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## *Proprietary Mentality and the New Non-Profit Corporation Laws*

Howard L. Oleck\*

NEW YORK'S NEW "Not-For-Profit Corporation Law"<sup>1</sup> statute is likely to increase the abuse of non-profit status by many persons who pretend to be governed by altruistic motives but who actually are motivated mainly by the desire to enrich themselves.—That is the unpalatable thesis of this paper.

Unhappily, I have seen so much abuse of non-profit and tax-exempt status that I am very suspicious of anything that seems likely to encourage such abuse. If my suspicions are unjustified, nobody will be more gratified than I.

But the new New York statute, that took effect on September 1, 1970, already was being studied as a model for a contemplated new Pennsylvania statute in May of 1970,<sup>2</sup> with action on the final report scheduled for January 1971. Even before the revolutionary new statute had been tested, it was being emulated. And, for example, the Ohio Association of Colleges (numbering some 47 schools) queried me in August 1970 about the effects and probability of emulation of the New York statute in Ohio; and I had to say that it seems probable that the new statute will be widely copied.

I believe that non-profit organization and activity, for mutual-and-public-benefit, is the finest feature of American (or any other) society. While altruism may not be the main force in most men's actions, it is the best part. And today, there is a growing popular demand for a shift in emphasis from profit-making activities to activities that aim mainly at promotion of human welfare. Legislative action that instead may serve to provide "social welfare coloration" to activities that actually are selfish in purpose, ought to be scrutinized most carefully.

Naive as it may seem, I still am disturbed to see lawyers refer quite cold-bloodedly to "the uses of charity" for personal gain.<sup>3</sup> God

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[*Editors' Note:* This paper is a consolidation of two papers delivered by Prof. Oleck recently at a two-day seminar on the new New York Not-for-Profit Corporation Law statute, conducted in New York City by the Practising Law Institute.]

<sup>1</sup> Chapter 35, Consolidated L. of N.Y.; Senate Bill Number 956-A (1969); Assembly Bill Number 1690 (1969); signed into law by Gov. Nelson A. Rockefeller on May 26, 1969, effective Sept. 1, 1970.

<sup>2</sup> Tentative Report of the Sec. of Corp., Banking & Bus. L. of Penna. Bar Assn., on Draft Legislation Revising and Codifying the Law Relating to Corps. Not-For-Profit (Harrisburg, Penna., May 1970) [c/o Wm. P. Hackney, Esq. (committee chairman), P.O. Box 2009, Pittsburgh, Penna., 15230].

<sup>3</sup> See: Moore, Estate Planning Under the Tax Reform Act of 1969: The Uses of Charity, 56 Va. L. Rev. 565 (May 1970).

help us all if self-enrichment is to be clothed *by law* with the robe of *charity*.

I do not doubt the good motives of the men who drafted the New York statute. I do doubt the wisdom of their product. They concentrated on "lawyerlike" technique-and-procedure rules, at the expense of *conceptual* legal architecture, though the foundation of non-profit status law ought to be *morality*, not technique.

The new statute plays right into the hands of the man who views his non-profit organization as *a property* (of his) rather than as a moral obligation willingly assumed. This is a mistake that may have dire consequences for our society.

The main reason offered for the adoption of New York's new non-profit "business" corporation law is said to be that it will enable non-profit organizations to build housing for the poor, etc., by attracting business capital investments for profit. But New Jersey's Limited-Dividend Non-Profit Housing Corporations or Associations Law, for example, accomplishes the same purpose without throwing away centuries of experience of the dangers of inviting abuse of non-profit status.<sup>4</sup> Even the "reason" for the new-morality law is unconvincing.

### Proprietary Mentality

Officers or employees who think that they "own the organization" are found in many business companies. In some cases they are correct; where, for example, the officer is the controlling stockholder in a business corporation. But the same human phenomenon is seen, all too often, in non-profit organizations. And *there*, that kind of *proprietary mentality* is quite improper—even if the organization was founded and funded entirely by "the owner." This is because a non-profit organization is, by definition, one that nobody owns, in that nobody is supposed to get from it any personal profit (in the pecuniary sense) such as *owners* get from their property.<sup>4a</sup>

The *proprietary mentality* is most thoroughly improper and unhealthy in non-profit organizations that have fallen under the domination of *one* or a *very few* domineering officers or employees or members. It is all too common in such organizations, though seldom openly criticized, usually because of fear of defamation suits or of reprisals, by the dominating person or persons, against critics. Such danger of reprisal is a very effective silencer. The ones in the best position to know of improper domination usually are the employees of the organization, and

<sup>4</sup> N.J. Stat. Anno., Tit. 55, c. 16-1 et seq. (1967); and see, *Id.* c. 14 J-1 et seq. (1967); Tit. 40, c. 55 (1953); Tit. 55, c. 14 H (1949). An 8 percent profit is provided for, and if that is not enough it should not pretend to have any charitable aspect.

<sup>4a</sup> See definitions in Oleck, Non-Profit Corporations, Organizations, and Associations, Secs. 1, 2 (2d ed., 1965); Oleck, Non-Profit Types, Uses, and Abuses: 1970, 19 Clev. St. L. Rev. 207, at 211 (May 1970). Control of business organizations by majority stock vote, or by cumulative voting, is approved by statute in most states; see, e.g., Ohio Rev. Code Sec. 1701.55.

they usually cannot afford to risk their jobs by openly stating unpleasant facts about their "employers." Third persons who are aware of improper "ownership attitudes" in various organizations, seldom are able or willing to *prove* such unedifying attitudes.

I make the above, rather bitter and cynical, broad statements on the basis of over thirty years of intensive experience in and with many kinds of non-profit organizations.

Obviously, written records of case decisions of such phenomena are almost non-existent, because employees who have the courage to criticize "the owners" usually soon cease to be employed in the organizations concerned. Nor do they usually bring lawsuits even when unjustly fired or otherwise abused, because an employee or member who attacks or sues a non-profit (especially a charitable) organization for *unkind* or *unfair* treatment is simply wasting time and effort. The "owners" hold the aces in the game, under our system of defamation tort law and of scant or non-existent supervision or inspection by public officers and agencies.<sup>5</sup>

This last, parenthetically, is the key element in abuse of non-profit status. Privilege without scrutiny is fatally tempting to most people.

The history of abuse of the benefits of charitable status is long and disheartening. Today, as in centuries past, the "trustees" (in the generic sense of that term) can and do make the organization pay the expenses of defending their abuses, while the one who questions the abuses usually pays out of his own pocket for his concern about propriety and morality.<sup>6</sup> The history of occasional (and futile) public investigations of abuses of charitable status is long and terribly depressing to everyone except the persons who abuse that status.<sup>7</sup>

Even in the time of Queen Elizabeth the First, of England, the prevalence of abuse of trust in charitable activities was common enough to require legislative action. The preamble to The Statute of Elizabeth I, in 1601, said:

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<sup>5</sup> See, Gray, State Attorney-General, Guardian of Public Charities?!, 14 Clev.-Mar. L. Rev. 236 (1965); Oleck, *op. cit. supra* n. 4, at Secs. 158, 187; Bogert, State Supervision of Charities, 52 Mich. L. Rev. 639 (1954). See, as to a proposed system of self-regulation of foundations only, Oleck article *supra* n. 4, at 19 Clev. St. L. Rev. 207, at 234. "Ownership by management, in most non-profit organizations, is a flat contradiction of the *pro bono publico* idea that is the essence of (proper) group activity not for profit." Oleck, *op. cit. supra*, n. 1, at 313.

<sup>6</sup> See, Lord Eldon's opinion in Corporation of Ludlow v. Greenhouse (1827), 1 Bli. N.S.P.C., 17, 48; and Jones, History of the Law of Charity 1532-1827, at p. 161 (Cambridge Univ. Press, 1969); Chester New, The Life of Henry Brougham 217, 218, 223, 224 (Oxford Univ. Press, 1961).

The public is concerned especially when tax or other benefits are enjoyed by people who abuse tax-free status. See, DiMarco and Kane, Privileges and Immunities of Non-Profit Organizations, 19 Clev. St. L. Rev. 264 (1970).

<sup>7</sup> *E.g.*, Jones, *op. cit. supra*, n. 6 at 167; and see for example the Commission of 1818 (in England) described therein, and the next one in the 1840's, etc., down to the Mills Committee and the resulting (U.S.) Tax Reform Act of 1969 described in Oleck article *supra* n. 4 and in the Symposium in 19 Clev. St. L. Rev. (No. 2) 207-322 (May 1970).

Whereas lands tenements rentes annuities, profittes hereditamentes, goods chattels money and stockes of money, have been heretofore given . . . , some for the reliefe of aged impotent and poore people, some for the maintenance of sicke and maymed souldiers and mariners, schooles of learninge, free schooles and schollers (etc.), . . . which lands tenements (etc.) nevertheless have not byn employed accordinge to the charitable intente of the givers and founders thereof, by reason of fraudes breaches of truste and negligence in those that should pay deliver and imploy the same . . .<sup>8</sup>

The Charities Act of 1960 in England repealed that preamble, but did not change human nature and the tendency of many people to treat trust property as their own.

With this caveat in mind, let us look quickly at the new New York statute and see if it seems suitable in view of the probable attitude of many people towards non-profit status vis-a-vis personal aggrandizement.

### The New New York Statute: General Provisions

First, we must notice the advertised idea that the new statute has revealed a certain mystical differentiation between "non-profit" and "not for profit." The P.L.I. circular announcement of its seminar on the new law emphasized this idea.<sup>9</sup> It said "the distinction between 'non-profit' and 'not for profit' corporations, both as to functions and legal rules governing them, is very real indeed."<sup>10</sup>

In examining the alleged distinction I began by looking at all the nonprofit organization law statutes of all the states. Alabama and Alaska statutes speak only of "non-profit." Arkansas' statute says that non-profit is not for profit; as a synonym, in effect.<sup>11</sup> Arizona and California speak only of "non-profit." Colorado has a "Corporations Not For Profit" Act, which means not for business nor for personal profit.<sup>12</sup> Connecticut is simply a "non-profit corporation law." Then Delaware says "Corporations Not For Profit" and mixes those provisions right in among those of its general business corporation statute.<sup>13</sup> And Florida says "Corporations Not For Profit" means eleemosynary type organizations only.<sup>14</sup>

<sup>8</sup> As to the history of the Act, subsequently, see generally, Jordan, *Philanthropy in England 1480-1660* (1959); and Marshall, *The Charities Act, 1960* (1961) 24 M.L.R. 44, 445-446.

<sup>9</sup> In the summer of 1970, titled "New York Not-For-Profit Corporations" (2 day "course"), at which the speakers were the writer of this paper, Robert S. Leshner of the law firm of Leshner, Howitt & Jenkins of Buffalo, N.Y., Prof. James K. Weeks and Asst. Prof. Jon Bischel of Syracuse Univ. Law School, and Julius Greenfield, the Chief of the Bureau of Charitable Foundations, N.Y. State Attorney-General's Office. Leshner and Greenfield had participated in the drafting of the new statute.

<sup>10</sup> At page 2 of the 6 page P.L.I. circular.

<sup>11</sup> Ark. St. Sec. 64-1902.

<sup>12</sup> Colo. Rev. St. Art. 19 Sec. 31-19-1.

<sup>13</sup> Del. Gen. Corp. L. Art. 8 Sec. 141(e).

<sup>14</sup> Fla. St., Ch. 617.

There is hardly any need to labor the point. The alleged mystical distinction, when examined, turns out to be nothing. There is no distinction, and the two terms are used interchangeably.

Next, we turn to the first sections of the new New York statute,<sup>15</sup> and see which provisions (if any) suggest a possibly erroneous approach to, or misconception of, the true nature of, non-profit organization and operation. Our approach, in my opinion, should be *conceptual* rather than technical.

Section 102(a) (4) speaks of "conducting of activities" as equivalent to "doing of business" as that phrase is used in other statutes. This is customary boilerplate, where careful distinction of business and of non-profit concepts would have been wise.

Section 103(a) excludes education, charitable or religious organizations; but then Section 201(b) permits application to (Type B) charitable, educational, *etcetera* corporations. This is confusing, and raises doubts.

Section 104(d) (5) speaks of signatures (for incorporation, amendment, etc.) "by a capital contributor not a member . . . (etc.) or his successor in interest." This makes investor (dividend-business-type-operation) an inherent and controlling feature of ostensibly non-profit organizations. This is repugnant to the basic idea of public-service or public-welfare organization.

Section 110 contains a boilerplate kind of severability provision, to save what remains if (and when) a part of the statute be declared void. This provision may well be necessary. At a seminar at Ann Arbor recently, in speaking of the new New York statute, a former Internal Revenue Service expert was queried about a possible collision between the statute and the Tax Reform Act of 1969. He expressed the belief that the I.R.S. would take a dim view of the New York statute.

Section 113(b) says that all existing non-profit corporations must file a certificate stating their class type (A, B, C, or D) under the New York statute, and those *not* complying by September 1, 1973, "shall be considered a Type B (charitable) Corporation until it has complied. . . ." Then the Revisers' Notes say that this is meant to give "the supreme court and the attorney-general (power) to regulate its activities." But it gives charitable status to those who disobey the requirement. What was proposed to be a control may well become a shield for abuses.

Section 201 is the main new-idea provision, establishing four types (A, B, C, and D) of non-profit corporation purposes, including types C and D as *business* corporations. This looks like abandonment of the concept of altruism as the underlying principle that justifies non-profit status privileges. This section is ironically emphasized in the New York Consolidated Laws Service volume by annotation with many

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<sup>15</sup> See, *supra* n. 1.

case decisions *forbidding* business purposes in a non-profit organization. The whole statute revolves around this section's definitions; and it throws out the wisdom accumulated in centuries of experience in exchange for a most doubtful encouragement to "invest" for dividends in money to be acquired in altruistic activities. I do not doubt that the altruism soon will be mere lip service, and personal profit the real motive (and almost sole motive), in many "Not-For-Profit" corporations organized under this statute. And the beauty of it will be that this motivation will be practically impossible to prove.

Section 202(7) and (8) is another revolutionary innovation. It permits "capital contributions or subventions . . ." by or to non-profit organizations. It means that one may "invest" an endowment for charitable objectives, *and then take back the endowment when desired*. This is a shocking idea, to me. It may intend to afford capital for desirable public construction or the like; but it is almost certain to be used as a device for self-enrichment primarily. More, it will encourage pyramiding and holding company control of operational companies by management (financier) companies (people), worse than the kind sought to be controlled by the Holding Company Act of the 1930's.

Section 202(12) permits directors to compensate themselves and each other for merely being trustees (directors) even in charities, and to indemnify . . . etc. This is a kind of encouragement hardly needed by most humans. They surely will value themselves high. In good morality, trustees should serve *pro bono publico*, not for fees, in public service organizations, and especially in charities.

Section 202(16) (b) allows big (over 20 million dollar) holdings, and allows many far bigger concentrations. Yet, the "capitalization" will not be easy to ascertain, by interested persons. This encourages "giantism" in an area where it hardly is desirable.

Section 202(d) permits corporations that are to hold park, educational, etc. "meetings" to appoint their own special policemen with the powers of town constables, by mere filing of an oath with the county clerk. This invites establishment of private armies ("police forces"), a power too dangerous to be so casually granted to all takers. And Section 202(12) permits directors to pay themselves just for being directors, even in charities. This verges on the indecent.

At this point the number of "trouble spots" in the New York statute began to be so serious, right at the beginning of the lengthy statute, that I stopped my section-by-section survey. I shall mention only a few more points in it, before turning to the dangerous tendency in human beings that may be the catalyst that makes this statute explosive in the area of non-profit organization and operation.

Section 404(a) eliminates from New York's statute one of its best features respecting non-profit organization law—the requirement of

scrutiny by a judge, of incorporation documents, etc. For some types of corporations this requirement at least *tended* to restrain cynical misuse of the non-profit form. The last thing that the non-profit field should be given is *reduction* of supervision by public authorities. Many people are suggesting that what is needed is a kind of S.E.C. to keep non-profit operations honest, not reduction of supervision.

Section 907 also eliminates judicial supervision (for Class A corporations) of mergers; and Section 1002(d) of dissolution—more *reductions* of supervision, instead of sorely necessary *increases* of supervision by public authorities.

Section 203 eliminates *ultra vires* remedies except for certain limited situations. This is business-type-corporation law. It encourages deviousness that is the very antithesis of the morality that should permeate non-profit organization law.

Section 401 permits one man incorporation—the very opposite of the idea of joint efforts of several (or many) people for the general welfare. If this is not a cynical, it is a defeatist approach to law making.

Sections 504, 505 are the provisions that authorize *subventions*—capital contributions that later may be taken back. Surely this is the most outrageous legislative enactment of the century. The idea of granting authority to obtain charitable gift status and then be free to take back the “charity” is breathtaking. Comment is futile, for such law.

Section 601 et seq. copy such business corporation devices as voting agreements (i.e., control agreements). This is a denial of the essence of altruistic cooperation, and authorizes approvals by “votes cast” at a meeting, etc. Here again is serious encouragement of the proprietary mentality and of *use* of charitable status for selfish purposes, by activists rather than by majority rule. The results of this may be disastrous to the social need for cooperative work for honest public purposes. Democracy may fail because so many people give lip service only. A fine example of the result of the “votes cast” rule is the recent experience of the American Bar Association Section of Legal Education: There, for several years in a row, a small group of activists “packed” the meetings, defeated committee proposals for improved standards of legal education, and finally defeated an attempt to change the rules to prevent packing of meetings.<sup>16</sup> Only a few members usually attend the meetings, though only those present may vote.

Section 723(b) permits indemnification and insurance as to directors and officers who are *convicted* or who plead *nolo contendere* for wrongdoing; and no presumption of bad faith may be read even from criminal conviction. This is madness, it seems to me. I would call this *pirates*'

<sup>16</sup> This last was in August 1970 at St. Louis. For details ask the Chairmen of the Section (of 1965 to 1970).



law. It is close kin to the recently adopted New York Business Corporation Law Section 727, which permits indemnification of cost of defense even when final adjudication establishes active and deliberate dishonesty.

At this point I must stop. The statute calls to mind a saying of one of my daughters, much used by her when she was very young and disliked something fed to her: "Daddy, I fink I going to fwow up."

### What Is Properly Proprietary?

Not all "proprietary" attitudes are improper. Nor is the terminology of non-profit law and practice at all clear or precise on this point. Even so-non-profit-sounding a term as "a private club" does not necessarily mean one in which a proprietary mentality is improper. Such organizations as *The Stork Club*, *Playboy Club*, or other private business organizations such as "night clubs," properly are proprietary businesses, and can and do use names that sound non-profit but are well known to be businesses. In England particularly, social or drinking clubs, very similar to voluntary associations of members into clubs, often are businesses in fact; but these are species quite distinct from the voluntary members' groups that we usually associate with the word "club."<sup>17</sup> In final analysis, if the "members" actually are customers, the club is a proprietary business even if the patrons are called "members."<sup>18</sup> The relation of the members of the club then is a contractual one, not as between members perhaps, but as between members and the proprietor.<sup>19</sup>

But all this does *not* mean that a founder of a "charitable foundation," even if he contributed all of its assets, is entitled to treat *the foundation* as his property. Though the 1970 "Not-For-Profit-Corporation Law" of New York *does* permit *business* purposes<sup>20</sup> and even (subventions) gifts to charity that may be taken back by the grantor,<sup>21</sup> the adoption of that law does not change the real nature of real non-profit organization and operation.<sup>22</sup> Even if we cannot legislate immorality out of existence, we do not have to legislate it into propriety.

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<sup>17</sup> See, Josling and Alexander, *The Law of Clubs*, 3-4 (Oyez Publications, London, 1964).

<sup>18</sup> *Ibid.*, p. 10.

<sup>19</sup> *Cassel v. Inglis* (1916) 2 Ch. 211, at 221. *Cf.*, as to members clubs, Josling and A., *supra* n. 17 at p. 11, citing cases.

<sup>20</sup> Chap. 35, Consolid. L. of N.Y. (effective Sept. 1, 1970) Sec. 508, Types C and D, expressly provide for business type operation of "non-profit" corporations.

<sup>21</sup> *Ibid.* Secs. 501-521.

<sup>22</sup> See, Oleck, *Non-Profit Types, Uses and Abuses: 1970*, in 19 *Clev. St. L. Rev.* 207, 231 (May 1970); but, *cf.*, Weeks, *The Not-For-Profit Business Corporation*, in 19 *Clev. St. L. Rev.* 303 (May 1970). And see generally, Kutner, *Legal Aspects of Charitable Trusts & Foundations (A Guide for Philanthropoids)* esp. ch. V-c (Fiduciary Duty of Trustees) pp. 197 et seq. (1970).

### Another Attack on Altruism

Another shock was sustained by American non-profit schools and colleges in 1969 (and by many other non-profit organizations) when a Federal District Court ruled that open proprietary operation does *not* justify disaccreditation of a school<sup>23</sup>—this, in flat contradiction of the standards for most college and law school accreditation, for example. This was a return to the dark ages, in the view of most educators. Court support and *legitimization* of proprietary conduct in, let alone open ownership of, “non-profit organizations with charitable functions,” is a dreadful misdirection of law.

Under the rules of the American Bar Association, for example, proprietary conduct of officers of a law school is a ground for disaccreditation. Its Standards state that a law school “shall not be operated as a commercial enterprise . . .”<sup>24</sup> Yet, the Federal District Court in the case of *Marjorie Webster Junior College v. Middle States Association of Colleges and Secondary Schools*<sup>25</sup> had held that refusal of accreditation on the ground that a college is *not* non-profit is improper. On appeal, the Circuit Court of Appeals, District of Columbia, reversed.<sup>26</sup> The American Bar Association and the Association of American Law Schools had filed a joint brief *Amicus Curiae* in the appeal of that case, urging that non-profit status be a “must” for higher education school accreditation.

The Appeals Court said that if operators of colleges may make commercial profits therefrom, standards other than academic and educational benefit to students are likely to become dominant. Business-type operations are not governed by the same considerations as those in non-profit organizations.

In this case, Bazelon, C.J., said: “The increasing importance of private associations in the affairs of individuals and organizations has led to a substantial expansion of judicial control over non-profit associations. *The extent of this judicial power must be related to the necessity for intervention.*” (Emphasis supplied.)<sup>27</sup>

The 1969 tendencies in non-profit organization law make one almost despair of American law-morality. If charity-flavored self-enrichment is legislated, we may as well stop all pretense that altruism is anything but a myth.

<sup>23</sup> *Marjorie Webster Junior College v. Middle States Association of Colleges and Secondary Schools, Inc.*, 302 F. Supp. 459 (D.C., D.C., 1969).

<sup>24</sup> Standards of the A.B.A. for Legal Education, Sec. (1)(e) (as of Nov. 1, 1969) [pamphlet published by Section of Legal Education and Admissions to the Bar, of the A.B.A.].

<sup>25</sup> *Supra*, n. 23.

<sup>26</sup> \_\_\_ F.2d \_\_\_ (C.A., D.C., June 30, 1970); 39 U.S. Law Week 2021 (July 14, 1970).

<sup>27</sup> *Ibid.*

## Tax Exemption Mushrooms

Meanwhile, proponents of tax exempt status for many charitable organizations are very voluble—arguing that the concept of tax exemption is *not* the equivalent of a public subsidy.<sup>28</sup> To them, as one interested in this field of law [but even more, as a *taxpayer*] I say, “Nuts.” If an organization does not pay taxes, but gets the protections and services for which I pay as a taxpayer, it is being subsidized *by me* and the other taxpayers. I do *not* accept the argument that they all are doing something for which the government otherwise would have to pay. Tax exemptions now are becoming a terrible burden on those who *do* pay taxes.<sup>29</sup> Merely as one example, I mention the city of Cleveland, where now one out of every three dollars of real estate is tax exempt, and since 1965 the taxable real estate has dropped by \$80 million while the tax exempt realty has increased by more than \$82 million.<sup>30</sup> And the story is worse in other places.

Even the United States Supreme Court is bemused (to use a politer term than “intimidated”) by the power of tax exempt churches, for example, into such “logic” as the recent *Walz* case decision.<sup>31</sup> In that case the Court said, in effect, that because we so long have not labelled tax exemption of churches as a public subsidy, we therefore *must* continue longer. In the field of tax exempt church organizations, the proprietary mentality thus is encouraged to build ever-more-lofty castles. This may not offend the First Amendment to the Constitution (at least so said most of the Supreme Court Justices), but it offends common sense, not to mention one’s sense of elementary justice. The Court triumphantly pointed to the fact that tax exemption has *not yet* led to “an establishment of (any) religion” by the State. But it left unanswered the plaintiffs’ objections that their tax monies were being used to benefit churches to which they do not belong; or, worse yet, compelled non-believers (agnostics, atheists, etc.) to support religious organizations. Thank God (get *that* expression, dear reader), even atheists are free not to believe in God in this country; and I say “Amen” to that.

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<sup>28</sup> See, for example, Bittker, Churches, Taxes, and the Constitution, 78 Yale L.J. 1285 (1969).

<sup>29</sup> See, for some statistics, Oleck article *supra* n. 4, at 228.

<sup>30</sup> Cleveland Plain Dealer, p. AA1 (Aug. 30, 1970).

<sup>31</sup> *Walz v. Tax Commissioner of City of N.Y.*, 90 S. Ct. 1409 (1970), 38 U.S. Law Week 4347 (May 4, 1970), following 90 S. Ct. 149, 259 (1969), following 395 U.S. 957, 89 S. Ct. 2105, and facts in 30 A.D. 2d 778, 292 N.Y.S. 2d 353, 24 N.Y. 2d 30, 298 N.Y.S. 2d 711, 246 N.E. 2d 517.

### Inherent "Ownership" Rights of Members

Ultimate "ownership" of a non-profit organization and of its assets is in the members, in a membership organization. The member's right to vote is his basic means of control. In organizations such as labor unions or professional-accreditation societies, where membership is a necessity in order to earn a living at the trade, the courts often now recognize a *property-right* kind of interest of members.<sup>32</sup> In social groups a property-right in assets is generally recognized.<sup>33</sup> The same is true of trade association type groups.<sup>34</sup> It even has been extended to assets of independent church entities.<sup>35</sup> Yet, this recognition has been grudging and not unanimous; and it often has been denied, particularly to unincorporated associations.<sup>36</sup> Since 1947 there has been widespread acceptance of the idea that members' rights in non-profit organizations are *inherent* natural rights.<sup>37</sup>

Of course, members' rights are limited by the contract of membership, and its usual requirement of submission to bylaws and internal rules.<sup>38</sup> The practical facts of life, about the holding of control by well-known "labor bosses," in flat violation of members' rights sometimes, are well known.<sup>39</sup> And the actualities of racial and other discrimination against members and would-be members of labor unions and other non-profit organizations are well known.<sup>40</sup>

Rights in organizations consisting solely of trustees are treated as if the trustees are members.<sup>41</sup>

<sup>32</sup> *Falcone v. Middlesex County Med. Assn.*, 34 N.J. 582, 170 A. 2d 791, 799 (1961); *DeMille v. American Federation of Radio Artists*, 31 Calif. 2d 139, 187 P. 2d 769 (1947); *Smith v. Kern County Med. Assn.*, 19 Calif. 2d 263, 120 P. 2d 874 (1942); *Pinsker v. Pacific Coast Soc. of Orthodontists*, 83 Calif. Rptr. 623, 460 P. 2d 495 (1969).

<sup>33</sup> *Waugaman v. Skyline Country Club*, 227 Ala. 495, 172 S. 2d 381 (1965).

<sup>34</sup> See, *Oleck, op. cit. supra*, n. 4, at 35, citing *Wallick v. Intnat'l. Union, etc.*, 90 Ohio L. Abs. 584, 36 Ohio Bar (17) 584 (1963), which used the concept of conspiracy in a labor union assault liability case.

<sup>35</sup> *Randolf v. First Baptist Church*, 68 Ohio L. Abs. 100, 120 N.E. 2d 571 (1945).

<sup>36</sup> See, *State ex rel. Givens v. Superior Court of Marion County*, 233 Ind. 235, 117 N.E. 2d 553 (1954); and, *Oleck, op. cit. supra*, n. 4, at chap. 3.

<sup>37</sup> *Berrien v. Politzer*, 83 App. D.C. 23, 165 F. 2d 21 (1947).

<sup>38</sup> *Ginossi v. Samatos*, 3 Ill. App. 2d 514, 123 N.E. 2d 104 (1954); *Oklahoma Assn. of Ins. Agents v. Hudson*, 385 P. 2d 453 (Okla. 1963). And this limitation is permitted by such statutes as 25 Calif. Code, Sec. 9301; Ohio Rev. Code, Sec. 1702.20 (*i.e.*, one vote per member *unless otherwise provided*).

<sup>39</sup> Read your daily newspapers and news journals, wherever you live.

<sup>40</sup> See, *Pasley, Exclusion and Expulsion From Non-Profit Orgns.—The Civil Rights Aspect*, 14 Clev-Mar. L. Rev. 203 (1965). But truly private groups, "not affected with a public interest" may be exclusive if they wish. *Daniel v. Paul*, 395 U.S. 298 (1969). And see, *Pinsker case, supra*, n. 32; *Everett v. Riverside Hose Co. No. 4, Inc.*, 261 F. Supp. 463 (S.D.N.Y. 1966). See, as to power to refuse membership, *Packel, Organization and Operation of Cooperatives, Sec. 19 (ALI-ABA, 1970)*.

<sup>41</sup> Ohio Rev. Code, Secs. 1702.14, 1719.01.

## Officers' Proper Powers

Officers (and this includes trustees, executive secretaries, etc.) of non-profit organizations are in a fiduciary relation (at least) to their organizations and their members. No ownership is reposed in them. Yet, they must use only reasonable judgment and good faith.<sup>42</sup> Their conduct in exceeding the proprieties in the actions of the organization (e.g., *ultra vires* acts), may be questioned, today in most states, only by (1) the State, (2) the corporation itself against an officer, or (3) a member against an officer or other member.<sup>43</sup>

Improper conduct or decisions by trustees may be enjoined by petition of other trustees.<sup>44</sup> But such public collisions of trustees rarely are seen.

Special limitations on trustee powers are found in some states in some types of organizations. Thus, in Ohio, in non-profit educational corporations, trustees are forbidden to receive any compensation or benefit, directly or indirectly, except that they may freely visit the premises of the institution or organization.<sup>45</sup> This rule is honored in the breach as often as in obedience, in many cases.

## Officers and Committees and Control

Committees do much of the most important work of non-profit organizations, far more than in business organizations. The committee fundamentally is an administrative, not an executive, device. It often is a technique for research or supervision, in theory. It is not essentially a repository of executive power—though it often *has* such power. The committee ordinarily is an *assistance* to the executive officers. It is not itself the executive—at least it is not supposed to be.

Nevertheless, actual management or decision of a matter may be entrusted to a committee. In one case<sup>46</sup> not long ago a committee that had autonomy (e.g., a welfare fund or grievance committee for several branches of the organization) was allowed to be sued *as an entity*, under its own name. Delegation of any authority of the trustees, to an *executive committee*, for example, is specifically permitted by statute in many states.<sup>47</sup> Usually statutes permit the bylaws to provide for committees and their authority.<sup>48</sup>

<sup>42</sup> Oleck, *op. cit. supra* n. 4, at Sec. 159.

<sup>43</sup> Ohio Rev. Code, Sec. 1702.12(H). And see, Oleck, *op. cit. supra*, n. 4, at Sec. 54.

<sup>44</sup> Holt v. College of Ost. Physicians & Surg., 61 Calif. 2d 750, 394 P. 2d 932 (1964).

<sup>45</sup> Ohio Rev. Code, Sec. 1713.30.

<sup>46</sup> Marsh v. General Grievance Committee, 1 Ohio St. 2d 165, 205 N.E. 2d 571 (1965).

<sup>47</sup> Ohio Rev. Code Sec. 1702.33.

<sup>48</sup> *Ibid.*, Sec. 1702.11(A) (8). See also, Grange, Corporation Law for Officers & Directors, c. 35 (1940); Prentice-Hall, Directors' & Officers Encyc. Manual, 103 (1955). See also, the statutes of Mass. (Sec. 156.13), N.Y. Not-For-Profit Corp. L. (Sec. 712), Mich. (Sec. 450, 13), Fla. (Sec. 618.12), Calif. Corps. (Sec. 9401).

In general, there is an inherent power, in the board and in officers, to delegate to committees the performance of administrative (ministerial) acts.<sup>49</sup> This means the study of any matter, or even the management of routine matters.<sup>50</sup> Management of the organization's routine affairs *may* be entrusted to a committee, as well as to an officer or agent.<sup>51</sup> There is nothing inherently wrong in this. Even the doing of such important executive acts as the making of contracts or leases may be delegated to a committee.<sup>52</sup> Power to delegate authority ordinarily is not clearly defined in most non-profit corporation statutes, except as to the *executive committee*.<sup>53</sup>

Although the power to delegate *administrative* duties is clear, the power to delegate *discretionary* (executive) duties or powers is not. The board of directors may not freely give away the discretionary power inherent in it.<sup>54</sup> Yet, they too often do just that.

The power to delegate even discretionary authority to some extent is an inherent power of the directors and officers. How far it extends depends on the necessity for the delegation, the nature of the duties involved, and the reasonableness of the delegation.<sup>55</sup> In theory this power is used cautiously.

Certain powers may not be delegated at all. Statutes, the charter, and the bylaws may (and do) confer certain powers expressly (or by implication) on specific officers or on the board.<sup>56</sup> The board of directors, for example, may *not* completely turn over to others the power to exercise the authority of the board. The appointment of even an *executive committee* (see below) must not amount to an abandonment of board powers to that committee.<sup>57</sup> At least that is what the law *says*. What very often happens in actuality is a very different thing.

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<sup>49</sup> See, *Schulte v. Ideal Food Pmts. Co.*, 208 Iowa 767, 226 N.W. 174 (1929).

<sup>50</sup> See, Note, *The Executive Committee in Corporate Organization—Scope of Powers*, 42 Mich. L. Rev. 133 (1943).

<sup>51</sup> See, *Wallace v. International Trade Exhibition, Inc.*, 170 La. 55, 127 S. 362 (1930).

<sup>52</sup> *Holwick v. Walker*, 6 Calif. App. 2d 699, 45 P. 2d 374 (1935).

<sup>53</sup> See below.

<sup>54</sup> *Social Security Board v. Warren*, 142 F. 2d 974 (D.C., 1944). But a grant of powers may be implied as well as express. *Hahnemann Hospital v. Golo Slipper Co.*, 135 Penna. Super. 395, 5 A. 2d 605 (1939).

<sup>55</sup> See, *Dewey v. Natl. Tank Maint. Corp.*, 233 Iowa 58, 8 N.W. 2d 593 (1943).

<sup>56</sup> *Lane v. Bogert*, 116 N.J. Eq. 454, 174 A. 217 (1934); *Farmers' Gin Co. v. Kasch*, 277 S.W. 746 (Tex. Civ. App. 1925).

<sup>57</sup> Note, *The Executive Committee in Corporate Organization—Scope of Powers*, 42 Mich. L. Rev. 133 (1943).

### Continued Responsibility of the Delegating Authority

When the board, or the officers, delegate authority to committees or agents, they continue to be responsible for the proper exercise of this authority.<sup>58</sup> They must maintain a general supervision over the exercise of the powers that they have delegated.<sup>59</sup> If they negligently permit the delegate to abuse the delegated powers, they may be liable for the consequences of that abuse.<sup>60</sup> Cases of such negligence being punished, however, are very rare indeed.

### Appointment of Committees or Executives

Fundamentally, the power to delegate authority to officers or committees springs from the board of trustees. The board often vests this power (the power to appoint committees or agents) in the president. Often the charter or bylaws give express powers of this kind to the president or to other officers. But the power continues to reside in the board. Any such power not expressly placed elsewhere by the charter and bylaws, or by statutes, lies in the board.<sup>61</sup>

The power of the board to delegate authority is most dramatically expressed by the appointment of the *executive committee*. Statutes in many states now expressly recognize this power; but they often require that it be stated in the bylaws.<sup>62</sup> With or without such statutes, the appointment of even such a powerful committee is valid.<sup>63</sup>

Appointment of an *Executive Secretary* or *Executive Director* is common; but such officers are employees primarily, and not policy makers in theory. In practice the Executive Secretary often tends to develop a proprietary attitude towards the organization that employs him.

### Executive Committee Powers

Use of executive committees by non-profit as well as by business organizations now is widespread.<sup>64</sup> Delegation of managerial authority also often is made to officers,<sup>65</sup> or even at times to persons having no

<sup>58</sup> *Martin v. Hardy*, 251 Mich. 413, 232 N.W. 197 (1930).

<sup>59</sup> *Ibid.*

<sup>60</sup> See, *Hoit & Co. v. Detig*, 320 Ill. App. 179, 50 N.E. 2d 602 (1943).

<sup>61</sup> See the foregoing sections.

<sup>62</sup> N.Y. (old) Memb. Corp. L. Sec. 20 (for all non-profit corporations) and Secs. 141, 142 (for YMCA and YWCA state executive committees). This statute has been replaced by the new (1970, Sept.) statute.

<sup>63</sup> *Harris v. Harris*, 137 Misc. 73; 241 N.Y.S. 474 (1930).

<sup>64</sup> See, 2 Oleck, *Modern Corporation Law*, Sec. 958 (1965 supp.); Comment, *Corporate Management by an Executive Committee*, 25 Albany L. R. 93 (1961).

<sup>65</sup> *Hoyt v. Thompson's Exr.*, 19 N.Y. 207 (1859).

affiliation with the organization.<sup>66</sup> In non-profit organizations, delegation of such power may not be given to outsiders; indeed, statutes today often require that the members of the executive committee must be trustees.<sup>67</sup>

The power of the board of directors or trustees to appoint an executive committee is an inherent one.<sup>68</sup> So, generally, is the power to delegate authority to officers and agents as well.<sup>69</sup>

The executive committee is a kind of sub-board of directors, and normally should act as a unified or collective group. Yet, lack of a formal meeting does not invalidate its actions, if the members later agree in writing to a decision reached without a meeting.<sup>70</sup> In general, the executive committee is subject to the same rules that apply to the trustees or directors.<sup>71</sup>

Complete abdication of the board, by transfer of its powers to the executive committee, is improper.<sup>72</sup> Thus, surrender of board powers to a management company for twenty years was held to be against public policy.<sup>73</sup> Yet, a five-year grant of complete authority over editorial policy, to an editor of a newspaper, was held to be valid.<sup>74</sup>

Ordinarily, the charter or bylaws (usually the bylaws) may (and do) set forth the power to appoint an executive committee, and the rules regarding exercise of this power.<sup>75</sup> Some statutes (*e.g.*, California and New York) state that the articles or bylaws *may*, provide for an executive committee.<sup>76</sup> Others (*e.g.*, Minnesota and Ohio) state that directors may appoint an executive committee *unless* the articles or bylaws provide otherwise.<sup>77</sup>

<sup>66</sup> See, *In re Lone Star Shipbuilding Co.*, 6 F. 2d 192 (2d Cir., 1925); *contra*: *Long Park, Inc. v. Trenton-New Brunswick Theatres Co.*, 297 N.Y. 174, 77 N.E. 2d 633; *Noted*, 61 *Harv. L. Rev.* 1251 (1948).

<sup>67</sup> Use of directors from other corporation is improper. 1955 *Op. Attny. Gen.* (N.Y.) *Mar. Ohio Rev. Code*, Sec. 1702.33 requires that executive committee members be trustees.

<sup>68</sup> *McNeil v. Boston Chamber of Commerce*, 154 *Mass.* 277, 28 *N.E.* 245 (1891); *Harris v. Harris*, 137 *Misc.* 73, 241 *N.Y.S.* 474 (1930); and see, *Gordon, Business Leadership in the Large Corporations 46 et passim* (Brookings Institute, 1945).

<sup>69</sup> *Jones v. Williams*, 139 *Mo.* 1, 39 *S.W.* 486, 490 (1897); *San Antonio Joint Stock Land Bank v. Taylor*, 129 *Tex.* 335, 105 *S.W. 2d* 650, 654 (1937).

<sup>70</sup> *Ohio Rev. Code*, Sec. 1702.33(D); *Caldwell v. Mutual Reserve Fund Life Assn.*, 53 *A.D.* 245, 65 *N.Y.S.* 826 (1900).

<sup>71</sup> *Wingate v. Bercut*, 146 *F. 2d* 725 (9th Cir. 1944).

<sup>72</sup> *Lane v. Bogert*, 116 *N.J. Eq.* 454, 174 *A.* 217 (1934).

<sup>73</sup> *Sherman & Ellis, Inc. v. Indiana Mut. Casualty Co.*, 41 *F. 2d* 588 (7th Cir.), *cert. den.*, 282 *U.S.* 893, 51 *S. Ct.* 107, 75 *L. Ed.* 787 (1930).

<sup>74</sup> *Jones v. Williams*, 139 *Mo.* 1, 39 *S.W.* 486 (1897).

<sup>75</sup> See n. 62, above.

<sup>76</sup> *Anno. Calif. Corp. Code*, Sec. 9401; *N.Y. Not For Profit Corp. L.*, Sec. 712 (1970).

<sup>77</sup> *Minn. Stat. Anno. Sec.* 317.20; *Ohio Rev. Code*, Sec. 1702.33.



An executive committee usually is empowered to exercise all of the power of the board of directors at times when the board is not in session. In theory it is supposed to execute the policy of the board in routine affairs during intervals between board meetings. Almost invariably it consists of a number of the directors themselves, or of a combination of directors and officers. It must follow the general directions of the board.<sup>78</sup>

The executive committee may manage routine affairs, but may not lawfully take extraordinary or drastic action, such as liquidating the organization, on its own discretion.<sup>79</sup> Also, it ordinarily may not run corporate affairs for an unduly long period without meetings or decision by the board itself.<sup>80</sup> In fact, the authorization for the appointment of an executive committee (the bylaw, charter provision, or resolution) is invalid if it fails to set reasonable limits on the authority of the committee.<sup>81</sup>

This committee, like all committees, must act by a quorum, and by majority vote, unless other provisions are expressly made.<sup>82</sup> It may not again further delegate its powers—not even to one of its own members.<sup>83</sup>

Calling a meeting of the board of directors suspends the power of the executive committee to act until after the meeting of the board.<sup>84</sup> If an executive committee deals with third persons, the usual rules of express, implied, and apparent authority of agents apply.<sup>85</sup> If, for example, the corporation impliedly ratifies the unauthorized act of the committee, by accepting its benefits, the corporation will be estopped from later denying the committee's authority to do that act.<sup>86</sup>

The committee may validly act only within the limits of its real purpose—interim supervision. Thus, it may not change the officers or their salaries, amend bylaws, or expel or change committee members.<sup>87</sup>

<sup>78</sup> *Wallace v. International Trade Exhibition, Inc.*, 170 La. 55, 127 S. 362 (1930), *Tempel v. Dodge*, 89 Tex. 69; 32 S.W. 514; 33 S.W. 222 (1895); *First Natl. Bk. v. Commercial Trav. Home Assn.*, 108 A.D. 78; 95 N.Y.S. 454; *affd.*, 185 N.Y. 575; 78 N.E. 1103 (1906); Note, *The Executive Committee in Corporate Organization—Scope of Powers*, 42 Mich. L. Rev. 133 (1943).

<sup>79</sup> See n. 61 above; and see, *Fensterer v. Pressure Lighting Co.*, 85 Misc. 621; 149 N.Y.S. 49 (1914); *Lawrence v. Atlantic P. & P. Corp.*, 298 F. 246 (D.C. 1924).

<sup>80</sup> See, *Sherman & Ellis, Inc. v. Indiana Mut. Cas. Co.*, 41 F. 2d 588 (7th Cir. 1930); see above, n. 73, 74.

<sup>81</sup> See, *Ryder v. Bushwick R. Co.*, 134 N.Y. 83; 31 N.E. 251 (1892).

<sup>82</sup> *Marshall v. Industrial Federation of America*, 84 N.Y.S. 866 (1903); *Puerifoy v. Loyal*, 154 S.C. 267; 151 S.E. 579 (1930); but see, above, n. 69.

<sup>83</sup> *Caldwell v. Mutual Reserve Fund L. Assn.*, 53 A.D. 245; 65 N.Y.S. 826 (1900).

<sup>84</sup> See, *Commercial Wood & C. Co. v. Northampton P. C. Co.*, 190 N.Y. 1; 82 N.E. 730 (1907).

<sup>85</sup> See *Oleck*, *op. cit. supra*, n. 4, at c. 22, 23.

<sup>86</sup> See, *Respass v. Rex Spining Co.*, 191 N.C. 809; 133 S.E. 391 (1926).

<sup>87</sup> *Tempel case*, n. 78, above; *Hayes v. Canada, A. & P.S.S. Co., Ltd.*, 181 F. 289 (C.A. 1, 1910).

But if the power to fix salaries, or some other such routine discretionary power, is given to the committee by the board, it may validly exercise such a power.<sup>88</sup>

It should be clear that the functions and powers of an executive committee depend on the charter and bylaw provisions, on statutory limitations that require action by the directors themselves in certain matters, and on the purpose for which the committee was established. Its powers largely are those implied in, or necessary to, the purpose for which it was formed, as declared in the bylaw or resolution for its formation.<sup>89</sup> Attempts of executive committees to usurp control, and to exclude some of the board members from this control, have been called quite possible "dangerous to the democracy of a cooperative" or other non-profit group, and are uniformly condemned.<sup>90</sup> Yet, in practice I have seen such committees ignore the law without hesitation, again and again.

### Examples of Executive Committee Structure

A few current illustrations show how executive committees are (or, are not) used, to serve the *proper* purposes of such devices. All these examples are proper ones, and are from Cleveland organizations, as of summer of 1970, and were obtained by inquiry by a student in a Seminar on Non-profit organizations, run by the writer.

*Insurance Board of Cleveland*: 12 trustees on the Board of Trustees; a 5 member executive committee, one a non-member who serves in an advisory capacity only.

*Cleveland Touchdown Club* (boosters for the *Cleveland Browns Club*, and to encourage interscholastic football): 15 trustees on the Board of Trustees; no provision for an executive committee, and no such committee.

*Cleveland Conference of Laymen* (Catholic religion and education): Charter calls for 9 to 40 trustees; at present there are 16. An executive committee is provided for, with maximum of 15 members.

*Garfield Memorial Church*: 18 member Board of Trustees; no provision for an executive committee, and no such committee.

*Cleveland Chapter, Society for Property and Liability Underwriters*: Has an executive committee of 7 members, all being directors, and 4 of them are respectively the president, vice-president, secretary, and treasurer.

<sup>88</sup> Wallace case, n. 78, above; *Haldeman v. Haldeman*, 176 Ky. 635; 197 S.W. 376, 382 (1916); *San Antonio Joint C.S. Bk. v. Taylor*, 129 Tex. 335; 105 S.W. 2d 650 (1937).

<sup>89</sup> See, *Wingate v. Bercut*, 146 F. 2d 725 (C.A. 9, 1944).

<sup>90</sup> See, *Packel, Organization & Operation of Cooperatives*, 137 (4th ed., 1970); and see *Hayes case*, n. 87, above; *Robinson v. Benbow*, 298 F. 561, 570 (C.C.A. 4, 1924).

*St. Luke's Hospital of Cleveland* (Methodist Church): Maximum of 36 trustees, but actual number each year is set by the annual meeting of members. Executive committee, of trustee members, to be not less than 5 nor more than 12 members. In this kind of (hospital) operation, the need for every-day decisions results in the executive committee being an integral part of the operation of the organization.

### **"Control Agreements" and Executive Committees**

The new New York statute expressly permits control agreements.<sup>91</sup> This will make unnecessary the devious (and improper) methods hitherto employed, such as these:

Attempts by a few members to fasten their personal control onto a non-profit corporation often have revolved about the executive committee. In business corporations, perpetuation of control can be accomplished by stockholders' and pre-incorporators' agreements, voting trusts, and other devices.<sup>92</sup> But in non-profit corporations, the executive committee often is deemed to be the best device. Attempts to control are, of course, contrary to the proper purpose of non-profit organizations in society. Seizure of power is hard to accomplish if any organized resistance is offered.

When the incorporators draft the charter and bylaws to suit themselves and elect themselves to the board of directors and to the executive committee, they can grasp control. But the next elections may oust them. And the members can at any time amend the bylaws or even the charter. Attempts to enforce discriminatory, or control-purpose rules cannot overcome a vigorous defense of members' rights. Also, the very presence of oligarchic rules in the charter or bylaws may defeat their own purpose. Few members may join or long remain in an organization after they discover such rules.

### **Control of Dual Power Groups**

An interesting device for gaining or holding control of charitable corporations (*i.e.*, schools or hospitals) is use of dual power control groups. Thus, a school or hospital often needs no membership, under modern statutes, other than the board of trustees. The board, in such organizations, literally holds the corporation's property in trust for the corporate purposes.

By forming a non-profit corporation with a few members, plus a

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<sup>91</sup> N.Y. Not-For-Profit Corp. L. Secs. 601 et seq. See comment on it, above, in the summary of the N.Y. statute's "sick points."

<sup>92</sup> See, Oleck, *New York Corporations*, Secs. 34, 43, 45, 399, 417 (1961 supp. ed.); 3 Oleck, *Modern Corporation Law*, c. 58 (1965 supp.).

board of trustees most of whom are not members, two power groups are created. They tend to neutralize each other, both often performing their duties perfunctorily. The "managers" provide for granting of control power to themselves as officers, usually placing themselves in the members group. If they are trustees they often are not supposed to get any salaries or compensation.<sup>93</sup>

Often the "managers" have themselves appointed as the *executive committee*, by the trustees, who are grateful for the honor of being appointed as trustees of a public service organization. Trustees too often enjoy their status and avoid actual work, as I well know. I have seen them, more than once, simply resign when asked to do any actual work, or devote any actual time to their duties.

Where statutes require members of the executive committee to be trustees, as many do,<sup>94</sup> the title of *administrative committee*, or the like, is employed. Or, the bylaws simply grant wide powers to the officers (the "managers"). The trustees then are subordinated to the managing members, as the members have final amendment powers. The members are kept content with jobs in administration, salaries, or other favors from the organization's managers. Trustees' and members' meetings are called as seldom as possible, and are perfunctory.

The officers or administrative committee often run such an organization well, in practice. But the evasion of the principle of control of operations by a disinterested board is unhealthy. Probably, in such a device, the members could be deemed to be a *class* of trustees, and thus not entitled to compensation, as noted above, in case of challenge of the managerial group. Such challenges are surprisingly seldom offered.

This device is typical of the "proprietary mentality" in non-profit organizations. A determined board of trustees, of course, can upset such a plan by exercising its statutory powers. So, too, the members can upset it by amending the articles or bylaws. Such seizure of power, of course, may lead to destruction of the organization. Sometimes, individual lethargy or self-interest allows the aggressive managerial group to remain in power indefinitely.

Another major device for control, often used in conjunction with an executive committee instrumentality, is the power to change the articles or bylaws. This usually is provided for in the original incorporation papers or bylaws. The power to change the size or composition of the board of trustees is a crucial one in control of the organization.<sup>95</sup>

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<sup>93</sup> Ohio Rev. Code Sec. 1713.30.

<sup>94</sup> *Ibid.* Sec. 1702.33(A).

<sup>95</sup> See, Taft, *Control of Foundations and Other Non-Profit Organizations*, 18 Clev-Mar. L. Rev. 478 (1969).

## Lawsuits to Discipline Errant Management

Assets contributed to non-profit (and especially, charitable) organizations, must be devoted to the announced purposes of the organization which drew forth the contributions—not to what the managers *sua sponte* decide or prefer.<sup>96</sup> The rules governing charitable trusts are applicable, and there is a duty to follow the declared purposes, and not to divert assets to other uses—and this duty is supposed to be enforced by the attorney-general of the state.<sup>97</sup> The actual lack of supervision and enforcement by attorneys-general is one of the major features of the “utility” of non-profit organizations as devices for personal enrichment (usually tax-free, too).<sup>98</sup> Attorneys-general and their almost studied blindness to blatant abuses, are shocking and persistent phenomena, in this regard, in American society.<sup>99</sup> A hopeful development is the New York addition of a 9-attorney and 7-accountant staff in the Non-Profit section of the Secretary of State’s office. California, too, seems to have improved its facilities.

But the provision that the attorney-general is a “necessary” party in actions concerning charitable trusts ought not to be viewed as exclusive. The attorney-general ought to be viewed as an *additional* party, *not* as the *only one* who can bring action.<sup>100</sup> The requirement that only *he* act for the public has vitiated the adoption in about ten states<sup>101</sup> of the “Uniform Supervision of Trustees for Charitable Purposes Act” of 1954; the Act omits educational, religious and hospital organizations, anyhow.<sup>102</sup>

While the Restatement of Trusts (2d) says that a contributor has no standing to sue, having parted with his property,<sup>103</sup> that is clearly an unsound and unhealthy view, and should not be the law. Such a rule is an open invitation to hypocritical abuse of charitable organization status. Fortunately, the Restatement is not law.

It is well settled that trustees who object (*e.g.*, a minority) may sue to enjoin actions by other trustees that are improper.<sup>104</sup> And a

<sup>96</sup> *St. Joseph’s Hospital v. Bennett*, 281 N.Y. 115, 22 N.E. 2d 305 (1939).

<sup>97</sup> Restatement of Trusts (2d), Sec. 348; Ohio Rev. Code, Secs. 109.23-.99 (1964). In N.Y. and California, reasonably adequate staffing seems to have been added recently.

<sup>98</sup> See, Gray, *State Attorney-General—Guardian of Public Charities?!*, 14 *Clev. Mar. L. Rev.* 236 (1965).

<sup>99</sup> “In sum, the present state of charitable trust enforcement is wholly inadequate.”, Note, *Charitable Trust Enforcement . . .*, 56 *Va. L. Rev.* 716, at 724 (May 1970).

<sup>100</sup> See, Ohio Rev. Code, Secs. 109.23-.99 (1964).

<sup>101</sup> Calif., Ill., Mich., N.Y., Ore., etc.

<sup>102</sup> See, *Handbook of Natl. Conf. of Commrs. on Unif. State Laws* 169-72 (1954).

<sup>103</sup> Restatement of Trusts (2d), Sec. 391 (1959); *Holden Hospital Corp. v. Southern Illinois Hospital Corp.*, 22 Ill. 2d 150, 174 N.E. 2d 793 (1961).

<sup>104</sup> *St. James Church v. Superior Court*, 135 Calif. App. 2d 352, 287 P. 2d 387 (1955); Note, *Capacity of Charitable Corporation to Sue Co-Trustees to Enjoin Breach of Trust*, 16 *Hastings L. J.* 479 (1965); Note, *Trusts: Gifts to Charitable Corporation—Nature of Interest Created—Duties of Trustees*, 26 *So. Calif. L. Rev.* 80 (1952).

recent Ohio decision clearly indicates that others may bring, or join in (as interested parties), actions to prevent boards of trustees (and, certainly, individuals) from misusing their powers.<sup>105</sup> In that case, an action was brought against a controlling group of a hospital administration (and board) by a group of staff and affiliated physicians, and by a medical society, joined by a local social welfare organization, and (when its inaction became noticeable), later, by the office of the attorney-general. The basis of action was the fact that public canvass had raised funds, not very long before, for the building of a major part of the hospital facilities.<sup>106</sup> That hospital was ordered into receivership in the Fall of 1970.<sup>107</sup>

The standing-to-sue of these various "parties" was recognized, in practice; and in June 1970 they had moved to have the hospital put into receivership in order to prevent an announced trustees' (5 to 4) decision to sell the hospital to a business corporation hospital-operation enterprise.<sup>108</sup> Yet, a recent New Jersey case still had held (only a few months earlier) that a taxpayer could not prevent the moving away of a hospital.<sup>109</sup> The blindness of some courts, and their worshipful deference to the *title* of "charitable," is almost incredible for men who are supposed to be worldly wise.

### Some Horrible Examples

After more than a third of a century of law practice, much activity as organizer, counsel, officer, member, researcher and student, etc., of, in, and around, many non-profit organizations, I have come to a very ugly conclusion, namely that:

PROBABLY HALF OF ALL NON-PROFIT ORGANIZATIONS ARE RUN BY INDIVIDUALS OR SMALL GROUPS (VERY OFTEN ALMOST CONSPIRATORIAL IN NATURE) WHO ARE INTERESTED AND ACTIVE SOLELY OR ALMOST SOLELY IN THEIR OWN PROFIT OR ADVANTAGE THEREFROM, WHILE THEY LOUDLY PROCLAIM THEIR ALTRUISM.

If this makes me seem to be a cynic and patently a believer in the inherently animal nature of man—the answer is "Yes, I am—God help me."

<sup>105</sup> *Matthews v. Ingleside Hospital, Inc.*, 254 N.E. 2d 923 (Ohio Com. Pleas Ct., Cuyahoga Co., case No. 873358—1969). And see, Goshien, *Relocation of Publicly Supported Charitable Organization*, 19 *Clev. St. L. Rev.* 316 (1970).

<sup>106</sup> See, *Cleveland Plain Dealer*, p. 1 (Sept. 25, 1965); *Cleveland Press* (editorial) (Oct. 24, 1968).

<sup>107</sup> *Ibid.*, *Plain Dealer* (Sept. 2, 1970); and p. 12 (Oct. 3, 1970).

<sup>108</sup> *Cleveland Plain Dealer*, p. 5C (June 13, 1970).

<sup>109</sup> *City of Paterson v. Paterson General Hospital*, 250 A. 2d 427 (N.J. 1969), *appl. dismiss.* 251 A. 2d 131 (N.J. 1969).

Let me cite a very few, very typical examples from my own experience:

(1) *The Triumvirate*: This was an institution that was run by a trio of officers (the Executive Committee), none of them a trustee, though that state's law said that only trustees could be on such committees. It was "charitable" and thus tax exempt, evinced no interest in filing detailed required reports, and never was "bothered" by any public supervisor in many years of operation. The trustees met once or twice a year for about an hour, heard a brief report by the trio, received a sketchy financial summary, rarely questioned a thing, and let things continue thus, so long that the institution's staff spoke of two of the trio (quite seriously) as "the owners." The management power was reposed, in effect, in the two more willful committee members, who used their power boldly. Ultimately, a threat by the two to ditch the third member of the committee, plus a claim of supreme power by another (new) officer, led to an explosion, a sudden flash of attention by the trustees, introduction of new blood and scrutiny by the board of trustees, and the end of the power of "the owners." The history of this operation would fill a fat book that most people would believe to be a fevered fiction writer's fantasies.

(2) *The Boss*: An accredited law college in a major city was headed by a president who was known to the faculty and staff as "The Boss." He hand picked the trustees from the bench and bar and public offices of the community, himself being a lawyer and a public official and a big wheel in his political party. He was in practical effect a one-man owner and acted as such, while the trustees seemed to rubber stamp the few things on which he asked their attention. They, too, met once a year, for a jovial cocktail hour which included a ten minute sketch "report" on the affairs of the law school. He hired and fired faculty and staff practically at will, moved his law office and partner into a sumptuous suite at the school, kept the records of finances, had magnificent personal offices in the school (which he rarely used, as he also had grand offices in a municipal building), made his law partner a highly paid officer too, rode a chauffeured limousine at school expense, drew salaries for an imaginary staff to do his administrative work, etc. He rarely filed reports with anybody, but had the Attorney-General as one of his board of trustees. He died not long ago, very old, very mean, loaded with riches and honors, and still president and "The Boss." The eulogies of him, in the public press, were lush, when he went to his reward.

(3) *The Medical Society*: A certain few medical-specialty practitioners retained me to set up a Blue-Cross-type-organization which they would head, to obtain for them the benefits of insurance type activity without the investment needed for launching an insurance com-

pany, and without supervision by the State Superintendent of Insurance. I did so (for the hell of it, and a promised later bonus) by making a mix of professional and lay members and a neatly will-o-the-wispworded charter and bylaws. Lay members, for a membership fee, got what amounted to Blue Cross coverage in the specialty involved. The profits seemed to be so sure, and so large, that several pirates moved in at once, trying to take over my clients' gravy. One "blew the whistle," calling in the Attorney-General and Superintendent of Insurance. I had warned that a court fight would be certain, but when it loomed so soon, the gentlemen refused to chip in for a reasonable fee. So I agreed to consent dissolution of the new corporation.

(4) *The Trade Association*: One member of a certain trade association retained me, while he was chief officer, to revise the association's articles and bylaws in such a way as to perpetuate domination by this member and the group that he spoke for. I set it up for him, and apparently he still runs the association as he sees fit. (Call me any names that you deem appropriate; as, if I had refused to do what he wanted to try to do, some other lawyer undoubtedly would have done the job for him).

(5) *The Animal Lovers*: A certain "Home For Animals" is operated by certain people, with branches in several cities in several states. They specialize in giving and finding homes for animals whose owners cannot keep them, and who may pay a fee in order to make sure that the animals are well cared for and placed in good homes. But the operators take practically all of the animals and sell them. Their operation has the appearance of a tax exempt society, though it is not tax exempt. I presently am helping a certain national society to try to end this lucrative operation.

(6) *The Improver of The Breed*: A man called me recently to guide him in an enterprise which he had acquired. It was a non-profit organization dedicated to improving the breed of, and further popularizing, a certain species of animal. To his astonishment, his operation had been picked up by the Internal Revenue Service in one of its rare, "scattergun" spot checks. It turned out that, in about 50 years of operation, and of collecting contributions, fees, etc., it never had been incorporated, never had obtained tax exemption, and never had filed properly. But it had been acting as a tax-exempt charitable corporation for half a century. The trouble really is not hard to cure, *nunc pro tunc*, by filing articles of incorporation, tax exemption application, etc. Really; no sweat.

(7, etc.) I could go on and on. The foregoing examples are no more horrible than many more that I could mention.



## Conclusion

The New York statute probably will lead to an open season on abuse of the status and privileges of "non-profit" operation; which already are being badly abused by many people.

Man is a pretty contradictory animal in his non-profit organization activities as in his other activities. Some men devote their lives to altruistic works, but most devote their lives to personal advantage and enrichment, too often under the cloak of alleged charity and with the benefits of non-profit status. Use of non-profit status for personal advantage now is becoming almost the majority rule, rather than the rare and exceptional case.

In all too many cases the various attorneys-general and legislatures of the various states don't seem to care.

It is all very sad and disheartening—so depressing that one wonders what really can be done about it.

Perhaps the thing to do is to hum the popular song titled "Is That All There Is?", and then to follow its advice—to break out the booze, etcetera.

It reminds me of an expression used by youngsters today, when queried as to what they will do about problems that seem to be insoluble.

Their answer is poignant:

"Cry a lot."