

²⁴³ Theda Skocpol has advocated similar tax (and election law) reforms "to deliver the biggest advantages to associations that derive relatively high proportions of their funding from membership contributions and actually have interactive memberships who enjoy rights to participate in associational decision-making." Skocpol, *supra* note 174, at 287-88.

Although I favor revision of the federal tax-benefit regime to be more cognizant of differences in nonprofit governance, the details of how to rework this complex system of subsidization is beyond the scope of this Article. It is interesting to note, however, that some membership information is already collected by the IRS. In Line 11 of IRS Form 1023, applicants for exemption must disclose whether they are membership organizations and, if so, their requirements, fees, promotions and benefits for members. See IRS Form 1023 Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, available at <http://www.irs.gov/pub/irs-pdf/k1023.pdf>.

²⁴⁴ See Joseph J. Cordes, Marie Gantz, & Thomas Pollak, *What is the Property-Tax Exemption Worth?*, in PROPERTY-TAX EXEMPTION FOR CHARITIES, 81, 85-99 (Evelyn Brody ed., 2002).

²⁴⁵ See Janne Gallagher, *The Legal Structure of Property-Tax Exemption*, in PROPERTY-TAX EXEMPTION FOR CHARITIES, *supra* note 244, at 3, 5, 10-12.

A state concerned about the diminishing number of nonprofits with members could reshape its property tax exemption regulations to include a membership requirement, or it could permit membership to substitute for the lack of some other requirement necessary to qualify for exemption. For at least some of those nonprofits with large real estate holdings, it will be worthwhile to adopt or maintain governance with members, despite its costs, in order to obtain or retain property tax exemption. The contributions made by these nonprofits' more democratic governance structures to civil society would be the benefit received by the state in exchange for the property tax preference.

In addition, recently there has been an outcry, particularly from municipal governments, that property tax exemption for nonprofit institutions is overly burdensome in light of the imbalance of services they require from their communities and their financial contribution to them.²⁴⁶ In response, some nonprofits have negotiated payment-in-lieu-of-taxes (PILOT) agreements with the municipalities in which they operate.²⁴⁷ These agreements provide for transfers of funds from a nonprofit to relevant government units as a way of compensating for some of this imbalance and staving off attacks on the general premise of tax exemption.²⁴⁸ If local governments negotiating these agreements recognize the detrimental impact of a loss of civil society in their communities, they may decide to include governance requirements as terms in these agreements.

Another way to encourage governance with members would be to lift or loosen regulatory requirements for those nonprofits that use members. States, particularly their attorneys general, are involved in the day-to-day regulation of nonprofits.²⁴⁹ In most jurisdictions, nonprofits must submit annual reports on their activities and finances,²⁵⁰ and the attorney general or another state official often must receive notice of or approve cer-

²⁴⁶ See *id.* at 12-14.

²⁴⁷ See generally PROPERTY-TAX EXEMPTION FOR CHARITIES, *supra* note 244 (various chapters address PILOTs).

²⁴⁸ See Gallagher, *supra* note 245, at 14-19. Some municipalities also have entered into agreements by which nonprofits agree to provide in-kind contributions or contributions of services in lieu of taxes (SILOTs). See *id.* at 15.

²⁴⁹ Alternatively, these duties may be ministerially performed through the office of the secretary of state, as part of the secretary's role in the general regulation of corporations. See, e.g., TENN. CODE ANN. § 48-66-203 (West 2002).

²⁵⁰ See *supra* note 111.

tain transactions.²⁵¹ In addition, state attorneys general regulate charitable solicitation by nonprofits, again by requiring disclosures and sometimes by approving organizations for charitable appeals.²⁵² Of course, the decision to ease regulation in a field where enforcement already is weak requires serious consideration.²⁵³ However, reduced regulation for nonprofits with members may represent merely the legal recognition of pre-existing enforcement priorities.²⁵⁴ Perhaps a lower administrative burden or a reduced level of regulation would be seen by states as an appropriate advantage to extend to nonprofits that provide civil society benefits through their chosen governance structures. Or, due to the limited extent that a voting membership may be able to monitor the actions of boards,²⁵⁵ attorneys general may be comfortable shifting to members some of the monitoring responsibilities they formally hold, but are not practically able to perform for all nonprofits under their jurisdiction. Perhaps such a delegation might be made on the theory that members would at least be capable of alerting attorneys general to the most serious potential problems.

States also can assist in encouraging the use of members in nonprofit governance merely by invoking the powerful tool of language. One substantial benefit of nonprofit incorporation is the halo effect of being able to refer to a corporation as nonprofit in character. Citizens may perceive nonprofit institutions as

²⁵¹ See, e.g., MASS. GEN. LAWS ANN. ch. 180, § 8A(c) (West 2002) (requiring notice to the attorney general prior to certain transfers of assets); ALA. CODE §§ 10-3A-103 and 10-3A-104 (2002) (requiring that the secretary of state find articles of merger and consolidation “conform to law” before certifying them, which certification will make the merger or consolidation effective); N.Y. NOT-FOR-PROFIT CORP. LAW § 1002(d) (McKinney 2002) (requiring court approval for some nonprofit dissolutions).

²⁵² See Renee A. Irvin, *Nonprofit Accountability and State Regulation: Trading a Little Fraud for a Lot of Forms*, 3-5, Presentation at the Annual Conference of the Association for Research on Nonprofit Organizations and Voluntary Action (November 16, 2002) (on file with author) (collecting and analyzing reporting requirements across jurisdictions).

²⁵³ Such consideration should include an analysis of any incentives to game the system that classification may create. For example, if utilizing a voting membership structure will significantly reduce regulation or an organization’s income or property tax burden, problems of sham members may arise.

²⁵⁴ Cf. Fishman, *supra* note 12, at 667-68 (“[c]reating a category of nonprofit close corporations would remove from the . . . attorney general supervision [of] thousands of small nonprofit corporations that . . . may be too insignificant to monitor, given scarce resources”).

²⁵⁵ The considerable extent of this limitation was explored in depth in Part III.C *supra*.

more trustworthy than for-profit institutions with the same mission or activities.²⁵⁶ States could further segregate options for incorporation in order to encourage internal democracy by reserving “nonprofit” incorporation for those institutions with members. Those formerly “nonprofit” corporations with self-perpetuating boards could be deemed “nondistributing corporations,” or some other less glorified term.²⁵⁷

A classification response still would require significant legislative initiative and considerable research and drafting to implement effectively. Some efforts in this direction may be welcomed by legislatures, in response to general concerns of individuals and for-profit constituencies about whether the nonprofit sector deserves the special treatment it receives.²⁵⁸ However, support from within the nonprofit community is uncertain. This response is likely to result in the transformation or reduction of governmental benefits flowing to some of the most powerful nonprofit constituencies—large, institutional nonprofits—and thus is likely to face substantial opposition from those groups.²⁵⁹ Although an attempt might be made to cast this change as a benefit to nonprofits with members, rather than as a penalty to nonprofits without them, the commencement of a comprehensive legislative program to more carefully regulate and apportion benefits to nonprofits still would be an uphill battle.²⁶⁰

²⁵⁶ See Hansmann, *supra* note 9, at 896-97 (noting that consumers prefer to deal with nonprofits in purchasing services, based on a feeling that nonprofits will not exploit the consumer). *But see* Carrol L. Estes, Elizabeth A. Binney & Linda A. Bergthold, *How the Legitimacy of the Sector Has Eroded*, in *THE FUTURE OF THE NONPROFIT SECTOR*, *supra* note 98, at 35-36 (reporting that most survey respondents did not perceive a difference between nonprofit and for-profit home health care providers); Steven E. Permut, *Consumer Perceptions of Nonprofit Enterprise: A Comment on Hansmann*, 90 *YALE L.J.* 1623, 1626-31 (1981) (describing similar results from a survey regarding nonprofits in various industries).

²⁵⁷ Another language-based solution might capture and reserve for internally democratic nonprofits one of the many connotative terms often mistakenly used to describe the full nonprofit sector. Others also have noted the importance of language in nonprofit reform initiatives. *See, e.g.*, Hansmann, *supra* note 96, at 598-99.

²⁵⁸ *See, e.g.*, Stephanie Strom, *Nonprofit Groups Reach for Profits on the Side*, *N.Y. TIMES*, March 17, 2002, § 1, at 32.

²⁵⁹ *But see* VAN TIL, *supra* note 3, at 202-03 (arguing that true nonprofit advocates would prefer a leaner nonprofit sector, consisting only of service and advocacy groups, benefits for which might be more broadly defended).

²⁶⁰ It also may be dangerous for supporters of the nonprofit sector to combine with forces decrying its unfair competition, even if they seek only to advocate a more rational and defensible nonprofit regulatory scheme. Perhaps their efforts might result in weakening the sector overall.

C. *Changing the Rhetoric*

A final and more modest response would merely seek to change the rhetoric surrounding the nonprofit sector. Like the classification response, this response takes into account the importance of language and of the halo effect of being a part of the nonprofit sector. However, it may be easier to implement. The tool here would be education rather than legislation. The educative project would be to break down perceptions of the nonprofit sector as cohesive, with all of its organizations able to engage in each of the various beneficial roles ascribed to it.²⁶¹

A more nuanced and realistic understanding of the nonprofit sector would feature an appreciation of various types of nonprofits for the benefits they provide to society, but without using a single halo to cover them all. Some nonprofits would be cheered for solving market failures by providing combinations of goods and services that the competitive market is unable optimally to produce.²⁶² Other nonprofits would be lauded for addressing needs that government would otherwise have to serve, a situation that would unfavorably expand state control or simply subject crucial services to inept government bureaucracy.²⁶³ Still other nonprofits would be appreciated for the benefits they provide in constituting civil society.²⁶⁴

Of course, this response is not an exclusive solution; in fact, it would be a useful adjunct to an attempt at classification along the lines suggested above. Indeed, a change in the collective understanding of the rationale for the existence of the nonprofit sector likely would spur efforts at additional legal classification and differentiation of benefits. However, even without subsequent or concurrent codification, an evolution in rhetoric would be a positive development. If Tocqueville's conception of the nonprofit sector no longer captures its reality, responsible members of the nonprofit sector and its advocates should educate the public to

²⁶¹ Cf. WARREN, *supra* note 85, at 70 (advocating a more refined analysis of the democratic contributions of associations).

²⁶² See VAN TIL, *supra* note 3, at 211.

²⁶³ See FISHMAN & SCHWARZ, *supra* note 26, at 39.

²⁶⁴ Individual nonprofits can and do engage in more than one of these functions, pursuing service-delivery and advocacy, for example. Perhaps more of them would be wise to adopt such a multidimensional approach. See PETER FRUMKIN, ON BEING NONPROFIT 178-81 (2002). The educative reform concept is not intended to force each nonprofit to choose a single function. Rather, it seeks to inform the public about the various types of useful functions nonprofits play in our society, and that individual organizations may perform one or several of them.

change its conception accordingly and to convince the public of its many real and important contributions to society. Only then can these advocates honestly argue in favor of benefits for the various constituent parts of the sector.

The educative response has a greater likelihood of implementation than either of the other two responses since it does not require legislation. It also has less potential to fracture the nonprofit community into warring constituencies fighting one another for access to tax and other benefits. It will, however, require nonprofit leaders and advocates to take the initiative to embark on a substantial public education campaign and to dedicate to that campaign their already strapped financial and human resources. There is reason for some optimism on this front. In response to the call by Putnam and others to stem the decline of civil society, some foundations have asked nonprofits applying for grant support to submit a "social capital impact statement."²⁶⁵ Information about governance structure should be an important element of such statements and it could play a role in the selection of those groups to which support is awarded.

Although the educational response has much to offer, it is unlikely to stem a trend away from members.²⁶⁶ Thus, it is a response to the critique presented here, but not a solution of the problem it identifies. If nonprofits are resigned to abandon structural requirements that bolster their ability to constitute civil society, it will become necessary to look elsewhere for institutions to take up this responsibility.²⁶⁷

CONCLUSION

Optionality results in a systematic bias against internal democracy in nonprofit governance. Without some form of encouragement for the adoption of democratic, membership-based governance structures, members will become more and more rare. Adopting governance without members will not consist-

²⁶⁵ See, e.g., The Winston Salem Foundation, *How to Apply for an ECHO Fund Grant*, at http://www.wsfoundation.org/echo_how_to.html.

²⁶⁶ Cf. Brody, *Institutional Dissonance in the Nonprofit Sector*, *supra* note 136, at 503-04 (arguing that law reform is neither the best nor the only way to solve the accountability and other problems of the nonprofit sector).

²⁶⁷ See, e.g., Estlund, *supra* note 217, at 1-7 (describing the potential of for-profit corporations to aid in constituting civil society); DIANA SACO, *CYBERING DEMOCRACY* 35-74 (2002) (describing the potential for the Internet to contribute to building democracy).

ently detract from the efficiency or accountability of individual nonprofit organizations. And, as legislatures, individual nonprofit founders, and their counsel appreciate, adopting a governance structure without members can help nonprofits to make quick changes they need to compete in more sophisticated industries and endeavors.

However, dismembering the nonprofit sector would exact a serious social cost by reducing its ability to constitute a sphere of civil society with democracy-enhancing effects. This failure alone should concern a society that believes in the importance of civil society and of democracy. Moreover, without the ability to constitute civil society, the nonprofit sector fails, at least in part, to earn the advantages it receives, further endangering its reputation and legitimacy. Therefore, future work should continue the search for responses commenced here, to develop legal or other solutions to mitigate the social costs of optionality.