

Foreword to the Fourth Edition

By Lawrence J. Beaser and William H. Clark, Jr.

The Fourth Edition (the “Fourth Edition”) of the Model Nonprofit Corporation Act (the “MNCA”) is a substantial revision of the model statute that preserves important aspects of the MNCA Third Edition (the “Third Edition”). The Fourth Edition contains many changes that follow the updated provisions and revised official comments in the 2016 revision of the Model Business Corporation Act (the “MBCA”) along with a variety of other changes that are summarized below.

Although the Fourth Edition may appear to be significantly different from prior versions of the MNCA because portions have been renumbered, the Fourth Edition stands in direct continuity with prior versions and continues the substantive approach of the Third Edition. The renumbering of the Fourth Edition, and what it means that this publication contains the “stand-alone” version of the Fourth Edition, are explained below.

PREPARATION OF THE WRITING OF THE FOURTH EDITION

Preparation of the Fourth Edition of the MNCA was a five-year process that began in 2016. Revision of the MNCA was begun as a result of the completion of the 2016 revision of the MBCA. The Nonprofit Organizations Committee of the American Bar Association’s Business Law Section also considered it appropriate to begin a revision of the MNCA as a result of the promulgation in 2013 of the Uniform Business Organizations Code (“UBOC”) by the Uniform Law Commission (“ULC”). The relationships of the Fourth Edition to both the 2016 revision of the MBCA and the UBOC are discussed below.

The task force that prepared the Fourth Edition was comprised of volunteers from the Nonprofit Organizations Committee. The task force met for full day drafting sessions at almost all meetings of the Business Law Section beginning in 2016 and task force meetings continued until approval of the Fourth Edition on September 23, 2021. The task force also met four times for stand-alone in-person two-day drafting sessions. In addition, the task force held numerous conference calls and virtual meetings to review comments and discuss various issues. Two exposure drafts were issued publicly. Comments were received from members of the Nonprofit Organizations Committee and from members of the public. The task force discussed in detail all comments submitted and changes were made to the draft as warranted.

PRIOR VERSIONS OF THE MNCA¹

The original MNCA (the “1952 MNCA”) was prepared by the Committee on Corporate Laws of the Section of Corporation, Banking, and Business Law (now the Business Law Section) of the American Bar Association in 1952. Until the 1952 MNCA was promulgated and nonprofit statutes were adopted by various states, most “non-business” organizations, if they chose to incorporate, used devices such as “nonstock” provisions found within the state’s general corporation law; or, as was the case with many churches, petitioned the state legislature for a charter. Amendments to the original MNCA by the Committee on Corporate Laws took place in 1957 and 1964.

In the Foreword to the 1952 MNCA, the Committee stated that the MNCA “. . . is a companion to the Model Business Corporation Act. . . . In organization, style and procedures, the Model Nonprofit Corporation Act follows the Model Business Corporation Act as closely as the subject matter permits.”

In 1979, the Committee on Nonprofit Corporations (as it was then called) of the Business Law Section assumed the responsibility for revising the MNCA. A drafting committee was appointed and met regularly over the next eight years. The completed revision was approved in 1987 and published in 1988 by Prentiss Hall Law and Business as the Revised Model Nonprofit Corporation Act (the “1987 MNCA”).

The fundamental policy decisions for the 1987 MNCA were as follows: The 1987 MNCA superseded the earlier versions of the MNCA and was intended to be a single integrated statute covering all nonprofit corporations. Further, the purpose of the 1987 MNCA “. . . was to attempt to provide a framework in which an organization could be structured by its creators to implement their goals and allow them flexibility in operation and design.” As with the 1952 MNCA, the intent of the 1987 MNCA was to follow the MBCA “as closely as the subject matter permits.”

The 1987 MNCA included updates to conform the model statute more closely to the MBCA. In addition, the 1987 MNCA adopted a scheme of classifying nonprofit corporations into public benefit corporations, mutual benefit corporations, and religious corporations as a result of legislative developments in New York and California.

New York had adopted a nonprofit corporation statute totally different from the 1952 MNCA that divided nonprofit corporations into four distinct classifications: Type A (mutual corporations), Type B (charitable organizations), Type C (business-like organizations), and Type D (miscellaneous). Each classification had different rules and a different regulatory pattern.

¹ Much of the following history of the MNCA is from the Forward to the Third Edition prepared by Lizabeth A. Moody.

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California, after passing a revolutionary business corporation statute, passed an equally revolutionary nonprofit statute in 1980. The California statute was unrelated to the new California business corporation statute. Somewhat following New York's lead, California adopted a classification system where nonprofit corporations were divided into three categories: Public Benefit, Mutual Benefit, and Religious. The California nonprofit statute essentially became the pattern for the 1987 MNCA.

Following the adoption of the 1987 MNCA, there was no further action with respect to the MNCA until 2000. In the meantime, the MBCA was continually reviewed and amended by the Business Law Section's Committee on Corporate Laws. Although between 1988 and 2000 many states adopted new nonprofit corporation legislation, relatively few used the 1987 MNCA in its entirety. Of even more significance is that very few states adopted the classification system for nonprofit corporations that had been built into the 1987 MNCA. As a result, the Business Law Section Committee on Nonprofit Corporations decided to undertake a general revision of the 1987 MNCA.

The Third Edition was the work of a drafting task force chaired by Elizabeth A. Moody, which worked through the early 2000s to produce the Third Edition, a significant overhaul of the 1987 MNCA that was approved at the Annual Meeting of the Business Law Section of the American Bar Association in 2008. The Third Edition continued the goal of following the provisions of the MBCA as much as possible, while providing significant flexibility in organization and governance to the wide variety of nonprofit corporations that exist. In doing so, the Third Edition deleted the corporation classification scheme contained in the 1987 MNCA, updated provisions to better conform the nonprofit statute to the then current version of the MBCA, and included additional provisions, such, as the concept of a "designated body," to provide for increased flexibility for nonprofit corporations to operate in the manner they determine is best suited to accomplish their goals. Please see the Foreword to the Third Edition by Elizabeth A. Moody for a more in-depth description of the important innovations made in the Third Edition.

After the Third Edition was published, from 2008 to 2016 a subcommittee of the Nonprofit Organizations Committee continually reviewed and amended the MNCA in a similar fashion to how the Committee on Corporate Laws worked to revise the MBCA. William H. Clark, Jr., who was the Reporter for the Third Edition, continued to serve as the Reporter for these statutory revisions. Lawrence J. Beaser, who was a member of the Task Force that drafted the Third Edition, was appointed as Chair of the Model Nonprofit Corporation Act Subcommittee. From 2008 to 2016, several amendments to the Third Editions were published in *The Business Lawyer* and adopted as part of the MNCA.

GENESIS OF THE FOURTH EDITION

As noted earlier, the 2016 revision of the MBCA and the development of the UBOC were the main reasons why the preparation of the Fourth Edition was undertaken.

1. Relationship between Nonprofit and Business Corporation Law

The general approach in past editions of the MNCA was to follow the language of the MBCA, except where a substantive difference between the two laws was intended. The Fourth Edition continues that approach. The purpose is to create a baseline set of rules for corporations generally and avoid traps for the unwary. Where the language of the MNCA follows the MBCA, the MNCA should be interpreted in the same way. This approach makes it easier to identify rules that only apply to nonprofit corporations because they will be apparent from the substantive differences between the laws.

Following the wholesale revision of the MBCA completed in 2016, it was obvious that the MNCA should be revised in order to maintain the correspondence between the MBCA and the MNCA. Thus, the Fourth Edition follows the 2016 revision of the MBCA and adopts much of the current language of the MBCA, except as necessary to preserve the unique nature of nonprofit corporations. The Fourth Edition also tracks much of the revisions and updating to the MBCA's official comments and includes additional official comments focused on the formation and governance of nonprofit corporations.

2. The Development of Entity Organization Codes

Recognizing that states were beginning to prepare integrated codes to organize their business entity laws, in 2013 the ULC developed and promulgated the UBOC. The purpose of the UBOC is to provide a framework that a state can use to integrate all of its entity laws into a single body of law.

The UBOC is organized in a “hub-and-spoke” format. The hub provisions of the UBOC are ones that apply to all forms of entities, while each spoke is unique to a particular type of entity. The hub provisions deal with (i) filings with the secretary of state and related issues, and (ii) fundamental transactions. The fundamental transaction provisions of the UBOC are based on the Model Entity Transactions Act, which also was promulgated in its current form by the ULC in 2013.

As is the case with the current text of the various uniform unincorporated entity laws promulgated by the ULC, the Fourth Edition is designed to fit within a state's code of entity laws. However, the Fourth Edition also can be enacted as a “stand-alone” statute. In this volume, the text of the Fourth Edition is the stand-alone version. If the Fourth Edition is enacted in that form it will be a classic entity law and will be able to stand apart on its own and not as a part of a code of entity laws.

The text of the Fourth Edition approved by the Nonprofit Organizations Committee and set forth in this publication is the stand-alone version and is a complete nonprofit law.

A “code version” of the Fourth Edition designed for integration into the UBOC will be made available in a separate document posted on the website of the Nonprofit Organizations Committee. The code version will omit from the nonprofit “spoke” the provisions found in the UBOC hub. Because the provisions of the MNCA that are not needed in the code version are found throughout the model statute, the task force that prepared the Fourth Edition decided that the MNCA should be renumbered in a way that eliminates gaps in the numbering sequence if the Act is enacted as part of a code. Thus, chapters that are omitted in their entirety from the code version are placed at the end of the Fourth Edition; and provisions that are omitted from a chapter in the code version are placed at the end of the chapter. Please see the Derivation Chart at the end of this Foreword that shows the derivation of each Chapter of the Fourth Edition as compared with the Third Edition.

Significant Aspects of the Fourth Edition

1. Corporate Opportunities

The articles of incorporation may limit or eliminate the corporate opportunity doctrine. The provision to be included in the articles may apply to directors, officers, or any other person. In addition, it may apply to a specific, or one or more classes or categories of opportunities.

2. Ratification

A new subchapter creates a procedure to ratify defective corporate acts. Ratification under the new procedure requires board action and possibly member action as well. If what is being ratified involves a filing with the secretary of state, provision is made for a corrective filing so that the public record will be accurate. Provision also is made for judicial review of defective actions or ratifications.

What may be ratified is any corporate action purportedly taken where there has been a failure of authorization. “Corporate action” is any action taken by or on behalf of a nonprofit corporation; and “failure of authorization” is any failure to authorize, approve, or otherwise effect a corporate action in compliance with the nonprofit corporation law, articles of incorporation, bylaws, corporate resolution, or plan or agreement.

The new ratification procedure is not the exclusive manner in which defective corporate acts may be ratified, but it is designed to provide more certainty than has been possible in the past using a common law approach.

3. *Forum Selection*

The articles of incorporation or bylaws may require an internal corporate claim to be brought in a specified court of the state of incorporation or “in any other jurisdiction with which the nonprofit corporation has a reasonable relationship.” An internal corporate claim that may be subject to a forum selection clause is a claim for breach of duty, a derivative action brought on behalf of the nonprofit corporation, a claim arising under the MNCA or the articles of incorporation or bylaws, or any other action asserting a claim governed by the internal affairs doctrine.

4. *Remote (Virtual) Participation in Member Meetings*

The Fourth Edition provides for remote (virtual) participation in member meetings. The provision in the Fourth Edition is patterned after the MBCA’s provision permitting remote participation in shareholders’ meetings.

5. *Amendments of Articles of Incorporation and Bylaws*

The Fourth Edition provides that a member of a nonprofit corporation does not have a vested property right resulting from any provision of the articles of incorporation including provisions relating to management, control, purpose or duration of the corporation. This expressly rejects the concept that an otherwise lawful amendment of the articles of incorporation might be restricted or invalidated because it modified particular rights conferred on members by the original or prior version of the articles. The articles of incorporation, of course, may specify that certain provisions of the articles may not be changed without the agreement of the members or a specific class of members.

6. *Continuation of Important Reforms and Provisions*

The Fourth Edition continues important reforms contained in the Third Edition. These include:

Elimination of Classification Scheme Continued

The Fourth Edition continues the decision made in the Third Edition to move away from, and not include, a system of dividing nonprofit corporations into separate types, such as public benefit corporations, mutual benefit corporations and religious corporations, as was the case in the 1987 MNCA.

As Lizabeth Moody pointed out in her Foreword to the Third Edition, “[a]lthough the Third Edition has eliminated the classification system, it still recognizes the special position of certain nonprofit corporations; for example, it includes two important restrictions that apply to charities. One of those restrictions provides that in a fundamental transaction property held in trust or otherwise dedicated to a charitable purpose may not be diverted from

that purpose without an appropriate order. The other restriction prohibits private inurement in transactions such as mergers.” That “special position” of certain nonprofit corporations continues to be recognized in the Fourth Edition.

Flexible, Alternative Governance Provisions Continued

A general nonprofit corporation statute must be designed to provide rules for all types of nonprofit corporations from large hospital systems to small human services nonprofits to country clubs and to the other thousands of nonprofit corporations that exist in each state. Besides following the MBCA as much as possible, one of the goals of the Third Edition, which has been continued in the Fourth Edition, is providing as much flexibility as possible to nonprofit corporations as to how they are structured and governed.

To that end, the Fourth Edition continues providing great flexibility for nonprofit corporations to organize and operate in what they believe to be the most efficient and effective manner. For example, recognizing that nonprofit corporations differ from for profit corporations in that nonprofit corporations do not have shareholders, the Fourth Edition continues to permit nonprofit corporations to have – or not to have – members, delegates or designated bodies. Members, delegates and designated bodies are permitted to participate in the governance of the nonprofit corporation and may have rights that are similar to those of shareholders.

The “designed body” concept, which was introduced in the Third Edition, is continued in the Fourth Edition. It provides significant, practical flexibility by permitting the founders of a nonprofit corporation to easily set up a governance structure that meets the needs and furthers the nonprofit corporation’s mission as determined by the nonprofit’s founders.

A “designated body” is defined as “a person or group, other than a committee of the board of directors that has been vested by the articles of incorporation or bylaws with powers that, if not vested in that person or group, would be required. . .to be exercised by the board or the members.” This permits “some, but less than all” of the powers of the board of directors or the members to be transferred to the designated body. In that case, the rules applicable to the board of directors or the members apply to the designated body. If this involves the directors, the directors are relieved of their duties and liabilities to the extent they have been replaced by the designated body.

Optional Provisions Relating to the Attorney General

Consistent with the Third Edition’s approach, the Fourth Edition continues to mark as optional provisions regarding the role of the state’s attorney general. The recommendation of the Fourth Edition is that a state’s law regarding the

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supervisory role of the attorney general is better located in a different portion of the state's law so that the Attorney General will have supervisory authority over all nonprofit organizations, regardless of form.

Prohibition Against Cumulative Voting Continued

The Fourth Edition continues the prohibition against cumulative voting contained in the Third Edition. Like its predecessor, the drafting task force for the Fourth Edition considered cumulative voting as being inappropriate in nonprofit corporations. The reason, as Lizabeth Moody observed in the Foreword to the Third Edition, is that “. . .the voting power of members should not be tied to their economic investment and because a nonprofit director is often chosen for reasons other than the betterment of the economic results of the corporation.”

Electronic Technology Provisions

The electronic technology provisions of the Fourth Edition are patterned after and intended to be consistent with the Uniform Electronic Transactions Act, as were those in the Third Edition. Thus, for example, the term “written” is replaced with “in the form of a record.”

Broad Liability Shield Provisions Continued

In the Fourth Edition, as in the Third Edition, nonprofit corporations may include in their articles of incorporation a broad liability shield protection. This is in addition to other broad liability shield language applicable to charitable nonprofit corporations.

Protection of Charitable Assets

The Fourth Edition continues protections for charitable assets in the event of the dissolution of the nonprofit corporation as well as if assets are sold or there is a merger, interest exchange, domestication or conversion involving the nonprofit corporation.

7. *Official Comments Significantly Revised*

The 2016 revision of the MBCA contained updated and significantly rewritten official comments. The Fourth Edition adopts many of the MBCA official comments and adds additional official comments specifically focused on nonprofit corporations. Official comments that merely restated or paraphrased a provision of the MNCA have been deleted and many official comments have been simplified.

8. *Technical Amendments*

As mentioned in this Foreword, some material in the Fourth Edition has been renumbered and reordered so as to eliminate the problem of having gaps in the numbering of sections. Also, the convention for the numbering of sections

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has been changed so that all sections are shown as whole numbers. Thus, former Section 8.44 has been changed to Section 844. This was done to conform to the system of numbering the ULC used. The source notes have been revised and additional cross references are added. Finally, edits have been made to the Third Edition's black letter text for consistency and clarity.

THE FUTURE OF THE MODEL NONPROFIT CORPORATION ACT

The Fourth Edition is not intended to be the final word in nonprofit corporation statutes. As with the MBCL, the MNCA will continue to be reviewed and amended as necessary to provide an up-to-date and relevant model statute that meets the needs of the nonprofit sector and the public.

MODEL NONPROFIT CORPORATION ACT, FOURTH EDITION

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<u>MNCA Fourth Edition Chapter</u>	<u>MNCA Third Edition Chapter</u>
Chapter 1 – General Provisions	Chapter 1 – General Provisions
Chapter 2 – Incorporation	Chapter 2 – Incorporation; Chapter 4 – Name; and Chapter 5 – Registered Office
Chapter 3 – Purposes and Powers	Chapter 3 – Purposes and Powers
Chapter 4 – Records and Reports	Chapter 16 – Records and Reports
Chapter 5 – Derivative Proceedings	Chapter 13 – Derivative Proceedings
Chapter 6 – Memberships and Financial Provisions	Chapter 6 – Memberships and Financial Provisions
Chapter 7 – Member Meetings	Chapter 7 – Member Meetings
Chapter 8 – Directors and Officers	Chapter 8 – Directors and Officers
Chapter 9 – Amendment of Articles of Incorporation and Bylaws	Chapter 10 – Amendment of Articles of Incorporation and Bylaws
Chapter 10 – Disposition of Assets	Chapter 12 – Disposition of Assets
Chapter 11 – Dissolution	Chapter 14 – Dissolution
Chapter 12 – Entity Transactions	Chapter 11 – Mergers and Membership Exchanges and Chapter 9 – Domestication and Conversion
Chapter 13 – Foreign Corporations	Chapter 15 – Foreign Corporations
Chapter 14 – Transition	Chapter 17 – Transition