

12-15-1979

## New California Nonprofit Corporation Law: A Unique Approach

William T. Fryer III

David R. Haglund

Follow this and additional works at: <http://digitalcommons.pepperdine.edu/plr>

 Part of the [Corporation and Enterprise Law Commons](#)

---

### Recommended Citation

William T. Fryer III and David R. Haglund *New California Nonprofit Corporation Law: A Unique Approach*, 7 Pepp. L. Rev. 1 (1980)  
Available at: <http://digitalcommons.pepperdine.edu/plr/vol7/iss1/1>

This Article is brought to you for free and open access by the School of Law at Pepperdine Digital Commons. It has been accepted for inclusion in Pepperdine Law Review by an authorized administrator of Pepperdine Digital Commons. For more information, please contact [Kevin.Miller3@pepperdine.edu](mailto:Kevin.Miller3@pepperdine.edu).

# New California Nonprofit Corporation Law: A Unique Approach

WILLIAM T. FRYER, III\*  
DAVID R. HAGLUND\*\*

*The California statutory law relating to nonprofit corporations has undergone a major revision. The new act, effective January 1, 1980, divides nonprofit corporations into three distinct areas according to function: public benefit, mutual benefit and religious corporations. Each of the forms are variously regulated to different degrees. This approach contrasts with the former nonprofit corporations act which regulated all three forms under a single set of statutory provisions. The authors provide a thorough overview of the new act and a detailed analysis of specific issues expected to generate controversy.*

## I. INTRODUCTION

In 1978 California enacted a new Nonprofit Corporation Law to take effect on January 1, 1980.<sup>1</sup> The nonprofit corporation and the association are two alternative nonprofit organizational forms.<sup>2</sup>

---

\* B.S. Lafayette College, 1955; J.D. with Honors, George Washington University, 1960; Member of Maryland, Ohio, South Dakota and Texas Bars; Professor of Law, University of South Dakota; Visiting Professor of Law, Pepperdine University, 1978-79.

\*\* B.S. Oregon State University, 1974; M.B.A. University of Washington, 1977; Third year student, Pepperdine University School of Law.

1. CAL. CORP. CODE §§5002-10083 (West Supp. 1979).

2. In general, an association is similar to a nonprofit corporation except it is not incorporated. See H. OLECK, NON-PROFIT CORPORATIONS, ORGANIZATIONS AND ASSOCIATIONS §§ 31-44A (3rd ed. 1974) [hereinafter cited as OLECK]; Oleck, *Non-profit Unincorporated Associations*, 21 CLEV. STATE L. REV., 44 (1972); Oleck, *Na-*

The preferred form is the corporation, primarily due to the limited liability afforded its members<sup>3</sup> and because a workable operating structure that is set forth in the statute.<sup>4</sup>

The new Nonprofit Corporation Law will have a significant impact on nonprofit corporations. It will affect, either directly or indirectly, professional organizations, statewide foundations and community charities.<sup>5</sup> The new Nonprofit Corporation Law changed the former law<sup>6</sup> in a variety of respects. Although many of these changes are positive, some appear unclear or unwise. Any statutory revision as extensive as California's Nonprofit Corporation Law, requires an exhaustive and critical analysis. This article will subject key areas of the new statute to such an analysis. Where appropriate, specific improvements will be suggested.

## II. HISTORICAL PERSPECTIVE

The new Nonprofit Corporation Law's impact is best understood when viewed in historical perspective. Most states have long struggled with the problem of disjointed collections of statutes relating to charities, service organizations, and a penumbra of entities broadly known as nonprofit corporations.<sup>7</sup> California adopted a General Nonprofit Corporation Law in 1947 and structured it to include provisions uniquely applicable to nonprofit corporations while relying on the existing General Corporation Law,<sup>8</sup> for sup-

---

*ture of American Non-Profit Organizations*, 17 N.Y. L.J. 1066 (1972); Oleck, *Non-Profit Types, Uses, and Abuses*, 19 CLEV. ST. L. REV. 207, 216 (1970); *Development in the Law, Judicial Control of Actions of Private Associations*, 76 HARV. L. REV. 983 (1963).

3. CAL. CORP. CODE §§ 5350, 7350, 9350 (West Supp. 1979). For a general discussion of the limited liability of a stockholder, see H. HENN, *HANDBOOK OF THE LAW OF CORPORATIONS* § 73 (1961). See also Garfinkle, *Liability of Members and Officers of Nonprofit Unincorporated Associations for Contracts and Torts*, 42 CALIF. L. REV. 812 (1954) and Note, *Torts: Charitable Institutions: Liability for Negligence of Agents*, 39 CALIF. L. REV. 455 (1951).

4. CAL. CORP. CODE §§ 5210-5238, 7210-7238, 9210-9240 (West Supp. 1979) gives the structure for the board of directors and officers. The sections provide a detailed and established format for the corporation to follow. See generally Jackson, *Non-Profit Homeowners' Associations: Should They Incorporate?* 49 L.A. B. BULL. 509 (1974) and A. CARROL & I. ROSENBLATT, *CALIFORNIA NONPROFIT CORPORATIONS* (1969).

5. "Perhaps half of the organizations in the United States are nonprofit in nature today, and the proportion as compared with profit-oriented organizations is growing rapidly." OLECK, *supra* note 2, at 1. "[T]he power, wealth, and numbers of non-profit organizations in the United States, and their impact on our society, are known, and understood by very few Americans (including very few lawyers)." Oleck, *Non-Profit Types, Uses, and Abuses*, 19 CLEV. ST. L. REV. 207 (1970).

6. CAL. CORP. CODE §§ 9000-10703 (West 1977).

7. See Haller, *The Model Non-Profit Corporation Act*, 9 BAYLOR L. REV. 309 (1957) which provides an excellent historical sketch of the early development of nonprofit organizations.

8. The former General Corporation Law was repealed effective Jan. 1, 1977

plemental provisions.<sup>9</sup> This approach tied the General Nonprofit Corporation Law to the General Corporation Law as to changes in the shared provisions. The General Nonprofit Law was left without statutory treatment in the absence of an applicable provision from the General Corporation Law.

While the previous General Nonprofit Corporation Law allowed many types of nonprofit organizations to be formed,<sup>10</sup> few of the specific types of nonprofit corporations were affected.<sup>11</sup> In effect,

---

and replaced by the new General Corporation Law. (CAL. CORP. CODE §§ 100-2319 (West 1977)).

The text to the former General Corporation Law is contained in the appendix of CAL. CORP. CODE (West 1977).

9. CAL. CORP. CODE §§ 9000-9802 (West 1977).

10. CAL. CORP. CODE § 9200 (West 1977).

11. CAL. CORP. CODE §§ 12000-12006 (West 1977) allowed for the formation of Chambers of Commerce, etc. These sections are repealed effective Jan. 1, 1980. CAL. CORP. CODE § 1200 (West Supp. 1979) provides for the incorporation of this type of corporation under the General Corporation Code, CAL. CORP. CODE §§ 100-2319 if the corporation has stock. If the corporation is organized without stock, it comes under the Nonprofit Mutual Benefit Corporation Law, CAL. CORP. CODE §§ 7710-8910 (West Supp. 1979).

Cooperative corporations are covered by CAL. CORP. CODE §§ 12000-12956 (West 1977 and Supp. 1979). Cooperative corporation law has not been effected by the new Nonprofit Corporation Laws. It did and still does incorporate the former General Nonprofit Corporation Law, CAL. CORP. CODE §§ 9000-9802 (West 1977).

Corporations formed for purposes relating to fish marketing under CAL. CORP. CODE §§ 13200-13356 (West 1977), have not been affected by the new laws. Nor has California Job Creation Corporation Law, CAL. CORP. CODE §§ 14000-4271 (West Supp. 1979) been affected. Both the Fish Marketing Act and the California Job Creation Law allow for the formation of nonprofit corporations but are independent and unattached to other statutes.

Corporations Sole, CAL. CORP. CODE §§ 10000-10015 (West 1977), is a religious corporation which can only be formed by a church official and remains unaffected. Corporations for charitable or eleemosynary purposes could be formed under CAL. CORP. CODE §§ 10200-10207 (West 1977). The statute has been repealed effective Jan. 1, 1980. Corporations existing on Dec. 31, 1979, which had been formed under the statute are deemed to be nonprofit public benefit corporations and subject to the provisions of CAL. CORP. CODE §§ 5110-6910 (West Supp. 1979). Societies for the prevention of cruelty to children and animals could be incorporated under CAL. CORP. CODE §§ 10400-10406 (West 1977). The statute has been repealed, and effective Jan. 1, 1980 these corporations will be deemed to be nonprofit public benefit corporations subject to CAL. CORP. CODE §§ 5110-6910 (West Supp. 1979) except for the additional requirement of twenty or more incorporators who are citizens and residents of California. CAL. CORP. CODE § 10400 (West Supp. 1979).

Port and terminal protection and development corporations could be formed under CAL. CORP. CODE §§ 10700-10703 (West Supp. 1979). This statute incorporated the former General Nonprofit Corporation Law, CAL. CORP. CODE §§ 9000-9802 (West 1977). This latter statute incorporates the Nonprofit Mutual Benefit Corporation Law, CAL. CORP. CODE §§ 7110-8910 (West Supp. 1979).

an attorney could, in many situations, select which statute to use,<sup>12</sup> particularly in the case of charitable nonprofit corporations.<sup>13</sup> After enactment of the General Nonprofit Corporation Law, the Model Non-Profit Corporation Act<sup>14</sup> was published, bringing the various types of nonprofit corporations within a single statute. Additionally, the drafters of the Model Act presented alternative provisions for legislatures to choose from, due to the conflicting viewpoints of the drafters.<sup>15</sup>

In addition to the single statute for all nonprofit corporations, the Model Non-Profit Corporation Act used the same fundamental approach paralling the Model Business Corporation Act.<sup>16</sup> The Model Non-Profit Corporation Act often uses the exact text of corresponding sections from the Model Business Corporation Act in order to benefit from the larger number of court decisions involving business corporations.<sup>17</sup>

When the California legislature considered a new nonprofit corporation law, it had the Model Non-Profit Corporation Act as a resource, as well as a very extensive report and proposed statute prepared by the California Law Revision Commission.<sup>18</sup> The Commission summarized its recommendations:

[T]he Commission recommends the adoption of a complete and self-contained nonprofit corporation law. The new statute should follow the new General Corporation Law to the extent practicable but should be tailored

---

12. A nonprofit medical service corporation could also be formed under CAL. CORP. CODE § 9200 (West 1977) authorizing the formation of such corporation for the purpose of defraying or assuming the loss of professional medical services. *Complete Service Bureau v. San Diego County Medical Soc.*, 43 Cal. 2d 201, 272 P.2d 497 (1954).

13. CAL. CORP. CODE § 10200 (West 1977) allowed for the formation of "a nonprofit corporation for . . . charitable and eleemosynary purposes. . . ." CAL. CORP. CODE § 9200 (West 1977) allowed for the formation of a corporation for any lawful purpose including religious and charitable purposes. The purpose sections clearly overlapped leaving the option to the incorporators.

14. MODEL NON-PROFIT CORPORATION ACT § 4 (1964).

15. MODEL NON-PROFIT CORPORATION ACT § 4 (1964) has an alternative section. The alternative allows the corporation to form for any lawful purpose unless there are restrictions put into the section. MODEL NON-PROFIT CORPORATION ACT § 5(n) (1964) allows indemnification of directors only after court approval. An alternative to this section allows indemnification without court approval.

16. MODEL BUSINESS CORPORATION ACT ANNOTATED (1971).

17. "The Model Non-Profit Corporation Act in the form of the 1964 Edition follows as closely as permitted by the difference in subject matter the corresponding provisions of the Model Business Corporation Act as supplemented and modified by the 1964 addendum." Preface to MODEL NON-PROFIT CORPORATION ACT vii-viii (1964).

18. CALIFORNIA LAW REVISION COMMISSION, NONPROFIT CORPORATION LAW (Nov. 1976). The commission published a report [hereinafter cited as COMMISSION REPORT] and within the reports proposed statutes [hereinafter cited as COMMISSION PROPOSED STATUTE].

to the particular needs and practices of nonprofit corporations.<sup>19</sup>

The Commission found the existing California nonprofit corporation law was scattered through many statutes.<sup>20</sup> It recommended a single law founded on the Commission's proposed statute which, they asserted, would allow the nonprofit corporation law to develop on its own.<sup>21</sup> The Commission also chose to follow the basic organization of the new California General Corporation Law<sup>22</sup> which became effective January 1, 1977. The Commission selectively copied provisions from the new General Corporation Law into their proposed statute, eliminating any direct dependence on the General Corporation Law. However, a substantial relationship remained in certain situations.<sup>23</sup>

Another feature of the Model Non-Profit Corporation Act was the establishment of numerous operating norms. An example of this approach would be the setting, by statute, of the percentage of outstanding votes needed to amend the corporation articles at a member meeting. A nonprofit corporation may have a simple set of articles and bylaws which contain no provision for the percentage of votes necessary for amending the articles. In the absence of such a specific article or bylaw, the Model Non-Profit Corporation Act sets as a minimum, a vote of two-thirds of the members and proxy votes present at such a meeting.<sup>24</sup> This statutory norm sets a standard. In some cases the norm is a minimum standard, below which the corporation articles and bylaws cannot go, as with the article amendment vote.<sup>25</sup> In other instances the act gives the corporation complete freedom to select the operating procedure and is operative only in the absence of an article and bylaw provision on point.<sup>26</sup> The Commission's pro-

19. COMMISSION REPORT, *supra* note 18 at 2224.

The commission's philosophy for the proposed law was to keep unchanged existing nonprofit corporation law unless there is a demonstrated need to parallel the General Corporation Law, and to provide flexibility and extensive regulation only where it is needed. *Id.* at 2227-28.

20. COMMISSION REPORT, *supra* note 18, at 2224. See notes 10-13 *supra*.

21. The COMMISSION PROPOSED STATUTE, *supra* note 18 is located in the COMMISSION REPORT, *supra* note 18, at 2305. The draftsmen of the COMMISSION REPORT made comments following many of the sections of the proposed statute. The comments are helpful in determining the Commission's intent.

22. COMMISSION REPORT, *supra* note 18, at 2227.

23. See notes 19 and 22, *supra*.

24. MODEL NON-PROFIT CORPORATION ACT, § 93 (1964).

25. MODEL NON-PROFIT CORPORATION ACT, § 34 (1964).

26. See note 24, *supra*. CAL. CORP. CODE § 5034 (West Supp. 1977) approval of a vote of the members to require at least a majority. The articles can provide for a

posed statute increased the use of such norms, adding additional certainty to the law.<sup>27</sup>

The Commission and the legislature had, as examples, several fairly recent nonprofit corporation statutes from other states.<sup>28</sup> Most of the states suffered from a multiplicity of nonprofit corporation statutes as had the former California Nonprofit Corporation Law.<sup>29</sup> These multiple statutes resulted from attempts to meet the special needs of particular organizations.<sup>30</sup> In particular, the charitable and religious concerns, with their widespread political support, were able to have specific acts passed designed to their specialized needs.<sup>31</sup> Social organization statutes governing fraternal and large trade associations also multiplied rapidly.<sup>32</sup>

One group of states had a single statute for business and nonprofit corporations with a few provisions specifically applicable to the nonprofit type.<sup>33</sup> This group had the advantage of statutory uniformity and completeness. The remainder of the states separated the business and nonprofit statutes, although reference in the nonprofit corporation statute to the business corporation statute was very common.<sup>34</sup> The multiple, overlapping statutes created a maze that perplexed even the most skillful business

---

greater proportion of the votes of the members. The norm was set at fifty percent and if the members so desired they could raise it. The point is that the norm is set and will rule even if the members had not thought of it before. Uniformity is increased and uncertainty decreased. CAL. CORP. CODE §§ 5810-5820, 7810-7820, 9620 (West Supp. 1979) provides for the amendment of the articles.

27. "In the absence of an applicable provision in the articles or bylaws, the nonprofit corporation law should provide rules to cover the most commonly occurring internal situations" COMMISSION REPORT, *supra* note 18, at 2229. The MODEL NON-PROFIT CORPORATION ACT (1964) also makes frequent use of norms.

28. See N.Y. NOT-FOR-PROFIT CORP. LAW §§ 101-1411 (McKinney 1970 Supp. 1978-1979) and PA. STAT. ANN. tit. 15 §§ 7101-8145 (Purdon Supp. 1979-1980).

29. See note 11, *supra*.

30. Nevada's statutory law is a good example of the multiplicity of statutes for specific purposes. See NEV. REV. STAT. §§ 81.010-.340 (1973) (nonprofit corporations for educational, religious, scientific, charitable and eleemosynary activities); NEV. REV. STAT. §§ 81.350-.400 (1973) (nonprofit corporations for advancement of state and local interests); NEV. REV. STAT. §§ 81.410-.540 (1973) (nonstock, nonprofit cooperative corporations); NEV. REV. STAT. §§ 81.550-.660 (1973) (charitable corporation act); and NEV. REV. STAT. §§ 82.101-.690 (1973) (specific fraternal, churches and other organizations).

31. See E. FISCH, D. FREED, AND E. SCHACTER, CHARITIES AND CHARITABLE FOUNDATIONS § 231 (1974) [hereinafter cited as CHARITIES AND CHARITABLE FOUNDATIONS].

32. OLECK, *supra* note 2, at 5-7, 25-35.

33. An excellent example is HAW. REV. STAT. §§ 416-1 to 154 (1976). HAW. REV. STAT. §§ 416-19 (1976) covers the granting of a charter to a nonprofit corporation. Another example is DEL. CODE ANN. tit. 8 §§ 101-398 (1974).

34. See CHARITIES AND CHARITABLE FOUNDATIONS, *supra* note 31 at 231 n.18. In 1979, Idaho enacted a nonprofit corporation act. IDAHO CODE §§ 30-301 to 332 (Supp. 1979), which references the state's general corporation code. Religious, charitable and social organizations are all regulated under the same statute.

lawyer. The Commission and the legislature, therefore, in examining the alternatives available, opted for a separate, unified nonprofit corporation statute for California, with a minimum of special nonprofit statutes and overlap remaining.<sup>35</sup>

### III. NEW CALIFORNIA NONPROFIT CORPORATION STATUTE— ORGANIZATIONAL FEATURES

The historical background of the various types of nonprofit corporation statutes and the Commission's proposed statute can prove very useful in analyzing the new Nonprofit Corporation Law, because it is a unique combination of several of these approaches. The most important features of the new Nonprofit Corporation Law can be summarized as follows.

1. The single nonprofit corporation statute is divided into four basic parts: Part 1 contains introductory definitions applicable selectively to Parts 2 through 4.<sup>36</sup> Part 2 relates to public benefit corporations,<sup>37</sup> Part 3 to mutual benefit corporations,<sup>38</sup> and Part 4 to religious corporations.<sup>39</sup>

2. Each of Parts 2 through 4 is essentially self-contained, governing the corporate formation, operation, reorganization, and dissolution of each type of nonprofit corporation.

3. Each of Parts 2 through 4 parallel the new General Corporation Law, even to the extent of using the same language.<sup>40</sup>

4. Parts 2 through 4 are uniform on given issues where appropriate, and, in most instances, are easily traced to the corresponding sections of each part.<sup>41</sup>

5. There is a recognizable difference in degree of detailed statutory regulation between Parts 2, 3, and 4. A decreasing continuum running from the more highly controlled public benefit

35. See note 12, *supra*.

36. CAL. CORP. CODE § 5002 (West Supp. 1979).

37. CAL. CORP. CODE § 5110 (West Supp. 1979).

38. CAL. CORP. CODE § 7110 (West Supp. 1979).

39. CAL. CORP. CODE § 9110 (West Supp. 1979).

40. See text following note 45, *infra*.

41. CAL. CORP. CODE §§ 5134, 7134, 9134 (West Supp. 1979) pertaining to the power of the incorporators is a prime example of the internal uniformity. The public benefit corporation section, CAL. CORP. CODE § 5134 (West Supp. 1979), and the mutual benefit corporation section, CAL. CORP. CODE § 7134 (West Supp. 1979) are identical.

"If initial directors have not been named in the articles, the incorporator or incorporators, until the directors are elected, may do whatever is necessary and proper to perfect the organization of the corporation, including the adoption and



corporation to the less controlled mutual benefit corporation, and ending with the minimally regulated religious corporation.<sup>42</sup>

6. Both Part 2, which deals with public benefit corporations, and Part 3, which concerns mutual benefit corporations, contain an extensive number of statutory norms that set the operating mode in the absence of applicable articles or bylaw provisions.<sup>43</sup>

7. The special needs for each type of corporation are included in the appropriate part by tailoring the statute, either by adding another provision following the applicable uniform provision, by modifying the uniform provision or by including a new section.<sup>44</sup> A lawyer researching a point of law will use these features to locate case law that aids in the interpretation of a related provision, or will use the differing parts of the act to distinguish a seemingly pertinent case. This technique will be demonstrated in connection with some of the topics discussed later.<sup>45</sup>

#### A. *Organization Rationale*

Completeness, internal uniformity and parallelism with the new General Corporation Law are strong advantages of the new Non-profit Corporation Law. The question remains, however, why the statute should be expanded if it serves to repeat many of the same provisions in each part? An even more basic question is what prompted the three-part division into public benefit, mutual benefit, and religious corporations? Do the benefits of this arrangement outweigh the obvious problem of adapting to seemingly new terms and coping with the increased number of sections? Time and experience will tell, but some of the strengths and weaknesses of the organization of the statute can be examined now.

The primary advantages of the new organization of the statute are that it affords the maximum benefit of a single statute, where a common approach can be used, and it minimizes the confusion and conflict brought on by the different nature of the three non-

---

amendment of bylaws of the corporation and the election of directors and officers." *Id.*

The religious corporation section, CAL. CORP. CODE § 9134 (West Supp. 1979), is almost identical but leaves out the more detailed instructions.

"If the initial directors have not been named in the articles, the incorporator or incorporators, until the directors are elected, may do whatever is necessary and proper to perfect the organization of the corporation." *Id.* There is a tendency throughout the Nonprofit Corporation Law to be less detailed and specific in the sections dealing with religious corporations.

42. See note 41, *supra* for an example of the less statutory regulation of religious corporations.

43. See text accompanying notes 24-27, *supra*.

44. See note 41, *supra*.

45. See note 135, *infra*.

profit groups by separating them within the statute. Each type of nonprofit corporation within one group must follow the same rules. This approach gives maximum flexibility in fashioning the law within each group. The public benefit section applies to charities.<sup>46</sup> The mutual benefit section applies to social groups.<sup>47</sup> The third section, the religious corporation, applies to the church organization.<sup>48</sup>

The statutory groups, prescribing the forms which a nonprofit corporation may take, are not exclusive. The new Nonprofit Corporation Law clearly allows a mutual benefit corporation<sup>49</sup> or a religious corporation<sup>50</sup> to receive and supervise charitable assets. In the same respect, service clubs with their dual purposes of public service and mutual benefit are not prevented from incorporation under the mutual benefit section. Under the new Nonprofit Corporation Law, the common dual function of a public and mutual benefit purposes requires the lawyer to use a primary purpose test, as a practical matter, to select the statutory group in which to incorporate, even if the statute does not include such a primary purpose test for these groups. In contrast, the religious section leaves no doubt as to the criteria to be used. The religious corporation definition<sup>51</sup> and statement of purpose<sup>52</sup> limit permissible activities to those "primarily or exclusively for religious pur-

---

46. "The commonly accepted definition of charity in a legal sense is that it is a gift to be applied consistently with existing laws for the benefit of an indefinite number of persons, either by bringing their hearts under the influence of education or religion, by relieving their bodies from disease, suffering, or constraint, by assisting them to establish themselves in life, by erecting or maintaining public buildings or works or otherwise lessening the burdens of government, or by making better the condition of the general public or some class of the general, indefinite as to names and numbers. In short, it is a gift for a general public use." 12 CAL. JUR. 3d, *Charities* § 1 (1974).

47. "Any incorporated society, order or supreme lodge, without capital stock, conducted solely for the benefit of its members and their beneficiaries and not for profit, operated on a lodge system with ritualistic form of work, having a representative form of government, and which makes provision for the payment of benefits in accordance with this chapter, is hereby declared to be a fraternal society." CAL. INS. CODE § 10990 (West 1972). The above statute defines fraternal organization for the purposes of insurance regulation but it clearly points out a fraternal society is for the benefit of its members.

48. See generally 42 CAL. JUR. 2d *Religious and Charitable Societies* §§ 1-35 (1958).

49. CAL. CORP. CODE § 7142 (West Supp. 1979).

50. CAL. CORP. CODE § 9142 (West Supp. 1979).

51. CAL. CORP. CODE § 5061 (West Supp. 1979).

52. CAL. CORP. CODE § 9111 (West Supp. 1979).

poses.”<sup>53</sup> The result is to force organizations that are not primarily religious in nature to form in one of the other groups. However, if an organization passes this “primarily religious” test, the presence of charitable assets will not exclude the organization from the religious corporation category.<sup>54</sup>

It is apparent that the line between the purposes of the public benefit and mutual benefit corporations is somewhat hazy, while a sharp line is drawn by the statute for religious corporations. Though more sharply defined by the Act, religious corporations are subject to less regulation than its two counterparts.<sup>55</sup> Because of this separation, the law on the religious corporation will most likely develop with less interaction and confusion than for the other groups of nonprofit corporations.<sup>56</sup>

Perhaps a similar approach should be used to redefine the public benefit group, restricting it to activities primarily for public or charitable purposes. This change would enlarge the public benefit group by forcing some of the primarily public or charitable organizations from the mutual benefit corporation group. As the public benefit corporation regulation is stricter,<sup>57</sup> more of the organizations needing such increased regulation would be reached. By narrowing the boundaries for the public benefit corporation and considering the already narrow boundary for the religious corporation, the mutual benefit corporation group would become a more clearly defined group. This would improve the opportunity for the public benefit section’s law to develop more independently of the other sections. This change might provide a rationale for separation of the groups that is easier to apply.

When comparing the Commission’s proposed statute with the new Nonprofit Corporation Law, there is one primary difference. The Commission recommended a separate, unified statute, closely paralleling the new General Corporation Law, where appropriate,<sup>58</sup> but left the law for each type of nonprofit corporation to develop around the single set of statutory provisions for all nonprofit types. The new Nonprofit Corporation Law utilized the Commission’s fundamental features and went one step further, in setting up three separate, unified statutory nonprofit corporation groups. In principle, it is hard to criticize such thoroughness. What remains to be seen is whether the legislature and the courts

---

53. *Id.*

54. *See* note 50, *supra*.

55. *See* text at notes 110-124, *infra*.

56. *See* note 86, *infra*.

57. *See* text at notes 77-86, *infra*.

58. *See* note 19, *supra*.

can retain the essential qualities of the Act in amendments and decisions.

A comparison of the new Nonprofit Corporation Law with the Model Non-profit Corporation Act reveals that both provide separate and unified statutes paralleling the general corporation law and the Model Business Corporation Act, respectively.<sup>59</sup> The main difference is that the new Nonprofit Corporation Law is divided into separate groups, with complete statutory treatment for each group. The adoption of separate, complete statutory treatment for each group contrasts the approach taken by some states that have repealed their separate statutes to rely on one set of statutory provisions for all nonprofit corporations.<sup>60</sup>

Additional insight into the organization rationale, as well as the strengths and weaknesses of the new Nonprofit Corporation Law can be gained by analyzing specific issues. The following analysis of several topics expands on many of the observations made in the preceding material.

#### IV. NONPROFIT CORPORATION OPERATION OF A PROFIT-MAKING BUSINESS

One of the more difficult nonprofit concepts to understand is the seeming inconsistency of nonprofit corporations being allowed to make a profit.<sup>61</sup> The confusion has been compounded by slippery statutory and editorial terminology that shifts from "not-for-profit",<sup>62</sup> to "nonprofit",<sup>63</sup> to "merely nonprofit",<sup>64</sup> or "profit inci-

59. See text at note 14, *supra*.

60. IND. CODE ANN. §§ 23-7-1.1-1 to 66 (1972 and Supp. 1978) is a perfect example of an instance where both charitable and religious corporation statutes were repealed to be replaced by the MODEL NON-PROFIT CORPORATION ACT (1964) type statute.

61. See Leshner, *The Non-Profit Corporation—A Neglected Stepchild Comes of Age*, 22 BUS. LAW. 951, 957 (1967) and Haller, *Profits for Non-Profits*, 10 BUS. LAW. 17 (1955).

62. The New York and New Jersey statutes use the not-for-profit terminology rather than the term nonprofit. See N.Y. NOT-FOR PROFIT CORPORATION LAW §§ 101-1411 (1970 and Supp. 1978-1979); N.J. STAT. ANN. §§ 15:1-1 to 5 (1939); and Oleck, *Propriety Mentality and the New York Non-Profit Corporation Law*, 20 CLEV. ST. L. REV. 145 (1971).

63. California uses the nonprofit terminology. See CAL. CORP. CODE § 9000 (West 1967) and CAL. CORP. CODE § 5000 (West Supp. 1979). There has been some attempt to draw a distinction between the terms nonprofit and not-for-profit, but Texas has specifically declared the two terms to be equivalent. "'Non-Profit Corporation' is the equivalent of 'not-for-profit corporation' and means a corporation, no part of the income of which is distributable to its members, directors, or of-

dental to the corporation's main nonprofit purpose."<sup>65</sup> The Commission proposed the bold step which the legislature enacted of clearly authorizing profit-making activity if the profit is applied in furtherance of its nonprofit purpose.<sup>66</sup>

The profit dispute seems to have been settled in California under the new Nonprofit Corporation Law.<sup>67</sup> Each nonprofit group has specific statutory authority to make a profit as long as it uses the profit for a proper purpose. This decisive approach is in sharp contrast with the positions taken in parts of the Model Non-Profit Corporation Act.<sup>68</sup> Some members of the Model Act's draftings committee recommended certain profit making activities be restricted.<sup>69</sup>

---

ficers." TEX. CIV. CODE ANN. art. 1396-1.02A.(3) (Vernon 1959). See, OLECK *supra* note 2, at 33-34.

64. Professor Oleck has coined the word "merely non-profit".

"A non-profit corporation is not necessarily a charitable corporation, but a charitable corporation necessarily is a non-profit corporation. The term non-profit, as compared with charitable, becomes clearer if we amplify the word into the term *merely non-profit*. In other words, the word non-profit is a general term, while *charitable* is a specific one. An organization that is merely non-profit is not a charitable organization." See OLECK, *supra* note 2, at 8. Professor Oleck developed the term to make it clear the terms non-profit and charity are not always equivalent.

65. CAL. CORP. CODE § 9200 (West 1977).

66. COMMISSION PROPOSED STATUTE § 5315, *supra* note 18. The COMMISSION PROPOSED STATUTE retained the language "incidental to" from the former General Nonprofit Corporation Law. CAL. CORP. CODE § 9200 (West 1977) added the alternative "infurtherance of". The Commission's language seems clearly broader. See also People *ex rel.* Groman v. Sinai Temple, 20 Cal. App. 3d 614, 99 Cal. Rptr. 603 (1971).

67. CAL. CORP. CODE § 5140(b)(5) (West Supp. 1979) (public benefit corporation); CAL. CORP. CODE § 7140(b)(5) (West Supp. 1979) (mutual benefit corporation); and CAL. CORP. CODE § 9140(b)(5) (West Supp. 1979) (religious corporation). These sections are an example of the internal uniformity that exists within the statute. Note the section numbers are the same except for the first digit.

68. See note 69, *infra*.

69. See Haller, *Profits for Non-Profits*, 10 BUS. LAW. 17 (1955). See note 62, *supra*. The MODEL NON-PROFIT CORPORATION ACT has had three editions, 1952, 1957 and 1964. None of the editions have specifically authorized operation for profit. See MODEL NON-PROFIT CORPORATION ACT § 4 (1952, 1957 and 1964). The MODEL NON-PROFIT CORPORATION ACT § 4 (1957) proposed section reads:

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

The MODEL NON-PROFIT CORPORATION ACT § 4 (1957) alternative section reads:

Corporations may be organized under this Act for any one or more lawful purposes not for pecuniary profit.

In 1964 the MODEL NON-PROFIT CORPORATION § 4 (1964) alternative section was changed to read:

Corporation may be organized under this Act for any lawful purpose or purposes except . . . [list, if any].

Another concern of paramount importance from a planning standpoint is the Internal Revenue Code's treatment of nonprofit corporations that are making a profit, insofar as the granting of a federal tax exemption.<sup>70</sup> The corporate freedom granted under state law may be taken away, as a practical matter, if the federal exemption is denied.

### *Nonprofit Corporation Proper Purpose Test*

The new Nonprofit Corporation Law provides internal uniformity for the public benefit and mutual benefit corporations in the application of the proper purpose test.<sup>71</sup> That test is: "[F]or any

---

The *foreword* to the MODEL NON-PROFIT CORPORATION ACT (1964) at viii stated that a majority of the drafting committee supported the alternative section 4, in that a nonprofit corporation's profit making activities should be limited to incidental income generating functions. The committee reaffirmed the MODEL NON-PROFIT CORPORATION ACT § 4 (1957) alternative position that nonprofit corporations cannot operate primarily for pecuniary profit. Even now the MODEL NON-PROFIT CORPORATION ACT (1964) is not completely clear. Actions speak louder than words and the fact is the MODEL NON-PROFIT CORPORATION ACT (1964) committee, in rewriting alternative section 4, indicates a less strict limitation on profit making activities. The primary test remaining in the MODEL NON-PROFIT CORPORATION ACT (1964) is limited distribution of profit to members. See notes 72-78, *infra*. It is also interesting to note the most recent edition of the MODEL NON-PROFIT CORPORATION ACT (1964) removed all reference to "not-for-profit" and now uses only the "non-profit" terminology. See MODEL NON-PROFIT CORPORATION ACT § 2(a), (b), (c) (1964).

70. It is worth considering in a more detailed analysis, which is beyond the scope of this article, how the new Nonprofit Corporation Law, CAL. CORP. CODE §§ 5111, 7111 (West Supp. 1979) standard on profit making operation compares with the federal standard that determines whether a nonprofit corporation is entitled to a tax exemption under I.R.C. § 501(c)(3). Generally, the Internal Revenue Service has refused to allow an exemption where an alleged nonprofit corporation is operating a business normally operated by a business and there is no public service overriding benefit. See generally B. HOPKINS, THE LAW OF TAX-EXEMPT ORGANIZATIONS (3d ed. 1979). The Internal Revenue standard would more closely follow the standard applied by Haller in this article; Haller, *Profits for Non-Profits*, 10 BUS. LAW. 17 (1955). While the federal tax law does not affect state incorporation of nonprofit corporations, as a practical matter such a federal tax restriction would control the corporation's planning and operation, leaving the situation back in the shape the Model Non-Profit Corporation Act Committee (1964) left it, or close thereto.

71. CAL. CORP. CODE §§ 5060, 5111, 5410 (West Supp. 1979) (public benefit corporation); CAL. CORP. CODE §§ 5059, 7111, 7411 (West Supp. 1979) (mutual benefit corporations). The public benefit corporation purpose is more limited than the mutual benefit corporation purpose, illustrating the more detailed treatment of the former type. The statute limits the public benefit corporation to "any public or charitable purpose," CAL. CORP. CODE § 5111 (West Supp. 1979), while the mutual benefit corporation is allowed to form for any "lawful purpose", CAL. CORP. CODE § 7111 (West Supp. 1979) involving a mutual benefit service, by implication.

lawful purpose which does not contemplate the distribution of gains, profits or dividends to members . . . .”<sup>72</sup> This criteria has been carefully developed in California case law.<sup>73</sup> The absence of a similar limiting purpose provision on profit distribution for a religious corporation is not surprising considering the aforementioned rationale for regulation of the religious corporation.<sup>74</sup>

The restriction on distribution of gains, profits, or dividends to members cannot be absolute. There are usually benefits of being a member of a nonprofit corporation and the profit, if any is used to provide these benefits. This conflict between no distribution to members and the practical benefits members usually receive has been dealt with in the leading case of *People ex rel. Groman v. Sinai Temple*.<sup>75</sup>

In *Groman* the court upheld a cemetery association’s practice of giving a discount on cemetery plots to members while not giving a discount to nonmembers. The court distinguished between “the inurement of benefits and distribution of profits.”<sup>76</sup> The furnishing of benefits to members is not *per se* a distribution of profits. Benefits which are incidental to the purpose of the organization are valid.

Section 5049(a) of the new Nonprofit Corporation Act defines the term distribution for purposes of public benefit and religious

---

72. CAL. CORP. CODE § 5060(b) (West Supp. 1979) (public benefit corporation) CAL. CORP. CODE § 5054(b) (West Supp. 1979) (mutual benefit corporation).

73. See *People ex rel. Groman v. Sinai Temple*, 20 Cal. App. 3d 614, 94 Cal. Rptr. 603 (1971). See also Bassett, *Private Hospitals and the Public Right: Needed Standards of Consent for the Statutory Delegation of the Power of Eminent Domain*, 11 U.S.F. L. REV. 53, 98 (1976).

74. CAL. CORP. CODE §§ 5061, 9111 (West Supp. 1979) limits the religious corporation to be “operated primarily or exclusively for religious purposes.” There is no statutory limitation on distribution of profit to its members. Basic nonprofit corporation common law will control on this point, effectively limiting the distribution of profits or benefits to members, to the extent constitutional constraints permit.

The MODEL NON-PROFIT CORPORATION ACT (1964) appears to support this view, since it simply includes the religious corporation within the collection of other nonprofit types, and applies the prohibition against distribution to members to all nonprofit types, without apparent concern over the constitutional implications. See MODEL NON-PROFIT CORPORATION ACT §§ 2(c), 4 (1964).

The new Nonprofit Corporation Law, CAL. CORP. CODE §§ 5002-9927 (West Supp. 1979) applies a tailored approach to fit the anticipated special situation of the religious corporation. See text following note 45, *supra*, discussing the design rationale of the statute.

California chose to let case law develop the limits for religious corporations and not to become too involved in the difficult job of trying to draft a constitutional statutory limit on the distribution of profits to members in a religious corporation. See note 86, *infra*.

75. *People ex rel. Groman v. Sinai Temple*, 20 Cal. App. 3d 621, 99 Cal. Rptr. 603 (1971).

76. *Id.* at 626, 99 Cal. Rptr. at 608 (1971).

corporations. Part (b) defines the term distribution for mutual benefit corporations.

(a) "Distribution," as used in Part 2 and Part 4 means the transfer of cash or property by the corporation to any member without adequate consideration other than in conformity with its public, charitable or religious purposes and includes the redemption or purchase of memberships.

(b)(i) Except as provided in subparagraph (ii), "distribution," as used in Part 3, means the transfer of cash or property by the corporation to any member without adequate consideration and includes the redemption or purchase of memberships.

(ii) Distribution does not include:

- (1) Contributions to charitable organizations whether or not such organizations are members of the corporation;
- (2) The sale or furnishing to members of newsletters, newspapers, magazines or any other periodic report;
- (3) Payments of reasonable compensation to members for services actually rendered; or
- (4) The sale or furnishing of goods or services to members.

Even if the definition of distribution for a mutual benefit corporation were the same as the one used for public benefit and religious corporations, most likely the exceptions in subparagraph (ii) would have been implied from the words "in conformity with its" mutual benefit purposes. Separating the mutual benefit definition from the others makes it clear what benefits are not going to be considered distributions. A public benefit corporation is for the benefit of the public; a religious corporation is for the benefit of the religion. A mutual benefit corporation by its own name implies the corporation is for the benefit of its own members. To forbid such *distributions* would be to restrain its very purpose.

## V. NONPROFIT CORPORATION SUPERVISION BY THE STATE

In California, as in most states, the government has a significant role in supervising operation of nonprofit corporations' holdings, to protect the public interest.<sup>77</sup> The new Nonprofit Corporation

---

77. See CAL. CORP. CODE § 9505 (West 1977). See generally Bogert, *Recent Developments Regarding the Law of Charitable Donations and Charitable Trusts*, 5 HASTINGS L. REV. 95, 96 (1954). Property held under public or charitable trust by a nonprofit corporation was under the supervision of the attorney general. Private foundations were subject to CAL. CORP. CODE § 9501.1 (West 1977), which required the federal law to be part of state law so a corporation could obtain the federal tax exemption.

A second California statute, CAL. CORP. CODE §§ 10200-10208 (West 1977), covered charitable corporations, before it was repealed as part of the enactment of the new Nonprofit Corporation Law, CAL. CORP. CODE § 10200 (West Supp. 1979). The attorney general under CAL. CORP. CODE § 10207 (West 1977) also supervised these corporations. A third statute that continues in force deals specifically with the supervision of a charitable trust. CAL. CORP. CODE §§ 12580-12597 (West 1977).



Law tailors the degree of attorney general supervision to the needs of each of the three nonprofit groups.<sup>78</sup> The public benefit corporation is generally supervised by the attorney general and at several stages the attorney general must participate before certain steps can be completed.<sup>79</sup> This supervision is consistent with the former General Nonprofit Corporation Law.<sup>80</sup> The mutual benefit corporation's only contact with the attorney general is when there are charitable assets under its care.<sup>81</sup> Usually, there is no need for the State to verify that actions are within the proper purpose of a mutual benefit corporation. This role can be best served by the membership, as members are most directly affected. The mutual benefit corporation may consider setting up a separate public benefit corporation to handle charitable assets.<sup>82</sup>

---

*See also* new Nonprofit Corporation Law, Cal. Corp. Code § 6324 (West Supp. 1979) which avoids any possible conflict with Cal. Corp. Code §§ 12580-12597 (West 1977).

The new Nonprofit Corporation Law has continued the attorney general's role in supervising nonprofit corporations holding assets in a charitable trust organized for charitable purposes. *See* CAL. CORP. CODE §§ 5142, 5223, 5225, 5226, 5233, 5250, 5420, 5515, 5617, 5913, 6010, 6216, 6510, 6511, 6612, 6613, 6614, 6712, 6716 (West Supp. 1979).

Under the MODEL NON-PROFIT CORPORATION ACT (1964) interrogatories by the Secretary of State were the key supervisory power. MODEL NON-PROFIT CORPORATION ACT § 87 (1964) allowed "such interrogatories as may be reasonably necessary and proper to enable him to ascertain when such corporation has complied with all the provisions of this Act. . . ." The specific supervisory requirements regarding charities or charitable assets were left to each state to design.

78. Public benefit corporations are thoroughly regulated by the attorney general. *See* CAL. CORP. CODE § 5233 (West Supp. 1979) (action to prevent self dealing; CAL. CORP. CODE § 5250) (West Supp. 1979) (Subject to continued attorney general supervision); CAL. CORP. CODE §§ 6510, 6511 (West Supp. 1979) (involuntary dissolution action supervised by attorney general); and CAL. CORP. CODE § 6611 (West Supp. 1979) (voluntary dissolution supervision of attorney general). Mutual benefit corporations are less regulated than the public benefit corporations. *See* CAL. CORP. CODE § 7142 (West Supp. 1979) (examination of assets held in charitable trusts); and CAL. CORP. CODE § 8510 (West Supp. 1979) (involuntary dissolution where charitable assets are involved required attorney general supervision). At least on first impression religious corporations appear to be less regulated. *See* CAL. CORP. CODE § 9230(a)(1) (West Supp. 1979) (attorney general can examine for proper purpose); CAL. CORP. CODE § 9230(a)(2) (West Supp. 1979) (attorney general can examine for fraud in connection with property use); CAL. CORP. CODE § 9230(a)(3) (West Supp. 1979) (attorney general can examine for diversion of property to private benefit); CAL. CORP. CODE § 9230(a)(4) (West Supp. 1979) (attorney general can examine for property solicited not used for a stated purpose); and CAL. CORP. CODE § 9230(a)(5) (West Supp. 1979) (attorney general can examine for diversion of corporate assets from stated purposes).

79. *See* note 78, *supra*.

80. *See* note 77, *supra*.

81. *See* text at note 49, *supra* and CAL. CORP. CODE § 7142 (West Supp. 1979) (charitable assets).

82. Some of the advantages of a mutual benefit or religious corporation incorporating a separate public benefit corporation would be to isolate the charitable assets and focus the attorney general's attention on the separate public benefit entity. The mutual benefit corporation would seem to benefit most from the arrange-

The unexpected change comes from the increased attorney general involvement in the supervision of religious corporations.<sup>83</sup> The rationale<sup>84</sup> distinguishing the nonprofit corporation groups for separate treatment clearly sets the religious corporation for some very special supervision. One can only speculate on what motivated the deep involvement authorized by the statute.<sup>85</sup> On the surface, the supervision appears limited to specific areas, but in fact it is quite extensive. Serious constitutional issues are present, warranting a more detailed analysis than can be given in this article, to see if the new Nonprofit Corporation Law accurately defines the constitutional interface.<sup>86</sup>

---

ment, because it would not be supervised by the attorney general unless it had charitable assets. See note 78, *supra*. The difference for a religious corporation may not be significant, since with or without charitable assets it appears to be closely supervised, until the constitutional issues are resolved. The disadvantage of using two entities is the fairly substantial cost in time and money of setting up and operating them, see note 90, *infra* on reporting requirements. The tax considerations may control again, as a public benefit corporation can receive tax deductible donations under I.R.C. § 170 and I.R.C. § 501(c)(3), while a mutual benefit corporation cannot, giving another reason to use two entities.

83. See note 78, *supra*.

84. See text following note 45, *supra* on design rationale.

85. In California there has been recent litigation between the State of California and the Church of God. The State alleges the founder of the Church is using his position for his own personal financial benefit. The Church of God contends its activities are protected from government regulation by the First Amendment. The case is pending. Such litigation was probably a motivating force in the act's regulation of religious corporations than charitable or mutual benefit corporations.

86. See generally, Note, INTERNAL REVENUE SERVICE AS A MONITOR OF CHURCH INSTITUTIONS: THE EXCESSIVE ENTANGLEMENT PROBLEM, 45 FORDHAM L. REV. 929 (1977); Bernard, *Churches, Members, and the Role of the Courts: Toward Contractual Analysis*, 51 NOTRE DAME LAW. 545 (1973); Lyall, *Religion and Law*, 1976 JURIS. REV. 58; and Rakay & Sugarman, *Reconsideration of the Religious Exemption: The Need for Financial Disclosure of Religious Fund Raising and Solicitation Practices*, 9 LOY. CHI. L.J. 863 (1978). The law relating to government interaction with church organizations is most developed in the area of government aid to church schools. From these cases the United States Supreme Court has developed what is referred to as a "three-prong test." *Meek v. Pittinger*, 421 U.S. 349 (1975) states the test:

"First the statute must have a secular legislative purpose. Second, it must have a "primary effect" that neither advances nor inhibits religion. Third, the statute and its administration must avoid excessive government entanglement with religion." *Id.* at 358.

In the case of state nonprofit corporation acts, the first two prongs of the test are easily satisfied. One secular purpose is the protection of the members of the corporation by having annual reports supplied to the members. All corporations are generally subject to reporting requirements, so the religious corporation is neither inhibited or advanced. The problem arises in the third prong of the test, relating to excessive government entanglement. For example, the requirement that members are not to receive financial benefits from the corporation requires auditing of

## VI. NONPROFIT CORPORATION REPORTING, RECORDS AND INSPECTION

The corporate democracy, as some envision it, is preserved by a free flow of information to its members or stockholders.<sup>87</sup> The theory is that wrongs will be corrected or not attempted if they are likely to be exposed. The new Nonprofit Corporation Law follows the business corporation statute's trend of greater disclosure,<sup>88</sup> but allocates the degree of disclosure according to the apparent needs of the public benefit, mutual benefit, and religious corporations.<sup>89</sup> The extent of record keeping and reporting requirements is greatest for the public benefit corporation, as expected, and least for the religious corporation, probably to avoid a constitutional conflict.<sup>90</sup> The mutual benefit corporation is treated selectively, depending on the size.<sup>91</sup>

---

the church's financial books. Quite possibly, the enforcement of the statutory requirement might go too far and result in the statute being ruled unconstitutional as being in violation of the first amendment. Another example of avoidance of government entanglement is the tax exempt status of churches. To tax churches would require extensive reporting of their financial affairs. The third prong of the test would be in serious jeopardy of being breached. See M. LARSON & C. LOWELL, *THE CHURCHES: THEIR RICHES, REVENUES AND IMMUNITIES* (1969) and ROBERTSON, *SHOULD CHURCHES BE TAXED* (1968). Further study and experience is required to determine if the Nonprofit Religious Corporation Law, CAL. CORP. CODE §§ 9110-690 (West Supp. 1979) has approximated the constitutional limit.

87. See Black, *Shareholder Democracy and Corporate Governance*, 5 SECURITIES REG. L.J. 291 (1978).

88. The MODEL NON-PROFIT CORPORATION ACT § 25 (1964) requires each corporation to keep records of account, minutes of its member, board, committee meetings, and a record of the names and addresses of the members. These records are to be open for inspection by members or their agents for any proper purpose. Annual reports were required by MODEL NON-PROFIT CORPORATION ACT § 81 (1964) for all domestic and foreign nonprofit corporations. The most revealing information mandated was:

"A brief statement of the character of the affairs which the corporation is actually conducting, or, in the case of foreign corporations, which the corporation is actually conducting in this state." *Id.* § 81(c).

The former General Nonprofit Corporation Law, CAL. CORP. CODE §§ 9402(3), 9606 (West 1977) specified only that a membership list would be kept and incorporated by the records and inspection provisions of the former General Corporation Law, CAL. CORP. CODE §§ 3000-22 (West 1954). Former CAL. CORP. CODE §§ 10200-208 (West 1977) relating to charitable corporations did not have any record keeping requirements or inspection rights specified.

89. Public benefit corporations: CAL. CORP. CODE §§ 6310-6324 (West Supp. 1979) (required records); CAL. CORP. CODE § 6330-6338 (West Supp. 1979) (rights of inspection). Mutual benefit corporations: CAL. CORP. CODE §§ 8310-8324 (West Supp. 1979) (required records); CAL. CORP. CODE §§ 8330-8338 (rights of inspection). Religious corporations: CAL. CORP. CODE § 9510 (West Supp. 1979) (required records); CAL. CORP. CODE §§ 9511-9514 (West Supp. 1979) (rights of inspection).

90. See note 86, *supra*.

91. See note 89, *supra*.

### A. *The Public Benefit Corporation Under the New Act*

The primary record keeping and reporting vehicles are the same under the new act as under the old. The public benefit corporation must keep correct financial records,<sup>92</sup> minutes of member, board and committee meetings,<sup>93</sup> and membership details.<sup>94</sup> The annual report continues to be the main reporting device<sup>95</sup> and very specific financial information is required.<sup>96</sup> The annual report can serve as the conveyor of a novel report<sup>97</sup> on transactions of the corporation with "interested persons",<sup>98</sup> or any indemnification of a corporate officer, director, or agent over \$10,000.<sup>99</sup> The transaction specified must exceed \$40,000 in value, and transactions over the reporting year can be aggregated to reach that level.<sup>100</sup> The persons to whom the section applies are officers, directors, and holders of more than ten percent of the voting power of the corporation, its parent, or subsidiary.<sup>101</sup> The content of the report on such a transaction includes the person's relationship to the corporation, the nature of the person's interest in the transaction and the amount involved in the transaction.<sup>102</sup> The "interested person" report should be a topic of some interest to boards of nonprofit corporations.

---

92. CAL. CORP. CODE § 6320(a)(1) (West Supp. 1979).

93. CAL. CORP. CODE § 6320(a)(2) (West Supp. 1979).

94. CAL. CORP. CODE § 6320(a)(3) (West Supp. 1979).

95. CAL. CORP. CODE § 6321(a) (West Supp. 1979). An alternative to the distribution of an annual report is to include the same information in material used to solicit contributions if five hundred or more persons are solicited and certain other disclosure steps are followed. CAL. CORP. CODE § 6321(f) (West Supp. 1979). The small public benefit corporation is excluded from the annual report distribution, but it must have a report for its directors and members who request one, CAL. CORP. CODE §§ 6321(c), (e) (West Supp. 1979). The definition of "small" is 100 members or less or \$10,000 assets or less at any time during the fiscal year, CAL. CORP. CODE § 6321(c) (West Supp. 1979).

96. CAL. CORP. CODE § 6321(a)(1) (West Supp. 1979).

97. CAL. CORP. CODE § 6322 (West Supp. 1979).

98. CAL. CORP. CODE § 6322(b) (West Supp. 1979).

99. See CAL. CORP. CODE §§ 5238, 6322(a) (West Supp. 1979) on indemnification. The Commission recommended this type of report and required it to be in the annual report, COMMISSION REPORT, *supra* note 18, at § 5940(b). The New Nonprofit Corporation Law gives the option of a separate report or placing it in the annual report.

100. CAL. CORP. CODE § 6322(d)(1) (West Supp. 1979).

101. CAL. CORP. CODE § 6322(b) (West Supp. 1979).

102. CAL. CORP. CODE § 6322(d)(2) (West Supp. 1979).

## B. *The Mutual Benefit Corporation Under the New Act*

The mutual benefit corporation records and reports requirement follows the same basic pattern with regard to financial records, minutes, member details,<sup>103</sup> and the annual report.<sup>104</sup> What appears to be a less demanding requirement for mutual benefit corporation financial information in the annual report,<sup>105</sup> where only a balance sheet and income statement are required,<sup>106</sup> may turn out to be a request for the same information demanded from a public benefit corporation, if the mutual benefit corporation has charitable assets. The accountants will puzzle over the differences but will be well advised to include the items specified for the public benefit corporation in the annual report for a mutual benefit corporation with charitable assets, along with the required balance sheet and income statement.

The annual report requirement does not apply to mutual benefit corporations below a certain size,<sup>107</sup> in contrast to a similar exception for public benefit corporations that only releases the corporation from the duty to routinely circulate reports to its members.<sup>108</sup> Another consideration is the procedure to be followed in issuing the annual report, or whether one is to be prepared. Before a decision is reached on this matter, the possibility of an interested person must be considered. Mutual benefit corporations of all sizes are subject to the same report requirements for any interested persons transactions or indemnification within the limits set, and the only way to comply is to put the information in the annual report.<sup>109</sup>

## C. *Religious Corporations Under the New Act*

Religious corporations have the fewest statutory requirements for record keeping and reporting. The financial records, minutes, and membership details are all that are mentioned in the new act.<sup>110</sup> The burden of discovering the financial status of the religious corporation appears to rest with the members, using their inspection rights.<sup>111</sup> There is no requirement for an interested person transaction report or a report on indemnification. The

---

103. CAL. CORP. CODE § 8320 (West Supp. 1979).

104. CAL. CORP. CODE § 8321 (West Supp. 1979).

105. CAL. CORP. CODE § 8321(a)(1) (West Supp. 1979).

106. See note 96, *supra*.

107. CAL. CORP. CODE § 8321(c) (West Supp. 1979). This [Annual Report] Section does not apply to corporations which have more than 100 members or \$10,000 in assets at anytime during the fiscal year.

108. See note 95, *supra*.

109. CAL. CORP. CODE § 8322 (West Supp. 1979).

110. CAL. CORP. CODE § 9510 (West Supp. 1979).

111. *Id.* See also notes 121-23, *infra*.

only other avenue open to a concerned member is the litigation route, or to seek help from the attorney general. The reason for the reduced demand on the religious corporation may be a desire not to burden it with higher operating costs, or possibly a conviction this group is reasonably well regulated internally, or to avoid a constitutional confrontation.<sup>112</sup> The supposed constitutional reluctance does not seem to have deterred the legislators from giving a very far reaching role to the attorney general to probe the religious corporation when alleged problems exist. The question can be asked, would not required annual reports to religious corporation members and reports on interested person transactions and indemnification agreements accomplish a useful result without raising the specter of governmental intrusion? They would appear to have as much benefit to the religious corporation member as the members of the other groups. A size limit could be used to reach only the larger religious corporations. The greater disclosure might minimize potential State interference by allowing an informative membership to keep tabs on the church's hierarchy. It is a topic that might warrant more research and analysis in view of the struggles between churches and church members in California and elsewhere.<sup>113</sup>

## VII. INSPECTION RIGHTS

The inspection rights of members and directors are spelled out in seemingly minute detail for the public benefit corporation<sup>114</sup> and mutual benefit corporation.<sup>115</sup> This approach is the consequence of an effort to create a set of due process norms.<sup>116</sup> At the same time the statute gives the corporation a chance to develop a satisfactory alternative approach. The detailed due process provisions do not eliminate the court's role of resolving disputes, but the court's job is simplified with the statutory norms. For exam-

---

112. See note 86, *supra*.

113. See note 112, *supra*.

114. CAL. CORP. CODE §§ 6330-6338 (West Supp. 1979).

115. CAL. CORP. CODE §§ 8330-8338 (West Supp. 1979).

116. For the public benefit corporation see, CAL. CORP. CODE § 6331 (West Supp. 1979) (procedure to set aside a demand); CAL. CORP. CODE § 6332 (West Supp. 1979) (restrictions to protect the constitutional rights of other members); and CAL. CORP. CODE § 6338 (West Supp. 1979) (membership list protection). The corresponding sections for the mutual benefit corporations are: CAL. CORP. CODE §§ 8331, 8332, 8338 (West Supp. 1979), respectively. This numerical parallel of the two groups exemplifies the design rationale used in the new Nonprofit Corporation Law.

ple, a member's demand to inspect the membership list must either be acted upon in ten days or a reasonable alternative to such inspection presented to the requestor within the time period.<sup>117</sup> The statute establishes a norm unless the corporation can arrive at an alternative that meets the statutory standard of reasonableness. The corporation can petition the court to set aside the demand or issue a protective order, following the detailed procedure set forth in the statute.<sup>118</sup> Any member can intervene to protect their constitutional rights.<sup>119</sup> These inspection provisions are excellent examples of the organizational rationale of this statute.<sup>120</sup>

In sharp contrast, the religious corporation member has the statutory right to inspect financial records, minutes, and the membership list. Interestingly the act is quiet on due process rights for the religious corporation.<sup>121</sup> A provision authorizes the court to enforce any uncomplained with demand and to fashion the applicable rules.<sup>122</sup> The appearance is that another sensitive constitutional interface is involved. A statutory due process norm would serve a useful purpose for a religious corporation just as it does for the other groups. If no constitutional prohibition exists, the due process norm should be.<sup>123</sup>

#### VIII. NONPROFIT CORPORATION MEMBERSHIP TRANSFERABILITY AND RELATED MATTERS

The new Nonprofit Corporation Law does not allow a nonprofit corporation to issue stock.<sup>124</sup> Most states use this non-stock approach, following the lead of the Model Non-Profit Corporation Act, to distinguish a nonprofit corporation from a business corpo-

---

117. CAL. CORP. CODE § 6330(c) (West Supp. 1979) for the public benefit corporation and CAL. CORP. CODE § 8330(c) (West Supp. 1979) for the mutual benefit corporation.

118. CAL. CORP. CODE § 6331 (West Supp. 1979) for the public benefit corporation and CAL. CORP. CODE § 8331 (West Supp. 1979) for the mutual benefit corporation).

119. CAL. CORP. CODE § 6332 (West Supp. 1979) for the public benefit corporation and CAL. CORP. CODE § 8332 (West Supp. 1979) for the mutual benefit corporation.

120. See text following note 46, *supra* discussing design rationale of the statute.

121. CAL. CORP. CODE §§ 9510-9513 (West Supp. 1979).

122. CAL. CORP. CODE § 9514 (West Supp. 1979).

123. See note 88, *supra*.

124. The new Nonprofit Corporation Law does not specifically state stock cannot be issued, but there is no authorization to issue stock. See CAL. CORP. CODE § 5140 (West Supp. 1979) for public benefit corporations and CAL. CORP. CODE §§ 7140, 9140 (West Supp. 1979) for mutual benefit and religious corporations, respectively. The Commission recommended no stock be issued in a nonprofit corporation, Commission Proposed Statute, *supra* note 19 at § 5210(d), and noted no corresponding provision existed in the former Nonprofit Corporation Law. See Commission's Comment to section 5210(d).

ration.<sup>125</sup> The new Nonprofit Corporation Law permits a nonprofit corporation to issue memberships.<sup>126</sup> A membership, however, can take on one or more of the characteristics of stock. Consequently, a careful analysis of the new Nonprofit Corporation Law must consider how a membership in each of the public benefit, mutual benefit, and religious corporations is defined and restricted. The new Nonprofit Corporation Law allows the desired membership characteristics to be structured to fit the needs of each nonprofit group.

Before analyzing the membership characteristics of each nonprofit group, a brief review of typical business corporation stock features will be helpful in the comparison.<sup>127</sup> Each share of the stock represents a proportionate ownership of the business. When the corporation is dissolved the stockholder will receive payment for the share value representing a part of the ownership of the net worth of the business, in proportion to the total number of shares outstanding.<sup>128</sup> The corporate assets can grow by accumulation of earnings and asset appreciation with the usual result that the value of a share appreciates. For convenience in comparison, this feature will be termed stock ownership right. Another characteristic of stock is the right to vote, usually with one vote per share, although there can be an infinite variety of arrangements with different classes and voting priorities. For convenience, this feature will be termed the stock voting right. The other major characteristic of stock is the right to transfer it to a third party for a price to be determined only by the seller and purchaser, in most situations. Agreements binding the shareholder may alter this right. For convenience, this feature will be termed the stock transfer right.

#### *A. Public Benefit Corporations*

An examination of the new Nonprofit Corporation Law for the membership characteristics that resemble the aforementioned stock characteristics presents an interesting picture which illus-

---

125. The MODEL NON-PROFIT CORPORATION ACT § 26 (1964); see also alternative sections *Id.* § 2, 3, 37A, 83 that are designed to convert a nonprofit stock corporation to a membership only type.

126. Public benefit corporation, CAL. CORP. CODE § 5140(a)(5) (West Supp. 1979); mutual benefit corporation, CAL. CORP. CODE § 7140(a)(6) (West Supp. 1979); and religious corporation, CAL. CORP. CODE § 9140(a)(5) (West Supp. 1979).

127. See H. HENN, LAW OF CORPORATIONS §§ 157-161 (2d ed. 1970).

128. CAL. CORP. CODE § 6716 (West Supp. 1979).



trates more vividly the unique makeup of the three nonprofit groups. On dissolution the member of a public benefit corporation cannot receive any profit distribution based on membership<sup>129</sup> and charitable asset distribution is made under the *cy pres* doctrine, to similar public or charitable organizations with the supervision of the attorney general.<sup>130</sup> In effect, there is no ownership right for a member of a public benefit corporation except as to the original, non-charitable assets contributed. The voting rights of a member in a public benefit corporation are set by the articles or bylaws, and if there are no applicable provisions, the statute states there will be one vote per member.<sup>131</sup> The effect of this statutory provision is to allow a flexible approach to the design of the corporate structure, with a norm that sets the operating procedure if no other standard is set by the corporation. Finally, a membership in a Public Benefit Corporation cannot be transferred for value.<sup>132</sup>

A comparison with profit corporation's characteristics of stock, ownership right, voting right, and transfer right, as defined above, shows the public benefit corporation membership's only similarity is the voting right characteristic. A public benefit membership has this unique characteristic separating it from the other nonprofit groups.

### *B. Mutual Benefit Corporations*

A mutual benefit corporation membership includes the right to receive on dissolution the corporate net worth, on a proportional basis, unless the article or bylaws state otherwise.<sup>133</sup> This feature corresponds closely to the stock ownership right and can result in quite an increase in value, due to land or building appreciation or

---

129. CAL. CORP. CODE § 5060(b) (West Supp. 1979) limits profit distribution during corporate operation and upon dissolution.

130. CAL. CORP. CODE §§ 6716, 6717 (West Supp. 1979):

Where property is given in trust for a particular charitable purpose, the trust will not ordinarily fail even though it is impossible to carry out the particular purpose. In such a case the court will ordinarily direct that the property be applied to a similar charitable purpose. The theory is that the testator would have desired that the property be so applied if he had realized that it would be impossible to carry out the particular purpose. (A. SCOTT, SCOTT ON TRUSTS § 399 (3d ed. 1967)).

131. CAL. CORP. CODE § 5610 (West Supp. 1979). Nonprofit corporation structure design flexibility has been added by the new Nonprofit Corporation Law, CAL. CORP. CODE § 5312(b) (West Supp. 1979) to allow one membership per member in each class of memberships. The Commission recommended this change in Commission proposed statute § 5610, *supra*, note 19.

132. CAL. CORP. CODE § 5320(a) (West Supp. 1979).

133. CAL. CORP. CODE § 8717(b) (West Supp. 1979). The new Nonprofit Corporation Law also provides for return of assets received under conditions requiring such return, in CAL. CORP. CODE § 8717(b) (West Supp. 1979).

profit making activities.<sup>134</sup> Mutual benefit membership entitles the member to one vote, unless the articles or bylaws provide otherwise.<sup>135</sup> The transferability of a mutual benefit membership must be authorized in the articles or bylaws.<sup>136</sup> If so authorized, the statute clearly permits the transfer of memberships without any limitation on the transfer price.<sup>137</sup>

The treatment of mutual benefit corporation membership transfers under the new Nonprofit Corporation Law presents an interesting picture. The path is clear for the transfer, if desired, either by sale to a third party or back to the corporation. The question is, at what price? Since the statute clearly includes such a transfer as a distribution,<sup>138</sup> the basic purpose of a mutual benefit corporation must be examined to see if it is violated by such a distribution. The mutual benefit corporation purpose prohibits "distribution of gains, profits or dividends to members. . . ."<sup>139</sup> When these related provisions are put together, the question of what transfer price limitation is applicable is not clear. It is common practice for some mutual benefit corporation memberships to be transferred at premium prices that increase with each transfer. Did the new Nonprofit Corporation Law intend to cut out these profitable transfers? In a like manner, a mutual benefit corporation may redeem its memberships. The question again is, at what price? Can the corporation pay the member an appreciated market value, or would that transfer violate the prohibition against the member receiving any gains? These difficult questions need to be addressed.

The approach which appears most reasonable would be to separate the redemption and the transfer to third parties. This step would allow a membership to appreciate and be sold for the market price to a third party. This third party purchase does not involve any direct distribution by the corporation. On the other hand, the redemption by a mutual benefit corporation would be

---

134. See text at note 61, *supra* related to profit making activities.

135. CAL. CORP. CODE § 7610 (West Supp. 1979) allows the same flexibility referenced in note 131, *supra* for public benefit corporations applies to mutual benefit corporations. CAL. CORP. CODE § 7312 (West Supp. 1979) provides an additional feature tailored to the needs of the mutual benefit corporation and allows branches, divisions, or offices to hold separate memberships.

136. CAL. CORP. CODE § 7320 (West Supp. 1979).

137. *Id.*

138. CAL. CORP. CODE § 5049(b)(i) (West Supp. 1979).

139. CAL. CORP. CODE § 7111 (West Supp. 1979).

restricted by the gain prohibition, so the member would not receive more than was paid when purchased. The other alternatives would be to let the member sell the membership to the corporation at market value, or at dissolution value and to receive a profit if the value goes up. The injustice of this restriction on membership transfer price is that the member who waits it out will be entitled, at dissolution, to receive the appreciated membership value, in accordance with the specific terms of the statute allowing distribution of gain on dissolution.<sup>140</sup> On balance, the statute forces this result and the consequences are not unlike what happens with stock in a business corporation, where the market price and value at dissolution differ.

It is now apparent that the mutual benefit corporation membership can have each of the characteristics of stock, including the ownership, voting, and transfer rights, with certain limitations. It may be easier to see why many persons are initially confused<sup>141</sup> over the seeming inconsistency of saying a nonprofit corporation cannot issue stock and then giving a membership in a nonprofit corporation one or more of the characteristics of stock.

### C. Religious Corporations

The religious corporation dissolution is tightly controlled by the statute, like the public benefit corporation, which is under the supervision of the attorney general.<sup>142</sup> The articles or bylaws must set forth the plan for distribution at dissolution. However, there is no statutory prohibition against members receiving their proportionate share of the non-charitable net worth at dissolution. Accordingly, the religious corporation has a characteristic similar to the stock ownership right.<sup>143</sup> This right allows one vote per member.<sup>144</sup> The transfer of a religious corporation membership, if

---

140. CAL. CORP. CODE §§ 5059(b), 7111 (West Supp. 1979).

141. The new Nonprofit Corporation Law adds to the confusion a bit, because of the definitions that reference Part 3 (mutual benefit corporations) and define "common shares," "preferred shares," "shareholders" and "shares," CAL. CORP. CODE §§ 5043, 5067, 5071, 5072 (West Supp. 1979), respectively. A careful search failed to reveal these terms are used in CAL. CORP. CODE § 8717 (West Supp. 1979).

142. CAL. CORP. CODE § 9680(c) (West Supp. 1979).

143. CAL. CORP. CODE § 5061(b) (West Supp. 1979). The omission of a specific prohibition for distribution of gain, profit, or dividends to the religious corporation member comes as a surprise. This prohibition is in public benefit corporation, CAL. CORP. CODE § 5060 (West Supp. 1979) and mutual benefit corporation, CAL. CORP. CODE § 5059 (West Supp. 1979) and in states that collect all nonprofit corporations under a single statutory purpose section. See MODEL NON-PROFIT CORPORATION ACT § 2(d) (1964). It may be this omission is another cautious encounter with the constitutional limitations. However, if the constitutional conflict is slight, this would seem to warrant adding the general prohibition against profit distribution to the statute. See note 86, *supra*.

144. CAL. CORP. CODE § 5416 (West Supp. 1979).

allowed by the articles or bylaws, cannot result in profit to the member.<sup>145</sup> It seems unusual the limitation of profits would be placed only in the membership transfer provision and not also in the purpose section.<sup>146</sup> The effect clearly is to limit the religious corporation member to being paid the cost of the membership if it is transferred to a third party or to the corporation. The distinction drawn for mutual benefit corporation transfers<sup>147</sup> does not seem to fit the broader mandate prohibiting the religious corporation member from profit in membership transfers. It is clear that religious corporation membership at least has a voting right, corresponding to the stock voting right characteristic, and some degree of ownership and transfer rights, limited by statute and the articles and bylaws.

#### IX. MEMBERSHIP TERMINATION

The last membership related matter to be singled out for comment is membership termination. The statutory approach used in public benefit<sup>148</sup> and mutual benefit corporations<sup>149</sup> is essentially the same, with extensive due process norms built in, and using existing case law as guidelines.<sup>150</sup> The religious corporation has no such norms in its membership termination provisions.<sup>151</sup> In contrast to those areas where the unique qualities demanded a tailored approach for each nonprofit group, the due process norms set forth for the public benefit and mutual benefit corporations to protect members' rights against illegal membership termination, appear to suit the religious corporation members' needs as well. Statutory due process norms should be added for the religious corporation, unless there is a basic constitutional conflict that makes the task unapproachable.

#### X. DIRECTORS' STANDARD OF CARE AND RELATED MATTERS

◊ Nonprofit corporations have not been sheltered from the debate on what standard of care should apply to its directors, officers,

---

145. CAL. CORP. CODE § 9320(a) (West Supp. 1979).

146. See note 143, *supra*.

147. See text and notes 138-40, *supra*.

148. CAL. CORP. CODE § 5341 (West Supp. 1979).

149. CAL. CORP. CODE § 7341 (West Supp. 1979).

150. See COMMISSION PROPOSED STATUTE § 5631, *supra*, note 18, and accompanying comments for relevant cases.

151. CAL. CORP. CODE § 9340(d) (West Supp. 1979).

and agents.<sup>152</sup> For convenience, the term director will be used to include officers and corporate agents, unless otherwise indicated. California resolved its statutory position in 1947 by adopting for all nonprofit corporations the same statutory standard applied to business corporations.<sup>153</sup>

The new nonprofit corporation laws follows the same pattern, using a statutory standard of care for two of the three nonprofit groups, public benefit and mutual benefit corporations, that is the same as the new general corporation standard of care for directors.<sup>154</sup>

This consistency does not end debate over whether case law interpreting such statutes should use a relaxed standard for nonprofit corporation directors. Professor Oleck has argued that too high a standard would be unreasonable for nonprofit corporation directors who serve voluntarily and with little time or opportunity to supervise an organization that is usually run much less effectively than a business corporation. The other view, held by Professor Pasley, is that there is no justification for reduction of the standard.<sup>155</sup> The latter argument suggests the presence of charitable assets in a nonprofit corporation require the same standard of care as for directors in a business corporation.<sup>156</sup> The Model Non-Profit Corporation Act was not involved in the debate,<sup>157</sup> but the Model Business Corporation Act continued to refine its treatment in this regard.<sup>158</sup> California essentially adopted the Model Business Corporation Act standard in its new general corporation law, with one important change.<sup>159</sup> This change was an additional requirement that the director make reasonable inquiry, a step that was readily implied in the broader standard of care, but now was emphasized by statutory declaration.<sup>160</sup>

---

152. Pasley, *Non-Profit Corporations-Accountability of Directors and Officers*, 21 BUS. LAW. 621 (1966).

153. The former General Nonprofit Corporation Law, CAL. CORP. CODE §§ 9000-802 (West 1977) did not contain a provision on director standard of care. The director standard of care provisions of the former General Corporation Law, CAL. CORP. CODE § 820 (West 1954) were incorporated by reference under former General Nonprofit Corporation Law, CAL. CORP. CODE § 9002 (West 1977).

154. Public benefit corporation, CAL. CORP. CODE § 5231 (West Supp. 1979); and mutual benefit corporation, CAL. CORP. CODE § 7231 (West Supp. 1979). *See also* CAL. CORP. CODE § 309 (West 1977).

155. *See* OLECK, *supra* note 2, at § 159 (1956) and Pasley, *Non-Profit Corporation-Accountability of Directors and Officers*, 21 BUS. LAW. 622-23 (1966).

156. Pasley, *Non-Profit Corporations-Accountability of Directors and Officers*, 21 BUS. LAW. 637-39 (1966).

157. There is no provision in the MODEL NON-PROFIT CORPORATION ACT (1964) on director standard of care.

158. MODEL BUSINESS CORPORATION ACT ANNOTATED § 35 (2d 1971).

159. CAL. CORP. CODE § 309 (West 1977).

160. CAL. CORP. CODE § 309(a) (West 1977).

The new General Corporation Law standard of care for directors adopted for the public benefit corporation utilizes both a good faith standard and a requirement that a director exercise the standard of care of an ordinary prudent person.<sup>161</sup> The director must act in the best interest of the corporation.<sup>162</sup> These standards are applied by considering how a reasonably prudent director would have acted under similar circumstances.<sup>163</sup> It appears this test allows for a lower standard of care due to special circumstances existing in certain nonprofit corporations. Cases applying the same test to business corporations can be distinguished on this basis, as well as other grounds, if appropriate. The debate over what standard to follow for nonprofit corporations is not over, although the new act will serve to clarify the issue considerably.

The drafters of the new Nonprofit Corporation Law must have sensed a possible reluctance in the courts to apply the director standard of care test uniformly to all nonprofit corporations, especially to the most sensitive, the public benefit corporation which controls vast charitable wealth. To quiet this unrest, the new Nonprofit Corporation Law included a provision, copied from the new corporation code, that clarifies the limits of a director's liability. "A person who performs these duties of a director in accordance with subdivisions (a) and (b) [standards summarized above] shall have no liability based upon any failure or alleged failure to discharge the person's obligations as a director."<sup>164</sup> (Comments added). The following, which serves to tailor the above to the needs of the public benefit corporation provided that, "including, without limiting the generality of the foregoing any actions or omissions which exceed or defeat a public or charitable purpose of which a corporation, or assets held by it, are dedicated."<sup>165</sup> It is now clear there should be no special standard of

---

161. "A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interest of the corporation and with such care, *including reasonable inquiry*, as an ordinarily prudent person in a like position would use under similar circumstances.

CAL. CORP. CODE §§ 5231(a), 7231(a) (West Supp. 1979). (emphasis added.)

162. *Id.*

163. *Id.*

164. CAL. CORP. CODE § 309(c) (West 1977). See Nonprofit Public Benefit Corporation Law, CAL. CORP. CODE § 5231(c) (West Supp. 1979).

165. *Id.*

care used when charitable assets are involved. A single statutory test applies to all nonprofit corporations within the public benefit group.

The director of a public benefit corporation is subject to specific regulations on self dealing transactions,<sup>166</sup> and conflicts of interest arising from interlocking directorships.<sup>167</sup> The new General Corporation Law<sup>168</sup> provides a standard of reasonableness in applying director and officer compensation.<sup>169</sup> The nonprofit corporation director is closely scrutinized in carrying out his necessary role within the public benefit corporation. The parallel relationships between the new General Corporation Law and the new Nonprofit Corporation Law allows reference to the case law developments on each provision, to the extent appropriate.<sup>170</sup>

The mutual benefit corporation director is subject to essentially the same standards as the public benefit corporation director<sup>171</sup> and is relieved of liability when these standards are followed.<sup>172</sup>

The religious corporation was separated from the former General Nonprofit Corporation Law, which had set a standard of care applicable to directors.<sup>173</sup> In the new Nonprofit Corporation Law for Religious Corporations, there is a provision defining the director's standard of care. At the same time the new Nonprofit Corporation Law added a provision that effectively continued the existing law regarding director liability.<sup>174</sup> The obvious attempt to go no further in regulating the religious corporation director's liability can be viewed as a step backward.<sup>175</sup> A worthy task would be to see if any barrier exists, constitutional or otherwise, against amending the new Nonprofit Corporation Law by adding the public benefit corporation standard of care for directors to regulate the religious corporation director.

A logical difference exists between the new General Corpora-

---

166. CAL. CORP. CODE § 5233 (West Supp. 1979).

167. CAL. CORP. CODE § 5234 (West Supp. 1979).

168. CAL. CORP. CODE § 310 (West 1977).

169. CAL. CORP. CODE § 5235 (West Supp. 1979). See H. OLECK, MODERN CORPORATION LAW § 998 (1951).

170. See text following note 45, *supra* on organizational rationale.

171. CAL. CORP. CODE § 7231 (West Supp. 1979). See notes 161-170, *supra*.

172. CAL. CORP. CODE § 7233 (West Supp. 1979). There is no statutory provision for the mutual benefit corporation on director and officer compensation corresponding to CAL. CORP. CODE § 5235 (West Supp. 1979) which is applicable to public benefit corporations. See note 164, *supra*.

173. See note 155, *supra*.

174. CAL. CORP. CODE § 9240 (West Supp. 1979).

175. It is an unrealistic burden to reference the former Corporation Code, CAL. CORP. CODE §§ 100-2319 (West 1977), which has no other active role than to serve this section. If the prior Nonprofit Corporation Law, CAL. CORP. CODE §§ 9000-10703 (West 1977) was adequate, why were not the relevant sections copied into the new Nonprofit Corporation Law, CAL. CORP. CODE §§ 5002-10831 (West Supp. 1979)?

tion Law<sup>176</sup> and the new Nonprofit Corporation Law insofar as the extent the board can delegate its supervisory role. The new Nonprofit Corporation Law clearly states the parameters of the board's responsibilities. "The board may delegate management of the activities of the corporation . . . provided that the activities and affairs of the corporation shall be managed and all corporation powers shall be exercised under the ultimate direction of the board."<sup>177</sup> The nonprofit corporation board's overall authority and responsibility for operation of the corporation cannot be delegated. In contrast, the new General Corporation Law allows a corporation to structure its operation, even to remove the board's role, by amending the articles specifically setting forth the arrangement, or by stating in the articles that the corporation will be governed by the close corporation provisions. Then, a shareholders' agreement can be used to define the management structure.<sup>178</sup> The justification for close corporation, to preserve the partnership-like operating form, does not exist for a nonprofit corporation.

An interesting feature of the new Nonprofit Corporation Law is that one person can incorporate and be the sole director as well as the only member in any one of the three groups of nonprofit corporations.<sup>179</sup> The effect is to create a one party nonprofit corporation. This arrangement may be very popular, once the opportunity becomes known.<sup>180</sup> The question is whether a one person

---

176. See text following note 45, *supra* on organization rationale.

177. Public benefit corporation, CAL. CORP. CODE § 5210 (West Supp. 1979); mutual benefit corporation, CAL. CORP. CODE § 7210 (West Supp. 1979); religious corporation, CAL. CORP. CODE § 9210 (West Supp. 1979). Note the internal uniformity of the numbers among the different types of nonprofit corporations.

178. The new General Corporation Law, CAL. CORP. CODE § 158(a) (West 1977) requires the articles of incorporation of a close corporation to contain a statement "[T]his corporation is a close corporation." CAL. CORP. CODE § 186 (West 1977) provides for the use of shareholder agreements for close corporations where 100% of the shareholders consent to the agreement. For the general corporation, CAL. CORP. CODE § 300(a) (West 1977) provides for the vesting of all corporate powers under the direction of the board of directors unless the articles of incorporation provide otherwise.

179. See CAL. CORP. CODE §§ 5120(a), 7120(a), 9120(a) (West Supp. 1979) (on incorporation); CAL. CORP. CODE §§ 5151(a), 7151(a), 9151(a) (West Supp. 1979) (on number of directors); and CAL. CORP. CODE §§ 5310, 7310, 9310 (West Supp. 1979) (on membership).

180. Consider the charitable or religious organizations run by one person. It is fraught with potential vices. Corporate democracy can act as somewhat of a control, but does not exist in this case. See note 88, *supra*. The attorney general lacks staff to police such small operators, but the harm is real to the solicited persons.



nonprofit corporation should be allowed to operate. Perhaps the desire for flexibility has gone too far on this point, and a little of the former reasoning that kept the board to a minimum of three is worth reconsidering.

## XI. DIRECTOR INDEMNIFICATION

California's new Nonprofit Corporation Law makes a dramatic, although not surprising change in the area of director indemnification. To appreciate this shift in policy, a look at the developments in indemnification of business corporation directors is essential. For convenience, the term director again will be used to include officer and corporate agent, unless otherwise stated. Indemnification of business corporation directors has been a controversial issue.<sup>181</sup> The business community has long lamented the problem of finding capable persons who are willing to take necessary risks as a director in this age of increased litigation. Public interest groups generally want to keep the directors at risk, without indemnification, to insure boards act in a reasonable manner. The statutory solutions of most states have been influenced by the Model Business Corporation Act.<sup>182</sup> The Model Act gives the corporation the statutory power, within limits, to indemnify directors who defend against a charge relating to corporate matters, win or lose. A statutory right to indemnification is given if the director prevails, and other types of relief, such as indemnification insurance, are allowed, without limitation.<sup>183</sup>

Initially, California did not follow the business corporation trend on indemnification.<sup>184</sup> In fact, it stood out as a prime example that business corporation directors should be indemnified only by action of a court.<sup>185</sup> The new General Corporation Law

---

Another question is what kind of mutual benefit corporation can be set up with only one member?

181. See Johnston, *Corporate Indemnification and Liability Insurance For Directors and Officers*, 33 BUS. LAW. 1993 (1978); Matter, *Indemnification and Liability Insurance for Corporate Boards of Directors and Trustees—A Legal Guide for the Director*, 83 COM. L.J. 550 (1978); and *Not-For-Profit Corporation Director: Legal Liabilities and Protections* 28 FEDERATION INS. CONN. Q. 57 (1977).

182. MODEL BUSINESS CORPORATION ACT ANNOTATED § 5 (2d ed. 1971).

183. MODEL BUSINESS CORPORATION ACT ANNOTATED § 5(c), (g) (2d ed. 1971).

184. Former General Corporation Law, CAL. CORP. CODE § 830 (West 1955) provided for the indemnification of officers, directors or employees for their litigation expenses.

185. *Id.* § 830(a):

(a) Assessment by court; grounds; amount. When a person is sued, either alone or with others, because he is or was a director, officer, or employee of a corporation, . . . indemnity for his reasonable expenses, including attorneys' fees incurred in the defense of the proceeding, may be assessed against the corporation, . . . by the court in the same or a separate legal proceeding, if both of the following conditions exist:

has shifted the approach to follow the Model Business Corporation Act by increasing director protection. The court's supervisory role was reduced to deciding when the director should be indemnified "in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation in the performance of such person's duty to the corporation. . . ."<sup>186</sup> (Emphasis added). The court's jurisdiction was limited to those situations where the shareholders sued in the name of the corporation, leaving it to the corporation to decide which other situations within prescribed limits if it wished to provide indemnification. Of course, the court continued to play an important role in ensuring that these provisions were followed.

The Nonprofit Corporation Law had its own debate going over director indemnification, focused on the Model Non-Profit Corporation Act. The 1957 Model Non-Profit Corporation Act had two alternative provisions on indemnification, with Section 5(n) giving the corporation's board the power to indemnify a director, unless the director was judged liable for negligence or misconduct.<sup>187</sup> Nonetheless, under this provision, indemnification could be pro-

---

(1) The person sued is successful in whole or in part, or the proceeding against him is settled with approval of the court.

(2) The court finds that his conduct fairly and equitably merits such indemnity.

The amount of such indemnity shall be so much of the expenses, including attorneys' fees, incurred in the defense of the proceeding, as the court determines and finds to be reasonable.

186. New General Corporation Law, CAL. CORP. CODE § 317 (West 1977). MODEL BUSINESS CORPORATION CODE ANNOTATED § 5 (2d ed. 1971) is the corresponding Model Act section.

187. MODEL NON-PROFIT CORPORATION ACT § 5(n) (1957) gave the corporation the power:

To indemnify any director or officer or former director or officer of the corporation, . . . against expenses actually and necessarily incurred by him in connection with the defense of any action, suit or proceeding in which he is made a party by reason of being or having been such director or officer, except in relation to matters as to which he shall be adjudged in such action, suit or proceeding to be liable for negligence or misconduct in the performance of duty; but such indemnification shall not be deemed exclusive of any other rights to which such director or officer may be entitled, under any by-law, agreement, vote of the board of directors or members, or otherwise.

The pros and cons of the MODEL NON-PROFIT CORPORATION ACT (1957) approaches the state of the law at that time and thoroughly covered by Haller, *Directors' Indemnity in Non-Profit Corporations: Should Charity Begin at Home?*, 11 BUS. LAW. 6 (1956). The MODEL NON-PROFIT CORPORATION ACT §§ 5, 24A (1964) continued the same alternative provisions.

vided through a bylaw or article provision.<sup>188</sup> In contrast, the 1957 Model Non-Profit Corporation Act alternative provision Section 24A placed the control of all indemnification in the hands of the court. In supporting alternative Section 24A, the Model Non-Profit Corporation Act comments described the former California General Nonprofit Corporation Law<sup>189</sup> as a “radical departure” from the trend that was liberalizing the corporation’s flexibility in awarding indemnification,<sup>190</sup> but stated that a slight majority of the Model Non-Profit Corporation Act committee at that time favored the Section 24A “court controlled” approach.<sup>191</sup>

Under the pressure of the overwhelming trend for greater corporate director indemnification, and following the recommendation of the Commission,<sup>192</sup> and in spite of the Model Non-Profit Corporation Act committee recommendation, California’s new Nonprofit Corporation Law adopted, in total, the new General Corporation Law provision on indemnification<sup>193</sup> for each of the public benefit and mutual benefit corporations.<sup>194</sup> Whether it serves the best interests of these nonprofit corporations or the public, remains to be seen. The proper balance is closely tied in with the standard of conduct applied to the nonprofit corporation director.<sup>195</sup> Since the director standard of care is defined in some detail by the statute and it can be adjusted to the circumstances of each case, the opposition to the more liberal indemnification approach may subside. The new Nonprofit Corporation Law will shift the role of the court from that of a supervisor, involved in each indemnification decision, to that of reviewing indemnification awards, if requested. This new position for the court is a more proper role.

Each potential and current nonprofit corporation director should review the question of indemnification with an attorney, who will examine the articles and bylaws for indemnification provisions and explain their impact, along with the statutory norms

---

188. *Id.* THE MODEL NON-PROFIT CORPORATION ACT (1964) did not give the board authority to purchase indemnification insurance, in contrast to the MODEL BUSINESS CORPORATION ACT ANNOTATED § 5(g) (1971).

189. Former Nonprofit Corporation Law, CAL. CORP. CODE § 9002 (West 1977) incorporated by reference the former General Corporation Law, CAL. CORP. CODE § 830. See notes 183-84, *supra*.

190. Haller, *Directors' Indemnity in Non-Profit Corporations: Should Charity Begin at Home?*, 11 BUS. LAW. 6 (1956).

191. *Forward* to MODEL NON-PROFIT CORPORATION ACT at vii (1957).

192. The *Commission Report*, *supra* note 18, at 2217, adopted without significant comment, the new General Corporation Law indemnification sections, CAL. CORP. CODE § 317 (West 1977).

193. CAL. CORP. CODE § 317 (West 1977).

194. Public benefit corporation, CAL. CORP. CODE § 5238 (West Supp. 1979) and mutual benefit corporation, CAL. CORP. CODE § 7237 (West Supp. 1979).

195. See text at note 152, *supra* on director standard of care.

within which a director must operate. At the same time, the lawyer must advise the corporation that indemnification given or advanced to cover legal expenses, must be reported<sup>196</sup> if it exceeds \$10,000 in a fiscal year to any officer or director.<sup>197</sup>

The statute's treatment of religious corporations on director indemnification follows the same pattern.<sup>198</sup> The religious corporation is not covered by specific statutory provision on indemnification. Rather, it appears on the surface that the religious corporation cannot indemnify its directors. The religious corporation powers section<sup>199</sup> makes no mention of the power to indemnify, and there is not a separate provision giving the corporation such power. The religious corporation statute does preserve the law applicable to director standard of conduct,<sup>200</sup> and it may be argued this preservation includes the former General Nonprofit Corporation Law's role of the court deciding on indemnification.<sup>201</sup> However, in the absence of a specific statute on indemnification the court can properly reject this argument and force the legislature to address the issue by amendment of the statute. The legislature should consider such an amendment at least to bring indemnification under the law for religious corporation directors and officers to a level similar to the one under the former General Nonprofit Corporation Law, where the court controlled the awards. A strong argument can be made to go further and follow the new General Corporation Law approach that is

196. See text at note 87, *supra* on reporting and inspection.

197. CAL. CORP. CODE § 6322(e) (West Supp. 1979) is not free of ambiguity, because one or more directors could be indemnified for amounts aggregating as to each less than \$10,000, but as a group totaling more than \$10,000 in a fiscal year. Would a report be required? The reason for such limitations on full reporting is one of convenience, to reduce unnecessary reporting. The principle of full disclosure should prevail over convenience and the statute should be interpreted to require a report of the amount of total indemnification if it exceeds \$10,000 in a fiscal year. The report must disclose also the circumstances of the payment.

198. See text at note 110, *supra* on reporting and inspection. See also text at note 173, *supra* on director standard of care for religious corporations.

199. CAL. CORP. CODE § 9140 (West Supp. 1977).

200. Cal. Corp. Code § 9240 (West Supp. 1979).

Notwithstanding the enactment of the act containing this part, except as specifically provided in this part, the duties and liabilities of directors of corporations formed under or subject to this part shall continue to be governed by the law which would be applicable in the absence of such enactment.

*Id.* See text discussing director standard of care for religious corporations, *supra* notes 173-176.

201. See notes 189-90, *supra*.

also used for the public benefit and mutual benefit corporations.<sup>202</sup> This would have the advantage of internal uniformity and parallelism with the new General Corporation Law, one of the organizational features of the new Nonprofit Corporation Law.<sup>203</sup> Subsequent research may resolve whether there are constitutional grounds for special treatment which leaves the religious corporation director without indemnification.<sup>204</sup>

## XII. FOREIGN NONPROFIT CORPORATION

The area of foreign nonprofit corporations and their treatment under the new act would generally be too mundane for comment. In California, however, "pseudo foreign corporation" rules exist in the new General Corporation Law.<sup>205</sup> This fact requires a brief analysis. Following the example of the Model Business Corporation Act, each foreign corporation must qualify to do business in the State.<sup>206</sup> The qualification process submits key information to the State,<sup>207</sup> and a failure to file can be corrected without significant penalty.<sup>208</sup> In addition, the new General Corporation Law requires the corporation to comply with basic provisions before foreign corporations falling within statutorily defined limits can do business in the state.<sup>209</sup> A qualified foreign business corporation is required to follow statutory norms set up to insure corporate democracy.<sup>210</sup> The foreign corporations subject to these California norms on corporate structure are termed "pseudo foreign corporations."

The Commission recommended the new General Corporation Law be followed for foreign nonprofit corporation qualification, except for the "pseudo foreign corporation" rules and the annual

---

202. See note 194, *supra*.

203. See text following note 45, *supra* on organizational rationale.

204. See note 86, *supra*.

205. See Halloran & Hammer, *Section 2115 of the New California General Corporation Law—The Application of California Law to Foreign Corporations*, 23 U.C.L.A. L. REV. 1282 (1976).

206. See new General Corporation Law, CAL. CORP. CODE §§ 2105, 2106 (West 1977) and MODEL BUSINESS CORPORATION CODE ANNOTATED §§ 106, 108 (2d ed. 1971), concerning admission and corporate names of foreign corporations for each statute respectively.

207. See CAL. CORP. CODE § 2105 (West 1977) and MODEL BUSINESS CORPORATION ACT ANNOTATED § 110 (2d ed. 1971).

208. See CAL. CORP. CODE § 2108 (West 1977) and MODEL BUSINESS CORPORATION ACT ANNOTATED § 121 (2d ed. 1971).

209. New General Corporation Law, CAL. CORP. CODE § 2115(a) (West 1977). In general, the criteria is based on a foreign corporation having greater than 50% sales and property in California and more than 50% of the voting securities owned by California residents. These corporations are primarily California based, measured by the corporate activity, leading to the label "pseudo foreign corporation."

210. CAL. CORP. CODE § 2115(b) (West 1977).

report related requirements.<sup>211</sup> The path followed by the new Nonprofit Corporation Law in this area is now a familiar one. The public benefit and mutual benefit corporations have requirements for qualifying as a foreign corporation, in this case, by referencing most of the new General Corporation Law provisions mentioned above,<sup>212</sup> except for the provisions on "pseudo foreign corporations"<sup>213</sup> and the annual report to the State.<sup>214</sup> The deletion of the annual report requirement is a realistic step, since that report is primarily for tax related information and the nonprofit corporation is not normally taxed.<sup>215</sup>

The religious corporation under the new Nonprofit Corporation Law does not have any statutory requirement for qualifications. Religious corporations are not required to qualify with the State as a foreign corporation, in sharp contrast to the procedure under the former General Nonprofit Corporation Law, which required the initial qualification step for all nonprofit corporations.<sup>216</sup> What prompted this total rejection of qualification requirements for foreign religious corporations is a mystery. The procedure is nothing more than a simple record keeping process, as a service to the public and to the State, who may need the current corporate address or the more important information on the corporate agent for service of process. When a corporate form is used, a foreign religious organization should be required to file the basic information that every other type of foreign nonprofit corporation must file. If no constitutional barrier exists,<sup>217</sup> an amendment of the new Nonprofit Corporation Law is in order to conform the foreign religious corporation to the qualification procedure followed for the public benefit and mutual benefit corporations.

---

211. See COMMISSION PROPOSED STATUTE § 5226, *supra* note 18.

212. See Nonprofit Public Benefit Corporation Law, CAL. CORP. CODE § 8910 (WEST SUPP. 1979); and note 206, *supra*. The Commission recommended that new General Corporation Law, CAL. CORP. CODE § 2109 (West 1977) be excluded also, but the failure to delete its effect on the new Nonprofit Corporation Law, while an oversight, is not of significance. New General Corporation Law, CAL. CORP. CODE § 2109 (West 1977), only applies to a forfeiture occurring if, CAL. CORP. CODE § 2108 (West 1977) is not followed and CAL. CORP. CODE § 2108 (West 1977) has to be excluded.

213. CAL. CORP. CODE § 2115 (West 1977).

214. CAL. CORP. CODE § 2108 (West 1977).

215. See OLECK, *supra* note 2, at 761.

216. Former General Nonprofit Corporation Law, CAL. CORP. CODE § 9002 (West 1977), included reference to the former General Corporation Law, CAL. CORP. CODE §§ 6200-6804 (West 1955) on foreign corporations.

217. See note 86, *supra*.

The decision not to include the "pseudo foreign corporation" provisions of the new General Corporation Law in the new Non-profit Corporation Law is a more difficult question. The rationale for not including it may be based on a concern over the possible constitutional conflict, a concern which may be justified.<sup>218</sup>

### XIII. NONPROFIT COOPERATIVE CORPORATION

As we have seen, the nonprofit corporation cannot distribute any profit, gain, or dividends to its members,<sup>219</sup> although the members can receive some limited benefits in accordance with the corporate purpose.<sup>220</sup> Also, a nonprofit corporation cannot issue stock.<sup>221</sup> These basic nonprofit corporation characteristics are at odds generally with the traditional form of nonprofit cooperative corporation formed under the California Cooperative Corporation Law.<sup>222</sup> The Cooperative Corporation Law included by reference the former General Nonprofit Corporation Law, for its basic operative provisions, except where cooperative corporation provisions were in conflict.<sup>223</sup>

The Commission recognized these inconsistencies and urged an immediate re-examination of the Cooperative Corporation Law.<sup>224</sup> The legislature followed the lead of the Commission, since the new Nonprofit Corporation Law does not reference to the Cooperative Corporation Law, which is left dependent on the former General Nonprofit Corporation Law.<sup>225</sup> The Commission's concern and the reluctance of the legislature are probably founded on the fundamental differences between a nonprofit corporation and a cooperative corporation. The essence of a cooperative is the distribution of profits to its member patrons.<sup>226</sup> While the Cooperative Corporation Law overrides the related former General Nonprofit Corporation Law where conflict exists,<sup>227</sup> the conflict of

---

218. *Id.*

219. *See* text at note 60-70, *supra*.

220. *See* text at note 70, *supra*.

221. *See* note 124, *supra*.

222. CAL. CORP. CODE §§ 12200-12950 (West 1977). CAL. CORP. CODE § 12205 (West 1977) incorporates the former General Corporation Law, CAL. CORP. CODE §§ 100-6804 (West 1955) by reference.

223. CAL. CORP. CODE § 12205 (West 1977).

224. COMMISSION REPORT, *supra* note 18, at 2279-81. The Commission chose to continue the law as it stood and not to reference their COMMISSION PROPOSED STATUTE, *supra* note 18, to the cooperative corporation law. *See* COMMISSION REPORT, *supra* note 18, at 2672-73. The Commission did not explain its reluctance, but did recommend a further commission study which underlines a basic concern for the compatibility of cooperative and nonprofit statutes.

225. CAL. CORP. CODE § 12205 (West Supp. 1979).

226. *See* Cooperative Corporation Law, CAL. CORP. CODE § 12805(c) (West 1977); and R. PATTERSON, THE TAX EXEMPTION OF COOPERATIVES 3 (2d ed. 1961).

227. CAL. CORP. CODE § 12205 (West 1977).

fundamental characteristics remains, since a basic element of a nonprofit corporation is the lack of any profit distribution to members. Another difference is the cooperative corporation is allowed to have both stock and memberships,<sup>228</sup> reopening the confusion over the distinction between stock and membership so carefully reduced by the use of only the membership in the new Nonprofit Corporation Law.<sup>229</sup> These differences are enough to justify a re-examination of whether the Cooperative Corporation Law should be related to a nonprofit corporation statute.

The Cooperative Corporation Law needs to be freed from the former General Nonprofit Corporation Law. Under a unified statute, hopefully embracing the Marketing Cooperative Association,<sup>230</sup> the cooperative corporation law can develop properly. This long recognized uniqueness prompted the Model Non-Profit Corporation Law to state "[C]ooperative organizations . . . may not be organized under this Act."<sup>231</sup> The Cooperative Corporation Law revision should not be difficult to complete. It would follow the separate, unified statutory approach used in many other states that have been careful to maintain the fundamental distinction between a nonprofit corporation and a cooperative.<sup>232</sup> The cooperative and the nonprofit corporations each have a very important role to play and the revision of the Cooperative Corporation Law should be given high priority.

#### CONCLUSION

Each topic analysis in this article has included a conclusion with a proposed change, where appropriate. Those remarks will not be repeated here. However, there are a few general conclusions that should be covered when looking at these topics as a group.

---

228. Cooperative Corporation Law, CAL. CORP. CODE § 12402 (West 1977).

229. See text following note 124, *supra*.

230. The Nonprofit Cooperative Association Law, CAL. FOOD & AGRIC. CODE §§ 54001-294 (West 1968) should also be a part of this review. Its statutory designation as well as its components need to be compared with the new Nonprofit Corporation Law, CAL. CORP. CODE §§ 5002-10831 (West Supp. 1979), to see if any revisions are appropriate.

231. MODEL NON-PROFIT CORPORATION ACT § 4 (1964).

232. See I. PACKEL, THE ORGANIZATION AND OPERATION OF COOPERATIVES §§ 2, 6 (4th ed. 1970). The line is not always clear, as a cooperative can be designed to have characteristics of a nonprofit corporation. The key is the nonprofit corporation does not distribute profit during operation while the cooperative does allow such distribution.



The new Nonprofit Corporation Law is organized in a manner to facilitate an understanding of the act. Fundamentally, it separates the nonprofit corporation law from a general dependence on the new General Corporation Law, but parallels the new General Corporation Law where appropriate. The division into three nonprofit corporation groups permits considerable internal uniformity while allowing the flexibility to adopt measures to their special needs. The careful attention to conceptual integrity has removed most of the confusion that existed previously. The desire to remain true to this integrity is no better demonstrated than in the refusal to associate the cooperative corporation with the new Nonprofit Corporation Law. The design rationale generally presents a strong set of operating norms to guide the public benefit corporation and the mutual benefit corporation, while the religious corporation has been left without such norms in many key areas.

Hopefully, legal scholars will select some of the topics outlined herein for more intense analysis. The new Nonprofit Corporation Law requires significant analysis to realize its full potential. Indeed, California has a unique nonprofit corporation statute, one that other states will want to examine closely before their next revision.