

Please Support

House Bill 1068

MAJOR POINTS:

- The Nonprofit Corporation Act was enacted in 1965 and has not had major updates in over 50 years (the “1965 Act”).
- The proposed Revised Model Nonprofit Corporations Act (the “RMNCA”) updates laws to allow nonprofits to operate in the 21st century and is “business friendly” for nonprofits:
 - o Updates the law so nonprofits can use modern technology such as e-mail for notices, Internet software for meetings, and the electronic storage of records.
 - o Provides new law for nonprofits to be able to utilize domestication, conversions, derivative proceedings, membership exchanges, mergers with entities other than nonprofits, and protect proprietary rights such as fictitious names (under existing law these are not options for nonprofits as there is no law on these matters).
 - o Provides more thorough law and further clarity for mergers, standards of conduct and governance procedures.
 - o Provides nonprofits with the choice of entity as nonprofits can select whether they want to form as a nonprofit limited liability company or a nonprofit corporation. Under the 1965 Act, nonprofits do not have a choice and must be a nonprofit corporation to fall under the 1965 Act.
 - o The liability protections afforded to nonprofits under the 1965 Act are carried over and kept the same under the RMNCA.
- Existing nonprofits will have the ability to select whether to stay governed under the existing 1965 Act or be governed under the new RMNCA. Nonprofits formed after the RMNCA is enacted would be governed under the RMNCA.
 - o If existing nonprofits want to stay governed under the 1965 Act, they will need to do: NOTHING.
 - o If existing nonprofits want to be governed under the RMNCA, they will need to do: amend articles of incorporation by adding a sentence that states they are governed under the RMNCA. (Note that a nonprofit would also want to update bylaws to take advantage of the modernization of law so they can utilize e-mail, etc.)

BACKGROUND:

The current Nonprofit Corporation Act was enacted in 1965. Diverse types of nonprofits are governed under the 1965 Act, such as religious organizations, private and community foundations, health care organizations, educational institutions, homeowners associations, cooperatives, and the list goes on. Although many of our nonprofits have pushed to be at the forefront and to be leaders in industries, our nonprofit laws have not kept pace. There have been no major updates to our nonprofit laws in over 50 years.

The proposed language in the bill is developed from the Third Edition of the Revised Model Nonprofit Corporation Act that was adopted by the America Bar Association in August of 2008. Most states have derived their nonprofit corporation laws from or are closely related to the various

model legislation adopted by the American Bar Association. Domiciles that follow some version of the Model Nonprofit Corporation Act are generally viewed favorably as it provides for greater uniformity, richer sources of precedent, statutory interpretation and clarity of law.

In 2010, a nonprofit law subcommittee of the Business Law Committee of the State Bar of South Dakota was assigned to analyze and modify the model legislation to tailor to the needs of South Dakota. The subcommittee sought input from nonprofit entities and also worked with the offices of the Secretary of State, Attorney General and Department of Revenue. After passing through the subcommittee and larger Business Law Committee, the proposed legislation was passed by the State Bar of South Dakota in June, 2014, to be recommended for consideration by the South Dakota State Legislature. The proposed revised Act was introduced in the legislature in 2015. Concerns were expressed regarding existing nonprofits. The proposed bill was tabled; and immediately thereafter, the nonprofit subcommittee of the Business Law Committee began revising the proposed law.

The most significant change made to the bill that was introduced in 2015 is that the 1965 Act will stay in place as is with the addition of a separate Chapter reflecting the proposed RMNCA. This will enable existing nonprofits the ability to elect if they want to be governed under the new law or stay under the 1965 Act. Newly organized nonprofits will fall under the updated RMNCA once it is effective and cannot elect to be governed under the old law. Further revisions were also made to tailor to meet the needs of South Dakota nonprofits.

Two continuing legal education seminars were held in September of 2015 in Rapid City and in Sioux Falls. These seminars were free and open to the public. Over 400 nonprofits were mailed invitations to attend and all legislators were invited to attend as well. The proposed RMNCA has been posted on the State Bar of South Dakota's website for anyone to view, along with the videos and materials from the continuing legal education seminars.

OVERVIEW OF HOUSE BILL 1068:

The proposed legislation improves governance by updating the code to allow nonprofits to operate in the 21st century and allows South Dakota to become business friendly for nonprofits. The notice requirements are expanded in the proposed legislation to include multiple means of communication, including electronic communication. This allows nonprofits to use existing technology such as e-mail to communicate and do business, a convenience that has been afforded to for-profit businesses for years. In contrast, current nonprofit laws only allow written notice in most circumstances. In the proposed bill, meetings may occur by means of the Internet or other electronic communications technology so that members have the opportunity to read or hear the proceedings substantially concurrently with their occurrence, vote on matters submitted to the members, pose questions, and make comments.

Where possible, provisions are updated to mirror the for-profit sections of SDCL. For example, the proposed model legislation addresses whether or not a record of incorporation filed with the Secretary of State must be in English. Like many other provisions, this issue is not addressed in the 1965 Act, but the issue is addressed within the for-profit sections of SDCL. Matters relating to the setting of a record date, determining the members entitled to vote, addressing how directors conduct meetings, actions by ballots, and the formation of voting agreements are all provisions addressed in our for-profit sections and are now addressed in the proposed legislation. The 1965 Act is simply devoid in certain areas. The current law does not address nonprofit domestication, conversion, derivative proceedings, membership exchanges, or transition provisions, all of which are addressed in the proposed legislation and are currently addressed in our for-profit sections of SDCL.

With regard to articles of incorporation and bylaws, few changes have been made. The RMNCA allows one or more persons to act as incorporators of a nonprofit to align with the for-profit businesses and be less burdensome for nonprofits. The RMNCA has fewer mandatory requirements to be set forth in the articles of incorporation than currently exist. However, the RMNCA has additional optional provisions that nonprofits may select to set forth in the articles of incorporation. Likewise, the RMNCA is similar to the 1965 Act that mandates the corporation to adopt bylaws and the bylaws may contain any provision for managing the activities and regulating the affairs of the corporation that is not inconsistent with law or the articles of incorporation. The filing, service and copying fees remain similar to the current law. Another area that remains similar is liability protection afforded to nonprofits. Significantly, the current law does provide reduced liability exposure in comparison to the Third Edition of the RMNCA. Accordingly, the current law pertaining to liability is maintained in the proposed legislation so there is no liability change for nonprofits with regard to such statutes.

The general powers granted to a nonprofit under the 1965 Act were not changed by the RMNCA which added a few more powers for nonprofits. One difference is that the powers granted by the RMNCA are limited by any contrary language in the articles of incorporation or bylaws, whereas the general powers granted under current law are generally not constrained by the articles or the bylaws. The RMNCA gives great deference to the articles of incorporation and bylaws in determining the right to vote, voting procedures, and quorum requirements.

Because nonprofits may supersede the general provisions of the RMNCA, they have great latitude to individually shape their governing requirements as they see fit and not put undue burden on nonprofit organizations. On the whole, the RMNCA is more comprehensive to help improve governance by allowing nonprofits to operate in the 21st century and by reducing the uncertainty and inconsistency that exists with the absence of law.

SECTION SUMMARY:

Sections 1-19: General Provisions

There are a number of minor changes found within the proposed RMNCA from the existing 1965 Act, such as changing the timeframe for the refusal of the Secretary of State to file a document from ten days to five days. There are a number of substantive changes such as greatly expanding the definitions section to provide clarity for nonprofits and other parties what terms mean. Additionally, the RMNCA will establish a much needed framework for members, delegates, directors, and officers when they challenge the validity of a nonprofit corporation's actions, and it requires a notice be given to the attorney general when such challenges occur. This will provide clarity for nonprofits and other parties if these situations arise. Finally, the RMNCA allows religious doctrine and canon law to specifically trump any inconsistent state law to the extent required by either the United States Constitution or the Constitution of the State of South Dakota in order to preserve freedom of religion for religious nonprofits.

Sections 20-25: Incorporation

The RMNCA removes the requirement that three or more persons act as incorporators so that one or more persons may act as the incorporators of a nonprofit. This requirement is similar to our for-profit business and is less administratively burdensome for nonprofits. The mandatory provisions in the articles of incorporation stay the same with the exception that there must be a sentence referencing that the nonprofit corporation is incorporated under the RMNCA if the nonprofit will be governed under said proposed law. This sentence will allow clarity about which law governs the nonprofit. The optional provisions in the articles of incorporation are expanded so that nonprofits can include additional governing provisions than currently set forth under the 1965 Act.

Sections 26-29: Purposes and Powers

Deviating from the 1965 Act, the RMNCA removes the specific and limited list of activities that nonprofits may engage in and replaces the same by stating that a nonprofit corporation can have the purpose of engaging in any lawful activity unless a more limited purpose is set forth in the articles of incorporation. This allows for greater flexibility for nonprofits in defining their own purpose and activities. It also aligns with the requirements of our for-profit entities. These sections attempt to streamline existing statutes into fewer and easier to read sections.

Sections 30-32: Name

These sections generally seek to streamline existing state law into fewer and easier to read sections and provide clarity for what is required of a name. It also discusses fictitious names, which is otherwise nonexistent in the 1965 Act.

Sections 33-49: Membership and Financial Provisions

The RMCNA retains many of the same aspects as the 1965 Act while implementing some new aspects. The RMNCA limits transfers of membership interest to those permitted in the articles of incorporation or bylaws, allows for the collection of dues, assessments, or fees that may vary among classes of members, allows capital contributions from members, and permits membership resignation, termination, or suspension. The RMNCA also explicitly requires creditors to obtain a judgment against the nonprofit before pursuing any member who may owe a debt to the nonprofit.

Sections 50-68: Member Meetings

These sections set forth the rules for member meetings. The rules and procedures for calling and holding member meetings are clarified and expanded by the RMNCA. Some notable new features include clarifying that meetings can be held electronically, allowing balloting on actions by members with or without meetings, allowing and describing voting by groups, and allowing members to enter into voting agreements.

Sections 69-111: Directors and Officers

These sections contain some of the most significant updates and clarifications to the 1965 Act. It creates and clarifies standards of conduct, liability, and indemnification rules for Directors and Officers. The RMNCA introduces the idea of allowing the Board of Directors to vest certain powers and functions (but not all) in a “designated body.” A member of a designated body need not be an individual, and need not be a Director, Officer, or member of the nonprofit. To the extent delegated, the Board of Directors or the members are relieved of responsibility as to the delegated powers. Significantly, the proposed RMNCA carries over the same immunities that protect nonprofits from liability of the 1965 Act. South Dakota has some of the strongest immunity in this regard, and the RMNCA carries that forward or expands such immunity.

Sections 112-133: Domestication and Conversion

The 1965 Act does not address domestication and conversion. Domestication or conversion of nonprofit corporations has therefore not been an option under current law. These sections consist of wholly new statutes to allow for domestication and conversion of foreign entities to SD entities and for-profit to nonprofit, and vice versa. These domestication and conversion sections are similar to for-profit entities.

Sections 134-147: Amendments of Articles of Incorporation and Bylaws

Under the RMNCA, the articles may allow for certain administrative amendments to be adopted by the Board alone, such as extending the duration of the corporation, deleting the name and address of

the initial incorporators or members as well as the name and address of the registered agent or office. The RMNCA allows the members or other designated body to repeal, in whole or in part, a corporation's Bylaws without Board action under certain situations. Where there is more than one class of members and a proposed amendment would affect the classes differently, the members of each class are entitled to vote as a separate voting group.

Sections 148-155: Mergers and Membership Exchanges

Under the 1965 Act, the choices for reorganization of nonprofit corporations are limited to merger or consolidation with another nonprofit corporation. The RMNCA allows mergers with entities other than nonprofit corporations, including business corporations, general partnerships, limited liability companies, limited partnerships, business or statutory trusts, joint stock associations, and unincorporated nonprofit associations. The RMNCA also allows membership exchanges between a nonprofit corporation and the same type of entities that may be subject to merger. The mechanics of a merger are similar to current law but more developed so that there are clearer procedures.

Sections 156-158: Disposition of Assets

The RMNCA updates and clarifies the governance provisions for the sale or disposition of assets of a nonprofit. Under the 1965 Act, there is no distinction between a sale, or other transfer, and a pledge or encumbrance, and they are treated in the same manner. Under the 1965 Act, the disposition of assets uses the phrase "all, or substantially all" which is undefined. The RMNCA provides express definitions and clarity to procedures.

Sections 159-167: Derivative Proceedings

The RMNCA provides new law so derivative actions may be brought. Derivative proceedings are not addressed under the 1965 Act.

Sections 168-185: Dissolution

The 1965 Act and RMNCA are very similar. The RMNCA specifies direction on director duties and defines certain terms that are undefined under the 1965 Act.

Sections 186-199: Foreign Corporations

The RMNCA provides new procedures for foreign corporations for compliance and transferring authority where they are lacking under the 1965 Act.

Sections 200-207: Records and Reports

The RMNCA provides procedures and scope for maintaining and providing inspection rights of records and reports. The RMNCA allows records and reports to be stored electronically.

Sections 208-213: Transition Provisions

Most significantly, the RMNCA allows existing nonprofits the ability to select whether they desire to be governed under the RMNCA or continue to be governed under the 1965 Act. Nonprofits formed after the RMNCA is enacted must be governed by the RMNCA.