

NONPROFIT ORGANIZATIONS:
ORGANIZATIONAL FORM AND STRUCTURE*

by

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As American law presently stands, any person or group who desires to organize for goals other than making money has a relatively limited set of structural alternatives. These alternatives may be described as a choice between structure and chaos. The organizer may choose to operate as a nonprofit corporation incorporated under the laws of one of the fifty states or the District of Columbia (structure) or to operate as an unincorporated association (chaos).¹ In fact, for many organizations the choice may be between chaos and chaos in that the nonprofit corporation structure may not fulfill the functions which the participants seek to serve through its form of organization.

Given the choices which exist, one can evaluate those choices on a number of factors from which a conclusion may be drawn as to be best available structure for a given organization. Despite any such conclusion as to the better choice between the existing options, it is quite likely that for many small and middle-sized organizations a suitable structure is yet to be developed. Although there has been a substantial amount of law reform activity directed to nonprofit corporations in the past two decades this activity has focused on the revision of state laws governing nonprofit corporations.² The greater part of the attention directed to these laws, however, has

1. There are other options which will not be considered in this paper. Corporations may be chartered by special acts of a legislature or of the United States Congress; e.g., Little League Baseball Inc., Future Farmers of America and Daughters of the American Revolution are federally chartered corporations. It is also possible to form a charitable trust if the organization has goals which would fit within the definition of charitable in the governing state's law; however, today charitable trusts fulfill rather specialized objectives and will not be considered herein as an alternative which would appeal to a promoter of nonprofit activity.

2. Since the adoption of the New York Not-For-Profit Corporation Law in 1969, the following states have made general revisions to their nonprofit corporation laws: California, Pennsylvania, New Jersey, Illinois, Massachusetts, Rhode Island, Minnesota, Michigan, Virginia, Tennessee and Mississippi. States presently considering general
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concerned the purposes for which such corporations may be organized and finding a method of classification which insures the application of resources to approved goals, assuages participant's concerns about director and officer liability and the public's concern about accountability and private inurements.³ Little thought has been given to whether or not the existing laws accommodate the legitimate and commendable operations of vast numbers of these operations, including most local groups organized for social or community purposes and the bulk of public interest organizations. Revisers have proceeded on the assumption that the statutes were sufficiently flexible so as to allow the organization to be structured to suit its peculiar organizational needs.

Traditional thinking about nonprofit organizations has been permeated by our thinking about business organizations so that the structures devised for most nonprofit organizations, i.e., nonprofit corporations, have been drawn from concepts and forms based on general business corporation laws.⁴ As a result it is not surprising

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revisions are: Colorado, Florida, Georgia, Indiana, Missouri, North Carolina, Oregon, South Carolina, Texas and Wisconsin.

In 1988, the Business Law Section of the American Bar Association promulgated the Revised Model Nonprofit Corporation Act.

3. See Hansmann, The Role of Nonprofit Enterprise, 89 Yale L.J. 835 (1980); Hansmann, Reforming Nonprofit Corporation Law, 129 U. Pa. L. Rev. 497 (1981); Ellman, Another Theory of Nonprofit Corporations, 80 Mich. L. Rev. 999 (1982); Fessler, Codification and the Nonprofit Corporation: The Philosophical Choices, Pragmatic Problems and Drafting Difficulties Encountered in the Formulation of a New Alaska Code, 33 Mercer L. Rev. 543 (1983); and Moody, The Who, What and How of the Revised Model Nonprofit Corporation Act, 16 No. Ky. L. Rev. 251 (1989).

4. The first organizations in English law which we would look on as corporate were in fact nonprofit organizations, e.g., the University of Oxford; nonetheless today's corporation laws have evolved from the general business corporation laws enacted in the Nineteenth Century. See Fishman, The Development of Nonprofit Corporation Law, 34 Emory L. J. 617 (1985); Henn and Boyd, Statutory Trends in the Law of Nonprofit Organizations, California Here We Come, 66 Cornell L. Rev. 103, 1106 (1981); Moody, supra n. 3, at 252-254 and 256; and Oleck, Mixtures of Profit and

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that the organizations served by such laws are organizations which have both the resources and organizational needs of similar business corporations. What is surprising is that there has been no development of nonprofit parallels to the partnership and close corporation laws which serve business organizations which are less formal than the large public corporation.

A number of attributes of the corporate and unincorporated forms as they presently exist will usually dictate any purposeful choice of structure. These may be equally important to the organizations (of which there are many) which inadvertently operate in one form or another.

It is the purpose of this paper to identify the major non-tax factors which affect nonprofit organizations and which promoters should take into account in making a decision as to form. It further poses questions as to whether or not present laws pertaining to nonprofit organizations accommodate rational choices as to structure.

Non-Tax Factors in Choosing Organizational Form

The structure choice for a nonprofit organization is different from that for a business corporation. Business organizations are generally organized to make money. Nonprofit organizations are organized for many diverse purposes. Business corporations generally are centrally controlled or shareholder controlled. Nonprofit organizations operate from an endless array of arrangements, many of which "just happened." Business organizations or their investors are taxed; nonprofit organizations are not.

It can be argued that a weighing of the relative benefits and burdens of certain non-tax factors is far more important to a decision with respect to the structure of nonprofit organizations than to business organizations. These factors include expense, governmental regulation, recordkeeping and disclosure of information, flexibility and informality, continuity of existence and powers, requirements for

4. (...continued)

Nonprofit Corporation Purposes and Operations, 16 Northern Ky. L. Rev. 225, 243-244 (1989).

termination, foreign corporation registration, rules for operation, limited liability and the availability of legal advice. Such factors vary considerably between corporations and unincorporated associations and one or more will almost always dictate the ideal structure for a given organization under presently existing laws.

Expense

The expense involved in maintaining an organizational form is frequently a principal factor in choosing one form over another, in both nonprofit and business organizations. It is of particular concern to the nonprofit organization which will be tax exempt in that no benefit can be obtained from a tax deduction for such expenses. Participants in nonprofit ventures, moreover, focus on garnering resources to do good rather than to make money and tend to view expenses related to maintaining an organizational form as diverting scarce resources away from the good purposes of the organization.

Corporations are much more expensive to maintain than unincorporated organizations. The cost of organizing and maintaining a corporation are substantial and include such items as: accounting fees; attorney fees; filing fees in connection with incorporation and amendments to the charter; fees related to other filings required by state laws governing the supervision of charities; costs of maintaining a registered office and/or an agent for the service of process, and costs of complying with required corporate formalities such as notices to members.⁵

In contrast, unincorporated associations usually have little need to file anything unrelated to taxes. Their creation can be completely without formality or with a minimal filing such as a certificate to do business under an assumed name. The extent to which an unincorporated organization keeps books and records or makes information available to its members or the public are matters either of the contractual or fiduciary obligations among the participants or of the express regulation of the activity in which it is engaged.

5. See, Cavitch, BUSINESS ORGANIZATIONS, Sec. 1.02[2] (1986).

Government Regulation

In an era of ever increasing government regulation, both unincorporated and incorporated organizations need to be informed about and comply with an extensive number of governmental requirements. While many statutes regulate the activities of organizations without regard to form, corporations as such are extensively regulated. Corporations are themselves creatures of statute. They come into being only through compliance with the statute which gives them a juristic existence. Such statutes typically require filings and reporting by corporations throughout their existence.

In many states nonprofit corporations organized for charitable purposes are subject to supervision of the state's attorney general. As such they are required to register annually with the attorney general and give him/her notice of extraordinary transactions such as indemnification, the transfer of substantially all of the corporation's assets, merger or dissolution.⁶ Although in most states, the enforcement of such statutes is lax, compliance with disclosure and notice requirements are burdensome to the regulated organizations.

In addition to regulatory provisions contained in the applicable nonprofit corporation law, many governmental regulations, such as laws regulating political activities of corporations, were enacted without any thought being given to their impact on nonprofit corporations. The regulations, nonetheless, at least facially apply to all corporations and may well serve as a trap for the unwary nonprofit corporation.⁷

6. Throughout this paper, the Revised Model Nonprofit Corporation Act (1988) [hereinafter RMNA] will be used as a reference to indicate typical statutory provisions. See Secs. 1.70; 6.30; 14.21; 14.31; 14.02; 14.03; 8.55; 11.02; 8.10; 12.02 and 3.04. See also Oleck, Trends in Nonprofit Corporation Law 1976; 10 Akron L. Rev. 1 (1976); and Ohio Rev. Code Ann. Sec. 109.23 (Anderson 1988).

7. See, e.g., 28 U.S.C.A. Sec. 441b(a) which provides, in part: "It is unlawful for...any corporation organized by authority of any law of Congress, to make a contribution or expenditure in connection with any election to any political office...." See also Comment, Federal Election Commission v. Massachusetts Citizens for Life:

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Unincorporated associations, are rarely expressly included in regulatory enactments. As a result they either may have the advantage of nonregulation or be faced with the uncertainty as to whether or not they are subject to a given statute. As neither a corporation nor a partnership, statutes which regulate these organizations may be interpreted to apply to them and classify them as a corporation or other business organization for such purposes.⁸

Recordkeeping and Disclosure of Information

Because incorporation is regarded as a privilege granted by the state, a corporation is subject to many requirements for public and intra-corporate disclosure and recordkeeping. Its charter is a matter of public record. Anyone may obtain a copy for the cost of duplication. Additionally, corporations must maintain a corporate agent and/or corporate office which is included in the files of the secretary of state and available to the public. Many corporation laws require that the corporation file an annual statement with a designated state officer each year listing information such as: the corporation's name, address and state of incorporation; the name and address of the registered agent; the address of its principal office; the principal activities of the corporation for the year.⁹ Nonprofit corporation laws contain a number of

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Nonprofit Expenditures in Federal Elections, 60 Notre Dame L. Rev. 138 (1984). The comment discusses Federal Election Commission v. Mass. Citizens For Life, 589 F. Supp. 646 (D. Mass. 1984) which construed 28 USCA Sec. 441b supra to exclude from its prohibitions the publishing of a newsletter urging pro life adherents to vote for candidates who supported their position. See also Ohio Rev. Code Ann. Sec. 3599.03 (Anderson 1988).

8. See, e.g., Ohio Rev. Code Ann. Sec. 109.23. This section includes "association" in the definition of "charitable trust" for the purposes of attorney general upervision.

9. See, e.g., RMNA supra n. 6, Sec. 16.22. See also Model Nonprofit Corporation Act Sec. 87 (1964) which provides: "The Secretary of State may propound to any corporation, domestic or foreign, subject to the provisions of this Act, and to any officer or director thereof such interrogatories as may be reasonably necessary and

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provisions which entitle members to information. Members are typically entitled, on demand, to inspect and copy the articles of incorporation, the bylaws, resolutions of the board of directors relating to members, minutes of meetings of members, recording of actions by members, written communications to members, names and addresses of the officers and directors and the corporation's annual report.¹⁰ Subject to certain limitations the members are also entitled to inspect and copy minutes of all meetings of the board of directors, all actions taken by the directors without a meeting, records of all actions by committees of the board of directors, financial records and the membership list.¹¹ In jurisdictions in which the corporation law does not spell out such rights in detail, case law usually establishes similar rights.¹² Recordkeeping for most corporations also is mandated by state corporation laws. These laws require that the corporation maintain certain records; typically minutes of members' and directors' meetings, accounting records and membership lists.¹³ Failure to maintain such records can result in forfeiture of the corporate charter.¹⁴

Unincorporated organizations, by comparison, usually are not subject to any specific disclosure requirements other than the registration of an assumed name.¹⁵ The extent to which an unincorporated organization may have to make information

9.(...continued)
proper to enable him to ascertain whether such corporation has complied with the provisions of this Act applicable to such corporation...."

10. RMNA, supra n. 6 at Sec. 16.02.

11. Id.

12. See, State ex rel. Pillsbury v. Honeywell, Inc., 291 Minn. 322, 191 N.W.2d 406 (1971).

13. RMNA, supra n. 6 at Secs. 16.01, 16.20.

14. 74 C.J.S.2d Sec. 14 QUO WARRANTO.

15. See, e.g., N.Y. Gen. Bus. Law Sec. 130 (McKenny's 1989). There is a trend to adopt statutes requiring registration of partnerships. See Hawaii Rev. Statutes ecs. 425-1 - 425-17 (1985).

available to its members is uncertain, governed by the principles of contract and agency law and by conclusions derived from such principles as to the relationships among the various participants.¹⁶

Flexibility and Formality of Operation

Although most modern nonprofit corporation laws have been drafted to enable the nonprofit corporation to be structured in a variety of ways, state corporation laws do impose a specific organization and other requirements for operation which some nonprofit groups may find oppressive or opposed to their general notions of participation. While many of the requirements of the corporation law may be varied by agreement some are not subject to such variation. Universally, general corporation laws require that a corporation have some group consisting of three or more persons who function as a board of directors and that certain officers be designated.¹⁷ These statutes also require that the corporation adopt bylaws,¹⁸ have an annual meeting,¹⁹ observe quorum and notice requirements²⁰ and observe voting procedures.²¹ Corporation laws also provide procedures and voting requirements for extraordinary transac-

16. See, infra, n. 42.

17. RMNA, supra n. 6 at Sec. 8.01.

18. Id. at Sec. 2.06.

19. Id. at Sec. 7.01.

20. Id. at Secs. 7.05, 7.22, 8.22 and 8.24.

21. Id. at Secs. 7.07, 7.20 and 7.21.

tions such as amendments to the charter,²² mergers,²³ sales of assets²⁴ and dissolution.²⁵

Unincorporated organizations are subject to no such express requirements. Since there are no comparable laws, such as the Uniform Partnership Act, which apply to unincorporated nonprofit organizations, those organizations are free to structure their operation in any way within the bounds of law. The participants may agree as to how they shall manage the association's affairs.²⁶

Continuity of Existence and Powers

Typically, a general corporation statute expressly confers upon a corporation certain powers as well as continuity of existence. For example the Revised Model Nonprofit Corporation Act provides:

Unless its articles of incorporation provide otherwise, every corporation has perpetual duration and succession in its corporate name and has the same powers as an individual to do all things necessary or convenient to carry out its affairs....²⁷

Among the powers expressly enumerated are the power to sue and be sued in the corporate name,²⁸ to adopt a corporate seal,²⁹ to make bylaws,³⁰ to purchase, hold

22. Id. at Secs. 10.01-10.08.

23. Id. at Secs. 11.01-11.07.

24. Id. at Secs. 12.01-12.02.

25. Id. at Secs. 14.01-14.08; 14.20-14.23 and 14.30-14.33.

26. One caveat to such a statement is that organizations which seek to obtain exempt status under I.R.C. Sec. 501(a) will have to provide the Internal Revenue Service with proof that its organizational documents meet the requirements for tax exemption, such as the dedication of assets upon dissolution. I.R.C. Sec. 501(c)(3); Sec. 1.501(c)(3)-1(b).

27. RMNA, supra n. 6, Sec. 3.02.

28. Id. at Sec. 3.02(1).

and deal with any legal or equitable interest in real or personal property,³¹ to dispose of its property,³² to deal in shares or other interests or obligations of any entity³³ to contract,³⁴ to enter into guarantees,³⁵ to lend money,³⁶ to be a partner,³⁷ to conduct activities in another state³⁸ to make donations³⁹ and to carry on a business.⁴⁰

The extent to which an unincorporated association, in the name of the organization can conduct any of those activities is an unknown. Although many states have passed statutes allowing these organizations to sue or be sued in a common name⁴¹ and banks usually allow them to open bank accounts in a common name, in all other things they may be simply treated as an aggregation of individuals. Dealings in property are uncertain and may be generally assumed to be on the basis of laws

29. (...continued)

29. Id. at Sec. 3.02(2).

30. Id. at Sec. 3.02(3).

31. Id. at Sec. 3.02(4).

32. Id. at Sec. 3.02(5).

33. Id. at Sec. 3.02(6).

34. Id. at Sec. 3.02(7).

35. Id.

36. Id. at Sec. 3.02(8).

37. Id. at Sec. 3.02(9).

38. Id. at Sec. 3.02(10).

39. Id. at Sec. 3.02(13).

40. Id. at Sec. 3.02(16).

41. See, e.g., N.J. Stat. Ann. Sec. 2A:64-1 (West 1987). See also Note, Imposing Corporate Forms on Unincorporated Denominations: Balancing Secular Accountability with Religious Free Exercise, 55 So. Cal. L. Rev. 155 (1981).

governing joint ownership. Other matters are determined on the basis of contract or consent.⁴² It is reasonably clear that the unincorporated organization can exercise none of the powers which corporations enjoy either by express grant or as an inherent characteristic of the corporate form.

The power to indemnify directors, officers and other agents against liabilities incurred in serving the corporation may be of particular concern to the participants in any nonprofit endeavor. Modern corporation laws expressly enable the corporation to make such indemnification.⁴³ Unincorporated associations generally must look to the principles of agency law for such power.⁴⁴

The factor of continuity of existence as an inherent characteristic of the corporate form is one which has not been much considered with respect to nonprofit organizations. Although it is of major importance in business organizations, it may or may not be a crucial attribute to many nonprofit organizations. While it is clear that both business and nonprofit corporations are unaffected by changes in the identity of their members and that a partnership is so affected, no clear rules apply to nonprofit associations. Most unincorporated organizations have some rules for the admission of new members; in the absence of such rules it may be assumed that the principle of delectus personae would be applied giving every present member the right to consent to the addition of a new member.

It may be postulated that members assume the continuity of existence but such an assumption is ill founded. In unincorporated business organizations such as

42. It is generally stated that the constituent documents of an unincorporated organization constitute a contract between the members and that rights, duties and liabilities proceed from an interpretation of such contract. See generally, Wells v. Mobile County Board of Realtors Inc. 387 So. 2d 140 (1980); California Dental Assn v. American Dental Assn 152 Cal. Rptr 547, 590 P.2d 401 (1979), Aspell v. American Contract Bridge League of Memphis 595 P.2d 191, 122 Ariz. 399 (1979).

43. See, e.g., RMNA, supra n. 6 at Secs. 8.50-8.55 and Introductory Comment.

44. See Restatement 2d Agency Sec. 438. See also Texas Society v. Fort Bend Chapter 590 S.W.2d 156 (Tex. Civ. App. 1959).

partnerships it is well known that the business does not continue beyond the life or retirement of a participant. As a result, both agreements and statutory provisions give careful attention to arrangements for continuing the business on the death or retirement of a partner. Many unincorporated associations do not give any attention to such problems.⁴⁵ Strategies for overcoming this problem through agreement which have been developed for partnership law generally have not been adapted to nonprofit associations. The resulting uncertainty as to property rights and organizational status as members go and come presents a series of issues worthy of a law school examination.

Termination

Corporations are given a procedure for dissolution in the governing law which not only serves as a guide to termination for those who desire to cease operation but also requires corporate formalities, a public filing and notice.⁴⁶ Express judicial and administrative remedies providing for termination are also a feature of corporation law.⁴⁷

Having no official life, unincorporated associations have no official death. Here again the matter may generally be referred to the articles of association.⁴⁸ Absent any express rules in such documents, participants may simply "silently steal away," leaving the questions of unpaid debts or undistributed assets for the courts.⁴⁹

45. See, e.g., OLECK, NONPROFIT CORPORATIONS ORGANIZATIONS AND ASSOCIATIONS, "Forms for Unincorporated Associations," Form No. 1 (Prentice Hall 1988).

46. RMNA, supra n. 6 at Secs. 14.01-14.08.

47. RMNA, supra n. 6 at 14.20 - 14.23 and 14.30 - 14.33.

48. Supra n. 45.

49. It is likely that principles of agency law allowing for the revocation of consent to the relationship would govern. See Restatement 2d AGENCY Sec. 118; cf Uniform Partnership Act Sections 29-43. An equity court would generally have jurisdiction to administer the winding up of an unincorporated association. See Labor Youth League v. Subversive Activity Control Board, 322 F.2d 364 (D.C. Cir. 1963).

Rules for Operation

The correlative to the fact that nonprofit corporation laws impose certain requirements with respect to structure and operation is that corporation laws also tend to be gap-filling, that is, they provide a structure for a corporation which supplies the details of its day-to-day operations in default of any arrangement agreed to by its participants. Such rules are based upon assumptions about choices which participants would make if they had considered the issue. These, for the most part, are subject to change by adopting a bylaw or charter provision. Gap-fillers include such provisions as:

All members shall have the same rights and obligations with respect to voting, dissolution, redemption and transfer, unless the articles or bylaws establish classes of membership with different rights or obligations. All members shall have the same rights and obligations with respect to any other matters, except as set forth in or authorized by the articles or bylaws.⁵⁰

Some nonprofit corporation statutes do not require that the members adopt bylaws and provide a fairly complete set of rules for the operation if it does not adopt any for itself.⁵¹ The Uniform Partnership Act and Uniform Limited Partnership Act serve such a function for unincorporated business associations; however, to date, no state has provided gap fillers for unincorporated nonprofit associations. They are relegated to the vagaries of agency or contract law in any questionable situation. In case of a dispute among various participants, as to matters not covered by the organization's bylaws, if any exist, the only recourse is to take the matter to the courts.

The lack of legal precedents with respect to both nonprofit corporations and unincorporated nonprofit associations is a source of major difficulty to either form of organization. The case law is extremely sparse. Nonprofit corporations, however, may benefit from many rulings applicable to business corporations, especially where the business corporation and nonprofit corporation statutes are parallel. Unincorpo-

50. Revised Model Nonprofit Corporation Act Sec. 6.10 (1988).

51. See, Ohio Rev. Code Ann. Sec. 1702.10. (Anderson 1988.)

rated associations, on the other hand, do not benefit very much from precedents applicable to unincorporated business associations because of the dissimilarity of their activities and the lack of parallel statutes.

Foreign Corporations

A factor that may be significant to nonprofit organizations which either are organized on a national basis or raise funds across state lines is the ability to operate in more than one state. Unless classified by a local statute as a corporation, or, in some jurisdictions a partnership, nonprofit associations may set up shop in any and all jurisdictions without any more formality than that required in its domicile.⁵² Corporations, on the other hand, are subject to statutes which require that nonprofit corporations register to operate in that jurisdiction. These statutes usually apply equally to business and nonprofit corporations.⁵³ A corporation which seeks to comply will inevitably incur substantial expenses and reporting requirements in connection with such compliance.⁵⁴

Limited Liability

Limited liability for participants in nonprofit organizations is a concept of unknown origin but one of much concern to the average participant in a nonprofit venture, despite the fact that participants have rarely been held liable as a result of their participation in either a nonprofit corporation or an unincorporated association. Although limited liability probably is the result of deriving the nonprofit form from the business form, nonprofit organizations undoubtedly serve a function different

52. Increasingly provisions are being enacted which require foreign partnerships to register. See e.g., Hawaii Revised Statutes Sec. 425-3 (1988); Mass. Gen. Laws Ann. Ch. 109 Sec. 48 (1989). The same approach may be taken with respect to unincorporated nonprofit associations.

53. RMNA, supra n. 6 at Chapter 15.

54. Id.

from that served in business corporations, i.e., attracting capital by "limiting" liability to the amount of one's investment.⁵⁵ An investment of money is not a requirement to participate in nonprofit endeavors, but limited liability has been extended to them as well as to business corporations and is a major reason why the corporate form is chosen.⁵⁶ Although the fact is not widely appreciated no structure can completely insulate participants from potential liabilities: participants may be liable for a breach of their duties to the corporation; statutes may impose direct liability on directors or management for certain acts or omissions, such as the organization's failure to file tax returns or the corporate veil may be pierced on the same theories as those applied to business corporations.⁵⁷

Regardless of its origins, unlikely application or rationale, limited liability is often the prime factor in decisions to incorporate. Participants have a high anxiety level about protecting their individual assets from the liabilities of the organization as well as about liabilities which may accrue to them in connection with their participation in the activities or management of the corporation. The corporation does provide a higher degree of protection than any unincorporated form in that, at least in theory, it protects individual participants against third party claims against the organization as such.

Added to conventional limited liability certain other corporate law provisions give a measure of protection from liabilities. Almost all nonprofit corporation statutes

55. See Easterbrook and Fischel, Limited Liability and the Corporation, 52 U. of Chicago L.R. 89 (1985). The authors state the following: "It may be helpful to recall what limited liability is, the liability of 'the corporation' is limited by the fact that the corporation is not real.... The rule of limited liability means that the investors are not liable for more than the amount they invest...." Id. at pp. 89-90.

56. Modern nonprofit corporation laws usually include a section covering limited liability. See, e.g., RMNA supra n. 6 at Sec. 6.12 which provides, "A member of a corporation is not, as such, personally liable for the acts, debts, liabilities or obligations of the corporation."

57. See Note, Piercing the Nonprofit Corporate Veil, 66 Marquette L. Rev. 134 (1982).

enable the corporation to indemnify officers, directors and others who act for the corporation against unfounded claims and their attendant expenses, including attorney fees. Such statutes frequently also enable the corporation to purchase insurance to indemnify the participant against claims which could not be indemnified and to underwrite the corporation's own obligation to indemnify.⁵⁸ Newer corporation statutes also protect self dealing transactions which satisfy the statute's criteria.⁵⁹ Other provisions exonerate directors from liability if they have relied on the corporation's records, recommendations of a committee or expert advice.⁶⁰ Recent provisions allow the articles of incorporation to limit the personal liability of a director to the corporation for breach of fiduciary duties in the absence of intentional misconduct or self dealing.⁶¹ These protections do not apply to unincorporated organizations.⁶²

The extent of potential liability and the ability to indemnify are both unsettled questions for unincorporated nonprofit associations. While such associations are frequently treated as general partnerships with unlimited liability, other authorities have held that only those participants who actually participate in any given activity are liable.⁶³ Few cases have held members generally to be liable.⁶⁴ The only aspect of

58. See discussion supra p. 12. See also RMNA, supra n. 6, Sec. 8.50-8.58.

59. See RMNA supra n. 6 at Sec. 8.31.

60. Id. at Sec. 8.30.

61. Id. at Alternative Provisions, Secs. 2.02(b)(5) and 8.30.

62. But discussion concerning volunteer statutes infra notes 66 and 67.

63. See NOTE: "Liability of Members of Unincorporated Associations," Conard, Knauss and Siegal, ENTERPRISE ORGANIZATION at p. 34 (Foundation Press 1982). See also Annotation, Liability of Member of Unincorporated Association for Tortious Acts of Association's Nonmember Agent, or Employee, 62 ALR 3d 1165 (1975); Annotation, Tort Liability of College University, Fraternity, or Sorority for Injury or Death of Member or Prospective Member by Hazing for Initiation Activity, 18 ALR 4th 28 (1989); Note, Member Liability for Dues, Fines and Assessments in Nonprofit Associations and Corporations, 19 U. of San Francisco L. Rev. 393 (1985).

the law of unincorporated nonprofit associations on this issue which is clear is that some participants are personally liable and that limited liability, as such, does not pertain to organizations which, in law consist only of aggregates of individuals.

The value of limited liability is frequently dismissed with respect to unincorporated business associations because the participants may protect themselves by insurance or contractual arrangements and because many business venturers, even if doing business in corporate form, must sacrifice limited liability in order to obtain financing. Neither argument applies to nonprofit associations where it is unlikely either that a participant will guarantee a loan or that a protective arrangement, such as insurance or contractual terms, will be readily available. For long periods of time, insurance is unavailable to both large and small nonprofit enterprises.⁶⁵ Insurance almost always is unavailable to a smaller organization at a price it can afford.

The fact that there are few cases which have found members of nonprofit associations to be liable for the obligations of the association is a powerful one; however, it is quite likely that one is enough to discourage many from participating in a venture if it is unincorporated. In the last few years a series of statutes have been passed which apply equally to corporations and unincorporated associations. These appear to provide limited liability to certain arrangements.⁶⁶ The statutes are of two types: those which extend a kind of charitable immunity to volunteers against third party claims for ordinary negligence and those which give a measure of protection to

64. (...continued)

64. A review of all cases digested under "Associations" in the American Digest System 1981-1989 revealed no case where members, solely because of membership, were found individually liable.

65. See, Comment, Charity Is No Defense: the Impact of the Insurance Crisis on Nonprofit Organizations and an Examination of Allowable Insurance Mechanisms, 2 U. of San Francisco L. Rev. 599 (1988).

66. These statutes offer some protection to the volunteer whether the organization is incorporated or not.

volunteers who participate in sports activities sponsored by nonprofit organizations.⁶⁷ These statutes are yet to be interpreted and their effect on participants is still to be determined.⁶⁸

Another aspect of limited liability is that donors consider it to be a determining factor as to organizational form. Donors (particularly funding agencies and foundations) fearing some liability from the donee's activity invariably require that donees incorporate. This may be an unnecessary requirement in the light both of the infrequency of liability even for participants and of the possibility of liability in the corporate form.

Availability of Legal Advice

One factor which is rarely isolated in considering organizational form is the availability to the organization of legal advice. Organizations which have access to legal advice will be able to make deliberate decisions about structure and comply with statutory requirements. Organizations which do not have legal advice, by and large, will proceed on the basis of myth and borrowed information, frequently in violation of statutory requirements.

Organizations which incorporate without access to lawyers knowledgeable about nonprofit organizations inevitably err both in the organization and operation of the corporation. Organizers of a nonprofit corporation, to a much greater extent than those of a business corporation, cannot fill out the form obtained from the secretary of state or the local legal blank store without making serious errors. Each corporation must be tailored to the activities and methods of operation unique to it

67. See, e.g., New Jersey Stat. Ann. See 2A: 62A-6 (West 1986). See also, Ohio Revised Code Sec. 2305.38 (Anderson 1988). Note, Immunity for Nonprofit Corporations, 23 Willamette L. Rev. 220 (1987).

68. These statutes seem to be reestablishing a kind of charitable immunity which has been abolished in almost all American jurisdictions. See Note, The Quality of Mercy: "Charitable Torts" and Their Continuing Immunity, 100 Harv. L. Rev. 1382 (1987).

including the requirements for tax exempt status.⁶⁹ As a result, most lay persons and many lawyers, including lawyers who represent corporations, are unable to competently organize a nonprofit corporation. A review of any nonprofit corporation act will reveal the complexity of the procedure. Using the Revised Model Nonprofit Corporation Act, as an example, the following decisions must be deliberately made with respect to the Articles of Incorporation:

- (a) the classifications of the corporation as a public benefit, mutual benefit or religious corporation;⁷⁰
- (b) whether or not the corporation will have members;⁷¹
- (c) whether to include optional provisions relating to
 - (i) the purpose for which the corporation is organized
 - (ii) the names and addresses of the initial directors
 - (iii) managing and regulating the officers of the corporation
 - (iv) defining, limiting or regulating the powers of the corporation, the board of directors or any class of members
 - (v) the characteristics, qualifications, rights, limitations and obligations attaching to any class of members;⁷² and
- (d) whether to include any provisions required or permissible to be set forth in the bylaws.⁷³

69. If a corporation intends to apply for a determination of the exempt status, it must include a number of special provisions in its Articles of Incorporation such as the lack of intention to engage in political activities and the disposition of the assets on liquidation. See IRS Publication 557 (1988), at 9-11. See also Harris, The Dangers of Incorporating Nonprofit Corporations, *The Colorado Lawyer* 762 (May 1984).

70. RMNA, supra n. 6, at Sec. 2.02(a)(2).

71. Id. at Sec. 2.02(a)(5).

72. Id. at Sec. 2.02(b).

73. Id. at Sec. 2.02(b)(4).

In addition to the decision to include such provisions other legal details must be considered:

- (a) A name must be chosen which does not contain language stating or implying that the corporation is organized for a purpose other than that permissible by the statute and the articles of incorporation and is "distinguishable" from that of other corporations upon the records of the secretary of state.⁷⁴
- (b) The organization must maintain a registered office and a registered agent the function of which is to accept service of process and to receive notices.⁷⁵

Many of the provisions of the act are self executing unless it is otherwise provided in the articles or bylaws. For example:

- (a) The corporation may admit members for no consideration or for such consideration as is determined by the board.⁷⁶
- (b) All members will have the same rights and obligations.⁷⁷
- (c) A member of a mutual benefit corporation may not transfer membership rights.⁷⁸
- (d) Corporate action may be by written consent.⁷⁹
- (e) Corporate action may be taken by written ballot.⁸⁰

74. Id. at Secs. 2.02(a)(1) and 4.01.

75. Id. at Secs. 5.01-5.04.

76. Id. at Sec. 6.02.

77. Id. at Sec. 6.10.

78. Id. at Sec. 6.11.

79. Id. at Secs. 7.04 and 8.21.

80. Id. at Sec. 7.08.

- (f) Each member is entitled to one vote.⁸¹
- (g) Membership in the names of two or more persons will have one vote divided depending on who votes.⁸²
- (h) Ten percent of the voters constitute a quorum.⁸³
- (i) A bylaw amendment to change the quorum may be approved by the members or the board.⁸⁴
- (j) Members may vote by proxy.⁸⁵
- (k) All corporate powers shall be exercised by the board of directors.⁸⁶
- (l) The only qualification for a director is that he/she be an individual.⁸⁷
- (m) Vacancies will be filled as specified in the act.⁸⁸
- (n) Regular meetings of the board of directors may be held without notice; special meetings, on 2 days' notice.⁸⁹
- (o) The quorum for a directors' meeting is a majority of the directors in office.⁹⁰

81. Id. at Sec. 7.21.

82. Id.

83. Id. at Sec. 7.22.

84. Id.

85. Id. at Sec. 7.24.

86. Id. at Sec. 8.01(b).

87. Id. at Sec. 8.02.

88. Id. at Sec. 8.11.

89. Id. at Sec. 8.22.

90. Id. at Sec. 8.24.

- (p) The board of directors may create committees which may exercise the authority of the board.⁹¹
- (q) The corporation shall have a president, a treasurer and a secretary.⁹²
- (r) The corporation shall indemnify a director or officer who is successful in the defense of any proceeding to which the director was a party because of the position with the corporation.⁹³
- (s) Amendments to the article of incorporation must be made as set forth in the statute.⁹⁴
- (t) A merger, sale of assets not in the regular course of activities or dissolution must be adopted by the board of directors and the members by a two-thirds vote.⁹⁵

Additionally there are many requirements or options in any nonprofit corporation act which must be structured into the corporation. The Revised Model Nonprofit Corporation Act, for example, requires that a corporation which has members adopt a procedure governing the expulsion or termination of membership⁹⁶ and that any purchase of membership or termination be according to a provision in the articles or bylaws.⁹⁷ It further allows the terms of directors to be for one to five years⁹⁸ and for the directors terms to be staggered through provisions in the articles or bylaws.⁹⁹ All

91. Id. at Sec. 8.25.

92. Id. at Sec. 8.40.

93. Id. at Secs. 8.52 and 8.56.

94. Id. at Secs. 10.02-10.03, 10.21-10.22.

95. Id. at Secs. 11.03, 12.02 and 14.02.

96. Id. at Sec. 6.21.

97. Id. at Sec. 6.22.

98. Id. at Sec. 8.08.

99. Id. at Sec. 8.06.

of these arrangements need careful consideration and are unlikely to be given the needed attention absent the help of competent counsel.

Unincorporated associations which muddle along without the help of counsel may be less at a disadvantage than those which choose to incorporate in that they neither will be operating in violation of the statute nor will be subject to rules they would not have desired; however, many of the concerns for structure that exist in the corporation are equally existent for the unincorporated group. Although the unincorporated association will not be violating the terms of any statute, its functioning is likely to be less crises ridden if skilled advance planning takes place. No doubt, with the aid of Robert's Rules of Order, meetings can go forward, but when questions arise, a crisis soon follows. As noted above, unincorporated nonprofit organizations do not have the back-up of statutory "gap-fillers."¹⁰⁰

All nonprofit unincorporated organizations would be much better served if they had competent help both in establishing the structure of the organization with a constitution and bylaws which address the basic topics of operation and in being advised as to the pitfalls to be avoided and precautions to take such as avoiding unlimited liability by contractual provisions disclaiming liability. Such a group will undoubtedly need advice if they are seeking exempt status under the federal tax laws.

Available Laws to Accommodate Structural Choice

One advantage of the corporate form is that the organization may choose a jurisdiction in which to incorporate. Given a decision to incorporate based on the relative importance of the respective factors outlined above, state laws can be evaluated to determine the extent to which a particular statute may accommodate any given organization. Nonprofit corporation laws vary from state to state and comparisons of the provisions are desirable prior to incorporation.

State statutes providing for the incorporation of nonprofit corporations, while differing in some respects, are generally one of several types. The most prevalent are

100. See discussion, supra, pp. 14-15.

those based on either the Model Nonprofit Corporation Act¹⁰¹ or the state's business corporation act.¹⁰² In these statutes there are no subclassifications. Charities, trade associations, clubs and cemetery societies are organized and governed by the same provisions.¹⁰³

The New York type¹⁰⁴ statute divides nonprofit corporations into Types "A," "B," "C," and "D": Type A provides for incorporation of civic, patriotic, social, fraternal, athletic, agricultural, horticultural, animal husbandry, and trade or service organizations.¹⁰⁵ Type B provides for incorporation of what is commonly termed charitable corporations.¹⁰⁶ Type C provides for the incorporation for any lawful business purpose to achieve a lawful public or quasi-public objective;¹⁰⁷ and Type D provides for the incorporation as a nonprofit corporation when authorized by a specific statute.¹⁰⁸

101. Model Nonprofit Corporation Act (1952), promulgated by the Committee on Corporate Law of the Business Law Section of the American Bar Association.

102. See, e.g., Del. Code Ann. Title 8 (1987) which covers both business and nonprofit corporations. Many states have business corporation laws which are based on the Model Business Corporation Act promulgated by the ABA Section of Business Laws Committee on Corporate Laws in 1950, on which the Model Nonprofit Corporation Act of 1952 was also based.

103. The Illinois General Not for Profit Corporation Act of 1986 allows incorporation pursuant to its provisions for any of the 29 listed purposes or similar purposes. Ill. Ann. Stat. Ch. 32 Sec. 103.05 (Smith-Hurd 1989).

104. New York Not-for-Profit Corporation Law Sec. 201(b) (McKinney 1989).

105. Id.

106. Id.

107. Id.

108. Id.

The third type of statute is that adopted by California¹⁰⁹ and the Revised Model Nonprofit Corporation Act.¹¹⁰ These acts classify nonprofit corporations into public benefit, mutual benefit and religious corporations allowing the category to be self selecting.¹¹¹

Despite the fact that the statutes differ considerably from each other in type, all extant statutes generally provide a structure for nonprofit corporations which allows them to operate in much the same way as business corporations. These statutes uniformly place responsibility for corporate management in a governing board of directors (or trustees). They also provide a method of choosing the board and regulate extraordinary transactions such as merger or dissolution. A pro forma set of rules govern the intra-corporate relationships but, to some extent, provide for rearrangement to suit the requirements of the organization.

Major differences among such statutes relate to the amount of government regulation, rules of accountability for directors and officers and purposes for which incorporation is allowed. Factors which should be considered in deciding among them are: standard of conduct for directors and officers;¹¹² arrangements for meetings and voting,¹¹³ and indemnification.¹¹⁴ Of paramount importance particularly for a local organization is a requirement that it must register as a foreign corporation if it incorporates in a jurisdiction other than the one in which it operates.¹¹⁵

109. Cal. Corporations Code Secs. 5110, 7110, 9110 (West 1989).

110. RMNA supra n. 6.

111. Id. at Sec. 2.02.

112. Id. at Sec. 8.30.

113. Id. at Secs. 7.01-7.30. See, also, Note, A Call to Reform the Duties of Directors Under State Not-for-Profit Corporation Statutes, 72 Iowa L. Rev. 725 (1987).

114. RMNA, supra n. 6 at Secs. 8.50-8.58. See also Moody, State Statutes Governing Directors of Charitable Corporations, 18 U. of San Francisco L. Rev. 749 (1984).

115. See discussion supra pp. 15-16. See also RMNA, supra n. 6 at Sec. 15.01.

If an organization values factors which dictate that it be unincorporated or, through ignorance, operates as unincorporated, it will for the most part be lawless. Laws which apply to unincorporated associations are few and far between and usually relate to matters such as the right to sue and be sued in the group name.¹¹⁶ Since it is not an entity, its associates cannot choose a jurisdiction by which its operations will be governed. Disputes will usually be subject to conflicts of law rules applicable to contracts or agency. The universally adopted Uniform Partnership Act (UPA) has no application to such organizations in that it expressly defines a partnership as an association of two or more persons to carry on as co-owners a business for profit; therefore, if an organization is organized for nonprofit purposes it cannot be affected by the UPA.

In addition to the absence of statutes, case law applicable to such associations presents little to aid in choosing a forum. Case law in every jurisdiction either does not exist or is sparse and contradictory as to liabilities, rights and duties of associates and the application of various corporate laws to them.

Tax-Factors in Selecting Corporate Form

It is beyond the scope of this paper to discuss the various tax classifications for which a nonprofit organization will qualify. Since both corporations and unincorporated associations equally may qualify for exemption under the provisions of the Internal Revenue Code,¹¹⁷ tax considerations should be a neutral factor in choosing a structure except to the extent that tax exemption requires that certain provisions be included in structural documents.¹¹⁸ In fact, tax considerations often are the motivat-

116. See discussion supra p. 10.

117. The language of the relevant Internal Revenue Code Provision is "Corporations and any community chest, fund or foundation...." I.R.C. Sec. 501(c)(3).

118. One other consideration which may controvert the neutrality of the tax treatment is the existence of unrelated taxable income. Such income would be taxed according to the classification of the organization as a corporation (the definition of which includes "association") or trust. I.R.C. Secs. 7701(a)(3); 511(a)(1) and (b). It is also possible that an association could be classified as a "partnership." See 1.761-1 and IRC Sec. 7701(a)(2).

ing factor in opting for the corporate form. This happens for a number of reasons: Many organizations are under the misapprehension that incorporation is a condition precedent to obtaining a determination letter that the organization is tax exempt. Donors tend to emphasize incorporation and tax exemption as a package of requirements. It is somewhat simpler to meet the organizational test of the 501(c)(3) regulations if the organization can produce articles of incorporation in substantially the form suggested by the Internal Revenue Service.¹¹⁹

The entire tax scenario that has been written for new organizations, in fact, is a wasteful process which causes many organizations to incorporate and seek tax exemption before demonstrating viability as an organization. In many situations a corporation is formed, a determination letter is obtained and the project is never funded. The nonprofit world is laden with skeletons of corporations awaiting death by cancellation, many of them having been inadvertently classified as private foundations because they cannot prove they are not.

Is There a Need for Statutory Reform

It can be assumed that large organizations are relatively well served by existing state corporation statutes. Most are sufficiently related to business corporations both to be comfortable with laws based on business codes and to benefit from the attention given to business law reform. All will deliberately choose the corporate form because its advantages are obvious to them and the major disadvantages are of little concern. They not only have been represented in the process of the adoption of nonprofit corporation statutes but also have the resources and influence to effect change to

119. I.R.S. Publication No. 557.

accommodate their needs or to seek out other jurisdictions which are more accommodating. Whenever such organizations have identified a particular need, such as for provisions for indemnification, it generally has been forthcoming.¹²⁰

What we do not know and cannot assume is the extent to which medium and small sized organizations are served by the laws which presently exist and the nature of their unfulfilled requirements. One knows that there are many organizations which operate in a totally unstructured way and are happy to do so until they are required by a funding organization to incorporate, the treasurer disappears with the treasury or someone is injured at a fund raising event. One further suspects that there are many organizations which incorporate but do nothing further. What amount of law these organizations need or can tolerate is a perplexing question and defies deduction. It is likely that many organizations would be better off if left alone barring the spectre of unlimited liability. The trend in many modern corporation statutes, particularly those modelled on the California Act and the Revised Model Nonprofit Corporation Act, is to increase state government supervision of "public benefit" corporations.¹²¹ Whether such supervision is necessary or effective, particularly as it relates to the smaller corporation is questionable. It is quite possible that common law doctrines of fraud and fiduciary duty, as well as statutory rules of director and officer conduct, and expanded rules of standing allowing beneficiaries to sue, obviate the need for allowing general supervision.¹²² It is also likely that there is a large group of organizations which need a corporate structure more tailored to the spouse's auxiliary than to the Ford Foundation. It is very likely that many organizations would benefit by some simple form of organization which could integrate organizational and tax simplicity.

Research Agenda

120. See supra n. 51. The statutes which exempt volunteers from liability was initially sponsored by the United Way.

121. See Moody, supra n. 3 at 281.

122. See Fishman, supra n. 4 at 666.

Because so little research related to nonprofit corporations has been done a research agenda is very long. It includes: comparing the actual structural needs of such organizations vis a vis the existing models, looking at adaptations of present structures to accommodate informal and uninformed operations, studying governmental supervision and alternatives thereto such as broadened standing, the use of relator actions and attempting to integrate state organization law and federal tax requirements.

The greatest need for research activity about to structure is related to the smaller nonprofit organizations, typically the public interest corporation or theater group. To date almost all nonprofit organization law has been based on anecdotal data, much of which is related to larger organizations. Any further progress in improving nonprofit corporation law as it relates to the smaller organization, will make it necessary to collect empirical data about the organizations which have not been at the table when the present provisions were passed around, to determine the importance of each of the factors related to structure both in the organization's structure and in its operation. This would include the demography, incidence of liability and availability of legal advice.

Based on the anecdotal data available it is already clear that we should explore ways of accommodating informal operation which do not require sophistication, tolerance for bureaucracy or complicated legal advice. It is also possible that legal advice could be provided to such organizations through bar associations and law school clinics. Research directed to developing a series of model programs could be productive.

Two approaches to statutory reform have been presented which merit a great deal of attention from the nonprofit sector. The National Conference of Commissioners on Uniform Laws has before it a project in its initial stages to develop a uniform law of unincorporated associations. There can be little doubt that such a project will be useful first of all in putting together the thin threads of authority that exist with respect to such associations and secondly in shaping a set of provisions to clarify and improve existing law as well as to define distinctions among nonprofit

associations and business associations. The success of any such law, however, ultimately will depend on whether or not it can develop a statute that does something more than develop a corporation law called by another name but requiring similar registration, filings and substantial bureaucracy. It will also depend on the perceived value of limited liability for many organizations.

Professor Fishman has suggested another approach to smaller organizations which may have more potential, i.e., that a corporation statute similar to the close corporation statutes, which have become almost universal for business corporations, be developed for nonprofit corporations.¹²³ Business corporations which operate in close corporation form are really incorporated partnerships. They allow the shareholder - officer-director to operate on an informal basis.¹²⁴ Professor Fishman has suggested a number of characteristics which could be singled out to identify a group of nonprofit corporations for "close corporation" status, *viz*: integration of directors and employees and an upper level of permitted assets.¹²⁵ Organizations which choose the close corporation status would be free to operate informally and without direct attorney general supervision, but would still be able to obtain tax exempt status.

There are many questions about how simplified nonprofit organization statutes would function which can only be answered by extensive exploration; however, there can be little doubt that the exploration of the subject might lead to an important contribution to nonprofit activities.

123. *Id.* at 667.

124. *See e.g.*, Del. Code Ann. Title 8 Secs. 102(b)(7).

125. *See* Fishman, *supra* n. 4 at 667.