Vanderbilt Law Review

Volume 29
Issue 3 *Issue 3 - Symposium: Financial Institutions, Municipal Finance, and Community Development*

Article 3

4-1976

Membership Rights in Nonprofit Corporations: A Need for Increased Legal Recognition and Protection

Robert H. Brownlee

NOTES

Membership Rights in Nonprofit Corporations: A Need for Increased Legal Recognition and Protection

I. INTRODUCTION

For a variety of reasons, the laws governing nonprofit corporations are in large measure unclear and susceptible of improvement.[1] This Note will examine one area of nonprofit corporation law in which ambiguity and potential inequity presently exist—the rights and privileges of membership status, and the legally permissible restrictions upon certain of those rights.

Membership in a nonprofit corporation is a legal status authorized by statute, arising after the individual has complied with prerequisites established by the particular corporation.[2] Conceptually, the member of a nonprofit corporation corresponds to the business corporation shareholder, although the member may not "own" a portion of the nonprofit corporation because his status may have been acquired in many ways. For example, the country club member may have purchased his certificate of membership with a large initial payment of money plus a promise to continue supporting the organization through periodic payments. A church member, or a

1. For the purposes of this Note, the term "nonprofit" is intended to include nonbusiness corporations in every jurisdiction, regardless of whether the applicable state code employs the term "nonprofit," "not-for-profit," "nonstock," or other general descriptive term. Further, the "Type C" nonprofit business corporation under New York law is included. *See* text accompanying notes 42-45 *infra*.

2. The various types of state statutes governing nonprofit corporation formation and subsequent existence are considered in text accompanying notes 23-45 *infra*.

member of a social organization, may have attained membership through personal commitment or services rendered absent any significant economic assessment. Similarly, the member of a nonprofit professional licensing corporation may have been chosen because his peers believed he was concerned about maintaining high levels of competency and honesty in the professional community.[3] Regardless of the method by which the relationship arises, however, the individual member justifiably can assert that he is among the constituent group that forms the nucleus of the association.

Although one might expect that the member would have certain legally protected rights, privileges, and obligations with respect to association affairs, this is not necessarily so. Membership rights largely are permissive rather than mandatory; that is, the law provides that rights enumerated in nonprofit corporation laws may be made inapplicable to particular members by a provision to that effect in the by-laws of the individual organization. The primary thesis of this Note is that the rights of members should be clarified and expanded, particularly with respect to voting and standing to sue. The remainder of this discussion will examine the limitations on membership rights allowable under existing state laws, and will propose a means by which the deficiencies considered may be remedied. First, a brief background to the development of American nonprofit corporations and to presently existing statutory regulation will be set forth. Secondly, state law provisions affecting membership voting rights will be examined and interpretive case law will be analyzed. Thirdly, the standing of members, individually and derivatively, to obtain judicial review or redress of grievances concerning nonprofit corporation actions will be explored along with a consideration of possible alternative avenues of relief. Subsequent to the discussion of each asserted deficiency, the Note will propose certain changes that better would define and protect these membership rights.

II. BACKGROUND

A. *Development of Nonprofit Corporations*

Nonprofit corporations exist in every jurisdiction for purposes ranging from those purely eleemosynary to those completely social and a host of reasons in between. Religious, education, social wel-

3. The practice of granting "memberships" primarily as a public relations device to spur small individual contributions or increase interest and awareness of the corporation is criticized in note 22 *infra* and accompanying text.

fare, cooperative, and trade union groups all are included within this broad categorization.[4] Although the nonprofit corporation in fact provided the historical impetus for the development of "corporation" law, with its attendant benefits and obligations,[5] predominate attention in this century has focused on control over "business" corporations.[6] The legal problems of nonprofit corporations, outside the tax area,[7] have received relatively little consideration by either scholars or courts during this time.[8] Nonetheless, nonprofit corporations are of more than historical interest; they aggregately control considerable wealth,[9] they affect in some manner the daily lives of most Americans,[10] and in sheer number they approach business concerns in this country.[11] The importance of the nonprofit corporation in modern America is disproportionate to the attention it has received in the legal community.

Unlike nonprofit voluntary associations which may be created by informal means,[12] the nonprofit corporation in every state must be established in a formal manner similar to the process required for business corporations. Required documents and accompanying

4. An extended discussion of the various types of American nonprofit organizations may be found in H. OLECK, NON-PROFIT CORPORATIONS, ORGANIZATIONS, AND ASSOCIATIONS 1-24 (3d ed. 1974). The use of the nonprofit form for public or quasi-public corporations, a comparatively recent development, is considered in Lesher, *The Non-Profit Corporation—A Neglected Stepchild Comes of Age*, 22 BUS. LAW. 951, 958-67 (1967). *See also* R. BOYER, NONPROFIT CORPORATION STATUTES: A CRITIQUE AND PROPOSAL 3-6 (1957).

5. *See* Rooney, *Maitland and the Corporate Revolution*, 21 N.Y.U.L. REV. 24 (1951). A good historical sketch of early colonial and state laws allowing incorporation of nonprofit organizations appears in Haller, *The Model Non-Profit Corporation Act*, 9 BAYLOR L. REV. 309, 312-17 (1957).

6. Lesher, *supra* note 4, at 951.

7. Issues of nonprofit corporation tax treatment are beyond the scope of this Note. For an introduction to these areas, see Bromberg, *Non-Profit Organizations: Organizational Problems and Tax Exemptions*, 17 BAYLOR L. REV. 125 (1965); Schoenfeld, *Federal Taxation and Non-Profit Organizations*, 19 CLEV. ST. L. REV. (2) 290 (1970); Sierk, *State Tax Exemptions of Non-Profit Organizations*, 19 CLEV. ST. L. REV. (2) 281 (1970).

8. Statutory coverage also has been inadequate. *See* text accompanying notes 23-32 *infra*.

9. OLECK, *supra* note 4, at 7; Note, *New York's Not-for-Profit Corporation Law*, 47 N.Y.U.L. REV. 761, 761-62 (1972).

10. Given the broad spectrum of nonprofit corporation types and the tendency of Americans to become "joiners" rather than observers, it is almost inconceivable that the average citizen does not deal continuously with such organizations. See the breakdown of clubs and other societies now existing in nonprofit corporation form listed in Oleck, *Non-Profit Types, Uses, and Abuses: 1970*, 19 CLEV. ST. L. REV. (2) 207 (1970).

11. See Oleck, *Nature of American Non-Profit Organizations*, 17 N.Y.L.F. 1066 (1972).

12. Chafee, *The Internal Affairs of Associations Not for Profit*, 43 HARV. L. REV. 993, 1008-09 (1930). *See generally* Oleck, *Nonprofit Unincorporated Associations*, 21 CLEV. ST. L. REV. (3) 44 (1972).

fees must be tendered under the applicable statutes in exchange for the grant of entity status by the state.[13] Although a precise definition of "nonprofit" seldom has been attempted by state legislatures,[14] and a few older judicial pronouncements restrictively interpret the permissible scope of such an enterprise,[15] it generally is accurate to state that whether incidental activities or investment of corporate assets in fact produce income is not determinative. As long as the monies or property of the organization are employed in furtherance of a proper corporate purpose as set forth under state law, the association is deserving of nonprofit status.[16] If such income is even partially distributable to individual members, contributors, officers, or directors,[17] however, nonprofit status and its accompanying benefits and privileges should be denied.

Once a nonprofit corporation charter is obtained, however, subsequent corporate activities often are subjected to minimal supervision. It has been asserted that a crucial problem presently existing in the area is the tendency of those in management positions to develop personal, proprietary interests in the assets of such entities, in direct conflict with the supposed *pro bono publico* purposes of the organization.[18] The most prolific author in the field has charged that perhaps as much as one-half of the total wealth of American nonprofit corporations presently may be subject to diversion for personal use.[19] It is one thesis of this Note that fuller protection of membership rights may help alleviate existing managerial abuse.[20]

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13. The process basically is parallel to that for creating business corporations and is governed in some states by the same statutory provisions. *See* text accompanying notes 37-41 *infra*.

14. For example, the Model Nonprofit Corporation Act defines the term nonprofit corporation to mean "a corporation no part of the income or profit of which is distributable to its members, directors, or officers." ABA-ALI MODEL NONPROFIT CORPORATION ACT § 2(c) (Rev. ed. 1964) [hereinafter cited as MODEL ACT].

15. The division of judicial opinion often has centered on whether the term "profit" embraces only direct monetary benefits such as dividends or includes any monetary or pecuniary benefit whatsoever. *See* Read v. Tidewater Coal Exch., Inc., 13 Del. Ch. 195, 116 A. 898 (1922).

16. The distinctions are set forth with clarity in Note, *Nonprofit Corporations-Definition*, 17 VAND. L. REV. 336, 336-42 (1963). *See also* Burton Potter Post No. 185, American Legion v. Epstein, 219 N.Y.S.2d 224 (S. Ct. 1961).

17. This is not to suggest that officers or directors may not be compensated for their efforts, or that members may not have the right to share in corporate property division upon dissolution. Neither of these benefits generally is prohibited, and usually both are statutorily authorized. *See, e.g.*, MODEL ACT §§ 5(k), 46(d).

18. *See* OLECK, *supra* note 4, at 54-57.

19. *See* Oleck, *Proprietary Mentality and the New Non-Profit Corporation Laws*, 20 CLEV. ST. L. REV. (1) 145, 165 (1971). *See also* Oleck, *supra* note 10, at 233-37 (1970).

20. The powers of state officials to correct or punish such abuses through investigation

Present gaps in nonprofit code draftsmanship offer the prospective organizer with profiteering motives an invitation to establish a "nonprofit corporation" whose activities likely will avoid the scrutiny and complaint of members of the organization.[21] Problems concerning improper use of nonprofit assets, however, do not provide the sole justification for greater recognition and protection of membership rights. The instance of the membership relationship[22] and the interests that inhere in that status, without more, arguably provide ample reason for clarifying and expanding the member's right to participate in nonprofit corporation affairs.

B. Statutory Coverage

Nonprofit corporation statutes in the United States historically have not provided sufficient guidance for either regulators or incorporators.[23] Business corporation codes generally have been better drafted and have provided a more complete, logical, and sophisticated exposition of legal requirements and restrictions.[24] Every jurisdiction provides for some statutory control of the nonprofit corporation, however, and there are indications that increasing awareness of the importance of these organizations and the inadequacy of existing legislation will lead to significant revisions of present code substance.[25] Nonetheless, through inadequate coverage and lack of organization present law can cause confusion. One aspect of state

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and legal actions, and the efficacy of those safeguards in the recent past, are discussed in text accompanying notes 128-36 *infra*.

21. The standing of nonprofit corporation members to institute derivative actions against mismanagement is the subject of part IV(b) of this Note. *See* text accompanying notes 112-36 *infra*.

22. One practitioner has suggested that prospective incorporators should not confer membership status as a public relations device, but rather should restrict such standing to those with a legitimate interest in the nonprofit corporation. Bromberg, *supra* note 7, at 154. The proposals made hereafter in this Note accept this as the proper view, and thus relate to all members with the caveat that the term is intended to mean *members who have a demonstrable economic or personal interest in the welfare of the organization*. To restrict consideration only to those with a significant economic investment would be inappropriate, as the memher of a society, club, church, civic group, or any other nonprofit organization may have a legitimate stake in nonprofit corporation welfare notwithstanding the lack of personal investment or contribution of wealth.

23. An examination of the idiosyncracies of each state nonprofit code would be unduly burdensome. To avoid confusion and repetition, specific statutory variations or holdings will be isolated only when important.

24. Chidlaw, *Non-Profit and Charitable Corporations in Colorado*, 36 COLO. L. REV. 9 (1963); Henn & Pfeifer, *Nonprofit Groups: Factors Influencing Choice of Form*, 11 WAKE FOREST L. REV. 181, 207 (1975).

25. See the discussion of the 1970 revision of New York nonprofit corporation law at text accompanying notes 42-45 *infra*.

regulation of nonprofit corporations initially providing difficulty is the nonuniform approaches employed by various jurisdictions in structuring statutory requirements. The three basic schemas presently in use are: consolidated state acts substantially following the Model Nonprofit Corporation Act (the Model Act),[26] consolidated acts not comparable to the Model Act, and business corporation codes that include sections applicable to nonprofit corporations.[27] Each form will be outlined briefly.

The Model Act (last updated in 1964) has been adopted in whole or in large part by over a dozen jurisdictions, and many of its substantive provisions are reflected in other consolidated state acts.[28] It consists of one hundred sections that in essence parallel the approach and organization of most business corporation statutes. With the exception of cooperatives, labor unions, and insurance-related concerns, the Model Act would apply to all domestic nonprofit corporations existing within the adopting state.[29] The drafters have stated that the Model Act was intended to provide a more complete treatment of the nonprofit corporation area as well as to preserve fiexibility to deal with new developments in the field.[30] Nevertheless, the Act primarily was designed as an enabling statute, and as such does not catalogue exhaustively the rights and obligations of interested parties or set forth remedies for specific improper activities that might occur. The drafters of the Model Act believed that to do so would detract from the central objective of providing a "basic simple pattern" for nonprofit corporation creation and regulation, and thus left those collateral concerns to individual enacting legislatures.[31] It may be fair to assert, however, that much of the present ambiguity and uncertainty has resulted because of the tendency of adopting legislatures simply to adopt the

26. MODEL ACT, *supra* note 14.

27. This is a genral breakdown only; there is much variance in the statutes in any of the three categories, especially as to provisions relating solely to one "type" of nonprofit organization.

28. ALA. CODE ANN. tit. 10, §203 (1959); ALAS. STAT. § 10.20.005 (1962); D.C. CODE ANN. § 29-1001 (1973); GA. CODE ANN. § 22-2101 (1970); IOWA CODE ANN. § 504.1 (1946); MONT. REV. CODE § 15-2301 (1947); NEB. REV. STAT. § 21-1901 (1974); N.C. GEN. STAT. § 55A-1 (1975); N.D. CENTURY CODE ANN. § 10-24-01 (1960); ORE. REV. STAT. § 61.005 (1975); TEX. CIV. STAT. ANN. art.1396, § 1.01 (1962); VA. CODE ANN. § 13.1-201 (1973); WIS. STAT. ANN. § 181.01 (West 1957). Consolidated state acts closely following the Model Act in many respects include ILL. STAT. ANN. tit. 32-163a, § 32-163a-1 (Smith-Hurd 1970); OHIO CODE ANN. § 1702.01 (Page 1964).

29. MODEL ACT, *supra* note 14, §§ 3-4.

30. *Id.* at vii.

31. *Id.* at ix.

skeletal Model Act provisions and to leave the flesh and blood of nonprofit corporation law to be filled in by the judiciary. Unfortunately, the relatively small number of cases dealing generally with associational relationships have not sufficiently rounded out the law of nonprofit corporations in many jurisdictions. At least the Model Act provides a logical and organized set of basic incorporation requirements and post-incorporation procedures such as meeting, quorum, and periodic reporting requirements that are preferable to the treatment in many non-Act states, and courts in the adopting states can benefit from interpretations of the uniform sections in other adopting jurisdictions.

A second group of states have promulgated individual consolidated acts that differ significantly *inter se*.[32] In many of these state codes, one group of provisions applies generally to all nonprofit corporations, while separate segments relate specifically to one type of nonprofit organization, such as marketing cooperatives[33] or fraternal societies.[34] A few such consolidated acts incorporate by reference certain sections of the state business corporation statutes.[35] While these nonprofit corporation laws vary greatly in terms of complexity, all provide an enabling mechanism for creation of the nonprofit entity, set forth allowable purposes for such organizations, describe any applicable periodic reporting requirements, and grant to some state officer or agency (usually the Secretary of State or Attorney General) the authority to investigate allegations of misconduct and to enforce the statutory requirements.[36]

Some jurisdictions have not enacted a unified set of provisions relating solely to nonprofit corporations. In these states nonprofit organizations are regulated by certain sections of the general business corporation law.[37] Such an approach literally can force the practitioner to search through all of the business corporation laws for applicable sections, often relying upon references to "stockhold-

32. *E.g.*, ARK. STAT. ANN. § 64-101 (1966); IND. STAT. ANN. § 23-7-1.1-1 (Burn's 1972); KY. REV. STAT. ANN. § 273.160 (1970); LA. REV. STAT. ANN. § 12:201 (1969); ME. REV. STAT. ANN. tit. 13 § 901 (1964); MICH. STAT. ANN. § 21.62 (1974); MINN. STAT. ANN. § 317.01 (1969); MISS. CODE ANN. § 79-11-1 (1972); MO. ANN. STAT. § 355.010 (Vernon 1966).

33. *See, e.g.*, ARIZ. REV. STAT. § 10-701 (1956).

34. *See, e.g.*, REV. CODE WASH. ANN. § 24.20 (1969).

35. *See, e.g.*, CAL. CORPORATIONS CODE § 9002 (West 1955).

36. The relative efficacy of existing state supervisory schemes is discussed hereafter. *See* text accompanying notes 129-36 *infra*.

37. *E.g.*, DEL. CODE ANN. § 8-101 (1975); HAWAII REV. STAT. § 416-1 (1968); IDAHO CODE § 30-101 (1967); MASS. GEN. LAWS ANN. § 155-1 (1970). In some of these jurisdictions, a few sections specifically applicable to nonprofit corporations are inserted in the business corporations act. *See* TENN. CODE ANN. §§ 48-601 to 608 (1964).

ers and members," or to "all domestic corporations," or upon annotations to a nonprofit corporation case to discover whether a given section directly applies or may provide a useful analogy.[38] These difficulties in interpretation can be especially distressing when a supposedly applicable section seems inconsistent with the nature of the particular nonprofit corporation.[39] In these "afterthought" jurisdictions,[40] the drafter of nonprofit corporation documents may be unsure of the required information that must be provided in incorporation documents or periodic reports, or unable to provide certain facts that actually have relevance primarily to "for profit" corporations.[41] While the subsequent discussion of membership rights generally concerns all jurisdictions, a basic need for overall statutory reform with respect to nonprofit corporations is particularly pressing in those jurisdictions without consolidated acts.

One state statutory scheme, due to its novelty and potential importance, deserves brief characterization. New York in 1970 substantially revised and expanded its nonprofit corporation code, promulgating a "not-for-profit corporation law"[42] that in many respects represents a radical departure from the previously discussed approaches. The provisions generally are more complex than their counterparts in the Model Act, and mirror the length and sophistication of most business corporation statutes. Nonprofit corporations are "typed" into four categories under the New York law, one of which expressly allows formation of nonprofit groups for certain "business" purposes.[43] Further, the code appears to allow creation of complicated tiers of controlled and controlling nonprofit corporations, analogous to holding company formation under business corporation or banking laws.[44] Although certainly innovative, the New York law has been criticized on several grounds, including the

38. *See* Chidlaw, *supra* note 24, at 18-21 (discussing problems of interpretation in the Colorado statute).

39. *Id.* at 19-20.

40. The phrase is Professor Oleck's. *See* OLECK, *supra* note 4, at 32.

41. For example, much of the information required in periodic reports under business corporation statutes may concern dividend rates, etc. — information simply inapplicable to the nonprofit corporation.

42. N.Y. NOT-FOR-PROFIT CORP. LAW § 201 (McKinney 1970).

43. The "Type C" nonprofit corporation under the New York act is an organization not-for-profit created expressly to transact business for any legal purpose as set forth in the code. A detailed examination of the New York act, including the Type C provisions, appears in Note, *New York's Not-for-Profit Corporation Law*, 47 N.Y.U.L. REV. 761 (1972). *See also* Weeks, *The Not-For-Profit Business Corporation*, 19 CLEV. ST. L. REV. (2) 303 (1970).

44. *See* Pasley, *Organization and Operation of Non-Profit Corporations—Some General Considerations*, 19 CLEV. ST. L. REV. (2) 239, 242 (1970).

charge that it resulted from legislative misconception of the appropriate nature of nonprofit corporation organization and operation.[45] Whether the New York nonprofit code is a harbinger of future revisions in other jurisdictions and the method by which such revisions might be accomplished remains an open question, but the increased flexibility and sophistication it allows in the nonprofit corporation area emphasizes the need to resolve presently existing ambiguities concerning membership rights. If other states follow the New York approach, nonprofit corporation affairs will become increasingly complex, and members unable to assert established rights would likely become lost in the infrastructure and ignored by management.

III. Membership Voting Rights

With a brief survey of applicable state nonprofit corporation law complete, the first major issue to be addressed concerns the limitations that may be placed on members' rights to vote on nonprofit corporation affairs. The following discussion will set forth the legal means by which such restrictions may be accomplished, examine members' past efforts to void or avoid such corporate actions, analyze the justification for allowing such limitation or denial, and propose a means by which increased recognition and protection may be given to the member's legitimate voting interest in major corporate decisions.

Under the Model Act, a nonprofit corporation member may be denied voting rights by a provision to that effect in the articles of incorporation or the by-laws. Section 15 of the Model Act provides in appropriate part:

> 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.
>
> . . .
>
> If a corporation has no members *or its members have no right to vote*, the directors shall have the sole voting power.[46]

With some variation in language, the states that substantially have adopted the Model Act all have retained this approval of corporate discretion to modify members' voting rights.[47] Further, most non-

45. For a step-by-step criticism of the alleged "pitfalls" in the New York statute, see Oleck, *supra* note 4, at 46-50.

46. Model Act, *supra* note 14, § 15 (emphasis added).

47. *See, e.g.*, Ga. Code Ann. § 22-2503(a) (1970); Neb. Rev. Stat. § 21-1914 (1974); Ore. Rev. Stat. § 61.111 (1975); Va. Code Ann. § 13.1-217 (1973).

Act jurisdictions either expressly or implicitly allow potential limitations on voting rights.[48] The underlying rationale of this legislative policy is at best difficult to discover or construct. Voting provisions similar to section 15 of the Model Act often are recommended by reform commissions with no further explanation than a citation to the Act or to a few jurisdictions that have enacted a parallel provision.[49] While it has been asserted that the Model Act voting section reflects the influence of business corporation law in failing to protect the individual member,[50] that explanation is both inadequate and illogical. General business corporation law, although granting broad discretion to management in many instances, does provide several enforceable rights directly to shareholders and does not allow disenfranchisement. Moreover, recent case law arguably has expanded the shareholder's role in corporate decision-making.[51] As will be discussed hereafter, while the legislative imprimatur placed upon denial of voting rights to members of nonprofit corporations appears to be based primarily on the belief that nonprofit corporation management is in a different situation from business corporation directors, and thus requires added discretion, such sanction creates the potential for injustice to members with valid voting interests and for misuse of nonprofit corporation funds.

Given statutory voting sections that provide for potential denial of voting rights through nonprofit corporation by-laws, the disillusioned plaintiff-member has little chance for success in a legal challenge to his disenfranchisement.[52] Courts understandably are hesitant to establish greater membership rights by decision when the legislature has had a similar opportunity and has failed to act. The following examination of major cases dealing with members' efforts to establish judicial recognition of a right to vote will consider the primary theories that have been asserted by the courts in upholding restrictive nonprofit corporation by-laws. The case law generally

48. *See, e.g.*, DEL. CODE ANN. § 8-215(b) (1975); ILL. STAT. ANN. § 31-163a-14 (Smith-Hurd 1970); MICH. STAT. ANN. § 21.123 (1974).

49. *See* 2 TENNESSEE LAW REVISION COMMISSION, BUSINESS CORPORATIONS STUDY, NON-PROFIT CORPORATIONS 80 (1964); R. BOYER, NONPROFIT CORPORATION STATUTES 161-62 (1957).

50. Note, *Removal of Voting Power from Members of Non-Profit Organizations*, 16 CLEV.-MAR. L. REV. (2) 384, 390 (1967).

51. *See, e.g.*, Sensabaugh v. Polson Plywood Co., 135 Mont. 562, 342 P.2d 1064 (1959) (business corporation may not deprive shareholders of cumulative voting rights through restrictive by-law); Auer v. Dressel, 306 N.Y. 427, 118 N.E.2d 590 (1954) (*inter alia*, stockholders have inherent right to remove directors notwithstanding charter provision giving board of directors such power).

52. The standing of a member to litigate personal claims is discussed in text accompanying notes 92-111 *infra*.

indicates that, to demonstrate a protected interest in voting, a member must show the existence of a vested right to participate in corporate decision-making, and further must justify going beyond the terms of the member-corporation contract evidenced by the charter and by-laws. This "bound by the by-laws" theory in nonprofit corporation law has been approved judicially at least since the 1912 decision in *Boston Club v. Potter*,[53] in which the Massachusetts Supreme Court found that the defendant-member could resign from the club without further liability for membership dues only if he accomplished the resignation in accordance with the contractual requirements of the by-laws. The Supreme Court of Oklahoma more recently reiterated the application of this viewpoint to disputes between a member and a nonprofit corporation,[54] stating: "It is patent that the by-laws . . . constitute a contract between the members . . . ."[55] The court further observed that the act of joining a nonprofit corporation, in and of itself, provides sufficient evidence of the member's assent to the contractual by-law provisions to bind him to their substantive requirements.[56] Because this contract theory will preclude any initial presumptions of invalidity of a restrictive by-law, dissenting members have attacked such voting clauses as restrictions so unreasonable that they are unenforceable, have argued that membership status by nature encompasses a vested right to vote on corporate matters of importance, or have asserted that their right to vote is protected constitutionally.

Arguments based on an unreasonable regulation theory seldom carry much weight in the face of statutory approval of restrictions on or denial of membership voting rights. In two Illinois cases, *American Aberdeen-Angus Breeders' Ass'n v. Fullerton*[57] and *People ex. rel. Hoyne v. Grant*,[58] precisely such challenges were rejected. The *Aberdeen-Angus* plaintiffs claimed that an amended corporate by-law preventing cumulative voting for directors was an impermissible attempt to regnlate the conduct of members. While the state supreme court acknowledged that the argument would be appropriate under the business corporation laws,[59] it noted that the nonprofit corporation statutes did not operate similarly in plaintiffs' favor.

53. 212 Mass. 23, 98 N.E. 614 (1912).
54. Oklahoma Ass'n of Ins. Agents v. Hudson, 385 P.2d 453 (Okla. 1963).
55. *Id.* at 455.
56. *Id.* at 456; *accord*, Mackey v. Moss, 175 So. 2d 749, 752 (Ala. 1965).
57. 325 Ill. 323, 156 N.E. 314 (1927).
58. 283 Ill. 391, 119 N.E. 344 (1918).
59. 325 Ill. at 328, 156 N.E. at 316-17.

Emphasizing that the applicable code provision ". . . does not provide that the members shall be authorized to vote for directors,"[60] the court found the restrictive by-law to be a valid and binding internal contractual provision. In *Grant*, members of the American Medical Association asserted that they were entitled to vote for the corporate trustees notwithstanding a by-law providing that trustees were to be elected by a group of delegates much smaller in number than the entire membership. The court advanced two lines of reasoning in support of its decision upholding the restrictive by-law: the members of a nonprofit corporation were not in a similar position to that of a shareholder in a for-profit organization; and the substance of the provision was consistent with the state nonprofit corporation statute.[61] As the plaintiff-members were unable to present any statutory provision or legal precedent to support their claim, the court refused to find that the voting restriction was an unreasonable restriction of internal corporate affairs.

Similarly, assertions that a member by nature has a vested right to vote on major corporate matters have been received unsympathetically by the judiciary. In *Schutze v. Austin Saengerrunde*,[62] members of an incorporated singing society, who were classified in the by-laws as "passive" members with no voting rights,[63] argued that the provision was void because it purported to deny a vested right of membership. The plaintiffs obtained a preliminary injunction, but were unsuccessful at trial. Applying a contractual analysis to the forty-seven-year-old set of corporate by-laws, the Texas appellate court found that the plaintiffs' vested right argument could prevail only if they could show a direct statutory grant of membership rights beyond those provided in the organization's governing documents. Determining that the Texas nonprofit corporation act provided no guarantee of substantive voting rights beyond those specified in the group's by-laws, the court affirmed dismissal of the complaint and dissolution of the injunction that would have allowed the dissenting members to vote.[64] Moreover, in *In re Sousa's Petition*[65] a New York court declared that because a member of a

60. *Id.* at 332, 156 N.E. at 318.

61. 283 Ill. at 395-96, 119 N.E. at 345-46.

62. 244 S.W.2d 341 (Tex. Civ. App. 1951).

63. "Passive" members under the society's by-laws apparently were those who did not sing at society presentations. *Id.* at 341.

64. *Id.* at 347. *See also* State *ex rel.* Givens v. Superior Court, 233 Ind. 531, 117 N.E.2d 553 (1954).

65. 203 N.Y.S.2d 3 (S. Ct. 1960).

nonprofit corporation had no personal claim to a share of corporate funds or property, a claim that those members had a vested interest in voting was invalid. Again, the state statute applicable in *Sousa* provided that managing boards of nonprofit corporations were to be elected in accordance with provisions of the corporate by-laws, and did not provide that members had a vested interest in participation in corporate decision-making. In light of the statutory language, the court held that "[a] charitable corporation may change its method of electing directors of such a corporation so that the board of directors shall be self-perpetuating and the members of the corporation shall have no vote."[66] An argument comparable to, and often asserted simultaneously with, the vested right theory, that members have certain "inherent powers" which include protected voting interests, has not been asserted successfully in a voting case and appears subject to the counter-argument that, even if such inherent rights did exist, the contractual restrictive by-law evinces the member's voluntary release of his voting interests.[67]

Further, a constitutionally based attack on restrictive by-laws has been rejected in two often-cited cases, *In re Mount Sinai Hospital*[68] and *Westlake Hospital Ass'n v. Blix*.[69] In *Mount Sinai Hospital*, the challenged by-law required vacancies on the hospital board of trustees to be filled through an election held among the surviving trustees. The court reasoned that a member could assert a constitutional right to vote only if he could demonstrate a property interest in the nonprofit corporation similar to the property rights

66. *Id.* at 5.

67. The decision in Randolph v. First Baptist Church, 68 Ohio L. Abs. 100, 103-04, 120 N.E.2d 485, 488-89 (Hamilton County C.P. 1954), includes some discussion of "inherent rights" of church members in the context of a challenge to expulsion. It is difficult to determine the applicability of the *Randolph* reasoning, however, because the opinion is confusing, voting rights issues were not argued, and the court emphasized the "special nature" of the church-member relation.

Indeed, cases involving complaints against the actions of incorporated churches often provide difficult problems of constitutional guarantees of religious freedom that make doubtful their general applicability to nonprofit corporations. While the *Randolph* court rejected the church's argument that separation of church and state issues precluded judicial review of the organization's internal affairs, *id.* at 103, 120 N.E.2d at 488, it acknowledged that other courts had found such a block to judicial interference. *See* Note, *Judicial Intervention in Disputes Over the Use of Church Property*, 75 HARV. L. REV. 1142 (1962).

Under business corporation laws, it has been held that shareholders do have certain inherent or "implied" rights beyond those granted in the governing statute. Campbell v. Loew's, Inc., 36 Del. Ch. 563, 134 A.2d 852 (Ch. 1957). The *Loew's* court did not decide, however, "whether the stockholders can by appropriate charter or by-law provision deprive themselves of this right." *Id.* at 573, 134 A.2d at 858.

68. 250 N.Y. 103, 164 N.E. 871 (1928).

69. 13 Ill. 2d 183, 148 N.E.2d 471, *appeal dismissed*, 358 U.S. 43 (1958).

of a shareholder in a business corporation. Emphasizing the lack of this membership property interest under the facts of the case, and the absence of any voting rights in the member-corporation contract, the New York court rejected plaintiffs' constitutional claim. The *Mount Sinai* court did observe that in some types of nonprofit corporations it was conceivable that a member might demonstrate sufficient proprietary interests to gain constitutionally protected voting rights.[70] The subsequent decision by the Illinois Supreme Court in *Westlake Hospital*, however, went beyond the narrow charitable corporation analysis of *Mount Sinai*, and rejected a constitutional claim to voting rights on the broader ground that a nonprofit corporation member is bound by the contractual nature of the by-laws even when the corporate management has the sole power to amend them under state law. At the time of *Westlake*, the Illinois Constitution directly protected the voting rights of shareholders in business corporations, preventing by-law restrictions of those rights.[71] The court noted that Illinois nonprofit corporation law clearly allowed denial of voting rights through restrictive by-laws, and ruled that ". . . the right of members of a not-for-profit corporation to vote is not constitutionally protected."[72] In response to plaintiffs' contention that self-perpetuating directorships were incompatible with the proper concept and purposes of a nonprofit corporation, the court observed that, whatever the merit of those arguments, they should be directed to the legislature and not to the judiciary.[73]

In only one reported case has a court demonstrated a willingness to engraft protection of membership voting rights onto existing

70. 250 N.Y. at 113, 164 N.E. at 875.

71. ILL. CONST., art. XI, § 3 (1870); *see* Wolfson v. Avery, 6 Ill. 2d 78, 126 N.E.2d 701 (1955); Stroh v. Blackhawk Holding Corp., 117 Ill. App. 2d 301, 253 N.E.2d 692 (1969). In the 1970 Illinois constitutional revision, the voting protection was not included due to the statutory guarantees provided by the business corporation statute. *See* ILL. ANN. CONST., art. 13, § 6 (Smith-Hurd). Not all states previously have provided similar constitutional protection to shareholder's voting rights. *See* Williams v. Davis, 297 Ky. 626, 180 S.W.2d 874 (Ct. App. 1944).

72. 13 Ill. 2d at 196, 148 N.E.2d at 479. The *Westlake* court cited the *Aberdeen-Angus* and *Grant* cases, discussed in text accompanying notes 57-61 *supra*, in support of its position. The *Aberdeen-Angus* opinion points out that a constitutional claim was not present in *Grant*, but states that as the *Grant* court properly recognized "the different character of corporations organized for pecuniary profit and corporations organized not for pecuniary profit," constitutional protection of membership voting rights would be inconsistent with the *Grant* rationale. 325 Ill. at 330, 156 N.E. at 317. Citing this brief discussion, and failing to analyze any arguments favoring plaintiffs' constitutional contentions, the *Westlake* court simply found the members' argument to be without merit. *Id.*

73. 13 Ill. 2d at 196, 148 N.E.2d at 479.

state nonprofit corporation law. The plaintiffs in *Valle v. North Jersey Automobile Club*[74] challenged a restrictive by-law of the defendant club that provided that members, to present a candidate for a vacant directorship, must first have convinced five percent of the total membership to sign a certificate favoring presentation of the candidate. In the face of defendant's vigorous assertion that the members were bound by all properly promulgated by-laws not in conflict with state law, the court found that the by-law effectively denied membership participation in the selection of director candidates since club membership totalled over 100,000, and gaining 5,000 signatures on a candidate's petition practically would be impossible. Rejecting defendant's further complaint that prior "judicial *laissez-faire*" concerning membership voting rights required approval of the by-law, the court concluded that:

> It is incongruous that such an organization, which controls substantial income and assets contributed by its members, should . . . have its electoral process so structured that the persons managing it—its board of directors—may, for all practical purposes, be perpetuated in office. The prospect of possible failure of reelection may help instill in each director a sensitivity to the public trust aspect of his role.[75]

Thus the *Valle* court determined the by-law to be patently unreasonable and ordered both a new election of directors and formulation of a by-law requiring some verification of member candidate petitions that would not prevent presentation of candidates in the future.[76] The court's reasoning is persuasive and its articulation is engaging; three years hence, however, no reported case acknowledges its existence.

The overwhelming majority of judicial responses to members' attempts to gain voting rights notwithstanding a restrictive by-law not surprisingly have upheld the provisions after rather peremptory references to state nonprofit corporation acts. Nonetheless, the legislative policy decision to allow and perhaps to encourage such action by nonprofit corporation management is difficult to defend; the member is denied participation in an organization in which he can assert a legitimate interest, and there is an accompanying potential for misuse of corporate assets by an unbridled directorate. Unless members have voting interests, the nonprofit corporation's management has total control over all major corporate decisions. The Model Act directly provides that if such an organization has no voting

74. 125 N.J. Super. 302, 310 A.2d 518 (1973).
75. *Id.* at 318, 310 A.2d at 526.
76. *Id.* at 319, 310 A.2d at 526-27.

members, decisions concerning the selection and removal of directors,[77] proposed merger with another corporation,[78] sale or exchange of some or all of corporate assets,[79] and voluntary dissolution of the corporation[80] are reserved to a majority vote of the directors. Further, this removal of any member control over corporate action can be effectuated under the Model Act by an amendment to the by-laws at any time, and the right to amend the by-laws also is reserved to the directors. Section 12 of the Model Act provides:

> The power to alter, amend or repeal the by-laws or adopt new by-laws shall be vested in the board of directors unless otherwise provided in the articles of incorporation or the by-laws.[81]

Thus a member with voting rights and an expectation of participation in corporate affairs may lose that status at any time at the whim of the directorate. Even a protective by-law to the contrary arguably would not be sufficient to save the members' interests, as under the Model Act the management of the corporation has authority to repeal a by-law and insert a new one in its place.[82]

In such a situation it is difficult to conceive of any real value remaining in the grant of "membership status." Cases dealing with the expulsion of members from nonprofit corporations, however, have indicated that a nonprofit corporation member has a sufficient and bona fide interest in the nature of the relationship to trigger due process safeguards in expulsion procedures.[83] Membership status is authorized statutorily and the member has an inherent legal interest that should be recognized. Statutory approval of denial of voting

77. MODEL ACT, *supra* note 14, § 18.
78. *Id.* §§ 38-40.
79. *Id.* § 44.
80. *Id.* § 45.
81. *Id.* § 12.
82. No case appears in which a member has asserted an argument of unconscionability or promissory estoppel against a disenfranchisement occurring subsequent to the memhership relation. As no federal law comparable to the Securities Acts applies generally to actions of nonprofit corporations, it would appear that reasoning such as that used in *SEC v. Transamerica Corp.*, 163 F.2d 511 (3d Cir. 1947), *cert. denied*, 332 U.S. 847 (1948), would not apply by analogy. In *Transamerica* the court held that a "blocking by-law" that prevented shareholder proposals in proxy solicitations unless they had been approved by management was invalid because it conflicted with the policies underlying the federal securities laws. Nonprofit corporation voting, however, is governed by state code provisions only, and whether the revocation of a by-law granting voting rights to the membership and replacement of it with a restrictive by-law, effectuated solely by the directors and without notice to the membership, would be open to attack by members on any of the above grounds is an unanswered question.
83. *See, e.g.*, Weinberg v. Carton, 196 Misc. 74, 90 N.Y.S.2d 398 (S. Ct. 1949) (due process safeguards inhere even when by-laws silent on procedure for expulsion); Briggs v. Technocracy, 85 N.Y.S.2d 735 (S. Ct. 1948) (notice and hearing required prior to expulsion).

rights to members thus is an anomaly that has resulted perhaps primarily from a lack of legislative foresight, and the problem best can be corrected by revision of the voting sections of state nonprofit corporation codes. The *Valle* decision, while no doubt encouraging to members of New Jersey nonprofit corporations, has not inspired similar rulings in other jurisdictions. At least two examples of an attempt to deal legislatively with the problem presently exist. In the most recent version of his *Proposed Uniform Non-Profit Organizations Act*,[84] Professor Oleck has structured the voting section to insure membership voting rights concerning election of directors by stating simply, "[d]irectors other than those named in the certificate of incorporation shall be elected by the members and other persons entitled to vote."[85] Further, that section contains no language approving by-law provisions that limit or deny voting rights of the members. The present Arkansas nonprofit corporation act[86] also guarantees members' participation in the election of directors, providing that "[e]ach member shall be entitled to one [1] vote in the election of the board of directors."[87] This preservation of the member's role in the selection of management clearly represents a more logical and desirable view of the nature of membership status.

In fact, given the alleged magnitude of current problems concerning the misuse of nonprofit corporation assets[88] and a reasonable and realistic recognition of legitimate membership interests in nonprofit corporation affairs,[89] existing state voting statutes are out of focus generally. They should be revised to insure membership voting rights not only in the election of directors, but also in major corporate decisions such as proposed merger, sale, or exchange of assets, and voluntary dissolution. Existing state law allows the organizers of a nonprofit corporation initially to decide whether to have members.[90] Should a corporation decide to have members, it is reasonable to provide statutorily a concomitant requirement that members will have a voice in corporate affairs. Granting membership absent voting rights is an artificial action. Moreover, nonprofit corporations need not designate every contributor a member for public relations reasons; other designations are available or may be created to be

84. OLECK, *supra* note 4, at 961-79.
85. *Id.* at 968.
86. ARK. STAT. ANN. § 64-901 (1966).
87. ARK. STAT. ANN. § 64-911 (1966).
88. *See* text accompanying notes 18-21 *supra*.
89. *See* note 22 *supra* and accompanying text; text accompanying note 91 *infra*.
90. *See, e.g.*, MODEL ACT, *supra* note 14, § 11.

conferred in appreciation.[91] Conversely, the individual with a significant economic investment or personal stake in the association should not be denominated a "member" and then be denied the right to participate. The threshold decision from management's viewpoint just as easily is made at the organizational stage; if corporate organizers desire total control and self-perpetuation, they should indicate their wishes and form a nonmember entity. The statutory distinction between nonmember and member organizations otherwise becomes meaningless. In terms of potential for abuse, choice of the nonmember form at the initial stage of corporate existence will inform state supervisory officials that management will have sole decision-making authority, and stricter scrutiny of subsequent actions therefore may be in order. Only a revision of state laws to so provide can insure that members will not be inequitably prevented from voting on major corporate decisions.

IV. Membership Standing To Sue

The standing of a member to bring suit alleging improper interference with an interest in a nonprofit corporation is another broad area in which issues remain unresolved. Two primary questions will be considered: first, whether the member individually may sue to protect purely personal interests, and secondly, whether he may institute a derivative action on behalf of the corporation to correct alleged mismanagement or other improper or illegal actions. Material to the latter issue are questions concerning the adequacy of supervision exercised by state officials over nonprofit corporation affairs, and the relative value of the established membership right to inspect corporate books and records absent the availability of standing to institute a derivative action by which uncovered improprieties might be attacked.

A. Standing To Assert Individual Claims

To gain judicial scrutiny of a claimed interference with an asso-

91. An alternative would be to protect legislatively the right of a member with a *sufficient economic or personal interest* to vote, and thus allow nonprofit corporations to continue granting membership status to persons with minimal interests without threatening management control. To do so, however, would require that either courts or legislatures determine some standards by which the requisite amount of *interest* necessary to give rise to protected voting rights could be determined. This balancing of interests process surely would lead to inconsistent and uneven protection of the member's franchise. It would seem preferable to require the corporations to characterize those associates who have insufficient interest in the corporation to receive voting rights as something other than "members," and statutorily protect the membership franchise.

ciational relationship, a nonprofit corporation member historically was forced to resort to courts of equity.[92] The development of equity jurisdiction, however, resulted in a judicial tendency to protect only demonstrated property interests while refusing to determine cases involving purely "moral" claims which were essentially personality conflicts.[93] Because the nonprofit corporation member by definition could not claim a right to a pro rata share of organizational profits, difficult questions arose concerning the member's standing to assert alleged violations of his personal rights. As one commentator has observed:

> The incorporation of a non-profit-making association does not put its members in a materially different situation [from the members of a voluntary unincorporated group with respect to standing]. They are not shareholders, and so they must establish some other reasons for equitable relief than the remedies of shareholders with respect to the property and business of the ordinary commercial corporation.[94]

Predictably, several theories arguably justifying standing have been advanced by members of nonprofit corporations wishing to litigate questions of personal interference, and while the variations are too numerous to treat in great detail,[95] they will be summarized briefly. Most of the reported cases in this area have dealt with challenges to the expulsion of members under internal corporate procedures.

In older cases members most often attempted to demonstrate a sufficient "property interest" in the affairs of the nonprofit corporation. Although an increasing number of state courts have recognized a right to common use of corporate property, or to a share of assets at dissolution, as a proprietary right sufficient to confer standing,[96] members of nonprofit organizations not protected by preemptive federal law[97] may find that the asserted property rights

92. *See* Chafee, *supra* note 12; Comment, 37 YALE L.J. 368 (1927).

93. *See Developments—Private Associations*, 76 HARV. L. REV. 983, 998-99 (1963), discussing Rigby v. Connol, 14 Ch. D. 482 (1880) (equity has no jurisdiction in associational rights dispute unless property interest involved).

94. Chafee, *supra* note 12, at 997.

95. For a fuller discussion of these theories, see *id.* at 999-1010. *See also* OLECK, *supra* note 4, at 564-75.

96. *See, e.g.*, Davis v. Scher, 356 Mich. 291, 97 N.W.2d 137 (1959) (members' right to use synagogue equals sufficient interest); Joseph v. Passaic Hosp. Ass'n, 38 N.J. Super. 284, 118 A.2d 696 (App. Div. 1955) (right to earn livelihood through membership status equals sufficient interest); Stein v. Marks, 44 Misc. 140, 89 N.Y.S. 921 (Sup. Ct. 1904) (right to share of assets in event of dissolution equals sufficient interest).

97. For example, the National Labor Relations Act expressly allows members of unions to protest actions of their union that arguably are not in the members' best interest, and provides that the unions must function under an obligation of full and fair representation of the membership. *See* National Labor Relations Act §§ 8(b)(1)(A), (2), 9(a), 29 U.S.C. §§

are characterized in older cases as merely incidental to corporate membership and thus too insubstantial to justify judicial acknowledgment. For example, in *Lawson v. Hewel*[98] the California Supreme Court found that members of a fraternal order who had common use rights in corporation property, were allowed to participate in societal decision-making, and would receive a proportion of associational assets in the event of dissolution, nevertheless did not prove a property interest sufficient to confer standing to challenge societal disciplinary rules. The court characterized the enumerated interests as incidental to membership status. Finding judicial interference to be justified only when "direct" interests were involved, the court ruled that plaintiff-members had no standing to assert their individual claims.[99] While courts may be retreating from this restrictive view, the surviving decisional law may cause problems for the nonprofit corporation member who asserts a property right in the association as a basis for standing.

Other theories to support membership standing have been accepted only occasionally by the judiciary. Under one view, the member-corporation contract evidenced by the charter and by-laws may be attacked under a theory of unconscionability.[100] One drawback to the unconscionability approach, however, is that it most often has been accepted in suspension or expulsion cases, and its value when less crucial, but nonetheless viable, complaints are in issue is less certain.[101] Further, the contract approach to standing encompasses the "bound by the by-laws" theory, and thus for the member can be a two-edged sword, as is demonstrated by the decision in *Real Estate Multiple Listing Exchange v. Rubin*.[102] The

158(b)(1)(A), (2), 159(a) (1970). Title VII of the Civil Rights Act of 1964 also provides that union members in certain situations may have standing to challenge employer actions although the union of which the party is a member has refused to act. *See* Title VII of the Civil Rights Act of 1964, §§ 703-06, 42 U.S.C. §§ 2000e-2 to e-5 (1970). To this extent federal labor law has provided the union member with standing to process individual claims against the particular nonprofit corporation, and thus has preempted the area.

98. 118 Cal. 613, 50 P. 763 (1897). *See also* Weyrens v. Scotts Bluff County Med. Soc'y, 113 Neb. 814, 277 N.W. 378 (1938).

99. 118 Cal. at 615, 50 P. at 764-65. *See also* Minton v. Leavell, 297 S.W. 615 (Tex. Civ. App. 1927).

100. *See, e.g.*, Campbell Soup Co. v. Wentz, 172 F.2d 80 (3d Cir. 1948); Farrall v. District of Columbia A.A.U., 153 F.2d 647 (D.C. Cir. 1946) (improper expulsion equivalent to breach of association-member contract).

101. Further, the member protesting under the contract theory must demonstrate that he has exhausted all available internal procedures, unless those procedures clearly would be futile. *See* Branham v. Benevolent & Protective Order of Elks, Lodge No. 942, 427 S.W.2d 572 (Ky. 1968).

102. 7 Misc. 2d 194, 168 N.Y.S.2d 645 (Rockland County Ct. 1957).

Rubin court found that, due to the contractual nature of the by-laws, the plaintiff-members to succeed would have to find by-law authority for judicial determination of a complaint involving internal corporate relationships or actions. The *Rubin* court observed that unless the by-laws themselves authorized a member's right of action for interference with his interests, judicial scrutiny would be inappropriate.[103] The contract theory of standing also has been criticized on the grounds that it is too artificial and vague; its acceptance logically would require any complaint of a member to be heard, even if frivolous.[104] Another approach sometimes employed is to claim that through the associational relationship the members have become in essence the beneficiaries of an implied charitable trust whose rights are protected judicially.[105] The trust theory arguably is useful, however, only when the corporate management (the "trustees") are in some manner misusing assets of the organization to the detriment of the membership.[106] Moreover, courts generally have been reluctant to imply enforceable trust relationships absent some specific indication of intent of the parties. The efficacy of the trust approach also is weakened by the tendency of some prospective plaintiffs to assert it even when it is not clear that they are members of the defendant nonprofit corporation. In *Miller v. Alderhold*,[107] for example, students at a private nonprofit university advanced the implied trust doctrine in a suit challenging misuse of university assets by the board of trustees. The court affirmed dismissal of the complaint, emphasizing the tenuous financial interests demonstrated by plaintiffs, the lack of formal membership status, and the absence of any express trust language in the university charter.[108] Thus neither the contract nor trust approaches presents to the member wishing to challenge infringement of individual interests in a nonprofit corporation a generally acceptable justification for standing.

In fact, the property, contract, and trust approaches all primarily are inadequate because each prevents a realistic determination of the membership standing issue. The question should be whether the alleged infringement states a claim upon which relief can be

103. *Id.* at 196, 168 N.Y.S.2d at 647.

104. *See* Chafee, note 12 *supra*, at 1001-07.

105. *Cf.* Local 1140, United Elec. Workers v. United Elec. Workers, 232 Minn. 217, 45 N.W.2d 408 (1950) (members as beneficiaries); Trustees v. Taylor, 359 Mo. 417, 221 S.W.2d 964 (1949) (general public as beneficiaries).

106. *See Developments, supra* note 93, at 1003.

107. 228 Ga. 65, 184 S.E.2d 172 (1971).

108. *Id.* at 69, 184 S.E.2d at 175.

granted; sufficient interest inheres in the instance of membership itself to satisfy preliminary procedural concerns. Over forty years ago, Professor Chafee stated that:

> Judicial consideration must be given to the seriousness of the injury . . . . Sometimes the relation, unlike membership in business corporations and partnerships, may involve only interests of personality, but the courts should still consider whether justice and policy require them to protect it.[109]

This more realistic approach allows courts to sift out those claims that are frivolous or calculated to harass by simply finding that the claimed infringement is not one for which the law grants a remedy. An examination of proprietary rights is unnecessary if it is recognized that membership status in itself confers standing to assert an individual claim. While there are indications that this view is gaining more and more acceptance,[110] the residue of older, more restrictive cases justifies a reassertion of the "moral right" or "natural right" approach to membership standing.[111] Under this approach, the instance of the relationship is evidence of sufficient member interest to allow presentation of the merits of a claim. Hopefully, future state court cases in which the threshold standing issue arises will examine the specific infringement alleged in determining whether a justiciable question exists.

B. Standing To Sue Derivatively

Another question involving membership standing is whether a member is entitled to bring a derivative action on behalf of the nonprofit corporation against directors or officers for breach of fiduciary duty or illegal action.[112] No such provision appears in the Model Act or in most consolidated state acts.[113] In those jurisdictions in which the business corporation provisions are applicable to nonprofit corporations, derivative suit sections often are phrased only in terms of shareholders and do not mention members.[114] Further problems may develop for the member due to frequent recitations in business corporation cases that derivative suits may be

109. Chafee, *supra* note 12, at 1008.

110. *See* OLECK, *supra* note 4, at 571-72.

111. The term "natural rights" is used by Professor Oleck as descriptive of the same viewpoint. *Id.*

112. For a discussion of the fiduciary duties and obligations of association officers and directors, see Pasley, *Non-Profit Corporations—Accountability of Directors and Officers*, 21 BUS. LAW. 621 (1966).

113. The New York code provision is discussed in text accompanying notes 125-26 *infra*.

114. *See, e.g.*, DEL. CODE ANN. ch. 8, § 327 (1974); TENN. CODE ANN. § 48-718 (1964) (expressly concerning only "for profit" corporations).

instituted only by shareholders, directors, or officers of a corporation.[115] Thus the member may be forced to argue that he is included in the business corporation derivative suit section *sub silentio*, but holdings in older cases may undercut that argument. In *First United Presbyterian Church v. Young*,[116] a group of member-plaintiffs sued to enjoin a proposed merger between their church and another. Plaintiffs alleged that derivative standing was implied under a statute providing that "members in good standing" could vote for directors. Although the court expressly did not reject plaintiffs' arguments that their minority interests and those of the body corporate might be damaged by the merger, it found that only trustees of the church had standing to bring a derivative action and dismissed the suit.[117] Commentators also have doubted the existence of the derivative right in members of a nonprofit corporation. One writer has stated that, in its broadest form, a corporate remedy could be brought by "the corporation itself, a receiver, a trustee in bankruptcy, another officer or director, a judgment creditor, or, in the case of a [nonprofit] corporation having capital stock, a shareholder bringing a derivative suit in the right of the corporation."[118] The list obviously excludes the nonstockholding member, who is of primary concern in the nonprofit corporation since most such organizations issue no capital stock.[119]

Nonetheless, the member desiring to bring a derivative action is not without some legal support. One writer has argued in favor of a derivative right of action, stating:

> Another danger is that non-profit corporations, partly because of their charitable character, have a public image which can be usurped by being used as fronts for illicit interests . . . . Remedies equivalent to a shareholders' derivative action should be available to members of nonprofit corporations.[120]

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115. *See, e.g.*, Stockton v. Ortiz, 37 Cal. App. 3d 167, 111 Cal. Rptr. 617 (Cal. App. 1974), *vacated on other grounds*, 47 Cal. App. 183, 120 Cal. Rptr. 456 (1975) (only shareholders, officers, directors, or creditors allowed to bring derivative suit).

116. 29 Ohio Dec. 477 (Muskingum C.P. 1918), *aff'd without decision*, Apr. 29, 1919 (Ct. App.).

117. The court found this power in the board of trustees by analogizing from an existing section of the business corporation statute that provided:

> The corporate powers, business and property of corporations formed under this title shall be exercised, conducted and controlled by the board of directors; or, if there is no capital stock, by the board of trustees.

Id. at 479.

118. Pasley, *supra* note 112, at 635.

119. While some state nonprofit corporation codes allow such organizations to issue stock, many do not (hence the term "nonstock" corporation is used often). Further, many corporations with members in those states allowing issuance of shares opt simply to grant membership certificates or statements.

120. Lesber, *supra* note 4, at 966.

A few courts, moreover, appear to have been convinced that the need for such a remedy outweighs counter-arguments centering on lack of direct statutory authority. The California Court of Appeals, in *Horner v. Marine Engineers' Benevolent Ass'n, No. 97*,[121] held that a union member had standing to bring a derivative action against union officers for misuse of corporate funds even though the member could not establish any particularized individual damage. In *In re Cleveland Savings Society*,[122] however, an Ohio court ruled that a member could sue derivatively only when a solely corporate injury was alleged and thus disallowed a derivative suit based on combined damage incurred by the minority class of members. Further complicating the matter, the third case to find a derivative right of action in members did not qualify its holding in any manner. In *Valle v. North Jersey Automobile Club*,[123] the plaintiff-members asserted that they were included by implication in the derivative suit section of the New Jersey business corporation law. While the defendant club argued that the legislature would have included members expressly had it so intended, the court rejected that assertion, stating, "[t]here can be no question that the term 'shareholder,' as employed in [the business corporation statute], includes a 'member' of a nonprofit corporation who seeks to proceed on a derivative cause of action."[124] Therefore the *Valle* court proceeded to the merits of plaintiffs' claim. Three decisions thus have ruled that some member's derivative rights exist, although *Cleveland Savings Society* would allow such actions only when a purely corporate interest allegedly has been infringed. It also is unclear whether courts in most consolidated act jurisdictions would be willing to imply a derivative cause of action when the applicable nonprofit corporation act is silent. These problems in establishing a uniform derivative cause of action through case law suggest that a legislative response would be preferable since the remedy is both justifiable and desired.

An example of the ease with which such a statutory derivative cause of action can be instituted is the derivative suit section of the New York Not-for-Profit Corporation Act.[125] In three brief para-

121. 1 Cal. Rptr. 113 (Dist. Ct. App. 1959).

122. 90 Ohio L. Abs. 3, 183 N.E.2d 234 (Ct. App. 1962).

123. 125 N.J. Super. 302, 310 A.2d 518 (1973).

124. *Id.* at 308-09, 310 A.2d at 521. The decision on the merits in *Valle* is discussed at text accompanying notes 74-76 *supra*.

125. N.Y. NOT-FOR-PROFIT CORPORATIONS § 623 (McKinney 1970), provides in appropriate part:

graphs, that section provides that any individual with membership status at the time suit is initiated may sue derivatively on behalf of the nonprofit corporation. The one limitation in the New York statute is that five percent of the total membership must be willing to join as plaintiffs.[126] Given the difficulty of achieving uniformity through state decision law,[127] it is submitted that the New York approach should be followed by those legislatures willing to recognize the need for an additional check on the actions of nonprofit corporation management.

The need for member derivative actions is apparent given the present lack of adequate safeguards to prevent misuse of nonprofit corporation assets by individuals in management positions. Most jurisdictions give continuing supervisory authority over nonprofit corporation actions to the Secretary of State or the Attorney General's office (as does the Model Act).[128] In some states the appropriate official may be limited to a *quo warranto* action to dissolve,[129] while in others authority is granted to take any action necessary to enforce the nonprofit corporation law.[130] Since members do not share the profit maximization concerns of the business corporation stockholder, in theory they would not be interested similarly in internal policing of the nonprofit corporation.[131] Statutory provision for state

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(a) An action may be brought in the right of a domestic or foreign corporation to procure a judgment in its favor by five percent or more of any class of members or capital certificate holders of record or owners, not of record, of a beneficial interest in the capital certificates of such corporation.

(b) In any such action, it shall be made to appear that each plaintiff is such a member, holder or owner at the time of bringing the action.

(c) In any such action, the complaint shall set forth with particularity the efforts of the plaintiff or plaintiffs to secure the initiation of such action by the board of [sic] the reason for not making such effort.

126. The reasoning behind the aggregate-joinder requirement apparently is that it will prevent institution of frivolous litigation; whether the limitation has been successful in so deterring plaintiffs without justiciable or meritorious claims is unclear. *See* Note, *supra* note 9, at 787-88.

127. With 50 state codes in effect and the infrequency of state or federal supreme court decisions on the subject, it would appear that statutory creation of the derivative suit right is the only reasonable means of avoiding uncertainty in the area by solidly establishing the right in jurisdictions in which the legislature is willing to act.

128. *See, e.g.*, MODEL ACT, *supra* note 14, §§ 87-90.

129. *E.g.*, NEB. REV. STAT. ANN. § 21-1950; GEN. STAT. N.C. ANN. § 55A-51.

130. *E.g.*, ILL. STAT. ANN. § 32-163a-96 (Smith-Hurd 1970); REV. CODE WASH. ANN. § 24.03.440. In many states, the Secretary of State is given the authority to administer the provisions of the nonprofit corporation act concomitantly with the authority of the Attorney General to bring a *quo warranto* action to dissolve under certain specified conditions. *See also* Sheard, *Forfeiture of Non-Profit Corporation Charters*, 14 CLEV.-MAR. L. REV. (2) 253, 254-56 (1965).

131. This reasoning, however, is unpersuasive when the member does have common use

supervision thus appears reasonable. This assumption that members generally are uninterested in the actions of nonprofit corporation management, however, is belied by past membership efforts to institute suit on behalf of the organization.

Further, the present system of state supervision increasingly has been subjected to severe criticism. One complaint is that even a broad grant of supervisory authority to state officials "may be tantamount to no enforcement powers at all,"[132] due to the increase in the number of nonprofit corporations and to the limited resources available for policing nonprofit corporation management. An analogous state supervisory duty, the power and obligation to scrutinize the maintenance of charitable trusts, has been characterized as providing inadequate protection because state officials already are too overburdened with other duties and are too concerned with political pressures to do a competent job.[133] Certainly there are few state-instituted enforcement actions on record, and as one writer has stated:

> When the number of charters which have been granted is compared with the number of forfeitures it is apparent that one of two situations prevails. Either the organizations and their operations are extremely law abiding or they simply are not being supervised with enough vigor by those charged with keeping them honest.[134]

Compounding the problems raised by such complaints are decisions holding that the state supervisory official is an indispensible party to *quo warranto* actions, by whomever instituted.[135] Conceivably, even another officer or director wishing to attack allegedly improper corporate activities could be stymied by failure to convince the state to join in the action.

A final criticism of the efficacy of state supervision of nonprofit corporations is in fact an argument in favor of the member's derivative action. It has been asserted that even where the power and

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rights in corporate property or other strong personal or economic interests in the nonprofit corporation. In such a situation, the member may believe that be has as much to lose from gross mismanagement or illegal corporate action as does the shareholder in the business corporation.

132. *See* Note, *supra* note 9, at 790.

133. *See* Bogert, *Proposed Legislation Regarding State Supervision of Charities*, 52 MICH. L. REV. 633 (1954); Note, *State Attorney General—Guardian of Public Charities ???*, 14 CLEV.-MAR. L. REV. (2) 236 (1965).

134. Sheard, *supra* note 130, at 264. *See also* Moody, *Non-Profit Corporations—A Survey of Recent Cases*, 21 CLEV. ST. L. REV. (3)6, 43 (1972).

135. *See, e.g.*, New Liberty Med. & Hosp. Corp. v. E.F. Hutton & Co., 474 S.W.2d 1 (Mo. 1971) (suit dismissed when state authorities had not joined as co-plaintiffs).

interest exist, legislation is necessary to give state officials some means of discovering information concerning nonprofit corporation activities.[136] A membership with the right to institute a derivative action could obtain an awareness of management activity both through the associational relationship and through the statutorily conferred power of members to examine corporate books and records upon request. Section 25 of the Model Act, and the nonprofit corporation codes of almost every jurisdiction, require that a nonprofit corporation keep accurate minutes, accounts, and records of transactions and other activities.[137] The Model Act further provides that "[a]ll books and records of a corporation may be inspected by any member, or his agent or attorney, for any proper purpose at any reasonable time."[138] Even absent statutory access to such information, the Maryland Court of Appeals recognized in *Parish v. Maryland & Virginia Milk Producers Ass'n*[139] that nonprofit corporation members had a common law right to such inspections. In so holding, the court exempted members from the five percent joint-shareholder-demand requirement of the business corporation inspection section then in effect, thus giving members broader rights of inspection than those available to shareholders.[140] Similarly, in *Bill Reno, Inc. v. Rocky Mountain Ford Dealers' Ass'n,*[141] the Colorado Supreme Court reversed dismissal of a complaint on the ground that an allegation of interference with a member's statutory right to inspection of nonprofit corporation books and records was sufficient to state a cause of action.

Thus the member's right to inspection of corporate books and records may be viewed as a factor militating in favor of standing to institute a derivative action. While state officials may have neither the familiarity with nonprofit corporations nor the resources with which to supervise management actions adequately, the individual member who is interested in the welfare of the organization to which he belongs is not so limited. Certainly there is potential for some internal policing through the vehicle of a derivative action, and

136. Note, *supra* note 133, at 238.

137. Although the specificity in comparable sections across jurisdictions varies, the substance of the requirements closely follows the Model Act.

138. MODEL ACT, *supra* note 14, § 25. The Louisiana statute, however, restricts access to corporate books and records to *voting* members, perhaps because at the time of enactment it was believed that only voting members would have standing to sue. LA. STAT. ANN. § 12:223(c) (1959).

139. 250 Md. 24, 57, 242 A.2d 512, 547 (Ct. App. 1968).

140. *Id.* at 58, 242 A.2d at 548.

141. 151 Colo. 406, 378 P.2d 206 (1963).

there is a further possibility that state officials would be less burdened if members provided some check on nonprofit corporation management. While the member's derivative action likely would not become a magic wand, the continuous waving of which would prevent any future misuse of nonprofit corporation assets, such action could be of significant value. Moreover, a statutory provision creating such a right of action may be drafted simply and effectively and could be passed with dispatch by a truly concerned legislature.[142]

V. CONCLUSION

This Note has focused on three issues concerning membership in nonprofit corporations: whether members are entitled to increased protection of voting rights; whether state courts adequately have analyzed questions of membership standing to assert individual claims; and whether members should have standing to institute derivative actions on behalf of a nonprofit corporation. In each of these areas membership rights deserve increased legal recognition and protection.

With respect to standing to litigate an individual claim, the judiciary uniformly should recognize that it is the nature of the alleged infringement, rather than a fictional construct of the type of interest inherent in the relationship, that is the proper object of consideration. Membership status in itself represents a sufficient relationship to justify standing unless the claim is frivolous or intended to harass. The remaining two problems best are corrected through statutory revision that directly provides increased membership protection. Existing state code provisions allowing limitation or denial of member's voting rights should be replaced with a section that guarantees a right to vote in major corporate decisions. A member's derivative cause of action may be created through the addition of a provision similar to section 623 of the New York nonprofit laws.

These suggestions are not radical, but logical and needed. While it is surprising that such gaps in membership rights presently could exist, inertia provides no excuse for further neglect. The po-

142. Certainly the member's derivative action, if successful as a policing mechanism, would be more economical than the dual system of federal and state SEC-type supervisory agencies that Professor Oleck has suggested may be necessary to combat misuse of nonprofit corporation funds. *See* OLECK, *supra* note 4, at 906. Even if this more structured, external control approach should prove to be necessary, the member's derivative suit could provide a useful internal complement thereto.

tential for inequity will remain until steps are taken to insure that the legitimate interests of the nonprofit corporation member properly are perceived and protected.

ROBERT HAMMEL BROWNLEE