

To: New Jersey Law Revision Commission
From: Susan G. Thatch
Re: Nonprofit Organizations
Date: May 11, 2015

MEMORANDUM

This Memorandum is intended to provide the Commission with information regarding proposed revisions to New Jersey's Nonprofit Corporations law and the Revised Uniform Unincorporated Nonprofit Association Act. Commission consideration of the Nonprofit Corporations law was raised by a member of the public and Staff is seeking Commission authorization to work in this area.

Executive Summary

New Jersey's Nonprofit Corporations law may benefit from revisions reflecting similar provisions in New Jersey's Business Corporation statute. Additionally, it should be determined whether unincorporated nonprofit associations require statutory protections traditionally afforded to other types of entities.

Introduction

The National Center for Charitable Statistics reports that over 2.3 million nonprofit organizations operate within the United States.¹ According to the most recent data, more than 31,000 non-profits operate within New Jersey and collectively employ approximately 7% of the workforce.² Statutes and regulations governing these nonprofit organizations are tasked with balancing the potentially overly burdensome compliance mechanisms with the need to combat potential abuses of the nonprofit system.³

Examination of New Jersey's nonprofit law is a timely project for the Commission. In a broader context, Legislatures' across the country continue to seek additional flexibility for nonprofit or socially responsible business entities. New Jersey, along with 28 other states,⁴

¹ NAT'L CTR. FOR CHARITABLE STATISTICS, *Number of Nonprofit Organizations in the United States, 2003-2013*, available at <http://nccsweb.urban.org/PubApps/profile1.php?state=US> (last visited May 4, 2015). The Center reports that that this represents a 10% increase in nonprofit organizations between 2003 and 2013.

² THE CTR. FOR NON-PROFITS, *New Jersey's Non-Profit Sector: An Economic Force for Strengthening the Garden State*, (2009-10), available at http://www.njnonprofits.org/EconForce2009_10.pdf.

³ James J. Fishman, *Wrong Way Corrigan and Recent Developments in the Nonprofit Landscape: A Need for New Legal Approaches*, 76 FORDHAM L. REV. 567, 574 (2007).

⁴ BENEFIT CORP. INFORMATION CENTER, *State by State Legislative Status*, available at <http://www.benefitcorp.net/state-by-state-legislative-status> (last visited May 5, 2015).

recently enacted statutory provisions permitting hybrid “benefit” corporations,⁵ which permit a corporation to act in the interest of a “public benefit,” and adjusts the powers and duties of its officers and directors accordingly.⁶ Further, national debate surrounding the low-profit limited liability company organizational structure popularly known as “L3C” continues.⁷ Both trends manifest a desire to create beneficial legal structures for nonprofit or low-profit entities so that they may leverage their time and resources towards greater social good. The modernization of New Jersey’s existing nonprofit entity law may be viewed as both a measured and important step in ensuring the continued health of New Jersey’s nonprofit organizations.

Analysis

I. Title 15A – Corporations and Associations Not for Profit

Nonprofits possessing the resources and desire to formalize an organizational structure may incorporate under the provisions of the New Jersey Nonprofit Corporation Act (“Nonprofit Corporations Act”), N.J.S. 15A:1-1 *et seq.* The Legislature enacted the Nonprofit Corporations Act in 1983 upon the recommendation of the Nonprofit Law Revision Committee (“NLRC”) of the Corporate and Business Law Section of the New Jersey State Bar Association.⁸ The Nonprofit Corporations Act was the culmination of the NLRC’s five years of analysis and discussion regarding New Jersey’s existing nonprofit corporation statute dating from 1898 (codified as N.J.S. 15:1-1 *et seq.*)⁹

In the course of its work, the NLRC sought to (1) modernize New Jersey’s nonprofit corporation law to apply generally to all types of nonprofit corporations, (2) harmonize the nonprofit corporation law as closely as possible to the New Jersey Business Corporation Act

⁵ N.J.S. 14A:18-1 – 11 (2011).

⁶ N.J.S. 14A:18-6 – 9 (2011).

⁷ To date, eight States have adopted legislation permitting the formation of “low-income limited liability companies” or “L3Cs.” Advocates of this structure assert that it serves the dual purposes of social responsibility and moderate profitability while also providing certain tax benefits allowing L3C’s to leverage Program-Related Investments. Susan A. Maslow & Timothy White, *Enlightened Capitalism and L3Cs*, N.J. LAWYER 63, 64 (April 2010). Opponents maintain that an L3C does not provide more IRS certainty regarding PRI investments and could disrupt the nonprofit sector and its tax scheme. *See generally*, James R. Hines Jr. et. al., *The Attack on Nonprofit Status: A Charitable Assessment*, 108 MICH. L. REV. 1179 (2010). Notably, North Carolina enacted an L3C statute in 2010 and subsequently repealed it in 2013. Anne Field, *North Carolina Officially Abolishes the L3C*, FORBES (January 11, 2014), available at <http://www.forbes.com/sites/annefield/2014/01/11/north-carolina-officially-abolishes-the-l3c/>.

⁸ Report of the Nonprofit Law Revision Committee, September 23, 1980, at XII.

⁹ *Id.* Operationally, the 1983 Nonprofit Corporations Act repealed most provisions of existing N.J.S. Title 15 and codified as N.J.S. Title 15A. Certain sections of Title 15 were saved as applying to very specific organizations (boards of trade, detective association, volunteer fire companies, patriotic societies, etc). N.J.S. 15A:16-1 (1983). The 1983 Nonprofit Corporations Act also preserved the structure of New Jersey’s Title 16, which governs religious organizations with denominational specificity, but extended certain overarching provisions to corporations organized thereunder. *See, e.g.*, N.J.S. 15A:1-3 (1983) (applying dissolution, insolvency, receiver and reorganization provisions to Title 16 corporations).

(“Business Corporations Act”), and (3) expressly permit or prohibit certain actions that may be common in practice.¹⁰

A. *New Jersey’s Business Corporations Act*

Numerous NRLC comments on provisions of the Nonprofit Corporations Act reference comparable provisions of the Business Corporations Act, codified in N.J.S. 14A:1-1 *et seq.* The rationale for closely aligning the Nonprofit and Business Corporations Acts was “that unless distinguishable due to the inherent difference in their natures, ‘corporation case law’ as it developed could be applied to, and provide guidance for, practitioners of both business law and nonprofit law.”¹¹

The Legislature promulgated New Jersey’s Business Corporations Act in 1968, revising it substantially in 1972 and 1988. Given its importance to New Jersey’s corporate entities and business climate, the Business Corporations Act has been amended and modernized over the years. Yet similar useful revisions have not been incorporated into the Nonprofit Corporations Act. Accordingly, the Legislature’s intent to create consistency between the Nonprofit Corporations Act and the Business Corporations Act is frustrated.

While the Nonprofit Corporations Act was most recently amended in 1999, these amendments did not address the modernization of corporate practices.¹² Some examples of Business Corporations Act modifications that may prove equally appropriate for incorporation into the Nonprofit Corporations Act include:

- Provision for certain notices by telecopy (N.J.S. 14A:1-10).
- Provision for certain notices by electronic transmission (N.J.S. 14A:1-8.1).
- Provisions relating to filing and recording of documents (N.J.S. 14A:1-6 (6)(7)).
- Provision permitting Secretary of State to provide information and documents upon telephone request or over the counter in accordance with OPRA (14A:1-9).
- Provision for termination of corporate alternate names (14A:2-2.1 (3)).
- Renewal process for reserved names (14A:2-3).
- Certain provisions relating to the Certificate of Incorporation (14A:2-7).
- Provisions relating to indemnification of trustees in connection with employee benefit plans and to retroactive impairment of indemnification provisions (14A:3-4).
- Provisions relating to derivative suits (14A:3-6.1 -9).
- Provision relating to notice required for resignation of registered agent (14A:4-4).

¹⁰ *Id.* at XII-XIV.

¹¹ Stuart L. Pachman, *A Look at the Corporate Law of Nonprofit Corporations*, N. J. LAWYER, April 2010, at 24.

¹² N.J.S. 15A:3A-1 –5 (1999) (adding provisions regarding criminal background checks for nonprofit youth serving organizations)

- Provisions regarding the Annual Report, including where and how it is filed, and the process for revocation/reinstatement (14A:4-5).

These provisions only represent Staff’s analysis of initial sections of the Nonprofit Corporations Act; accordingly, it is not an exhaustive list of Nonprofit Corporations Act sections that may benefit from amendments in keeping with the Business Corporations Act. This project will require a thorough analysis of each section and comparison of the two Acts to determine whether useful and appropriate modifications can be made to the Nonprofit Corporations Act.

B. The Model Nonprofit Corporation Act

The Commission may wish to note that, in 1952, the American Bar Association developed a Model Nonprofit Corporation Act (“Model Act”). The ABA revised the Model Act in 1964, 1987, and most recently, in 2008. The NLRC considered the 1964 version¹³ of the Model Act in drafting the New Jersey Nonprofit Corporations Act and incorporated its provisions to a limited degree¹⁴ - particularly in areas in which the nonprofit and business corporation laws must necessarily differ according to their intrinsic purpose.¹⁵

While potentially instructive for certain specific provisions of the Nonprofit Corporations Act, wholesale adoption of the Model Act would be a dramatic departure from New Jersey’s Nonprofit Corporations Act and would sever the relationship between New Jersey’s Nonprofit Corporations Act and New Jersey’s Business Corporations Act. In light of the legislative commentary accompanying the Nonprofit Corporations Act, as well as preliminary discussions with interested stakeholders, it may prove most beneficial to realign the Nonprofit Corporations Act with the Business Corporations Act, remaining cognizant of the fundamental differences between for-profit and nonprofit business entities.

II. Revised Uniform Unincorporated Nonprofit Association Act

A related area of nonprofit law is addressed by the Revised Uniform Unincorporated Nonprofit Association Act (“RUUNAA”). A nonprofit association is an entity that is not organized under any statutory law.¹⁶ Many nonprofit organizations begin as small enterprises; incorporating such a nonprofit entity requires a commitment of time and financial resources that may be difficult for the fledgling organization and might not be pursued.¹⁷ Lacking the

¹³ Report of the Nonprofit Law Revision Committee, September 23, 1980, at XV.

¹⁴ See e.g., N.J.S. 15A:1-1, N.J.S. 15A:1-2, N.J.S. 15A:1-3, N.J.S. 15A:2-, N.J.S. 15A:9-1.

¹⁵ N.J.S. 15A:2-1 provides that “[n]o corporation organized under this act shall have or issue capital stock or shares” and is borrowed from § 26 of the 1964 Model Act.

¹⁶ REVISED UNIF. UNINCORPORATED NONPROFIT ASS’N ACT, Prefatory Note (2008).

¹⁷ THE CTR. FOR NON-PROFITS, *Thinking of Forming a Non-Profit? What to Consider Before You Begin* 11 (2014), available at <http://www.njnonprofits.org/ThinkingOfForming.pdf> (last visited May 5, 2015) (detailing New Jersey filing fees and reporting requirements).

protections provided by business entity statutes, these unincorporated associations are governed by “a hodgepodge of common law principles and statutes governing some of their legal aspects.”¹⁸

The Uniform Law Commission (“ULC”) recognized these unique issues and adopted the Uniform Unincorporated Nonprofit Associations Act in 1996. The 1996 Uniform Act was drafted for the benefit of small informal associations and focused solely on the most troublesome issues facing unincorporated nonprofit associations: the tort and contractual liability of members, property ownership, and status as an entity having the capacity to sue and to be sued.¹⁹ The 1996 Uniform Act was adopted in thirteen jurisdictions.²⁰

The ULC determined to take a more comprehensive approach towards unincorporated nonprofit associations and adopted the RUUNAA in 2008. The RUUNAA similarly acts as a “default” law for nonprofit associations by improving upon common law principles but further adds provisions regarding the internal governance, dissolution, and merger of unincorporated nonprofits.²¹ RUUNAA has been enacted in four States and the District of Columbia and introduced in one additional State.²²

New Jersey

Historical versions of New Jersey’s nonprofit corporation statute contained provisions applicable to unincorporated nonprofit associations. In drafting the Nonprofit Corporations Act, the Nonprofit Law Revision Committee expressly declined to include protections or rights for unincorporated associations, stating “since . . . formation of nonprofit associations without incorporation should be discouraged, no provision for them is included in this act.”²³ The NLRC further cautioned that unincorporated associations could unexpectedly expose members to contract or tort liabilities under the common law.”²⁴

New Jersey law grants “unincorporated organizations” the right to sue and be sued in the skeletal statutory provisions contained of N.J.S. 2A:64-1-6. Yet, the final subsection clarifies that these provisions are not applicable “to a fraternal, charitable or other organization not

¹⁸ REVISED UNIF. UNINCORPORATED NONPROFIT ASS’N ACT, Prefatory Note (2008).

¹⁹ REVISED UNIF. UNINCORPORATED NONPROFIT ASS’N ACT, Prefatory Note (2008).

²⁰ Elizabeth S. Miller, *Doctoring the Law of Nonprofit Associations with a Band-Aid or a Body Cast: A Look at the 1996 and 2008 Uniform Unincorporated Nonprofit Association Acts*, 38 WM. MITCHELL L. REV. 852, 853 (2012).

²¹ *Id.* at 867.

²² Enacting States include: Pennsylvania, Iowa, Arkansas, and Kentucky. A proposed bill is pending in South Carolina. Uniform Law Commission, Legislative Enactment Status, *available at* <http://www.uniformlaws.org/LegislativeMap.aspx?title=Unincorporated Nonprofit Association Act>.

²³ N.J.S.A. 15A:1-3 (1983)(Comment)

²⁴ *Id.* (concluding that “accordingly such organizations are discouraged because the members rarely anticipate such liabilities or provide for casualty insurance.”)

organized for pecuniary profit,”²⁵ excluding nonprofit associations from its legal recognition. Unincorporated for-profit associations are also contemplated by and subject to certain provisions of the Business Corporations Act.²⁶ While not governed by the provisions of the Nonprofit Corporations Act, nonprofit associations do benefit from the tort liability protections of New Jersey’s robust Charitable Immunity Act, codified in N.J.S. 2A:53A-7-11.²⁷

The Nonprofit Law Revision Commission’s statement in 1980 encouraging the incorporation of nonprofit entities does not contemplate the relatively recent ability to organize new enterprises as limited liability companies. While only viable since 1988, limited liability company formations outnumber corporate formations in many states.²⁸ Originally utilized with respect to for-profit enterprises, the Revised Uniform Limited Liability Company act contemplates the formation of nonprofit LLCs.²⁹ Similarly, New Jersey’s Revised Limited Liability Company Act of 2012 permits an LLC to operate for any lawful purpose, whether profit or nonprofit.³⁰ Additionally, while New Jersey’s prior LLC act required operating agreements to be in writing, the Revised Limited Liability Company Act permits operating agreements to be oral, written, or implied based on the way an LLC has operated.³¹ The flexibility provided by an LLC and the looser standard governing operating agreements may encourage unincorporated associations to organize as an LLC and lessen the need for a default law such as RUUNAA.

It is unclear whether a law such as RUUNAA discourages small non-profit entities from organizing as either a corporation/LLC or whether it is instead simply recognizes the existing reality of these small organizations. If stakeholders feel that unincorporated nonprofit associations do require statutory protections in New Jersey, it may be preferable to draft law that

²⁵ N.J.S.A. 2A:64-6; see *Davidson v. Roselle Park Soccer Fed'n*, 304 N.J. Super. 352, 355 (Ch. Div. 1996) (holding that “[a]s the group does not appear to be organized for a pecuniary purpose it cannot be sued,” and is therefore not liable for plaintiff’s attorney fees.); see Howard L. Oleck, *Nonprofit Unincorporated Associations*, 21 CLEV. ST. L. REV. 44, 47 (1972) (noting that this limitation of New Jersey law “is not explained”).

²⁶ N.J.S. 14A:1-2.1 defines “Other business entity” as “a partnership, limited liability company, statutory trust . . . or any other unincorporated business.” Title 15A (the Nonprofit Corporations Act) does not contain a similar definition. Title 14A’s definition of “Other business entity” is operational in certain Business Corporations Act provisions. See e.g. N.J.S. 10-1 *et seq.* (detailing procedures for merger or consolidation).

²⁷ The statute reads in relevant part:

[n]o nonprofit corporation, society or association organized exclusively for religious, charitable or educational purposes or its trustees, directors, officers, employees, agents, servants or volunteers shall ... be liable to respond in damages to any person who shall suffer damage from the negligence of any agent or servant of such corporation, society or association, where such person is a beneficiary, to whatever degree, of the works of such nonprofit corporation, society or association....

N.J.S. 2A:53A-7 (1959).

²⁸ Kleinberger, Daniel S., *A Myth Deconstructed: “The Emperor’s New Clothes” on the Low-Profit Limited Liability Company*, 35 DEL. J. CORP. L. 879, 886 (2010)

²⁹ REVISED UNIF. LTD. LIAB. CO. ACT § 104, cmt. at 17.

³⁰ N.J.S. 42:2C-4 (2012).

³¹ N.J.S. 42:2C-2 (2012).

conforms more closely to New Jersey's existing Nonprofit Corporations Act and Business Corporations Act. In conjunction with the potential revision of Title 15A, Staff will conduct outreach regarding RUUNAA to ascertain whether this Act has relevance in New Jersey.

Conclusion

Staff requests the Commission's authorization to conduct further research and outreach regarding revisions to Title 15A. In conjunction with a Title 15A project, Staff will also investigate whether RUUNAA has potential applicability for New Jersey.