

#77

5/7/76

Memorandum 76-52

Subject: Study 77 - Nonprofit Corporations (History of Study)

At the last meeting, the Executive Secretary was directed to prepare a history of the significant events in connection with the nonprofit corporation study. The requested information is attached. We do not plan to discuss it at the meeting unless some member of the Commission wishes to bring it up for discussion.

The Chairman will report at the meeting on the results of our May 4 meeting with Assemblyman Knox and others.

Respectfully submitted,

John H. DeMouilly
Executive Secretary

EXHIBIT I

HISTORY OF EVENTS IN CONNECTION WITH NONPROFIT
CORPORATIONS STUDY

1. 1969. Request for authority to make study. See 1969 Annual Report, 9 Cal. L. Revision Comm'n Reports 107-108 (1969) (Exhibit II attached).
2. 1970. Study authorized. Res. Ch. 54, Cal. Stats. 1970.
3. May 1970. Subcommittee appointed to investigate the possibility of obtaining the services of Mr. James Gaither, San Francisco lawyer, to prepare a comprehensive study relating to nonprofit corporations with the assistance of Dean Bayless Manning of Stanford Law School and Professor Joseph Sneed, Law Revision Commission member. Subcommittee reported at June 1970 meeting that it was unable to obtain the services of Mr. Gaither and that no alternative consultant appeared to be immediately available.
4. 1971-1973. The Commission decided to give top priority to the field of creditors' remedies and eminent domain. (Various creditor remedies were held unconstitutional in a series of decisions, the first of which was Sniadach v. Family Finance Corp., 395 U.S. 337 (1969).)
5. January 1972. Commission discussed the possibility of retaining Mr. Jerry Davis as an expert consultant on this topic. No action was taken at that time because of a lack of funds to finance the study and because the Commission determined to give top priority to the study of prejudgment attachment and eminent domain.
6. 1973. A member of the Commission's staff commenced work on the project and completed a staff draft of a comprehensive nonprofit corporation statute, based primarily on the comprehensive statutes recently enacted in other states, in April 1974. The staff draft consisted of more than 300 pages and was accompanied by 181 pages of source and comparable provisions.
7. November 1973. A contract was made with Mr. Davis to serve as expert consultant on the nonprofit corporations study.

8. May 1974. At the direction of the Commission, the Executive Secretary wrote to the State Bar, advising that the Commission was engaged in drafting a new nonprofit corporation law and requesting--as had been the practice in the case of all other major Commission studies--the appointment of a committee of the State Bar to work with the Commission on the project. It was noted in the letter that the State Bar already had a committee engaged in revising the business corporation law but that this committee did not plan to work on the nonprofit corporation law. Suggestions were made for coordinating the work and for methods of communication between the committee and the Commission. See the letter attached as Exhibit III.

9. May-June 1974. The Commission considered the staff draft at the May and June, 1974, meetings. The first 100 pages were covered at the May 1974 meeting, which was devoted almost entirely to this subject. A major portion of the remainder of the staff draft was reviewed at the June 27-29, 1974, meeting, and important policy issues presented by portions not reviewed in detail were discussed. After the June meeting, the staff made revisions in the staff draft to reflect Commission decisions at the May and June 1974 meetings. However, Commission consideration of the topic was deferred pending completion of the new General Corporation Law since one of the policy decisions the Commission made was that the nonprofit corporation law should conform to the business corporation law unless some reason existed for deviation. At the June meeting, the Commission received oral comments from Lawrence R. Tapper and George C. Apallas, both of the Attorney General's office, and considered written comments from Mr. Robert Sullivan of Pillsbury, Madison, and Sutro, San Francisco, concerning various provisions of the staff draft. Mr. Jerry Davis, the Commission's expert consultant, attended both the May and June 1974 meetings.

10. February 1975. Work on the eminent domain project was basically completed in 1974, and the recommended legislation was presented to the 1975 Legislature. Starting in February 1975, the staff from time to time worked on the nonprofit corporation law study. It was

decided at the staff level to prepare a series of memoranda covering specific aspects of the topic rather than a complete staff draft of an entire statute. The earlier draft was available to be drawn on as a source of material and earlier Commission decisions, but the new General Corporation Law, which was then before the Legislature, was to be used as the starting point in preparing the new draft.

11. August 1975. A staff memorandum prepared in August 1975 suggested that the nonprofit corporation law study be given a top priority. The memorandum pointed out the problem created by Section 119 of the Corporations Code which makes the prior General Corporation Law applicable to nonprofit corporations absent some special inconsistent provision applicable to the nonprofit corporation and will require the practitioner to retain the obsolete volumes of the Corporations Code so he can determine the law applicable to nonprofit corporations.
12. October 1975. At its October 9-11, 1975, meeting, the Commission decided to give top priority to the study of nonprofit corporations with the goal of submitting a recommendation to the 1977 legislative session.
13. October 1975. The State Bar designated the Subcommittee on Revision of Nonprofit Corporations Law to work with the Law Revision Commission on the nonprofit corporation law project. The procedure to be followed was outlined in Memorandum 75-80 (attached as Exhibit IV). (Pursuant to this designation, the Chairman of the Subcommittee, Carl A. Leonard, attended two meetings of the Commission and a member of the Subcommittee, Henry L. Stern, attended a portion of another meeting.) The details of how the State Bar Committee will review tentative drafts of portions of the statute have yet to be worked out.
14. November 1975. Beginning at its November 6-7, 1975, meeting, the Commission considered various memoranda relating to nonprofit corporations. By January 1976, the staff work on major portions of the topic had been substantially completed or was well underway and the Commission itself had considered various portions of the mate-

rials produced by the staff. By early April, approximately one-half of the basic statute was in tentatively approved draft form. By May 15, this portion will be revised to reflect decisions at the April meeting and the remainder of the statute (excluding the transitional provisions) should be in staff draft form ready to be considered at the Commission's May 13-15 meeting. Persons attending one or more of the meetings during November-March as observers included Wells A. Hutchins, James P. Molinelli, Robert H. Nida, A. S. Kaufer, and R. U. Robinson. The Commission's consultant, Jerry Davis; Carl Leonard, Chairman of the State Bar Subcommittee; H. L. Stern, member State Bar Subcommittee; Robert McMahon, State Bar Staff; and Lawrence R. Tapper, office of the Attorney General also were present. An extended communication from Professor Oleck, in response to a request from the Commission, was discussed. Several letters from Mr. Robert Sullivan also were considered.

15. February 1976. A letter from Robert McMahon, staff attorney, State Bar, requested that we include members and affiliates of the State Bar Committee on Corporations on our mailing list for nonprofit corporation materials or that we send him copies for duplication and distribution. He attended the February 1976 meeting of the Commission and we provided him with two large boxes of material with the understanding that we would work out procedures to distribute future materials directly or through the State Bar. In a subsequent telephone conversation, he indicated that the members of the State Bar Committee had indicated that they did not wish to receive all the materials but would prefer to receive the tentative drafts. The staff advised him that we hoped to have a tentative draft of the statute available soon.
16. February 1976. Early in February 1976, Assemblyman McAlister advised the Commission that Assemblyman Knox and the State Bar Committee on Corporations were concerned that the Law Revision Commission would not produce the nonprofit corporation law revision bill for the 1977 session. The Executive Secretary advised Assemblyman McAlister that the bill would be produced for the 1977 session and that staff work on a substantial portion already had been completed and the Commission would be considering the bill.

portions of the materials produced by the staff. The Executive Secretary discussed the matter with Assemblyman Knox. The Executive Secretary thought that the result of the conversation with Assemblyman Knox was that there would be a coordinated joint project and that Assemblyman Knox would be the author of the resulting bill. Assemblyman Knox apparently has a different view of the result of this conversation.

17. February 1976. Peter A. Whitman, a Palo Alto lawyer who is a specialist in corporation and nonprofit corporation law, indicated that he had planned a short term public service sabbatical leave from his law firm and the project he had planned to do had fallen through. He indicated his interest in participating in the nonprofit corporation law study. He was retained as an expert consultant on a short term basis on a contract approved in February 1976. Despite a shortage of funds, the contract was approved to expedite the production of the bill to the extent possible in view of the concern expressed by Assemblyman Knox that a bill be ready for the 1977 session and because it was desired to clear the decks in case the Commission is directed to undertake a major study later this year.
18. February 1976. Starting early in February 1976, the staff, at the suggestion of Mr. Leonard, began sending letters to the Chairman of the State Bar Committee on Corporations noting provisions of the new General Corporation Law and related statutes that appeared to be in need of possible revision. Letters from the Chairman of the State Bar Committee indicated that such letters were useful to the Committee. Many of the problems identified in the letters are being dealt with in the corrective bill (AB 2849).
19. March 1976. Each member of the State Bar Committee on Corporations was sent a copy of the recommendation relating to service of process on unincorporated associations and comments were requested. None were received, apparently because the recommendation presented no significant policy issues and had been cleared in advance with Bill Holden of the office of the Secretary of State and revised prior to approval by the Commission to incorporate his suggestions. Assemblyman Knox agreed to author this bill for the Commission and introduced the corrective legislation.

A study to determine whether the law relating to nonprofit corporations should be revised

The Corporations Code and special provisions in a number of other codes authorize and regulate the incorporation and operation of nonprofit corporations.¹ However, the scheme has developed piecemeal and, as noted recently, "historically the orphan of corporate law, nonprofit corporations [have] suffered from undefined and poorly articulated statutes governing their organization. . . ."² As an example, Section 9002 of the Corporations Code provides that the general business corporation law applies to nonprofit corporations, "except as to matters specifically otherwise provided for." Thus, it would appear that the general corporation law relating to the issuance and handling of shares should apply to nonprofit corporations, but the latter do not distribute profits or normally even issue stock.³ The situation is further confused by provisions that incorporate the nonprofit corporation provisions by reference,⁴ and thus requires reference first to the general nonprofit corporation law which in turn requires reference to the general business corporation law.

Such confusion and ambiguity could be excused or, at least, ignored except that:⁵

In recent decades nonprofit corporation law has taken on a new importance. . . .

Nonprofit corporations are no longer confined to the traditional category of political, religious, or social endeavor but have expanded to include community theaters, hospitals, thrift shops, conservation clubs, etc. Moreover, the tax problems, the state and local laws regulating fund-raising, the effect of various activities on the tax-exempt status, the effects of reorganization or dissolution, and many other problems are complex and difficult. Because of these reasons nonprofit corporation law has recently gained a greater vitality.

A study should, therefore, be made to determine whether the law relating to nonprofit corporations should be revised.⁶

¹ See generally Divisions 2 and 3 of Title 1 of the Corporations Code. Other provisions are scattered throughout the codes. See, e.g., AGRIC. CODE § 51002 (nonprofit agricultural associations); EDUC. CODE §§ 29004, 29005 (private educational institutions); INS. CODE § 11406 (hospital corporation).

² Preface to CALIFORNIA NONPROFIT CORPORATIONS (Cal. Cont. Ed. Bar 1969).

³ See II. CHECK, NON-PROFIT CORPORATIONS, ORGANIZATIONS, AND ASSOCIATIONS § 9 (2d ed. 1965).

⁴ See CORP. CODE § 12205 (provisions relating to nonprofit corporations "apply to cooperative corporations formed under this part, except where such provisions are in conflict with those of this part").

⁵ Preface to CALIFORNIA NONPROFIT CORPORATIONS (Cal. Cont. Ed. Bar 1969).

⁶ It is anticipated that such a study would lead to a comprehensive revision of the law relating to nonprofit corporations, and, in this connection, the New York comprehensive Not-For Profit Corporation Law (effective September 1, 1970) and the Model Nonprofit Corporation Act, drafted by the American Bar Association Committee on Corporate Laws, may provide some guidance. See ABA COMMITTEE ON CORPORATE LAWS, MODEL NONPROFIT CORPORATION ACT (1964).

May 13, 1974

John S. Malone, Esq.
State Bar of California
601 McAllister Street
San Francisco, California 94102

Dear Mr. Malone:

The California Law Revision Commission is engaged in drafting a new Nonprofit Corporations Code. The Commission seeks the assistance of the State Bar in this project.

Specifically, the Commission requests that a committee of the State Bar be designated to work with the Commission on the nonprofit corporation law project. As you know, the State Bar already has a committee engaged in revising the business corporation law, but this committee does not plan to work on the nonprofit corporation law.

If it is decided to create a new committee to work with the Commission on the nonprofit corporation law project, the Commission suggests that consideration be given to appointing to this new committee some members of the committee that is now engaged in revising the business corporation law. This would greatly assist in coordination of the two projects and would help avoid unintended inconsistencies between the law governing business corporations and the law governing nonprofit corporations.

If the State Bar is willing to designate a committee to work on the nonprofit corporation law revision, the Commission suggests that the committee be authorized to send its comments on various drafts of the new code directly to the Commission. The Commission recognizes that these would not represent the views of the State Bar, but the direct communication between the committee and the Commission would greatly facilitate the drafting of the new code. The Board of Governors has authorized other committees that have worked with the Commission to communicate directly with the Commission.

The Commission already has a staff draft of the new code under consideration. Accordingly, it would be desirable to have the State Bar committee designated as soon as possible.

Sincerely,

John H. DeMouly
Executive Secretary

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Subject: Study 77 - Nonprofit Corporations (Subcommittee of State Bar Committee)

The State Bar Committee on Corporations has appointed a Subcommittee on the Revision of the Nonprofit Corporations Law to work with the Law Revision Commission. The Chairman of the subcommittee is Carl A. Leonard, San Francisco. The members of the subcommittee are listed on Exhibit I attached.

The Chairman of the State Bar Subcommittee advised me that the State Bar Committee on Corporations had a meeting with Assemblyman Knox and others interested in the law in this field. Those present were strongly of the view that it is essential that the nonprofit corporations law revision be produced as soon as possible. As you know, the reason is that the new business corporations law does not apply to nonprofit corporations; the law relating to nonprofit corporations incorporates the old business corporations law by reference. This requires the practitioner to keep his obsolete business corporations law volumes. This was the reason the Commission decided at the last meeting to give this topic a top priority and tentatively scheduled its recommendation on this subject for the 1977 legislative session. I so advised the chairman of the subcommittee and further advised him that there was no guarantee that the recommendation of the Commission would be produced in time for the 1977 session. The goal was to produce a recommendation for 1977, but whether this will be possible will depend upon the speed with which the various problems could be solved. I further advised him that we did not want to rush in with a recommendation that was not carefully worked out and then have to make many changes at a subsequent session to correct technical defects and substantive deficiencies.

The subcommittee wants to work with the Commission in the most efficient way and wants to avoid having to review a massive proposal in a short time before it is to be submitted to the Legislature. Accordingly, the chairman of the

subcommittee suggested that the subcommittee might try to keep up with the Commission as the Commission goes through the various problems. In this way, the work can be spread out over the period of the project and the subcommittee will have time to give careful consideration to each problem area.

The chairman asked that we provide him with a copy of all the material on each subject that is sent to the members of the Commission so that he will be aware of the status of the project at all times. He also wants to send the material to the individuals on the subcommittee who have expertise in the particular area. Also, when a section or group of sections is tentatively approved by the Commission, he asks that the section or group of sections be sent to each member of the subcommittee to be taken up by the subcommittee for review and comment. At the same time, background material concerning the particular section or group of sections should be provided to the members of the subcommittee (probably in the form of the staff background memorandum that was submitted to the Commission in connection with the section or group of sections). The chairman of the subcommittee understands that any section or group of sections so provided would be extremely tentative in nature but believes that the proposal is the best method to involve the subcommittee in the project at the earliest time the subcommittee would be able to work in a meaningful way. The subcommittee also requests copies of any background studies as soon as they have been prepared.

The chairman plans to suggest a method of procedure along the above lines at the next meeting of the full Committee on Corporations and will advise thereafter as to the views of the committee. It is obvious that the crash nature of this project requires some procedure that will give the subcommittee the maximum amount of time to consider various problems and to review tentative Commission decisions on particular aspects of the project. What is the Commission reaction to the procedure outlined above?

I advised the Chairman of the Subcommittee that our meetings are public meetings and that we encourage interested persons to attend as observers. Although the meetings are not hearings, the Commission does permit observers to make remarks and persons attending meetings obtain considerable background information concerning matters being considered by the Commission. The Chairman indicated that some members of the Subcommittee might be able to attend meetings when nonprofit corporations law is considered. This should be helpful not only to the State Bar Subcommittee but also to the Commission since the members of the Subcommittee have a variety of experience with nonprofit corporations.

So that we can move this project along as fast as possible, the staff plans to devote a maximum amount of staff resources to the project. We plan to have Nat Sterling work generally full time on the project and to have one other staff member devote a substantial portion (approximately one-half time or more) to the project. We will do this as soon as we have prepared our 1976 legislative program for the printer.

The staff believes that our goal of a recommendation for the 1977 session is a very ambitious one but is one that may be possible to achieve. We intend to exert every effort to meet that goal.

Respectfully submitted,

John H. DeMouilly
Executive Secretary

EXHIBIT I

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