

## CHAPTER III

# Nonprofit Corporations Generally

### I. COVERAGE

**T**HESE sections are the most comprehensive of all the statutory provisions herein studied. They encompass many types of corporations for which more specific statutes may also be provided. It will be readily apparent that churches, charitable foundations, labor organizations, secret fraternal societies, organizations of professional men, patriotic associations, cemeteries, and countless other groups either are or may be nonprofit organizations. The nature of these groups may range from a small bird-watching society with practically no funds to huge foundations or charitable trusts endowed with millions of dollars. They may vary from solitary units with a handful of members to vast international organizations with millions of members. They may encompass units whose sole purpose is social or cultural as well as those which control particular types of employment or exert vast political and economic influence. Clearly, the formulation of intelligent, flexible, and just provisions sufficiently comprehensive to provide adequately for this multitude of divergent groups is a challenging task.

The incorporation of the nonprofit social type of organization is governed in Michigan by the provisions of sections 117 to 132a of the General Corporation Act.<sup>1</sup> Practically all types of social, political, historical, cultural, scientific, literary, and similar organizations with a lawful

<sup>1</sup> Mich. Pub. Acts 1931, No. 327 as amended; Mich. Comp. Laws secs. 450.117 to 450.132a (1948).

and nonprofit purpose may be organized under these sections.<sup>2</sup> Burial and funeral benefit societies, except for three specific exemptions,<sup>3</sup> are excluded since such organizations must conform to the Insurance Code.<sup>4</sup> However, societies for the relief of distressed members which do not pay more than one hundred and fifty dollars on account of any one member may incorporate under these provisions.<sup>5</sup> Further, nonprofit organizations hereinunder incorporated may

<sup>2</sup> Section 132 provides in part: "The provisions of sections 117 to 131, both inclusive, of this act shall be held to apply to all associations, societies and corporations of the nature of clubs, boards of trade and commerce, associations of persons engaged in the same or allied professions, trades, occupations and industries, when such persons desire to associate for mutual benefit, comfort or instruction not involving direct pecuniary profit; and to societies for the advancement of particular scientific or sociological, political views or opinions, the collection and dissemination of historical or scientific facts, the advancement of literature, cultivation of art, the prevention of cruel and inhuman practices, and to any other such society, except . . ." Mich. Comp. Laws sec. 450.132 (Mason's Supp. 1954).

<sup>3</sup> These are the Ladies Lutheran Benevolent Federation of Michigan, the Metropolitan Club of America, Inc., (National Spirit), and the Ladies Auxiliary of the Metropolitan Clubs of America National Spirit. The first two of these organizations were exempted by amendments in 1945 (Mich. Pub. Acts 1945, No. 229 for the Metropolitan Club of America, and Mich. Pub. Acts 1945, No. 326 for the Ladies Lutheran Benevolent Federation), after the Attorney General construed section 132 as prohibiting the Ladies Lutheran Federation from paying death benefits up to \$500 in spite of an express exemption in the Insurance Code, Mich. Comp. Laws sec. 524.29 (1948). The Attorney General's opinion is found in 1945-46 Mich. Ops. Att'y. Gen. p. 246. The exemption in favor of the Ladies Auxiliary of the Metropolitan Clubs was passed in 1952. Mich. Pub. Acts 1952, No. 23.

<sup>4</sup> Mich. Comp. Laws secs. 501.1 *et seq.* (1948). See 1941-42 Mich. Ops. Att'y. Gen. p. 350; 1945-46 Mich. Ops. Att'y. Gen. p. 493.

<sup>5</sup> Mich. Comp. Laws sec. 450.132 (Mason's Supp. 1954). The Attorney General has concluded that this section includes benevolent societies whose relief payments are only incidental to the main purpose, but does not include organizations whose sole purpose is the payment of sick benefits. 1937-38 Mich. Ops. Att'y. Gen. p. 344.

buy and sell products for their members if without direct pecuniary profit.<sup>6</sup>

## II. HISTORY OF THE MICHIGAN STATUTES

As was the prior practice with other corporations,<sup>7</sup> non-profit organizations were incorporated either by specific act or by general acts of rather limited scope. Thus, for example, there were acts to incorporate teachers' associations,<sup>8</sup> musical societies,<sup>9</sup> companies for the detention and apprehension of horse thieves,<sup>10</sup> gymnastic societies,<sup>11</sup> boards of trade and chambers of commerce,<sup>12</sup> polytechnic associations,<sup>13</sup> eclectic medical societies,<sup>14</sup> firemen's associations,<sup>15</sup> engineering societies,<sup>16</sup> merchants' and traders' associations,<sup>17</sup> associations for the prevention of cruelty to

<sup>6</sup> Mich. Comp. Laws sec. 450.132 (Mason's Supp. 1954).

<sup>7</sup> See *supra* chapter 1, sec. 3, History of the Michigan General Corporation Act, p. 7.

<sup>8</sup> Mich. Pub. Acts 1855, No. 117. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>9</sup> Mich. Pub. Acts 1857, No. 128. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>10</sup> Mich. Pub. Acts 1859, No. 217. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>11</sup> Mich. Pub. Acts 1861, No. 212. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>12</sup> Mich. Pub. Acts 1863, No. 166. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>13</sup> Mich. Pub. Acts 1869, No. 95. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>14</sup> Mich. Pub. Acts 1877, No. 58. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>15</sup> Mich. Pub. Acts 1879, No. 111. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>16</sup> Mich. Pub. Acts 1887, No. 232. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>17</sup> Mich. Pub. Acts 1887, No. 299. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

animals,<sup>18</sup> and associations for the prevention of cruelty to children.<sup>19</sup> In 1903<sup>20</sup> a rather brief act was passed providing for the incorporation of nonprofit organizations generally, and providing that in the future all nonprofit corporations without capital stock, except religious associations, were to organize under that act. Notwithstanding this provision, however, there were at least two subsequent acts of a limited nature. These provided for the incorporation of women's<sup>21</sup> and art clubs.<sup>22</sup> The General Incorporation Act of 1921<sup>23</sup> repealed these acts of limited scope and enacted general provisions for the incorporation of nonprofit organizations.<sup>24</sup> The substance of these provisions was adopted in the General Corporation Act of 1931<sup>25</sup> and, with minor amendments, constitute the present provisions.

### III. INTEGRATION WITH OTHER PROVISIONS OF THE MICHIGAN GENERAL CORPORATION ACT

*Authorization.* Any number of persons not less than three may incorporate a nonprofit organization for any lawful purpose not involving pecuniary gain to the mem-

<sup>18</sup> Mich. Pub. Acts 1877, No. 119. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>19</sup> Mich. Pub. Acts 1893, No. 161 and Mich. Pub. Acts 1899, No. 206. Both repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>20</sup> Mich. Pub. Acts 1903, No. 171. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>21</sup> Mich. Pub. Acts 1905, No. 64. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>22</sup> Mich. Pub. Acts 1913, No. 245. Repealed by Mich. Pub. Acts 1921, No. 84, Pt. 5, c. 3, sec. 1.

<sup>23</sup> Mich. Pub. Acts 1921, No. 84.

<sup>24</sup> Mich. Pub. Acts 1921, No. 84, Pt. 3, c. 1.

<sup>25</sup> Mich. Pub. Acts 1931, No. 327 as amended, sections 117 to 132a; Mich. Comp. Laws secs. 450.117 to 450.132a (1948).

bers.<sup>26</sup> The requirement of three incorporators may be noted. It is provided that one person, either natural or corporate, may incorporate a profit corporation.<sup>27</sup> This is a realistic approach, since many small businesses are in fact incorporated by one dominant stockholder, even in states that require more than one incorporator. The requirement of more than one incorporator can so easily be satisfied by having family members or attorneys hold a nominal interest for a short time that it serves no useful purpose in the business corporation. Similarly, a requirement that the incorporators be natural persons presents no effective barrier to a corporation being the real incorporator. It is a simple matter for the corporation's officers to sign the articles of incorporation of the new organization.

The Michigan statutes make no specific requirement as to the number of incorporators for cooperatives,<sup>28</sup> and, therefore, the general requirement of one incorporator would seem to apply. It is apparent that there must be more than one real party in interest in a cooperative, since the fundamental theory of the organization is mutual service for the members.<sup>29</sup> Furthermore, the statute requires that at least fifty per cent of the business be done with members.<sup>30</sup> Similarly, there must be more than one real party in interest in the case of these social nonprofit corporations since they originate from a felt need for the

<sup>26</sup> Mich. Comp. Laws sec. 450.117 (1948).

<sup>27</sup> Mich. Comp. Laws sec. 450.3 (1948). In speaking of this requirement in relation to the General Corporation Act of 1931, it was stated: "Lawyers will recognize statutory permission to do directly what in the past has been done by technical subterfuge." James, "The New Michigan Corporation Act," 11 MICH. S. B. J. 187, 187 (1931).

<sup>28</sup> Mich. Comp. Laws secs. 450.98-450.109 (1948).

<sup>29</sup> *Supra*, c. 2, sec. 1, Nature of Cooperatives, p. 10.

<sup>30</sup> Mich. Comp. Laws sec. 450.98 (1948).

society, companionship, or assistance of others. It might be argued, therefore, that there is good reason for requiring more than one incorporator. This is undoubtedly true, but the same argument can be made in the case of cooperatives, yet the statutes contain no such requirement. From a practical standpoint, it really makes little difference whether the statute requires one or several incorporators. There certainly could be no active club or social organization without active members regardless of the number of incorporators. The requirement of a sole incorporator, as is recommended in the proposed Act,<sup>31</sup> would simply make for greater ease of incorporation. The statutory provision<sup>32</sup> permitting just three of the incorporators to sign the articles in case there are more at the organizational meeting indicates legislative recognition that there is no special significance in the number of incorporators.

It is provided that any nonprofit corporation can be organized on either a stock or non-stock basis.<sup>33</sup> If it is organized on a non-stock basis, then the articles shall state, in lieu of the specified amount of capital stock, the amount of assets which the corporation possesses and the terms of any general scheme of financing the organization.<sup>34</sup> There is no such similar express requirement in the case of a non-stock cooperative.<sup>35</sup> In such a case, however, the provisions requiring a statement of the stock structure would be clearly inapplicable. It would seem advisable, although perhaps not absolutely necessary, to state in the articles

<sup>31</sup> Part II, Proposed Act, sec. 217.

<sup>32</sup> Mich. Comp. Laws sec. 450.117 (1948).

<sup>33</sup> The permission, although not express, is necessarily implied from references to both stock and non-stock nonprofit corporations. See Mich. Comp. Laws secs. 450.117 and 450.119 (1948).

<sup>34</sup> Mich. Comp. Laws sec. 450.117 (1948).

<sup>35</sup> Mich. Comp. Laws secs. 450.98 to 450.109 (1948).

of a non-stock cooperative the general scheme of original financing. The proposed Act achieves this by requiring a statement of the property rights of the members in a non-stock cooperative.<sup>36</sup> The requirement of section 5<sup>37</sup> that a minimum of \$1000 be paid in before the corporation commence business would seem to be applicable to all cooperatives but not to these nonprofit corporations. It is therefore omitted in the proposed Act.<sup>38</sup> These organizations do not contemplate doing business, and, therefore, there would seem to be no public policy in requiring them to possess any minimum amount of capital. The statute, simply requiring a statement of their assets without specifying any minimum amount,<sup>39</sup> confirms this conclusion. Such result is not inconsistent with the further provision that the General Act shall govern except as otherwise provided.<sup>40</sup> The proposed Act clarifies these provisions by providing separate sections<sup>41</sup> for the articles in both the cooperative and nonprofit sections.

*Capitalization.* Excessive capitalization of these nonprofit corporations is expressly prohibited by statute.<sup>42</sup> Capitalization is limited generally to the amount necessary to carry out the corporate purposes, but such amount includes that necessary for the purchasing or leasing of corporate property, the salaries of officers for five years, and the estimated expenses of operation aside from the annual or periodic contributions from sources other than annual

<sup>36</sup> Part II, Proposed Act, sec. 204(e).

<sup>37</sup> Mich. Comp. Laws sec. 450.5(3) as amended by Mich. Pub. Acts 1953, No. 155.

<sup>38</sup> Part II, Proposed Act, sec. 219.

<sup>39</sup> Mich. Comp. Laws sec. 450.117 (1948).

<sup>40</sup> Mich. Comp. Laws sec. 450.117 (1948).

<sup>41</sup> Part II, Proposed Act, secs. 204 and 219.

<sup>42</sup> Mich. Comp. Laws sec. 450.118 (1948).

membership fees.<sup>43</sup> This limitation of capitalization does not apply to corporations organized to carry out the terms of any trust instrument or to corporations used in connection with trust property to carry out the intention of the maker of such instrument.<sup>44</sup> Thus, there is a general requirement limiting capitalization to the amount necessary to carry out the purposes of the organization, but such requirement is not applicable to corporations administering or supplementing trusts.

This limitation is probably indicative of similar restrictions formerly rather common and originating from a fear of economic corporate concentrations.<sup>45</sup> This limitation in its present form works no real hardship because no minimum or maximum amounts are specified, the only restriction being whatever is necessary to carry out the corporate objects. The exemption in favor of trusts is a safeguard against possible losses to society of the gifts of benevolent donors. No specific penalties for violations are provided. Presumably the Michigan Corporation and Securities Commission could refuse to file the articles in case of a clear violation, and, probably, if other relief were warranted, a court of equity would have inherent power to grant it. It is difficult to see how the statute serves any real purpose. It is eliminated in the proposed Act.<sup>46</sup>

<sup>43</sup> *Ibid.*

<sup>44</sup> *Ibid.*

<sup>45</sup> This present provision is the same as Mich. Pub. Acts 1921, No. 84, Pt. 3, c. 1, as amended by Pub. Acts 1929, No. 267, being Mich. Comp. Laws sec. 10051 (1929). Before the 1929 amendment, capitalization was limited to a maximum of \$500,000 unless the former Michigan Securities Commission consented to a greater amount. Mich. Pub. Acts 1921, No. 84, Pt. 3, c. 1, sec. 6. A somewhat similar maximum restriction was provided for the corporation formed by Mich. Pub. Acts 1865, No. 233. See sec. 5 of that act which is Mich. Comp. Laws 1871, sec. 3191, Mich. Comp. Laws sec. 8208 (1897), and Mich. Comp. Laws sec. 10742 (1915).

*Stock.* If the corporation is organized on a stock plan basis, the shares may be issued for any amount which the articles provide but for not more than one hundred dollars per share.<sup>47</sup> No dividends are to be paid on stock or membership investment, and the members are not entitled to dividends, earnings, or to a pro rata share of any increment in value.<sup>48</sup> Of course, at dissolution the excess assets over liabilities belong to the members.<sup>49</sup> Accordingly, if there are any increments in value during the life of the corporation, such would naturally inure to the benefit of the members at that time. These provisions are certainly warranted and consistent with the nature of these organizations. They are, however, inadequate in so far as they purport to cover all types of nonprofit corporations. It is clear, for example, that rarely would church members or members of charitable corporations expect to receive a pro rata share of the assets at dissolution. A more comprehensive treatment of this matter should therefore be enacted.<sup>50</sup>

*Membership.* The members of these nonprofit corporations are given wide latitude in regulating, restricting, or otherwise prescribing qualifications for membership.<sup>51</sup> It is provided that membership shall be governed by such rules of admission, retention, and dismissal as the articles or by-laws shall prescribe, the only qualification being that such rules be reasonable, germane to the purposes of the corporation, and equally enforced as to all members.<sup>52</sup> The members are also empowered to fix membership fees

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<sup>46</sup> Part 11, Proposed Act, secs. 217 to 255. See Additional Notes following sec. 255.

<sup>47</sup> Mich. Comp. Laws sec. 450.119 (1948).

<sup>48</sup> *Ibid.*

<sup>49</sup> *Ibid.*

<sup>50</sup> Part II, Proposed Act, secs. 252 to 255.

<sup>51</sup> Mich. Comp. Laws secs. 450.120, 450.123, 450.128 and 450.119 (1948).

<sup>52</sup> Mich. Comp. Laws sec. 450.120 (1948).

or dues and to provide for their enforcement, such enforcement provisions including the cancellation and reinstatement of membership.<sup>53</sup>

It is expressly provided that membership may be limited to persons who are members in good standing in other incorporated associations, lodges, churches, clubs or societies.<sup>54</sup> Where such limitations are imposed, however, they must be defined in the articles of incorporation.<sup>55</sup> It is further provided that the articles may also state that failure to remain a member in good standing in such other organization shall be sufficient cause for expulsion or dismissal.<sup>56</sup> Such expulsion or dismissal, however, must be in conformity with the rules and regulations governing such action as may be defined in the by-laws.<sup>57</sup> It may be noted that this section expressly authorizes membership restriction only to members of other incorporated societies and not to other societies generally. It would seem, however, that similar restrictions also could be validly imposed limiting membership to persons who are members in other unincorporated organizations. The general provisions authorizing limitation of membership would seem sufficiently comprehensive.<sup>58</sup> The deletion of the word "incorporated" in this section of the statute, however, would eliminate any possible ambiguity.<sup>59</sup>

Auxiliary to this authorization of prescribing qualifications for membership are the provisions prohibiting the transfer of stock, even by inheritance or will, except in accordance with provisions in the by-laws.<sup>60</sup> The organi-

<sup>53</sup> Mich. Comp. Laws sec. 450.121 (1948).

<sup>54</sup> Mich. Comp. Laws sec. 450.123 (1948).

<sup>55</sup> *Ibid.*

<sup>56</sup> *Ibid.*

<sup>57</sup> *Ibid.*

<sup>58</sup> Mich. Comp. Laws sec. 450.120 (1948).

<sup>59</sup> Part II, Proposed Act, sec. 225.

zation may exclude from further membership any person who fails to comply with the reasonable requirements of the rules and regulations of the corporation, and may cancel the stock or membership of any such offending member without liability for an accounting unless otherwise provided in the articles or by-laws.<sup>61</sup> If the Uniform Stock Transfer Act is inconsistent with any of these sections, that Act is held inapplicable.<sup>62</sup> The statute, in short, evidences an intention on the part of the legislature to give the members great freedom in running their organization. Such freedom, however, is not absolute, and, in some instances, the State, through the Judiciary, will interfere on behalf of an aggrieved member.<sup>63</sup>

*Voting.* By express statutory provision all members of a nonprofit corporation are given equality of voice and vote upon any proposition presented to the membership.<sup>64</sup> However, if the corporation is organized on a stock basis, the articles or by-laws may provide for stock voting.<sup>65</sup> It is also provided that in all nonprofit corporations the articles or by-laws may provide that only certain types or classes of members may vote.<sup>66</sup> Except in these two instances there shall be no preferences as between members

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<sup>60</sup> Mich. Comp. Laws sec. 450.119 (1948).

<sup>61</sup> *Ibid.* Although this section refers specifically only to stock, it would be applicable to memberships also under section 2 (Mich. Comp. Laws sec. 450.2 (Mason's Supp. 1954)), which equates share of stock and membership in a non-stock corporation.

<sup>62</sup> Mich. Comp. Laws sec. 450.119 (1948). The Uniform Stock Transfer Act is found in Mich. Comp. Laws secs. 441.1 to 441.25 (1948). The basic difference in the transferability of shares in these corporations and the shares of business and cooperative corporations seems to be that the shares of the latter corporations are transferable unless restricted, whereas shares in these nonprofit corporations are nontransferable unless so provided.

<sup>63</sup> See *infra*, sec. 4, Nonprofit Corporations in the Courts, p. 72.

<sup>64</sup> Mich. Comp. Laws sec. 450.122 (1948).

<sup>65</sup> *Ibid.*

<sup>66</sup> *Ibid.*

or shareholders based upon obligations of the corporation to them.<sup>67</sup> These provisions are sound. In the social type of organization, normally each member should be entitled to one vote. If the group wishes to have stock voting, however, in order to encourage greater contributions by those who can afford it, there would seem to be no public policy against such a scheme of financing. Similarly, there is good reason for providing for voting and nonvoting membership generally. This is particularly true in the type of nonprofit corporation which is supporting a charitable, educational, or other socially desirable project. Such corporations seek contributions in varying amounts from a large number of donors. It frequently serves as an inducement for contributions to award the donor with membership in the corporation. However, it may be impractical to give voting rights to all the one dollar contributors, whereas to give such rights to the larger donors is not only practical but also a stimulant for greater benefaction. The proposed Act forthrightly provides for voting differentiation at the outset and also authorizes corporations without members.<sup>68</sup>

Provision is made for the calling of a special meeting in case the articles or by-laws fail to provide a method for calling one.<sup>69</sup> In that case notice is to be published in accordance with the provisions of section 68 of the Act.<sup>70</sup> If the articles or by-laws provide for a different method of calling the special meeting, such provisions supersede the statutory method.<sup>71</sup>

*Trustees or directors.* The above section dealing with

<sup>67</sup> *Ibid.*

<sup>68</sup> Part II, Proposed Act, secs. 224 and 233.

<sup>69</sup> Mich. Comp. Laws sec. 450.122 (1948).

<sup>70</sup> Mich. Comp. Laws sec. 450.68 (1948).

<sup>71</sup> This is a necessary inference from the wording of section 122, Mich. Comp. Laws sec. 450.122 (1948).

voting rights does not change the fundamental rule that the corporation is governed by its directors or trustees but, instead, simply regulates the voting rights among the members.<sup>72</sup> Section 124<sup>73</sup> provides that the corporation shall be governed by a board of trustees or directors of at least three persons. Generally, the number,<sup>74</sup> qualifications, classifications, terms of office, manner of election or removal, time and place of meetings, and the powers and duties of said trustees or directors may be prescribed by the articles or by-laws.<sup>75</sup> In case the term of the directors is fixed at longer than one year, at least one third of the board shall be elected each year.<sup>76</sup> Each director shall serve for his term or until his successor is duly elected and qualified. Vacancies in the board shall be filled by the remaining members until a successor is duly elected at a regular or special meeting.<sup>77</sup>

A majority of the board shall be necessary to constitute a quorum, and the acts of a majority of the trustees at a meeting at which a quorum is present shall constitute the acts of such board.<sup>78</sup> Provision is made, however, that if the trustees or directors, either collectively or severally, consent in writing to any corporate action, such action shall be valid as though it had been approved at a regular board meeting.<sup>79</sup> Presumably unanimous consent is necessary for such informal action. If the board consists of more

<sup>72</sup> *Ayres v. Hadaway*, 303 Mich. 589, 6 N.W. 2d 905 (1942).

<sup>73</sup> Mich. Comp. Laws sec. 450.124 (1948).

<sup>74</sup> Mich. Pub. Acts 1954, No. 124, added sec. 124a to the Corporation Act. This section authorizes the board of trustees of a nonprofit educational corporation to increase the number of trustees by not more than 50%.

<sup>75</sup> Mich. Comp. Laws sec. 450.124 (1948).

<sup>76</sup> *Ibid.*

<sup>77</sup> *Ibid.*

<sup>78</sup> *Ibid.*

<sup>79</sup> *Ibid.*

than seven members, the articles or by-laws may provide that a quorum shall consist of less than a majority but not less than one third.<sup>80</sup> The board may delegate interim authority to an executive committee, and meetings need not be held in any particular locality.<sup>81</sup>

The directors or trustees are held individually liable for the misapplication or misuse of the corporation's funds or property where such misuse is caused through the neglect to exercise reasonable care and prudence in the administration of corporate affairs, or through the willful violation of the laws governing the same.<sup>82</sup> The degree of care required of these directors is thus substantially the same as that required of directors generally under section 47.<sup>83</sup> In addition to the imposition of liability on behalf of directors, a court of equity can grant other appropriate relief as the case warrants.<sup>84</sup>

Provisions in the by-laws for a self-perpetuating board of trustees were upheld in *Detroit Osteopathic Hospital v. Johnson*.<sup>85</sup> That corporation was formed under a general nonprofit corporation act<sup>86</sup> which has since been replaced by the present provisions. The articles provided that members of the corporation should consist of all osteopathic physicians and other persons who should contribute to its support. The trustees were given power at their discretion to call meetings of the members, but at least one such meeting was to be called in each calendar year. The powers of the members were limited in the articles to that

<sup>80</sup> *Ibid.*

<sup>81</sup> *Ibid.*

<sup>82</sup> Mich. Comp. Laws sec. 450.126 (1948).

<sup>83</sup> Mich. Comp. Laws sec. 450.47 (1948).

<sup>84</sup> A deed was set aside for fraud in *German Corp. v. Negaunee German Aid Society*, 172 Mich. 650, 138 N.W. 343 (1912).

<sup>85</sup> 290 Mich. 283, 287 N.W. 466 (1939).

<sup>86</sup> Mich. Pub. Acts 1903, No. 171.

of making recommendations. The by-laws provided that the trustees were to serve for one year and then to select their successors. They were also empowered to fill vacancies.<sup>87</sup>

The court held that the nature of this corporation was so much in the nature of a trust that it would be inequitable and destructive of the original plan for the court not to act to preserve its original method of functioning.<sup>88</sup> It accordingly held invalid an attempt by the members to change the by-laws to provide for membership voting, and enjoined the defendants from attempting to amend them in such a manner as would prevent the trustees and their successors from exercising control over the execution of the corporate trust.<sup>89</sup>

The court found that there was no public policy against such a self-perpetuating board of trustees either at the time of organization or at the time of suit.<sup>90</sup> Although the court could have probably reached the same result solely on contractual grounds,<sup>91</sup> the result seems sound. It will be noted that the present statute does authorize nonvoting members and also permits the manner of selection of the trustees or directors to be governed by provisions in the by-laws.<sup>92</sup> There is a stipulation, however, that at least one third of the board be elected annually,<sup>93</sup> but so long as this is done, there is no statute preventing the old trustees from making the selection as was the practice in the *Osteopathic Hospital*<sup>94</sup> case. Such a method of operation is especially

<sup>87</sup> 290 Mich. 283, 287 N.W. 466 (1939).

<sup>88</sup> *Ibid.*

<sup>89</sup> *Ibid.*

<sup>90</sup> *Ibid.*

<sup>91</sup> The case is discussed in a note, 38 MICH. L. REV. 406 (1940).

<sup>92</sup> Mich. Comp. Laws secs. 450.122 and 450.124 (1948).

<sup>93</sup> Mich. Comp. Laws sec. 450.124 (1948).

<sup>94</sup> *Detroit Osteopathic Hospital v. Johnson*, 290 Mich. 283, 287 N.W. 466 (1939).

advantageous for similar charitable types of nonprofit corporations because it permits a greater selectivity of management, and, at the same time, encourages contributions by offering membership. Although it might be preferable to incorporate such organizations under the statutory provisions for trustee corporations,<sup>95</sup> there seems to be no reason why these sections cannot be used in case of doubtful applicability of the trustee provisions. The proposed Act<sup>96</sup> specifically authorizes a self-perpetuating board.

*Powers.* Nonprofit corporations are expressly authorized to transact business, collect and disburse money, purchase, sell and care for properties, and engage in any other incidental business if the purposes of the corporation so require.<sup>97</sup> They are likewise empowered to borrow money, issue promissory notes, and mortgage property as security for their debts.<sup>98</sup> If the by-laws expressly authorize such action, then no further authorization need be acquired. If such action is not expressly authorized in the by-laws, the corporation may still borrow and issue notes and mortgages, but in this case authorization must be granted by a resolution of the members at any duly called meeting at which a quorum was present.<sup>99</sup> It will be sufficient in this case if a general authority is granted; the resolution need not specify the particular sums, rates of interest, or maturities, as such items may be agreed upon and authorized by the directors.<sup>100</sup>

*Local units.* Grouping of nonprofit corporations into local units is expressly authorized if the corporation is formed on a membership and not a stock basis, if it con-

<sup>95</sup> Mich. Comp. Laws secs. 450.148 *et seq.* (1948).

<sup>96</sup> Part II, Proposed Act, sec. 233.

<sup>97</sup> Mich. Comp. Laws sec. 450.125 (1948).

<sup>98</sup> Mich. Comp. Laws sec. 450.127 (1948).

<sup>99</sup> *Ibid.*

<sup>100</sup> *Ibid.*

sists of more than five hundred members, and if it occupies a territory or district not less than a geographical county in extent.<sup>101</sup> This privilege is afforded only to those non-profit corporations formed under this Act or under its predecessor, Act No. 84 of the Public Acts of 1921. This grouping into local units may be accomplished by the adoption of a by-law proposed by the board of directors.<sup>102</sup> The unit of division may be territorial or any other basis as determined in the by-laws.<sup>103</sup> The local units may, but need not, incorporate, and they are given power to do all things necessary to effectuate this subdivision.<sup>104</sup> The purpose, of course, is more effectively to give representation to the individual members and local groups in the larger organization.<sup>105</sup>

The board of directors is to determine the basis on which the local units are formed and also do all things necessary to insure representation of each local unit.<sup>106</sup> The board also determines the basis of representation and the number of delegates to which said local unit or units are entitled, but each local unit is entitled to at least one delegate, and no such delegate shall have a greater number of votes than the total membership of his local unit.<sup>107</sup>

It may be noted that these sections providing for local units apply only to non-stock corporations.<sup>108</sup> A similar result, however, can be obtained in the stock type of corporation. The ability of a nonprofit corporation to own stock in another such corporation is recognized, and the

<sup>101</sup> Mich. Comp. Laws sec. 450.128 (1948).

<sup>102</sup> *Ibid.*

<sup>103</sup> *Ibid.*

<sup>104</sup> Mich. Comp. Laws sec. 450.130 (1948).

<sup>105</sup> Mich. Comp. Laws sec. 450.128 (1948).

<sup>106</sup> Mich. Comp. Laws sec. 450.129 (1948).

<sup>107</sup> *Ibid.*

<sup>108</sup> Mich. Comp. Laws sec. 450.128 (1948).

corporate shareholder is given all the rights, powers, privileges, and liabilities of individual shareholders.<sup>109</sup> Further, the directors and officers of the corporate shareholder are specifically made eligible for the office of director of the other corporation the same as if they were individual shareholders.<sup>110</sup> Thus, a nonprofit stock corporation could issue its stock **only** to local nonprofit corporations or associations, and these local groups, through their stock ownership in the central corporation, would secure representation. The method would be slightly different, but the result substantially similar. The proposed Act broadens these statutory provisions and reduces duplication by eliminating many of the similar provisions dealing with fraternal organizations.<sup>111</sup>

*Real estate corporations.* Section 132a<sup>112</sup> specifically authorizes nonprofit corporations to own stock or memberships in nonprofit corporations whose purpose is the controlling or owning of buildings used as centers or homes of regularly organized fraternal organizations. This amounts to an express approval of the corporation's separation of its real estate from its social or other activities. There would seem to be no valid reason for not permitting such separation of activities, but, in view of the other sections of the statute, it is not clear that this added authorization is necessary. At any rate, a little broadening of the sections permitting local groups and inter-corporate stock ownership should render unnecessary this section. The proposed Act makes this change.<sup>113</sup>

<sup>109</sup> Mich. Comp. Laws sec. 450.131 (1948).

<sup>110</sup> *Ibid.*

<sup>111</sup> Part II, Proposed Act, secs. 236-248.

<sup>112</sup> Mich. Comp. Laws sec. 450.132a (1948).

<sup>113</sup> Part II, Proposed Act, sec. 248.

## IV. NONPROFIT CORPORATIONS IN THE COURTS

Although these nonprofit corporations include a large number of dissimilar organizations, and although most of them have not been extensively involved in litigation,<sup>114</sup> a few principles can be gleaned from the reported cases. An apparent basic principle is that the articles of association and by-laws are binding on the members of the organization.<sup>115</sup> Membership alone charges the person with knowledge and makes him subject to the articles and by-laws.<sup>116</sup>

Since the articles and by-laws control the relationship between the corporation and its members, it follows that, if the organization provides for an internal method of settling disputes, that internal method must be exhausted before a complaining party can resort to the courts.<sup>117</sup> In

<sup>114</sup> Of these nonprofit corporations, organizations providing mutual insurance or benefits of one kind or another have been the most frequently involved in litigation.

<sup>115</sup> *Bretzlaff v. Sick-Benefit Society*, 125 Mich. 39, 83 N.W. 1000 (1900); *Kern v. Arbeiter Verein*, 139 Mich. 233, 102 N.W. 746 (1905); *Harris v. Detroit Typographical Union*, 144 Mich. 422, 108 N.W. 362 (1906); *Bone v. Grange Mutual Fire Insurance Co.*, 215 Mich. 396, 184 N. W. 406 (1921).

<sup>116</sup> *Harris v. Detroit Typographical Union*, 144 Mich. 422, 108 N.W. 362 (1906); *Mazurkiewics v. Aid Society*, 127 Mich. 145, 86 N.W. 543 (1901); *Bretzlaff v. Sick-Benefit Society*, 125 Mich. 39, 83 N.W. 1000 (1900).

<sup>117</sup> *Palmer v. Patron's Mutual Fire Ins. Co.*, 217 Mich. 292, 186 N.W. 511 (1922); *Jackson v. State Mutual Rodded Fire Ins. Co.*, 217 Mich. 301, 186 N.W. 514 (1922); *Bone v. Grange Mutual Fire Ins. Co.*, 215 Mich. 396, 184 N.W. 406 (1921); *Patron's Mutual Fire Ins. Co., v. Att'y. Gen.*, 166 Mich. 438, 131 N.W. 1119 (1911); *Bishop v. Brotherhood of L. F. & E.*, 204 Mich. 605, 171 N.W. 528 (1919), involving also the construction of provisions for the internal machinery; *Larkin v. Modern Woodmen of America*, 163 Mich. 670, 127 N.W. 786 (1910); *Allen v. Patron's Mutual Fire Ins. Co., Ltd.*, 165 Mich. 18, 130 N.W. 196 (1911); *Conley v. Supreme Ct., I. O. F.*, 158 Mich. 190, 122 N.W. 567 (1909); *Harris v. Detroit Typographical Union*, 144 Mich. 422, 108 N.W. 362 (1906); *Derry v. Great*

fact, if the articles and by-laws do not provide for judicial review after a final determination within the order, that final determination is conclusive on the party.<sup>118</sup> Of course, a court of equity can always nullify an award or determination for fraud, mistake, accident, or inequitable conduct.<sup>119</sup> In all of these instances, however, the complaining party must first exhaust his remedy within the order before resorting to the courts.<sup>120</sup>

The organization, moreover, must act within a reasonable time,<sup>121</sup> the provisions must not be void as contrary to law or public policy,<sup>122</sup> the complaining party must not be denied a hearing,<sup>123</sup> and he must not be denied a

Hive, *Maccabees*, 135 Mich. 494, 98 N.W. 23 (1904); *Barker v. Great Hive, Maccabees*, 135 Mich. 499, 98 N.W. 24 (1904); *Hoag v. Supreme Lodge*, 134 Mich. 87, 95 N.W. 996 (1903); *Van Poucke v. Netherland St. Vincent Society*, 63 Mich. 378, 29 N.W. 863 (1886).

<sup>118</sup> *Palmer v. Patron's Mutual Fire Ins. Co.*, 217 Mich. 292, 186 N.W. 511 (1922); *Patron's Mutual Fire Ins. Co. v. Att'y Gen.*, 166 Mich. 438, 131 N.W. 1119 (1911); *Derry v. Great Hive, Maccabees*, 135 Mich. 494, 98 N.W. 23 (1904); *Barker v. Great Hive, Maccabees*, 135 Mich. 499, 98 N.W. 24 (1904); *Van Poucke v. Netherland St. Vincent Society*, 63 Mich. 378, 29 N.W. 863 (1886).

<sup>119</sup> *Erd v. Bavarian Nat'l Aid & Relief Ass'n.*, 67 Mich. 233, 34 N.W. 555 (1887); *People ex rel. Pulford v. Fire Dep't. of Detroit*, 31 Mich. 457 (1875); *People ex rel. Roehler v. Mechanics' Aid Society*, 22 Mich. 86, McGrath No. 1225 (1870). The rule is dictum in the following cases: *Patron's Mutual Fire Ins. Co. v. Att'y Gen.*, 166 Mich. 438, 131 N.W. 1119 (1911); *Van Poucke v. The Netherland St. Vincent Society*, 63 Mich. 378, 29 N.W. 863 (1886); *Palmer v. Patron's Mutual Fire Ins. Co.*, 217 Mich. 292, 186 N.W. 511 (1922).

An award was set aside for waiver of a suspension in *Rich v. State Mutual Fire Ins. Co.*, 235 Mich. 446, 209 N.W. 569 (1926).

<sup>120</sup> Cases cited in notes 117 and 119 *supra*.

<sup>121</sup> *Shapiro v. Patron's Mutual Fire Ins. Co.*, 219 Mich. 581, 189 N.W. 202 (1922); *Larkin v. Modern Woodmen of America*, 163 Mich. 670, 127 N.W. 786 (1910), dictum.

<sup>122</sup> *Worker's Educational Ass'n v. Renner*, 218 Mich. 302, 188 N.W. 289 (1922). In *Howe v. Patron's Mutual Fire Ins. Co.*, 216 Mich. 560, 185 N.W. 864 (1921), the by-law was in conflict with the articles of association. Hence, an award based on the by-law was not binding on the member.

<sup>123</sup> *Rose v. Supreme Court, Order of Patricians*, 126 Mich. 577, 85 N.

right to appeal within the order.<sup>124</sup> If any of these requirements are violated, the party may seek judicial relief. There is thus superimposed over the articles and by-laws judicial concepts of natural rights or due process of law.<sup>125</sup> A presumption in favor of the regularity of the organization's procedure, however, must first be overcome in order for the relator to get relief.<sup>126</sup>

Expulsion from membership can be one of the most effective ways for the organization to compel compliance with its regulations and at the same time can be of the most serious consequence to the expelled member. In case of strictly social organizations, the expelled member may suffer a slight loss of prestige, but he still has other friends and, in all probability, will bear no great burdens as a result of his ostracization. The forced withdrawal from a church group may cause great mental anguish; the expulsion from a mutual benefit or aid society may mean the loss of pecuniary assistance in the time of need; and the exclusion from a labor union may have the direst of consequences to the expelled member by effectively depriving him of the opportunity of plying his trade and earning a livelihood. These different consequences suggest that the court might have different attitudes toward judicial interference in these different cases of expulsion or exclusion. Apparently, however, such is not the case, or, at least, the

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W. 1073 (1901); *People ex rel. Roehler v. Mechanics' Aid Society*, 22 Mich. 86, McGrath No. 1225 (1870).

<sup>124</sup> *Ruterbusch v. Supreme Court of The Independent Order of Foresters*, 162 Mich. 213, 127 N.W. 288 (1910); *Steiner v. Supreme Court Independent Order of Foresters*, 149 Mich. 567, 113 N.W. 15 (1907).

<sup>125</sup> The conclusion is based on cases cited in notes 121 to 124 *supra*. A similar observation and critique is made by Chafee, "The Internal Affairs of Associations," 43 HARV. L. REV. 993, 1014 to 1020 (1930).

<sup>126</sup> *Burton v. St. George's Society of Detroit*, 28 Mich. 261, McGrath No. 1227 (1873).

court has not admitted it. The Michigan courts have granted mandamus to restore a person to membership after he has been illegally or improperly expelled.<sup>127</sup> These cases, however, turned on the regularity, fairness, or due process of the procedure.<sup>128</sup> Unexcused laches has been held a bar to reinstatement where no substantial rights were involved.<sup>129</sup>

It would thus seem that the legislature and the judiciary have both evidenced an intention to make these nonprofit corporations as independent as possible and to give them the maximum amount of freedom in regulating membership and in otherwise operating as autonomous bodies. If they act contrary to statute or public policy; if their dealings with the members are unfair, oppressive, contrary to rules of natural justice, or due process; if they act in disregard of their own regulations; or if their conduct is malicious, then the judiciary will grant the appropriate relief. Thus, the role of judicial review in these cases is not dissimilar to the role of judicial review in litigation involving administrative tribunals.<sup>130</sup>

## V. CONCLUSION

The nonprofit organizations provided for in these sections are essentially different from both the cooperative and regular business corporations. It seems advisable, therefore, to have separate provisions for their incorpora-

<sup>127</sup> *Erd v. Bavarian Nat'l. Aid & Relief Ass'n.*, 67 Mich. 233, 34 N.W. 555 (1887); *People ex rel. Pulford v. Fire Dep't. of Detroit*, 31 Mich. 457 (1875); *People ex rel. Roehler v. Mechanics' Aid Society*, 22 Mich. 86, McGrath No. 1225 (1870).

<sup>128</sup> Cases cited note 127 *supra*.

<sup>129</sup> *Bostwick v. Fire Department of Detroit*, 49 Mich. 513, 14 N.W. 501 (1883).

<sup>130</sup> The same observation is made by Chafee, *op. cit. supra* n. 125, at 1005.

tion. The statutes on the whole are sufficiently comprehensive to provide for all types of nonprofit nonbusiness corporations and to allow great diversity in membership and organizational structure. A few changes, however, may be suggested. The requirement of three incorporators<sup>131</sup> can be eliminated, and the requirement of one under the general provisions made applicable.<sup>132</sup> Since the prohibition against excessive capitalization<sup>133</sup> serves no useful purpose, it is recommended that the statutes be further simplified by eliminating this section.<sup>134</sup>

The authorization of membership limitations<sup>135</sup> and the transfer of stock provisions<sup>136</sup> are sound, but a few changes are suggested. Section 123,<sup>137</sup> specifically permitting membership limitations to members of other organizations, should be amended by deleting the word "incorporated" so as to authorize such limitations to members of other nonprofit organizations generally. The proposed Act<sup>138</sup> follows this procedure. The retention of this provision thus broadened results in more definitiveness than if the section were eliminated as unnecessary in view of section 120,<sup>139</sup> authorizing general prescription of membership.

The section on membership voting<sup>140</sup> is good but can be improved. The proposed Act changes this section both formally and substantively to authorize cumulative voting.<sup>141</sup> The sections on trustees or directors<sup>142</sup> are generally

<sup>131</sup> Mich. Comp. Laws sec. 450.117 (1948).

<sup>132</sup> Mich. Comp. Laws sec. 450.3 (Mason's Supp. 1952).

<sup>133</sup> Mich. Comp. Laws sec. 450.118 (1948).

<sup>134</sup> Part II, Proposed Act, Additional Notes following sec. 255.

<sup>135</sup> Mich. Comp. Laws secs. 450.120 and 450.123 (1948).

<sup>136</sup> Mich. Comp. Laws sec. 450.119 (1948).

<sup>137</sup> Mich. Comp. Laws sec. 450.123 (1948).

<sup>138</sup> Part II, Proposed Act, sec. 225.

<sup>139</sup> Mich. Comp. Laws sec. 450.120 (1948).

<sup>140</sup> Mich. Comp. Laws sec. 450.122 (1948).

<sup>141</sup> Part II, Proposed Act, sec. 224.

desirable, with most recommended changes being formal rather than substantive.<sup>143</sup> A provision specifically authorizing a self-perpetuating board of directors for corporations with or without members is included.<sup>144</sup> Provision for amending the articles of a nonmember corporation should be enacted.<sup>145</sup> The specific provisions giving the corporation authority to determine directors' qualifications and manner of selection<sup>146</sup> are retained in the proposed Act.<sup>147</sup>

The conferring of power to transact incidental business<sup>148</sup> is desirable and adequate. The authorization of local units<sup>149</sup> contravenes no public policy and should be retained. The proposed Act,<sup>150</sup> however, enlarges and broadens these provisions in the general nonprofit sections. They are made applicable to all types of nonprofit corporations. Simplification results from omitting unnecessary repetition in the fraternal sections. At the same time, maximum flexibility is achieved in central-subordinate groupings.

More detailed provisions on dissolution are recommended for general nonprofit corporations. A statutory *cy pres* doctrine<sup>151</sup> should be enacted for the disposition of the assets of religious and charitable corporations at their dissolution. Judicial rather than legislative dissolution<sup>152</sup> should be authorized upon the happening of cer-

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<sup>142</sup> Mich. Comp. Laws secs. 450.124 and 450.126 (1948).

<sup>143</sup> Part II, Proposed Act, secs. 226-232.

<sup>144</sup> Part II, Proposed Act, sec. 233.

<sup>145</sup> Part II, Proposed Act, sec. 249.

<sup>146</sup> Mich. Comp. Laws sec. 450.124(3) (1948).

<sup>147</sup> Part II, Proposed Act, sec. 227.

<sup>148</sup> Mich. Comp. Laws sec. 450.125 (1948).

<sup>149</sup> Mich. Comp. Laws secs 450.128-450.130.

<sup>150</sup> Part II, Proposed Act, secs. 236-248.

<sup>151</sup> Part II, Proposed Act, sec. 254(3).

<sup>152</sup> Part II, Proposed Act, secs. 252 and 253.

tain contingencies. Uniformity and simplicity can be achieved by putting these provisions in the general sections and omitting them from those sections dealing with specific types of nonprofit corporations.

The legislatively manifested laissez-faire policy seems desirable as it would be impracticable to describe detailed regulations in advance for so great a diversity of organizations. Instances of specific injustices can best be handled by the judiciary. *Prima facie*, it might seem that different rules and regulations should be prescribed for those organizations having more coercive power on their members, as, for example, a labor union which either does or might effectively control employment, than for a strictly social organization, membership in which carries no special significance either to the individual or the community. Should investigation disclose such provisions socially desirable, however, it is far from certain that they should be enacted as a part of the corporation act. The mischief, if such it be, applies equally to unincorporated associations.

One rather significant policy change should be made. Michigan is committed to the view that charitable organizations are not liable for the torts of their agents to beneficiaries of the charity.<sup>153</sup> This is generally considered an

<sup>153</sup> *Erwin v. St. Joseph's Hospital*, 323 Mich. 114, 34 N.W. 2d 480 (1948); *De Groot v. The Edison Institute*, 306 Mich. 339, 10 N.W. (2d) 907 (1943); 1939-40 Mich. Ops. Att'y. Gen. p. 534; *Greatrex v. Evangelical Deaconess Hospital*, 261 Mich. 327, 246 N.W. 137 (1933); *Bruce v. Henry Ford Hospital*, 254 Mich. 394, 236 N.W. 813 (1931); *Robinson v. Washtenaw Circuit Judge*, 228 Mich. 225, 199 N.W. 618 (1924); *Pepke v. Grace Hospital*, 130 Mich. 493, 90 N.W. 278 (1902); *Downes v. Harper Hospital*, 101 Mich. 555, 60 N.W. 42 (1894). See notes: 25 A.L.R. (2d) 29, Michigan cases at 163 (1952), 23 MICH. L. REV. 905 (1925), 9 MICH. L. REV. 151 (1910).

Liability was imposed in the case of a non-beneficiary in *Bruce v. Central M. E. Church*, 147 Mich. 230, 110 N.W. 951 (1907); *Winslow v. V. F. W. Nat'l. Home*, 328 Mich. 488, 44 N.W. (2d) 19 (1950). Liability

outmoded viewpoint and should be changed. A statute is therefore recommended.<sup>154</sup>

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was imposed for false imprisonment as the breach of a non-delegable duty in *Gallon v. House of Good Shepherd*, 158 Mich. 361, 122 N.W. 631 (1909). Apparently one falsely imprisoned is not a beneficiary, at least not a willing one.

<sup>154</sup> Part II, Proposed Act, sec. 201.