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## For Love or Money: Nonprofit Survival in a For Profit World

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wide-sweeping cases is *Oates v. Jag, Inc.* 311 S.E.2d 369 (1984), rev'd, 333 S.E.2d 222 (North Car. 1985) holding that the tort of negligence will lie for the third owners of a house when shown that the builder failed to comply with building code provisions and used inferior building materials. The North Carolina Supreme Court relied extensively on a pair of Florida cases recognizing the right of remote purchasers of condominiums to sue the builder for defects; see, *Simmons v. Owens*, 363 So.2d 142 (Fla. App. 1978) and *Navajo Circle, Inc., v. Development Concepts Corp.*, 373 So.2d 689 (Fla. App. 1979).

98. *Richman v. Watef*, 565 S.W.2d 101 (Tex. Civ. App. 1978); *Blagg v. Fred Hunt Co., Inc.*, 612 S.W.2d 321 (Ark. 1981); *Towers Tenant Association, Inc., v. Towers Limited Partnership*, 563 F. Supp. 566 (D.C. 1983).

99. *Richman v. Watef*, 565 S.W. 2d 101 (Tex. Civ. App. 1978); *Blagg v. Fred Hunt Co., Inc.* 612 S.W. 2d 321 (Ark. 1981); *Towers Tenant Association, Inc., v. Towers Limited Partnership*, 563 F.Supp. 566 (D.C. 1983). The D.C. Court relies upon *Berman v. Watergate West, Inc.*, 391 A.2d 1351 (D.C. 1978) which held "...the District of Columbia Court of Appeals concluded that products liability principles apply to the sale of newly constructed homes and cooperative units. As a result, the Court held that plaintiff had a viable cause of action grounded in breach of implied warranty/strict liability in tort." *Towers Tenant Assoc.*, *supra* at 574.

100. *Blagg, supra*, at 323-324.

101. *Prosser, supra* note 2 at 1122-1124.

102. 377 P.2d 897 (1963); this case lays out the prototypical strict liability standards using the facts of an injury resulting from an allegedly faulty power tool; these standards were later codified in Section 402A of the Second Restatement of Torts.

103. *Kriegler v. Eichler Homes, Inc.*, 73 Cal. Rptr. 749 (1969).

104. *Prosser, supra* p. 1124.

105. *Coburn v. Lenox Homes, Inc.*, 173 Conn. 567, 378A. 2d 599, 601 (1977).

106. *Oliver v. City Builders, Inc.*, 303 So. 2d 466, 468 (Miss. 1974); (see fn. 96 *infra*, while this case has been overruled, it is used here for illustrative purposes only).

107. For a detailed listing of jurisdictions recognizing negligence as a remedy, see Robert L. Cherry, *Builder Liability for Used Homes Defects*, 18 REAL ESTATE LAW JOURNAL 115-141 (1989).

108. See, California: *Kriegler v. Eichler Homes, Inc.*, *supra*, District of Columbia: *Berman v. Watergate West, Inc.*, *supra*; New Jersey: *Hermes v. Staiano*, *supra*, Arkansas: *Blagg v. Fred Hunt Co.*, *supra*.

## FOR LOVE OR MONEY: NONPROFIT SURVIVAL IN A FOR PROFIT WORLD

by

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Once upon a time, the process of budgeting for most nonprofit organizations was very simple. My favorite illustration is the story of how one Ivy League university set its budget in the years right after World War II. The university was run by one vice-president and two deans...The vice-president and senior deans would meet with the president early in the summer at his summer home... Somewhere between the first and second martini, the president and his two chief administrators would settle the budget for the year and decide on the amount of any tuition increase needed to keep the university happily in the black.

Times, of course, have changed.<sup>1</sup>

Various known as charitable, eleemosynary or nonprofit associations, small community based organizations whose mission it is "to help the less fortunate" are deeply imbedded in the American psyche. Such organizations sprang up fast and furiously as the Industrial Revolution sped forward in this

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country, providing some relief (usually minimal) from the economic dislocation caused by the shift from an agrarian to an urban economy.<sup>2</sup>

Many of these organizations, direct descendants of those founded in the late nineteenth and early twentieth centuries, still exist today. Frequently, these small nonprofits share similar origins: the community's wealthiest and most influential people came together and formed an organization to fill a need in their community. These early charities would spout such values as sobriety and hard work and only provide assistance to those deemed "deserving". Of course, as is the case today, there was probably far more need in these towns than there was relief available. One wonders if the community leaders were motivated more by altruism or by the desire to get the "riffraff" off the streets. Funding was provided by the wealthy themselves, both by start up donations and annual charity balls. Social prestige, and not business acumen, was the driving force.

The Great Depression of the 1930's actually brought little change to this small, community-based nonprofit model. Even though the government ultimately provided a "safety net" of sorts - unemployment compensation and social security insurance - somehow there were those who slipped through the net and had only community relief efforts on which to rely. These local relief societies were still coordinated and largely funded by the local leading citizens--those with wealth, power and prestige. A charity's primary mission might change with the times, but its major source of funding was still found in the local leadership with their yearly charitable and social events.

For the wealthy, charitable work provided a social outlet. The business principals that formed the basis of their professional successes were not applied to their volunteer organizations. Long-range planning was minimal. Even well endowed organizations were to suffer erosions of their asset bases caused by the inflation and recessions which have become typical since the early 1970's. The innovation and creativity that is characteristic of American entrepreneurship were sorely lacking in the nonprofit sector of the economy.

The board of a not-for-profit institution, with its traditional business membership, ought to be well-positioned to press management to think and act in a businesslike fashion as well as to insist that the staff of the organization has the professional competence to conduct the business of the enterprise. But business executives serving on such boards are often hesitant in their roles as trustees to be assertive in suggesting that business

practices have a place in the management of not-for-profit organizations. As the general manager of a major public broadcasting station put it, "When my business trustees come to a board meeting, they seem to check all their business expertise at the door."<sup>3</sup>

Corporate types...leave their corporate brains outside the door.<sup>4</sup>

At a time when the demand and need for nonprofit services far outstrips the supply, it is obvious that the time has come to put the old fashioned "charity model" to rest. Assertive and aggressive approaches must be taken to stimulate this sector of the economy; in fact, the law demands of nonprofit directors no less than it demands of directors of for profit corporations.

Specific sections of nonprofit corporate codes will be discussed *infra*. Auditing standards for nonprofit corporations also merit mention. Certified public accountants who specialize in nonprofit audits follow Generally Accepted Auditing Standards (GAAS), and also Office of Management and Budget Circular A133. Additionally, a particular funding source may have its own guidelines that must be followed as well.

In an audit of a for profit corporation, an auditor will check to see whether the financial statements fairly reflect the corporation's transactions during the prior year, and also whether reliable internal controls are in place. In a nonprofit audit, the additional issue of compliance is key: whether monies received were spent for the designated programs. Ultimate accountability is to the public, an onerous burden for any board of directors.<sup>5</sup> Thus a nonprofit corporation today is no place for a sleepy board. The failure to recognize the need for change jeopardizes the very survival of these organizations since the future has arrived for nonprofits. This \$500 billion dollar per year sector of the American economy<sup>6</sup> must make hard decisions if it is to remain viable in the face of continued recession, government funding cuts, implementation of programs such as United Way Donor Choice,<sup>7</sup> and a lack of health insurance to cover services such as mental health counseling.<sup>8</sup>

Professionalization of management is rapidly becoming the rule. Executive director positions are being retitled "President" and "CEO" to reflect this changing reality.<sup>9</sup> State organizations such as Family Service Association of New Jersey and national organizations such as Family Service America provide expertise and training to their member agencies. Agency heads form consortiums to gain a

competitive edge when seeking grants from government agencies. Some agencies merge as a way to combine strengths while better ensuring survival.

Efficiency and results are stressed in today's nonprofit world. More and more government agencies are demanding quantifiable results as a condition of awarding grants. "Having quantifiable goals is an essential starting point if managers are to measure the results of their organizations activities. It is difficult to quantify the output of social programs, but if managers define their goals well, it can be done."<sup>10</sup> However, long term survival for these organizations will depend on more than operating in a "leaner and meaner" fashion. By their nature, nonprofits have tended to operate on a shoestring all along such that when cutbacks are suggested, there is little if anything to cut.

Until recently, the answer to the problem of nonprofit financial woes was thought to be fund development - more creative and aggressive fund raising. In fact, since the beginning of modern nonprofits, directors were often selected because of their potential as a funding source (whether personally or via corporate connection). While the role of fundraising should not be diminished, it should no longer be overemphasized as the great panacea. Fundraising has serious limits; among them are state regulations<sup>11</sup> and increasing competition for the charitable dollar.

Greater emphasis should be placed on making nonprofits partially self-funding by having certain successful operations which can help to underwrite those services which lose money or for which adequate funding is not available. Clearly, nonprofits should think in terms of income generation. As this paper's discussion of the law will emphasize, the law does not say that nonprofits must operate in the red; it only says that excessive salaries can't be paid and that profits cannot be distributed to shareholders.

Family Service Association of Atlantic County has begun to generate income via its sister corporation Family Service Enterprise. Both of these organizations are subsidiaries of a holding company formed to provide management services including long range planning and investment guidance. Family Service Enterprise runs only programs which pay for themselves out of program fees such as its highly successful Consumer Credit Counseling Service. No public money is involved. Right now this entity represents only a small percentage of Family Service Association of Atlantic County's business. However, it is clearly understood that should there be a "profit" the decision of how to best utilize this positive return will be made at the holding company level

for the good of the organization as a whole, in a way which furthers the overall aims and goals of this Atlantic County, New Jersey nonprofit. The board of directors of the holding company is made up of members of the boards of the various constituent organizations. Jerome Johnson, President and CEO of this \$4.5 million dollar per year Family Service Association (which has on its payroll 130 employees) stresses the importance of recognizing change and modifying operations as required.<sup>12</sup>

Any discussion of the adaptations to be made by not-for-profit corporations in recognition of the changing economic and regulatory climates must, of necessity, revolve about the relevant statutory framework. After all, compliance with state and federal statutes and regulations is the minimum level of acceptable behavior. Therefore, this Article will examine the Revised Model Nonprofit Corporation Act (with a glance at its predecessor), the New Jersey statute known as Corporations and Associations Not for Profit<sup>13</sup>, and the New York Not-for-Profit Corporation Law<sup>14</sup> - one of the pioneering legislative schemes.<sup>15</sup>

The New York legislature in 1969 enacted the current statute which repealed the former Membership Corporation Law<sup>16</sup> and which draws a significant number of provisions from the state's General Corporation Law.<sup>17</sup> The law, which became effective on September 1, 1970, was the result of a Joint Legislative Committee which was formed in 1956 to plan "for the revision of the corporation laws of New York."<sup>18</sup> The drafters of the statute felt that not-for-profit organizations were sufficiently unique so as to warrant legislation distinct from the Business Corporation Law, a product of the same committee. The separate law also gives the legislature additional flexibility to deal with issues peculiar to not-for-profit corporations.<sup>19</sup>

It is of interest to note that the committee members specifically rejected the nomenclature "Non-profit Corporation Law" in favor of the Not-for-Profit Corporation Law. Their reasoning was that the latter more accurately reflected the reality of such organizations. While not organized for profit, they may in fact show a surplus of revenues over expenses in connection with their operations.<sup>20</sup>

For a not-for-profit corporation to carry out its (usually)<sup>21</sup> admirable functions and to allow for long term planning, it must attempt to maintain a surplus to cover periodic negative cash flow periods. Since they cannot reach out to the equity markets, not-for-profit's also require a surplus to finance the maintenance, replacement and expansion of its capital plant.<sup>22</sup> New York specifically grants a not-for-profit the right to make "an incidental profit" so long as it is used for the

"maintenance, expansion or operation of ... the corporation."<sup>23</sup> However to avoid being in violation of the statute, as interpreted by the courts, profits may not inure to the benefit of any members of the corporation.<sup>24</sup>

The New Jersey act<sup>25</sup>, while referring to "Corporations and Associations Not for Profit" nevertheless inferentially recognizes the possibility that such an organization may, in fact, show a surplus. Though it provides that "a corporation may be organized .. for any lawful purpose other than for a pecuniary profit ...",<sup>26</sup> it further requires that "... no part of the income or profit of a corporation organized under this act shall be distributed to its members, trustees or officers..."<sup>27</sup> Similarly, the Revised Model Nonprofit Corporation Act specifies that no distributions can be made<sup>28</sup>, with distributions defined as the "payment of a dividend or any part of the income or profit of a corporation to its members, directors or officers."<sup>29</sup> The Model Nonprofit Corporation Act had a virtually identical provision.<sup>30</sup>

Like the New York law, the current New Jersey statute can trace its history to late in the last century. The predecessor legislation, identically named, has roots in 1875<sup>31</sup> with a codification enacted in 1898.<sup>32</sup> However, it wasn't until 1975 that a major revision was contemplated. The Nonprofit Law Revision Committee of the Corporate and Business Law Section of the New Jersey State Bar Association issued its report in 1980.

The Committee sought to provide a uniform regulatory scheme applicable to all nonprofit corporations, regardless of their purpose.<sup>33</sup> It also attempted, and to a great extent succeeded, to "track" the New Jersey Business Corporation Act,<sup>34</sup> while recognizing their inherent differences.<sup>35</sup> By so doing, the drafters hoped "that the similarity between the two acts will lead to a body of case law in which the interpretation of either act may be used as a guide in interpreting the parallel section of the other ...".<sup>36</sup> The very first provision of the legislation sets forth as one of its "Underlying purposes and policies ... to make the law governing nonprofit corporations as nearly compatible with the New Jersey Business Corporation Act ... as may be practicable, subject to the particular requirements of nonprofit corporations."<sup>37</sup> The law became effective October 1, 1983.

The Revised Model Nonprofit Corporation Act also explicitly notes the utility of recognizing the connection between itself and the Model Business Corporation Act. The Subcommittee on the Model Nonprofit Corporation Act stated, "Shortly after the project (to revise the Model Nonprofit Corporation Act) began, the Committee on Corporate Laws decided to completely revise the Model

Business Corporation Act ('MBCA'). The Subcommittee decided to track the MBCA in form and substance wherever appropriate ...".<sup>38</sup>

Thus, even this brief look at these various statutes leads to the conclusion that the decision of a not-for-profit corporation to organize its activities to provide for a cash surplus is consistent with a structure envisioned by the regulatory framers. The prudent and forward looking executive director *must* plan for an operating surplus in at least some of the group's activities to allow for long range planning and its very existence.

Acting within the legal constraints imposed, some of the best known not-for-profits have long had profit making ventures. New York's Metropolitan Museum of Art began selling photographs of its collection in 1874 and opened a sales shop in 1908.<sup>39</sup> Girl Scout cookies and P.T.A. bake sales are part of our culture and additional examples of not-for-profit earned income ventures. For these and similar activities to be successful, the not-for-profit corporation administrators must have a strictly businesslike approach to the activities.<sup>40</sup> As we have seen in the example of the Family Service Association of Atlantic County, the foresight, talent and perseverance of an executive director can make the difference between success or failure of these ventures.

As noted by Brooke W. Mahoney, executive director of Volunteer Consulting Group, Inc., "nonprofits are starved for the skills and perspectives of financial executives from the profit-making realm."<sup>41</sup> Merely having the right to engage in profit making activities is no guarantee that they will be successful. All of the abilities needed by the managers and owners of profit making entities are required by their not-for-profit colleagues.

Attracting and retaining directors or trustees<sup>42</sup> with the skills and desires necessary to assist a not-for-profit corporation can be greatly enhanced if the statute regulating the operation provides sufficient flexibility in appointing, protecting, retaining and dismissing those persons.

The Revised Model Nonprofit Corporation Act requires that each corporation formed under it must have a board of directors<sup>43</sup> consisting of at least three members.<sup>44</sup> Similarly, New Jersey mandates a board consisting of not fewer than three members.<sup>45</sup> New York presumes that a not-for-profit corporation will operate through a board of directors consisting of three member "except as otherwise provided in the certificate of incorporation."<sup>46</sup>



The not-for-profit corporation hoping to tune up its operations may seek to "clean up" its board. As noted above, for decades the board of directors of the local not-for-profit has been considered the fiefdom of those people (and their descendants) who had the money, name and clout to form and fund such organizations. Though needs and funding methods have changed, board membership may not reflect such transition. Reelection as a director was usually a formality satisfied at the brief business meeting which preceded the annual dinner dance.

The Revised Model Nonprofit Corporation Act deals with the issue of director tenure by holding that if the bylaws do not provide otherwise, the term of a director shall be one year. In no event may a term exceed five years.<sup>47</sup> The Act does allow for successive terms.<sup>48</sup> New York has a virtually identical section<sup>49</sup>, while New Jersey requires terms which vary from one to six years.<sup>50</sup> Though reelection is permitted, the existence of statutory limitations on term length at least gives the activists on the board and among the membership a basis for suggesting to the "dead wood" that while their service has been greatly appreciated, it is time for them to move on to the category of (non-voting) directors *emeriti*.

Of course, the changes planned by a newly hired executive director and partially reconstituted board may require the removal of obstinate directors. As expected, the statutes deal with this rather unpleasant subject. Because of the various methods of electing directors under it, the Revised Model Nonprofit Corporation Act sets forth a number of ways to remove a director without specific cause.<sup>51</sup> Essentially, if the number of members needed to elect a director decide to remove him or her, that director is off the board. New York<sup>52</sup> and New Jersey<sup>53</sup> deal with the subject in a similar manner. A hanging-on director, facing certain removal once the required number of votes are assembled, is likely to resign. Failure to do so only validates the decision to seek that person's removal.

While monetary compensation is not likely to be the incentive to join the board of directors of a not-for-profit corporation, the acts examined all permit reasonable compensation.<sup>54</sup> The fact is, few nonprofits pay their directors though many will reimburse them for their actual out of pocket expenses.

Though most directors have altruistic motives and are not interested in payment for their services, they are concerned about their being exposed to liability based upon their actions. For these volunteers, even the smallest possibility of being found liable is unacceptable.<sup>55</sup> That issue is directly dealt with by several statutes contained in the various codes we have examined.

Before considering methods of reducing the risk to directors, we will first look at the standard of care imposed upon them. The Revised Model Nonprofit Corporation Act sets forth "General Standards for Directors."<sup>56</sup> The standard is not extraordinarily stringent. Discharging a director's obligation is satisfied by acting "in good faith"<sup>57</sup> and "with the care of an ordinarily prudent person in a like position..."<sup>58</sup> This level of accountability is certainly no higher than common sense dictates as the minimum standard required of a director.

While a stricter standard of care, such as holding a director liable for simple negligence, may have certain appeal, it would undoubtedly have the effect of discouraging volunteers.<sup>59</sup> Since the commonly accepted standard requires that the director act in good faith, it strikes an appropriate balance between the conflicting concerns. Conforming to that standard will address the issues raised by the recent problems encountered by the United Way of America in connection with allegations of lavish compensation and nepotism attributed to their president.<sup>60</sup>

In addition, a director is permitted to rely, unless the facts require otherwise, upon reports, statements, opinions, etc. of corporate officers, counsel, employees, committees, etc. in determining the propriety of their actions.

The New Jersey act contains provisions quite similar.<sup>61</sup> That statute goes even further by permitting a not-for-profit corporation to eliminate all director liability by so providing in the certificate of incorporation.<sup>62</sup> New York also imposes a standard of good faith and prudence<sup>63</sup> and allows directors to rely upon financial statements found in a report prepared by a certified public accountant or represented to them as accurate by the president of the organization.<sup>64</sup>

Of course, however lenient a statute may be concerning the level of care required of a director, an action may be brought seeking to hold the director liable based upon his conduct as a director. To that end, the codes also address the issue of indemnification of those directors who are sued. The Revised Model Nonprofit Corporation Act takes the straight-forward position that a not-for-profit corporation may indemnify a director so long as that director's conduct comported with the standards of conduct specified in the Act<sup>65</sup>, and, in the case of a criminal proceeding, the director had no reasonable cause to believe that the conduct was unlawful.<sup>66</sup>

The Act requires mandatory indemnification when a director is wholly successful in defending an action<sup>67</sup>, allows for the corporation to advance defense

costs<sup>68</sup>, and, unless prohibited by the articles of incorporation, authorizes a court to grant a director's application to have the court order indemnification.<sup>69</sup>

The New Jersey provision dealing with indemnification gathers all of the components found in the Revised Model Nonprofit Corporation Act.<sup>70</sup> In 1987, New York reorganized, and to some extent expanded its statutes dealing with permitted and mandatory indemnification of directors.<sup>71</sup>

The states have recognized the necessity of protecting directors of nonprofits from litigation other than in cases of self-dealing and bad faith. The statutory provisions examined allow the organizations to recruit directors who might otherwise decline the honor due to their concern of being caught up in a lawsuit brought by an unhappy member or client.

For smaller not-for-profit corporations to succeed, they must break away from traditional notions of funding, organization and the role of their directors. Much of their business operations have been based upon the "myth" that operating efficiently and showing a "profit" is improper. They have treated their directors either with utmost reverence or merely as rubber stamps, and have failed to utilize the business talents possessed by many of them.

As this paper has shown, the law has not imposed these results upon nonprofits, in fact, the law grants to those groups the latitude to adopt operating methods appropriate for now and in the future.

#### ENDNOTES

<sup>1</sup> PAUL B. FIRSTENBERG, *MANAGING FOR PROFIT IN THE NONPROFIT WORLD* 143 (1986).

<sup>2</sup> Much of the historical information for this paper is from Nancy Ilyse Lasher, *The Power Network of the New Brunswick Elite: 1870-1905*, unpublished thesis, Alexander Library, Rutgers University, 1982. Significant primary sources include: *Constitution of the Children's Industrial Home*, Special Collections, Alexander Library, New Brunswick, New Jersey; *Records of the Children's Industrial Home, 1903*, Special Collections, Alexander Library, New Brunswick, New Jersey; *Reports of the Children's Industrial Home, 1883--1903*, Special Collections, Alexander Library, New Brunswick, New Jersey; *Collection of Annual Reports, Charity Organization Society*, Special Collections, Alexander Library, New Brunswick, New Jersey.

<sup>3</sup> Firstenberg, *supra* note 1, at 205.

<sup>4</sup> Interview with Andrea Krich, Executive Director, Family Service Association of Middlesex County (February 11, 1994). Much of the information concerning the operation of Family Service Associations came from this interview as well as from the experiences of one of the authors who serves as a director of one of the New Jersey Family Service Association agencies.

<sup>5</sup> Interview with Brian D. Levine, CPA (March 23, 1994).

<sup>6</sup> Ann Monroe, *A World of Difference*, CFO, September 1993 at 34. About half of the organizations and enterprises in the United States are now nonprofit in nature. Currently, there are nearly one million of these organizations in the United States. The numerical significance of nonprofits cannot be disputed. Gordon Dabbs, *Nonprofit Businesses in the 1990s: Models for Success*, Business Horizons, September/October, 1991 at 68.

<sup>7</sup> This procedure allows a donor to specify which of the United Way recipients will receive a portion of his or her contribution. This clearly gives an advantage to larger, better known organizations.

<sup>8</sup> It is not clear that all nonprofits that currently provide mental health counseling would be considered "providers" under the Clinton health plan. Obviously, exclusion from the plan would have disastrous consequences for those nonprofits. Additionally, to the extent that the Clinton health plan may limit the number of therapy sessions, alternate funding would need to be provided for long-term counseling.

<sup>9</sup> Interview with Jerome Johnson, President and CEO, Family Service Association of Atlantic County (March 30, 1994).

<sup>10</sup> Philip D. Harvey and James D. Snyder, *Charities need a bottom line too*, Harvard Business Review, January/February 1987 at 14.

<sup>11</sup> See, e.g. Assembly, No. 839, 1994 New Jersey Laws which would create a "Charitable Registration and Investigation Act."

<sup>12</sup> Interview with Jerome Johnson, President and CEO, Family Service Association of Atlantic County (March 30, 1994).

<sup>13</sup> N.J. Stat. Ann. §15A:1-1 *et seq.* (West 1993).

<sup>14</sup> N. Y. Not-For-Profit Corporation Law § 101 *et seq.* (McKinney 1993).

<sup>15</sup> These statutes are as broad as their business corporation counterparts. We will examine only a few of the provisions which directly impact upon the ability, and the need, of not-for-profit corporations to "modernize" to the extent necessary to survive and flourish.

<sup>16</sup> The Membership Corporation Law can be traced to portions of the Gen. Corp. Law of 1890 and various amendments and additions in 1909, 1929, 1941 and 1962.

<sup>17</sup> N. Y. Gen. Corp. Law § 1 *et seq.* (McKinney 1993).

<sup>18</sup> Forward to the Committee's Thirteenth Interim Report.

<sup>19</sup> *Id.*

<sup>20</sup> Memorandum No. 1 of the Joint Legislative Committee.

<sup>21</sup> At least at the formation stage, the statutes examined do not differentiate between "good" and "bad" organizations. "The revised Act (The Revised Model Nonprofit Corporation Act) does not deal with the question of whether the activities of a ... nonprofit corporation can be so offensive to public policy that its existence can be challenged by the state in a quo warranto or other proceeding. The matter is left to judicial development on a state by state basis. Michael C. Hone, *Introduction to the Revised Model Nonprofit Corporation Act*, Prentice Hall Law & Business, 1988.

<sup>22</sup> Robert P. Fallon, *Not-for-profit/No Profit: Profitability planning in not-for-profit organizations*, Health Care Management Rev., Summer 1991, at 47.

<sup>23</sup> N. Y. Not-For-Profit Corporation Law § 508 (McKinney 1993).

<sup>24</sup> *New York State Liquor Authority v. Salem Social Club, Inc.*, 76 A.D.2d 908, 429 N.Y.S.2d 235 (1980). The prohibition against "distribution of profits" encompasses any division or sharing of surplus before dissolution. Also included is payment of excess salaries or fees. Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 Yale L.J. 835, 838 (1980).

<sup>25</sup> N.J. Stat. Ann. § 15A:1-1 *et seq.* (West 1993).

<sup>26</sup> *Id.* at § 15A:2-1.

<sup>27</sup> *Id.* at § 15A:2-1 (d).

<sup>28</sup> Revised Model Nonprofit Corporation Act §13.01 (1988).

<sup>29</sup> *Id.* at §1.40(10).

<sup>30</sup> *Id.* at §26.

<sup>31</sup> Act of April 9, 1875.

<sup>32</sup> P.L. 1898, c.79.

<sup>33</sup> Report of the Nonprofit Law Revision Committee. Though there are obvious differences between the traditional not-for-profit models - Public Benefit Corporations, Mutual Benefit Corporations and Religious Corporations - they have much in common when it comes to regulation of their formation and operation. The constitutional protections granted religious organizations frequently leads to a separate statute dealing with their special needs. See, e.g., N.J. Stat. Ann. § 16:1-1 *et seq.* (West 1993).

<sup>34</sup> N.J. Stat. Ann. § 15A:1-1 *et seq.* (West 1993)

<sup>35</sup> Report of the Nonprofit Law Revision Committee.

<sup>36</sup> *Id.*

<sup>37</sup> N.J. Stat. Ann. § 15A:1-1.c(1) (West 1993).

<sup>38</sup> MICHAEL C. HONE, INTRODUCTION TO THE REVISED MODEL NONPROFIT CORPORATION ACT, 1988.

<sup>39</sup> Edward Skloot, *Should not-for-profits go into business?*, Harvard Business Review, January/February, 1983 at 20.

<sup>40</sup> *Id.* at 22.

<sup>41</sup> Ann Monroe, *A World of Difference*, CFO, September 1993 at 36.

<sup>42</sup> For the sake of simplicity we will use the term "director" to cover all of the possible names for those who are given the task of setting policy for a not-for-profit corporation.

<sup>43</sup> Revised Model Nonprofit Corporation Act §8.01 (1988).

<sup>44</sup> *Id.* at § 8.03.

<sup>45</sup> N.J. Stat. Ann. § 15A:2-8(9) (West 1993).

<sup>46</sup> N. Y. Not-For-Profit Corporation Law § 701 (McKinney 1993).



<sup>47</sup> Revised Model Nonprofit Corporation Act §8.05 (1988).

<sup>48</sup> *Id.*

<sup>49</sup> N. Y. Not-For-Profit Corporation Law § 703(b) (McKinney 1993).

<sup>50</sup> N.J. Stat. Ann. §§15A:6-3, 15A:6-4(a) (*West 1993*).

<sup>51</sup> Revised Model Nonprofit Corporation Act §8.08 (1988).

<sup>52</sup> N. Y. Not-For-Profit Corporation Law § 706 (McKinney 1993).

<sup>53</sup> N.J. Stat. Ann. §15A:6-6 (*West 1993*).

<sup>54</sup> Revised Model Nonprofit Corporation Act §8.12 (1988); N. Y. Not-For-Profit Corporation Law § 715 (McKinney 1993); N.J. Stat. Ann. §§15A:6-8(c) (*West 1993*). Case law provides some guidance in determining the reasonableness of compensation paid to director. In addition to the quantity and quality of services rendered, the financial condition of the organization must be considered. *See, e.g. Baker v. Cohn*, 292 N.Y. 570, 54 N.E.2d 689 (1950).

<sup>55</sup> Louis S. Harrison and Eric L. Marhoun, *Protection for Unpaid Directors and Officers of Illinois Not-for-profits: Fact or Fiction?*, Illinois Bar Journal, April, 1991 at 172.

<sup>56</sup> Revised Model Nonprofit Corporation Act §8.30 (1988).

<sup>57</sup> *Id.* at 8.30 (a)(1).

<sup>58</sup> *Id.* at §8.30(a)(2).

<sup>59</sup> *Developments - Nonprofit Corporations*, 105 Harvard Law Review 1578, 1602 (1992).

<sup>60</sup> *See, Felicity Barringer, United Way Head is Forced Out in a Furor Over His Lavish Style*, N.Y. Times, February 28, 1992 and note 24 *supra*.

<sup>61</sup> N.J. Stat. Ann. §15A:6-14 (*West 1993*).

<sup>62</sup> *Id.* In addition, in the case of many religious, charitable, educational and hospital nonprofits, there is mandated charitable immunity for non-compensated directors, officers and members. N.J. Stat. Ann. §2A:53A-7 (*West 1993*).

<sup>63</sup> N. Y. Not-For-Profit Corporation Law § 717(a) (McKinney 1993).

<sup>64</sup> N. Y. Not-For-Profit Corporation Law § 717(b) (McKinney 1993).

<sup>65</sup> *See, Notes, 56, 57 and 58, supra.*

<sup>66</sup> Revised Model Nonprofit Corporation Act §8.51 (1988).

<sup>67</sup> *Id.* at § 8.52.

<sup>68</sup> *Id.* at § 8.53. This section requires a writing from the director that he or she has met the required standard of conduct and an agreement to reimburse the organization to repay the advance if it is determined that the director did not meet that standard.

<sup>69</sup> *Id.* at § 8.54.

<sup>70</sup> N.J. Stat. Ann. §15A:3-4 (*West 1993*). N.J. Stat. Ann. §15A:2-8 (*West 1993*) dealing with the Certificate of Incorporation of a nonprofit specifies indemnification language which may appear in that document.

<sup>71</sup> N. Y. Not-For-Profit Corporation Law §§ 721-726 (McKinney 1993).