
Model Nonprofit Corporation Act – A Review

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historical context

- current Revised Model Nonprofit Corporation Act was adopted in 2008
- prior act was adopted in 1987
 - was not subsequently amended until the 2008 revision
- 2008 act is currently being revised
 - the Model Business Corporation Act was completely revised in 2016
 - the 2008 MNCA is being revised to follow the language of the 2016 MBCA

historical context (cont.)

- the general approach of the MNCA is to follow the language of the MBCA except where a substantive difference between the two laws is intended
 - this approach highlights the differences and similarities between the laws
 - where the language is the same, it should be interpreted in the same way

historical context (cont.)

- the notion of “nonprofit” is in flux
 - new entity forms are emerging
 - benefit corporations
 - social purpose corporations
 - community interest companies (in Canada and the UK)
 - low profit limited liability companies
 - nonprofit forms of traditional entities are appearing
 - limited partnerships
 - limited liability companies
 - note that the traditional restrictions on nonprofit corporations are not always applied to these entities

important aspects of the revision

1. elimination of classification scheme
2. alternative governance arrangements (“designated body”)
3. director duties and liabilities
4. what it means to be a “member”
5. fundamental transactions
6. elimination of cumulative voting
7. validation of use of electronic technology
8. role of the attorney general

topic 1 –
elimination of classification scheme

classification scheme

- prior act classified nonprofit corporations into:
 - mutual benefit corporations (e.g., country clubs)
 - public benefit corporations (charities)
 - religious corporations
- classification did not meet with wide acceptance
- revised act eliminates the classification
 - this only affects a limited number of sections, mostly dealing with action by members

classification scheme (cont.)

- although elimination of the classification scheme does not affect many of the substantive sections of the act, it does affect the required contents of the articles of incorporation
 - the articles of incorporation will no longer identify which of the three types the corporation is
- but new concepts of “charitable corporation” and religious activity have been added

charitable provisions

- “charitable corporation” defined in § 1.40(5) to mean:
 - “a domestic nonprofit corporation that is operated primarily or exclusively for one or more charitable purposes”
- “charitable purpose” defined in § 1.40(6) to mean a purpose:
 - “(i) that would make a corporation operated exclusively for that purpose eligible to be exempt from taxation under Section 501(c)(3) or (4) of the Internal Revenue Code, or
 - (ii) considered charitable under law other than this [act] or the Internal Revenue Code”

charitable provisions (cont.)

- optional provisions in §§ 1.51 – 1.53 giving the attorney general the right to seek review of corporate action
- § 8.31(d) (see also § 2.02(c)) providing an automatic liability shield for directors of a charitable corporation
- § 6.22 permitting the articles or bylaws of a non-charitable corporation to provide for repurchasing memberships from the members

charitable provisions (cont.)

- § 6.42 permitting the articles or bylaws of a non-charitable corporation to provide for capital contributions
- §§ 13.09 and 14.02(g) requiring notice to the attorney general of the commencement of a derivative proceeding or before filing articles of dissolution

charitable provisions (cont.)

- §§ 9.03(b), 10.09(b), 10.23(a), 11.01(b), 12.03(a), 14.05(c) providing that property may not be diverted by a fundamental transaction without an appropriate order
- §§ 9.03(c), 10.09(c), 10.23(b), 11.01(c) providing that, without an appropriate order, a fundamental transaction may not affect:
 - a restriction imposed by the entity's organic documents
 - a restriction imposed on the entity's property
 - the existing rights of third persons
- §§ 9.03(d), 10.09(d), 10.23(c), 11.01(d), 12.03(b), 14.05(d) prohibiting private inurement in fundamental transactions

religious activity

- “religious” is not defined
- § 1.60: recognizes role of canon law
- § 8.30(f)(4): directors may rely on religious authorities
- § 8.42(c)(3): officers may rely on religious authorities
- § 14.32(f): receiver cannot be appointed for corporation engaged in religious activity
- § 16.20(a): corporation engaged in religious activity may limit rights of members to demand financial information

topic 2 –
alternative governance arrangements
 (“designated body”)

designated body

- concept was in the prior act in § 8.01(c):

“The articles may authorize a person or persons to exercise some or all of the powers which would otherwise be exercised by a board. To the extent so authorized any such person or persons shall have the duties and responsibilities of the directors, and the directors shall be relieved to that extent from such duties and responsibilities.”
- revised act makes the concept more transparent

definition of “designated body”

- defined in § 1.40(11) 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 by the articles or bylaws in that person or group, would be required by this [act] to be exercised by the board or the members.”

effect of using a designated body

- § 8.12(a): some, but less than all, the powers, authority or functions of the board may be vested in a designated body; and if that is done:
 - provisions of law relating to the board of directors apply to the designated body (§ 8.12(a)(1))
 - directors are relieved from their duties and liabilities to the extent they have been replaced by a designated body (§ 8.12(a)(2))
 - members of the designated body are entitled to indemnification and exoneration from liability (§ 8.12(a)(3))
- similar provisions apply if designated body has some of the rights or obligations of members

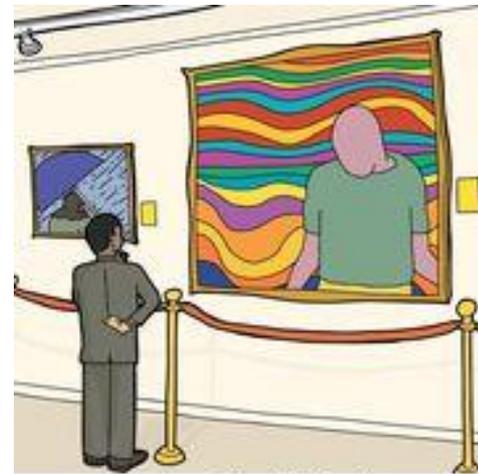
topic 3 –
director duties and liabilities

director duties and liabilities

- articulation of duties follows latest revision of Model Business Corporation Act
- § 8.31(d): liability shield automatically applies to directors of charitable corporations
- § 2.02(c): optional liability shield available for directors of other corporations
- indemnification follows Model Business Corporation Act

topic 4 –
what it means to be a “member”

- what do most people think it means to be a member of:



definition of “member”

“A person who has the right, in accordance with the articles of incorporation or bylaws and not as a delegate, to select or vote for the election of directors or delegates or to vote on any type of fundamental transaction.”



voting is central to what it means to be a director

comment to definition of “member”

“A nonprofit corporation will sometimes refer to contributors or other persons interested in the activities of the corporation as “members” even though those persons do not fit within the definition in Section 1.40(37). If a person does not have the right to vote for the election of directors or delegates or to vote on fundamental transactions, the person will not be a “member” for purposes of this act even though the person may be referred to by the corporation as a member.”

topic 5 –
fundamental transactions

fundamental transactions

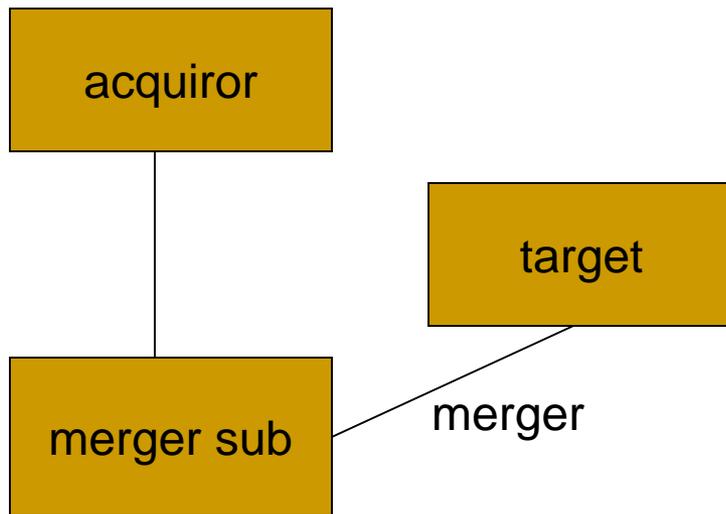
- revised act contains the full set of cross-entity transaction provisions found in the MBCA:¹
 - domestication
 - Idaho nonprofit corporation becomes Wyoming nonprofit corporation
 - for-profit conversion
 - Arkansas nonprofit corporation becomes Arkansas business corporation
 - useful mainly for mutual benefit corporations
 - entity conversion
 - Maryland LLC becomes Maryland nonprofit corporation
 - cross-entity mergers
 - Delaware LLC merges into Pennsylvania nonprofit corporation

1. Examples assume, of course, that the referenced states have adopted the new act.

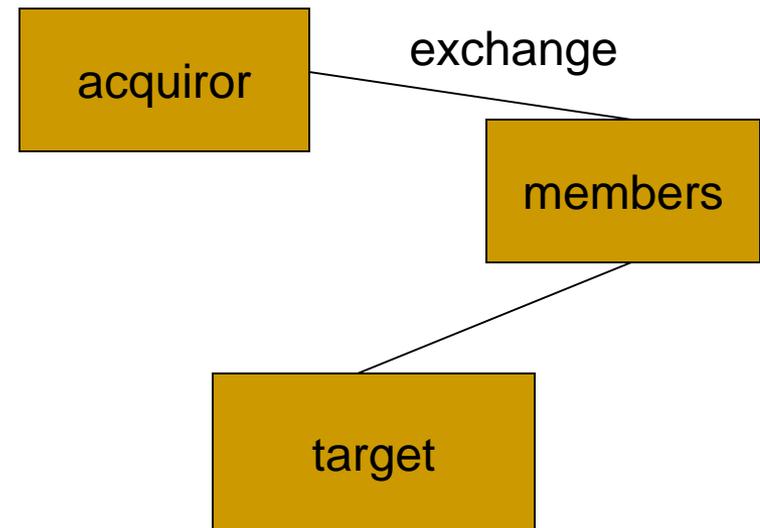
fundamental transactions (cont.)

- revised act adds a new type of transaction called a membership exchange

triangular merger



membership exchange



fundamental transactions (cont.)

- the member vote required to approve a fundamental transaction is “approval of the members at a meeting at which a quorum exists consisting of at least a majority of the votes entitled to be cast”
 - approval requires more votes “for” than “against” (§ 7.24(c))
 - abstentions are not “votes” (§ 1.40(62))



this is a potentially very low vote

topic 6 –
elimination of cumulative voting

elimination of cumulative voting

- cumulative voting increases the ability of small blocks of shares to elect directors in a business corporation
- revised act eliminates cumulative voting for nonprofit corporations:
 - voting power of members not tied to their economic investment in the corporation
 - composition of the board of directors is often determined by other factors

cumulative voting (cont.)

- revised act prohibits cumulative voting (§ 7.27(b))
- but existing cumulative voting rights are grandfathered (§ 17.03(c))
 - prior act permitted articles or bylaws to authorize cumulative voting
 - such an articles or bylaws provision adopted under the prior act will continue to apply until amended under the revised act

topic 7 –
validation of use of electronic
technology

electronic technology

- revised act broadly validates the use of electronic technology
- revised acts uses terminology developed in Federal E-SIGN and UETA
- “electronic” defined in § 1.40(15) to mean:
“relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities”

electronic technology (cont.)

- “record” defined in § 1.40(53) to mean:
“information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form”
- “sign” defined in § 1.40(58) to mean:
“with present intent to authenticate or adopt a record:
“(i) to execute or adopt a tangible symbol; or
“(ii) to attach to or logically associate with the record an electronic sound, symbol, or process”

rules for electronic messages (§ 1.41(h))

(1) Unless otherwise provided in the articles of incorporation or bylaws, or otherwise agreed between the sender and the recipient, an electronic communication is received when:

- (i) it enters an information processing system that the recipient has designated or uses for the purpose of receiving electronic records or information of the type sent and from which the recipient is able to retrieve the electronic record; and
- (ii) it is in a form capable of being processed by that system.

(2) An electronic communication is received under (1) even if no individual is aware of its receipt.

(3) Receipt of an electronic acknowledgement from an information processing system described in (1) establishes that a record was received but, by itself, does not establish that the content sent corresponds to the content received.

topic 8 –
role of the attorney general

attorney general

- most provisions relating to the role of the attorney have been marked as optional
- reason is that those provisions belong in a different location
 - nonprofits can also be organized as unincorporated nonprofit associations or (in an increasing number of states) as limited partnerships or LLCs
 - to cover those other forms of entities requires a statute with broader scope