

# Indiana Law Review

Volume 18

1985

Number 4

## Regulation of Not-For-Profit Corporations in Indiana

JOHN T. BAKER\*

### I. INTRODUCTION

There were approximately twenty-five thousand nonprofit corporations incorporated in the state of Indiana as of 1984.<sup>1</sup> These corporations ranged in size from the small family foundation with a few thousand dollars in assets to the Lilly Endowment,<sup>2</sup> from small health care facilities to large metropolitan hospitals, from nursery schools to universities. Given the extensive presence of nonprofit corporations in the state, the activities carried on by their managers have a significant impact on the cultural, economic, social, and intellectual lives of citizens of Indiana.

The one common element among these nonprofit corporations is that they were formed under the Indiana Not-For-Profit Corporation Act or its predecessors.<sup>3</sup> Moreover, many of these nonprofits are also exempt from state and federal taxation.<sup>4</sup> The underlying rationale for

---

\*Dean, Howard University Law School; B.A., Fisk University, 1962; J.D., Howard University Law School, 1965.

<sup>1</sup>Telephone interview with Judy Webb, Filing Clerk for the Legal Department of the Office of the Secretary of State of Indiana (June 17, 1984).

<sup>2</sup>The Lilly Endowment is one of the largest private endowments in the United States.

<sup>3</sup>IND. CODE § 23-7-1.1-1 to -66 (1982 & Supp. 1985).

<sup>4</sup>Property tax exemptions for Indiana's nonprofit corporations are provided in IND. CODE § 6-1.1-10-16 (1982) (buildings and land used for educational, literary, scientific, religious, or charitable purposes); *id.* § 6-1.1-10-18 (1982) (nonprofit corporations supporting fine arts); *id.* § 6-1.1-10-18.5 (Supp. 1985) (nonprofit corporation property used in operation of health facility, home for the aged); *id.* § 6-1.1-10-21 (1982) (churches or religious societies); *id.* § 6-1.1-10-23 (1982) (fraternal benefit associations); *id.* § 6-1.1-10-25 (Supp. 1985) (miscellaneous organizations).

Gross income tax exemptions for nonprofit corporations in Indiana are located at IND. CODE § 6-2.1-2-20 (1982) (religious, charitable, scientific, literary, educational, or civic organizations); *id.* § 6-2.1-3-21 (Supp. 1985) (fraternal or social organizations, business leagues, contributions, fees, and receipts from the sale of intangible property or from trade shows or exhibitions); *id.* § 6-2.1-3-22 (1982) (hospitals, labor unions, religious institutions, schools, pension trusts).

Indiana nonprofit corporations are exempt from gross retail tax under IND. CODE § 6-2.5-5-25 (1982) (acquisitions by nonprofit organizations); *id.* § 6-2.5-5-26 (1982) (sales

both the state and federal tax exemptions is that nonprofits constitute a vehicle used by people to create and allocate resources that are not created or allocated by private market sector organizations or by the government.<sup>5</sup>

Their existence appears quite important to many people.<sup>6</sup> Because of the perceived importance of these organizations in a democratic society, government has provided incentives to stimulate their growth and development. The incentives provided by state government include the availability of the corporate form and income, property, and sales tax exemptions under appropriate circumstances.<sup>7</sup> At the federal level, the prime incentives are exemptions from federal income taxation and the tax deduction for donors to qualified nonprofit corporations.<sup>8</sup>

Attempting to justify these governmental incentives is significantly harder than the description of their existence. Clearly, there is a well-established notion that nonprofits advance the public good.<sup>9</sup> Charitable foundations provide resources to beneficiaries which would, in many instances, otherwise have to be provided by government. Scientific organizations, through experimentation, are often able to produce new medical and industrial products for future mass production and distribution by private industry or government. Educational institutions foster academic achievement. Social organizations serve as mediating institutions for individuals who daily must confront the large, impersonal institutions of business and government. Trade associations permit entrepreneurs to further their interests collectively. The activities of most of these organizations are carried out by nonprofit corporations.<sup>10</sup> Yet, nothing in the delineation of the activities pursued by nonprofit corporations explains why the activity is carried out by a nonprofit corporation as opposed to a for-profit corporation or governmental agency. An explanation of

---

by nonprofit organizations). Some nonprofit corporations are also exempt from the Indiana intangibles tax. *Id.* § 6-5.1-5-1 (1982) (religious, charitable, or educational associations). There is, additionally, an exemption from the adjusted gross income tax. *Id.* § 6-3-2-2.8 (Supp. 1985). Finally, some nonprofits are exempt from the state employment tax. *Id.* § 22-4-8-2(j) (1982). Federal income tax exemptions are available to nonprofit corporations under the Internal Revenue Code. *See* I.R.C. § 501(c) (1982).

<sup>5</sup>*See generally* B. WEISBROD, *THE VOLUNTARY NONPROFIT SECTOR: AN ECONOMIC ANALYSIS* (1977).

<sup>6</sup>*See* B. WEISBROD, *TOWARD A THEORY OF THE VOLUNTARY NON-PROFIT SECTOR IN A THREE-SECTOR ECONOMY* (1975).

<sup>7</sup>*See supra* note 4.

<sup>8</sup>*See* I.R.C. § 170 (1982). The amount allowed for charitable contributions is deducted in arriving at one's adjusted gross income. I.R.C. § 62 (4) (1982).

<sup>9</sup>*See generally* G. MCCONNELL, *THE PUBLIC VALUE OF THE PRIVATE ASSOCIATION IN VOLUNTARY ASSOCIATIONS* 147-48 (1969); Karst, *The Efficiency of the Charitable Dollar: An Unfulfilled State Responsibility*, 73 HARV. L. REV. 433 (1960).

<sup>10</sup>Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 845 (1980).

the conceptual justification for nonprofit corporations is beyond the scope of this Article.<sup>11</sup>

While a conceptual foundation is emerging, there is still very little in the way of case law, legislation, or legal literature to describe the extent to which social expectations for these corporations have been or should be translated into legal rules. At the same time, there has been a proliferation of legal literature examining various aspects of corporate

---

<sup>11</sup>In recent years, some scholarly attention has been devoted to this issue. In his article on nonprofit corporations, Professor Henry Hansmann attributed the existence of nonprofit corporations to "contract failure," a condition that exists when "consumers [are] incapable of accurately evaluating the goods promised or delivered," thereby making "ordinary contractual services inadequate to provide the purchaser of the service with sufficient assurance that the service was in fact performed as desired." See Hansmann, *supra* note 10, at 843-45. Hansmann defined "patrons" as all who transfer money to nonprofit corporations whether they are donors or customers. *Id.* at 841. Hansmann asserted that when patrons who are customers find themselves in the position of being unable to evaluate the producer's output, "[they] might be considerably better off if they deal with nonprofit producers rather than with for-profit producers. The nonprofit producer, like its for-profit counterpart, has the capacity to raise prices and cut quality . . . without much fear of customer reprisal; however, it lacks the incentive to do so because those in charge are barred from taking home any resulting profits." *Id.* at 844. Hansmann's primary emphasis is on the limitations of the private market in providing particular services.

Other theorists have approached the issue from a governmental perspective. Perhaps the clearest theoretical explanation of the existence of nonprofit corporations because of "government failure" is provided by Professor Burton Weisbrod. See B. WEISBROD, *THE VOLUNTARY NONPROFIT SECTOR: AN ECONOMIC ANALYSIS* (1977). Weisbrod assumed that different citizens want public goods to varying extents, or, in the language of economics, have different demand functions for public goods. *Id.* at 175. He also assumed that public goods may be provided by government, by private nonprofit organizations, and even by commercial enterprises when the demand for the public good (e.g., clear air) may be satisfied by private-good substitutes (e.g., air filters). *Id.* at 179. Weisbrod examined the manner by which the government decides how much of a public good to produce. He assumed that for each level of output there is a corresponding level of costs to be paid in taxes. In addition, Weisbrod stated that each citizen has a different demand function; each citizen will be prepared to pay in taxes for different amounts of the goods in question. *Id.* at 175. Weisbrod concluded that government will produce to the level determined by the median voters' demand schedules, to the point where there will be as many voters who want more of that public good as there are voters who want less. *Id.* Weisbrod, of course, recognized that this is not the way that governments really determine the level of public expenditures, although the bargaining process of democratic politics may come close to it. *Id.* at 177. The actual level at which government sets the public expenditure on that service is ultimately irrelevant to Weisbrod's argument. *Id.* at 177. As long as the assumption that different voters have different demand functions remains true, there will always be some citizen-voters who are under-satisfied with the level of production of the public good, and some citizen-voters who are over-taxed by that level. *Id.* at 178. The over-taxed citizens do not have many options. They may be able to exert political pressure to lower the output-tax level. But if they fail, they can only tolerate it or emigrate from the jurisdiction. *Id.* at 182. The under-satisfied citizens, however, also

governance of the business or for-profit corporation.<sup>12</sup> It seems, therefore, that some insight into the issue of governing the nonprofit corporation may be gained from examining these legal developments and writings. Consequently, the analysis in this Article will draw upon these sources. This analysis first briefly describes the ways in which nonprofit corporations in Indiana are regulated. Second, it examines the comparative strengths and weaknesses of Indiana's regulatory scheme from the standpoint of accountability. Third, the nonprofit corporation acts of New York and California are considered. Finally, this Article suggests some proposals for strengthening the Indiana Not-For-Profit Corporation Act. The Appendix to this Article contains a proposal for a new statutory scheme for Indiana nonprofit corporations.

## II. THE INDIANA NOT-FOR-PROFIT CORPORATION ACT

Indiana adopted the present version of its Not-For-Profit Corporation Act in 1971.<sup>13</sup> The Act defines a not-for-profit corporation as "any corporation which does not engage in any activities for the profit of its members and which is organized and conducts its affairs for purposes other than the pecuniary gain of its members."<sup>14</sup> A nonprofit corporation must have a nonprofit purpose and must not distribute its assets or income to its members, including directors and officers.<sup>15</sup> An Indiana nonprofit corporation is also prohibited from issuing stock or dividends.<sup>16</sup>

Nonprofit corporations must have members, who may comprise one or more classes as provided for in the certificate of incorporation.<sup>17</sup> All members are immune from liability for corporate debts except to the extent of any unpaid portion of membership dues.<sup>18</sup> The Act requires a quorum of a majority of the membership to transact business at a

---

have the option of supplementing the public provision (which in the limiting case can be zero) by voluntary provision which must be nonprofit because the theory is dealing with goods that cannot be made the subject of market transactions. Thus, Weisbrod concluded that private nonprofits will tend to supply the sorts of public goods for which there is not yet a demand from the majority of citizens or which a majority of citizens are only prepared to supply and pay for in taxation in what a minority consider inadequate quantities. *Id.*

<sup>12</sup>See, e.g., Black, *Shareholder Democracy and Corporate Governance*, 5 SEC. REQ. L.J. 291 (1978); Hershman, *Liabilities and Responsibilities of Corporate Officers and Directors*, 33 BUS. LAW 263 (1977); Schwartz, *Corporate Responsibility in the Age of Aquarius*, 109 TR. & EST. 1004 (1970).

<sup>13</sup>Act of Apr. 16, 1971, Pub. L. No. 364, §§ 1-4, 1971 Ind. Acts 1499 (codified at IND. CODE §§ 23-7-1.1-1 to -66 (1982 & Supp. 1985)).

<sup>14</sup>IND. CODE § 23-7-1.1-2(d) (Supp. 1985).

<sup>15</sup>*Id.* § 23-7-1.1-1 to -66 (1982 & Supp. 1985)).

<sup>16</sup>*Id.* § 23-7-1.1-7.

<sup>17</sup>*Id.* That Indiana nonprofit corporations must have members is implicit in the definition of "not-for-profit." See *id.* § 23-7-1.1-2(d) (Supp. 1985).

<sup>18</sup>*Id.* § 23-7-1.1-7 (1982).

meeting unless otherwise specified in the articles of incorporation or the bylaws.<sup>19</sup> Proxy voting is permitted and, if provided for by the certificate of incorporation, members may use cumulative voting.<sup>20</sup>

The Indiana Act promotes strong boards of directors for nonprofit corporations. The Act provides that the board of directors shall manage the affairs of the corporation.<sup>21</sup> It contains no express provisions for alternative arrangements which would allow for greater membership control. The Act does, however, permit delegation of the board's authority to an executive committee consisting of at least two members of the corporation.<sup>22</sup>

The board of directors for a nonprofit corporation is normally not subject to personal liability for corporate actions.<sup>23</sup> However, a board member who incurs expenses in connection with the defense of any civil action involving the corporation may be indemnified provided she is not found guilty of negligence or misconduct in the performance of her duties. Conversely, directors who vote for or concur in certain proscribed corporate actions are jointly and severally liable for all resulting damages. Such proscribed actions include false statements in annual or special reports, improper distributions, and improper loans.<sup>24</sup> Directors held liable for violations may obtain contribution from other directors who have voted for or concurred in the action.<sup>25</sup>

Under the Indiana Act, nonprofit corporations may not issue shares.<sup>26</sup> Members may lend or advance money to the corporation. Those contributions are redeemable for the total amount loaned plus a reasonable interest.<sup>27</sup>

Mergers and consolidations of nonprofit corporations are permitted under the Act.<sup>28</sup> There is also a provision permitting foreign corporations to qualify to conduct local activities.<sup>29</sup> Finally, upon dissolution of the corporation and satisfaction of creditors' claims, the statute provides the priority of distribution of the nonprofit corporation's assets: (1) repayment of amounts advanced or loaned to the corporation by members; (2) transfers of the remaining assets to another nonprofit organization having a purpose substantially similar to that of the dissolving corporation; (3) escheat to the state of all remaining assets.<sup>30</sup>

---

<sup>19</sup>*Id.* § 23-7-1.1-9(g) (Supp. 1985).

<sup>20</sup>*Id.* § 23-7-1.1-9(f).

<sup>21</sup>*Id.* § 23-7-1.1-10(a).

<sup>22</sup>*Id.* § 23-7-1.1-10(h).

<sup>23</sup>*See* IND. CODE § 23-7-1.1-4(b)(9) (1982).

<sup>24</sup>*Id.* § 23-7-1.1-64(b).

<sup>25</sup>*Id.* § 23-7-1.1-62.

<sup>26</sup>*Id.* § 23-7-1.1-7.

<sup>27</sup>*Id.*

<sup>28</sup>*Id.* § 23-7-1.1-41.

<sup>29</sup>*Id.* § 23-7-1.1-48.

<sup>30</sup>*Id.* § 23-7-1.1-33(b)(3)(E) (Supp. 1985).

### III. ACCOUNTABILITY

When referring to organizations that hold and manage resources on behalf of others, accountability means the ability of those on whose behalf the resources are being managed, the constituents, to establish and change the goals of the organization. Accountability mechanisms are consequently necessary to measure the effectiveness of the organization's managers in their efforts to achieve the nonprofit's goals.<sup>31</sup> More concretely, in the context of this Article, if one of the goals in regulating nonprofit corporations is to impose accountability upon the managers of those corporations, then the constituencies of nonprofits need to be specifically identified.

The first constituency of all nonprofit corporations is the electorate. Both federal and state governments sacrifice revenue which would otherwise be generated through the taxing system because the income of qualified nonprofits is exempt from federal and, in most jurisdictions, state taxation.<sup>32</sup> The electorate is entitled to some indication of the effectiveness of these organizations, and should also consider the desirability of promoting the social welfare through this type of subsidy.

Two other constituencies of nonprofit corporations also have the capacity to effect goal changes as well as managerial and operating changes. The nonprofit's *donors* may threaten to discontinue providing support to a particular nonprofit unless that corporation modifies or expands its goals.<sup>33</sup> Likewise, the nonprofit's *members* may express their disagreement with the corporation's goals by resigning.<sup>34</sup> Finally, *beneficiaries* may also have an impact upon the organization's goals. Their failure to use the services of a nonprofit or threats to refuse services unless the corporation's goals are changed may, under particular circumstances, prove effective.<sup>35</sup> Through these constituencies, accountability serves as a mechanism for goal change as well as a measure for the effectiveness of goal achievement.

The types of accountability mechanisms generally associated with corporations may be broadly classified as structural mechanisms, adjudicative mechanisms, and market forces. Structural accountability mech-

---

<sup>31</sup>See J. Becker, *Accountability: A New Form of Tease*, in ACCOUNTABILITY: A STATE, A PROCESS, OR A PRODUCT (ed. W.J. Gephart) 1 (1975).

<sup>32</sup>See *supra* note 4. See also Bittker & Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299 (1976).

<sup>33</sup>Professor Albert Hirshman argues that stockholders, customers, or members of organizations have three mechanisms available to them to communicate satisfaction or dissatisfaction with the organization: exit, voice, and loyalty. See A. HIRSCHMAN, EXIT, VOICE AND LOYALTY, 4 (1970). Clearly, discontinuing financial or voluntary labor support to the nonprofit corporation is a communication device that Hirshman would call "exit."

<sup>34</sup>*Id.*

<sup>35</sup>*Id.*

anisms include statutes, administrative regulations, and the organizations' constitutions, articles of incorporation, and bylaws.<sup>36</sup> Accountability through adjudication means that some constituents of the organization have a right to resolve issues of goal definition, operating procedure, managerial authority, and other areas of organizational status by resort to litigation.<sup>37</sup> Finally, accountability through the market in the case of nonprofits means the organization's ability to raise funds, acquire and retain members, and, where applicable, attract customers.<sup>38</sup> For comparative purposes, nonprofit corporation statutes from other jurisdictions will be considered.

### A. Structural Mechanisms

The primary structural mechanism for promoting the accountability of nonprofits in Indiana is the Indiana Not-For-Profit Corporation Act.<sup>39</sup> This Act promotes accountability to the state, to donors, to members, and to beneficiaries by requiring a statement of organizational purposes,<sup>40</sup> periodic reports,<sup>41</sup> and by granting state officials the right to inspect corporate books and records.<sup>42</sup> The Act also defines a number of standards of conduct for officers, directors, and the corporation itself.<sup>43</sup>

1. *Accountability at the Formation Stage.*—Accountability is achieved

<sup>36</sup>Structural accountability simply means formal rules that should govern the conduct of the corporation's managers. These rules may be adopted by the government, as in the case of nonprofit corporation statutes, or they may be adopted by the members of the organizations, as is the case with the corporation's articles of incorporation and by-laws.

<sup>37</sup>The best example of this type of accountability for nonprofit corporations is the member's derivative action. See, e.g., N.Y. NOT-FOR-PROFIT CORP. LAW § 720(b)(3) (McKinney 1970).

<sup>38</sup>Professor Hansmann divides nonprofits into two categories: donative nonprofits (those that "receive most or all of their income in the form of grants or donations") and commercial nonprofits (those that "receive the bulk of their income from prices charged for their services"). Hansmann, *supra* note 10, at 840. Clearly there is, in the traditional use of the term, a *market* for the goods and services of commercial nonprofits. See, e.g., E. KAITZ, PRICING POLICY AND COST BEHAVIOR IN THE HOSPITAL INDUSTRY (1968); S. LAW, BLUE CROSS: WHAT WENT WRONG? (1974); M. MENDELSON, TENDER LOVING GREED (1974); Newhouse, *Toward a Theory of Non-Profit Institutions: An Economic Model of a Hospital*, 60 AMER. ECON. REV. 64 (1970). There is far less understanding of the "market" for donations to and members of donative nonprofits. *But see* K. BOULDING, THE ECONOMY OF LOVE AND FEAR (1973); Buchanan, *An Economic Theory of Clubs*, 32 ECONOMICS 1-14 (1965); Nelson, *Economic Factors in the Growth of Corporate Giving*, NATIONAL BUREAU OF ECONOMIC RESEARCH AND RUSSELL SAGE FOUNDATION (1970).

<sup>39</sup>IND. CODE § 23-7-1.1-1 to -66 (1982 & Supp. 1985).

<sup>40</sup>*Id.* § 23-7-1.1-18 (Supp. 1985).

<sup>41</sup>*Id.* § 23-7-1.1-36.

<sup>42</sup>*Id.*

<sup>43</sup>See *id.* §§ 23-7-1.1-13, -11, -15, -36, and -61.

in part through an incorporation process that forces the original members of the corporation to disclose the corporation's purposes and the procedures under which it will operate.<sup>44</sup> This information is available to officials of the state, potential members, donors, and beneficiaries. The corporate purpose must be included in the proposed articles of incorporation, along with a corporate name, the duration of the corporation's existence, its post office address, and its principal office. In addition, the articles of incorporation disclose the name and address of the non-profit's resident agent, the number of corporate directors, the names and addresses of the initial board of directors and the incorporators, a statement of membership rights, and a statement concerning the property that will be owned by the corporation when it begins business.

Approval of the proposed articles of incorporation in Indiana appears to be largely a formality. Indiana Code section 23-7-1.1-19 requires the secretary of state to approve the proposed articles of incorporation if he finds that they "conform to law."<sup>45</sup> If this language means that the articles of incorporation must conform to the express formal requirements of the statute, it would appear that the secretary has no discretion to withhold approval once all statutory requirements are met.

Indiana Code section 23-7-1.1-63, however, contains significantly different language: "When any corporation . . . offers for filing articles of incorporation, . . . it shall be the duty of the secretary of state to ascertain whether the corporation is a bona fide not-for-profit corporation."<sup>46</sup> This language may mean that the secretary of state has discretion to conclude that the proposed corporation's purposes are inconsistent with one or more public policies of Indiana; that the proposed corporation has insufficient assets to accomplish its mission; or even that the individuals who will serve as managers of the corporation are, for some reason, unqualified. Unfortunately, the language of Indiana Code section 23-7-1.1-63 is ambiguous as to what the "bona fide" test is, as well as with respect to which corporations might be subject to the test.<sup>47</sup> On its face, Indiana Code section 23-7-1.1-63 applies only to incorporation by an existing corporation. Thus, the section could be read as making the "bona fide" test applicable only to nonprofits seeking to reincorporate or to nonprofits acting as incorporators of new nonprofits.<sup>48</sup>

Such an interpretation, however, appears to be contrary to that given

---

<sup>44</sup>IND. CODE § 23-7-1.1-18 (Supp. 1985).

<sup>45</sup>*Id.* § 23-7-1.1-19 (1982).

<sup>46</sup>*Id.* § 23-7-1.1-63.

<sup>47</sup>IND. CODE § 23-7-1.1-2(a) defines the term "corporation" as "any corporation formed under this chapter." IND. CODE § 23-7-1.1-2(a) (Supp. 1985) (emphasis added).

<sup>48</sup>Corporations are specifically authorized to act as incorporators of a nonprofit corporation. IND. CODE § 23-7-1.1-16 (1982).



in *Lemmons & Co. v. Indiana Cooperative Hauling Association*.<sup>49</sup> In that case, the petitioner appealed from the Public Service Commission's dismissal of a complaint alleging that the respondents were operating as motor carriers in violation of the Commission's regulations. The respondent filed a motion to dismiss based upon a statutory exemption for nonprofit corporations from regulation under the Indiana Motor Carrier Act.<sup>50</sup> The respondent's motion was granted after the Commission determined the respondent's nonprofit status was based solely upon the fact of its incorporation under the Indiana Not-For-Profit Corporation Act. The court of appeals affirmed the dismissal and stated that the Commission had the right to rely upon the determination of nonprofit status by the secretary of state as evidenced by the respondent's certificates of incorporation.<sup>51</sup> In so holding, the court relied upon Indiana Code section 23-7-1.1-63: "Only after the secretary of state has determined that an *organization* is a bona fide nonprofit *organization* can that organization be incorporated under the Not-For-Profit Corporation Act."<sup>52</sup> The *Lemmons* court's reading of the section is questionable with respect to which corporations might be subject to the "bona fide" test, especially in light of the actual statutory language. This case does suggest, however, that courts may be willing to allow the secretary of state greater discretion in rejecting proposed articles of incorporation than the literal language of sections 23-7-1.1-19 and 23-7-1.1-63 would permit. Paradoxically, while the *Lemmons* case may indicate that the secretary can take a more discretionary role in determining whether or not an organization may properly incorporate as a nonprofit, the case also appears to limit severely the avenues of accountability once the nonprofit is formed. It appears to exclude from the accountability process challenges from outsiders whose own interests might be affected.

Indiana's statutory requirements for incorporation are fairly typical.<sup>53</sup> Like most state nonprofit corporation acts, the Indiana Act establishes one unitary standard for incorporation regardless of the activity to be undertaken. The Act provides for one method of incorporation by organizations as diverse as charities, churches, and fraternities. All of its provisions apply with equal force to all of these organizations. It is not at all clear that this is the best way to assure accountability to the constituents of these diverse organizations. Clearly, some of the statutory provisions needed for some types of nonprofits are of little use for

---

<sup>49</sup>175 Ind. App. 654, 373 N.E.2d 891 (1978).

<sup>50</sup>IND. CODE § 8-2-7-3(g) (1982).

<sup>51</sup>175 Ind. App. 654, 657, 373 N.E.2d 891, 892.

<sup>52</sup>*Id.* at 656, 373 N.E.2d at 892 (emphasis added).

<sup>53</sup>*See, e.g.*, 15 PA. CONS. STAT. ANN. § 7319 (Purdon Supp. 1984); VT. STAT. ANN. tit. 11, § 2402 (1984).

others.<sup>54</sup> Because of this, it is doubtful that the Indiana Act enforces a consistently high level of accountability for managers of all the non-profits organized thereunder.

2. *Accountability at the Operating Stage.*—While accountability at the formative stage of a nonprofit is important, accountability at the operating stage is crucial. To satisfy this need, the Indiana Act requires periodic reports relating to the corporation's financial and managerial affairs be filed with the secretary of state.<sup>55</sup> Additionally, the Act requires that corporations maintain accurate books and records, and keep them available for inspection by statutorily-authorized persons.<sup>56</sup>

a. *Periodic reports.*—Under the Indiana Not-For-Profit Corporation Act, the mandatory annual report is the primary device for disclosure of the corporation's activities.<sup>57</sup> The information disclosed in the annual report includes:

- (a) The name of the corporation.
- (b) The location and post office address of its principal office in this state and the name and address of the resident agent or of some designated person residing in this state upon whom service of process may be served.
- (c) The date of incorporation.
- (d) The law under which it was incorporated.
- (e) The names and residence addresses of officers and directors and the number of existing members.
- (f) The purposes of the corporation.
- (g) A totalled itemized account of all outstanding debts, including the names of persons or corporations to whom sums are owing, the original amount of the debt incurred, the method of making payment, and from what funds the debt is to be paid. If any member, any relative of a member, or any person having a contract or agreement concerning the subject matter of the debt has any interest or opportunity to profit from the transaction, an explanation must be filed together with copies of any written agreements connected with the subject matter of the indebtedness.
- (h) A list of all property, real and personal, owned by the corporation, itemized to the extent required by the secretary of state, and its current market value set opposite each respective item, provided that the list of all real property also includes the price paid for it by the corporation, a legal description, the

---

<sup>54</sup>See, e.g., *infra* text accompanying notes 148-49.

<sup>55</sup>See *infra* notes 57-62 and accompanying text.

<sup>56</sup>See *infra* notes 63-66 and accompanying text.

<sup>57</sup>IND. CODE § 23-7-1.1-36 (1982).

acreage or size of each tract or lot, and the assessed value of each tract or lot.

(i) The nature and kind of activities in which the corporation has been engaged during the year covered by the report.

(j) What, if any, distribution of funds has been made to any members during the year covered by the report.

(k) A statement of the aggregate amount of any loans, advances, overdrafts or withdrawals and repayments made to or by any officers, directors or members.

(l) A verified itemized statement of revenue received by the corporation from all sources during the preceding calendar year, clearly stating the source of the revenue in each instance, together with a general statement showing total disbursements and all cash and assets. No trust fund shall be included as an asset of the corporation, but must be separately listed and identified.<sup>58</sup>

Because of the importance of the annual report, the statute confers broad reviewing powers upon the secretary of state:

If, upon receipt of such report, the secretary of state, after reviewing it, determines or has reason to believe that the corporation filing the report is not disclosing its true financial condition or is violating any of the provisions of this chapter or the not-for-profit corporation law in general, he may require the corporation to disclose all material facts by submitting a duly verified audit bearing the certificate under oath of a qualified public accountant recognized by the secretary of state, replying to interrogatories and/or reporting under oath on any matters requested by the secretary of state.<sup>59</sup>

Several features of the Act's annual report requirements are significant. The first and most striking is that the Act does not require a detailed account of corporate distributions. It requires a statement of "[t]he nature and kind of activities in which the corporation has been engaged during the year"<sup>60</sup> and "[a] verified itemized statement of revenue . . . together with a *general* statement showing total disbursements."<sup>61</sup> Thus, nonprofit corporations in Indiana are not required to account to any of their various constituencies for specific corporate disbursements. A literal reading of the Act would permit, for example, a charitable nonprofit to report that it had disbursed \$100,000 to two beneficiaries in fulfillment of its charitable purposes. The corporation would not be

---

<sup>58</sup>*Id.*

<sup>59</sup>*Id.*

<sup>60</sup>*Id.*

<sup>61</sup>*Id.* (emphasis added).

required by the Act to disclose that it made a grant of \$5,000 to one beneficiary and \$95,000 to the second. The pattern of distribution and the identity of beneficiaries could be important to past and future donors. Yet, the Act does not mandate the corporation to disclose this type of information.

Second, while most of the emphasis of Indiana Code section 23-7-1.1-36 is on quantitative information, it also requires a statement of "[t]he nature and kind of activities in which the corporation has been engaged during the year covered by the report."<sup>62</sup> Nevertheless, the Act does not require management to send copies of the annual report to members of the corporation or to others.

*b. Corporate books and records.*—The next structural accountability mechanism at the state level is the statutory requirement that all non-profits maintain accurate books and records and permit representatives of the state and members of the corporation, under proper circumstances, to inspect them. The Indiana Not-For-Profit Corporation Act provides that "[a]ll books and records of any nature whatsoever . . . shall be open for inspection by any member, for proper purposes at any reasonable time."<sup>63</sup> Thus, on its face, the statute *limits* access to those falling within the statutory definition of "member,"<sup>64</sup> and having a proper purpose. The term "proper purpose" is not defined in the statute or in any judicial opinions. The term has been defined, however, in the context of a for-profit corporation shareholder's right of inspection. A "proper purpose" is one which is germane to an individual's interest in his

---

<sup>62</sup>*Id.* Only 14 jurisdictions that have separate nonprofit corporations statutes have a similar provision. ALASKA STAT. § 10.20.625 (1983); ARIZ. REV. STAT. ANN. § 10-1081 (1983); COLO. REV. STAT. § 7-28-101 (1973 & Supp. 1982); GA. CODE ANN. § 22-3301 (1981); IDAHO CODE § 30-1-125 (1980 & Supp. 1983); ILL. ANN. STAT. ch. 32 § 163a 62 (Smith-Hurd 1983); IOWA CODE ANN. § 496.1 (West 1949 & Supp. 1983-84); MONT. CODE ANN. § 35-1-1101 (1983); NEB. REV. STAT. § 21-1981 (1943 & Supp. 1983); N.M. STAT. ANN. § 53-8-82 (1978 & Supp. 1983); OR. REV. STAT. § 61.805 (1981); S.D. CODIFIED LAWS ANN. § 47-24-6 (1983); TEX. REV. CIV. STAT. ANN. art. 1396-9-.01 (Vernon 1979) W. VA. CODE § 31-1-55a (1982).

<sup>63</sup>IND. CODE § 23-7-1.1-13 (1982).

<sup>64</sup>"Member" is defined by statute as:

one who has signified his intention of being a member of a corporation organized or reorganized under this chapter and who has met the requirements of the corporation for membership, and who has been accepted as a member by the corporation. The term includes trustees or directors or incorporators of a corporation organized or reorganized under this chapter, and for purposes of this chapter the corporation may organize or reorganize although it has no membership apart from its trustees, directors, and incorporators. If in any case membership in the corporation is coextensive with the trustees, directors or incorporators of the corporation, for the purposes of this chapter the trustees, directors, or incorporators shall also constitute members within the meaning of this chapter.

IND. CODE § 23-7-1.1-(2)(g) (Supp. 1985).

capacity as a shareholder.<sup>65</sup> In the case of the nonprofit member, one could argue that a similar standard should be applicable and should allow inspection for the purpose of assessing the performance of management.

In addition to a member's right of inspection, it is clear that the secretary of state is also empowered, under certain circumstances, to require the corporation to permit inspection of its books and records.<sup>66</sup> The Act empowers the secretary of state to require a nonprofit to submit to an audit upon the secretary's determination that the corporation failed to disclose its true financial condition in its annual report.<sup>67</sup>

*c. Standards of conduct of officers and directors.—i. Transactions between the nonprofit and its officers and directors.*—Under Indiana law, transactions are possible in which a director or officer of a nonprofit corporation has a financial interest, either directly or indirectly, with another entity that is a party to the transaction with the nonprofit. The fact of the relationship or interest must, however, be disclosed to the nonprofit's board of directors or to its members entitled to vote.<sup>68</sup> Yet, no disclosure need be made if the transaction is "fair and reasonable to the corporation."<sup>69</sup>

Two observations are relevant. First, the information required to be disclosed is minimal. Only the "fact of the relationship or interest" need be disclosed.<sup>70</sup> With no Indiana case law on point and no relevant legislative history, the literal language of the statute seems to suggest that the interested director can choose to disclose *either* her relationship with the party contracting with the nonprofit *or* the nature of her interest in the transaction. If the director chooses to disclose the relationship rather than the interest, it may be difficult to determine whether or not she stands to make an unusually large gain from the transaction.<sup>71</sup> Second, assuming fairness of the transaction to the nonprofit, members cannot adequately assess the motivations and general performance of the in-

---

<sup>65</sup>See *Charles Hegewald Co. v. State*, 196 Ind. 600, 149 N.E. 170 (1925).

<sup>66</sup>IND. CODE § 23-7-1.1-36 (1982).

<sup>67</sup>*Id.*

<sup>68</sup>*Id.* § 23-7-1.1-61. Note that the statute does not, on its face, apply to transactions with interested officers. *Id.*

<sup>69</sup>*Id.* § 23-7-1.1-61(c).

<sup>70</sup>*Id.* § 23-7-1.1-61(a), (b).

<sup>71</sup>The question of directors' loyalty to the nonprofit is not necessarily the same as the question of whether a transaction is fair and reasonable to the corporation. Even where the transaction is fair, an interested director may be able to make substantial profits through commercial dealings with the nonprofit to the exclusion of other potential competitors. Under these circumstances two serious issues arise: First, is the director dealing with the nonprofit with a view to the corporation's best interest? Second, is the interested director using her position in the nonprofit to advance her own private pecuniary interests?

interested director based upon the information provided in the corporate books and records. Other jurisdictions provide more rigorous conflict of interest provisions.<sup>72</sup>

*ii. General standard of care and loyalty.*—The Indiana Act does not contain provisions defining general standards of care and loyalty for directors and officers of nonprofit corporations. This is significant because of the express exemption of charitable, educational, and cultural organizations from the standards of conduct imposed on trustees by the Indiana Trust Code.<sup>73</sup> Moreover, the Indiana General Corporation Act, which regulates for-profit corporations, provides that “[a] director shall perform his duties . . . in good faith, in a manner he reasonably believes to be in the best interests of the corporation, and with such care as an ordinarily prudent person in a like position would use under similar circumstances.”<sup>74</sup> One might infer that the absence of a statutory provision regarding nonprofit directors may be some indication of a legislative intent to hold nonprofit directors to a lower standard of conduct than for-profit directors.

Some language in the Act indicates, however, that there is a minimal acceptable standard of conduct for directors of nonprofit corporations. Indiana Code section 23-7-1.1-4(b)(9) authorizes a nonprofit to indemnify any director “against expenses actually and reasonably incurred by him in connection with the defense of any civil action” to which he is made a party by reason of his status as a director.<sup>75</sup> Indemnification is not available “in relation to matters as to which he is adjudged . . . to be liable for *negligence* or misconduct in the performance of *duty to the corporation*.”<sup>76</sup> Since these provisions speak either in terms of knowing and willful violations or liability for the failure to perform some act, regardless of negligence, they suggest that liability may attach for negligent conduct and that the source of standards against which to measure such conduct is the common law.<sup>77</sup> Thus, the issue of general standards

---

<sup>72</sup>See *infra* note 187 and accompanying text.

<sup>73</sup>IND. CODE § 30-4-1-1(c) (1982) provides that the rules of law contained in the Indiana Trust Code do not apply to religious, educational, and cultural institutions or to charitable nonprofit foundations, corporations, or associations, except that these organizations are required to comply with those provisions of the trust code which specifically relate to the maintenance of federal income tax privileges. See, e.g., IND. CODE §§ 30-4-5-18 to -24 (1982).

<sup>74</sup>IND. CODE § 23-1-2-11(a)(2) (Supp. 1985).

<sup>75</sup>IND. CODE § 23-7-1.1-4(b)(9) (1982).

<sup>76</sup>*Id.* (emphasis added).

<sup>77</sup>*Id.* § 23-7-1.1-36 (annual report requirement). Although not directly applicable to the issue of directors' standards of conduct, this section provides some support for the proposition that common law doctrines existing apart from the nonprofit statute also serve to regulate nonprofit conduct. This section specifically provides that the secretary of state may order a nonprofit to submit to a verified audit after reviewing the nonprofit's annual report if he “determines . . . that the corporation filing the report

of care and loyalty would appear to be open for definition by the courts as the common law of nonprofit corporations develops in Indiana.

*iii. Provisions for director liability.*—The express prohibitions on director conduct in the Indiana Act are aimed primarily at activities which might financially injure corporate creditors, nonprofit members, and the general public. These prohibitions are written so that no personal liability will be imposed on a director unless she was a knowing and willing participant in the proscribed conduct.<sup>78</sup>

Indiana Code section 23-7-1.1-62 describes the basic prohibitions on director conduct relating to corporate debts and contracts, and prescribes the penalties to which directors are subject when the prohibitions are violated:

The directors of a not-for-profit corporation shall jointly and severally be liable for the debts and contracts of the not-for-profit corporation in the following cases:

(1) For *knowingly and wilfully* declaring or assenting to the repayment of any advance or loan made by a member . . . if the . . . corporation is, or is thereby rendered insolvent . . . in an amount equal to the repayment . . . .

(2) For *knowingly and wilfully* making or assenting to make a loan to an officer or director, to the extent of the debts contracted between the time of making or assenting to make the loan and the time of repaying it, in an amount equal to the loan.

(3) For voting or assenting to any distribution of corporate assets to its members or otherwise during . . . liquidation . . . without payment and discharge of or making adequate provision for, all *known* debts, obligations and liabilities . . . . for the value of those assets which are distributed, to the extent that the . . . [corporate] liabilities . . . are not paid and discharged thereafter.

(4) For voting or assenting to the distribution of [corporate] assets . . . contrary to the provisions of this chapter or . . . any restrictions contained in the articles of incorporation; for the . . . value [of assets distributed].

(5) For voting or assenting to make a loan to an officer or director of the corporation; for the amount of the loan until its repayment.

\* \* \*

A director shall not be liable under subparagraphs (1), (3)

---

. . . is violating any provision of this chapter [23-7-1.1-1 to -66] or the *not-for-profit corporation law in general.*" *Id.* (emphasis added).

<sup>78</sup>See IND. CODE §§ 23-7-1.1-62, -64 (1982).

or (4) . . . if he *relied and acted in good faith* on financial statements of the corporation, represented to him to be correct by the president or the officer . . . having charge of its account books. . . . Nor shall he be liable if, in good faith in determining the amount available for any distribution, he considered the assets to be at their book value.<sup>79</sup>

This section is designed to prevent directors from making improper distributions to members, directors, or officers that may have the effect of injuring the corporation's creditors. While creditors are given some measure of protection against improper self-dealing within the corporation, this protection is less than complete. Under this provision, directors are relieved from liability for assenting to improper distributions made in good faith reliance upon the presentation of those on whom the directors are entitled to rely.<sup>80</sup> No duty of inquiry into the accuracy of such representations is required.

A second, and possibly more serious, defect in Indiana Code section 23-7-1.1-62 is that many types of misconduct by directors which might result in a substantial depletion of the corporation's assets do not result in director liability. For example, a director would not be liable under this section for corporate debts, even though he had assented to highly speculative investments which resulted in substantial depletion of corporate assets. The Indiana Not-for-Profit Corporations Act does, however, prohibit director conduct which might generally be characterized as fraud on members and the public.<sup>81</sup>

<sup>79</sup>*Id.* § 23-7-1.1-62 (emphasis added).

<sup>80</sup>*Id.*

<sup>81</sup>The Act provides:

\* \* \*

(b) An officer or director of a not-for-profit corporation who:

- (1) *knowingly* gives out or publishes, or files with the secretary of state, any written report, certificate, or statement of the condition or business of the not-for-profit corporation that is false in any material particular, statement or representation; or
- (2) *knowingly* issues, or consents to the acceptance of, any advances or loans to members in violation of this chapter; or
- (3) *knowingly* signs or issues a certificate for advances or loans by members containing any false statement;

commits a Class D felony.

(c) An officer or director of a not-for-profit corporation who, being charged with the duty of doing so, fails to make, file, produce, and keep open, prior to and during an election of directors, a list of members of the not-for-profit corporation entitled to vote at the election, commits a Class B infraction.

(d) All officers or directors of a not-for-profit corporation who violate subsection (b) or (c) of this section are jointly and severally liable for all damages which may arise therefrom.

*Id.* § 23-7-1.1-64 (emphasis added).



Indiana Code section 23-7-1.1-64 serves three separate accountability functions. First, it strengthens the "accountability through disclosure" mechanisms provided by the statutory reporting requirements by subjecting directors to criminal and civil liability for false statements in those reports.<sup>82</sup> Second, it helps to assure that the nonprofit form will not be used for the improper purpose of private pecuniary benefit; directors are personally liable for knowingly issuing or consenting to advances or loans to members in violation of the provisions of the Act.<sup>83</sup> A third function served by this section, and perhaps the most important in accountability terms, is that it imposes liability upon directors who fail to maintain and provide members with membership lists prior to the election of directors.<sup>84</sup> Thus, the Act ensures that members will not be denied the opportunity to change the corporation's management through communication with other members.

*iv. Legal consequences to the nonprofit corporation for defective director performance.*—The standards and the legal liabilities of directors of nonprofit corporations form an integral part of the accountability mechanisms for nonprofits, serving to assure proper director conduct and, therefore, proper functioning of the nonprofit. In addition to statutory provisions dealing with misconduct of directors, the Indiana Act imposes significant sanctions at the corporate level for defective director performance. Under such circumstances, the nonprofit corporation is treated as if it were synonymous with its defectively performing directors. The statutory scheme compensates, to some extent, for the lack of protection against the misconduct of directors by subjecting the nonprofit to various remedial sanctions:

If, at any time, the secretary of state is of the opinion that the corporation is not operating in good faith as a not-for-profit corporation, is violating any of the provisions of this chapter, is insolvent or has paid more than the fair and reasonable value for any real or personal property acquired, has engaged in any transaction with any person, firm or corporation which could result in more than a fair and reasonable profit to this person, firm or corporation, has failed to account fully for all proceeds and revenue derived from conducting the activities of the corporation, or has violated any of the laws of this state governing activities of the corporation, or has violated any of the laws of this state governing activities in which the corporation may be

---

<sup>82</sup>*Id.* It is not altogether clear what type of civil damages might result from false statements contained in official filings by the nonprofit with the state. IND. CODE § 23-7-1.1-62 appears only to contemplate damages for injury to some property interests.

<sup>83</sup>IND. CODE § 23-7-1.1-64(b).

<sup>84</sup>*Id.* § 23-7-1.1-64(c).

engaged, he shall withhold the filing of its papers and shall notify in writing the persons or corporation of such violation whereupon the same person or persons may correct any such violation or appeal this decision by the secretary of state.

\* \* \*

If the secretary of state at any time feels that any corporation organized or reorganized under this chapter is *violating any provisions of the chapter*, he shall notify the corporation, in writing, of this violation, and if the corporation does not comply with the provisions within fifteen (15) days thereafter, the secretary of state shall certify this information to the attorney general of Indiana, who shall immediately bring an action in the name of the State of Indiana in the Marion County superior or circuit court to dissolve the corporation.<sup>85</sup>

In this provision, the statute describes those circumstances in which the nonprofit corporation will be subject to legal sanctions for the misconduct of its directors. Many of those circumstances do not give rise to director liability under the director liability provisions. Directors are not expressly liable for assenting to transactions in which persons outside the nonprofit organization receive more than fair or reasonable profits. It is also likely that directors would not be personally liable for the failure to account fully for all corporate revenues or proceeds in the nonprofit's annual report.<sup>86</sup> Finally, directors do not appear to be liable for many other acts that might result in the corporation losing its nonprofit status, such as the failure to do those things required under the provisions of the Indiana Trust Code relating to the maintenance of federal tax exemptions.<sup>87</sup>

Indiana Code section 23-7-1.1-63 serves primarily as a "stop gap" through which director misconduct, not remedied through the imposition of legal sanctions upon directors, may be corrected at the corporate level. The remedial measure provided for by this section is the withholding of the filing of corporate papers by the secretary of state until the nonprofit complies by correcting any violations found by the secretary. If this fails, involuntary dissolution proceedings could be instituted by the state attorney general.<sup>88</sup>

---

<sup>85</sup>*Id.* § 23-7-1.1-63 (emphasis added).

<sup>86</sup>IND. CODE § 23-7-1.1-64(b)(1) (1982) imposes liability only for statements which are false in any material particular.

<sup>87</sup>See *supra* note 73.

<sup>88</sup>IND. CODE § 23-7-1.1-66 (1982) provides in part:

A not-for-profit corporation may be involuntarily dissolved by judgment of the circuit court or any superior court of the county in which the principal office of the corporation is, or was last, located in accordance with the following provisions:

Particularly significant is a provision that allows for court intervention in lieu of dissolution.<sup>89</sup> In that provision, the legislature has recognized that a nonprofit corporation may be composed of individuals and interests reaching beyond those represented by its defectively performing directors. To the extent that the nonprofit has assets which are to be used for the public interest or the interest of those not involved in the conduct resulting in dissolution proceedings, the courts are given broad discretion to fashion an appropriate remedy, other than dissolution, to protect such interests. In this manner, the Indiana Act is designed to protect the nonprofit's beneficiaries.

---

(a) Causes of Dissolution. Such dissolution may be adjudicated when it is made to appear to such court that:

- (1) The period for which the not-for-profit corporation was organized has terminated; or
- (2) The corporate franchise was procured through fraud practiced upon the state; or
- (3) The not-for-profit corporation has exceeded or abused authority conferred upon it by law or has exercised authority not conferred upon it by law; or
- (4) The not-for-profit corporation has failed to file the annual report required by this chapter; or
- (5) The not-for-profit corporation has done or failed to do any act which would result in a surrender or forfeiture of its corporate franchise; or
- (6) The members are deadlocked in the management of the corporate affairs and the not-for-profit corporation is suffering, or is about to suffer, irreparable injury from this deadlock.

(b) Procedure. All proceedings for the involuntary dissolution of not-for-profit corporations, except as otherwise provided by this chapter, shall be governed by the laws of this state which pertain to civil procedure.

Proceedings for dissolution based upon any of the causes specified in subparagraphs (1) through (5) inclusive of paragraph (a) of this section shall be filed and prosecuted in the name of the state. These proceedings may be filed and prosecuted by the attorney general when he is requested, in writing, to do so by the secretary of state. Before any proceedings based on causes (1), (3), (4) and (5) commence, the secretary of state shall notify the corporation in writing of the cause and of the violation within fifteen (15) days thereafter, the secretary of state shall certify this information to the attorney general who shall immediately take action to dissolve the corporation in the name of the state of Indiana.

\* \* \*

(g) With respect to a proceeding to dissolve any corporation under this chapter which has, as a part of its fixed assets, an endowment, other fund, or substantial property, which, under the purposes for which the corporation was organized or otherwise, are to be used in the public interest or in the interest of those not involved in the act or omissions causing the dissolution proceedings, the court, sitting as a court of equity, in lieu of dissolving the corporation, shall have the power to make such order as is necessary to protect the endowment fund or property in the public interest or in the interest of others.

<sup>89</sup>IND. CODE § 23-7-1.1-66(g).

Nevertheless, the fact that the continuation of the nonprofit is subject to the court's discretion could operate to circumvent the rights of the members to determine the corporation's future. This fact may reflect a legislative determination that the members are either unwilling or incapable of determining a proper future course of conduct for the corporation, especially when the membership originally may have been responsible for electing and maintaining defectively performing directors in managerial positions. In this regard, however, it should be remembered that one possible reason for the membership's failure or inability to exercise effective control over the nonprofit corporation's management is the failure of the Act to provide for adequate disclosure mechanisms through which the membership could be made aware of its directors' conduct. Although members have access to the corporate books and records for "proper purposes," no information concerning the affairs of the corporation is required to be actually reported to the members in a complete and concise manner.<sup>90</sup> Even where members are sufficiently motivated to examine corporate books and records, the time required to decipher the information necessary to ascertain whether the management is performing adequately could be substantial. Moreover, certain types of information, such as the identity and relationship of persons engaging in transactions with the corporation, might not be revealed through an examination of the corporation's records.

In summary, Indiana's statutory scheme of accountability for the misconduct of directors of nonprofits operates on two levels. In the case of directors' violations of express prohibitions, the Act's remedial measures focus on the directors through the imposition of personal liability. Where the conduct of directors would not subject them to personal liability, however, the Act operates to impose sanctions on the corporation. These corporate sanctions vary depending primarily upon the nature and extent of the interests of the nonprofit's beneficiaries. Curiously, the interest of the nonprofit's nondirector membership does not appear to be a factor in determining the appropriate remedies for correcting defective corporate performance caused by director misconduct.

While statutes can serve as standards for determining the levels and types of accountability owed by corporate management to its constituencies, those statutes are not self-enforcing. Some other institution must exist to interpret statutory provisions definitively and to resolve conflicts between management and its constituencies. In this society, courts have traditionally performed that function.

---

<sup>90</sup>There is no requirement for distribution of annual reports to members under the Indiana Not-For-Profit Corporation Act. IND. CODE §§ 23-7-1.1-1 to -66 (1982 & Supp. 1985).

### B. *Adjudicative Mechanisms*

Adjudication is essential to accountability. Some mechanism should be made available to a nonprofit's constituencies to permit them to enforce judicially the obligations of the nonprofit's managers.<sup>91</sup> Since there are several constituencies of nonprofits, however, an interesting issue is presented: Who has standing to challenge the action or inaction of nonprofit corporation managers?

Clearly, the state has standing to protect the interest of the public and to ensure compliance with the law.<sup>92</sup> The authority for the state attorney general to enforce laws relating to nonprofit corporations is rooted in common law and statute.<sup>93</sup> Because the purpose of all nonprofits is to further the public interest in some respect, it is not surprising that the states have delineated quite specific statutory authority for the attorney general to institute lawsuits against nonprofits.

Under the Indiana Act, the authority for enforcement of the nonprofit laws rests primarily in the Office of the Secretary of State.<sup>94</sup> The secretary has authority to compel a nonprofit to submit to a certified public accountant's audit when the secretary has reason to believe that the corporation has either violated provisions of the nonprofit law or has

<sup>91</sup>The enforcement function was best summarized by Justice Harlan in *Boddie v. Connecticut*:

Perhaps no characteristic of an organized and cohesive society is more fundamental than its erection and enforcement of a system of rules defining the various rights and duties of its members, enabling them to govern their affairs and definitively settle their differences in an orderly, predictable manner. . . . It is to courts . . . that we ultimately look for the implementation of a regularized, orderly process of dispute settlement.

401 U.S. 371, 374-75 (1971).

Professor Hansmann, arguing for more liberalized standing for a not-for-profit corporation's patrons, said:

Unfortunately, there is no reason to believe that the attorney general, or any other agency, will become an adequate instrument of enforcement in most states in the foreseeable future. Efforts at reform in this direction have been underway for forty years, and there is still rather little to show for them.

Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. 479, 608 (1981) (footnote omitted).

<sup>92</sup>It is the duty of the secretary of state to report violations of the Indiana Not-For-Profit Corporation Act to the attorney general. The attorney general must then bring an action in the name of the state to dissolve the not-for-profit corporation. IND. CODE § 23-7-1.1-63 (1982).

<sup>93</sup>See FREEMONT-SMITH, *FOUNDATIONS AND GOVERNMENT*, 194, 198 (1965). In most states, the attorney general is designated to enforce the responsibilities of nonprofits and their managers. See OFFICE OF THE OHIO ATTORNEY GENERAL, *The Status of State Regulation of Charitable Trusts, Foundations, and Solicitations, Commission on Private Philanthropy and Public Needs, Research Papers* 2705, 2710-25 (1977).

<sup>94</sup>See IND. CODE § 23-7-1.1-63 (1982).

failed to disclose its true financial condition.<sup>95</sup> He may also compel the nonprofit corporation to disclose all material facts concerning its operations through interrogatories or by requiring it to report such facts under oath. This method is available when the secretary believes that the corporation is operating contrary to law or for the purpose of determining whether or not it is a bona fide nonprofit corporation.<sup>96</sup> When the secretary discovers violations of the law, he is required to withhold the filing of any corporate papers in order to compel compliance. Alternatively, he may inform the attorney general of such violations.<sup>97</sup> In the latter case, the attorney general is required to initiate an action for involuntary dissolution.<sup>98</sup>

The Indiana Act does not authorize the secretary of state or the attorney general to enforce the rights of members, creditors, or beneficiaries. Other than the right to compel a nonprofit to answer interrogatories, neither the secretary nor the attorney general is given the right to inspect corporate books and records. Finally, only one state official in Indiana, the county prosecuting attorney, has the authority to institute an action against a nonprofit to nullify an ultra vires act.<sup>99</sup>

Thus, the state's regulation of nonprofits appears to be limited primarily to determining whether or not the corporation will be permitted to continue to exist or will be dissolved involuntarily. State officials oversee nonprofit conduct through the enforcement of the criminal laws dealing with specified types of misconduct. Other jurisdictions give more authority to state officials to police the activities of nonprofits. Because the Indiana attorney general's statutory authority is so limited, one would rightly question whether others who have a relationship to nonprofits in Indiana have standing to sue the corporation or its management.

The Indiana Not-For-Profit Corporation Act does not contain any provision for derivative actions by members. Consequently, while members can sue both the corporation and the board of directors to enforce their own rights, members have no way to protect the rights of the corporation through adjudication. Unfortunately, Indiana's statutory omission of a provision for derivative rights is typical.<sup>100</sup> Consequently, members of Indiana nonprofit corporations must rely on either the state attorney general or the directors of the corporation to protect the interests of the corporation. Even though members can protect their own interests through adjudication, members are not the only constituents of non-

---

<sup>95</sup>*Id.* § 23-7-1.1-36.

<sup>96</sup>*Id.* § 23-7-1.1-63.

<sup>97</sup>*Id.*

<sup>98</sup>*Id.*

<sup>99</sup>*Id.* § 23-7-1.1-65.

<sup>100</sup>Only ten jurisdictions explicitly permit members of nonprofits to sue derivatively: California, Delaware, Florida, Illinois, Michigan, New York, Ohio, Pennsylvania, South Carolina, and Wyoming.

profits. The adjudicative rights of two other constituencies are nonexistent. The Indiana Act does not give standing to actual or potential beneficiaries of a nonprofit to sue the corporation or its managers for mismanagement, waste of corporate assets, or any other recognized corporate causes of action.<sup>101</sup> Although the interest of beneficiaries is recognized in a provision of the Act dealing with involuntary dissolution, it appears that protection of such interests may be had only through actions brought in the name of the state.<sup>102</sup> Similarly, the Act does not confer standing on donors.

Obtaining accountability through adjudication in Indiana is possible. Yet, because of restricted standing rules, the lion's share of the enforcement burden falls on the state attorney general.

### C. *Accountability and the Tax Laws*

Special provisions of the state and federal tax codes relating to nonprofits have been enacted to encourage nonprofit activities.<sup>103</sup> Not only do these provisions exempt nonprofit income from taxation, some also permit donors to qualified nonprofits to deduct their donations from their own income taxes.

Simply exempting the activities of certain organizations from income and other taxes can, however, result in rather substantial abuses of the privilege. Some flagrant examples of such abuse already exist. Donors have created charitable foundations and then used the foundations' funds to finance the expansion of the donors' businesses.<sup>104</sup> Trustees of charitable organizations have used their positions as trustees to cause the organization to use the investment advisor or banking services of the interested trustees' investment or commercial bank.<sup>105</sup> Nonprofits have owned and operated businesses that competed unfairly with other businesses.<sup>106</sup> Nonprofits have been used to secure enough of the equity securities of a donor's business corporation to assure the nonprofit's control of the business corporation.<sup>107</sup> Clearly, all of these situations

---

<sup>101</sup>There is apparently no statutory authorization for these types of actions by beneficiaries in any jurisdiction in the country.

<sup>102</sup>IND. CODE § 23-7-1.1-63 (1982).

<sup>103</sup>See, e.g., I.R.C. § 501 (1982); CAL. REV. & TAX CODE § 2701(d) (West 1979); DEL. CODE ANN. tit. 30, § 1902 (1975); ILL. REV. STAT. ch. 120, § 2-205(a) (1974); IND. CODE § 6-2.1-3-20 (1982); MICH. COMP. LAWS ANN. § 206.201 (West 1967 & Supp. 1984-85); MO. ANN. STAT. § 143.441(2)(1) (Vernon 1976); WIS. STAT. ANN. § 71-101 (West Supp. 1983-84).

<sup>104</sup>See generally WELLS, CONFLICTS INTEREST: NONPROFIT INSTITUTIONS 59, 64-74 (1977).

<sup>105</sup>*Id.* at 29-41; see also *Stern v. Lucy Webb Hayes Nat'l Training School*, 381 F. Supp. 1003 (D.D.C. 1974).

<sup>106</sup>See, e.g., *C.F. Mueller Co. v. Commissioner of Internal Revenue*, 190 F.2d 120 (3d Cir. 1951).

<sup>107</sup>See WELLS, *supra* note 104, at 61-74.

involve an abuse of the nonprofit privilege. In some instances, they also involve a clear breach of a fiduciary duty. Even more importantly, in many cases where the privilege of nonprofit status is abused, money that should be taxed escapes taxation and yet is not used to further any public purpose.

To remedy the abusive uses of the tax laws by donors and managers of nonprofits, the state and federal governments have enacted elaborate laws.<sup>108</sup> These statutes and the accompanying regulations place limits on the types of activities that qualify for exemption, delineate the types of activities that may subject the nonprofit to penalties and fines, and indicate the types of activities that will bar an organization from becoming tax-exempt or that will result in decertification of an exempt organization. Enforcement of these laws by state and federal revenue agencies necessarily renders nonprofit corporations and their managers more accountable.

1. *Federal Tax Law.*—Subchapter F of the Internal Revenue Code provides for tax-exempt status for several categories of organizations.<sup>109</sup> The most liberal tax benefits are provided to organizations qualifying under section 501(c)(3).<sup>110</sup> There are three requirements for qualifying under this section:

- (1) the entity must be organized and operated exclusively for one or more of the stated exempt purposes: charitable, scientific, literary or educational, the prevention of cruelty to children or animals, or testing consumer products for public safety;
- (2) the organization's net earnings must not inure, in whole or in part, to the benefit of private shareholders or individuals; and
- (3) the organization must not devote a substantial part of its activities to carrying on propaganda or otherwise attempting to influence legislation, nor may it participate in, or intervene in, any political campaign on behalf of any candidate or public office.<sup>111</sup>

Contributions to section 501(c)(3) nonprofits are deductible from the contributor's income tax, subject to limitations based on a percentage of the contributor's income.<sup>112</sup> Contributions to these organizations may also be deducted from estate and gift taxes.<sup>113</sup>

---

<sup>108</sup>*Id.*

<sup>109</sup>*See* I.R.C. §§ 501-528 (1982).

<sup>110</sup>*Id.* § 501(c)(3).

<sup>111</sup>*Id.* *See also* P. TREUSCH & N. SUGARMAN, TAX EXEMPT CHARITABLE ORGANIZATIONS 49 (1979).

<sup>112</sup>I.R.C. § 170 (1982).

<sup>113</sup>*See* I.R.C. § 2055(a)(3) (1982).



Not only does Congress distinguish section 501(c)(3) organizations from other section 501(c) organizations, it also makes a distinction between organizations within section 501(c)(3)<sup>114</sup> pursuant to the Tax Reform Act of 1969.<sup>115</sup> This Act classified all section 501(c)(3) organizations as either public charities or private foundations. Indeed, every section 501(c)(3) nonprofit is presumed to be a private foundation unless it can show

- (1) that it is an educational institution, a hospital, church, medical research organization, development foundation of a state university; or
- (2) an organization supported in substantial part by government or by contributions from the public; or
- (3) an organization that normally receives more than one third of its support from contributions and gross receipts from the public or from governmental units and normally receives not more than one third of its support from gross investment income; or
- (4) an organization that is organized and operated for the benefit of, to perform the function of, or to carry out the purposes of, one or more specified public charities described in (1) or (2) and is operated, supervised, or controlled by, or in connection with, one or more such public charities and is not controlled directly or indirectly by one or more "disqualified persons"; and
- (5) an organization which is organized and operated exclusively for testing for public safety.<sup>116</sup>

Because of both documented and perceived abuses of their nonprofit status, Congress subjected private foundations to rather strict regulation.<sup>117</sup> They are prohibited from entering into certain transactions with "disqualified persons,"<sup>118</sup> required to pay out to qualified persons or organizations a certain percentage of their noncharitable assets,<sup>119</sup> prohibited from making risky investments,<sup>120</sup> and prohibited from owning, together with a disqualified person, more than twenty percent of the voting stock of a business enterprise.<sup>121</sup>

All of these provisions of the Tax Reform Act of 1969 were designed to make foundation managers and members more accountable to their

---

<sup>114</sup>*See id.* § 503(b).

<sup>115</sup>Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487 (1969).

<sup>116</sup>I.R.C. § 509(a) (1982).

<sup>117</sup>*Id.*

<sup>118</sup>I.R.C. § 4946 (1982).

<sup>119</sup>*Id.* § 4942.

<sup>120</sup>*Id.* § 4944.

<sup>121</sup>*Id.* § 4943(c)(2)(A).

various constituencies. The prohibition of certain transactions, such as sales or leases of property between a private foundation and a "disqualified person,"<sup>122</sup> is an attempt to prevent donors who create or make substantial contributions to a private foundation from engaging in acts of self-dealing.<sup>123</sup> The provision that requires a minimum annual distribution is designed to prevent charitable organizations from retaining funds, without sound reasons, for long periods of time.<sup>124</sup> The tax exemption provided to private foundations is given on the assumption that it will benefit the public welfare. When private foundations accumulate large sums of money or securities over long periods of time, there is no discernible benefit to the public. Likewise, the public does not benefit from extremely risky investments made by private foundations. The risk-reward analysis engaged in by private capitalists is simply not appropriate for private foundations.<sup>125</sup> Finally, the restriction on business holdings is obviously designed to prevent a donor who wants to gain and maintain control of a business from using a private foundation to facilitate this goal.<sup>126</sup>

The tax laws are helpful in assuring accountability for all tax exempt organizations, not only private foundations. All nonprofits that have acquired exempt status under section 501(c) of the Internal Revenue Code are required to file informational reports.<sup>127</sup> These reports must set forth the organization's gross income, expenses, disbursements for exempt purposes, accumulations, balance sheets, total contributions and gifts received during the year, names and addresses of all substantial contributors if the reporting entity is a private foundation, names and amounts of compensation paid to foundation managers and highly compensated employees.<sup>128</sup> Certain organizations with annual gross receipts of less than \$10,000 and most church and religious organizations are exempt from this requirement.<sup>129</sup>

Finally, the Supreme Court of the United States has given the Internal Revenue Service broad powers to determine whether or not nonprofits are complying with the law and policy of the federal government. Indeed, in a recent ruling, the Court quite clearly acknowledged another mech-

---

<sup>122</sup>*Id.* § 4941.

<sup>123</sup>*Id.*

<sup>124</sup>*Id.* § 4942.

<sup>125</sup>*See, e.g.,* I.R.C. § 4944 (1982) (penalizing investments by private foundation in such a manner as to jeopardize the carrying out of its exempt purposes). A jeopardizing investment is one that *might* have the effect of preventing the foundation from pursuing its long and short term goals because of its financial situation. *See generally* P. TREUSCH & N. SUGARMAN, TAX-EXEMPT CHARITABLE ORGANIZATIONS 288-92 (1979).

<sup>126</sup>I.R.C. § 4941(d)(1)(E) (1982).

<sup>127</sup>*Id.* § 6033.

<sup>128</sup>Treas. Reg. § 301.6033-1 (1967).

<sup>129</sup>I.R.C. § 6033(a)(2) (1982).

anism to assure nonprofit accountability. In *Bob Jones University v. United States*, and its companion case, *Goldsboro Christian Schools, Inc. v. United States*,<sup>130</sup> the Supreme Court held that the Internal Revenue Service had lawfully revoked the tax-exempt status of one educational institution (Bob Jones University) and lawfully refused to grant tax-exempt status to another (Goldsboro Christian College) because both had racially discriminatory policies.<sup>131</sup> Bob Jones University denied admission to applicants engaged in an interracial marriage or dating and also prohibited interracial dating.<sup>132</sup> Goldsboro Christian College maintained a racially discriminatory policy based upon its interpretation of the Bible, primarily accepting only Caucasian students.<sup>133</sup> The Court held that to qualify for section 501(c)(3) status, an organization must be “charitable” within the common law meaning of “charity,” notwithstanding that section 501(c)(3) delineates five types of activities in addition to charitable which could serve to qualify nonprofits. The Court said:

Section 501(c)(3) therefore must be analyzed and construed within the framework of the Internal Revenue Code and against the background of the congressional purposes. Such an examination reveals unmistakable evidence that, underlying all relevant parts of the Code, is the intent that entitlement to tax exemption depends on meeting certain common law standards of charity—namely, that an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy.<sup>134</sup>

The Court held that “racial discrimination in education violates deeply and widely accepted views of elementary justice.”<sup>135</sup>

The dissent in this case argued that while it is clear that Congress could prevent organizations engaged in racial discrimination in education from obtaining section 501(c)(3) status, it did not follow that the Internal Revenue Service also has this power. The dissent stated that nothing in the statutory language or history of section 501(c)(3) permitted this conclusion.<sup>136</sup> Nevertheless, the majority eschewed this rather mechanical reading of the statute and upheld the agency determinations. *Bob Jones University* indicates that the Court will willingly permit the Internal Revenue Service to depart from a narrowly defined tax collection function and exercise some policy decisions, at least to the extent that the policy

---

<sup>130</sup>461 U.S. 574 (1983).

<sup>131</sup>*Id.* at 595.

<sup>132</sup>*Id.* at 580-81.

<sup>133</sup>*Id.* at 583.

<sup>134</sup>*Id.* at 586.

<sup>135</sup>*Id.* at 592.

<sup>136</sup>*Id.* at 617 (Rehnquist, J., dissenting).

has been well-defined by Congress. Thus, the I.R.S. has some latitude to perform a critically important accountability function when it certifies and decertifies nonprofits for tax-exemption under the Internal Revenue Code.

2. *Indiana Tax Laws.*—Indiana also provides incentives to people who want to engage in nonprofit activities. Most of the organizations that are qualified to receive tax exemption under section 501(c)(3) of the Internal Revenue Code are also exempt from paying tax on their gross incomes in Indiana, if they file for exemptions and comply with the annual reporting requirement of the tax code.<sup>137</sup> Moreover, organizations operated for fraternal or social purposes or as business leagues or associations are exempt from gross income tax on amounts received as contributions, tuition fees, initiation fees, membership fees, or earnings on receipts from the sale of tangible property.<sup>138</sup>

An organization exempted from the gross income tax is also exempt from the sales tax if (1) the sale is made to make money to carry on its nonprofit purpose and sales are not made during more than thirty days in a calendar year; or (2) the property sold is designed and intended primarily either for the nonprofit organization's educational, cultural, or religious purposes, or for improvement of the work skills or professional qualifications of members; the property sold is not designed or intended primarily for use in carrying on a private or proprietary business; and, the nonprofit is not operated predominantly for social purposes.<sup>139</sup> Indiana also provides a property tax exemption, primarily to organizations that qualify for Internal Revenue Code section 501(c)(3) and (4) exemptions.<sup>140</sup>

The tax privileges extended to nonprofits are premised on the assumption that they will aid these organizations in achieving their objectives. To assure accountability, the Indiana Tax Code requires all organizations that receive these benefits to file an annual report with the Indiana Department of Revenue.<sup>141</sup>

Thus, a second agency in Indiana has an opportunity to determine whether or not nonprofit corporations are operating in compliance with state law, in this case, tax laws. Obviously, this source of accountability is not as authoritative as that of the secretary of state. Unlike the secretary of state who can initiate revocation of the nonprofit status of a corporation, the Indiana Department of Revenue is only empowered to disallow a claimed tax privilege.<sup>142</sup> Nevertheless, the tax laws do serve

---

<sup>137</sup>IND. CODE §§ 6-2.1-3-20, -22 (1982).

<sup>138</sup>*Id.* § 6-2.1-3-21 (Supp. 1985).

<sup>139</sup>*Id.* § 6-2.5-5-26 (1982).

<sup>140</sup>*Id.* §§ 6-1.1-10-16, -18.5, -21, -23, -25 (1982 & Supp. 1985).

<sup>141</sup>*Id.* § 6-2.1-3-20.

<sup>142</sup>*See* 45 I.A.C. 1-1-132 (1984).

a type of accountability function insofar as the department of revenue prevents those organizations that do not comply with the laws from securing the tax advantages which it provides.

#### IV. STATUTORY COMPARISONS

The Indiana Not-For-Profit Corporation Act is similar to the non-profit statutes in most jurisdictions. Most of the nonprofit statutes in the country are unitary.<sup>143</sup> Most jurisdictions require some type of information in the nonprofit corporation's annual report.<sup>144</sup> The overwhelming majority of jurisdictions do not permit members to sue derivatively on behalf of the corporation.<sup>145</sup>

In addition, most states do not define a standard of care and loyalty for the corporation's officers and directors.<sup>146</sup> In at least two jurisdictions, however, the nonprofit statutes contain many provisions that make it possible for members and perhaps other constituents to enforce some level of accountability from corporate management.<sup>147</sup>

##### A. Structural Mechanisms

1. *Accountability at the Formation Stage.*—*a. New York.*—The New York Not-For-Profit Corporation Law<sup>148</sup> provides for four types of nonprofits:

Type A - A not-for-profit corporation of this type may be formed for any lawful non-business purpose or purposes in-

<sup>143</sup>H. OLECK, *NONPROFIT CORPORATIONS, ORGANIZATIONS AND ASSOCIATIONS* § 12 (4th ed. 1980).

<sup>144</sup>*See, e.g.*, ARIZ. REV. STAT. ANN. § 10-719 (1977); COLO. REV. STAT. § 7-20-105 (Supp. 1984); GA. CODE ANN. § 22-3301 (Supp. 1982); OR. REV. STAT. § 61.805 (1983); W. VA. CODE § 31-1-56a (1982).

<sup>145</sup>Express statutory authority for derivative actions by members exists in only two jurisdictions, California and New York. *See* CAL. CORP. CODE § 9142(a)(1) (West Supp. 1985); N.Y. NOT-FOR-PROFIT CORP. LAW § 623 (McKinney 1970 & Supp. 1984-85).

<sup>146</sup>Twelve jurisdictions have provisions in their nonprofit statutes which set out a fiduciary duty of care and loyalty for directors. *See* CAL. CORP. CODE §§ 309(a), 9002 (West 1977 & Supp. 1985); CONN. GEN. STAT. ANN. § 33-313 (West 1960 & Supp. 1985); GA. CODE ANN. 22-2614 (1977 & Supp. 1982); FLA. STAT. ANN. §§ 607.11C4, 617.002 (West 1977 & Supp. 1985); HAWAII REV. STAT. §§ 416.19, 416.91.5 (1976 & Supp. 1984); MD. CORPS & ASS'NS CODE ANN. §§ 2-405.1, 5-201 (1985); MINN. STAT. ANN. § 317.20, subd.6 (West 1969); N.Y. NOT-FOR-PROFIT CORP. LAW § 717 (McKinney Supp. 1984-85); 15 PA. CONS. STAT. ANN. § 7734 (Purdon Supp. 1985); OHIO REV. CODE ANN. § 1702.30(B) (Page Supp. 1984).

<sup>147</sup>Those jurisdictions are California and New York. *See* CAL. CORP. CODE § 9142 (West Supp. 1985); N.Y. NOT-FOR-PROFIT CORP. LAW §§ 623, 722 (McKinney 1970 & Supp. 1984-85).

<sup>148</sup>N.Y. NOT-FOR-PROFIT CORP. LAW §§ 101-1515 (McKinney 1970 & Supp. 1984-85).

cluding, but not limited to, any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, animal husbandry, and for a professional, commercial, industrial, trade or service association.

Type B - A not-for-profit corporation of this type may be formed for any one or more of the following non-business purposes: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals.

Type C - A not-for-profit corporation of this type may be formed for any lawful business purpose to achieve a lawful public or quasi-public objective.

Type D - A not-for-profit corporation of this type may be formed under this chapter when such formation is authorized by any business or non-business, or pecuniary or non-pecuniary, purpose or purposes specified by such other law, whether such purpose or purposes are also within types A, B, C above or otherwise.<sup>149</sup>

The New York law requires the following information in a proposed certificate of incorporation: corporate name, corporate purpose, location of corporate office, corporate duration, principal location where corporate activities are to be carried on, post office address for mailing legal notice, and any approvals which might be required as prerequisite to information.<sup>150</sup> Type C nonprofits are also required to state what public or quasi-public objective will be fulfilled by each business purpose.<sup>151</sup> Type B and C nonprofits are required to list the names and addresses of the initial directors.<sup>152</sup> Finally, the certificate must be filed with the department of state for approval.<sup>153</sup>

Governmental review of a proposed certificate may encompass a multi-step process, depending upon the type and specific nature of the particular nonprofit corporation. Certain nonprofits are required to obtain special consents or approvals before filing a certificate of incorporation and getting approval from the department of state. Section 404 of the New York law provides a noninclusive list of required approvals.<sup>154</sup> That provision specifically requires judicial approval of all nonprofits seeking to incorporate as Type B or C corporations and all trade and business associations. The section also requires notice to be sent to the

---

<sup>149</sup>*Id.* § 201(b) (McKinney 1970).

<sup>150</sup>*Id.* § 402.

<sup>151</sup>*Id.* § 402(a)(2).

<sup>152</sup>*Id.* § 402(a)(5).

<sup>153</sup>*Id.* § 402(a).

<sup>154</sup>*Id.* § 404. Trade and other business associations are Type A nonprofits. N.Y. NOT-FOR-PROFIT CORP. LAW § 1410 (McKinney 1970 & Supp. 1984-85). Judicial approval is not required for other Type A nonprofits. *See id.* § 404 comment.

state attorney general, for the purpose of allowing the attorney general to show cause for denial of judicial approval.<sup>155</sup>

Significant limitations exist upon the authority of governmental officials to withhold approval, even if they find that the proposed nonprofit's purpose is contrary to public policy or that those who will manage the corporation are irresponsible or ill-equipped to carry out their duties. Broadly stated, these determinations are limited to questions of lawfulness and thus appear not to differ from a determination that all formal requirements for incorporation are met.

The case of *In re Queens Lay Advocate Service, Inc.*<sup>156</sup> involved an application for judicial approval for incorporation of a "charitable" nonprofit. The organization, Queens Lay Advocate Service, included among its purposes protecting and expanding the rights of public school pupils, their parents, and the general public, and assisting pupils and their parents in public school disciplinary proceedings. In denying approval, the court noted that the corporate name and stated purpose implied that the nonprofit would provide legal services. Since the provision of legal services by lay persons constituted an unauthorized practice of law, the court found that incorporation for such purposes would violate public policy.<sup>157</sup> The court also noted that those who would operate the corporation were ill-equipped to carry out its purpose, not only because they lacked specialized legal training but also because they lacked legal authorization to give legal advice.<sup>158</sup> *In re Queens Lay Advocate Service* makes clear, therefore, that where a corporation proposes to conduct activities deemed to be unlawful or where those who would operate the nonprofit corporation would be acting unlawfully in carrying out their duties, approval of the certificate of incorporation may be properly denied.

On the basis of *In re Queens Lay Advocate Service*, one might be tempted to generalize that lawfulness is something to be *deduced* from the purposes set out in the articles. The court appeared to read into the stated purposes an implied purpose to engage in the unauthorized practice of law. This generalization, however, may be too hasty, as illustrated by the case of *Owles v. Lomenzo*.<sup>159</sup>

In *Owles*, the secretary of state rejected a proposed certificate of incorporation for the Gay Activist Alliance as contrary to public policy and unlawful. Among the stated purposes of the organization were the following:

---

<sup>155</sup>*Id.* § 404(a).

<sup>156</sup>Misc. 2d 33, 335 N.Y.S.2d 583 (1972).

<sup>157</sup>*Id.* at 35, 335 N.Y.S.2d at 585.

<sup>158</sup>*Id.* at 36, 335 N.Y.S.2d at 586.

<sup>159</sup>38 A.D.2d 981, 329 N.Y.S.2d 181 (N.Y. App. Div. 1972), *aff'd sub nom.* 31 N.Y.2d 965, 341 N.Y.S.2d 108 (N.Y. 1973).

- (a) To safeguard the rights guaranteed homosexual individuals by the constitutions and civil rights laws of the United States and the several States, through peaceful petition and assembly and non-violent protest when necessary.
- (b) To speak out on public issues as a homosexual civil rights organization, working within the framework of the laws of the United States and the several States, but vigilant and vigorous in fighting any discrimination based on sexual orientation of the individual.
- (c) To work for the repeal of all laws regulating sexual conduct and practices between consenting adults.
- (d) To work for the passage of laws ensuring equal treatment under the law of all persons regardless of sexual orientation.<sup>160</sup>

Arguably, these purposes imply that the organization would advise its members on legal issues relating to their activities. This possibility was not addressed in the opinion. In granting the petitioner's appeal of the secretary's ruling, the court stated that no public policy of the state would be violated unless the *express* purposes contained in the proposed certificate were unlawful.<sup>161</sup> The court observed that the purposes set forth in the proposed certificate — assembling peacefully to work for change within the law — were not illegal.<sup>162</sup> In requiring the secretary to accept the certificate, the court said, "Were it otherwise it would, in effect, permit the Secretary of State to impose his personal opinion on what he considers improper conduct."<sup>163</sup>

The cases of *In re Queens Lay Advocate Service* and *Owles* demonstrate that determining the lawfulness of proposed purposes is not always clear. The inquiry raises the issue of how far a reviewing governmental official may go in attributing implied unlawful purposes to a proposed nonprofit corporation. This issue, as well as the issue of how far such an official may go to withhold approval where evidence suggests that the persons who will operate the nonprofit are irresponsible, was decided in *Lueken v. Our Lady of the Roses*.<sup>164</sup>

In that case, the petitioner sought judicial approval of a certificate to incorporate a religious nonprofit for the purpose of promoting the

---

<sup>160</sup>*Id.* at 982, 329 N.Y.S.2d at 182.

<sup>161</sup>*Id.* at 984, 329 N.Y.S.2d at 183. This definitional rule regarding public policy was first enunciated in *Association for the Preservation of Freedom of Choice v. Shapiro*, 9 N.Y.2d 376, 214 N.Y.S.2d 388 (1961), and evolved in response to claims of abuse in the withholding of necessary approvals prior to incorporation.

<sup>162</sup>38 A.2d at 982, 329 N.Y.S.2d at 183. The court did not consider the impact upon the lawfulness of the organization's purposes in light of New York's sodomy laws.

<sup>163</sup>*Id.*

<sup>164</sup>97 Misc. 2d 201, 410 N.Y.S.2d 793 (1978).



Roman Catholic faith. Opponents of the incorporation claimed that the petitioner was seeking to incorporate in order to circumvent a previously issued court order enjoining her from conducting street services, an order which had been issued after a finding that the services conducted by the petitioner constituted a public nuisance. The court noted that its sole reason for reviewing a proposed certificate was to determine whether or not the purposes stated are in conformity with the law, not to determine the social desirability of the nonprofit.<sup>165</sup> The court stated that it could not presume an unlawful purpose based upon the petitioner's prior conduct and was limited to a consideration of information contained in the certificate about the purposes of the corporation.<sup>166</sup> The court observed that the purposes claimed were not illegal.<sup>167</sup> Thus, it appears that in reviewing a proposed certificate for incorporation under New York law, the review is strictly limited to that information contained in the certificate. Unlawful purposes may not be implied unless the stated purposes contain some clear indication of an intent to carry out unlawful purposes.

*b. California.*—California's nonprofit corporation law<sup>168</sup> classifies nonprofits by organizational purposes and provides for three types: public benefit nonprofits;<sup>169</sup> mutual benefit nonprofits;<sup>170</sup> and religious nonprofits.<sup>171</sup> The California Nonprofit Corporation Law is similar to the New York law insofar as distinctions are made between various classes of nonprofits. These distinctions determine the nature and volume of information required to be disclosed in connection with the formation and operation of a nonprofit as well as the extent to which a nonprofit will be subject to governmental scrutiny.

The California statute is divided into four primary parts. Part one<sup>172</sup> contains the general provisions and definitions that are applicable to parts two through four. Parts two through four contain provisions relating to the formation, operation, and dissolution of particular classes of

---

<sup>165</sup>*Id.* at 202, 410 N.Y.S.2d at 794.

<sup>166</sup>*Id.* at 203, 410 N.Y.S.2d at 795.

<sup>167</sup>*Id.* The court, however, denied approval because the petitioner failed to obtain approval from the appropriate authorities of the Roman Catholic Church as required under New York's Religious Corporation Law. *Id.* Because petitioner's purposes included promoting the Roman Catholic faith, the proposed corporation was subject to the provisions of both the Religious Corporation Law and the Not-For-Profit Corporation Law. See N.Y. RELIG. CORP. LAW § 2 (McKinney 1970 & Supp. 1984-85).

<sup>168</sup>CAL. CORP. CODE §§ 5000-8 (West Supp. 1984).

<sup>169</sup>*Id.* § 5110 (corporations formed for any public or charitable purposes).

<sup>170</sup>*Id.* § 7110 (corporations formed for any lawful purpose that does not contemplate the distribution of gain, profits, or dividends to members except upon dissolution).

<sup>171</sup>*Id.* § 9110 (corporations established primarily or exclusively for religious purposes).

<sup>172</sup>*Id.* §§ 5000-5080.

nonprofits: part two deals with public benefit nonprofits;<sup>173</sup> part three deals with mutual benefit nonprofits;<sup>174</sup> part four deals with religious nonprofits.<sup>175</sup> Generally, public benefit nonprofits are subject to more extensive disclosure requirements and governmental review than mutual benefit nonprofits, which are in turn subject to more extensive regulation than religious corporations. The separate treatment of religious corporations is based upon the constitutional policy of avoiding excessive governmental entanglement into religious affairs.<sup>176</sup>

Under the California Code, less information is required in the proposed articles of incorporation for a nonprofit than is required under either the Indiana or New York statutes. The information required includes corporate name, a statement of purpose, and the name and address of the initial corporate agent.<sup>177</sup> Public benefit nonprofits seeking incorporation for *public* purposes must include, in addition to the specified general statement of purpose, some further description of purpose.<sup>178</sup> In addition, certain other information is specifically authorized to be included within the articles, including information concerning directors, membership, and elaboration upon corporate purposes beyond the minimal statutory statement.<sup>179</sup>

The articles must be submitted to the secretary of state for approval.<sup>180</sup> Section 5008 of the California Code provides that the secretary must give approval and file the article if the content "conforms to law."<sup>181</sup> It appears that the secretary has no discretion to withhold approval based upon a determination that the proposed lawful purposes are contrary to public policy or that those individuals who will control the corporation are unfit for their responsibilities. Moreover, since only a limited amount of information is required to be in the proposed articles, it would seem that such a determination would be virtually impossible

<sup>173</sup>*Id.* §§ 5110-8910.

<sup>174</sup>*Id.* §§ 7110-8910.

<sup>175</sup>*Id.* §§ 9110-9610. The California law relating to religious nonprofits differs significantly in format from the New York law. Under New York law, the Religious Corporation Law governing religious nonprofits is separate from the Not-For-Profit Corporation Law and is incorporated by reference to the Not-For-Profit Corporations Law. N.Y. RELIG. CORP. LAW § 2-6 (McKinney Supp. 1984-85). When there is a conflict between the Religious Corporations Law and the Not-For-Profit Corporations Law, the Religious Corporations Law governs. *Id.* § 2-b(1)(a). In contrast, the California Law consolidates those provisions relating to religious nonprofits into a single statute. CAL. CORP. CODE §§ 9110-9610 (West Supp. 1984).

<sup>176</sup>See Hone, *California's New Nonprofit Corporation Law—An Introduction and Conceptual Background* 13 U.S.F.L. REV. 733, 743 (1979).

<sup>177</sup>CAL. CORP. CODE §§ 5130, 7130, 9130 (West Supp. 1984).

<sup>178</sup>*Id.* § 5130(b).

<sup>179</sup>*Id.* §§ 5132, 7132, 9132.

<sup>180</sup>*Id.* § 5008.

<sup>181</sup>*Id.*

to make. Although there are no California cases dealing with the issue of the secretary of state's discretion to withhold approval of a proposed nonprofit's articles of incorporation, there have been decisions under analogous provisions of the for-profit corporation statute which suggest that the secretary's discretion is limited to determinations of lawfulness of purpose and conformity to formal requirements.<sup>182</sup>

In addition to filing proposed articles with the secretary of state, a copy must be furnished to the secretary to be forwarded to the state attorney general in the case of public benefit corporations.<sup>183</sup> The purpose of this requirement is to facilitate public benefit corporation registration with the attorney general as required under the Uniform Supervision of Trustees for Charitable Purpose Act.<sup>184</sup> This nonprofit corporation law gives the attorney general broad investigatory and enforcement powers over corporate assets held for charitable purposes.<sup>185</sup>

2. *Accountability at the Operating Stage.—a. Periodic reports.*—The annual report requirements of the Indiana Act are more effective, in accountability terms, than those of New York and California. Neither California nor New York requires nonprofits to state the kinds of activities they have been engaged in for the year. The information required by the annual report provisions in these two jurisdictions is primarily financial.<sup>186</sup> Indiana, as well as fourteen other jurisdictions, requires a statement describing the activities in which the corporation has engaged during the year.<sup>187</sup> The deficiency in the statutes of most of these jurisdictions, however, is that they do not require distribution of annual reports to members. California does require large public benefit nonprofits to send copies of their annual report to members,<sup>188</sup> and smaller

<sup>182</sup>See, e.g., *Rixford v. Vordan*, 214 Cal. 547, 6 P.2d 959 (1931) (secretary has no discretion to reject proposed articles of for-profit corporation even though he determines that the proposed corporation will become an unfair competitor in trade).

<sup>183</sup>CAL. CORP. CODE § 5120(d) (West Supp. 1984).

<sup>184</sup>CAL. GOV'T CODE § 12585 (West 1977); see Abbott & Kornblum, *The Jurisdiction of the Attorney General Over Corporate Fiduciaries Under the New California Nonprofit Corporation Law*, 13 U.S.F.L. REV. 753, 771 (1979).

<sup>185</sup>See CAL. CORP. CODE §§ 5250, 6510, 6511, 6611 (West Supp. 1984).

<sup>186</sup>See CAL. CORP. CODE § 6321 (West Supp. 1984); N.Y. NOT-FOR-PROFIT CORP. LAW § 519 (McKinney 1970 & Supp. 1984-85).

<sup>187</sup>See ALASKA STAT. § 10.20.625 (1983); ARIZ. REV. STAT. ANN. § 10-1081 (1983); COLO. REV. STAT. § 7-28-101 (1973 & Supp. 1982); GA. CODE ANN. § 22-3301 (1981); IDAHO CODE § 30-1-125 (1980 & Supp. 1983); ILL. REV. STAT. ch. 32, § 163a62 (1983); IND. CODE § 23-7-1.1-36 (1982); IOWA CODE § 496.1 (West 1949 & Supp. 1983-84); MONT. CODE ANN. § 35-1-1101 (1983); NEB. REV. STAT. § 21-1981 (1943 & Supp. 1983); OR. REV. STAT. § 61.805 (1981); S.D. CODIFIED LAWS ANN. § 47-24-6 (1983); TEX. REV. CIV. STAT. ANN. art. 1396-9.01 (Vernon 1979); W. VA. CODE § 31-1-56(a) (1982).

<sup>188</sup>CAL. CORP. CODE § 6321 (West Supp. 1984). For the purpose of requiring nonprofits to send annual reports to members, California distinguishes between public benefit corporations that have more than 100 members or \$10,000 in assets during the fiscal year and corporations with fewer members or assets. *Id.*

public benefit nonprofits are required to send copies to members upon request.<sup>189</sup>

*b. Standards of Conduct of Officers and Directors.—i. Self-dealing and conflicts of interest.*—The New York Not-For-Profit Corporation law provides that directors and officers who have a “substantial financial interest” in transactions with the nonprofit, either directly or indirectly by virtue of a directorship with an entity which is a party to the transaction, must, in good faith, disclose the material facts relating to that interest to the board of directors or members entitled to vote.<sup>190</sup> Absent disclosure, the transaction may be voidable by the nonprofit unless the parties establish that it was fair and reasonable to the corporation at the time of authorization.<sup>191</sup>

The California provisions relating to disclosure of transactions with interested directors also require information concerning the nature of the director's interests.<sup>192</sup> In the case of public benefit and religious nonprofits, where transactions exist between the nonprofit and some other corporation for which a director of the nonprofit also serves as a director, full disclosure as to the nonprofit director's other directorship must be made even though that director might not have a material financial interest in the transaction.<sup>193</sup> Such disclosure is not necessary, however, in the case of public benefit and religious corporations where the state attorney general is notified and approves the transaction.<sup>194</sup> Finally, where disclosure is not made and approval is not given by the attorney general, transactions in which a director of a public benefit or religious nonprofit has a material financial interest are voidable unless it is established that a committee authorized by the board approved the transaction with knowledge of the director's interest, that it was not practical to obtain full board approval prior to the transaction, and that the board subsequently ratified the transaction after making a good faith determination that the first two conditions were met.<sup>195</sup> Thus, the California statute provides incentive to make the required disclosure because voidability turns not on the issue of the fairness of the transaction but on the issue of disclosure.<sup>196</sup>

---

<sup>189</sup>*Id.* § 6321(c).

<sup>190</sup>N.Y. NOT-FOR-PROFIT CORP. LAW § 715 (McKinney 1970 & Supp. 1982-83).

<sup>191</sup>*Id.* § 715(b).

<sup>192</sup>CAL. CORP. CODE §§ 5233, 5234, 7233, 9243, 9244 (West 1977 & Supp. 1984).

<sup>193</sup>*Id.* §§ 5234, 9244.

<sup>194</sup>*Id.* §§ 5233(d)(1), 9243(d)(1).

<sup>195</sup>*Id.* §§ 5233(d)(3), 9243(d)(3). These sections do not specifically state that unauthorized self-dealing transactions are voidable. However, they give the court broad discretion to provide a fair and equitable remedy. Presumably, this discretion includes the authority to void unauthorized self-dealing transactions.

<sup>196</sup>Although an unauthorized self-dealing transaction may be voidable due to the failure to disclose, the issue of reasonableness of the transaction to the nonprofit is

*ii. General standard of care and loyalty.* The Indiana Act does not have a statutory provision that delineates the general standards of care and loyalty required of directors of nonprofit corporations. New York, California, and ten other jurisdictions have such statutory standards.<sup>197</sup> A typical provision is that found in the New York statute:

(a) Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions.

(b) In discharging their duties, directors and officers, when acting in good faith, may rely upon financial statements of the corporation presented to them to be correct by the president or the officer of the corporation having charge of its books of accounts, or stated in a written report by an independent public or certified public accountant or firm of such accountants fairly to reflect the financial condition of such corporation.<sup>198</sup>

Such a provision is beneficial because it clearly defines the general duty of care for officers and directors. With this kind of provision in a state's nonprofit corporation act, the general duty of care need not await judicial definition.

## B. *Adjudicative Mechanisms*

*1. Role of the State Attorney General.*—New York, in sharp contrast to Indiana, gives various state officials a great deal of authority to compel compliance with the nonprofit law in general. Most of this authority is vested in the Office of the Attorney General.

Under the New York statute, the attorney general is authorized to maintain actions to dissolve a corporation that has acted *ultra vires*, (2) restrain a corporation from carrying on unauthorized activities, (3) to dissolve a corporation that was formed improperly, (4) restrain unincorporated associations from exercising corporate rights in the state, (5) remove directors for cause, (6) dissolve the corporation, (7) restrain

---

still relevant. Such considerations may be taken into account by the court in determining whether and to what extent interested directors will be liable to the nonprofits for any damages arising out of the transaction. *See id.* §§ 5233(h), 9243(h).

<sup>197</sup>CAL. CORP. CODE § 9241 (West Supp. 1984); N.Y. NOT-FOR-PROFIT CORP. LAW § 717 (McKinney 1970); *see also* CONN. GEN. STAT. ANN. § 33-455 (West 1984); FLA. STAT. ANN. § 617-26 (West 1976) (repealed); GA. CODE ANN. § 14-3-113 (1982); HAWAII REV. STAT. § 416-91.5 (1968 & Supp. 1983); IDAHO CODE § 30-1-35 to -142 (1977); MD. CORPS. & ASS'NS § 2-405.1 (1976 & Supp. 1983); MINN. STAT. ANN. § 317.20 (West 1969); OHIO REV. CODE ANN. § 964 (1984); PA. STAT. ANN. tit. 15, § 2851-506 (Purdon 1959 & Supp. 1983); TENN. CODE ANN. § 48-813 (1979).

<sup>198</sup>N.Y. NOT-FOR-PROFIT CORP. LAW § 717 (McKinney 1970 & Supp. 1984-85).

foreign corporations from acting within the state, (8) enforce members' rights, and (9) compel an accounting upon dissolution. In addition, the attorney general has the right to bring actions against directors and officers for making improper distributions, for an accounting by directors for misconduct, and to enjoin unlawful conveyances.<sup>199</sup>

As with the New York law, California gives the state attorney general expansive power to investigate and bring actions to correct misconduct. The California Code, however, gives the attorney general different amounts of authority depending upon the type of nonprofit corporation involved. For example, the attorney general is given broad powers over public benefit nonprofits. These corporations are subject at all times to examination by the attorney general for the purpose of determining whether or not the corporation has complied with trusts which it has assumed and whether there has been a deviation from the corporate purposes.<sup>200</sup> Moreover, the California attorney general is empowered to bring an action in the name of the state to correct any deviations discovered.<sup>201</sup> He is also empowered to institute suit to remedy any breach of charitable trust by the corporation and to bring an action to recover for the nonprofit any unlawful distribution.<sup>202</sup>

The attorney general is also given the authority to take action with respect to the composition of the board of directors and the protection of certain membership rights, as well as the continuing existence of the nonprofit. He has the authority to institute proceedings to remove directors for breach of the established standards of conduct, abuse of authority or fraudulent conduct, and to intervene in actions challenging the election of directors.<sup>203</sup> Finally, the attorney general is authorized to bring an action for involuntary dissolution based upon certain grounds, including the persistent fraudulent mismanagement or abusive conduct of the nonprofit's management, the existence of serious internal disputes which prevent the corporation from advantageously carrying on its operations, and the failure of a nonprofit to carry out its purpose.<sup>204</sup>

In the case of mutual benefit corporations, the attorney general has relatively limited power, primarily limited to situations where the nonprofit holds assets in charitable trust.<sup>205</sup> This difference in the attorney general's authority in the case of mutual benefit corporations is a reflection of the enforcement role imposed by law on the attorney general to protect the interests of the nonprofit's beneficiaries who would not

---

<sup>199</sup>*Id.* § 112.

<sup>200</sup>CAL. CORP. CODE § 5250 (West Supp. 1984).

<sup>201</sup>*Id.*

<sup>202</sup>*Id.* § 7240.

<sup>203</sup>*Id.* § 5250.

<sup>204</sup>*Id.* §§ 6510, 6511.

<sup>205</sup>*Id.* § 7240.

otherwise be in a position to protect themselves. In the context of a mutual benefit corporation where no charitable trust exists, the members are the nonprofit's beneficiaries and, therefore, are in a position to protect themselves. Thus, there is little need for protection action by the attorney general.

Nevertheless, the attorney general is granted authority in certain matters regarding mutual benefit nonprofits, even where no charitable trust is involved. Upon complaint of violations of the nonprofit law by a member, officer, or director, the state attorney general may notify management of the nonprofit of the complaint; the corporation's failure to respond adequately may cause the attorney general to institute proceedings seeking appropriate remedies to protect the rights of members.<sup>206</sup> Thus, the attorney general is empowered to take action where a mutual benefit nonprofit has failed to make required filings with the secretary of state, hold required meetings, or has violated other membership rights.<sup>207</sup>

Finally, the authority of the attorney general over religious corporations is very limited. The attorney general has the power to enforce state criminal laws; bring an action to determine judicially whether or not the organization is properly incorporated as a religious nonprofit; exercise any authority granted regarding required filings with the state, proceedings winding up the corporation, disposition of residual assets after dissolution, payment of liabilities, and criminal penalties; compel the nonprofit to use property solicited and received from the public for the designated purpose, where the nonprofit in making its solicitation represented that such property would be used for specific purposes.<sup>208</sup>

In summary, the role of the state attorney general in enforcing the nonprofit law and protecting the rights of beneficiaries, donors, and creditors varies. The Indiana attorney general's statutory authority appears quite limited compared to the more expansive New York and California statutes.

*2. Role of the Members.*—The Indiana Not-For-Profit Corporation Act does not contain any provision for derivative actions for members. In contrast, both New York and California nonprofit members have standing to initiate derivative actions. In New York, at least five percent of any class of members must join in the action.<sup>209</sup> In California, however, there is no such requirement. Any members may bring a derivative action if they were members at the time that the complained of transaction

---

<sup>206</sup>*Id.* § 8216.

<sup>207</sup>*Id.*

<sup>208</sup>*Id.* § 9230.

<sup>209</sup>N.Y. NOT-FOR-PROFIT CORP. LAW § 623(a) (McKinney 1970 & Supp. 1984-85).

occurred.<sup>210</sup> To mitigate the potential harrassing effects of this liberal standing provision, the statute permits the defendants to request that the court require the plaintiff to furnish security for expenses.<sup>211</sup> The most innovative aspect of the standing provision of the California statute is the extent to which it expressly gives standing to individual members to enforce their membership rights. Members, individually, have standing to bring action for judicial enforcement of the duty of the board to make and deliver any statements or reports required by law, bring action for judicial enforcement of inspection rights, bring action for a court order compelling the nonprofit to call or conduct meetings of members, and bring an action challenging the validity of any election, appointment, or removal of a director.<sup>212</sup>

#### V. REFORMING INDIANA'S NOT-FOR-PROFIT CORPORATION ACT

The preceding sections of this Article have analyzed the relevant regulations that exist to monitor and discipline the activities of nonprofits incorporated in Indiana. The major regulatory device, the Indiana Not-for-Profit Corporation Act, compares relatively well with similar statutes in other jurisdictions. Nevertheless, both New York and California have shown that regulation of nonprofit corporations can be much more finely tuned if nonprofits are classified according to their purposes.

Recognizing the different purposes served by different types of nonprofit corporations is not a radical departure for that part of the legal system concerned with regulating organizations that hold and manage resources for identifiable constituencies. Several states have acknowledged, through legislative enactment, the distinction between closely-held and nonclosely-held business corporations.<sup>213</sup> Likewise, most jurisdictions make a legal distinction between general and limited partnerships.<sup>214</sup> Finally, all jurisdictions acknowledge, through regulation, a distinction between charitable and other types of trusts.<sup>215</sup> Perhaps the most significant reason for making these statutory distinctions is that it permits the legislature to define different fiduciary obligations for managers according to the type and function of the organization. Thus, for example,

---

<sup>210</sup>CAL. CORP. CODE § 5710 (West Supp. 1984).

<sup>211</sup>*Id.*

<sup>212</sup>*Id.* § 5617(a).

<sup>213</sup>*See, e.g.*, CAL. CORP. CODE §§ 149, 158 (West 1977); DEL. CODE ANN. tit. 8, §§ 341-356 (1974).

<sup>214</sup>In a limited partnership, the limited partners are shielded from unlimited liability. To protect this privilege, the limited partner must refrain from taking an active role in the partnership business. *See, e.g.*, IND. CODE §§ 23-4-2-1, -7 (1982). Conversely, a partner in a general partnership has unlimited liability to creditors and has the right to take an active role in conducting the business of the partnership. *See, e.g.*, IND. CODE §§ 23-4-1-6, -15 (1982).

<sup>215</sup>*See generally* G. BOGART, LAW OF TRUSTS 200 (1973).



managers of closely-held corporations, where there is virtually no market for the firm's securities, have a much greater fiduciary obligation to minority shareholders in transactions involving the sale or exchange of securities than do managers of large, publicly held corporations.<sup>216</sup>

The danger of statutorily maintaining a single, unitary regulatory standard for organizations that may have a "family resemblance" but serve essentially different purposes is that the statute tends to overregulate as well as underregulate. This kind of statute is currently in force in Indiana. More specifically, the Indiana Act does not have a provision setting out a fiduciary standard for directors of nonprofit corporations. Also, the Act contains no provision for derivative suits by nonprofit members. Additionally, the self-dealing and conflict-of-interest provisions of the Act are not rigorous enough for directors of charitable organizations. Finally, the annual report provision does not require that the report be distributed to members and others. All of these features are shortcomings which emanate from the Act's underregulation of nonprofits. Moreover, one provision of the Act that overregulates is the dissolution provision which requires all assets that cannot be distributed according to the guidelines in the Act to escheat to the state. An analysis of the defects in the Indiana Act is necessary before appropriate remedial measures can be proposed.

#### A. *General Standards of Fiduciary Care and Loyalty*

Indiana, like most states, does not have a provision in its nonprofit corporation statute defining the standards of fiduciary care and loyalty owed by directors of these corporations. Consequently, in an action against directors of a nonprofit corporation for a breach of fiduciary duty, the court would be likely to apply the common law standard. Yet, in Indiana, there are no reported cases in which the courts have clearly set out the common law standard. Indeed, there are few cases on the subject in the country. The leading decision is *Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries*.<sup>217</sup> This was the first widely publicized case in which the court explored the potentially applicable fiduciary standards to be applied to directors of nonprofit corporations. The court declined to impose a trustee standard upon the directors as that imposed upon directors of business corporations. The court rationalized the imposition of the corporate standard on the basis of the broader responsibilities of directors of nonprofit corporations who are charged with managing the affairs of an operating corporation, while "the traditional trustee is often charged only with

---

<sup>216</sup>See, e.g., *Donahue v. Rodd Electrotpe Co.*, 367 Mass. 578, 328 N.E.2d 505 (1975).

<sup>217</sup>381 F. Supp. 1003 (S.D.N.Y. 1974).

the management of the trust funds and can therefore be expected to devote more time and expertise to that task."<sup>218</sup>

The problem with the *Stern* case and with the statutory standard which does exist in a few jurisdictions<sup>219</sup> is that the same standard is applicable to directors of all nonprofit corporations even though their functions vary enormously. For example, the directors of a corporation whose purpose is to assist abused children are held to the same fiduciary standard as the directors of a fraternity. A strong argument can be made that directors of charitable corporations like the one assisting abused children should be held to a higher fiduciary standard than the directors of a mutually beneficial nonprofit corporation like a fraternity.

Charitable nonprofits are fundamentally different from mutual benefit nonprofit corporations. Charitable or public benefit nonprofits<sup>220</sup> are frequently organized to serve a large or indefinite class of beneficiaries, such as alcoholics, abused children, or the poor.<sup>221</sup> Usually, beneficiaries of these corporations do not have an economic interest in the corporation and in some jurisdictions these corporations have no members other than those persons who serve as directors.<sup>222</sup> Moreover, beneficiaries of these corporations rarely sit on the boards of directors or become members of the corporation assisting them. In short, beneficiaries are not in a position to monitor and discipline the corporation's managers.<sup>223</sup> Furthermore, members have insufficient economic incentives to monitor and discipline management.<sup>224</sup>

In contrast, the primary beneficiaries of mutual benefit nonprofits are its members. The only purpose served by most mutual benefits is to further the interests of its members. Thus, the members of these organizations have strong incentives to monitor and discipline management.

---

<sup>218</sup>*Id.* at 1013.

<sup>219</sup>See *supra* note 146.

<sup>220</sup>See CAL. CORP. CODE § 5111 (West Supp. 1984).

<sup>221</sup>Public benefit nonprofits are distinguished from other nonprofits in roughly the same way that organizations that qualify for tax exemption under I.R.C. § 501(c)(3) (1982) are distinguished from other federally tax exempt organizations.

<sup>222</sup>See N.Y. NOT-FOR-PROFIT CORP. LAW § 601 (McKinney 1970 & Supp. 1984-85). In New York, for example, some nonprofit corporations are not required to have members. See also MODEL NONPROFIT CORP. ACT § 11 (1973).

<sup>223</sup>As noted, beneficiaries have no standing to sue on behalf of the corporation. See *supra* note 101. Moreover, unless the nonprofit corporation's articles of incorporation or by-laws specifically provide for it, beneficiaries have no right to attend board or membership meetings or to examine the nonprofit's books and records.

<sup>224</sup>Most members of charitable nonprofit corporations serve in a voluntary capacity, primarily because they believe that the organization is furthering a public purpose of which they approve. Nonprofit statutes in most jurisdictions prohibit these persons from receiving any of the revenues of the nonprofit, except as reimbursement for expenses incurred on behalf of the corporation. Consequently, any legal action taken by these members would be financed totally by them. Even if the action were successful, it would not produce any monetary return to the members.

As previously noted, the Indiana Act does not have a provision specifically delineating the standard of care or loyalty for directors of nonprofit corporations. Additionally, charitable, educational, and cultural organizations are expressly exempted from the standards of conduct imposed on trustees under the Indiana Trust Code.<sup>225</sup> This omission should be cured, and cured in such a way as to impose a higher standard of fiduciary duty on the directors of public benefit nonprofits when compared to mutual benefits. Whether the Indiana courts, in an appropriate case, would impose a higher standard on the directors of charitable nonprofits than on directors of mutual benefit nonprofits is an unanswered question. In view of the absence of statutory language and the absence of classification of nonprofits, the courts could either apply one unitary standard to all nonprofit fiduciaries or recognize the distinction between directors of public and mutual benefit nonprofits.<sup>226</sup> Notwithstanding the exemption of directors of charitable nonprofits from the standards imposed on fiduciaries by the Indiana Trust Code, the courts should impose a higher duty on fiduciaries of public benefits, because of the distinction between public and mutual benefit nonprofits. The tough questions are how one delineates these two standards and how one justifies the distinction.

In answering these questions, the law of business corporations may be helpful. During the first half of this century, some important and innovative changes occurred in the law of business corporations.<sup>227</sup> Nevertheless, business corporation codes in most jurisdictions make no allowance for the distinction between the large publicly-held corporations and small closely-held corporations.<sup>228</sup> These state statutes created more problems for closely-held corporations than for publicly held corporations.<sup>229</sup>

---

<sup>225</sup>IND. CODE § 30-4-1-1 (1982).

<sup>226</sup>See *infra* note 233.

<sup>227</sup>One of the most significant of these developments is the judicial and statutory recognition of close corporations. See *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1965); *Donahue v. Rodd Electrotpe Co.*, 367 Mass. 578, 328 N.E.2d 505 (1975); *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1936); *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934). Examples of other significant developments include *Zahn v. Transamerica*, 162 F.2d 36 (3d Cir. 1947) (judicial recognition of a fiduciary obligation owed by majority shareholders to minority shareholders when the majority controls the corporation); *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983); *Singer v. Magnavox*, 380 A.2d 969 (Del. 1977) (judicial recognition of the rights of minority shareholders to be protected against self-dealing by the majority in corporate combinations); DEL. CODE ANN. tit. 8, § 253 (1983) (legislation authorizing a corporation owning 90% or more of the stock of another corporation to merge the subsidiary into the parent without shareholder approval).

<sup>228</sup>See, e.g., IND. CODE §§ 23-1-1-1 to 23-6-3-5 (1982); MISS. CODE ANN. §§ 70-1-1 to 70-9-27 (1972); OKLA. STAT. ANN. §§ 70-1-1 to 70-9-27 (1972); OKLA. STAT. ANN. tit. 18, §§ 1.1-1.25 (West 1953).

<sup>229</sup>See Deutsch, *Roses in Search of Gertrude Stein: The Puzzle of the Close Corporation*, 9 U. TOL. L. REV. 458 (1978) (discussing the inherent contradictions of placing the close corporation in a structure designed for the large public corporation).

For example, the owners of closely-held corporations sometimes sought to commit the board of directors to specific courses of action such as the selection of officers and the establishment of their compensation.<sup>230</sup> Shareholders of closely-held corporations also attempted to establish dividend policy through shareholder agreement.<sup>231</sup> Finally, shareholders of closely-held corporations often attempted to increase statutorily-imposed quorum and voting requirements.<sup>232</sup> The combination of judicial opinions and legal articles suggesting that the distinction between closely-held and other corporations be acknowledged through statutory reform was eventually successful.<sup>233</sup> Today, several jurisdictions have provisions in their business corporation statutes that apply only to closely-held corporations.<sup>234</sup> Unfortunately, in spite of these legislative developments, courts did not recognize a distinction between the obligations owed by the fiduciaries of publicly-held corporations as opposed to those owed by the fiduciaries of closely-held corporations.<sup>235</sup>

Finally, in 1975, the Supreme Judicial Court of Massachusetts held that the majority shareholders of closely-held corporations owed a higher duty to a minority shareholder than the majority owed to the minority in nonclosely-held corporations.<sup>236</sup> In *Donahue v. Rodd Electrottype Co.*,<sup>237</sup> Rodd, a former director, officer, and controlling shareholder of a close corporation offered to sell to the corporation his shares of its own stock. Rodd made the offer to his son who was president and general manager of the corporation. Subsequently, the board of directors authorized the company to purchase forty-five shares from Rodd at \$800 per share. Approximately one year later, a special shareholders' meeting was held at which the transaction was officially disclosed. Mrs. Donahue, a minority shareholder, voted against a resolution ultimately adopted by the other shareholders ratifying the stock repurchase from Rodd. Mrs. Donahue then offered her shares for sale to the corporation on the same terms as those given to Rodd, but the corporation refused to buy them. She instituted suit, alleging that the stock repurchase by Rodd Electrottype was a violation of fiduciary duties owed to her by the defendants in their respective capacities as controlling

---

<sup>230</sup>See, e.g., *McQuade v. Stoneham*, 263 N.Y. 323, 189 N.E. 234 (1934).

<sup>231</sup>See, e.g., *Clark v. Dodge*, 269 N.Y. 410, 199 N.E. 641 (1936).

<sup>232</sup>See, e.g., *Benintendi v. Kenton Hotel*, 294 N.Y. 112, 60 N.E.2d 829 (1945).

<sup>233</sup>See, e.g., *Galler v. Galler*, 32 Ill. 2d 16, 203 N.E.2d 577 (1964); Hetherington, *Trends in Legislation for Close Corporations: A Comparison of the Wisconsin Business Corporation Law of 1951 and the New York Business Corporation Law of 1961*, 1963 WIS. L. REV. 92.

<sup>234</sup>See, e.g., CAL. CORP. CODE § 158 (West Supp. 1984); DEL. CODE ANN. tit. 8, §§ 341-356 (1983), N.Y. BUS. CORP. CODE §§ 620, 630 (McKinney 1970 & Supp. 1983).

<sup>235</sup>See *Donahue v. Rodd Electrottype Co.*, 367 Mass. 578, 328 N.E.2d 505 (1975).

<sup>236</sup>*Id.* at 590-91, 328 N.E.2d at 515-16.

<sup>237</sup>367 Mass. 578, 328 N.E.2d 505 (1975).

shareholders, officers, and directors. She sought to have the purchase rescinded on the basis of its infringement of her personal rights as a minority shareholder. More specifically, she urged that the controlling shareholders had a duty to offer her, as a minority shareholder, an equal opportunity to sell her shares to the corporation.<sup>238</sup> The Rodd family, as defendants, denied that a right to equal opportunity existed in corporate stock purchases for the corporate treasury. The trial court ruled for the defendants, finding that the transaction had been carried out in good faith and with inherent fairness.<sup>239</sup> The case was affirmed by the intermediate appeals court.<sup>240</sup> The Supreme Judicial Court of Massachusetts reversed,<sup>241</sup> noting that shareholders in close corporations face a restricted market for their holdings and that the remedy of voluntary dissolution was available primarily to majority interests. The court held that the dissident minority shareholder was entitled to protection.<sup>242</sup> The court stated that the majority shareholders had breached a fiduciary duty to the plaintiff and must afford her an equal opportunity to sell her shares to the corporation.<sup>243</sup> More importantly, the court imposed a new fiduciary standard upon the majority shareholders:

Because of the fundamental resemblance of the close corporation to the partnership, the trust and confidence which are essential to this scale and manner of enterprise, and the inherent danger to minority interests in the close corporation, we hold that stockholders in the close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another. . . . [W]e have defined the standard of duty owed by partners to one another as the utmost good faith and loyalty. Stockholders in close corporations must discharge their management and stockholder responsibilities in conformity with this strict good faith standard.<sup>244</sup>

Two years later, the Massachusetts Supreme Judicial Court reaffirmed this standard and imposed liability on the majority shareholders of a nursing home incorporated as a close corporation when they engaged in a “freeze-out” of a minority shareholder.<sup>245</sup>

The relevance of this judicially created distinction is that it may help to justify a similar distinction between the obligations of fiduciaries

---

<sup>238</sup>*Id.* at 585, 328 N.E.2d at 511.

<sup>239</sup>*Id.* at 582, 328 N.E.2d at 508.

<sup>240</sup>*Id.*

<sup>241</sup>*Id.* at 594, 328 N.E.2d at 521.

<sup>242</sup>*Id.* at 593, 328 N.E.2d at 519.

<sup>243</sup>*Id.* at 594, 328 N.E.2d at 520.

<sup>244</sup>*Id.* at 590, 328 N.E.2d at 515 (footnotes omitted).

<sup>245</sup>*Wilkes v. Springside Nursing Home, Inc.* 370 Mass. 842, 353 N.E.2d 657 (1976).

of public benefit and mutual benefit nonprofit corporations. The court in *Donahue* relied heavily on the trust and confidence which the law permits partners to have in each other.<sup>246</sup> The relationship is not one that imposes trust standards on partners, but it is clearly one that imposes a fiduciary obligation on them that is higher than the fiduciary obligations of directors of corporations.<sup>247</sup> The trust standard is inappropriate because total reliance on one partner to conduct *all* of the affairs of the partnership for the benefit of the other partner or partners is absent.<sup>248</sup> Each partner serves as a fiduciary for the other partners and, unlike a beneficiary of a trust, each partner has the right to participate in partnership decisionmaking. Nevertheless, partners frequently have committed most of their capital to the partnership under circumstances that make withdrawal from the partnership difficult without suffering severe financial loss. Since the mere status of partnership subjects participants to the law of agency, the partners are forced to have trust and confidence in each other. This is the reason that partnership agreements commonly provide partners with some type of veto power over new partners.

Many businesses that would otherwise operate as partnerships are incorporated to avoid the personal liability of the owners.<sup>249</sup> Nevertheless, the owner-managers of these businesses attempt to organize them so that they have the best of both worlds, so that they are operated as partnerships would be operated but have the corporate advantages of limited liability and perpetual existence. Their solution is the formation of a closely-held corporation. The court in *Donahue* said that a close corporation was "typified by (1) a small number of stockholders; (2) no ready market for the corporate stock; and (3) substantial majority stockholder participation in the management, direction, and operation of the corporation."<sup>250</sup> The critical distinction facing minority shareholders in publicly-held corporations compared to minority shareholders in closely-held corporations is that there is generally a market for the stock held by the former. The minority shareholder in a publicly held corporation is not locked in. The rule of equal opportunity announced in *Donahue* has not been applied to transactions in shares in large, publicly-held corporations precisely because of this "exit option" for minority shareholders.<sup>251</sup> It is suggested that the distinction between fiduciaries of public

---

<sup>246</sup>367 Mass. at 590, 328 N.E.2d at 515.

<sup>247</sup>*Id.* at 590-91, 328 N.E.2d at 515-16.

<sup>248</sup>That is, a partner is not a trustee for the other partners. Rather, each partner owes every other partner a fiduciary obligation to conduct the affairs of the partnership for the benefit of *all* partners.

<sup>249</sup>See *Symposium on the Close Corporation*, 52 *Nw. U.L. REV.* 345, 347 (1957).

<sup>250</sup>367 Mass. at 585, 328 N.E.2d at 511.

<sup>251</sup>The existence of the exit option does not, however, imply that the majority shareholders or directors of publicly-held corporations can engage in transactions or cause the corporation to take actions which injure minority shareholders.

and mutual benefit nonprofits should be drawn on the same basis that the court in *Donahue* drew the distinction between fiduciaries of closely-held and publicly-held corporations. The analogy is worth examining more closely.

The relationship between beneficiaries of, and perhaps donors to, public benefit nonprofits and the managers of these corporations resembles the fiduciary relationship between majority and minority shareholders of close corporations. First, decisions of managers of public benefit nonprofits are final and not subject to reversal or ratification because there are generally few members of these corporations. In close corporations, the decisions of the managers are also final because they generally own the majority of the outstanding shares of the corporation. Second, the beneficiaries of many public benefit nonprofits may have few or no effective "exit" options. That is, it is not likely that a poor person who is aided by a charity will decline benefits because he opposes management's decisions or believes that management is breaching a fiduciary duty. Similarly, patients in hospitals cannot easily move from one hospital to another. In sum, the beneficiary of a public benefit nonprofit resembles, in this respect, the minority shareholder of a close corporation who finds "exit" difficult because of the absence of a market for her shares.

Similarly, the shareholders of publicly-held corporations are analogous to members of mutual benefit nonprofits. The striking characteristic of most mutual benefit nonprofits is that they are organized to advance the interests of their members. Of course, this does not mean that mutual benefits do not serve a public purpose also; they do. Labor unions, for example, serve to reduce tension among laborers and management and to improve the workplace conditions of laborers.<sup>252</sup> Nevertheless, in the process of achieving these goals, labor unions also benefit their members.<sup>253</sup> Consequently, most mutual benefit nonprofits, like labor unions, have members who are active. The members of these nonprofits have an incentive to vote for management, to communicate their concerns to management, and, ultimately, to resign or exit from the organization if they become too disaffected. Members of mutual benefits share all of these characteristics with stockholders of publicly-held corporations. For example, there is generally a market for membership in organizations like country clubs, social clubs, and civic organizations.<sup>254</sup> In some jurisdictions, members can sue derivatively and managers of mutual benefit nonprofits are vulnerable to ouster at annual elections.<sup>255</sup>

---

<sup>252</sup>See Labor Management Relations Act § 1, 29 U.S.C. §§ 141-69 (1982).

<sup>253</sup>*Id.*

<sup>254</sup>See Buchanan, *An Economic Theory of Clubs*, 32 *ECONOMICA* 1 (1965).

<sup>255</sup>In every jurisdiction where there is a separate nonprofit statute, the statute requires an annual meeting for the purpose of electing directors. See, e.g., IND. CODE §§ 23-7-1.1-9, -10 (Supp. 1985).

In summary, it is recommended that a distinction be made between the fiduciary duties of managers of public benefit nonprofits and mutual benefit nonprofits. Directors of public benefit nonprofits should be held to the partnership standard of utmost good faith and loyalty, while it is appropriate to hold the directors of mutual benefit nonprofits to the standard of care and loyalty imposed on directors of public corporations.

### *B. Self-Dealing and Conflicts of Interest*

The self-dealing and conflict of interest provision of the Indiana Not-For-Profit Corporation Act contains the same language as its counterpart in the Indiana Business Corporations Act.<sup>256</sup> It states:

No contract or other transaction between a corporation and one or more of its directors or any other corporation, firm, association or entity in which one or more of its directors is a director or officer or is financially interested, shall be either void or voidable because of this relationship or interest or because the director or directors are present at the meeting of the board of directors or a committee thereof which authorizes, approves or ratifies such contract or transaction or because his or their votes are counted for such purpose, if:

(a) The fact of this relationship or interest is disclosed or known to the board of directors or committee which authorizes, approves, or ratifies the contract or transaction by a vote or consent sufficient for the purpose without counting the votes or consents of such interested directors, or

(b) The fact of such relationship or interest is disclosed or known to the members entitled to vote and they authorize, approve or ratify such contract or transaction by vote or written consent; or

(c) The contract or transaction is fair and reasonable to the corporation.

Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board of directors or a committee thereof, which authorizes, approves or ratifies such contract or transaction.<sup>257</sup>

Although this provision may be adequate for business corporations, it is not sufficient to protect beneficiaries of and donors to public benefit nonprofits. To be sure, the Indiana Trust Code subjects certain Indiana

---

<sup>256</sup>Compare IND. CODE § 23-7-1.1-61 (1982) (conflict of interest in nonprofit setting) with IND. CODE § 23-1-10-6 (1982) (conflict of interest in for-profit setting).

<sup>257</sup>*Id.* § 23-7-1.1-61.



nonprofits to a higher standard regarding self-dealing.<sup>258</sup> That standard prohibits private foundations from engaging in certain transactions with disqualified persons.<sup>259</sup> Foundation managers and their substantial contributors are considered disqualified persons.<sup>260</sup> Therefore, a certain number of public benefit nonprofits in Indiana are already subject to a much stricter self-dealing and conflicts of interest provision than that provided by the Not-For-Profit Act. Nevertheless, there are some public benefit nonprofits that are not private foundations and therefore are exempt from the Indiana Trust Code provisions.

Beneficiaries and donors have no easy way to detect managerial self-dealing. They are not permitted to sue on behalf of the corporation and the disclosure provisions of the Act make it extremely unlikely that beneficiaries, members, and donors will be able to determine whether the managers have engaged in some form of self-dealing.

One way of reducing the potential of self-dealing by managers of public benefit nonprofits that are not covered by the Indiana Trust Code is flatly to prohibit any dealings between the managers of these nonprofits and their corporations. This could be accomplished by amending the Indiana Trust Code to include *all* public benefit nonprofits. This may, however, be too stringent.

When it limited the application of the trust code standard, the Indiana legislature probably meant to leave some flexibility for nonprofits that were not private foundations. A sale or exchange of property between a private foundation and a disqualified person, for example, is prohibited by the Tax Reform Act.<sup>261</sup> Yet, under some circumstances it is conceivable that the *best* purchase of land for a public benefit nonprofit is from either a foundation manager or a substantial contributor. It would appear that there are fewer risks of abuse if the Indianapolis YMCA engages in this type of transaction than if a small, family controlled foundation does so. Despite the recognized difference between private foundations and other public benefit nonprofits, the conflict of interest provision of the Indiana Act should be strengthened considerably. An attractive alternative to subjecting all public benefit nonprofits to the Indiana Trust Code self-dealing provisions would be to adopt a provision similar to the California self-dealing law.<sup>262</sup>

---

<sup>258</sup>*Id.* § 30-4-5-21.

<sup>259</sup>*See supra* notes 193-94 and accompanying text.

<sup>260</sup>*See* I.R.C. § 4946(a)(1), (2) (1982).

<sup>261</sup>*See id.* § 4941(d).

<sup>262</sup>§ 5233. Self-dealing transactions; interested director; exceptions; actions; burden of proof; limitations; remedies

(a) Except as provided in subdivision (b), for the purpose of this section, a self-dealing transaction means a transaction to which the corporation is a party and in which one or more of its directors has a material financial interest and which does not meet the requirements of paragraph (1), (2), or (3) of sub-

This provision is superior to the current Indiana provision because it places the burden of persuasion on the person accused of self-dealing and it forces the managers of the corporation to show that the transaction authorized was *the* most "advantageous" under the circumstances. As opposed to the generalized fairness standard imposed by the Indiana

---

division (d). Such a director is an "interested director" for the purpose of this section.

(b) The provisions of this section do not apply to any of the following:

(1) An action of the board fixing the compensation of a director as a director or officer of the corporation.

(2) A transaction which is part of a public or charitable program of the corporation if it: (i) is approved or authorized by the corporation in good faith and without unjustified favoritism; and (ii) results in a benefit to one or more directors or their families because they are in the class of persons intended to be benefited by the public or charitable program.

(3) A transaction, of which the interested director or directors have no actual knowledge, and which does not exceed the lesser of 1 percent of the gross receipts of the corporation for the preceding fiscal year or one hundred thousand dollars (\$100,000).

(c) The Attorney General or, if the Attorney General is joined as an indispensable party, any of the following may bring an action in the superior court of the proper county for the remedies specified in subdivision (h):

(1) The corporation, or a member asserting the right in the name of the corporation pursuant to Section 5710.

(2) A director of the corporation.

(3) An officer of the corporation.

(4) Any person granted relator status by the Attorney General.

(d) In any action brought under subdivision (c) the remedies specified in subdivision (h) shall not be granted if:

(1) The Attorney General, or the court in an action in which the Attorney General in [sic] an indispensable party, has approved the transaction before or after it was consummated; or

(2) The following facts are established:

(A) The corporation entered into the transaction for its own benefit;

(B) The transaction was fair and reasonable as to the corporation at the time the corporation entered into the transaction;

(C) Prior to consummating the transaction or any part thereof the board authorized or approved the transaction in good faith by a vote of a majority of the directors then in office without counting the vote of the interested director or directors, and with knowledge of the material facts concerning the transaction and the director's interest in the transaction. Except as provided in paragraph (3) of this subdivision, action by a committee of the board shall not satisfy this paragraph; and

(D) (i) Prior to authorizing or approving the transaction the board considered and in good faith determined after reasonable investigation under the circumstances that the corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances or (ii) the corporation in fact could not have obtained a more advantageous arrangement with reasonable effort under the circumstances; or

(3) The following facts are established:

(A) A committee or person authorized by the board approved the transaction

Act, the California Act forces the directors to show that of all the options considered they chose the one that was most advantageous. This eliminates the possibility of selecting one method of proceeding with a deal and then simply characterizing that deal as fair. The managers must be able to show that they considered several methods and then must demonstrate that the one selected was the most advantageous.

---

in a manner consistent with the standards set forth in paragraph (2) of this subdivision;

(B) It was not reasonably practicable to obtain approval of the board prior to entering into the transaction; and

(C) The board, after determining in good faith that the conditions of subparagraphs (A) and (B) of this paragraph were satisfied, ratified the transaction at its next meeting by a vote of the majority of the directors then in office without counting the vote of the interested director or directors.

(e) Except as provided in subdivision (f), an action under subdivision (c) must be filed within two years after written notice setting forth the material facts of the transaction and the director's interest in the transaction is filed with the Attorney General in accordance with such regulations, if any, as the Attorney General may adopt or, if no such notice is filed, within three years after the transaction occurred, except for the Attorney General, who shall have 10 years after the transaction occurred within which to file an action.

(f) In any action for breach of an obligation of the corporation owed to an interested director, where the obligation arises from a self-dealing transaction which has not been approved as provided in subdivision (d), the court may, by way of offset only, make any order authorized by subdivision (h), notwithstanding the expiration of the applicable period specified in subdivision (e).

(g) Interested directors may be counted in determining the presence of a quorum at a meeting of the board which authorizes, approves or ratifies a contract or transaction.

(h) If a self-dealing transaction \* \* \* has taken place, the interested director or directors shall do such things and pay such damages as in the discretion of the court will provide an equitable and fair remedy to the corporation, taking into account any benefit received by the corporation and whether the interested director or directors acted in good faith and with intent to further the best interest of the corporation. Without limiting the generality of the foregoing, the court may order the director to do any or all of the following:

(1) Account for any profits made from such transaction, and pay them to the corporation;

(2) Pay the corporation the value of the use of any of its property used in such transaction; and

(3) Return or replace any property lost to the corporation as a result of such transaction, together with any income or appreciation lost to the corporation by reason of such transaction, or account for any proceeds of sale of such property, and pay the proceeds to the corporation together with interest at the legal rate. The court may award prejudgment interest to the extent allowed in Section 3287 or 3288 of the Civil Code. In addition, the court may, in its discretion, grant exemplary damages for a fraudulent or malicious violation of this section.

The Indiana provision on self-dealing and conflicts of interest is satisfactory for mutual benefit nonprofits if members of these corporations are permitted to sue derivatively to protect the corporation from managerial self-dealing. If the legislature grants this right, then members of mutual benefit nonprofits should be able to protect themselves and the corporation against managerial self-dealing. If, however, members of mutual benefit nonprofits are not granted the right to sue derivatively, the legislature should enact a law similar to the California self-dealing provision, and it should be made applicable to both mutual benefit and public benefit nonprofits.

### C. *Standing*

The Indiana Act makes no provision for derivative actions by members, donors, or beneficiaries of nonprofit corporations. Consequently, the secretary of state and the attorney general must protect nonprofits in Indiana if their managers refuse to do so or if the managers injure the corporations. The attorney general may resort to litigation, if necessary, to protect these corporations. Yet, it is difficult to believe that the attorney general has the resources to monitor adequately the affairs of more than twenty-five thousand corporations. What is needed is a legal mechanism to permit private enforcement of the rights of Indiana nonprofits. That there is need for private enforcement mechanisms is only an assumption. It is unknown whether managerial abuses exist, or how much of it exists in nonprofits incorporated in Indiana. Nor is it known how vigilant managers of Indiana nonprofit corporations are in seeking to enforce the rights of the corporation against third parties. There is no claim that there is widespread managerial abuse of nonprofits or that managers are lax in enforcing corporate claims against third parties. Rather, the more modest proposal is that the Indiana Act be amended to provide for derivative rights. If this proposal is considered, the relevant question becomes: Who should have the right to sue derivatively?

The law of business corporations may be helpful in answering this question. Shareholders of business corporations are permitted by statute in most jurisdictions to protect the corporation's interests by suing derivatively.<sup>263</sup> The theory of such causes of action is that shareholders have an investment in the corporation and are entitled to seek redress for corporate injury when that injury is inflicted by the managers of the corporation or when the managers of the corporation refuse to take action against a third party who has injured the corporation.<sup>264</sup> The

---

<sup>263</sup>See, e.g., N.Y. BUS. CORP. LAW § 623 (McKinney 1970).

<sup>264</sup>See *Stevens v. Lowder*, 643 F.2d 1078 (5th Cir. 1981); *Taormina v. Taormina Corp.*, 32 Del. Ch. 18, 78 A.2d 473 (1951); *Kavanaugh v. Kavanaugh Knitting Co.*, 226 N.Y. 185, 123 N.E. 148 (1919).

nature of the shareholder's investment in the business corporation is both economic, insofar as he has made capital available to the corporation and expects a return on this capital, and political, insofar as he holds voting stock and expects to participate in the selection of management and in fundamental decisions about the corporation's future. The legislature should consider whether one can justify derivative actions in the nonprofit context on this rationale.

Using this analogy, one could argue that members of nonprofits who have an investment in the nonprofit that resembles the shareholder's investment in the business corporation should be permitted to sue derivatively. To be sure, there are members of nonprofits who have an investment in the nonprofit that resembles the shareholder's investment in the business corporation. Members of social clubs, labor and agricultural organizations, and fraternal associations are examples.<sup>265</sup> In all of these, the nonprofit's members have both an economic and a political investment. Nevertheless, a rule of law limited to such a narrow segment of the broad category of nonprofit organizations is less than optimal. What is needed is a theoretical basis for broadening the scope of the rule.

If attention is shifted from the individual shareholder's or member's investment in the enterprise to society's investment in nonprofits, the justification for permitting derivative actions by members of both public and mutual benefit nonprofits becomes more compelling. Defining society's stake in nonprofits is not a difficult task. The availability of the corporate form, with its substantial advantages and various forms of tax exemptions, gives society a sufficient basis for insisting upon as much accountability as possible without, of course, unnecessarily restricting the ability of nonprofits to produce the results most desired. Moreover, donors, beneficiaries, and members have, at the very least, an interest in regulation that provides appropriate accountability mechanisms.

At a bare minimum, it would seem that the Indiana Act should be amended to permit derivative actions by members of nonprofits. Several jurisdictions have already included a derivative action provision in their nonprofit statutes.<sup>266</sup> Additionally, the notion of permitting private parties

---

<sup>265</sup>The members in these organizations are the *primary* beneficiaries. In most cases, they pay membership fees or dues which are used by the organization to further the interests of the members. The return on the "investment" of the members comes in the form of laws or regulations which help the members conduct their private businesses more profitably, broader social contacts, and a heightened sense of group identification for members of fraternal organizations.

<sup>266</sup>Nine state nonprofit statutes permit members of the corporation to sue derivatively. The states are California, Delaware, Florida, Idaho, New York, Oklahoma, Pennsylvania, South Carolina, and Wyoming. See, e.g., DEL. CODE ANN. tit. 8, § 327 (1983); IDAHO CODE § 30-1-49 (1980); N.Y. NOT-FOR-PROFIT CORP. LAW § 623 (McKinney 1970 & Supp. 1984-85).

to enforce corporate governance statutes, even in the absence of specific statutory language providing for private actions, is now generally accepted by the courts. The courts have treated these parties as "private attorneys general."<sup>267</sup>

Whether private attorneys general are needed in the case of nonprofits is an empirical question, one that cannot be answered in this Article. Nevertheless, the existence of a mechanism to activate member interest in vindicating the corporation's rights may be one way to answer that empirical question. If there are many such suits, one may conclude that such a mechanism was indeed needed. If there are no suits, the availability of such a mechanism has certainly caused no harm.

Several questions must be answered before the proposed amendment can be justified. First, while members of some mutual benefit nonprofits may have an economic incentive to sue derivatively, what incentive would members of public benefit nonprofits have to sue derivatively? Second, assuming that members of all nonprofits would have an incentive to utilize the derivative action provision, what benefits would accrue to the constituencies of nonprofits if such a provision were adopted? Finally, what safeguards need to be established to guard against the possibility of nuisance and strike suits?

There is no easy answer to the first question. Members of public benefit nonprofits generally serve in such a capacity *primarily* to help the corporation attain the desired goal. They rarely have a personal economic interest or stake in the organization. Realistically, it is highly improbable that members of public benefit nonprofits will sue either their managers or third parties derivatively. Beyond the fact that they are "public-spirited," why people serve as members of public benefit nonprofits is an unknown.<sup>268</sup> These public-spirited members, who appear at the annual meetings of nonprofits, spend their time engaged in voluntary work for the organization, and make periodic contributions to the organization, may well institute derivative actions if the circumstances are particularly egregious.<sup>269</sup> Certainly, suits instituted by members of public benefit nonprofits could benefit their constituencies.

The benefit to be derived by the successful prosecution of a derivative suit lies primarily in the fact that it will establish another level of accountability for the corporation's managers. Perhaps the very existence of a mechanism permitting member derivative actions may cause the

---

<sup>267</sup>See, e.g., *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 396 (1970); *Newman v. Piggie Park Enterprises, Inc.*, 390 U.S. 400, 402 (1968); *Associated Industries v. Ickes*, 134 F.2d 694, 704 (2d Cir. 1943), *vacated as moot*, 320 U.S. 707 (1943).

<sup>268</sup>See PHELPS, INTRODUCTION in ALTRUISM, MORALITY AND ECONOMIC THEORY (1975).

<sup>269</sup>See, e.g., *Stern v. Lucy Webb Hayes Nat'l Training School*, 381 F. Supp. 1003 (D.D.C. 1974).

directors to become more circumspect in their dealings with the nonprofit. Clearly, the absence of managerial self-dealing and conflicts of interest benefits the constituencies of these organizations. Of course, the effectiveness of the proposed derivative action provision is causally related to the extensiveness of the disclosure provisions. If members do not have access to sufficient information about the nonprofit's operations, it will be difficult for them to detect managerial indiscretions. Assuming adequate disclosure, however, the proposed derivative action provision must contain adequate procedural safeguards to prevent nuisance suits.

The New York Not-For-Profit Corporation Law has been in effect since 1969 and provides for derivative actions by members.<sup>270</sup> Consequently, it may help to examine the procedural devices built into this statute to prevent nuisance suits. There, members must meet three requirements before filing a derivative action: (1) at least five percent of the members of any class must be parties to the action; (2) the plaintiff must be a member at the time the action is brought; and, (3) the complaint must set forth the efforts of the plaintiffs to secure the initiation of such action by the board or the reason for not making the request.<sup>271</sup>

Clearly, the first requirement, that at least five percent of the members of a class be parties to the action, is intended to guard against situations in which one member becomes unhappy with the policy of the board of directors and decides to institute a lawsuit or decides to pursue a cause of action which other members think should not be pursued. This requirement increases the likelihood that at least a significant number of members believe that some injury has been committed against the corporation and that the corporation should be compensated. It is important that nonprofit corporation assets not be depleted by expenditures on groundless litigation, and one method of assuring the substantiality of the litigation is to require that at least five percent of the members join in a derivative action.

The second requirement, that the plaintiff must be a member at the time the action is brought, appears to be a sensible standing requirement. Why should one who is no longer a member of an organization or who has not yet joined the organization be aided by a court in suing on behalf of that organization? Since the statute grants members the right to sue derivatively it therefore should follow that one must be a current member to exercise the right.

Finally, the third requirement, that the complaint must set forth the efforts of the plaintiffs to secure the initiation of the action by the board or the reason for not making the request, is absolutely essential.

---

<sup>270</sup>N.Y. NOT-FOR-PROFIT CORP. LAW § 623 (McKinney 1970 & Supp. 1984-85).

<sup>271</sup>*Id.* § 623(a), (b), (c).

The Indiana Not-For-Profit Corporation Act provides that the board of directors shall manage the affairs of the corporation.<sup>272</sup> Initiating a lawsuit on behalf of the corporation is a responsibility of the board of directors. Therefore, the shareholder should show why the board has refused to act or why it would be futile to make such a request of the board. Courts have held that a shareholder will be excused from making a demand upon the board when the persons being sued are members of the board.<sup>273</sup> In situations where the directors are not named as defendants, however, it is essential for the member to show why she has not attempted to get the board to bring the action since this is normally a board function.

Nothing in the literature on New York's law suggests that the New York courts have been overwhelmed with nuisance suits by disgruntled members of nonprofits. Consequently, it would seem that Indiana could incorporate these procedural safeguards into an amended derivative action provision. These provisions appear adequate to protect both the nonprofit and the courts from a proliferation of nuisance lawsuits.

#### *D. Disclosure*

Disclosure improves accountability, depending on what it discloses and to whom. There are at least four categories of information essential to accountability: (1) information relating to contracts between officers and the corporation and directors and the corporation; (2) information relating to executive compensation; (3) information relating to the efforts of managers to fulfill the stated goals of the corporations; (4) information relating to the extent to which the board of directors has fulfilled its duty of care.

Transactions between members, directors, and officers and the corporation must be reported to permit corporation members and the secretary of state to determine the propriety of the transactions. The activities of the corporation for the year must be carefully delineated to allow members and donors to determine whether or not the board has been sufficiently productive and to help potential beneficiaries determine which nonprofit is appropriate for particular requests for money, services, or membership. A "verified" statement of revenue and its sources must be produced to help donors, potential beneficiaries, and the general public determine how productive the nonprofit corporation's managers have been with the amount of resources they had. Most of

---

<sup>272</sup>IND. CODE § 23-7-1.1-10 (Supp. 1985).

<sup>273</sup>See, e.g., *Barr v. Wackman*, 36 N.Y.2d 371, 329 N.E.2d 180 (1975). *But see In re Kauffman Mutual Fund Actions*, 479 F.2d 257 (1st Cir. 1973), *cert. denied*, 414 U.S. 857; *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).



this information is required by the annual reporting requirements of the Indiana Act.<sup>274</sup>

The problem arises when the second part of the question is addressed, namely, to whom should disclosure be made?

In Indiana, annual reports of nonprofits must be submitted to the secretary of state.<sup>275</sup> Members may examine these reports at the nonprofit corporation's office.<sup>276</sup> Moreover, all persons, including members, may examine these reports at the office of the secretary of state.<sup>277</sup> Nevertheless, it is questionable whether most people know that they have this right. Furthermore, annual reports are filed at different times during the year so that it could take several trips to the secretary of state's office before the desired annual report is found on file. The Internal Revenue Code presents one solution to overcome these difficulties. In the case of annual reports filed by private foundations with the Internal Revenue Service, the foundations are required to advertise the availability of the report in a newspaper in the county in which their principal office is located.<sup>278</sup> The annual reports may be inspected by any citizen at the office of the nonprofit for 180 days after the report is submitted to the I.R.S.<sup>279</sup> This is preferable to the current disclosure procedures available in Indiana. The newspaper advertisement calls one's attention to the fact that the annual report has actually been filed and is available for inspection. Additionally, the report may be inspected at the office of the nonprofit rather than at the secretary of state's office. This may be much more convenient and could serve as incentive for constituents to inspect the annual report.

Finally, the question remains whether disclosure in this form is adequate. Although roughly the same amount of information is required by the regulations governing nonprofit corporations as is required for business corporations, the critical difference is that financial intermediaries have an incentive to acquire the information on business corporations and disseminate it to shareholders and potential shareholders. There are no such intermediaries in the case of nonprofits. This does not imply that in some nonprofit sectors there are not commercial organizations that disseminate information to potential consumers. For example, there are commercial publications about colleges, day-care centers, and other nonprofits. It does suggest, however, that there may be a greater need for mechanisms to disseminate information about nonprofits to their constituencies. At least one jurisdiction, California, has

---

<sup>274</sup>See IND. CODE § 23-7-1.1-36 (1982).

<sup>275</sup>*Id.*

<sup>276</sup>*Id.* § 23-7-1.1-13.

<sup>277</sup>See *id.* § 5-14-3-3 (Supp. 1985).

<sup>278</sup>I.R.C. § 6104(d) (1982).

<sup>279</sup>*Id.*

taken a step in this direction. The California Not-For-Profit Corporation Act requires large nonprofits to send copies of annual reports to their members and requires smaller nonprofits to furnish the reports on request.<sup>280</sup>

Indiana should follow California's lead and require all nonprofits with more than one hundred members and ten thousand dollars in assets to send copies of their annual reports to their members. Additionally, Indiana should require those nonprofits with fewer than one hundred members and assets in excess of ten thousand dollars to send annual reports to members on request. Moreover, in the interest of the broadest disclosure possible, public benefit nonprofits should be required to submit a copy of the annual report to at least one library in every county in Indiana. In summary, the content of the annual report required by the Indiana Act is adequate. The reports must, however, be circulated more widely so that each of the constituencies will at least have an opportunity to examine them.

#### *E. Dissolution*

The one clear example of overregulation in the Indiana Act is that portion of the dissolution provision that specifies how assets must be distributed. That provision states:

\* \* \*

(3) Upon the authorization of the dissolution, the board of directors shall then proceed to:

\* \* \*

(IV) pay and discharge all the corporate debts and liabilities; and

(V) after the expiration of a period of ten (10) days following the publication of this notice, distribute the remaining corporate assets and property among the members in any of the following manners or any combination thereof:

(a) Pay any member of the corporation the amount advanced or loaned to the corporation by him, together with simple interest at the rate of six percent (6%) per annum, and no more; after which any member may receive an amount equal to the amount paid in by him as membership dues or otherwise, together with simple interest at the rate of six percent (6%) per annum and no more. If any assets remain after distribution in this manner, they shall be distributed in the manner provided in the following subsections, (b) and (c).

(b) Transfer all of its assets or, any assets remaining after distribution in the manner provided in subsection (a), above, to

---

<sup>280</sup>CAL. CORP. CODE § 6321 (West Supp. 1984).

any other not-for-profit corporation, organized for purposes substantially the same as those of the corporation being dissolved, if the laws, bylaws or regulations of the dissolving corporation so provide regardless of the state or law under which the distributee corporation was incorporated.

(c) Escheat to the state of Indiana all of its assets or any assets remaining after distribution as provided in either subsections (a) or (b) above. These assets shall be paid into the general treasury of the state of Indiana through payment to the treasurer of the state.<sup>281</sup>

The problem with the provision is the requirement that assets remaining after all steps have been complied with escheat to the state. This is a unique requirement and exists *only* in Indiana. Most jurisdictions follow the approach taken in the Model Nonprofit Corporation Act.<sup>282</sup> While the Model Act prohibits the distribution to members of assets "held by the corporation upon condition requiring return" and assets "subject to limitations permitting their use only for charitable . . . purposes," it does permit assets not subject to these limitations to be distributed to members upon dissolution.<sup>283</sup> With this provision, the Model Act probably

---

<sup>281</sup>IND. CODE § 23-7-1.1-33 (1982).

<sup>282</sup>The Model Nonprofit Corporation Act provides:

The assets of a corporation in the process of dissolution shall be applied and distributed as follows:

(a) All liabilities and obligations of the corporation shall be paid and discharged, or adequate provision shall be made therefor;

(b) Assets held by the corporation upon conditions requiring return, transfer or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred or conveyed in accordance with such requirements;

(c) Assets received and held by the corporation subject to limitations permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving corporation, pursuant to a plan of distribution adopted as provided in this Act;

(d) Other assets, if any, shall be distributed in accordance with the provisions of the articles of incorporation or the by-laws to the extent that the articles of incorporation or by-laws determine the distributive rights of members, or any class or classes of members, or provide for distribution to others;

(e) Any remaining assets may be distributed to such persons, societies, organizations or domestic or foreign corporations, whether for profit or non-profit, as may be specified in a plan of distribution adopted as provided in this Act.

MODEL NONPROFIT CORP. ACT § 46 (1964).

<sup>283</sup>*Id.* § 46(d), (e).

underregulates to the same extent that the Indiana Act overregulates.<sup>284</sup>

The Indiana Act's overregulation of nonprofit dissolutions is readily apparent. Indiana permits organizations with diverse goals to incorporate under the Indiana Not-For-Profit Corporation Act. Some of these organizations are self-serving, such as fraternities, social clubs, and labor unions. Nevertheless, they are subject to the Act's nondistribution constraint while they are going concerns. The assets of these corporations are primarily, if not exclusively, derived from contributions from members plus proceeds from fundraising activities. Rarely, if ever, do these organizations receive donations from the public. Indeed, the public has little or no expectation that these mutual benefit nonprofits will engage in charitable or public service activities.

Nevertheless, Indiana will not permit these nonprofits to distribute their assets to members on dissolution. The reasons for this prohibition are not clear. It is one thing to prohibit distribution to members when the nonprofit is an operating entity. In that instance, it is unfair to permit individuals to take advantage of the privileges accorded to nonprofits and nevertheless receive dividends. This result would not be sound public policy because it would provide an incentive for the corporation to defraud the public. Also, in the case of nonprofits such as nursing homes and day-care centers, the nonprofit corporation would have an unfair advantage over its for-profit counterparts. In the final analysis, it may be that the Indiana Act's failure to classify nonprofits has led to this overregulating provision. It does not seem an unreasonable or unwise public policy to force public benefit nonprofits to escheat their assets to the state if they cannot distribute them to nonprofits engaged in similar activities. The assets of these corporations have been contributed primarily by nonmembers with the expectation that they will be used to further the nonprofit's goals. It may have been that the Indiana legislature wanted to ensure that those associated with public benefit nonprofits had no expectation of receiving any monetary return on dissolution and therefore enacted the escheat provision as a safeguard. Nevertheless, since the legislation failed to classify nonprofits, the escheat provision applies to *all* nonprofit corporations and not just those organized for public benefit. This presents an example of overregulation.

The Indiana Act should be amended to eliminate the harshness of the escheat provision for mutual benefit nonprofits. Most jurisdictions permit members of mutual benefits to receive the assets of the organization upon dissolution. This may not be completely acceptable. The Indiana legislature should take into account the potential for abuse of the nonprofit form if nonpublic benefit nonprofits are given unfettered discretion to distribute assets to members on dissolution. Some com-

---

<sup>284</sup>See *infra* text accompanying notes 285-86.

mercial nonprofits may have an incentive to abuse the nonprofit form. For example, there would be nothing to prevent the members of a nonprofit day-care center from operating the corporation for a period of time, charging lower rates than its for-profit counterparts in the area,<sup>285</sup> soliciting funds for the corporation, and then dissolving and distributing the assets to themselves. In this situation, it is not clear that the nonprofit is simply returning the members' capital to them. The members may be receiving their capital plus accumulated dividends plus funds contributed by the public. This would be clear abuse of the nonprofit form.

To eliminate the potential for such abuse, Indiana should require judicial approval of dissolution in the case of nonpublic benefit nonprofits. If the court approves the dissolution plan of the corporation and is satisfied that there has been no abuse of the privilege of using the nonprofit form, then members of nonpublic benefit nonprofits should be permitted to distribute the corporation's assets to themselves. This may also be sound public policy in the case of public benefit nonprofits. Although there should be a heavy presumption that assets committed to public benefit nonprofits are irrevocably committed for the purpose of helping the nonprofit achieve its objectives, it may be possible in some instances for members to overcome this presumption.<sup>286</sup>

## VII. CONCLUSION

Ultimately, the reform measure that would greatly facilitate the implementation of the previously suggested reforms is the classification of nonprofits according to their purposes. Indiana should revise its Not-For-Profit Corporation Act to provide for two types of nonprofit corporations: Public benefit nonprofits and general purpose nonprofits. The California legislature recently adopted a new nonprofit corporation act and its definitions of these two types of nonprofits would seem adequate for Indiana's purposes. Public benefit nonprofits are defined as those corporations that further a "public or charitable" purpose.<sup>287</sup> California

---

<sup>285</sup>It is possible for nonprofit businesses to charge lower rates because of their lower operating costs. Nonprofit corporations do not have to pay federal or state income tax. Some nonprofits are exempt from state sales taxation and local property taxation. Consequently, nonprofits do have a competitive advantage over their for-profit counterparts.

<sup>286</sup>One example of a nonprofit that could overcome such a presumption would be a family foundation which received 100% of its assets from the family. The hypothetical foundation's purpose was to reduce by half child-abuse in a local community. When the directors of the foundation concluded that the foundation had accomplished its objective, they dissolved the corporation. It would seem that on these facts the corporation could overcome the presumption that its assets were irrevocably committed to charitable purposes.

<sup>287</sup>CAL. CORP. CODE § 5111 (West Supp. 1984).

also recognizes the mutual benefit corporation as one which "can operate for any lawful purpose that does not contemplate the distribution of gain, profits, or dividends to members, except upon dissolution."<sup>288</sup> Instead of using the term "mutual benefit," Indiana should use the term "general purpose" nonprofit.<sup>289</sup>

When nonprofits are classified, it will be considerably easier to set out those standards that are applicable to both types and those standards applicable only to one type of organization. Following this Article is a proposed revision of the Indiana Not-For-Profit Corporation Act which will demonstrate the efficacy of classification in eliminating the defects in the current Act.

---

<sup>288</sup>*Id.* § 7111 (amended).

<sup>289</sup>The term "mutual benefit" implies that a group of individuals are working together for some common purpose such as to promote community understanding of political issues or to promote better working conditions. It does not quite embrace those nonprofits that are engaged in essentially commercial activities such as hospitals, day-care centers, and the many research institutes around the country. Consequently, the term "general purpose" nonprofit has been selected to try to encompass both mutual benefit and commercial nonprofit corporations.

## Appendix

### Proposed Revised Non-Profit Corporation Act\*

#### SECTION 1. SHORT TITLE

*This Act shall be known and may be cited as the Indiana Non-Profit Corporation Act.*

#### SECTION 2. DEFINITIONS

As used in this chapter:

(a) "Corporation" means any corporation formed under this chapter, and includes any corporation formed before September 2, 1971, that elects to accept the provisions of this chapter by filing articles of acceptance as provided in this chapter.

(b) "Domestic corporation" means a corporation formed under the laws of this state, and the term "foreign corporation" means every other corporation.

(c) "Articles of incorporation" means both the original articles of incorporation and any and all amendments thereto (except where the original articles of incorporation only are referred to), and in the case of corporations organized before September 2, 1971, articles of acceptance filed in the office of the secretary of state and all amendments thereto.

(d) "*Nonprofit*" as applied to any corporation organized or reorganized under this chapter means any corporation which does not engage in any activities for the profit of its members and which is organized and conducts its affairs for purposes other than the pecuniary gain of its members. The term also shall include but not be limited to any religious, civil, social, educational, fraternal, charitable, or cemetery association organized or reorganized under this chapter which does not engage in any activities for the profit of its trustees, directors, incorporators, or members.

(e) "Incorporator" means one (1) of the signers of the original articles of incorporation.

(f) "Subscriber" means one who subscribes for a membership in a corporation organized or reorganized under this chapter, whether before or after incorporation.

(g) "Member" means one who has signified his intention of being a member of a corporation organized or reorganized under this chapter and who has met the requirements of the corporation for membership and who has been accepted as a member by the corporation.

---

\*Regular typeface denotes language currently in Indiana's Not-For-Profit Corporation Act. Italics indicates proposed additions and/or changes in the current Act.

The term includes the trustees or directors or incorporators of a corporation organized or reorganized under this chapter, and for the purposes of this chapter the corporation may organize or reorganize although it has no membership apart from its trustees, directors, and incorporators. If in any case membership in the corporation is coextensive with the trustees, directors, or incorporators of the corporation, for the purposes of this chapter the trustees, directors, or incorporators shall also constitute members within the meaning of this chapter.

(h) "Assets" includes all the property and rights of every kind of a corporation, and the term "fixed assets" means such assets as are not intended to be sold or disposed of in the ordinary course of business.

(i) "Principal office" means that place in this state designated by the corporation as its principal place of doing business, the address of which is required by this chapter to be kept on file in the office of the secretary of state.

(j) "Resident agent" means that person designated by the corporation, whose name and address is required by this chapter to be kept on file in the office of the secretary of state.

(k) "Subscription" means any written agreement or undertaking, accepted by the corporation, for a membership in the corporation.

(l) "Director" means any member of the managing board of a corporation, whether designated a director, trustee, manager, governor, or by any other title.

### SECTION 3. PURPOSES

*Two types of nonprofit corporations are eligible to incorporate under the provisions of the Act: (1) public benefit nonprofit corporations which may be formed for any public, charitable or religious purpose or purposes; and (2) general purpose nonprofit corporations which may be formed for any lawful purpose provided that the sole or even primary purpose is not to make profits for its members, directors, or officers.*

### SECTION 4. GENERAL POWERS

(a) Each corporation shall have the capacity to act possessed by natural persons, but shall have authority to perform only those acts as are necessary, convenient or expedient to accomplish the purposes for which it is formed and such as are not repugnant to law. Nothing in this chapter shall be construed or interpreted as permitting or authorizing the transaction or conducting of a banking, railroad (other than a tourist, amusement, and non-freight-carrying railroad), utilities other than rural water or sewer systems utilities, insurance, surety, trust, safe deposit, mortgage guarantee, building and loan or credit union business.



(b) Subject to any limitations or restrictions imposed by law, or the articles of incorporation, or any amendment thereto, each corporation shall have the following general rights, privileges and powers:

(1) To continue as a corporation under its corporate name for the period limited in its articles of incorporation, or, if the period is not so limited, then perpetually;

(2) To sue and be sued in its corporate name;

(3) To have a corporate seal and to alter the same at pleasure: however, the use of a corporate seal or an impression thereof shall not be required upon, and shall not affect the validity of any instrument whatsoever, notwithstanding the provisions of any other section of this chapter or of any other statute;

(4) To acquire, own, hold, use, lease, mortgage, pledge, sell, convey or otherwise dispose of property, real or personal, tangible or intangible;

(5) To borrow money and to issue, sell or pledge its obligations and evidences of indebtedness, and to mortgage its property and franchises to secure the payment thereof;

(6) To carry out its purposes in this state and elsewhere; to have one or more offices out of this state; and to acquire, own, hold and use, and to lease, mortgage, pledge, sell, convey or otherwise dispose of property, real or personal, tangible or intangible, out of this state;

(7) To acquire, hold, own and vote and to sell, assign, transfer, mortgage, pledge, or otherwise dispose of the capital stock, bonds, securities or evidences of indebtedness of any other corporation, domestic or foreign, insofar as the same shall be consistent with the purposes of the corporation;

(8) To appoint such officers and agents as the affairs of the corporation may require and to define their duties and fix their compensation;

(9) To indemnify any director or officer or former director or officer of the corporation, or any person who may have served at its request as a director or officer of another corporation, against expenses actually and reasonably incurred by him in connection with the defense of any civil action, suit or proceeding in which he is made or threatened to be made, a party by reason of being or having been a director or officer, except in relation to matters as to which he is adjudged in the action, suit or proceeding to be liable for negligence or misconduct in the performance of duty to the corporation: However, the indemnification is not exclusive and does not impair any other rights those indemnified may have under any provision of the articles of incorporation, by-laws, resolution, or other authorization adopted, after notice, by a majority of the members voting at an annual meeting; and provided further that expenses incurred in defending any action, suit, or proceeding, civil or criminal,

may be paid by the corporation in advance of the final disposition of such action, suit, or proceeding notwithstanding any provisions of this article to the contrary upon receipt of an undertaking by or on behalf of the director, officer, employee, or agent to repay the amount paid by the corporation if it shall ultimately be determined that the director, officer, employee, or agent is not entitled to indemnification as provided in this section;

(10) To purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against liability under the provisions of this section;

(11) To make by-laws for the government and regulation of its affairs;

(12) To cease its activities and to dissolve and surrender its corporate franchise; and

(13) To do all acts and things necessary, convenient or expedient to carry out the purposes for which it is formed.

(c) No corporation shall, by any implication or construction, possess the power of engaging in any activities for the purpose of or resulting in the pecuniary remuneration to its members as such, but this provision shall not prohibit reasonable compensation to members for services actually rendered; nor shall the corporation be prohibited from engaging in any undertaking for profit so long as such undertaking does not inure to the profit of its members.

#### SECTION 5. CORPORATE NAME

(a) The corporate name of every corporation that is organized under this chapter, and of every corporation which accepts the provisions of this chapter, shall include the word "Corporation" or "Incorporated", or one of the abbreviations thereof.

(b) A corporation that is organized under this chapter or which accepts the provisions of this chapter:

(1) may not use as a part of its corporate name any word or phrase which indicates or implies any purpose or power not possessed by corporations organizable under this chapter; and

(2) shall take a corporate name that is, upon the records of the secretary of state, distinguishable from the name of any other corporation then existing under the laws of this state or authorized to transact business in this state and distinguishable from any name to which another person has obtained exclusive rights under

subsection (c). However, a corporation may take a name that is not distinguishable from the name of another corporation if at the same time:

(A) the other corporation changes its corporate name, or dissolves or withdraws from transacting business in this state or ceases to exist; or

(B) the written consent of the other corporation, signed by any current officer of the corporation and verified and affirmed subject to penalties for perjury, is filed with the secretary of state.

(c) Any person intending to organize a corporation, any domestic corporation intending to change its name, any foreign corporation intending to make application for a certificate of admission to transact business in this state or authorized to transact business in this state and intending to change its name, and any person or persons intending to organize a foreign corporation and make application for a certificate of admission to transact business in this state may reserve the exclusive right to the use of a corporate name, except as hereinbefore provided, for a period of one hundred twenty (120) days, by filing in the office of the secretary of state a notice of intention and specifying the name, and paying the fee prescribed by IC 23-3-2-2(o).

(d) Subject to the provisions of this section, any corporation may change its corporate name at any time by amending its articles of incorporation in the manner hereafter provided.

#### SECTION 6. PRINCIPAL OFFICE; RESIDENT AGENT

(a) Each corporation shall maintain an office or place of business in this state, to be known as the "principal office", and have an officer or agent resident in this state designated as the resident agent of the corporation. The post office address of the principal office and the name and post office address of the resident agent must be stated in the original articles of incorporation at the time of incorporation. Thereafter, the location of the principal office or the designation of the resident agent, or both, may be changed:

(1) at any time, when authorized by the board of directors, by filing with the secretary of state on or before the day any such change is to take effect; or

(2) if within five (5) days after the death of the resident agent or other unforeseen termination of his agency, a certificate is filed, signed by any current officer of the corporation and verified and affirmed subject to penalties of perjury, stating the change to be made and reciting that this change is made pursuant to authorization by the board of directors.

(b) If the resident agent for one (1) or more corporations changes address, the agent may change the address on file with the secretary

of state by filing in the office of the secretary of state a statement setting forth:

- (1) the names of the corporations for which the change is effective;
- (2) the old and new addresses of the resident agent; and
- (3) the date on which the change is effective.

If the old and new addresses of the resident agent are the same as the old and new addresses of the principal office of the corporations, the statement may include a change of address of the principal office of the corporations.

(c) A resident agent who files a statement under subsection (b) shall first notify in writing each corporation for which the agent is resident agent that the statement will be filed, and the statement must recite the fact that this notice has been given. The statement shall be executed and verified in duplicate and affirmed subject to penalties of perjury by the resident agent in his individual name; however, if the resident agent is a foreign or domestic corporation, the statement must be executed by a current officer of the corporation and verified and affirmed subject to penalties of perjury. The statement, executed in duplicate, shall be delivered to the secretary of state. If he finds that it conforms to the requirements of law, the secretary of state shall, upon payment of the required fees, endorse upon each of the duplicates tendered for filing, over his signature and official seal, the word "filed" followed by the date of the filing. The secretary of state shall retain one (1) executed copy of the statement in his files. He shall attach to the other filed copy a certificate stating that the instrument is an executed copy of the statement filed in his office, giving the date of the filing, and shall return the other copy to the resident agent.

(d) Any person who has been designated by a corporation as its resident agent for service of process may file with the secretary of state a signed statement that he is unwilling to continue to act as resident agent for the corporation for the service of process. The secretary of state shall forthwith give written notice, by mail, to the corporation, of the filing of this statement and its effect, which notice shall be sent to the corporation at its principal office or place of business as shown in the records of his office. Five (5) days after the filing of this statement with the secretary of state, the person's responsibility as agent shall terminate. If and when the corporation shall not have available in this state its resident agent as hereinbefore provided, service of legal process upon such corporation, in all instances in which such service could be made on such agent if available, may be had by serving the secretary of state upon the same terms and provisions as provided in IC 23-1-11-6.

## SECTION 7. BY-LAWS

The power to make, alter, amend or repeal the by-laws of a corporation shall be vested in its board of directors unless otherwise provided in the articles of incorporation. The by-laws may contain any provision for the regulation and management of the affairs of the corporation not inconsistent with the articles of incorporation and the laws of this state, including provisions respecting: the time and place of holding and the manner of conducting meetings of members; the manner of calling special meetings of members or directors; the powers, duties, tenure and qualifications of officers and directors of the corporation and the time, place and manner of electing them; requirements for bonding officers or employees; the form of membership certificates and the manner of creating the exercising proxies.

## SECTION 8. MEMBERS

*A corporation may have one or more classes of members. Public benefit corporations may choose to have no members. If the corporation has one or more classes of members, the designation of such class or classes, the manner of election or appointment and the qualifications and rights of the members of each class shall be set forth in the articles of incorporation or the by-laws. If, in the case of public benefit corporations, the corporation has no members, that fact shall be set forth in the articles of incorporation or the by-laws. A corporation may issue certificates evidencing membership therein. The members, directors, officers and employees shall not, as such, be liable for the corporation's obligations except to the extent of their contributions to the corporation.*

## SECTION 9. MEETINGS OF MEMBERS

*Meeting of members may be held at such place, either within or without this state, as may be provided in the bylaws. In the absence of any such provision, all such meetings shall be held at the registered office of the corporation in this state.*

*An annual meeting of the members shall be held at such time as may be provided in the by-laws. Failure to hold the annual meeting shall not work a forfeiture or dissolution of the corporation.*

*Special meetings of the members may be called by the president or by the board of directors. Special meetings may also be called by such other officers or persons or number or proportion of members as may be provided in the articles of incorporation or the by-laws. In the absence of a provision fixing the number or proportion of members entitled to call a meeting, a special meeting of members may be called by members having one-twentieth of the votes entitled to be cast at such meeting.*

## SECTION 10. NOTICE OF MEMBERS' MEETINGS

*Unless otherwise provided in the articles of incorporation or the by-laws, written notice stating the place, day and hour of the meeting and, in case of a special meeting, the purpose or purposes for which the meeting is called, shall be delivered not less than ten or more than fifty days before the date of the meeting, either personally or by mail, by or at the discretion of the president or by the secretary, or the officers or persons calling the meeting, to each member entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail addressed to the member at his or her address as it appears on the records of the corporation, with postage thereon prepaid.*

## SECTION 11. VOTING

*The right of the members, or any class or classes of members, to vote may be limited, enlarged or denied to the extent specified in the articles of incorporation or the by-laws. Unless so limited, enlarged or denied, each member, regardless of class, shall be entitled to one vote on each matter submitted to a vote of members.*

*A member entitled to vote may vote in person or, unless the articles of incorporation or the by-laws otherwise provide, may vote by proxy executed in writing by the member or by his duly authorized attorney-in-fact. No proxy shall be valid after eleven months from the date of its execution, unless otherwise provided in the proxy. Where directors or officers are to be elected by members, the by-laws may provide that such elections may be conducted by mail.*

*The articles of incorporation or the by-laws may provide that in all elections for directors every member entitled to vote shall have the right to cumulate his vote and to give one candidate a number of votes equal to his vote multiplied by the number of directors to be elected, or by distributing such votes on the same principle among any number of such candidates.*

*If a corporation has no members or its members have no right to vote, the directors shall have the sole voting power.*

## SECTION 12. QUORUM

*The by-laws may provide the number or percentage of members entitled to vote represented in person or by proxy, or the number or percentage of votes represented in person or by proxy, which shall constitute a quorum at a meeting of members. In the absence of any such provision, members holding one-tenth of the votes entitled to be cast on the matter to be voted upon represented in person or by proxy shall constitute a quorum. A majority of the votes entitled to be cast on a matter to be voted upon by the members present or*

*represented by proxy at a meeting at which a quorum is present shall be necessary for the adoption thereof unless a greater proportion is required by this Act, the articles of incorporation or the by-laws.*

#### SECTION 13. MEMBERS' DERIVATIVE ACTIONS

*(a) A member of any corporation incorporated under this chapter shall have the right to maintain an action on behalf of the corporation.*

*(b) No action may be instituted or maintained in the right of any corporation by any member of such corporation unless all three of the following conditions exist:*

*(1) The plaintiffs allege in the complaint that they were members at the time of the transaction or any part thereof of which plaintiffs complain, or that plaintiffs' memberships thereafter devolved upon plaintiffs by operation of law from holders who were holders at the time of the transaction or any part thereof complained of; and*

*(2) The plaintiffs represent at least five percent (5%) of the membership of the corporation or of a particular class of members of the corporation; and*

*(3) The plaintiffs allege in the complaint with particularity plaintiffs' efforts to secure from the board such action as plaintiffs desire, or the reasons for not making such effort, and allege further that plaintiffs have either informed the board in writing of the ultimate facts of each cause of action against each defendant or delivered to the corporation or the board a true copy of the complaint which plaintiffs propose to file.*

#### SECTION 14. DIRECTORS

*(a) The affairs of every corporation shall be managed by a board of directors who may be members of the corporation, with such other qualifications as the bylaws may prescribe.*

*(b) The exact number of directors, or in lieu thereof the minimum and maximum number of directors, shall be prescribed in the articles of incorporation, but under no circumstances shall the minimum number of directors be less than three (3). However, the exact number of directors shall be prescribed from time to time in the by-laws of the corporation and may be either the minimum number or the maximum number or any number in between as prescribed in the articles of incorporation.*

*(c) In the event the number of directors is increased by the by-laws of any corporation, the election of the additional director or directors shall be by a vote of the members of the corporation.*

*(d) Each director shall serve for that period of time stipulated in the articles of incorporation. Where the articles of incorporation es-*

establish no term of office, each director shall serve not more than three (3) years, or until his successor is elected and qualified.

(e) When the board of directors consists of nine (9) or more members, the articles of incorporation may provide that the directors shall be divided into two (2) or more groups whose terms of office shall expire at different times, however, no term shall continue longer than three (3) years.

(f) Any vacancy occurring on the board of directors caused by a death, resignation, or otherwise, shall be filled until the next annual meeting through a vote of a majority of the remaining members of the board. A majority of the entire board of directors shall be necessary to constitute a quorum. However, when filling vacancies a majority of the existing directors shall be required for a quorum. However, the bylaws of any corporation may prescribe that a lesser number than the majority of the entire board may constitute a quorum, but the number shall not be less than one-third (1/3) of the total number of directors and in no case shall be less than two (2) directors. The act of a majority of the directors present at a meeting who constitute a quorum shall be the act of the board of directors.

(g) Meetings of the board of directors may be held upon such notice as may be provided in the articles of incorporation or the bylaws. Unless otherwise provided by the articles of incorporation or bylaws, any or all of the board of directors or of a committee designated by the board may participate in a meeting of the board or committee by means of a conference telephone or similar communications equipment by which all persons participating in the meeting can communicate with each other, and participation in this manner constitutes presence in person at the meeting.

(h) The board of directors may, by resolution adopted by a majority of the entire board pursuant to a provision of the bylaws, designate two (2) or more members of the corporation to constitute an executive committee, which to the extent provided in the resolution or in the bylaws, shall have and exercise all of the authority of the board of directors in the management of the corporation; but the designation of a committee and the delegation of authority to it, shall not operate to relieve the board of directors or any member thereof of any responsibility imposed upon it or him by this chapter.

(i) Unless otherwise provided by the articles of incorporation or bylaws, any action required or permitted to be taken at any meeting of the board of directors or of any committee thereof may be taken without a meeting, if prior to such action a written consent to such action is signed by all members of the board or of such committee, as the case may be, and such written consent is filed with the minutes of proceedings of the board or committee.



## SECTION 15. OFFICERS

The officers of a corporation shall be chosen by the board of directors at a time, in a manner, and for the terms and with the title which the by-laws may prescribe; however, the articles of incorporation or by-laws may also provide that officers are to be elected by the members of the corporation instead of by the board of directors. Each officer shall hold office until his successor is chosen and qualified. If the by-laws so provide, any two (2) or more offices may be held by the same person, except that the duties of the president and secretary shall not be performed by the same person.

All officers and agents of the corporation between themselves and the corporation shall have the authority and perform any duties in the management of the property and affairs of the corporation as may be provided in the by-laws, or, in the absence of any provision, as may be determined by resolution of the board of directors. Any officer or agent may be removed by the board of directors whenever, in its judgment, the best interests of the corporation will be served but this removal shall be without prejudice to the contract rights, if any, of the person removed. Election or appointment of an officer or agent shall not of itself create contract rights.

## SECTION 16. STANDARDS OF CONDUCT

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

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

*(c) Public Benefit and General Purpose Corporations. In performing the duties of a director, a director shall be entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by:*

*(1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the exercise of their duties; or*

(2) Counsel, independent accountants or other persons as to matters which the director believes to be within such person's professional or expert competence; or

(3) A committee of the board upon which the director does not serve, as to matters within its designated authority, which committee the director believes to merit confidence;

so long as, in any such case, the director acts in utmost good faith in the case of Public Benefit Corporations and in good faith in the case of General Purpose Corporations, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause such reliance to be unwarranted.

### SECTION 17. SELF-DEALING TRANSACTIONS

#### (1) Public Benefit Corporations.

(a) Except as provided in subdivision (b), for the purpose of this section, a self-dealing transaction means a transaction to which the corporation is a party and in which one or more of its directors has a material financial interest and which does not meet the requirements of paragraph (1), (2), or (3) of subdivision (d). Such a director is an "interested director" for the purpose of this section.

(b) The provisions of this section do not apply to any of the following:

(1) An action of the board fixing the compensation of a director as a director or officer of the corporation.

(2) A transaction which is part of a public or charitable program of the corporation if it: (i) is approved or authorized by the corporation in good faith and without unjustified favoritism; and (ii) results in a benefit to one or more directors or their families because they are in the class of persons intended to be benefited by the public or charitable program.

(3) A transaction, of which the interested director or directors have no actual knowledge, and which does not exceed the lesser of 1 percent of the gross receipts of the corporation for the preceding fiscal year or one hundred thousand dollars (\$100,000).

(c) The Attorney General or, if the Attorney General is joined as an indispensable party, any of the following may bring an action in the superior court of the proper county for the remedies specified in subdivision (h):

(1) The corporation, or a member asserting the right in the name of the corporation pursuant to Section 13.

(2) A director of the corporation.

(3) An officer of the corporation.

(4) Any person granted relator status by the Attorney General.

(d) In any action brought under subdivision (c) the remedies specified in subdivision (h) shall not be granted if:

(1) *The Attorney General, or the court in an action in which the Attorney General is an indispensable party, has approved the transaction before or after it was consummated; or*

(2) *The following facts are established:*

(A) *The corporation entered into the transaction for its own benefit;*

(B) *The transaction was fair and reasonable as to the corporation at the time the corporation entered into the transaction;*

(C) *Prior to consummating the transaction or any part thereof the board authorized the transaction in good faith by a vote of a majority of the directors then in office without counting the vote of the interested director or directors, and with knowledge of the material facts concerning the transaction and the director's interest in the transaction. Except as provided in paragraph (3) of this subdivision, action by a committee of the board shall not satisfy this paragraph; and*

(D)(i) *Prior to authorizing or approving the transaction the board considered and in good faith determined after reasonable investigation under the circumstances that the corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances or (ii) the corporation in fact could not have obtained a more advantageous arrangement with reasonable effort under the circumstances; or*

(3) *The following facts are established:*

(A) *A committee or person authorized by the board approved the transaction in a manner consistent with the standards set forth in paragraph (2) of this subdivision;*

(B) *It was not reasonably practicable to obtain approval of the board prior to entering into the transaction; and*

(C) *The board, after determining in good faith that the conditions of subparagraphs (A) and (B) of this paragraph were satisfied, ratified the transaction at its next meeting by a vote of the majority of the directors then in office without counting the vote of the interested director or directors.*

(e) *Except as provided in subdivision (f), an action under subdivision (c) must be filed within two years after written notice setting forth the material facts of the transaction and the director's interest in the transaction is filed with the Attorney General in accordance with such regulations, if any, as the Attorney General may adopt or, if no such notice is filed, within three years after the transaction occurred, except for the Attorney General, who shall have 10 years after the transaction occurred within which to file an action.*

(f) *In any action for breach of an obligation of the corporation owed to an interested director, where the obligation arises from a self-dealing transaction which has not been approved as provided in sub-*

division (d), the court may, by way of offset only, make any order authorized by subdivision (h), notwithstanding the expiration of the applicable period specified in subdivision (e).

(g) Interested directors may be counted in determining the presence of a quorum at a meeting of the board which authorizes, approves or ratifies a contract or transaction.

(h) If a self-dealing transaction has taken place, the interested director or directors shall do such things and pay such damages as in the discretion of the court will provide an equitable and fair remedy to the corporation, taking into account any benefit received by the corporation and whether the interested director or directors acted in good faith and with intent to further the best interest of the corporation. Without limiting the generality of the foregoing, the court may order the director to do any or all of the following:

(1) Account for any profits made from such transaction, and pay them to the corporation;

(2) Pay the corporation the value of the use of any of its property used in such transaction; and

(3) Return or replace any property lost to the corporation as a result of such transaction, together with any income or appreciation lost to the corporation by reason of such transaction, or account for any proceeds of sale of such property, and pay the proceeds to the corporation together with interest at the legal rate.

(2) *General Purpose Corporations.*

(a) No contract or other transaction between a corporation and one or more of its directors, or between a corporation and any domestic or foreign corporation, firm or association in which one or more of its directors has a material financial interest, is either void or voidable because such director or directors or such other corporation, business corporation, firm or association are parties or because such director or directors are present at the meeting of the board or a committee thereof which authorizes, approves or ratifies the contract or transaction, if:

(1) The material facts as to the transaction and as to such director's interest are fully disclosed or known to the members and such contract or transaction is approved by the members in good faith, with any membership owned by any interested director not being entitled to vote thereon;

(2) The material facts as to the transaction and as to such director's interest are fully disclosed or known to the board or committee, and the board or committee authorizes, approves or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the interested director or directors and the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved or ratified; or

(3) *As to contracts or transactions not approved as provided in paragraph (1) or (2) of this subdivision, the person asserting the validity of the contract or transaction sustains the burden of proving that the contract or transaction was just and reasonable as to the corporation at the time it was authorized, approved or ratified.*

*A mere common directorship does not constitute a material financial interest within the meaning of this sub-division. A director is not interested within the meaning of this subdivision in a resolution fixing the compensation of another director as a director, officer or employee of the corporation, notwithstanding the fact that the first director is also receiving compensation from the corporation.*

(b) *No contract or other transaction between a corporation and any corporation, business corporation or association of which one or more of its directors are directors is either void or voidable because such director or directors are present at the meeting of the board or a committee thereof which authorizes, approves or ratifies the contract or transaction, if:*

(1) *The material facts as to the transaction and as to such director's other directorship are fully disclosed or known to the board or committee, and the board or committee authorizes, approves or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the common director or directors or the contract or transaction is approved by the members in good faith; or*

(2) *As to contracts or transactions not approved as provided in paragraph (1) of this subdivision, the contract or transaction is just and reasonable as to the corporation at the time it is authorized, approved or ratified.*

*This subdivision does not apply to contracts or transactions covered by subdivision (a).*

#### SECTION 18. BOOKS AND RECORDS

All corporations shall keep full and complete books and records which shall show, at all times, the financial condition of the corporation and a separate financial account of each member. All books and records of any nature whatsoever of any corporation shall be open for inspection by any member, for proper purposes, at any reasonable time.

#### SECTION 19. EARNINGS

No member of any corporation organized or reorganized under this chapter shall have or receive any earnings from such corporation, except a member who is an officer, director, or employee of such corporation, in which event he may receive fair and reasonable compensation for his services as officer, director, or employee and a

member may also receive principal and interest on monies loaned or advanced to the corporation as hereinbefore provided.

#### SECTION 20. LOANS TO OFFICERS

No corporation shall make any advancement for services to be performed in the future or shall make any loan of money or property to any officer or director of the corporation.

#### SECTION 21. INCORPORATORS

One (1) or more persons, or a domestic or foreign corporation, may act as incorporator or incorporators of a corporation by signing, acknowledging and delivering, in duplicate, to the secretary of state articles of incorporation for the corporation.

#### SECTION 22. ARTICLES OF INCORPORATION

When the provisions of section 17 of this chapter have been complied with, the incorporators shall execute and file, in the manner hereafter provided, articles of incorporation setting forth the following:

- (1) The name of the proposed corporation;
- (2) The purpose or purposes for which it is being formed;
- (3) The period of time during which it is to continue as a corporation, if the time is to be limited;
- (4) The post-office address of its principal office and the name and address of its resident agent;
- (5) A definite, concise and complete statement of its classes of members and a statement of the relative rights, preferences, limitations and restrictions of each class thereof, together with a statement of the voting rights of each class;
- (6) The number of directors constituting the initial board of directors;
- (7) The names and addresses of the first board of directors;
- (8) The names and addresses of the incorporators;
- (9) A statement of the property and an estimate of its value, to be taken over by the corporation at or upon its incorporation;
- (10) Any other provision, consistent with the laws of the state, for the regulation of the affairs of the corporation, and creating, defining, limiting or regulating the powers of the corporation, of the board of directors or of its members.

The articles of incorporation shall be prepared and signed in duplicate in and upon the form prescribed by the secretary of state, signed by the incorporator and verified and affirmed subject to penalties for perjury and shall be presented in duplicate to the secretary of state at his office, accompanied by the fees prescribed by law.

### SECTION 23. CERTIFICATE OF INCORPORATION—ISSUANCE

Upon the presentation of the articles of incorporation, if the secretary of state finds they conform to law, he shall indorse his approval upon the duplicate of the articles, and, when all fees required by law have been paid, shall file one (1) copy of the articles in his office and issue a certificate of incorporation to the incorporators. The certificate of incorporation, together with the remaining copy of the articles bearing the indorsement of his approval, shall be returned by him to the incorporators or their representatives.

### SECTION 24. CERTIFICATE OF INCORPORATION—EFFECT

Upon the issuance of the certificate of incorporation by the secretary of state, the corporate existence shall begin, all subscribers for membership shall be deemed accepted by the corporation and the subscribers shall be deemed members of the corporation.

The certificate of incorporation issued by the secretary of state shall be conclusive evidence of the fact that the corporation has been incorporated; but proceedings may be instituted by the state to dissolve, wind up and terminate a corporation which should not have been formed under this chapter or which has begun business without a substantial compliance with the conditions prescribed by this chapter.

### SECTION 25. ADOPTION OF BY-LAWS

If the articles of incorporation provide for the adoption of by-laws by the members, the incorporators or a majority of them, after the issuance of the certificate of incorporation, shall call a meeting of the members for the purpose of adopting the by-laws, giving at least ten (10) days' notice by mail to each member of the time and place of the meeting, unless this notice is waived in writing by any or all of the members, in which cases the notice shall be given only to those who have not waived notice. The members shall meet at the time and place designated and shall adopt the by-laws. After the adoption of the by-laws, the directors named in the articles of incorporation as the first board of directors shall meet at the request of a majority of them and shall elect officers and transact any other business which may properly come before the board.

If the articles of incorporation do not provide for the adoption of the by-laws by the members, then, after the issuance of the certificate of incorporation, the directors, named in the articles of incorporation as the first board of directors, shall meet at the request of a majority of them, adopt the by-laws, elect officers and transact any other business which may properly come before the board.

## SECTION 26. AMENDMENT OF ARTICLES—AUTHORITY

A corporation may at any time amend its articles of incorporation without limitation so long as the articles as amended would have been authorized by this chapter as original articles, by complying with the provisions of sections 23 through 25 of this chapter.

## SECTION 27. AMENDMENT OF ARTICLES—PROPOSAL—ADOPTION

Every amendment to the articles of incorporation shall first be proposed by the board of directors by the adoption of a resolution setting forth the proposed amendment and directing that it be submitted to a vote of the members entitled to vote in respect thereof at a designated meeting of the members, which may be an annual meeting or a special meeting of the members. If the resolution shall direct that the proposed amendment is to be submitted at an annual meeting, notice of the submission of the proposed amendment shall be included in the notice of the annual meeting. If the resolution shall direct that the proposed amendment is to be submitted at a special meeting, this special meeting shall be called by the resolution proposing the amendment, and notice of the meeting shall be given at the time and in the manner provided in section 9 of this chapter.

An amendment so proposed shall be adopted upon receiving the affirmative votes of a majority of the votes entitled to be cast in regard to the amendment unless the articles of incorporation or by-laws require a larger proportion of votes.

SECTION 28. AMENDMENT OF ARTICLES—MEMBERS  
ENTITLED TO VOTE

The members entitled to vote in respect to proposed amendments to articles of incorporation shall be determined as follows:

(a) In addition to the members entitled by the articles of incorporation to vote upon amendments, the members of a class shall be entitled to vote as a class on a proposed amendment, if the amendment would:

(1) Authorize the board of directors to fix or alter by resolution the classes of members or the relative rights, preferences, qualifications, limitations or restrictions of any class or classes, or would revoke such authority of the board of directors.

(2) Change the designations, preferences, limitations or relative rights of the members of such class.

(3) Create a new class of members having rights and preferences prior and superior to the members of that class, or increase the rights and preferences of any class having them prior to or superior to the members of the class.



(b) As to all other proposed amendments, only the members who by the terms of the articles of incorporation are entitled to vote thereon, shall be entitled to vote in respect to the amendments.

#### SECTION 29. ARTICLES OF AMENDMENT—CONTENT—FILING

Upon the proposal and adoption of any amendment to the articles of incorporation, there shall be executed and filed, in the manner hereinafter provided, articles of amendment setting forth the following:

(a) The amendment so adopted.

(b) The manner of its adoption and the vote by which it was adopted.

Upon the adoption of any amendment, a corporation may file amended articles in the office of the secretary of state in lieu of the aforementioned articles of amendment. The amended articles, which may differ from the previously existing articles in the respects authorized by the resolution of amendment, shall contain a statement that they supersede and take the place of the previously existing articles of the corporation, and shall also contain all the statements required by this chapter, to be included in the original articles.

In lieu of stating the names and addresses of the first board of directors in amended articles, they shall state the names and addresses of the directors holding office at the time of adoption of the amended articles. In lieu of stating the names and addresses of the incorporators in amended articles, they shall state the names and addresses of the president or vice-president and secretary or assistant secretary of the corporation.

The articles of amendment or amended articles shall be prepared and signed in duplicate, in the form prescribed by the secretary of state, by any current officer of the corporation and verified and affirmed subject to penalties for perjury, and shall be presented in duplicate to the secretary of state, at his office, accompanied by the fees prescribed by law.

#### SECTION 30. CERTIFICATE OF AMENDMENT

Upon the presentation of the articles of amendment or amended articles, the secretary of state, if he finds that they conform to law, shall indorse his approval upon both of the duplicate copies of the articles of amendment or amended articles, and, when all fees have been paid as required by law, shall file one (1) copy of the articles of amendment or amended articles in his office, issue a certificate of amendment to the corporation, and shall return it to the corporation, together with the copy of the articles of amendment or amended articles, bearing the indorsement of his approval.

## SECTION 31. EFFECT OF CERTIFICATE OF AMENDMENT

Upon the issuance of the certificate of amendment by the secretary of state, the amendment shall become effective and the articles of incorporation shall be deemed amended accordingly.

If amended articles are filed and approved as herein provided, the secretary of state shall, upon request, certify a copy of them, or in the alternative, certify all or any part of the articles of incorporation, amendment, merger, consolidation, dissolution or amended articles, or other papers of the corporation, lawfully received and filed by him.

No amendment shall affect any existing cause of action in favor of or against the corporation, or any pending suit in which the corporation shall be a party, or the existing rights of persons other than members; and, in the event the corporate name shall be changed by any amendment no suit brought against the corporation under its former name shall be abated for that reason.

## SECTION 32. CHANGE OF CORPORATE NAME

(a) Whenever any corporation amends its articles of incorporation to change its corporate name, it shall, within ten (10) days after the issuance of the certificate of amendment, file for record, with the county recorder of each county in this state in which it has real property at the time the amendment becomes effective, a duplicate of the certificate of amendment, duly certified by the secretary of state under the seal of his office.

(b) Whenever any corporation shall restate its articles of incorporation in articles of acceptance so as to change its corporate name, a duplicate certificate of acceptance, duly certified by the secretary of state under the seal of his office, shall be filed for record, within ten (10) days after the issuance of the certificate of acceptance, with the county recorder of each county in this state in which the corporation has any real property at the time the certificate is issued.

(c) Whenever any corporation is a party to a merger or consolidation, the surviving or new corporation, as the case may be, shall, within ten (10) days after the merger or consolidation becomes effective, file for record with the county recorder of each county in this [sic] in which any of such corporations own real property at the time of the merger or consolidation the title to which will be transferred by the merger or consolidation, a duplicate of the certificate of merger or consolidation, certified by the secretary of state under the seal of his office.

## SECTION 33. SALE OF ENTIRE ASSETS

Any corporation may, at any time, if otherwise lawful, sell, lease, exchange, mortgage, pledge, or otherwise dispose of all or substan-

tially all of its fixed assets, for the purpose of terminating and winding up, or changing the nature of its business (such a sale, lease, exchange, mortgage, pledge or other disposition for such purpose being referred to in this chapter as a "Special Corporate Transaction"), upon any terms and conditions and for any consideration, including shares in other corporations, as it deems necessary to comply with the provisions of this chapter.

SECTION 34. SPECIAL CORPORATE TRANSACTION—  
PROPOSALS BY DIRECTORS—  
NOTICE TO MEMBERS

Any special corporate transaction shall first be proposed by the board of directors by the adoption of a resolution setting forth the terms and conditions of this transaction and directing that it be submitted to a vote of the members at a designated meeting, which may be an annual meeting or a special meeting of those members entitled to vote. If the designated meeting at which this special corporate transaction is to be submitted, is an annual meeting, notice of the submission of this transaction shall be included in the notice of the annual meeting. If this same transaction is to be submitted at a special meeting of members entitled to vote, the special meeting shall be called by a resolution designating the meeting, and notice of this meeting shall be given at the time and in the manner provided in section 9 of this chapter. *In the case of corporations formed without members, the vote of the board of directors shall be final.*

SECTION 35. SPECIAL CORPORATE TRANSACTIONS—  
AUTHORIZATION BY MEMBERS

The proposed special corporate transaction shall then be submitted to a vote of the members entitled to vote in respect thereof at the annual or special meeting directed by the resolution of the board of directors proposing such special corporate transaction, and shall be authorized upon receiving the affirmative votes of a majority of the members entitled to vote in respect thereof. Unless otherwise provided in the articles of incorporation if the members of any class are entitled to vote as a class, the proposal shall be adopted upon receiving the affirmative vote of the required percentage of the members of each class entitled to vote thereon as a class, and of the total members entitled to vote thereon.

The members of any corporation entitled to vote in respect to a proposed special corporate transaction shall be the members which by the articles of incorporation of such corporation are entitled to vote in questions involving such special corporate transaction.

SECTION 36. SPECIAL CORPORATE TRANSACTIONS—  
ABANDONMENT BY DIRECTORS

After authorization by a vote of the members, the board of directors, nevertheless, in its discretion, may abandon the special corporate transaction, subject to the rights of third parties under any related contracts without further action or approval by the members.

SECTION 37. VOLUNTARY DISSOLUTION

*A corporation may dissolve and wind up its affairs in the following manner:*

*(a) If there are members entitled to vote thereon, the board of directors shall adopt a resolution recommending that the corporation be dissolved, and directing that the question of such dissolution be submitted to a vote at a meeting of members entitled to vote thereon, which may be either an annual or a special meeting. Written notice stating that the purpose, or one of the purposes, of such meeting is to consider the advisability of dissolving the corporation, shall be given to each member entitled to vote at such meeting, within the time and in the manner provided in this Act for the giving of notice of meetings of members. A resolution to dissolve the corporation shall be adopted upon receiving at least two-thirds of the votes which members present at such meeting or represented by proxy are entitled to cast.*

*(b) If there are no members, or no members entitled to vote thereon, the dissolution of the corporation shall be authorized at a meeting of the board of directors upon the adoption of a resolution to dissolve by the vote of a majority of the directors in office.*

*Upon the adoption of such resolution by the members, or by the board of directors if there are no members or no members entitled to vote thereon, the corporation shall cease to conduct its affairs except in so far as may be necessary for the winding up thereof, shall immediately cause a notice of the proposed dissolution to be mailed to each known creditor of the corporation, and shall proceed to collect its assets and apply and distribute them as provided in this Act.*

SECTION 38. DISTRIBUTION OF ASSETS

*The assets of a corporation in the process of dissolution shall be applied and distributed as follows:*

*(a) All liabilities and obligations of the corporation shall be paid and discharged, or adequate provision shall be made therefor;*

*(b) Assets held by the corporation upon condition requiring return, transfer or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred or conveyed in accordance with such requirements;*

*(c) Assets received and held by the corporation subject to limitations permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving corporation, pursuant to a plan of distribution adopted as provided in this Act;*

*(d) Other assets, if any, shall be distributed in accordance with the provisions of the articles of incorporation or by-laws to the extent that the articles of incorporation or by-laws determine the distributive rights of members, or any class or classes of members, or provide for distribution to others;*

*(e) Any remaining assets may be distributed to such persons, societies, organizations or domestic or foreign corporations, whether for profit or non-profit, as may be specified in a plan of distribution adopted as provided in this Act.*

#### SECTION 39. PLAN OF DISTRIBUTION

*A plan providing for the distribution of assets, not inconsistent with the provisions of this Act, may be adopted by a corporation in the process of dissolution and shall be adopted by a corporation for the purpose of authorizing any transfer or conveyance of assets for which this Act requires a plan of distribution, in the following manner:*

*(a) If there are members entitled to vote thereon, the board of directors shall adopt a resolution recommending a plan of distribution and directing the submission thereof to a vote at a meeting of members entitled to vote thereon, which may be either an annual or a special meeting. Written notice setting forth the proposed plan of distribution or a summary thereof shall be given to each member entitled to vote at such meeting, within the time and in the manner provided in this Act for the giving of notice of meetings of members. Such a plan of distribution shall be adopted upon receiving at least two-thirds of the votes which members present at such meeting or represented by proxy are entitled to cast.*

*(b) If there are no members, or no members entitled to vote thereon, a plan of distribution shall be adopted at a meeting of the board of directors upon receiving a vote of a majority of the directors in office.*

#### SECTION 40. REVOCATION OF VOLUNTARY DISSOLUTION PROCEEDINGS

*A corporation may, at any time prior to the issuance of a certificate of dissolution by the Secretary of State, revoke the action theretofore*

*taken to dissolve the corporation, in the following manner:*

*(a) If there are members entitled to vote thereon, the board of directors shall adopt a resolution recommending that the voluntary dissolution proceedings be revoked, and directing that the question of such revocation be submitted to a vote at a meeting of members entitled to vote thereon, which may be either an annual or a special meeting. Written notice stating that the purpose, or one of the purposes, of such meeting is to consider the advisability of revoking the voluntary dissolution proceedings, shall be given to each member entitled to vote at such meeting, within the time and in the manner provided in this Act for the giving of notice of meetings of members. A resolution to revoke the voluntary dissolution proceedings shall be adopted upon receiving at least two-thirds of the votes which members present at such meeting or represented by proxy are entitled to cast.*

*(b) If there are no members, or no members entitled to vote thereon, a resolution to revoke the voluntary dissolution proceedings shall be adopted at a meeting of the board of directors upon receiving the vote of a majority of the directors in office.*

*Upon the adoption of such resolution by the members, or by the board of directors where there are no members or no members entitled to vote thereon, the corporation may thereupon again conduct its affairs.*

#### SECTION 41. ARTICLES OF DISSOLUTION

*If voluntary dissolution proceedings have not been revoked, then when all debts, liabilities and obligations of the corporation shall have been paid and discharged, or adequate provision shall have been made therefor, and all of the remaining property and assets of the corporation shall have been transferred, conveyed or distributed in accordance with the provisions of this Act, articles of dissolution shall be executed in duplicate by the corporation by its president or a vice president, and by its secretary or an assistant secretary, which statement shall set forth:*

*(a) The name of the corporation.*

*(b) If there are members entitled to vote thereon, (1) a statement setting forth the date of the meeting of members at which the resolution to dissolve was adopted, that a quorum was present at such meeting, and that such resolution received at least two-thirds of the votes which members present at such meeting or represented by proxy were entitled to cast, or (2) a statement that such resolution was adopted by a consent in writing signed by all members entitled to vote with respect thereto.*

*(c) If there are no members, or no members entitled to vote thereon, a statement of such fact, the date of the meeting of the board of directors at which the resolution to dissolve was adopted*

*and a statement of the fact that such resolution received the vote of a majority of the directors in office.*

*(d) That all debts, obligations, and liabilities of the corporation have been paid and discharged or that adequate provision has been made therefor.*

*(e) A copy of the plan of distribution, if any, as adopted by the corporation, or a statement that no plan was so adopted.*

*(f) That all the remaining property and assets of the corporation have been transferred, conveyed or distributed in accordance with the provisions of this Act.*

*(g) That there are no suits pending against the corporation in any court, or that adequate provision has been made for the satisfaction of any judgment, order or decree which may be entered against it in any pending suit.*

#### SECTION 42. FILING OF ARTICLES OF DISSOLUTION

*Duplicate originals of such articles of dissolution shall be delivered to the Secretary of State. If the Secretary of State finds that such articles of dissolution conform to law, he shall, when all fees have been paid as in this Act prescribed:*

*(1) Endorse on each of such duplicate originals the word "Filed," and the month, day and year of the filing thereof.*

*(2) File one of such duplicate originals in his office.*

*(3) Issue a certificate of dissolution to which he shall affix the other duplicate original.*

*The certificate of dissolution, together with the duplicate original of the articles of dissolution affixed thereto by the Secretary of State, shall be returned to the representative of the dissolved corporation. Upon the issuance of such certificate of dissolution the existence of the corporation shall cease, except for the purpose of suits, other proceedings and appropriate corporate action by members, directors and officers as provided in this Act.*

#### SECTION 43. APPROVAL OF SUPERIOR COURT

*No action for voluntary dissolution shall be final until approved by the superior court in the county in which the corporation is located. A copy of the petition for dissolution must be submitted to the Secretary of State and the Attorney General, both of whom shall have the authority to participate in the proceedings before the court.*

#### SECTION 44. INVOLUNTARY DISSOLUTION

*A corporation may be dissolved involuntarily by a decree of the superior court in an action filed by the Attorney General when it is established that:*

(a) *The corporation has failed to file its annual report within the time required by this Act; or*

(b) *The corporation procured its articles of incorporation through fraud; or*

(c) *The corporation has continued to exceed or abuse the authority conferred upon it by law; or*

(d) *The corporation has failed for ninety days to appoint and maintain a registered agent in this State; or*

(e) *The corporation has failed for ninety days after change of its registered agent to file in the office of the Secretary of State a statement of such change.*

#### SECTION 45. NOTIFICATION TO ATTORNEY GENERAL

*The Secretary of State, on or before the last day of December of each year, shall certify to the Attorney General the names of all corporations which have failed to file their annual reports in accordance with the provisions of this Act. He shall also certify, from time to time, the names of all corporations which have given other cause for dissolution as provided in this Act, together with the facts pertinent thereto. Whenever the Secretary of State shall certify the name of a corporation to the Attorney General as having given any cause for dissolution, the Secretary of State shall concurrently mail to the corporation at its registered office a notice that such certification has been made. Upon the receipt of such certification, the Attorney General shall file an action in the name of the State against such corporation for its dissolution. Every such certificate from the Secretary of State to the Attorney General pertaining to the failure of a corporation to file an annual report shall be taken and received in all courts as prima facie evidence of the facts therein stated. If, before action is filed, the corporation shall file its annual report, or shall appoint or maintain a registered agent as provided in this Act, or shall file with the Secretary of State the required statement of change or registered agent, such fact shall be forthwith certified by the Secretary of State to the Attorney General and he shall not file an action against such corporation for such cause. If, after action is filed, the corporation shall file its annual report, or shall appoint or maintain a registered agent as provided in this Act, or shall file with the Secretary of State the required statement of change of registered agent, and shall pay the costs of such action, the action for such cause shall abate.*

#### SECTION 46. VENUE AND PROCESS

*Every action for the involuntary dissolution of a corporation shall be commenced by the Attorney General in the superior court of the*



county in which the registered office of the corporation is situated. Summons shall issue and be served as in other civil actions. If process is returned not found, the Attorney General shall cause publication to be made as in other civil cases in some newspaper published in the county where the registered office of the corporation is situated, containing a notice of the pendency of such action, the title of the court, the title of the action, and the date on or after which default may be entered. The Attorney General may include in one notice the names of any number of corporations against which actions are then pending in the same court. The Attorney General shall cause a copy of such notice to be mailed to the corporation at its registered office within ten days after the first publication thereof. The certificate of the Attorney General of the mailing of such notice shall be prima facie evidence thereof. Such notice shall be published at least once each week for two successive weeks, and the first publication thereof may begin at any time after the summons has been returned. Unless a corporation shall have been served with summons, no default shall be taken against it earlier than thirty days after the first publication of such notice.

#### SECTION 47. JURISDICTION OF COURT TO LIQUIDATE ASSETS AND AFFAIRS OF CORPORATION

Courts of equity shall have full power to liquidate the assets and affairs of a corporation:

(a) In an action by a member or director when it is made to appear:

(1) That the directors are deadlocked in the management of the corporate affairs and that irreparable injury to the corporation is being suffered or is threatened by reason thereof, and either that the members are unable to break the deadlock or there are no members having voting rights; or

(2) That the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent; or

(3) That the members entitled to vote in the election of directors are deadlocked in voting power and have failed for at least two years to elect successors to directors whose terms have expired or would have expired upon the election of their successors;

(4) That the corporate assets are being misapplied or wasted; or

(5) That the corporation is unable to carry out its purposes.

(b) In an action by a creditor:

(1) When the claim of the creditor has been reduced to judgment and an execution thereon has been returned unsatisfied and it is established that the corporation is insolvent; or

(2) When the corporation has admitted in writing that the claim

*of the creditor is due and owing and it is established that the corporation is insolvent.*

*(c) Upon application by a corporation to have its dissolution continued under the supervision of the court.*

*(d) When an action has been filed by the Attorney General to dissolve a corporation and it is established that liquidation of its affairs should precede the entry of a decree of dissolution.*

*Proceedings under this section shall be brought in the county in which the registered office or the principal office of the corporation is situated.*

*It shall not be necessary to make directors or members parties to any such action or proceedings unless relief is sought against them personally.*

#### SECTION 48. PROCEDURE IN LIQUIDATION OF CORPORATION BY COURT

*In proceedings to liquidate the assets and affairs of a corporation the court shall have the power to issue injunctions, to appoint a receiver or receivers pendente lite, with such powers and duties as the court, from time to time, may direct, and to take such other proceedings as may be requisite to preserve the corporate assets wherever situated, and carry on the affairs of the corporation until a full hearing can be had.*

*After a hearing had upon such notice as the court may direct to be given to all parties to the proceedings and to any other parties in interest designated by the court, the court may appoint a liquidating receiver or receivers with authority to collect the assets of the corporation. Such liquidating receiver or receivers shall have authority, subject to the order of the court, to sell, convey and dispose of all or any part of the assets of the corporation wherever situated, either at public or private sale. The order appointing such liquidating receiver or receivers shall state their powers and duties. Such powers and duties may be increased or diminished at any time during the proceedings.*

*The assets of the corporation or the proceeds resulting from a sale, conveyance, or other disposition thereof shall be applied and distributed as follows:*

*(a) All costs and expenses of the court proceedings and all liabilities and obligations of the corporation shall be paid, satisfied and discharged, or adequate provision shall be made therefor;*

*(b) Assets held by the corporation upon condition requiring return, transfer or conveyance, which condition occurs by reason of the dissolution or liquidation, shall be returned, transferred or conveyed in accordance with such requirements;*

*(c) Assets received and held by the corporation subject to limita-*

tions permitting their use only for charitable, religious, eleemosynary, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution or liquidation, shall be transferred or conveyed to one or more domestic or foreign corporations, societies or organizations engaged in activities substantially similar to those of the dissolving or liquidating corporation as the court may direct;

(d) Other assets, if any, shall be distributed in accordance with the provisions of the articles of incorporation or the by-laws to the extent that the articles of incorporation or by-laws determine the distributive right of members, or any class or classes of members, or provide for distribution to others;

(e) Any remaining assets may be distributed to such persons, societies, organizations or domestic or foreign corporations, whether for profit or not for profit, specified in the plan of distribution adopted as provided in this Act, or where no plan of distribution has been adopted, as the court may direct.

The court shall have power to allow, from time to time, as expenses of the liquidation compensation to the receiver or receivers and to attorneys in the proceeding, and to direct the payment thereof out of the assets of the corporation or the proceeds of any sale or disposition of such assets.

A receiver of a corporation appointed under the provisions of this section shall have authority to sue and defend in all courts in his own name as receiver of such corporation. The court appointing such receiver shall have exclusive jurisdiction of the corporation and its property, wherever situated.

#### SECTION 49. QUALIFICATION OF RECEIVERS

A receiver shall in all cases be a citizen of the United States or a corporation for profit authorized to act as receiver, which corporation may be a domestic corporation or a foreign corporation authorized to transact business in this State, and shall in all cases give such bond as the court may direct with such sureties as the court may require.

#### SECTION 50. FILING OF CLAIMS IN LIQUIDATION PROCEEDINGS

In proceedings to liquidate the assets and affairs of a corporation the court may require all creditors of the corporation to file with the clerk of the court or with the receiver, in such form as the court may prescribe, proofs under oath of their respective claims. If the court requires the filing of claims it shall fix a date, which shall be not less than four months from the date of the order, as the last day for the filing of claims, and shall prescribe the notice that shall

*be given to creditors and claimants of the date so fixed. Prior to the date so fixed, the court may extend the time for the filing of claims. Creditors and claimants failing to file proofs of claim on or before the date so fixed may be barred, by order of court, from participating in the distribution of the assets of the corporation.*

#### SECTION 51. DISCONTINUANCE OF LIQUIDATION PROCEEDINGS

*The liquidation of the assets and affairs of a corporation may be discontinued at any time during the liquidation proceedings when it is established that cause for liquidation no longer exists. In such event the court shall dismiss the proceedings and direct the receiver to re-deliver to the corporation all its remaining property and assets.*

#### SECTION 52. DECREE OF INVOLUNTARY DISSOLUTION

*In proceedings to liquidate the assets and affairs of a corporation, when the costs and expenses of such proceedings and all debts, obligations, and liabilities of the corporation shall have been paid and discharged and all of its remaining property and assets distributed in accordance with the provisions of this Act, or in case its property and assets are not sufficient to satisfy and discharge such costs, expenses, debts, and obligations, and all the property and assets have been applied so far as they will go to their payment, the court shall enter a decree dissolving the corporation, whereupon the existence of the corporation shall cease.*

#### SECTION 53. SURVIVAL OF REMEDY AFTER DISSOLUTION

*The dissolution of a corporation either (1) by the issuance of a certificate of dissolution by the Secretary of State, or (2) by a decree of court when the court has not liquidated the assets and affairs of the corporation as provided in this Act, or (3) by expiration of its period of duration, shall not take away or impair any remedy available to or against such corporation, its directors, officers, or members, for any right or claim existing, or any liability incurred, prior to such dissolution if action or other proceeding thereon is commenced within two years after the date of such dissolution. Any such action or proceeding by or against the corporation may be prosecuted or defended by the corporation in its corporate name. The members, directors and officers shall have power to take such corporate or other action as shall be appropriate to protect such remedy, right or claim. If such corporation was dissolved by the expiration of its period of duration, such corporation may amend its articles of incorporation at any time during such period of two years so as to extend its period of duration.*

## SECTION 54. ANNUAL REPORT

*An annual report accompanied by a filing fee of one dollar [\$1.00] shall be filed with the secretary of state by all nonprofit corporations, domestic or foreign, whether incorporated under this or any other law. However, if a corporation is incorporated under a law of this state, which provides that it shall file annual reports with the secretary of state, this section shall not apply to it. The fee shall be in lieu of all other annual fees to be paid by the corporation. The report shall be filed in the month of February; however, any corporation which operates on a fiscal year basis, which is other than a calendar year, may file the report during the second calendar month following the end of the fiscal year, but shall first notify the secretary of state, on forms provided by the secretary of state, of the period of its fiscal year. Such report shall contain the following information as of the last day of the preceding calendar or fiscal year:*

*(a) The name of the corporation.*

*(b) The location and post office address of its principal office in this state and the name and address of the resident agent or of some designated person residing in this state upon whom service of process may be served.*

*(c) The date of incorporation, and, if a foreign corporation, the date when admitted and qualified in this state as a foreign corporation.*

*(d) The law under which it was incorporated.*

*(e) The names and residence addresses of officers and directors and the number of existing members.*

*(f) The purposes of the corporation.*

*(g) A totalled itemized account of all outstanding debts, including the names of persons or corporations to whom sums are owing, the original amount of the debt incurred, the method of making payment, and from what funds the debt is to be paid. If any member, any relative of a member, or any person having a contract or agreement concerning the subject matter of the debt has any interest or opportunity to profit from the transaction, an explanation must be filed together with copies of any written agreements connected with the subject matter of the indebtedness.*

*(h) A list of all property, real and personal, owned by the corporation, itemized to the extent required by the secretary of state, and its current market value set opposite each respective item, Provided that the list of all real property also includes the price paid for it by the corporation, a legal description, the acreage or size of each tract or lot, and the assessed value of each tract or lot.*

*(i) The nature and kind of activities in which the corporation has been engaged during the year covered by the report.*

(j) *What, if any, distribution of funds has been made to any members during the year covered by the report.*

(k) *A statement of the aggregate amount of any loans, advances, overdrafts or withdrawals and repayments made to or by any officers, directors or members.*

(l) *A verified itemized statement of revenue received by the corporation from all sources during the preceding calendar year, clearly stating the sources of the revenue in each instance, together with a general statement showing total disbursement and all cash and assets. No trust fund shall be included as an asset of the corporation, but must be separately listed and identified. Said reports shall be prepared and filed in and on forms prescribed and furnished by the secretary of state. If, upon receipt of such report, the secretary of state, after reviewing it, determines or has reason to believe that the corporation filing the report is not disclosing its true financial condition or is violating any of the provisions of this chapter or the nonprofit corporation law in general, he may require the corporation to disclose all material facts by submitting a duly verified audit bearing the certificate under oath of a qualified public accountant recognized by the secretary of state, replying to interrogatories and/or reporting under oath on any matters requested by the secretary of state.*

*The board will cause an annual report to be sent to the members not later than 120 days after the close of the corporation's fiscal year. This requirement need not be complied with if:*

(1) *The corporation is a public benefit corporation and has fewer than 100 members or ten thousand dollars (\$10,000) in assets at any time during the fiscal year.*

(2) *The corporation is a general purpose corporation. Notwithstanding the foregoing a copy of the annual report shall be furnished to:*

(1) *All directors of the corporation; and*

(2) *Any member who requests it in writing.*

*Public benefit corporations shall place an advertisement in a newspaper of general circulation in the county in which the corporation's principal place of business is located informing readers that their annual reports have been filed with the Secretary of State. The advertisement must appear within 120 days after the close of the corporation's fiscal year.*

*Public benefit corporations must place at least three (3) copies of their annual reports in the public library in the county in which their principal place of business is located.*

#### SECTION 55. MERGER OR CONSOLIDATION—AUTHORITY

Any one or more nonprofit corporations which are organized or re-organized under the provisions of this chapter may merge or consol-

idate with one or more other not-for-profit corporations organized under the laws of this state or any other state or states of the United States of America, if the laws under which the other corporation or corporations are formed, shall permit the merger or consolidation. The constituent corporations may merge into a single corporation, which may be any one (1) of the constituent corporations, or they may consolidate to form a new corporation, which may be a corporation of the state of incorporation of any one (1) of such constituent corporations as shall be specified in the agreement hereinafter required.

#### SECTION 56. MERGER OF DOMESTIC CORPORATION

Any two (2) or more domestic corporations may merge into another domestic corporation in the following manner:

(a) Agreement of Merger. The board of directors of each corporation shall, by a resolution adopted by a majority vote of the members of the board, approve a joint agreement of merger setting forth:

(1) The names of the corporations proposing to merge, and the name of the corporation into which they propose to merge, which is hereinafter designated as the surviving corporation.

(2) The terms and conditions of the proposed merger and the mode of carrying them into effect.

(3) A restatement of the provisions of the articles of incorporation of the surviving corporation as may be deemed necessary or advisable to give effect to the proposed merger.

(4) Any other provisions with respect to the proposed merger which are deemed necessary or desirable.

The resolution of the board of directors of each corporation approving the agreement shall direct that the agreement be submitted to a vote of the members of the corporation, who are entitled to vote in respect to the proposal for merger, at a designated meeting, which may be an annual meeting or a special meeting of those members entitled to vote. If the designated meeting at which the agreement is to be submitted is an annual meeting, notice of the submission of the agreement shall be included in the notice of the annual meeting. If the designated meeting is a special meeting, it shall be called by the resolution designating the meeting, and notice of this meeting shall be given at the time and in the manner provided in section 9 of this chapter.

(b) Adoption of Agreement. The agreement of merger so approved shall be submitted to a vote of the members of each corporation entitled to vote on the agreement, at the meeting directed by the resolution of the board of directors of the corporation approving the agreement, and the agreement shall be adopted by the corporation upon receiving the affirmative votes of those members who are entitled to vote in respect thereof. If the members of any class of

members are entitled to vote as a class, the proposal shall be adopted upon receiving the affirmative vote of a majority of the members of such class, and of the total shares entitled to vote.

Notwithstanding the requirements of this subsection, unless required by its articles of incorporation with respect to corporations having more than one hundred (100) members, no vote of the members of the surviving corporation shall be required to adopt an agreement of merger if the agreement of merger does not amend the articles of incorporation of the surviving corporation or contain any provision which, if contained in a proposed amendment to the articles of incorporation, would entitle the members of any class to vote as a class. If an agreement of merger is adopted by the surviving corporation through action of its board of directors and without any vote of its members, pursuant to this paragraph, then that shall be so stated in the articles of merger required to be filed with the secretary of state by the dictates of this section.

(c) **Members Entitled to Vote.** The members of any corporation entitled to vote in respect to an agreement of merger of the corporation, shall be the members who, by the terms of the articles of incorporation of the corporation, are entitled to vote upon questions of merger. Any class of members of any corporation shall be entitled to vote as a class if the agreement of merger contains any provision which, if contained in a proposed amendment to articles of incorporation, would entitle the class to vote as a class.

(d) **Notice to Members.** Within five (5) days after an agreement of merger is adopted by any corporation, the secretary of such corporation shall deliver or mail a written or printed notice of the adoption of the agreement to each member of record of the corporation, who was not present in person or represented by proxy at the meeting at which the agreement was adopted.

(e) **Reapproval by Directors and Execution of Agreement.** As soon as practicable after the expiration of a period of thirty (30) days from the adoption of the agreement of merger by the members of the merger corporation which is the last, in point of time, to adopt the merger, the agreement shall again be considered by the board of directors of each participating corporation at a regular or special meeting of the board, and if the board of directors of each corporation, by a majority vote, shall again approve the agreement and authorize its execution, the agreement shall be signed on behalf of each corporation by any current officer of the corporation and verified and affirmed subject to penalties for perjury. However, in the event that the members of the corporation vote unanimously in favor of the adoption of the agreement of merger, a reapproval of the agreement by the board of directors of each corporation shall not be required. The board of directors of any of the corporations, by appropriate



resolutions adopted at any time, may authorize the execution and consummation of the agreement of merger at such time as the procedures required by the section have been complied with.

The articles of merger shall be signed on behalf of each corporation by any current officer of the corporation and verified and affirmed subject to penalties for perjury, and shall then be presented to the secretary of state at his office, accompanied by those fees prescribed by law.

(f) Articles of Merger. Upon the execution of the agreement of merger by all of the corporations parties thereto, there shall be executed and filed, in the manner hereinafter provided, articles of merger setting forth the agreement of merger, the signatures of those authorized to sign for the merging corporations, the manner of its adoption and the vote by which it was adopted by each of the corporations.

(g) Certificate of Merger. Upon the presentation of the articles of merger, the secretary of state, if he finds that they conform to law, shall indorse his approval upon both of the duplicate copies of the articles, and, when all fees have been paid as required by law, shall file one (1) copy of the articles in his office, issue a certificate of merger, and shall return the remaining copy of the articles, bearing the indorsement of his approval, together with the certificate of merger, to the surviving corporation.

#### SECTION 57. CONSOLIDATION OF DOMESTIC CORPORATION

Any two (2) or more domestic corporations may consolidate into a new corporation organized under this chapter in the following manner:

(a) Agreement of Consolidation. The board of directors of each corporation shall by a resolution adopted by a majority vote of the members of the board, approve a joint agreement of consolidation setting forth:

(1) The names of the corporations proposing to consolidate, and the name of the resultant new corporation, which is hereinafter designated as the new corporation;

(2) The terms and conditions of the proposed consolidation and the mode of carrying it into effect;

(3) With respect to the new corporation, all of the statements required by section 18 of this chapter to be set forth in original articles of incorporation for corporations formed under this chapter; and

(4) Any other provisions with respect to the proposed consolidation which are deemed necessary or desirable.

(b) In all respects other than set forth in this section, the provisions for merger in section 42 of this chapter shall be complied with the same as if the proposed consolidation was to be a merger.

(c) Articles of Consolidation. Upon the execution of the agree-

ment of consolidation by all of the participating corporations, articles of consolidation shall be executed and presented to the secretary of state at his office, in duplicate, accompanied by the fees prescribed by law, in the same manner and form as prescribed above in subsection (f) of section 42 of this chapter for a merger.

(d) Certificate of Consolidation and Incorporation. Upon the presentation of the articles of consolidation, the secretary of state, if he finds they conform to law, shall indorse his approval upon both of the duplicate copies of the articles, and, when all fees have been paid as required by law, shall file one (1) copy of the articles in his office, issue a certificate of consolidation and incorporation to the new corporation and shall return to the new corporation or its designated agent, the remaining copy of the articles of consolidation, bearing the indorsement of his approval, together with the certificate of consolidation and incorporation.

#### SECTION 58. MERGERS AND CONSOLIDATIONS

*Author's Note: This section, and subsequent sections, would cover the merger or consolidation between domestic and foreign corporations, the merger of foreign corporations admitted to transact business in Indiana, the effective date of merger or consolidation and the effect of mergers and consolidations.*

One or more foreign corporations and one or more domestic corporations may be merged or consolidated in the following manner, if a merger or consolidation is permitted by the laws of the state under which each such foreign corporation is organized:

(a) Each domestic corporation shall comply with the provisions of this chapter with respect to a merger or consolidation of domestic corporations and each foreign corporation shall comply with those applicable provisions of the laws of the state under which it is organized.

(b) If the surviving or new corporation is to be governed by the laws of any state other than this state, it shall comply with the provisions of this chapter for foreign corporations if it is to transact business in this state, and in every case it shall file with the secretary of state;

(1) An agreement that it may be served with process in this state in any proceeding for the enforcement of any obligation of any domestic corporation which is a party to the merger or consolidation and in any proceeding for the enforcement of the rights of a dissenting member of any domestic corporation against the surviving or new corporation;

(2) An irrevocable appointment of the secretary of state as its agent to accept service of process in any proceeding together with the

address to which a copy of such process should be mailed by the secretary of state.

The effect of the merger or consolidation shall be the same as that of a merger or consolidation of domestic corporations, if the surviving or new corporation is to be governed by the laws of this state. If the surviving or new corporation is to be governed by the laws of any state other than this state, the effect of the merger or consolidation shall be the same as that of the merger or consolidation of domestic corporations except when the laws of the other state provide otherwise. The surviving or new corporation shall file for record duplicates of the certificate of merger or consolidation, duly certified by the secretary of state under the seal of his office, as provided in section 28(c) of this chapter. If the surviving or new corporation is to be governed by the laws of any state other than this state, within thirty (30) days after the effective date of the merger or consolidation, it shall file with the secretary of state a duplicate of the certificate of merger or consolidation issued by its state of incorporation, duly certified by the officer of the state having custody thereof.

#### SECTION 59. MERGER OR CONSOLIDATION OF DOMESTIC AND FOREIGN CORPORATIONS

One or more foreign corporations and one or more domestic corporations may be merged or consolidated in the following manner, if a merger or consolidation is permitted by the laws of the state under which each such foreign corporation is organized:

(a) Each domestic corporation shall comply with the provisions of this chapter with respect to a merger or consolidation of domestic corporations and each foreign corporation shall comply with those applicable provisions of the laws of the state under which it is organized.

(b) If the surviving or new corporation is to be governed by the laws of any state other than this state, it shall comply with the provisions of this chapter for foreign corporations if it is to transact business in this state, and in every case it shall file with the secretary of state;

(1) An agreement that it may be served with process in this state in any proceeding for the enforcement of any obligation of any domestic corporation which is a party to the merger or consolidation and in any proceeding for the enforcement of the rights of a dissenting member of any domestic corporation against the surviving or new corporation;

(2) An irrevocable appointment of the secretary of state as its agent to accept service of process in any proceeding together with the

address to which a copy of such process should be mailed by the secretary of state.

The effect of the merger or consolidation shall be the same as that of a merger or consolidation of domestic corporations, if the surviving or new corporation is to be governed by the laws of this state. If the surviving or new corporation is to be governed by the laws of any state other than this state, the effect of the merger or consolidation shall be the same as that of the merger or consolidation of domestic corporations except when the laws of the other state provide otherwise. The surviving or new corporation shall file for record duplicates of the certificate of merger or consolidation, duly certified by the secretary of state under the seal of his office, as provided in section 30 of this chapter. If the surviving or new corporation is to be governed by the laws of any state other than this state, within thirty (30) days after the effective date of the merger or consolidation, it shall file with the secretary of state a duplicate of the certificate of merger or consolidation issued by its state of incorporation, duly certified by the officer of the state having custody thereof.

#### SECTION 60. FOREIGN CORPORATIONS-ADMISSION

Any foreign corporation organized without capital stock and as a nonprofit corporation, not now qualified to transact business in this state, shall procure a certificate of admission from the secretary of state before transacting business in this state in the manner hereinafter provided and shall otherwise comply with the provisions and be subject to the regulations set forth in this chapter.

#### SECTION 61. FOREIGN CORPORATIONS-POWERS

No foreign corporation shall be admitted for the purpose of transacting any kind of business in this state which domestic corporations are not permitted to transact by the laws of this state. A foreign corporation admitted to do business in this state shall have the same, but no greater, rights and privileges, and be subject to the same liabilities, restrictions, duties and penalties, now in force or hereafter imposed upon domestic corporations of like character, and to the same extent as if it had been organized under this chapter to transact the business for which its certificate of admission is issued.

#### SECTION 62. FOREIGN CORPORATIONS-CORPORATE NAME

No foreign corporation shall be admitted to do business in this state having a name which, at the date of such admission, could not be taken by a domestic corporation under the provisions of section 5 of this chapter, except that the name of a foreign corporation need not

include the word "corporation" or "incorporated" or one of the abbreviations thereof; and no such foreign corporations after it has been admitted shall, by amendment to its charter, assume any name which, at the date of the filing of such amendment as hereinafter provided, could not be taken by a domestic corporation, under the provisions of said section 5 of this chapter.

### SECTION 63. FOREIGN CORPORATION-APPLICATION FOR ADMISSION

Whenever a foreign corporation desires to be admitted to do business in this state, it shall present to the secretary of state at his office accompanied by the fees prescribed by law:

- (1) a copy of its articles of incorporation or association, with all amendments thereto, duly authenticated by the proper officer of the state or country wherein it is incorporated; and
- (2) an application for admission, executed in the manner hereinafter provided, setting forth:
  - (a) The name of such corporation.
  - (b) The location of its principal office or place of business without this state, and the location of the proposed principal office or place of business within this state.
  - (c) The names of the states in which it has been admitted or qualified to do business.
  - (d) The character of business under its articles of incorporation or association which it intends to carry on in this state.
  - (e) The names and post-office addresses of its officers and directors.
  - (f) The name and post-office address of some person permanently residing in this state, upon whom, as the resident agent of the corporation until his successor shall have been appointed, service of legal process may be had.
  - (g) If the memberships are divided into classes the designations of the different classes, and a statement of the relative rights, preferences, limitations and restrictions of each class, together with a statement as to the voting rights of any such class.
  - (h) A statement of property in Indiana and an estimate of the value thereof, to be taken over by this corporation upon its admittance to Indiana.
  - (i) Any other provisions, consistent with the laws of the state of Indiana for the regulation and conduct of the affairs of the corporation, and creating, defining, limiting or regulating the powers of the corporation, of the directors or of the members or any class or classes of members.
  - (j) Such further information as the secretary of state may require which shall include a statement of assets and liabilities as of the

last day of the last calendar month preceding the submission of the application for admission.

The application shall be signed in duplicate in the form prescribed by the secretary of state, by any current officer of the corporation and verified and affirmed subject to penalties for perjury.

The secretary of state shall have power and authority to interrogate all foreign corporations, and the officers and agents thereof, applying for admission in this state, with respect to the character of business in which such corporations proposed to engage in Indiana, and with respect to any other matters required to be stated in applications for admission; and such interrogatories shall be answered under oath. Such interrogatories and answers shall be filed with the respective applications to which they pertain, and shall operate as a limitation upon the authority of such corporations to transact business in this state.

#### SECTION 64. FOREIGN CORPORATIONS-CERTIFICATE OF ADMISSION

Upon the presentation of the application of admission, the secretary of state, if he finds that it conforms to law, shall indorse his approval upon each of the duplicate copies, and, when all fees required by law shall have been paid, shall file one (1) copy of the application, together with the authenticated copy of the articles of incorporation or association of the corporation, in his office, and shall issue to the corporation a certificate of admission, accompanied by one (1) copy of the application bearing the indorsement of his approval, which certificate shall set forth:

- (1) The name of the corporation, the state or country where it was incorporated and the location of its principal office in such state or country;
- (2) The character of business it is authorized to transact in this state;
- (3) The amount of the fee paid for its admission;
- (4) The address of the corporation in this state, and;
- (5) The name and address of its resident agent in this state for the service of legal process.

Upon the issuance of a certificate of admission by the secretary of state, the corporation therein named shall be admitted, and shall have authority to transact in this state, the business set forth in such certificate, subject to terms and conditions prescribed by this chapter.

#### SECTION 65. RESIDENT AGENT FOR SERVICE OF PROCESS

(a) Each foreign corporation admitted to do business in this state shall constantly keep on file in the office of the secretary of state a certificate of any current officer of the corporation, verified and affirmed subject to penalties for perjury, setting forth the location of

its principal office in this state and the name of its agent or representative at that office on whom service of legal process may be had in all suits and actions that may be commenced against it. For the purposes of this section, the application for admission filed by a foreign corporation is such a certificate. Whenever a corporation changes the location of its principal office in this state or changes its agent for service of legal process or such agent shall be removed by death, resignation, or incapacity, the officers of the corporation shall immediately file a new certificate with the secretary of state.

(b) If the resident agent for one (1) or more corporations changes address, the agent may change the address on file with the secretary of state by filing in the office of the secretary of state a statement setting forth:

- (1) the names of the corporations for which the change is effective;
- (2) the old and new addresses of the resident agent; and
- (3) the date on which the change is effective.

If the old and new addresses of the resident agent are the same as the old and new addresses of the principal office of the corporations, the statement may include a change of address of the principal office of the corporations.

(c) A resident agent who files a statement under subsection (b) shall first notify in writing each corporation for which the agent is resident agent that the statement will be filed, and the statement must recite the fact that this notice has been given. The statement shall be executed and verified in duplicate and affirmed subject to penalties of perjury by the resident agent in his individual name; however, if the resident agent is a foreign or domestic corporation, the statement must be executed by a current officer of the corporation. The statement, executed in duplicate, shall be delivered to the secretary of state. If he finds that it conforms to the requirements of law, the secretary of state shall, upon payment of the required fees, endorse upon each of the duplicates tendered for filing, over his signature and official seal, the word "filed" followed by the date of the filing. The secretary of state shall retain one (1) executed copy of the statement in his files. He shall attach to the other filed copy a certificate stating that the instrument is an executed copy of the statement filed in his office, giving the date of the filing, and shall return the other copy to the resident agent.

(d) Any person who has been designated as resident agent for service of process by a foreign corporation may file with the secretary of state a signed statement that he is unwilling to continue to act as resident agent for the corporation. Upon the filing of such statement with the secretary of state, the capacity of the person as resident agent terminates and the secretary of state shall give written notice by mail to the foreign corporation of the filing of the state-

ment and its effect. The notice shall be addressed to the corporation at its principal office or place of business as shown by the records of his office.

(e) If and when any foreign corporation admitted to do business in this state shall not have available in this state its agent or representative on whom service of legal process may be made, service may be made upon the secretary of state, accompanied by a fee of five dollars (\$5), and the secretary of state shall mail such process by registered mail with return receipt requested to the post office address of the corporation in the state in which the corporation is incorporated as shown by its last annual report to the secretary of state. The returned receipt shall be filed with the court in which the action is pending and shall be considered sufficient service upon the nonresident corporation. In the event that the corporation refuses to accept or claim the registered mail, the registered mail shall be returned by the secretary of state to the plaintiff or his attorney, and it shall be appended to the original process, together with an affidavit of the plaintiff or of his attorney or agent to the effect that the summons was delivered to the secretary of state, and thereafter returned unclaimed by the post office department, and such affidavit, together with the returned envelope including the summons, shall be considered sufficient service upon the nonresident corporation. Any legal process served upon the secretary of state as herein provided shall not be returnable in less than thirty (30) days from the date on which the service is made upon the secretary of state. The court in which the action is brought may order such continuances as may be reasonable to afford the corporation opportunity to defend the action.

#### SECTION 66. AMENDMENTS TO CHARTER

Each foreign corporation admitted to do business in this state shall keep on file in the office of the secretary of state a duly authenticated copy of each instrument amending its articles of incorporation or association; but the filing of any such instrument shall not of itself enlarge or alter the character of business which the foreign corporation is authorized to transact in this state as set forth in the certificate of admission, nor authorize such corporation to transact business in this state under any other name than the name set forth in its certificate of admission unless such foreign corporation shall apply for and receive an amended certificate of admission as provided in the next succeeding section.

#### SECTION 67. AMENDED CERTIFICATE

Any foreign corporation admitted to do business in this state may alter or enlarge the character of business which it is authorized to



transact in this state under its articles of incorporation or association, and any amendments thereof filed with the secretary of state as hereinabove provided, and may obtain authority to transact business in this state under a different name than the name set forth in its certificate of admission, by procuring an amended certificate of admission from the secretary of state in the manner hereinafter provided.

Whenever a foreign corporation desires to procure an amended certificate, it shall present to the secretary of state at his office, accompanied by the fees prescribed by law, an application for an amended certificate of admission, stating the change desired in the character of business under its articles of incorporation or association and the name under which it desires to transact business. The application shall be signed in duplicate, in the form prescribed by the secretary of state, by any current officer of the corporation and verified and affirmed subject to penalties for perjury.

Upon the presentation of such application, the secretary of state, if he finds that it conforms to law, shall indorse his approval upon each of the duplicate copies and shall file one (1) copy of the application in his office and issue to the corporation an amended certificate of admission, accompanied by one (1) copy of the application bearing the indorsement of his approval. The certificate shall set forth the character of business that the corporation is authorized thereafter to transact in this state.

Upon the issuance of an amended certificate of admission by the secretary of state, the corporation shall have authority to transact the business set forth in the certificate, subject to the terms and conditions prescribed by this chapter.

If amended certificate of admission authorizes the corporation to transact business in this state under a new corporate name, the corporation shall, within ten (10) days after the issuance of any such amended certificate, file for record a duplicate amended certificate of admission, duly certified by the secretary of state under the seal of his office, with the county recorder of each county in this state in which it shall have real property at the time such amended certificate is issued.

#### SECTION 68. WITHDRAWAL FROM STATE

Any foreign corporation admitted to do business in this state may withdraw from this state by surrendering its certificate of admission, and any amended certificates of admission that may have been issued to it, and by filing with the secretary of state, accompanied by the fees prescribed by law, a statement of withdrawal setting forth:

- (1) The name of the corporation and the state or country in which it was incorporated.

(2) The date of the issuance of its certificate of admission, and of each amended certificate of admission, if any.

(3) That it is no longer operating in this state and that it has no property located in this state.

(4) That it surrenders its authority to transact business in this state and returns for cancellation its certificate of admission and any amended certificate of admission issued to it.

(5) That it revokes the authority of its then named resident agent to accept service of legal process; and that it consents that process against it thereafter may be had upon the corporation, in any action or proceeding upon any liability or obligation incurred within this state before the filing of the statement of withdrawal, by serving the secretary of state.

(6) A post-office address to which the secretary of state may mail a copy of any process against it that may be served upon him.

Such statement shall be signed, in the form prescribed by the secretary of state, by any current officer of the corporation and verified and affirmed subject to penalties for perjury.

Upon the filing of such statement, accompanied by the certificate of admission and any amended certificates of admission issued to the corporation, the authority of the corporation to transact business in this state shall cease; but the filing of such statement shall not affect any action by or against such corporation pending at the time thereof or any right of action existing at or before the filing of such statement in favor of or against such corporation.

#### SECTION 69. REVOCATION OF CERTIFICATE

The certificate of admission of any foreign corporation admitted to do business in this state may be revoked at any time by the secretary of state:

(1) upon the failure of an officer or director to whom interrogatories are propounded by the secretary of state to answer fully and to file such answers in the office of the secretary of state within thirty (30) days after the mailing of the interrogatories by the secretary of state;

(2) upon the existence in this state of the corporation for thirty (30) days without appointing and maintaining an agent in this state upon whom service of legal process may be had;

(3) upon the existence in this state of the corporation for thirty (30) days without keeping on file in the office of the secretary of state duly authenticated copies of each instrument amending its charter;

(4) upon the failure, neglect or refusal of the corporation to pay within thirty (30) days any fee required by the laws of this state; or

(5) for wilful misrepresentation of any material matter in any application, statement, affidavit, or other paper, filed by such corporation pursuant to this chapter.

No certificate of authority of a foreign corporation shall be revoked by the secretary of state unless he shall have given the corporation not less than sixty (60) days' notice thereof by first class mail addressed to its resident agent at his address in this state or, if there is no resident agent, to the principal office of the corporation outside this state.

Upon revoking any such certificate of admission, the secretary of state shall (1) issue duplicate copies of a certificate or revocation, (2) file one (1) copy in his office, and (3) mail to the corporation at its principal office outside this state by registered or certified mail a notice of such revocation, accompanied by one (1) of the copies of the certificate of revocation.

Upon the revocation by the secretary of state, the authority of the corporation to transact business in this state shall cease, and such corporation shall not thereafter transact any business in this state unless it applies for and receives a new certificate of admission.

#### SECTION 70. APPLICATION TO CORPORATIONS NOW QUALIFIED

Foreign corporations entitled to transact business in this state, as not-for-profit corporations, at the time this chapter becomes effective shall be entitled to all of the rights and privileges, and shall be subject to all the limitations, restrictions, liabilities and duties, prescribed herein for foreign corporations admitted to transact business in this state under this chapter.

#### SECTION 71. SERVICE OF PROCESS AFTER WITHDRAWAL OR REVOCATION

Whenever the certificate of admission of any foreign corporation shall be withdrawn or revoked, then, in any suit or proceeding thereafter commenced against it for or on account of any obligation or liability growing out of any business theretofore or thereafter done by it in this state, service of legal process may be had by serving such process upon the secretary of state upon the same terms and provisions as provided for by section 53 of this chapter in the case of service of legal process on a foreign corporation which is admitted to do business but does not have a resident agent in this state.

#### SECTION 72. TRANSACTION OF BUSINESS WITHOUT CERTIFICATE OF ADMISSION; MAINTENANCE OF SUITS; PENALTY

(a) No foreign corporation transacting business in this state without procuring a certificate of admission or, if such a certificate has been

procured, after its certificate of admission has been withdrawn or revoked, may maintain any suit, action or proceeding in any of the courts of this state upon any demand, whether arising out of contract or tort; and every such corporation so transacting business is liable by reason thereof to a penalty of not exceeding ten thousand dollars (\$10,000), to be recovered in an action to be begun and prosecuted by the attorney general in any county in which such business was transacted.

(b) If any foreign corporation transacts business in this state without procuring a certificate of admission, or, if a certificate has been procured, after its certificate has been withdrawn or revoked, or transacts any business not authorized by the certificate, the corporation is not entitled to maintain any suit or action at law or in equity upon any claim, legal or equitable, whether arising out of contract or tort, in any court in this state; and the attorney general, upon being advised that any foreign corporation is so transacting business in this state, shall bring an action in the circuit or superior court of Marion County for an injunction to restrain it from transacting such unauthorized business and for the annulment of its certificate of admission, if one has been procured.

(c) An agent of any foreign corporation who transacts for the corporation any business in Indiana before it has procured a certificate of admission or after its certificate has been withdrawn or revoked commits a Class C infraction.