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Evelyn Alicia Lewis

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WHEN ENTREPRENEURS OF COMMERCIAL NONPROFITS DIVORCE: IS IT ANYBODY'S BUSINESS? A PERSPECTIVE ON INDIVIDUAL PROPERTY RIGHTS IN NONPROFITS

EVELYN ALICIA LEWIS†

In this Article, Professor Lewis explores numerous issues raised by a relatively recent phenomenon: the blurring of traditional distinctions between the nonprofit and for-profit sectors of our economy due to increased commercial activity by nonprofit organizations. Specifically, Professor Lewis examines a divorce law question that, because of sector-blurring, is of growing potential relevance: Should a nonprofit entity's value be included for purposes of property-division allocations upon divorce when a divorcing spouse is a controlling manager of a small commercial nonprofit (a "closely held commercial nonprofit")? In answering this question affirmatively, Professor Lewis compares the interests of a manager/controller of a closely held commercial nonprofit to the ownership rights of a shareholder of a for-profit close corporation and finds no principled distinction between the two situations.

More expansively, Professor Lewis uses the divorce law question as a window for examining the control power of managers of closely held commercial nonprofits and various matters of more general applicability, resounding in close corporation, property, nonprofit, and divorce law. These matters include sector-blurring's power as an intersector of not only divorce and nonprofit law, but also other legal arenas that formerly seemed unrelated; the forces which entice entrepreneurially oriented individuals to select a nonprofit, rather than a for-profit, form as a medium for creating new value; the operations of closely held commercial nonprofits (and,

† Acting Professor of Law, University of California, Davis, School of Law. B.A. 1972, University of North Carolina, Chapel Hill; J.D. 1975, Harvard Law School. I am especially grateful to Edward Imwinkelried, Leslie Kurtz, Jack Ayer, and Carol Bruch for their helpful comments on draft portions of this Article. I also thank Mele Wood for her diligent and thorough research assistance.
inferentially, of a number of other types of small nonprofits), with particular focus on the implications of the nondistribution constraint imposed on nonprofits; the necessity for legal rules that recognize size and substance differences between nonprofits; and the importance of context to the discernment of the meaning of “property.”

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I. INTRODUCTION

Once upon a time the God of Charity ruled the world of altruism; his children were called the "Nonprofits" and they facilitated the provision of sustenance, health, education, religion, culture, and the like to their mortal descendants. Charity shared the universe with the Goddess of Commerce, who ruled the world of capitalism and business. Her children were known as the "For-Profits"; they facilitated their mortal descendants in profit-seeking endeavors. Occasionally, the Nonprofits and the For-Profits joined forces for a common purpose, but their spheres of operation generally remained separate. Government, the Ruler of the Universe, could easily tell them apart for purposes of regulating their rights and actions; it generally treated each group differently, with distinct rules for each. But then some of the children of Charity and Commerce began marrying each other, spawning progeny with mixed attributes. These progeny became known as the "Commercial Nonprofits." This Article is about the most self-contained and self-controlled of this new group: the closely held, commercial nonprofits. It examines whether the mortals who control and operate these nonprofits should be considered "owners" of the business interests held in the nonprofit form for the purposes of property-division allocations upon divorce of these operators. But this is not a bedtime story or a Greek myth.

Last year "Big Bird" and his Sesame Street neighbors grossed $31 million for their creators.1 "Barney," the purple dinosaur of Barney

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& Friends, reportedly made as much as $50 million.² Both programs have a primarily educational purpose, an admirable aim which qualifies, along with a number of other purposes,³ as a "charitable" endeavor, deserving of preferences under tax and other laws.⁴ Both programs serve the same basic group of patrons and customers. Both are produced by companies that received initial start-up funding in the form of sizeable gifts donated by grantors⁵ principally interested in "purpose accountability" rather than "profit accountability."⁶ Both generate most of their profit from ancillary, commercial activities—the licensing and sale of commercial products bearing the likeness of the television characters featured in the programs aired on public television stations.⁷ Finally, despite their monetary success, both programs continue to attract grant monies to subsidize their high production costs.⁸

Despite these similarities, there is a fundamental difference between the two programs. The producer of Sesame Street, the Children's Television Workshop (CTW), is organized as a "not-for-profit" or "nonprofit" corporation,⁹ and is thus prohibited from directly or indirectly distributing profits (generally referred to as the "non-distribution constraint").¹⁰ In contrast, the producer of Barney & Friends, the Lyons Group, is organized as a "for-profit" corporation that not only is free to distribute profits but is expected to do so.¹¹ The contrasting organizational statuses are offered here as an example of a fast-growing but relatively recent phenomenon: the blurring of

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² Edwards, supra note 1, at A1; see also PBS and CPB Plan "Harder Look" at Funded Shows' Ancillary Potential, PUB. BROADCASTING REP., Sept. 24, 1993, available in WESTLAW at 1993 WL 287165 [hereinafter Harder Look] (reporting that PBS is concerned with receiving a fair return on investment in children's educational shows in light of merchandising profits generated by the shows).
³ See discussion infra parts II.A., II.B.1., and II.C.1.c.
⁴ See discussion infra parts II.A., II.B.1., and II.C.1.c.
⁵ The Public Broadcasting Service (PBS), an educational television network, and its parent, the Corporation for Public Broadcasting (CPB), each contributed $1.125 million to fund almost one-half of the $4.5 million cost of the first 30 Barney installments. Edwards, supra note 1, at A8; Harder Look, supra note 2, at 1.
⁶ In contrast, for-profit ventures are funded by capital "investors" who, unlike grantors, purchase ownership interests in the ventures and generally seek profit accountability.
⁷ Edwards, supra note 1, at A1; Hall, supra note 1, at B1.
⁸ Elizabeth Jensen, Survival in the Cable Age, SEATTLE TIMES, Mar. 13, 1994, at F1.
⁹ See Edwards, supra note 1, at A1.
¹⁰ See discussion infra part II.A.
¹¹ See Edwards, supra note 1, at A1.
our nation's economic sectors caused by the substantial increase in business activities by nonprofit entities. This development, in turn, has precipitated reassessment of, and consequent changes in, the laws applicable to nonprofits.

This Article examines the implications of sector-blurring as a potential force for change in a legal arena that seems far removed from the world of nonprofits—the divorce law arena. In divorce law, it is well settled that business interests acquired or developed during marriage generally are divisible property upon divorce of the married business owners. If business interests now are being developed using the not-for-profit form, should these interests also be considered in property-division allocations upon divorce? This Article answers the question affirmatively, positing that when key managers of certain types of nonprofits divorce, they should be treated as de facto owners of the nonprofit businesses they control for purposes of property divisions. In reaching this conclusion, this Article examines numerous matters which resonate in legal contexts beyond those of nonprofit and divorce law, confirming the broad implications of the circumstances warranting the inquiry, i.e., the realities of sector-blurring.

A. The Sector-Blurring Phenomenon

Economists generally describe our market economy as composed of three sectors of activity, two of which—the government sector...
and the private, for-profit sector—are the most familiar. In recent years, however, the third "invisible sector," as it sometimes has been called, is finally receiving the scrutiny it warrants. Scholars, primarily economists and social scientists, are focusing increased attention on what they call "the third sector," the "independent sector," or "the nonprofit sector." All these terms refer to the

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15. Michael O'Neill, The Third America: The Emergence of the Nonprofit Sector in the United States 1 (1989) (noting that references to the "public" and "private" sectors often mean government and business, as if there were only two sectors).

16. Id.


18. See Salamon, supra note 14, at 4-5 (noting that the terms "voluntary sector," "charitable sector," and "tax-exempt sector" also are used and that each term emphasizes different aspects of this diverse sector); see also Hopkins, supra note 14, at 3-4 (listing the
private, nonprofit activities in this country that primarily involve the advancement of health, education, scientific progress, social welfare, culture, or other "charitable" purposes.  

Some blurring between the economic sectors has always existed, particularly between the governmental sector and the other two sectors. Government, using fee-for-services contracting, has long enlisted the services of the for-profit sector to carry out its functions. Similarly, government has long subsidized the activities of nonprofits through tax subsidies and grants, because these activities often privately advance the public good. But the phenomenon capturing scholarly attention in recent years is the blurring of the line between the operations of the for-profit and nonprofit sectors. Two powerful facts explain this phenomenon. First, the nonprofit sector has been the fastest growing sector of the economy in recent years. Second, the nonprofit sector's character has fundamentally changed.

The nonprofit sector is "huge, complex, important, and barely recognized. . . . It is perhaps the biggest unknown success story in American history." But the secret is getting out; its growth and maturation in the last twenty years command reassessment of our numerous terms used); O'NEILL, supra note 15, at 1-9 (emphasizing the term "third sector").

19. SALAMON, supra note 14, at 5.
21. See, e.g., Levy, supra note 12, at xiii. Levy notes that "the borders that once tidily separated governmental, for-profit, and nonprofit institutions are quickly vanishing. The cartographers who map these territories also confront a major challenge. Their representation of the third sector and its relationship to government and especially to business must keep pace with swiftly changing realities." Id.
22. As explained by Professor Peter Dobkin Hall:

Nonprofit organizations only became a significant and ubiquitous part of the American organizational universe in the very recent past: in 1940, there were only 12,500 secular charitable tax-exempt organizations . . . . Most of [the] growth took place after 1960—and did not become significant enough to merit the compilation of regular annual statistical reports until late in the decade. The effort to treat nonprofits as an institutional sector in the National Income Accounts dates only from 1980.

HALL, supra note 17, at 13 (1992); see also Hansmann, Evolving Law, supra note 17, at 812-13 (describing the difference in nonprofits pre- and post-1950); Daniel F. Skelley, Tax-Based Research and Data on Nonprofit Organizations, 1975-1990, 14 STAT. INCOME (SOI) BULL. 81, 81-83 (Sept. 1993) (citing statistics documenting the growth of the nonprofit sector relative to the economy as a whole).
23. See HALL, supra note 17, at 13, 259; Edward Skloot, Enterprise and Commerce in Nonprofit Organizations, in NONPROFIT HANDBOOK, supra note 17, at 380 (indicating that most of this change has occurred since 1980).
basic views about this sector. Available data reveals that "[f]rom 1977 to 1982 . . . [t]otal national income originating in the independent sector increased 85 percent in current dollars . . . . In comparison, total national income originating from business increased 55 percent and that from government, 58 percent." By 1990 (the base year for current, comprehensive data on the subject), 1.4 million nonprofit organizations existed in the nation, generating 6.2% ($289 billion) of the $4.6 trillion total national income. As one reviewer of this data noted, "This compares to 15% generated by government and 78.2% generated by the for-profit sector, and reflects a rate of increase for non-profits . . . substantially greater than increases in the other two sectors." Not only has the number of nonprofits increased, but nonprofits also have expanded the scope and size of their commercial activities, particularly since 1980. This increased "marketization" or commercialization of nonprofits is the predominant force blurring the distinction between the nonprofit and for-profit sectors. Thus, it is central to the issues examined in this Article.

Although nonprofits have carried on commercial activities for years, these activities formerly were confined to small pockets. However, financial pressures on nonprofits in the 1970s and 1980s forced adoption of new survival strategies. These pressures included the rising costs produced by the double-digit inflation of the late 1970s, the Reagan administration's reduction in funding in areas

26. See generally HODGKINSON, ALMANAC, supra note 25, at 13-178 (detailing findings on size, scope, and dimensions of diverse nonprofit sector and its various subsectors). For a statistical profile based on earlier data, see HOPKINS, supra note 14, at 21-27.
27. HODGKINSON, ALMANAC, supra note 25, at 16.
28. Id. at 17; see also Robert F. Carbone, Marketplace Practices and Fundraising Ethics, in NONPROFIT ORGANIZATIONS IN A MARKET ECONOMY, supra note 12, at 294-95 (citing the same figures presented by Hodgkinson); Howard P. Tuckman, How and Why Nonprofit Organizations Obtain Capital, in NONPROFIT ORGANIZATIONS IN A MARKET ECONOMY, supra note 12, at 203, 205-06 (noting the growth of nonprofits from 1977-1987).
29. Carbone, supra note 28, at 295; see also Skelley, supra note 22, at 81-83 (citing statistics documenting the growth of the nonprofit sector relative to the economy as a whole); OLECK, supra note 17, at 3-5 (discussing the "numbers and wealth of nonprofits" in a section so entitled).
30. See SALAMON, supra note 14, at 86. See generally Skloot, supra note 23 (describing the kinds of entrepreneurial activities favored by nonprofits and the impact of these activities).
31. See Skloot, supra note 23, at 380 (noting that the Metropolitan Museum of Art has been selling photos of its collections for more than 80 years and that several university presses were established before World War I).
where nonprofits were traditionally active, the Reagan administration’s call for increased self-reliance by nonprofits, and the resulting increased competition among nonprofits for corporate and foundation giving. In essence, “[a]s nonprofits cast about for new revenue opportunities, income-generating projects—once dismissed as illegal, irrelevant, or inconsequential—took on a particularly attractive cast... Thus, in the past few years, some nonprofits have established... a wide variety of earned income ventures.”

Nonprofits expanded their revenue-generating activities so much that by 1989 only 27.2% of the nonprofit sector’s annual revenues came from private gifts; the government provided slightly less than 26%. The sizeable balance of 37.9% came from dues, fees, and charges paid for products and services offered by the non-profit sector. As one commentator observed, “[I]t can be said that a substantial portion of the business of nonprofits is business.”

The success of nonprofits is so significant that for-profit businesses are crying foul, complaining that tax exemptions give nonprofits unfair advantages in the marketplace. These complaints even have prompted congressional hearings on the subject. There are

32. Id. at 380-81.
33. Id. at 381.
34. HODGKINSON, ALMANAC, supra note 25, at 9, 147; see also SALAMON, supra note 14, at 25-26 (giving overview and subsector breakdown of sources of funds). Budget-tightening efforts currently being undertaken by government portend even less governmental support of nonprofits in the future. See, e.g., Ellen Edwards & Jacqueline Trescott, Budget Ax Falls On Arts, Public TV—CPB Still Alive After Initial Cuts—More Pending?, WASH. POST, Feb. 23, 1995, at C1. These efforts are reminiscent of some of the same financial pressures that arose during the Reagan administration, which helped to precipitate the present level of sector-blurring activity. If history is a predictor, a new wave of increased sector-blurring activity may be on the horizon, heightening the need for more intense study of the legal implications of sector-blurring.
35. HODGKINSON, ALMANAC, supra note 25, at 9; see also SALAMON, supra note 14, at 26 (indicating that the percentage of income from dues, fees, and charges is as high as 51%).
37. See Non-Profit Competition: Hearings Before the House Comm. on Small Business, 100th Cong., 2d Sess. 52 (1988); see also HALL, supra note 17, at 269-70 n.3 (“[T]here is no industry in which ... proprietary ... and nonprofit firms do not compete—which is why the ‘unfair-competition’ issue has loomed so large with regard to nonprofits over the past two decades.”); HOPKINS, supra note 14, at 830 (discussing the unfair competition claims as responsible in part for the emerging “commerciality doctrine” being applied by the courts); O’NEILL, supra note 15, at 13 (observing that the report of the U.S. Small Business Administration was highly critical of the competitive advantage flowing from special nonprofit privileges, spawning proposed legislation to curb business activities); Skloot, supra note 23, at 9 (discussing the 1987 hearings of the Oversight Subcommittee of the House Ways and Means Committee); Cindy Skrzycki, Why Nonprofit Businesses are
numerous examples of the shift from the "bake sale"-type activities associated with our notions of traditional charities to the mass-marketed, high-end products and services offered by today's nonprofits: the popularity of Sierra Club calendars, the meteoric success of the Bank Street Writer educational software in the 1980s, and the "can't-keep-enough-in-stock" popularity of New Press's *May It Please The Court*, the controversial, unauthorized compendium of actual tapes and transcripts of leading United States Supreme Court cases. The selling of services by nonprofits is also big business. For example, renovated, sometimes even posh, exercise facilities in YMCAs across the country now compete directly with private health clubs.

Despite the proliferation of revenue-generating activities by nonprofits, the public perception of nonprofits is still dominated by images of break-even balance sheets and under-paid, altruistic staff assisted by martyr-like volunteers. Although these images are still accurate for many nonprofits, news reports of excessive or unethical behavior in the nonprofit sector provide inklings of the substantial room for profit-making, and even profiteering, by nonprofit managers. Recall, for instance, recent television coverage

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38. See Skloot, supra note 23, at 381.
39. Id. at 385. According to Skloot, [t]he Bank Street Writer reached the marketplace in January 1983, only nine months after conception of the idea. By summer, the Bank Street Writer, with a dozen rave reviews behind it, had become the second largest selling word processing software in the United States, with expectations of becoming the leader in sales by 1984.

40. See Paul D. Colford, "*May It Please the Court* Doesn't: "Secret" Audiotapes Bring History to Life*, NEWSDAY, Sept. 9, 1993, at 67 (commenting that the "boxed set, published by The New Press, a nonprofit house in New York, has become as hot as Madonna's 'Sex' book was [the previous] fall").

41. See Marcia Berss, *Taxation by Other Means*, FORBES, April 11, 1994, at 64, 64; see also Skloot, supra note 23, at 383-87 (discussing other nonprofit service providers).
42. See Avner Ben-Ner & Theresa Van Hoomissen, *A Portrait of the Nonprofit Sector in the Mixed Economy*, in *THE NONPROFIT SECTOR IN THE MIXED ECONOMY*, supra note 14, at 243, 263-64 (reporting data drawn from a study of 8010 nonprofits in New York state in 1985 and concluding that "most nonprofit organizations approximately break even: most nonprofit organizations' revenues exceed expenditures, but only by a minute margin"); see also Sharon McDonnell, *Many Nonprofit Leaders Don't Profit*, CRAIN'S N.Y. BUS., May 9, 1994, at 29 (reporting that leaders of low budget nonprofits receive low salaries).
of the allegedly excessive percentage of profits from annual Girl Scout cookie sales used to support an inflated staff and swank administrative headquarters in New York City.\textsuperscript{43} Recall also news accounts of the excessive $390,000 salary of William Aromony during his tenure as President of the United Way\textsuperscript{44} and the fraudulent activities of Jim Bakker at PTL (Praise the Lord).\textsuperscript{45}

Such publicity has the positive effect of heightening awareness of sector-blurring activities. Yet, it generally focuses attention on the sensational and aberrant rather than the normative conduct.\textsuperscript{46} The increased marketization of nonprofits does not signify abandonment by nonprofits of their altruistic goals. Just the opposite is true: The impetus for the expansion of commercial activities is survival. The revenues generated from commercial activities create a mechanism of internal "cross-subsidization" for nonprofits, to use the terminology of economists.\textsuperscript{47} In other words, these revenues subsidize the often costly, service intense, public-benefit activities undertaken by nonprofits.

There are abuses, of course, but this Article restricts its attention to the legitimate and well-intentioned affairs of nonprofits.\textsuperscript{48} The

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  \item \textsuperscript{43} "Rolling in Dough," Eye to Eye with Connie Chung (CBS television broadcast, Mar. 6, 1994); see also Ellen Graham, Thin Rewards: Sprawling Bureaucracy Eats Up Most Profits of Girl Scout Cookies, WALL ST. J., May 13, 1993, at A1 (commenting on angry backlash by Girl Scout troops from report); Paul Vitello, Forget Cookies, Go For Dough, NEWSDAY, Mar. 27, 1994, at A6 (citing Girl Scouts' inability to copy corporate support and fundraising dinners used by Boy Scout Council to raise funds).
  \item \textsuperscript{44} See Roger Kahn, How Much is Too Much in Nonprofit Compensation? NONPROFIT TIMES, Apr. 1992, at 18; see also Amy Saltzman, You Don't Have to be Poor to do Good, U.S. NEWS & WORLD REP., July 25, 1988, at 64 (commenting on the increasing salaries in the nonprofit work sector).
  \item \textsuperscript{45} See Bakker Reportedly Denied Early Release, L.A. TIMES, May 13, 1993, at A19. For additional examples of abusive conduct, see OLECK, supra note 17, at 10-11; Ira M. Ellman, Another Theory of Nonprofit Corporations, 80 U. MICH. L. REV. 999 passim (1982); Hansmann, The Role, supra note 17, at 874-75.
  \item \textsuperscript{46} See, e.g., Hansmann, The Role, supra note 17, at 875 ("[A]buses appear to be the exception rather than the rule; ... nonprofit [institutions] in most industries ... are operated on a fairly circumspect basis."); see also OLECK, supra note 17, at 11-12 (same).
  \item \textsuperscript{47} The term "cross-subsidization" is repeatedly found in the literature on nonprofits. See, e.g., Henry Hansmann, Economic Theories of Nonprofit Organization, in NONPROFIT HANDBOOK, supra note 17, at 27, 39 [hereinafter Hansmann, Economic Theories]; Richard Steinberg, How Should Antitrust Laws Apply to Nonprofit Organizations?, in YOUNG, GOVERNING, supra note 17, at 279, 294-98.
  \item \textsuperscript{48} I believe adequate formal and informal procedures and structures already exist to temper and penalize most types of excessive behavior, most notably fiduciary standards imposed on officers and directors and the extensive budget oversight procedures imposed by many institutional grantors. However, for the proposition that changed governance structures are needed to curb the potential for abuse, see Ben-Ner, Who Benefits, supra
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legal ramifications of sanctioned and encouraged commercial activities are sufficiently broad to provide ample areas for examination. One such area is the specific focus of this Article.

B. Focus of this Article

The reality of sector-blurring between for-profits and nonprofits is continuing to change the legal rules that apply to nonprofits. As nonprofits have become more business-like in character, many laws once considered inapposite have become relevant. The specific objective of this Article is to examine whether a change in the divorce law treatment of nonprofits is also warranted.

The relevance of divorce law to nonprofits may not be immediately evident. But this reflects one of the problems addressed by this Article: The subtleties of sector-blurring are masked by organizational forms that once accurately reflected organizational substance, but that now have lost their accuracy. The traditional for-purpose/for-profit dichotomy between nonprofits and businesses is no longer sufficiently substantial to justify equating organizational form with substance. Today, many nonprofits serve both for-purpose and for-profit goals due to a new "no market, no mission" reality that controls their existence. Therefore, many of the legal changes now applicable to nonprofits reflect logical extensions of settled law to the altered reality of nonprofits. Such extensions are based on a fundamental jurisprudential tenet: Similar factual situations dictate similar legal treatment. Building on this theme of applying settled law to changed circumstances, this Article shows that when the reality of sector-blurring is unmasked, so too is the potential applicability of divorce law.

1. The Basic Question

If business interests developed during marriage are generally considered divisible property upon dissolution of the marriage of the
business owner, should business interests developed in a nonprofit form receive similar treatment? For those familiar with nonprofits, it may be tempting to quickly answer “no,” because nonprofits have no “owners” in the traditional meaning of that term. But this rejoinder assumes too much; it equates form with substance in all nonprofit situations. Thoughtful reflection on the issue requires examination of both the meaning of “ownership” and the operative divorce law parameters.

“Ownership” is a concept embracing a spectrum of powers and rights. Some incidents of ownership may still be found even when other significant rights in the traditional “bundle of rights” are not present. This Article posits that key managers of certain types of nonprofits enjoy de facto ownership of the nonprofit businesses worthy of consideration for divorce law purposes.

2. The Nonprofit Entrepreneur

Specifically, this Article focuses on the divorce law treatment of divorcing managers who could be considered “nonprofit entrepreneurs.” As noted by Edward Skloot, “Until recently, the term nonprofit entrepreneur was an oxymoron.... Nonprofits were charitable organizations that worked without profit motive.... Entrepreneurs, on the other hand, were businessmen for whom profit was both the cardinal reason for existence and the sole definition of success.” Webster’s Dictionary supports the inconsistency, defining “entrepreneur” as “one who organizes, manages, and assumes the risks of a business or enterprise.” Today, however, nonprofit entrepreneurs are found in all reaches of the nonprofit sector. Many large nonprofits have marketing divisions run by professional business managers, and many small nonprofits are started and operated by individuals who clearly fit both the connotative and denotative meaning of the term “entrepreneur.” These entrepreneurs have discovered that “commerce and charity can safely coexist.” In particular, the nonprofit entrepreneurs examined in this Article are

53. See discussion infra part IV.B.
54. THE NONPROFIT ENTREPRENEUR—CREATING VENTURES TO EARN INCOME (Edward Skloot ed., 1988) [hereinafter NONPROFIT ENTREPRENEUR].
56. WEBSTER’S NINTH NEW COLLEGIATE DICTIONARY 416 (9th ed. 1988).
those who operate nonprofits that are both (1) primarily commercial and (2) small.

With regard to the first criterion, sometimes the term "commercial nonprofit" is broadly used by commentators\textsuperscript{58} to describe any nonprofit engaged in significant commercial activity, even when the commercial activity is an ancillary endeavor used to subsidize non-commercial activities that are the nonprofit’s principal mission. A commercial nonprofit might, for example, use the sale of logo products to help fund aid to the poor or cancer research. However, since this Article focuses on the divorce law arena, it isolates for examination those entrepreneurs who operate nonprofit entities that most resemble for-profit counterparts. Accordingly, it concentrates on the narrower class of entrepreneurs of nonprofits engaged in commercial activity that is also the principal nonprofit mission of the entity, such as the publication and sale of educational software for children or the provision of nursing or day care services. The activities of these commercial nonprofits represent the purest form of sector-blurring. These nonprofits are organized for the express purpose of producing and selling particular goods and services; they are truly businesses. Granted, society places a high value on the particular goods and services provided by these entities,\textsuperscript{59} and it consequently sanctions their provision through the nonprofit form. Sometimes the products or services are offered at reduced cost.\textsuperscript{60} From the perspective of the founders and chief operators of these commercial nonprofits, however, their activities are undeniably entrepreneurial as well as charitable.

With regard to the “small” size criterion, the nonprofit must have a limited staff and the entrepreneur must be the sole or one of only a few full-time managers of the nonprofit. The thesis of this Article is that when commercial nonprofits are small, their operational character is analogous to those for-profit organizations commonly

\textsuperscript{58} See discussion infra part II.B.2.
\textsuperscript{59} See discussion infra part II.C.1.
\textsuperscript{60} See Steinberg, supra note 47, at 284-86. Bargain pricing is one reason why the for-profit sector argues that nonprofits unfairly compete. As one commentator puts it: Although business knows that many nonprofits perform needed social services, the complaint is with “commercial nonprofits”—those that focus on sales. Among ones that have attracted attention [is] the state-sponsored Minnesota Educational Computing Consortium, which sells software at bargain prices to schools nationwide. The San Antonio-based Southwest Research Institute, going beyond basic research, inspects nuclear plants. And Seattle’s Northwest Hospital Speech and Hearing Center has a brisk walk-in trade. Skrzycki, supra note 40, at 65.
referred to as "closely held corporations" or "close corporations." The operators of small, primarily commercial nonprofits, often called "closely held commercial nonprofits" in this Article, have control powers equivalent in many respects to the key proprietary rights enjoyed by close corporation shareholders. Thus, in the context of divorce, the control powers held by the key managers of these nonprofits should be accorded treatment similar to that of the ownership rights of close corporation shareholders.

Small, commercial nonprofits are also analogous to closely held corporations in importance. Closely held corporations comprise a large subset of for-profit organizations, and the subset of nonprofits mirroring these entities is equally large in relative terms. Accordingly, in appropriate contexts, the small, nonprofit entities focused upon in this Article warrant separate evaluation—similar to that accorded closely held corporations. The divorce law arena is one such appropriate context.

3. The Implications of the Nondistribution Constraint

The reason nonprofits are not generally considered to have "owners" is the nondistribution constraint. The nondistribution constraint may not be reason enough to support such a broad conclusion, however, because it does not remove all incidents of ownership. Property law rules often focus on what property rights are left, rather than what rights have been taken away. Teachings from the for-profit sector illuminate how ownership-like rights are often exercised by managers/owners in ways that would not violate a nondistribution constraint or implicate their shareholder-owner status. Closely held corporations provide a particularly apt analogy.

While the nondistribution constraint may not be determinative of the existence vel non of ownership, it is a significant impediment to division of the actual business interests (i.e., an "in-kind" division).

61. See discussion infra part V.A (describing close corporations and their operational character).
62. Charles R. O'Kelley, Jr. & Robert B. Thompson, Corporations and Other Business Associations 56 (1992) ("[Ninety percent] of American corporations have fewer than ten shareholders and half have less than $100,000 in assets.").
63. See infra notes 114, 312 and accompanying text.
64. For instance, in determining whether restrictive land use regulations constitute a "taking" under the Fifth Amendment to the Constitution, courts generally examine whether significant property value remains after application of the regulation. See, e.g., Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 137 (1978) (holding that a taking had not occurred because the property owners still possessed some of their preexisting air rights).
However, in divorce situations in-kind division is not necessarily required. In divorce law, the inability to partition a tangible or intangible asset does not dictate the conclusion that its value should be excluded from the allocation of property rights. Courts often allocate the value of assets between spouses, rather than command their shared ownership or actual division. This is a common approach when division of asset control is infeasible or impermissible. Thus, divorce law focuses on whether a divorcing spouse holds an interest that can be fairly valued and treated as property for purposes of property division at divorce. Divorce law precedents offer useful guidance as to when property interests are sufficiently captured by an individual to warrant an allocation of proprietary value.

Given this perspective, the question explored by this Article can be refined: Should a nonprofit entity's value be included for purposes of property-division allocations upon divorce when one or both of the divorcing spouses has ownership-like control of the entity?

4. Practical Import and Related Perspectives

Do not assume the situation subsumed in the question bears more resemblance to a fanciful law school hypothetical than to a real-life issue. The impetus for this Article came from a pending divorce situation involving this very issue (fortunately, it appears that these particular parties will resolve their property division issues by settlement rather than asset-by-asset litigation). Also, some non-lawyer friends have shown unexpected interest in this Article, reporting anecdotal stories of past divorces involving nonprofit entrepreneurs where the issue was never raised, leaving the non-operator/spouses who had supported “the business” feeling unfairly disadvantaged. It is not that the legal issue is nonexistent, but only that the connections have not yet dawned on family law practitioners.

65. See discussion infra part IV.B.4.
66. I have been able to locate only one reported divorce case in which the issue is even raised, and in that case, the issue was raised inappropriately. See Allen v. Allen, 702 S.W.2d 819, 821 (Ark. Ct. App. 1986). In Allen, the court ruled against inclusion of a marital interest in a nonprofit supper club controlled by one of the divorcing spouses. Id. at 821. The court ruled correctly, but failed to articulate fully the proper reasons. The supper club was a membership club, owned by its members. Id. Thus, the club is distinguishable from the type of nonprofits upon which the present Article focuses. See discussion infra parts II.B.1 and II.B.2. See OLECK, supra note 17, at 1195 (detailing the differences, at dissolution, between membership nonprofits and other types of nonprofits). Nonetheless, the existence of the case illustrates the de facto ownership issued raised by the control power of managers of small nonprofits, and legitimate feelings of
that she or her spouse is employed as the president or chief executive of a small nonprofit entity, the de facto ownership issues are masked by the employment relationship. Few practitioners probe further into the underlying facts.

Moreover, the issues presented in this Article offer a useful perspective on a number of broader matters independently worthy of analysis: the potential expansiveness of sector-blurring's impact as a force of legal change; the differences in the operational realities of small nonprofits as compared to larger nonprofits and the significance of these differences for the design of nonprofit rules; the breadth of the control power of managers of small nonprofits; the shifting meaning of "property" in different legal contexts; and the relevance of form versus substance, particularly in the divorce context. This Article seeks not only to answer the specific divorce law question posed, but also to fuel discussion of these other matters.67

The balance of this Article is divided into four Parts. Part II provides an overview of the defining parameters of nonprofits and the theories about why they are organized and operated. It emphasizes those influences that dominate the motivations of nonprofit entrepreneurs of closely held, commercial nonprofits. Part III summarizes the evolutionary changes in nonprofit law precipitated by the sector-blurring phenomenon and discusses the implications of sector-blurring as an evolutionary force for change in other legal arenas, particularly divorce law. Part IV, using a hypothetical, reviews the divorce law treatment likely to be given the business interests held by a for-profit entrepreneur/shareholder of a close corporation. This Part identifies issues relevant to a comparative analysis of the appropriate divorce law treatment for a nonprofit entrepreneur. Part V uses the hypothetical to explore the essential proprietary rights enjoyed by a close corporation shareholder and compares these rights to the control powers held by a typical nonprofit entrepreneur. It concludes that the business interests held by the nonprofit

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67. See supra note 50 and accompanying text.
entrepreneur, particularly the goodwill value of the nonprofit business, deserve similar divorce law treatment.

II. OVERVIEW OF NONPROFITS

A. The Nondistribution Constraint

The terms “nonprofit” and “not-for-profit” generally are used synonymously to refer to entities possessing two negative characteristics. First, they are not part of government, and thus are called private; second, they are not profit-distributing, and thus are differentiated from the other component of the private sector—private businesses. In a well-known 1980 law review article, Professor Henry Hansmann, a leading authority on nonprofits, coined the term “nondistribution constraint” to refer to the prohibitions on profit distribution that give rise to the second defining parameter. Generally, the constraint “bar[s the entity] from distributing profits, or net earnings, to individuals who exercise control over it, such as its directors, officers or members.”

A chief advantage of nonprofit status is that an entity is eligible for exemption from federal and state income taxes, and usually from

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68. See OLECK, supra note 17, at 18 (“[T]here is no real difference between the two terms.”); see also Hansmann, Reforming, supra note 17, at 501 n.3 (explaining that confusion has arisen from attempts to distinguish the two phrases). However, “[s]ome persons see a subtle distinction between not-for-profit and nonprofit, in that the first term is more accurate because nonprofits may seek profit as long as that profit is employed only to fulfill the organization’s major (nonprofit) purpose.” OLECK, supra note 17, at 17.


70. Id. Lester Salamon notes:

Nonprofit organizations are neither part of the governmental apparatus nor governed by boards dominated by government officials. This does not mean that they may not receive significant government support. What is more, government participation on nonprofit boards is not unheard of... But the nonprofit organizations are fundamentally private institutions in basic structure.

SALAMON, supra note 14, at 6.

71. Id.

72. Hansmann, The Role, supra note 17, at 838.

73. Since the nondistribution constraint is contained in the operative provisions of the state laws under which a nonprofit entity chooses to be organized, the precise terminology of the constraint varies from state to state and depends upon the type of entity. When the nonprofit is a corporation, the constraint is imposed, explicitly or implicitly, by the state nonprofit corporation statutes under which they are formed. See Hansmann, Reforming, supra note 17, at 501-02. When the nonprofit is a charitable trust rather than a corporation, state trust law is the source of the nondistribution constraint. Id. at 502. If the entity is an unincorporated association, the source of the nondistribution constraint is vague and its nonprofit status is sometimes questionable. Id.

74. Id. at 501.
local income and property taxes, in whole or in part. Internal Revenue Code Section 501(c)(3) alludes to the nondistribution constraint, requiring that an applicant for tax exemption under this section be organized and operated so that "no part of [its] net earnings . . . inures to the benefit of any private shareholder or individual." Thus the nondistribution constraint is sometimes referred to as the "private inurement doctrine." In the words of the Office of the IRS Chief Counsel: "The inurement prohibition serves to prevent anyone in a position to do so from siphoning off any . . . income or asset for personal use...." Elsewhere, the chief counsel elaborates, "Inurement is likely to arise where the financial benefit represents a transfer of the organization's financial resources to an individual solely by virtue of the individual's relationship with the organization, and without regard to accomplishing exempt purposes."

Thus, the nondistribution constraint does not prohibit a nonprofit's receipt of profits. Nonprofits are quite free to make and even to accumulate profit, but profit may not be distributed to "insiders," i.e., "individual[s] . . . able to cause the application of the

75. See HOPKINS, supra note 14, at 6; SALAMON, supra note 14, at 5.
76. As Bruce Hopkins puts it:
    The exemption . . . does not extend to an organization's unrelated business taxable income. Thus, the term "tax-exempt organization" is often not literally accurate, inasmuch as this type of nonprofit organization may be subject to the tax on unrelated income, as well as other taxes, such as those imposed on private foundations, on organizations that engage in excessive lobbying, on organizations that engage in certain political activities, or on the investment income of certain nonprofit organizations.
    HOPKINS, supra note 14, at 31. Elaboration on the intricacies of the tax system are beyond the scope of this Article, since only the general parameters of the tax law are necessary to the focus here. However, HOPKINS, supra note 14, is an excellent source for those seeking more detailed treatment of this area.
77. Tax exemption is not automatic simply because an entity complies with the nondistribution constraint and other exemption requirements. Exemption is granted only upon application to the Internal Revenue Service and receipt of a favorable determination from the Service that the entity satisfies all of the exemption requirements. HOPKINS, supra note 14, at 29-31.
79. HOPKINS, supra note 14, at 266.
81. IRS Gen. Couns. Mem. 38,459 (July 31, 1980) (available in 1980 IRS GCM LEXIS 71); see also HOPKINS, supra note 14, at 264 (quoting the same language).
82. The term "insiders" is sometimes used to describe trustees, officers, members, founders, contributors, or others who have sufficient interest or control power to cause the prohibited action. See HOPKINS, supra note 14, at 266.
organization's net earnings for private purposes as the result of [their] exercise of control of or influence over the organization. In this Article, the term "control power" is a shorthand reference to such control and influence. Significantly, the nondistribution constraint does not proscribe transactions with insiders, only distributions to insiders. Transactions with insiders, sometimes called self-dealing transactions, are generally permissible as long as the payment for goods or services provided by insiders is reasonable. The nondistribution constraint proscribes only "unreasonable compensation, unreasonable rental charges, unreasonable borrowing arrangements," or other actions that effect disguised distributions of profits to persons with control power. Since profits are by definition "net earnings," reasonable expenses incurred by the nonprofit, even when paid to an insider, are not covered by the nondistribution constraint. The constraint is satisfied when net income/profit is applied to the purposes and missions of the nonprofit, including reasonable expenditures incurred in its behalf.

B. Types of Nonprofits, with Focus on the Closely Held Commercial Nonprofit

While the nondistribution constraint is the substantive dividing line between the nonprofit and for-profit sectors, the nonprofit sector itself includes many subsectors. The closely held commercial nonprofits examined in this Article comprise one such subset group. This Section provides a perspective on this group's placement relative to the larger nonprofit sector. While "[t]here is no canonized method

83. Id. Governing laws of most states and the tax laws also require nonprofits to be operated exclusively for charitable or tax-exempt purposes. This operational test gives rise to an over-arching "private benefit doctrine," which proscribes untoward benefits to anyone, including "outsiders." Generally, however, the nondistribution constraint focuses on insiders since this is usually the group of persons to whom any private benefit would accrue. See generally HOPKINS, supra note 14, at 297 (distinguishing the private benefit doctrine from the narrower private inurement doctrine/nondistribution constraint).

84. See discussion infra part V.B.

85. There are rules that limit self-dealing transactions with interested parties, particularly those which apply to a special category of nonprofits known as "private foundations." But this is not the focus of the nondistribution constraint. Self-dealing transactions are often the events that offer the opportunity for violation of the nondistribution constraint, so there is some correlation and analogy. See HOPKINS, supra note 14, at 274. However, the distinction between self-dealing transactions and violations of the nondistribution constraint must be kept clear.

86. See Hansmann, Reforming, supra note 17, at 501.
87. HOPKINS, supra note 14, at 267.
88. Id. at 266.
of grouping private nonprofit organizations, sorting them by purpose and mission is one useful means. Sorting by income sources and governance structure is another.

1. Sorting by Purpose: Member-Serving Versus Public-Serving Subsectors

In terms of purpose and mission, there are two basic, but very different, categories of nonprofits: member-serving nonprofits and public-serving nonprofits. The commercial nonprofits concentrated upon in this Article generally fit in the public-serving category. A brief explanation of the member-serving category helps to distinguish the focus category.

Member-serving nonprofits generally have some public purpose but primarily exist to benefit members of the organization rather than the public at large. They are sometimes referred to as “mutual benefit” organizations. The IRC lists 27 different types of member-serving nonprofits, including credit unions, country clubs, service, fraternal and professional organizations, trade associations, business leagues, political parties, member cooperatives, and labor unions. Chambers of commerce, Rotary clubs, golf and tennis country clubs, the American Automobile Association, the Consumers Union, and the American Bar Association are just a few examples of primarily member-serving organizations.

In contrast, public-serving organizations are most closely associated with our traditional notions of charities and nonprofits. These organizations primarily exist to serve the public at large rather than members. In fact, most do not even have dues-paying members or a membership structure. Their operations are directed towards serving a public purpose or furthering a specific cause rather than towards providing benefits to a particular group of people. They are often referred to as philanthropic or “public benefit” organizations.

90. See generally O’NEILL, supra note 15, at 4 (referring to these categories); SALAMON, supra note 14, at 13-16 (describing differences between the two categories).
91. SALAMON, supra note 14, at 14.
92. Some state nonprofit corporation laws, such as California’s, use the term “mutual benefit” corporation to identify a particular class of nonprofit which is subject to different organizational rules than other categories of nonprofits. See, e.g., CAL. CORP. CODE §§ 7110-8910 (West 1990 & Supp. 1995); see also O’NEILL, supra note 15, at 3, 156 (noting use of this term).
94. See O’NEILL, supra note 15, at 2; SALAMON, supra note 14, at 14.
to distinguish them from mutual benefit nonprofits. The target of these organizations' aid may be a narrowly defined group, such as homeless children or the elderly, but the activities of this sector as a whole generally are aimed at alleviating overall societal failings, inadequacies, or problems. The primarily public-serving subsector accounts for approximately sixty-five percent of the nonprofit organizations in this country and more than ninety percent of the total employees and revenues of the nonprofit sector.

Service providers comprise the heart of the primarily public-serving nonprofit subsector, delivering physical and psychological health services, day care, adoption services, historical awareness, education, counseling, community organization, protection of minority group rights, environmental improvement, employment and training, arts, culture, music, theater, and a vast array of "public goods." They include hospitals, nursing care facilities, libraries, universities, museums, and recycling organizations. Because these private organizations serve public purposes, they enjoy preferred status among nonprofits under the tax law. Their tax exemption stems from IRC Section 501(c)(3), which is reserved for those nonprofits operated "exclusively for religious, charitable, scientific, literary, or educational purposes." In addition to eligibility for tax exemption, Section 501(c)(3) organizations can receive grants and contributions from other nonprofit institutions. These institutions, sometimes called "funding intermediaries," predominately raise money and provide funding for other nonprofits rather than engage directly in active operations themselves. Moreover, Section 501(c)(3) nonprofits are eligible to receive tax-deductible donations from individuals and for-profit corporations. The justification for allowing individuals and for-profit corporations to deduct gifts to Section 501(c)(3) organizations

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95. See CAL. CORP. CODE §§ 5110-6910 (West 1990 & Supp. 1995); O'NEILL, supra note 15, at 2, 156.
96. SALAMON, supra note 14, at 13-14 (based on 1989 data).
98. SALAMON, supra note 14, at 22.
99. See infra notes 124-28 and accompanying text for elaboration of the meaning of "public goods."
100. O'NEILL, supra note 15, at 2.
102. This is the term used by Professor Lester Salamon to describe those public-serving nonprofit "organizations whose sole, or principal, function is to channel financial . . . support to other nonprofit organizations . . . Private foundations (e.g. The Ford Foundation, The Rockefeller Foundation, The Carnegie Corporation) are among the most visible." SALAMON, supra note 14, at 16.
derives from nonprofits' performance of public services that the
government might otherwise have to support through tax
revenues. Deductibility encourages voluntary contributions to
these entities.

2. Sorting by Income Sources and Governance Structure: Focus
on the Closely Held Commercial Nonprofit

As previously stated, the closely held commercial nonprofits
concentrated upon in this Article fit in the primarily public-serving
subsector of the nonprofit sector. This subsector is extremely diverse,
and its members can be further sorted by the nature of their activi-
ties or by a number of other criteria. Closely held commercial
nonprofits generally are not formally controlled by members or
patrons. Thus, they fall within a subset of the primarily public-serving
subsector that Professor Henry Hansmann calls the "commercial
entrepreneurial" category.

In his 1980 article and supplemental writings, Professor
Hansmann set forth a scheme for categorizing nonprofits based on the
sources of their income and according to the way they are governed.
Under the sources of income criterion, he classifies organizations as
donative if the bulk of their income comes from unrestricted
donations and contributions, and as commercial if the primary source
of income is payments received for goods and services. Under the
governance criteria, he describes organizations as mutual if members

103. Id. at 14.
104. For example, Professor Lester Salamon breaks this subsector down into four
different types of activity groups—(1) funding intermediaries, (2) religious congregations,
(3) service-providing organizations, and (4) political action agencies—and then identifies
subgroupings within each of these categories. See SALAMON, supra note 14, 13-26.
105. Some of the sub-subsector groupings often overlap when categorical criteria for
groupings are exhibited by nonprofits in either subsector. See generally Billis, supra note
12, at 249 (discussing zones of overlap as a factor in sector-blurring); Hansmann,
Reforming, supra note 17, at 503 (noting that his categorization describes ideal types and
that many nonprofits cannot clearly be assigned to one type or another).
Rev. 999, 1013-49 (1982) (criticizing various aspects of Hansmann's model in matters not
relevant to the focus of this Article).
107. Hansmann, The Role, supra note 17; Hansmann, Economic Theories, supra note
47; Hansmann, Reforming, supra note 17.
108. Hansmann, The Role, supra note 17, at 840-42; Hansmann, Reforming, supra note
17, at 502-03.
or patrons have ultimate control to elect the board of directors and as entrepreneurial if patrons do not have such control.

Hansmann combined these two classifications to arrive at four categories of nonprofits: donative mutual, donative entrepreneurial, commercial mutual, and commercial entrepreneurial. He explained that "these four categories . . . merely describe polar or 'ideal' types—extreme points on a continuum—rather than discrete forms of organization." Many entities will likely have aspects that qualify them for assignment to more than one of the four categories. For example, many organizations classified as "commercial" because of the sale of products or services generally will also have a donative funding base. Similarly, all organizations generally make it a practice to have patrons on their board of directors, whether the board is elected by members or patrons or both. A given entity's placement on the Hansmann continuum depends on the degree to which the various aspects are applicable.

Many nonprofits encompassed in Professor Hansmann's commercial entrepreneurial category are small corporations in which control power is often concentrated in one or only a few managers. This generalization is based on several facts. First, almost all nonprofits are organized as corporate entities under the applicable nonprofit corporation laws of the states of their incorporation, because incorporated entities receive the most favored tax and funding treatment. Second, the overwhelming percentage of nonprofits are small organizations. Large nonprofits (i.e., those with sizeable assets and staff, such as hospitals, universities, and major museums) attract the most attention from both scholars and the public because of their relative size, but small corporations predominate

109. The term "patrons" is used by Professor Hansmann to encompass all those persons who are the ultimate source of income for a nonprofit, such as members, contributors, and customers. Hansmann, The Role, supra note 17, at 841.
110. Hansmann, The Role, supra note 17, at 840-42; Hansmann, Reforming, supra note 17, at 502-03.
111. Id.
112. Id.
113. See HOPKINS, supra note 14, at 717-19; OLECK, supra note 17, § 9, at 19; PAUL E. TREUSCH, TAX-EXEMPT CHARITABLE ORGANIZATIONS 33-51 (3d ed. 1988); Hansmann, The Role, supra note 17, at 838 (noting that "most nonprofits of any significance are incorporated").
114. "The independent sector is dominated by a large number of small organizations about which little is known." HODGKINSON, ALMANAC, supra note 25, at 11; see also infra note 312 (setting forth statistical data on this point).
115. This may be partially attributable to a dearth of readily available data on small nonprofits, because they have fewer reporting requirements. Nonprofits are not required
in the nonprofit sector. Third, the initial boards of directors of these small corporations are frequently selected by the corporation's founders/managers and are usually self-perpetuating.116

All these facts converge to create a sizeable number of closely held, commercial nonprofit corporations that are analogues to the closely held corporations in the for-profit sector.117 The commercial activity in which these nonprofits engage is a part of their mission (rather than a collateral source of funding), and they are operated and controlled by a small staff with only one or a few managers. These managers are the nonprofit entrepreneurs focused upon in this Article.

3. The Implications of the Subset Size

Current laws still generally treat large and small nonprofits identically and are premised on a simplistic model that assumes the commercial activities of nonprofits are usually collateral rather than primary operations. However, the size of the subset of nonprofits that have small staffs, coupled with the increase in sector-blurring, commercial activities by all nonprofits, calls into question the appropriateness of this uniform treatment and the simplistic model. The data and facts outlined in this Section strongly indicate that the number of small, primarily commercial nonprofits is significant and that the national pool of nonprofit entrepreneurs who operate these entities is large.118 Once one distinguishes between the nonprofit or
to report to the Internal Revenue Service unless their gross receipts exceed certain base levels. See HOPKINS, supra note 14, at 778-79. Also, small nonprofits generally have fewer funders or donors who require or request financial reporting and so do not prepare annual statements or the like for broad distribution. In contrast, many large nonprofits release annual statements comparable to public companies. Further, many large nonprofits are in regulated industries, such as health care, where special reporting is required.

116. For authority for the position that these boards are usually self-perpetuating, see Fama & Jensen, supra note 17, at 319; Fishman, supra note 17, at 677; Hansmann, The Role, supra note 17, at 841.

117. See discussion infra part V.A; see also Fishman, supra note 17, at 666-68 (observing that a statutory nonprofit equivalent to the statutory close corporation is needed).

118. Perusal of the yellow pages of a local telephone directory or a polling of anecdotal experiences of random friends and colleagues generally will confirm this conclusion. The national news media are also replete with accounts of closely held commercial nonprofits. For example, NBC Nightly News recently reported about a new nonprofit called "Free Byte Computers," a computer recycling company started by a high school student and his friends in Atlanta, Georgia. The nonprofit company solicits donations of used, outdated computers from for-profit companies, and then it repairs, upgrades, and resells them to public schools and other nonprofits for a bargain price. When the teenager who started the endeavor was able to convert monochrome monitors to color, he caught the attention of the business industry and decided to form his own nonprofit company. NBC Nightly
for-profit status of businesses, the predominance of sector-blurring, nonprofit entrepreneurs becomes evident. The sheer number of closely held commercial nonprofits and of entrepreneurs who operate them heightens the need for separate legal evaluation of their situations, including the issues addressed in this Article.

Recognition of the significance of the small, commercial nonprofit subset is important for framing appropriate, contextual legal norms for the nonprofit sector. It is now widely accepted that the corporate law norms initially framed for the for-profit sector were deficient in their predominant focus on the large publicly held corporation. Differences in the operation of small, for-profit corporations dictated the later adaptation of special “close corporation rules,” which suffered in development because of their breached birth.\(^9\) Fortunately, the lessons of such prior oversights can aid in examination of the small, corporate nonprofit. The heightened attention now given the nonprofit sector offers opportunity for a systematic reassessment that embraces the distinctiveness of all subsets of the sector, including the closely held commercial nonprofit.

Indeed, lessons about the close corporation in the for-profit sector provide insights as to how the closely held, nonprofit corporate counterparts are operated and controlled. Specifically, lessons reveal how entrepreneurs of closely held, commercial nonprofit corporations often exercise significant control over the nonprofit’s business activities. This control power is sufficiently concentrated in these entrepreneurs to merit inclusion of the value of “their” closely held commercial nonprofits in property-division allocations upon the divorce of these entrepreneurs.\(^2\) Of course, I speak of those closely held commercial nonprofits that are relatively successful, because divorce issues are moot unless the business has some net positive value. Accordingly, before I elaborate further on the control power, it is appropriate to analyze why an entrepreneur would elect the nonprofit structure for a business that potentially could be economically viable as a for-profit entity.

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\(^9\) News (NBC television broadcast, Aug. 4, 1994). A California television news broadcast recently reported on a new, small architectural firm in Southern California that has incorporated as a nonprofit entity and will design and build ecologically safe homes for those who have special environmental sensibilities. KRON Evening News (NBC affiliate television broadcast, Aug. 4, 1994).

\(^119\) See discussion infra part V.A.1.

\(^120\) See discussion infra part V.B.
C. Why Nonprofit Entrepreneurs Select the Nonprofit Rather than the For-Profit Form

What forces operate to cause an entrepreneur to use a nonprofit vehicle to create and control economic value? Economists advance a number of demand-side and supply-side theories to explain the seemingly anomalous development of nonprofits in the market economy of the United States. Several of these theories are relevant to the discussion of why closely held, commercial nonprofits exist. Accordingly, they merit summary and analysis in this Section to aid in understanding the motivations of the nonprofit entrepreneur. This adds contextual understanding to later discussion of the proprietary nature of these nonprofits.

1. Demand-Side Theories

a. Contract-Failure Theory

A predominant demand-side theory that has broad applicability and wide acceptance is the contract-failure theory. This theory, articulated in significant detail by Professor Hansmann in 1980, derives from problems of principal-agent monitoring. According to this theory, nonprofits typically arise in situations where the ability of consumers to evaluate accurately the quantity or quality of a service or product is inadequate. This inadequacy often exists because the nature of the services or products or the circumstances under which they are purchased or consumed involve hard-to-measure attributes. The high cost of developing and enforcing a contract that specifies these attributes results in contract failure.

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121. Theories primarily only applicable to member-serving, mutual-benefit organizations, or specific industries, such as health care or the performing arts, are not discussed in this Article because of their particularized focus. See generally NONPROFIT HANDBOOK, supra note 17, chs. 12-17 (discussing certain specific industries).

122. Professor Henry Hansmann set forth this theory in his 1980 article titled The Role of Nonprofit Enterprise and his 1981 companion article titled Reforming Nonprofit Corporation Law. See Hansmann, The Role, supra note 17; Hansmann, Reforming, supra note 17. These articles have been credited with having “a seminal influence on the developing analyses of the law and economics of the nonprofit sector.” Steinberg & Gray, supra note 17, at 297.

123. Hansmann, The Role, supra note 17, at 839-44.

124. Clarke & Estes, supra note 17, at 946; see also ROBERT C. CLARK, CORPORATE LAW § 16.3.3 (1986) (discussing contract failure and the allocation of activities to nonprofits).
Several categories of situations in which hard-to-measure attributes arise can be identified. In the first, the persons who pay for a good or service are not its recipients, so that monitoring quality or quantity is difficult. This category includes the donation of money for the benefit of the poor. In the second situation, the nature of the product or service needed is complex and nonstandard, and the consumer lacks the ability or expertise to comparison shop or to assess quality. This category includes medical care and education. Finally, the product or service may be what is often called a "public" or "collective" good or service, meaning that the cost of providing the good to many persons is not appreciably more than the cost of providing it to one person; moreover, once provided, it is difficult to prevent others from "free-riding" on the payments of others. The indivisible nature of public goods makes it difficult for a consumer to determine whether her contribution has increased the level of service or instead has simply disappeared into someone's pocket as increased profit. Typical examples of public goods and services include listener-supported radio, public monuments, pollution control, and cancer research.

In all of the foregoing situations the provider of the goods or services (the agent) has an information advantage over the consumer (the principal). As Professors Richard Steinberg and Bradford Gray explain, "[F]or-profit firms have an incentive to take advantage of consumers in [such] cases of asymmetrical information, whereas the nondistribution constraint reduces this incentive in nonprofit organizations." Elaborating, Professors Lee Clark and Carroll Estes state, "Fearful of for-profit opportunism, clients search for a mechanism that 'mitigates [these] incentives . . . .' [R]ather than monitoring organizational output, clients rely on legal form as a signal that the urge

125. See Hansmann, Reforming, supra note 17, at 505-06, for further elaboration of these matters.
126. Professor Hansmann's example of listener-supported radio stations provides a good illustration of the operation of the contract-failure theory in the collective goods context. Such stations are providing the listening audience a public good. It is no more costly to make the radio signal available to all individuals living within a given radius . . . than it is to provide the signal to one individual within that radius . . . . This is, then, a situation in which enough people are willing to contribute voluntarily so that provision of a public good is economically viable on a nongovernmental basis . . . . A for-profit station would have every incentive to solicit payments far in excess of the total needed to pay for its broadcasts, and simply to distribute the difference to the owners as profits.

Hansmann, The Role, supra note 17, at 849-50.
127. Steinberg & Gray, supra note 17, at 297-98.
to profit maximize has been muted and, hence, that nonprofits merit institutional trust."\textsuperscript{128} In other words, the nondistribution constraint signals a trustworthiness upon which consumers rely in lieu of costly monitoring and contracting.

b. Market-Failure Theory

In the case of public goods and services, commentators emphasize that market-failure, as well as contract-failure, is involved. The free-rider problem, noted above, often produces too little of the collective goods and services and thus leaves everyone worse off.\textsuperscript{129} Even when contract-failure is or can be mitigated in the provision of a given public good or service, the market does not operate well in supplying it. For-profit firms have fewer incentives to produce a public good or service because the free-rider problem increases risks and reduces returns. Nonprofits serve as a non-market mechanism for correcting market failure. They allow groups of individuals who value the increased production of some good or service enough to bear the costs of its production to pool their resources through the medium of a nonprofit entity.\textsuperscript{130} This explains the historic dominance of nonprofits in industries providing public goods and services as well as the basis for our traditional notions of nonprofits as "charities."

c. Government-Failure Theory

Since governments also are limited by a nondistribution constraint, the contract-failure and market-failure theories do not explain why private nonprofits, rather than governmental entities, are the remedy for contract or market failure. In this regard, the government-failure theory complements the contract-failure and market-failure theories.\textsuperscript{131}

Proponents of the government-failure theory\textsuperscript{132} agree that

\textsuperscript{128} Clarke & Estes, supra note 17, at 946.
\textsuperscript{129} See, e.g., HOPKINS, supra note 14, at 21; SALAMON, supra note 14, at 7-8; Ben-Ner, Who Benefits, supra note 17, at 749-53; Hansmann, Economic Theories, supra note 47, at 29 n.2.
\textsuperscript{130} See SALAMON, supra note 14, at 8; Ben-Ner & Van Hoomissen, Governance, supra note 17, at 394.

\textsuperscript{131} The government-failure theory also applies as a supplement to the market-failure theory when market-failure is the applicable theory in the case of collective goods. See SALAMON, supra note 14, at 8-9.
\textsuperscript{132} See Clarke & Estes, supra note 17, at 947; Steinberg & Gray, supra note 17, at 299.

Professor Burton Weisbrod is generally credited for introducing this government-failure theory. See Burton A. Weisbrod, Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy, in ALTRUISM, MORALITY, AND ECONOMIC THEORY 171
nonprofit status symbolizes that quality will not be sacrificed for prof-

its. The proponents then observe that political and bureaucratic factors limit governmental provision. Chief among these factors is a limitation on governmental production of public goods determined by what the "median voter" is willing to support. In other words, governments tend to supply goods and services in accord with the wishes of the average or median preference voter. Thus, "when demand is diverse ... whatever quantities and qualities of services government provides will over-satisfy some people and under-
satisfy others." Individuals desiring different emphasis or focus may band together to supplement government, thus avoiding contract failure. Also, even when majority support exists for government financing of services or goods, other political and bureaucratic impediments may dictate government's contracting out of their provision. Government entities often choose nonprofit contractees to avoid government victimization by contract failure.

When we focus on the economics of nonprofits as gap-fillers for government failure, the immense non-economic value of these entities is revealed. Nonprofits are much more than economic entities; they are essential components of our democratic society. Nonprofits give voice to the full populace rather than merely the majority voter. As emphasized by Professors David Hammack and Dennis Young, [Nonprofits] enable Americans to express their opinions and to live by their religious beliefs and they help Americans to manage their religious, cultural, and ethnic conflicts. Thus, there are constitutional and civic as well as economic reasons


133. See SALAMON, supra note 14, at 8-9; see also Steinberg & Gray, supra note 17, at 299 (citing additional authorities on this point).

134. David C. Hammack & Dennis R. Young, Perspectives on Nonprofits in the Marketplace, in NONPROFIT ORGANIZATIONS IN A MARKET ECONOMY, supra note 12, at 1, 6; see also Hansmann, Economic Theories, supra note 47, at 29 (describing the role of the median voter in determining government production of public goods).

135. Steinberg & Gray, supra note 17, at 299.

136. BURTON A. WEISBROD, THE NONPROFIT ECONOMY 25 (1988); see also Clarke & Estes, supra note 17, at 947 (discussing Weisbrod's views); Steinberg & Gray, supra note 17, at 299 (reiterating arguments that governments provide goods and services to meet average wishes).

137. See Steinberg & Gray, supra note 17, at 299.

138. Id.; see SALAMON, supra note 14, at 8-9.

139. See generally SALAMON, supra note 14, at 3-4, 9-10 (describing the role of nonprofits in American society).
to be concerned about the economic behavior and economic well-being of nonprofit organizations.\(^{140}\)

d. Closely Held Commercial Nonprofits Only Partially Explained

Contract-failure, market-failure, and government-failure theories explain why certain industries, like social services, are dominated by nonprofits rather than for-profits.\(^{141}\) These theories explain the historical rise of nonprofits as potentially more trustworthy, higher-value suppliers of certain goods and services. They reveal why nonprofits have developed to meet the demands of consumers and patrons and why nonprofit entrepreneurs can anticipate patronage of their products and services. In other words, the contract-failure, market-failure, and government-failure theories explain the demand side of the demand-supply formula\(^{142}\) and some of the supply-side determinants.\(^{143}\) However, these theories do not fully explain the proliferation of nonprofits in recent years, particularly in industries where nonprofits compete with for-profit firms—the primary industries in which the closely held commercial nonprofits examined in this Article are found.

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140. Hammack & Young, supra note 134, at 14-15. Hammack and Young continue:

[N]onprofits made it possible to separate church and state... Nonprofits also make it possible for Americans to give concrete form to their rights of free speech. Through a nonprofit, it is possible to teach a very wide variety of political or scientific doctrines. It is possible to base a school, clinic, or antipoverty initiative on an idiosyncratic point of view that commands insufficient political support to influence a government-sponsored institution. And it is possible to found a museum, an academy of arts and sciences, or a cultural center whose purpose is to advance the values of a very specific national, ethnic, religious, or social group... The fragmentation of sovereignty makes it easier to accommodate diverse views because it provides the constitutional basis for the "marketplace of ideas."

141. See Hansmann, Economic Theories, supra note 47, at 37; Steinberg & Gray, supra note 17, at 300. Note, however, that a number of commentators have observed that the changes in the health care industry have made it more attractive to for-profits and that more and more for-profits are entering this field. They posit that the continued predominance of nonprofit hospitals and the like in the health care field is now more attributable to historical origins than to the demand-side theories articulated in this section. See, e.g., Theodore R. Marmor et al., Nonprofit Organizations and Health Care, in NONPROFIT HANDBOOK, supra note 17, at 221, 224-29; David B. Starkweather, Profit-Making by Nonprofit Hospitals, in NONPROFIT ORGANIZATIONS IN A MARKET ECONOMY, supra note 12, at 105, 106-07.

142. See Hansmann, Economic Theories, supra note 47, at 37.

143. See Hansmann, The Role, supra note 17, at 868-72.
Revenue generation for cross-subsidization of principal nonprofit missions explains increased commercial activity by many nonprofits;\textsuperscript{144} for instance, the sale of calendars by the Sierra Club subsidizes the principal mission of environmental protection. But this cross-subsidization motivation does not account for the increase in nonprofits in which the commercial activity is also the principal mission. In “mixed-market” industries—such as hospital care, nursing care, day care, theater, vocational education, media and publishing—in which both nonprofit and for-profit firms have substantial market share,\textsuperscript{145} the product or service sold is the prime activity and not simply a revenue generator for other pursuits. This commercial-activity-as-mission attribute is a key characteristic of the closely held commercial nonprofits operated by the nonprofit entrepreneurs examined in this Article.

In mixed-market industries the presence of for-profits is indicative of market response rather than market failure and of reduced or mitigated contract-failure problems. Why then do nonprofits enter these fields? Why isn’t the supply-side vehicle chosen by entrepreneurs for servicing the demand in mixed-market fields always a for-profit entity? Some observers note that the trustworthiness engendered by the nondistribution constraint gives nonprofits an edge in competing in mixed-market fields.\textsuperscript{146} This edge is rarely significant enough to warrant an entrepreneur’s voluntary subjection to the strictures of the nondistribution constraint, however, particularly in instances when the public is not even aware that it is dealing with a nonprofit entity.

Thus, demand-side theories provide only a partial understanding of an individual entrepreneur's motivations for choosing a closely held commercial nonprofit as a vehicle for creating new economic value. Accordingly, supply-side theories are needed to shed light on the additional factors that likely motivate the nonprofit entrepreneurs discussed in this Article.

2. Supply-Side Theories

Although demand-side theories receive the predominant attention from scholars,\textsuperscript{147} some supply-side theories and factors have been

\begin{enumerate}
\item \textsuperscript{144} See \textit{supra} notes 31-36, 47 and accompanying text.
\item \textsuperscript{145} Hansmann, \textit{Market Share}, \textit{supra} note 17, at 71.
\item \textsuperscript{146} Steinberg & Gray, \textit{supra} note 17, at 300.
\item \textsuperscript{147} Hansmann, \textit{Economic Theories}, \textit{supra} note 47, at 37.
\end{enumerate}
offered to explain the existence of nonprofits.\(^{148}\) Several of these theories help explain the motivations for the establishment of closely held commercial nonprofits.

a. Subsidy Theory

The subsidy theory\(^{149}\) focuses on "[t]ax exemption, low postal rates, the ability by some nonprofits to issue tax-exempt bonds, and favorable treatment under regulations governing . . . aspects of employment . . . [to] account for the presence of nonprofits in many fields."\(^{150}\) Some commentators argue that but for these explicit and implicit subsidies, the presence of nonprofits in mixed-market industries would decline,\(^ {151} \) and some evidence supports this theory.\(^ {152} \) For-profit firms espouse this theory in complaints that nonprofits have an unfair competitive advantage by virtue of the subsidies.\(^ {153} \)

This competitive advantage helps explain successful nonprofit encroachment on market-share in mixed-market industries. Thus, the subsidy theory serves as a demand-side theory as well as a supply-side theory. Indeed, some scholars discuss the subsidy theory as part of the former category,\(^ {154} \) or discount the subsidy theory as a supply-side explanation for why individuals are motivated to establish nonprofits in the first instance. They reason that subsidies may not be the principal motivating factor, because subsidies cannot legally accrue to the founders and because nonprofit presence in many industries pre-dates the laws establishing the subsidies.\(^ {155} \) This reasoning may be sound as a generalization about nonprofit founders as a whole. However, relative to the narrower category of founders examined in this Article—that is, entrepreneurs of closely held commercial nonprofits in mixed-market industries—I posit that the subsidy theory has significant credibility as a supply-side determinant to explain the enlistment of this specific group of entrepreneurs into

\(^{148}\) See generally id. at 28-40 (describing a number of both demand-side and supply-side theories); Steinberg & Gray, supra note 17, at 300-01 (noting the deficiencies of demand-side theories and proffered supply-side theories).

\(^{149}\) See Eugene F. Fama & Michael C. Jensen, Agency Problems and Residual Claims, 26 J.L. & ECON. 327, 344 (1983); see also Hansmann, Economic Theories, supra note 47, at 33 (citing authorities); Steinberg & Gray, supra note 17, at 300-01 (citing authorities).

\(^{150}\) Hammack & Young, supra note 134, at 7; see Fama & Jensen, supra note 149, at 344 (noting that tax concessions are important to some nonprofits).

\(^{151}\) See Hansmann, Market Share, supra note 17, at 71.

\(^{152}\) See id.

\(^{153}\) See supra notes 37, 60 and accompanying text.

\(^{154}\) See Hansmann, Economic Theories, supra note 47, at 33, 37.

\(^{155}\) Ben-Ner & Van Hoomissen, Governance, supra note 17, at 401.
the nonprofit ranks when two other sets of supply-side factors are applicable, as elaborated below. The first set involves the overlap of frustration and skill factors observed by scholars to be particularly evident in the nonprofit arena, which I group under one heading: the patron self-help factors. The second set involves the convergence of financial circumstances relative to both the chosen mixed-market industry and the personal situation of the would-be entrepreneur, which I group under another single heading: the financial tradeoff factors.

b. Patron Self-Help Factors

Professors Avner Ben-Ner and Theresa Van Hoomissen, two noted social scientists who study nonprofits, observe that the founding entrepreneurs of commercial nonprofits are often frustrated “stakeholders,” that is, would-be patrons of a particular good or service who are victimized by contract failure, market failure, or government failure in the search for that good or service in adequate quantity or quality to satisfy their needs. When would-be patrons of a good or service also have the skills and expertise to facilitate its production, they are motivated to effect the means to these ends for themselves and others seeking the same product or service.

Anecdotal examples of patron self-help include childhood educators who seek quality care for their own children organizing a day care center; computer experts with disabled relatives designing computers and software for use by the physically challenged; an African-American author dismayed by the lack of children’s books featuring minority characters deciding to write and publish them himself; and a commercial television producer interested in history forming an independent film production company featuring historical documentaries.

In the words of Professors Ben-Ner and Van Hoomissen, “Unlike for-profit firms, nonprofit organizations come into existence only when there is some overlap between those who demand nonprofit

156. This term is not used in the nonprofit literature but I use it to embrace various points from a number of different theories. See, e.g., Steinberg & Gray, supra note 17, at 299-301 (summarizing various supply-side theories).

157. See Ben-Ner & Van Hoomisen, Governance, supra note 17, at 401-03; see also Ben-Ner, Who Benefits, supra note 17, at 753-56 (referring to nonprofit controllers as “nonprofit demanders”); Dennis R. Young, Entrepreneurship and the Behavior of Nonprofit Organizations: Elements of a Theory, in NONPROFIT FIRMS IN A THREE SECTOR ECONOMY, supra note 17, at 135, 140-42 (discussing the different types of entrepreneurial managers).
provision and those who can engage in its supply."\textsuperscript{158} They also note that the net benefits stemming from control of the entity are powerful incentives for being a founder; control ensures that the organization will provide what the stakeholder wants, removing trustworthiness concerns.\textsuperscript{159}

In short, a chief motivation of these demand-side stakeholders is mission-maximization. This contrasts with the profit-maximization generally seen as the optimizing behavioral model applicable to for-profit entities.\textsuperscript{160} Nonetheless, a commitment to mission does not mean that profit motives are absent, since nonprofit entrepreneurs also have profit goals. The existence of the additional for-purpose goal simply means that quantity and quality concerns might not be sacrificed for \textit{maximum} profit. All firms, whether nonprofit or for-profit, must at least cover the costs of their undertaking, and this includes salaries for the entrepreneur and any other necessary personnel. Rarely would an entrepreneur have enough independent financial resources to donate her services for free.\textsuperscript{161} These financial needs raise economic impediments for entrepreneurs desiring to enter mixed-market industries as a means of patron self-help. They operate as incentives to make a financial tradeoff that exchanges the benefits of subsidy reliance for the limitations of the nondistribution constraint.

c. Financial Tradeoff Factors

The same demand-side factors that motivate the desire for patron self-help are strong predictors of business failure. Concededly, the analysis here already has been narrowed to mixed-market industries in which the potential viability of for-profit entities is evident. All businesses, however, carry risks of failure, and these risks are heightened in the situations examined here. The very fact that nonprofits also participate in these mixed-market industries indicates that the industries involve narrow patronage potential or complex product or service delivery aspects.\textsuperscript{162} The only ostensible difference

\begin{itemize}
\item \textsuperscript{158} Ben-Ner & Van Hoomissen, \textit{Governance, supra} note 17, at 402.
\item \textsuperscript{159} \textit{Id.} at 394, 402. \textit{See also infra} note 168 and accompanying text.
\item \textsuperscript{160} \textit{See CLARK, supra} note 124, ch. 16 (discussing behavioral models for corporate action); Hansmann, \textit{Economic Theories, supra} note 47, at 37-38 (discussing optimal models of nonprofit behavior). \textit{See generally Young, supra} note 157, at 135-36 (addressing profit motivation).
\item \textsuperscript{161} Even doctors who start "free" clinics would need an income stream.
\item \textsuperscript{162} \textit{See discussion supra} part II.C.1; \textit{see also} Steinberg, \textit{supra} note 47, at 292-94 (supporting this point).
\end{itemize}
between the nonprofit and for-profit providers of a particular mixed-
market good or service is the possibility that nonprofits might offer
superior levels of quality and quantity because of reduced profit-
maximization needs. However, this is a difference of real significance
to many. The “it might not pay” aspects of the industries, coupled
with their high value to society, are precisely why donors and
governments are willing to subsidize, through grants and preferential
tax treatment, the efforts of entrepreneurs to produce a higher
quantity or quality of the applicable good or service. 163

Given this high-risk context, the entrepreneur’s personal financial
situation will often be a final determinant of whether he selects a for-
profit or nonprofit form as his mode of entry into a mixed-market
industry. This determinant is relative, of course, to the minimum
start-up capital requirements for the particular business. If the
entrepreneur is confident of her skill and has sufficient money capital
(or the ability to raise money capital on the strength of past
reputation or contacts), the for-profit form offers an opportunity to
achieve maximum profit as well as mission. These entrepreneurs are
willing to assume the risks of loss for the promise of both mission and
profit. However, for the skilled or knowledgeable patron who
believes strongly in her potential for success, but who lacks capital or
the ability to raise it, the for-profit form is unrealistic. The patron
self-help motivations of these limited-capital entrepreneurs might go
unrealized were it not for the nonprofit option. These are the situ-
ations which lend significant credibility to the subsidy theory as a
supply-side determinant for the formation of closely held commercial
nonprofits in mixed-market industries.

For limited-capital entrepreneurs of small, closely held
nonprofits in mixed-market industries, nonprofit subsidies are
essential to the actualization of their businesses; the subsidy factors
work in conjunction with the patron self-help motivations to facilitate
implementation of the mission. This is particularly true when
eligibility for grant monies is added to the list of relevant subsidies,
as is the case for IRC Section 501(c)(3) organizations. 164 Tax
exemptions and other subsidies only reduce costs; they do not elim-
inate them. On the other hand, grants and donations provide a
source of capital for covering expenditures. Thus, the limited-capital
entrepreneur with a worthy mission and the ability to enlist the

163. See Steinberg, supra note 47, at 292-94 (arguing that “imperfect competition is a
necessary condition for the unique social benefits possible from nonprofit organizations”).
164. See supra notes 101-03 and accompanying text.
support of donors may see the nonprofit entity as a viable prospect. The increased competition among all nonprofits for funding dollars requires greater efforts by these entrepreneurs. As previously noted, this funding competition has increased commercial activity by nonprofits that seek cross-subsidization revenues in industries traditionally dominated by nonprofits. It also has meant that entrepreneurs of closely held nonprofits in mixed-market industries have had to become more commercially aggressive. They have had to rely more on independent revenue-generation from their primary goods and services for continued business viability. In earlier times, donors were more able and willing to finance a greater percentage of overhead and to sustain break-even or loss operations for years. Today, the successful nonprofit is the more attractive donee.

Thus, even with grant funding, entrepreneurs of closely held nonprofits in mixed-market industries face substantial economic risks. An entrepreneur's decision to invest her human capital in a nonprofit firm means that she will forego opportunities for investment of her labor in less risky endeavors. Unless she can obtain grant funding in sufficient amounts, resources will be inadequate to pay her a reasonable salary and to generate internal revenues from the

165. As observed by one commentator in the context of an unrelated point, "[m]any nonprofit organizations incorporate and seek tax exempt status solely to be eligible for foundation grants." Fishman, supra note 17, at 665. Consider also the comments of Judge Posner to the effect that "[t]he adoption of the nonprofit form does not change human nature.... Nonprofit status affects the method of financing the enterprise (substituting a combination of gift and debt financing for equity and debt financing) and the form in which profits... are distributed." Hospital Corp. of Am. v. FTC, 807 F.2d 1381, 1390 (7th Cir. 1986) (citation omitted). See generally Howard Tuckman, How and Why Nonprofit Organizations Obtain Capital, in NONPROFIT ORGANIZATIONS IN A MARKET ECONOMY, supra note 12, at 203-32 (exploring why nonprofits want capital and the sources of such capital). Professor Tuckman notes that "[f]oundation funding can be particularly important for nonprofits that are new, small or in areas that do not draw donor interest." Id., at 213.

166. See supra notes 31-32 and accompanying text.

167. For example, by law the National Endowment for the Arts (NEA) may only support organizations that are nonprofit and tax exempt. NATIONAL ENDOWMENT FOR THE ARTS, GUIDE TO THE NEA 1992-93, at 13 (1992). In addition, its funding policies expressly state that "[p]rogram guidelines generally preclude funding for new organizations, thereby focusing Endowment support on activities that have demonstrated their quality and value to their communities and ability to attract basic support from non-Federal sources." Id.; see also Don Adams & Arlene Goldbard, The Bottom Line, Funding for Media Arts Organizations, THE INDEPENDENT, Aug.-Sept. 1991, at 37, 39-40 (noting that it is becoming more difficult for additional groups to obtain funding support and that new nonprofits are being persuaded to increase their earnings).
production of goods or services. For this reason, control power is important to these entrepreneurs. In addition to insuring trustworthiness vis-a-vis the product or the service, control power insures that livelihood concerns will not be sacrificed for mission or be subject to the skills of others. If a would-be patron were solely motivated by a mission, patron self-help could be achieved by seeking employment at an established nonprofit, or even for-profit, entity that provides the desired goods or services or that could provide the quantity or quality of such goods or services with the aid and expertise of the skilled patron. However, when the patron also has profit motives, control power is needed to effect this goal. The patron-turned-entrepreneur is a person who has dual for-purpose and for-profit goals.

D. Summary

The material presented in the Introduction and in this part II details and explains the traditional parameters of nonprofits, the reasons for their formation, and their increasingly business-like nature, with special emphasis on closely held commercial nonprofits in mixed-market industries. The discussion reveals that the founder of a closely held commercial nonprofit often is a patron-turned-entrepreneur who has dual for-purpose and for-profit goals and also has limited capital resources. These entrepreneurs select the nonprofit, rather than the for-profit, closely held corporate form to create new economic value. The purpose goals qualify for nonprofit status and the nonprofit form provides a means of financing business operations when the entrepreneur lacks the means to finance a for-profit entity. The closely held nature of the entity allows the entrepreneur to have the necessary control power to ensure that her for-profit goals also can be effected as much as possible given the constraints of the nonprofit form. The next part explains further how sector-blurring has changed and is changing nonprofit law, and how this same phenomenon is so

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168. As one commentator stated: [C]ontrol of the nonprofit organization by these [organizing] demand-side stakeholders provides the only assurance that the firm will operate according to their economic demand . . . . [N]onprofit demanders . . . play the role of owners. [They] become involved in the control of nonprofit organizations if their expected benefits from operating a nonprofit organization, minus their expected costs, exceed the benefits they would receive from relying on the services provided by for-profit[s] . . . or government . . . or from entirely foregoing the service. Ben-Ner, Who Benefits, supra note 17, at 753.
pervasive that its evolutionary force commands change in other legal arenas, particularly the divorce law arena.

III. RAMIFICATIONS OF SECTOR-BLURRING FOR THE LAW

A. Sector-Blurring's Impact on Nonprofit Law

1. Historical Background

In an informative 1988 article summarizing the history of nonprofit law, Professor Hansmann noted that for over 100 years—until around 1950—the character of the nonprofit sector was quite different from what it is today:

[M]ost nonprofits were donatively supported organizations providing services that had the character of a public good for some substantial segment of the public—that is, they were traditional charities. Therefore, they could be treated as a unitary class. They also could be easily distinguished, both in terms of their finances and the services they provided, from the business firms for which most fiscal and regulatory legislation was primarily designed. Moreover, the nonprofit sector and most of the organizations within it were small. Thus, there was little incentive to work out approaches for extending fiscal and regulatory regimes to them . . .

For a long time, nonprofits benefitted from preferential treatment under fiscal and regulatory laws. In addition to receiving tax exemption and other privileged tax treatment, nonprofits were exempted from a long list of federal laws: Involuntary bankruptcy, collective bargaining, securities registration, etc.

170. *Id.* at 812.
171. Professor Hansmann categorizes laws as “fiscal” if they impose any form of general taxation or special taxes and user fees. *Id.* at 807-08. “Regulatory” laws include regulations bearing on the relationships between nonprofits and other private parties. *Id.* at 808. Professor Hansmann's article also discusses changes in “organizational” laws, i.e., the basic scheme of state nonprofit incorporation laws. *Id.* at 809-10, 814-16. Discussion of these organizational laws is beyond the scope of this Article.
172. *Id.* at 810-11.
Social Security,\textsuperscript{176} unemployment insurance,\textsuperscript{177} the minimum wage,\textsuperscript{178} and unfair trade practices\textsuperscript{179} were removed from the concerns of nonprofits. Moreover, nonprofits received favorable treatment under copyright\textsuperscript{180} and antitrust laws.\textsuperscript{181} They even obtained protected status from tort liability by virtue of the doctrine of "charitable immunity."\textsuperscript{182} A prime justification offered for many of these preferential laws was that they subsidized nonprofits in the effort to facilitate charitable activities.\textsuperscript{183} For non-subsidy type preferences, the justification was the assumption that nonprofits, given their "do-gooder" nature and activities, rarely, if ever, would engage in the type of negative behavior addressed by these laws.\textsuperscript{184}

2. Changes in Nonprofit Law Resulting from Sector-Blurring

Drastic changes in the nonprofit sector have occurred since the basic framing of these preferential laws, principally due to the commercialization of the sector. The entrenched nature of the legal preferences toward nonprofits slowed the progress of corresponding legal changes to reflect the altered character of the nonprofit sector.\textsuperscript{185} But, with time, the law has changed significantly.

\begin{itemize}
\item \textsuperscript{175} Securities Act of 1933, ch. 38, § 3(a)(4), 48 Stat. 74, 76 (current version codified at 15 U.S.C. § 77c(a)(4) (1988)).
\item \textsuperscript{178} 29 C.F.R. § 779.214 (1994); \textit{see also} Hansmann, \textit{Evolving Law}, supra note 17, at 811 n.11 (discussing past application of fair labor laws to nonprofits).
\item \textsuperscript{182} Hansmann, \textit{Evolving Law}, supra note 17, at 809.
\item \textsuperscript{183} \textit{Id.} at 825.
\item \textsuperscript{184} \textit{Id.} at 824.
\item \textsuperscript{185} One commentator notes:
\begin{itemize}
\item \textit{The rapid increase in the number and aggregate wealth of charitable organizations ... has taken the law by surprise. There has been no coherent development of the law of nonprofit organizations. Courts and commentators are still developing fundamental legal principles and attempting to achieve agreement as to what nonprofit organizations are and how they should be categorized. Fishman, supra note 17, at 618 (footnote omitted).}
\end{itemize}
\end{itemize}
A few of the changes include: judicial retrenchment from the charitable immunity doctrine in tort;\(^{186}\) the NLRB's gradual repudiation of the "worthy cause" exemption that shielded nonprofits from federal labor law;\(^{187}\) the deletion of nonprofits' ability to opt out of Social Security tax payments,\(^{188}\) making such taxes mandatory for nonprofits on the same basis as for-profits; the elimination of the nonprofit exemption from state unemployment insurance taxes;\(^{189}\) more aggressive application of the antitrust laws to nonprofits,\(^{190}\) in reversal of the prior partial exemption carved out by the judiciary; passage of the unrelated business income tax on nonprofits, which rolled back the broad tax exemption on all nonprofit income to subject to tax any portion of nonprofit income derived from "unrelated" commercial activities;\(^{191}\) and the passage of tax laws distinguishing among classes of nonprofits.\(^{192}\) Moreover, the law of nonprofits is still in a state of flux;\(^{193}\) additional reforms are being proposed and more changes can be predicted.\(^{194}\)

3. Evolutionary Nature of Changes

The legal changes set forth above are part of a natural, evolutionary process. First, nonprofit law no longer treats nonprofits monolithically and uniformly. Important legal distinctions exist

\(^{186}\) E.g., President & Directors of Georgetown College v. Hughes, 130 F.2d 810, 827 (D.C. Cir. 1942).


\(^{193}\) See Hansmann, Evolving Law, supra note 17, at 818 (noting, in particular, the withdrawal of tax exemptions for life and health insurance companies under the Tax Reform Act of 1986).

\(^{194}\) The reader can consult Professor Hansmann's 1989 article for elaboration of the listed changes and other proposed legal reforms, see id.; further detailing here is beyond the scope of this Article.
between different types of nonprofits and also between types of activities within a nonprofit entity. Second, although many legal changes required formal legislation and restructuring, a number evolved from judicial recognition of the altered reality of nonprofit operations. The courts extended established commercial law rules to commercial aspects of nonprofit operations. Operations cloaked in the nonprofit legal form are no longer automatically shielded from rules traditionally reserved for for-profit businesses. Third, even the changes wrought by legislation reflect application of the principle that similar situations should be treated the same under the law. Thus, as operational differences between nonprofits and for-profits have declined, so have the justifications for differing treatment.

B. Sector-Blurring as the Impetus for Evolutionary Change in Divorce Law

The evolutionary process affecting nonprofit law has been fueled by sector-blurring. It would be erroneous to assume that sector-blurring is a phenomenon that only affects nonprofit law; nonprofit law has simply been the principal arena in which the impact of the phenomenon already has been recognized. Sector-blurring is broad and deep and has the potential to fuel evolutionary change in legal arenas beyond nonprofit law. The established law of divorce is no exception. When a divorcing spouse is an entrepreneur of a closely held commercial nonprofit, her business interests in the nonprofit should be examined to determine if there is allocable property value attributable to these interests. The fact that the business interests are cloaked in nonprofit form should not automatically end the analysis. The realities of sector-blurring command a defrocking of form over substance in divorce law, as well as in nonprofit law. The same forces that require extension of traditional for-profit applications into the nonprofit sector compel similar extensions of divorce law applications into this sector.

Admittedly, nonprofits have no "owners" in the traditional meaning of that term. Therefore, it seems logical to conclude that

195. See, e.g., supra note 192 regarding exclusion of life and health insurance companies from I.R.C. 501(c)(3) status.
196. See, e.g., supra notes 186, 190 and accompanying text regarding judicial retreat from tort immunity and increased judicial application of antitrust laws.
197. See, e.g., supra notes 186-94 and accompanying text.
198. See, e.g., supra note 191 and accompanying text regarding taxation of income from unrelated commercial activities.
entrepreneurs of commercial nonprofits can have no proprietary value in something they do not own and that divorce law is thus inapplicable. However, it must be acknowledged that traditionally nonprofits generally had no quantifiable "business interests" that could have been the object of ownership by individuals; they were formed and operated for a purpose rather than for a profit. Thus, there is a circularity to the conclusion. The impetus for many of the proprietary property rules of our capitalistic society evolved from a reverse circularity; they developed in response to something of value that already was in existence. Property rules were designed to capture and corral existing value into a proprietary form. Had the original construct of nonprofits included the possible creation of new value, the framing of the law of nonprofits might have contemplated the implications of proprietary interests.

Reflection on the evolution of property law in general, and nonprofit law in particular, helps to focus both the arbitrariness and fallacy of assuming too quickly that divorce law is inapplicable to the nonprofit situation. If some types of nonprofits now create new value, then the evolutionary cycle of proprietary law dictates consideration of expanding that law to embrace it.

A business is still a business, whether it is cloaked in a nonprofit or for-profit robe. Recognition of this fact is the essential basis for the evolutionary changes that already have occurred in the nonprofit law arena. The legal form of a business may have particularized constraints that prevent wholesale transference of applications from one context to another. Fairness requires, however, that contextual similarities be respected—unless dissimilarities warrant difference in treatment. With respect to closely held commercial nonprofits, the chief dissimilarity between these entities and their for-profit counterparts is the non-distribution constraint. However, before we analyze

199. Property rules have evolved as a necessary mechanism of capitalism. They create, define, and protect entitlement to resources and value. The certainty of property entitlements is essential to efficient operation of the private property/contractual exchange regime. See generally Richard A. Posner, Economic Analysis of Law 29-77 (3d ed. 1986) (applying economic analysis to the common law of property); Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089 (1972) (proposing a framework for integrating the legal relationships between property and tort law that would hinge upon a concept of "entitlements" protected by property, liability, or inalienability rules). For instance, copyright laws give copyright holders exclusive property rights in work they create for a certain period of time. 17 U.S.C. §§ 101-803, 1001-1010 (1988 and Supp. V 1993). This is a property rule that fixes entitlement to something of value that, but for these laws, would be owned by no one. The laws evolved to capture value.
whether this dissimilarity warrants disparate treatment by divorce law of nonprofit and for-profit entrepreneurs, the serious fairness issues raised by the similarities between commercial nonprofits and for-profits merit examination. As to this point, the flip-side view of sector-blurring is very telling.

C. The Flip-Side View of Sector-Blurring: A Context for Assessing Similarities and Comparative Fairness

1. For-Profit Interlopers

Sector-blurring has occurred primarily because of the immense increase in commercial activity by nonprofits, including nonprofit entry into fields traditionally dominated by for-profit firms. But recent years also have witnessed an increase in the entry of for-profit firms in fields traditionally dominated by nonprofits. Public appreciation for quality child care, environmental concerns, cultural preservation, and similar endeavors has expanded; with this expansion has come increased demand for these value-based products and services.\(^\text{200}\) In many instances, the nonprofit sector must be credited with the increase in the high-value norms; nonprofits often have been forerunners in risky but valuable activities that for-profit businesses initially avoided due to predictions of low investment returns.\(^\text{201}\) Quality educational programming for children was risky business in the days when *Sesame Street* first aired;\(^\text{202}\) today, a winner in this arena is assured of profits.\(^\text{203}\) Nonprofit recyclers started curb-side

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200. See Hansmann, *Market Share*, supra note 17, at 78 (noting that there are industries in which nonprofit firms tend to serve relatively elite and presumably well-educated clientele and that the low-price, low-quality end of the market is served by government or for-profit firms); Skloot, *supra* note 23, at 389 (stating that the private sector is increasingly expanding into areas traditionally reserved for nonprofits).

201. See Hansmann, *Market Share*, supra note 17, at 77 (noting that “the proportion of hospitals that are for-profit has grown during periods in which demand for hospital services has expanded rapidly, and has then declined again when demand has leveled off”).

202. Edwards, *supra* note 1, at A2 (“When ‘Sesame Street’ began in the late 1960s, the producers knew they would have to look for additional revenues…. PBS did what nobody else was going to do ….”).

collection services when few cared; now recycling is a service municipalities want, and nonprofit recyclers must "find niches in a newly competitive marketplace dominated by for-profit firms." Similarly, nonprofits once dominated home health care; today it is a "multibillion dollar business, much of which is located in the for-profit arena."

In other words, capitalists have followed the dollar—often into markets created by the nonprofit sector. This contributes to sector-blurring, but it receives limited attention because it does not represent a fundamental change in the character of the for-profit sector. To the contrary, it is quite consistent with the established character of for-profits upon which legal norms are currently formulated. But these for-profit interlopers offer an excellent comparative reference for examining the unfairness of the current, disparate divorce law treatment of nonprofit and for-profit entrepreneurs. In particular, it is worthwhile to note a class of for-profit interlopers who engage in what might be termed "sector straddling."

2. Sector Straddling and Reverse Cross-Subsidization

Sector straddling involves the indirect use of nonprofit subsidies to generate for-profit revenues. Accordingly, it truly represents the flip-side of sector-blurring. Sector straddling is effected by the increasing trend, particularly in certain industries, to use various forms of public/private partnerships or affiliations and other intermediaries to channel "public" or nonprofit funds and deductible donations to for-profits for the undertaking of worthy endeavors. The underwriting arrangement between the Lyons Group—a closely held for-profit entity founded by a husband and wife filmmaking team—and PBS for the production of *Barney & Friends* is representative. Through such arrangements, grants and contributions are made to a qualifying nonprofit entity for a specific project. The nonprofit then contracts out the production of the goods and services necessary for the project to a for-profit entity, which usually initiated the idea for the "charitable" project. The nonprofit pays the contract

$80 million . . . "


206. See *infra* notes 209-10 and accompanying text.

207. See *supra* notes 2-11 and accompanying text.
fees to the for-profit, using the grant monies received from the project funder or funders. 208

When the subsidized, worthy endeavors of for-profits like the Lyons Group help to generate a large independent market for the products or services of the for-profit entities, it catches the attention of the public. In these cases, the public/private partnership results in a sort of "reverse" cross-subsidization that sometimes is more troubling to the public than the typical form of cross-subsidization that is received when nonprofits engage in revenue-generating commercial activities. There is a sense that the for-profit entity should share some of its profits with the nonprofit sector. For example, political pressures about such reverse cross-subsidization sparked PBS to seek return-on-investment (ROI) arrangements in future negotiations with for-profit producers such as the Lyons Group. 209

For-profit media and print companies are particularly well situated to benefit from such reverse cross-subsidization; the high visibility of their nonprofit endeavors, when successful, provides an opportunity for ancillary for-profit sales of tie-in products. For example, news reports have speculated about the profits made by Bill Moyers's for-profit production company, Public Affairs Television, Inc. (PAT), and Ken Burns's for-profit production company, Florentine Films. Both regularly use independent contrac-

208. See Andrew Ferguson, The Power of Myth: Bill Moyers, Liberal Fraud, THE NEW REPUBLIC, Aug. 19 & 26, 1991, at 22, 25 (reporting that such independent contractor arrangements are becoming increasingly common, particularly in the public television industry). Ferguson describes the practice as a type of "money-laundering." Id. I do not agree with the pejorative connotations that this term evokes because I am favorably disposed to the results of the practice in this context. However, I do believe the term is descriptively apt conceptually. See generally CLARK, supra note 124, at 696-701 (discussing the proper role of for-profits and nonprofits in providing public-regarding activities); PUBLIC-PRIVATE PARTNERSHIP: NEW OPPORTUNITIES FOR MEETING SOCIAL NEEDS (Harvey Brooks et al. eds., 1984) (presenting various viewpoints on forms of public and private collaborative efforts).


210. See Ferguson, supra note 208, at 24 (noting that since leaving CBS and forming his own production company in 1986, Bill Moyers has produced 136 hours of television).

211. For a description of Burns's company, Florentine Films, see DAVID MARC & ROBERT J. THOMPSON, PRIME TIME, PRIME MOVERS 301-08 (1992). Florentine Films was started in 1975 by a group of Hampshire College classmates who wanted to make films of their own choosing. Id. at 302. An interesting side note is that Amy Stechler, a classmate of Burns, joined Florentine Films soon after, became one of Burns's chief collaborators, and eventually married Burns. Id. She also is the current Vice President of Florentine Films. Recently, it was reported that Ken Burns and his wife are separated. See Richard
tor/nonprofit partnership arrangements. Because the commercial success of their features and documentaries increases demand for their services and imprimatur on products, the salaries paid by public television to Moyers and Burns for their programs are more competitive with those of top producers in commercial television than with those in public television.\footnote{212} In addition, sizeable earnings are generated by the royalties from the sale of television tie-ins such as books and tapes adapted from Moyers’s program—The Power of Myth—and Burns’s successful documentaries—The Civil War, which aired in 1990, and Baseball, which aired in 1994.\footnote{213} It is often difficult to determine the level of profit generated by such reverse cross-subsidization if, like PAT and Florentine Films, the for-profit

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Sandomir, *Hits, Runs and Memories*, N.Y. TIMES, Sept. 18, 1994, at B1. How problematic might their property division issues upon divorce be if Florentine Films were nonprofit rather than for-profit?

Husband and wife teams in sector-straddling film-making companies do not appear to be unusual. Lancit Media was founded by a husband and wife team who began in public television and now have taken their for-profit company public. See supra note 203. Bill Moyers’s wife is a noted filmmaker who is actively involved in the various Moyers productions and is President of PAT. See Ferguson, supra note 208, at 25. Consider also the late Jim Henson and his wife, another husband and wife television production team. Henson started as an employee of the nonprofit Children’s Television Workshop (CTW). He subsequently started his own for-profit company, Jim Henson Productions, Inc., with his wife, from whom he later became legally separated. See Jane Sumner, *The Master of the Muppets*, DALLAS MORNING NEWS, Jan. 16, 1993, at 1C; Carl T. Hall, *The Marketing of Nonprofit "Sesame Street," Licensing Contracts Bring in Millions*, S.F. CHRON., Dec. 30, 1991, at B1; see also Jeremy Gerard, ‘Sesame Street’ Talking About Race, From A to Z, N.Y. TIMES, Nov. 21, 1990, at C9 (describing the genesis and current economic status of Sesame Street).

\footnote{212} See Ferguson, supra note 208, at 24-25. The budget for Moyers’s project not only provides a salary for Bill Moyers, but also includes salaries for his wife and son. Id.

\footnote{213} According to one report:

The $50 “Civil War” companion [volume] has sold 750,000 copies, the most successful gift book ever. . . . There’s also an audio book, a soundtrack and a video set. All of which provide royalties. . . . The speaking fees aren’t bad either. . . . [Ken Burns’] typical fees have tripled to $7,500, although he has pulled in as much as $20,000 for a 40-minute appearance . . .


entities are not publicly held (and thus are not required to report their earnings publicly) and the information is not volunteered.214

However, concerns about such reverse cross-subsidization are balanced by the public service value of the endeavors undertaken by these for-profit entities. Most of these endeavors, like the predominant activities for which nonprofits are formed, are not considered commercially viable in the primary capital markets.215 This is why the public and nonprofit sectors subsidize these activities. Were it not for the subsidy, the endeavors or projects would not be undertaken at all or would be insufficient in their quantities or varieties.216 For this reason, funders like PBS argue that concerns about reverse cross-subsidization by for-profits are disproportionate to the context in which it occurs. They maintain that in the rare instances when a subsidized endeavor by a for-profit entity generates collateral success for that entity, the public gets what it paid for and often more.217 Further, the for-profit entity pays taxes on the unanticipated profits. Accordingly, as long as there is "purpose accountability" to the donors, and profit-sharing arrangements that curb excessive profits such as those earned by the Lyons Group,218 it is questionable whether significant changes or adaptation of laws should or will result in response to for-profit sector straddling.

3. A Comparative Reference for Analysis

Examination of the specific legal implications of sector straddling and reverse cross-subsidization are beyond the scope of this Article.

214. See Edwards, supra note 1, at A1 (reporting that The Lyons Group and other for-profit companies such as the PBS producers of the popular Thomas the Tank Engine would not reveal their licensing revenues); see also Ferguson, supra note 208, at 24-25 (indicating the same recalcitrance by Bill Moyers).

215. PBS representatives argue that "[w]ithout our funding, the television programs wouldn't necessarily have been there. . . . PBS did what nobody else was going to do. . . . The entire commercial broadcasting world had turned their backs totally on the preschool audience." Edwards, supra note 1, at A2.

216. See discussion supra part II.C.1. PBS executives have stated that "[f]or every 'Barney' there are 20 to 30 other programs that are underfunded," and "because public television won't provide total funding for shows, it has to offer incentives to attract "entrepreneurial" producers. You can't have it both ways." Jensen, supra note 8, at F2.

217. For instance, PBS executives note that public television benefits indirectly from programs produced by for-profits. To the extent shows like Barney or Bill Moyers' World of Ideas have broad appeal, they increase subscriber dollars. More funds are available to finance riskier programming by nonprofits. Cf. Jensen, supra note 8, at F2 (quoting a public broadcasting official who stated that public broadcasting "should get more [money] back" from profitable programs "to use to generate new shows").

218. See supra note 2 and accompanying text.
However, this flip-side view of sector-blurring underscores the similarities between the operations of certain types of for-profit and commercial nonprofit entities. For-profit sector straddlers offer an excellent comparative reference for examining the question of whether nonprofit business interests should be considered in divorce situations. Although any closely held for-profit entity could be used, a comparative reference to sector straddlers lends more force and focus to the fairness issues because these entities can capture nonprofit dollars without being subject to the nondistribution constraint. Thus, the divorce law analysis in Parts III and IV compares the divorce law treatment of the business interests of two hypothetical entrepreneurs: one who owns a closely held, for-profit entity that engages in sector straddling, and one who is the founder and chief operating officer of a closely held, commercial, nonprofit entity. Both hypothetical entrepreneurs are independent film producers in the television broadcast industry. A number of industries could have been selected for purposes of the hypothetical, but the television broadcast industry is a useful choice because its products—television programs—are generally familiar.

IV. BASIC DIVORCE LAW PARAMETERS

A. Two Hypothetical Entrepreneurs

Please meet Joe Quality and Sue Capital. Joe and Sue are having mixed feelings about their lives right now—their respective careers have just begun to take off, but both are beginning the process of divorce from their spouses. They reflect back over the last 10 years.

Joe and Sue both received their early training working in the news departments of competing, local commercial television stations, and both specialized in news features. Talented filmmakers, both soon became frustrated with their lack of editorial control over the selection, quality, and scope of projects on which they worked as staff employees. They wanted to do more in-depth work on projects with greater enduring significance, rather than continuing to hurriedly package the popular feature of the week. Eventually, frustration led to bravery.

219. The publishing, computer software, day care, and home health care industries are four other examples.
1. Nonprofit Company

Joe Quality was the first to leave the security of his steady job. He wanted to produce educational and cultural documentaries on his own. Joe's wife had a reasonably well-paying job. They could meet their household expenses if Joe brought in only one-half of the wages he earned at the station. Joe reasoned that he could write the narrative script for the first documentary and conduct and film most of the interviews, using the small extra room in the house as an office. Still, Joe needed money capital in order to provide a minimal salary for himself, to rent equipment, and to pay for necessary supplies, secretarial, editing, and other help on a contract-basis. However, the Qualitys had little savings or money contacts, so Joe formed a nonprofit company, "Quality Films," complying with IRC Section 501(c)(3) in order to qualify for funding by donors interested in educational and cultural television programming. He enlisted three respected educators/friends to serve on the company's board of directors on a volunteer basis.

Joe immediately submitted grant proposals to foundations and other funding sources in hopes of receiving adequate grant money to cover the relatively small budget for the first documentary, including a modest salary for himself. Joe's luck held and his talent yielded results. Quality Films received a small grant to cover the budget for the first documentary. Joe then quit his job and began working as the president of Quality Films and as executive producer of his dreamed-about documentaries. He was Quality Films's only full-time employee. The members of his board also served as treasurer, secretary, and assistant secretary of the corporation.

Quality Films's first documentary received widespread approval, and Joe's growing reputation as a successful filmmaker made it possible for Quality Films to receive increasingly larger grant monies for new film projects and a greater share of royalties and residuals on completed films.

2. For-Profit Company

About the same time Joe started Quality Films, Sue and her husband decided they had sufficient savings to allow Sue to see if she could be successful in her own film production business. Sue quit her job and formed a for-profit corporation called "Capital Films." She invested a modest amount of money capital in the company to cover basic equipment, supplies, marketing costs, and other start-up costs, and became the company's sole shareholder and sole full-time employee.
Sue's husband and brother agreed to serve with her as members of the company's board of directors and to fill out the company's required slate of officers, initially without compensation because their time involvement would be limited. However, they agreed that if and when the business became profitable, the corporation would compensate them for their services.

Sue got an early lucky break. A high-level contact at the local public television station was interested in one of her ideas for a small documentary. The television station agreed to co-sponsor the documentary with Capital Films by seeking funding for development of the documentary from PBS and other funders of nonprofit sources. The station contracted out the actual production of the documentary to Capital Films on a fee-for-services basis, plus royalties and residuals for repeat broadcasts. The joint venture was successful, and Sue used the credibility gained from this first project to enter into other joint venture/co-sponsorship arrangements with the same and other public stations. All her projects received nonprofit funding. The co-sponsorship arrangements required Sue to give up a degree of the creative control over projects that Joe retained, because of the involvement of an intermediary overseer. But this was not unlike Joe's situation, since even he had to deal with significant project oversight directly from his company's funders.

3. Eventual Success

The initial years of the two businesses were quite lean for the two entrepreneurs and their spouses. Both Joe and Sue often had to forego drawing a salary from their respective companies between grant funding of projects. Even when the companies received funding, their salaries were below market for a number of years. During these early years, they and their spouses frequently wondered if they should continue the businesses given the financial insecurity. Eventually, though, success begot success. With each completed documentary or feature grew the credibility and reputation of the companies and their key managers as talented producers of top-quality educational and cultural films. The companies were able to receive funding for larger and larger projects. Moreover, as the goodwill and credit history of the companies became established, relations improved with the company's suppliers and independent contractors, allowing greater credit flexibility. Also, the goodwill generated by the companies' track records allowed Joe and Sue to be even more selective about projects and to receive funding for budgets with higher overhead costs for their salaries, even salaries that were significantly above customary public television industry levels.
Over time Joe and Sue were able to move their companies' operations into rented office space; to purchase, rather than lease, certain necessary equipment; and to hire secretarial help. Joe and Sue continued to keep the overhead of the companies low by performing a good deal of the work on the films themselves and hiring additional, temporary help only as needed. Eventually, Quality Films and Capital Films began to receive increasing revenues from royalties and residuals on completed films from the licensing of repeat broadcast rights\textsuperscript{220} and the sale of videos to libraries and schools.

By the time Joe, Sue, and their respective spouses decided to divorce, Joe and Sue were earning significantly higher salaries as the chief operating officers of Quality Films and Capital Films, respectively, than they would have earned as staff producers in public television. Each was being touted in some circles as the Bill Moyers or Ken Burns of the next generation.

B. Standard Measure Reference: Treatment of a Closely Held, For-Profit Corporation Upon Divorce

Assume that Quality Films and Capital Films each has a total appraised value of $100,000: $70,000 for the aggregate assembled value of the tangible and intangible assets of the businesses and $30,000 for goodwill.\textsuperscript{221} Assume further that Sue holds 100 shares of stock in Capital Films as its sole shareholder of record.

In all United States jurisdictions, the 100 shares of Capital Films clearly would be property subject to division between Sue and her spouse upon divorce.\textsuperscript{222} To avoid dividing ownership of Capital Films, however, a court would likely distribute all the stock to Sue and distribute a greater share of other property\textsuperscript{223} to Sue's husband sufficient to compensate him for his foregone share of stock. In making these calculations, the value of the Capital Films stock for

\textsuperscript{220} Generally producers own the broadcast rights. They license initial broadcast and limited rebroadcast rights to the nonprofit intermediary and retain remaining rebroadcast rights. See NATIONAL ENDOWMENT FOR THE HUMANITIES, HUMANITIES PROJECTS IN MEDIA: GUIDELINES AND APPLICATION INSTRUCTIONS 9 (1992).

\textsuperscript{221} These values are not intended to be realistic relative to the hypothetical facts. The actual values of companies meeting the same description might well be significantly higher. The assumed values have been selected only for simplicity and ease of reference. The values for assembled assets and goodwill are set out separately, for purposes of the hypothetical, because of the different nature of these assets. See infra note 254 for an explanation of this difference.

\textsuperscript{222} See discussion infra parts III.B.1. through III.B.2.

\textsuperscript{223} The "other" property distributed to Sue's spouse might be other property owned by the spouses or a promissory note from Sue. See discussion infra part IV.B.4.
divorce purposes would probably be set near the full $100,000 estimate.\(^{224}\)

These conclusions about the treatment of Sue's business interest in Capital Films provide a standard measure reference for the general treatment of closely held corporate interests upon divorce. Is there sufficient justification to depart from this standard measure, in whole or in part, when a closely held commercial corporation is operated by a divorcing entrepreneur as a nonprofit rather than a for-profit? The nondistribution constraint seems, at first glance, to justify different treatment, but a critical analysis requires a more detailed justification. One must first review the authorities supporting the above conclusions about the treatment of Capital Films\(^{225}\) in order to identify the oper-

\(^{224}\) See discussion infra part IV.B.3.

ative divorce law guidelines at issue.

Of course, divorce laws vary from state to state and are quite complex in their vagaries. Hence, no summary of divorce laws can be precise, but enough areas of uniformity exist to discern generic patterns of treatment. This summary review emphasizes these patterns. This review outlines only existing, relevant divorce law; in keeping with this Article's emphasis on sector-blurring's force as an impetus for natural, evolutionary changes in the form of extended applications of established law, reform proposals are not included. However, the summary does note relevant areas of existing controversy that might result in differential treatment in given jurisdictions. The relevant guidelines culled from the summary will then be applied in Part V to the nonprofit setting. Accordingly, the following discussion of the basic guidelines applicable in Sue's situation also highlights issues for focus and examination in Part V's comparative analysis of the appropriate treatment of Joe's situation.

226. Accordingly, as the authorities cited supra in note 225 reveal, this section of the Article intentionally relies primarily on treatises, law review articles, casebooks, and other secondary sources by leading divorce law commentators that summarize the law of the various jurisdictions and patterns of uniformity. This reliance is intentional in order to confirm the benchmark nature of the standards used for the comparative analysis undertaken in this Article. Analysis of the efficacies of the current moorings of divorce law is not a focus of this Article. Rather, in this Article these moorings are treated as "givens" and are explored in terms of their applicability to a new context.

227. See discussion supra part III.A.3. This posture is not intended as a negative comment on proposals for organic changes or "new" legal constructs. The realities of sector-blurring may also command these types of changes in appropriate contexts. It is simply that examination of possible divorce law reforms is beyond the scope of this Article. Still, it is hoped that this Article's arguments for inclusion of nonprofit business interests in divorce considerations will inform understanding of the implications of the current moorings and offer a useful perspective for divorce law reformers on the current definitions of "property" used in some jurisdictions.

The property division process upon divorce generally involves four steps: (1) identification of the property of the spouses; (2) classification or characterization of the identified property; (3) valuation; and (4) distribution.

1. Identifying the Property

The threshold task in the property distribution process is to identify relevant assets held by either or both spouses. Determining what assets must be included is not always a simple process. Real property and tangible personal property generally present little concern. However, states differ on whether certain valuable intangibles may be included if the intangible right is so contingent that it is more in the nature of an expectancy or opportunity than "property" or if it is viewed as a "personal" right rather than as "property." Contingency concerns arise with intangibles such as nonvested pension rights, other types of contingent employee fringe benefits, and contingent trust interests. Whether something is a personal rather than property right becomes an issue, for example, when a party asserts claims to the increased future earning capacity of a spouse who has acquired a professional education or license, goodwill, or even celebrity status.

228. Moreover, views are changing as to the range of proprietary interests that should be embraced. See Bruch, Of Work, supra note 225, at 104; discussion infra part V.C.2.

229. See generally Blumberg, Intangible Assets, supra note 225, passim (discussing a wide range of intangible assets and their cognizance as "property" for marital property purposes); Blumberg, Goodwill, supra note 225, passim (focusing on the thorny legal questions and issues presented by professional and business goodwill); McKnight, supra note 225, at 199-203 (summarizing the various state provisions).


231. See, e.g., In re Marriage of Graham, 574 P.2d 75, 77 (Colo. 1978) (evaluating the value of an advanced degree); Hanson v. Hanson, 738 S.W.2d 429, 434-35 (Mo. 1987) (addressing professional goodwill); Piscopo v. Piscopo, 557 A.2d 1040, 1043 (N.J. 1988) (holding celebrity goodwill a marital asset subject to division); In re Peerenboom, 433 N.W.2d 282, 284 (Wis. Ct. App. 1988) (holding that goodwill is subject to division if it exists, is marketable, and has value). When a spouse claims an interest in such human capital items as these, the contingent nature of the value of such items may also be an issue, in addition to the personal versus property right dispute. See, e.g., Nail v. Nail, 486 S.W.2d 761, 764 (Tex. 1972). See generally Blumberg, Intangible Assets, supra note 225, §§ 23.05-23.06 (discussing goodwill, and professional degrees and licenses); Blumberg, Goodwill, supra note 225, § 25.02 (focusing on the valuation problems with respect to goodwill); Bruch, Definition and Division, supra note 225, at 813 n.170 (citing cases involving educational degrees and licenses); Heyman, supra note 225, at 17-21 (discussing
the interest or right is transferable or marketable—that is, whether it can be pledged or sold—as a test of whether intangible rights or interests are "property." Many states take a broader approach and emphasize whether the right or interest has economic value to the holder, regardless of its transferability.

Despite differences in state approaches, intangible rights that are defined and packaged in some tangible or recognized legal form, such as a contract, are generally includable as "property." For this reason, business interests wrapped up in with the recognized legal fiction of a for-profit corporation and evidenced by tangible stock certificates are universally included. Thus, the stock of Capital Films easily meets threshold "property" requirements under the most traditional of approaches. However, the question of when a valuable interest is "property" is an issue raised in Joe's situation because Joe does not "own" stock in Quality Films.

The minority position of some jurisdictions that income from professional goodwill is too speculative; McKnight, supra note 225, at 201 (discussing contingent interests); Zipp, supra note 225, at 104-05 (discussing goodwill cases).

232. See, e.g., Blumberg, Goodwill, supra note 225, § 25.02[2][c] (noting that, although the large majority of states recognize nonmarketable as well as marketable goodwill, a minority of states only recognize goodwill that can be transferred in the market); Heyman, supra note 225, at 26-27.

233. Often the issue of whether something is property and whether it can be valued are intertwined. Describing the interrelation of these two definitions, Professor Grace Blumberg wrote:

There is generally a tendency to ask whether a particular interest is cognizable as property for marital property purposes and then, if so, to determine how it is valued.

This approach tends, however, to obscure the reciprocity of the two inquiries. Valuation is, in many instances, a vital aspect of the definition of an intangible property interest. . . . [C]hoice of valuation technique represents an implicit or explicit response to the distinguishing characteristics of intangible assets, such as contingency, dependency on postcoverture spousal labor, nontransferability and nonsurvivability. Blumberg, Intangible Assets, supra note 225, § 23.01[2]; see also McKnight, supra note 225, at 201 (noting that some states include intangibles in the consideration even though their character as property may be questionable, but adjust for such imperfections in character by discounting the value of the right).

234. See, e.g., Lewis v. Lewis, 785 P.2d 550, 556 (Alaska 1990) (considering contingency stock similar to a nonvested pension in that both are contractual rights and are more than mere expectancies); In re Worth, 241 Cal. Rptr. 135, 137 (Cal. Ct. App. 1987) (stating copyright is personal property though intangible); see also Smith, supra note 227, at 692, 706-07 (emphasizing the deference accorded the familiar legal fiction of the corporate entity as contrasted to the less familiar legal fiction of the marital partnership).

235. The "intangible" is made tangible and, incidentally, more freely transferable, by the stock certificate form, thus eliminating characterization problems.

236. See discussion infra part V.C.2. Also, even when the is-it-property concern does not arise in the property identification stage of the divorce proceedings, it may arise as
2. Classification

Once spousal assets are identified, each asset must be classified to determine if it is part of the estate subject to division. The method of classification generally depends upon whether the jurisdiction uses a common-law marital property system or is one of the limited number of states that use a community property system. All common-law states have adopted some form of equitable distribution system for the purposes of property distribution upon divorce. In some of these equitable distribution jurisdictions, all property owned by either or both spouses, regardless of its source, is subject to division in order to "do equity." In other equitable distribution jurisdictions, only marital property is subject to division between the spouses upon marriage, in contrast to nonmarital property, which is not subject to division. In the states adhering to a community property system, the assets of divorcing spouses are classified as either community property or as separate property. Community property is jointly owned by each spouse during marriage and subject to division upon divorce. Separate property is not jointly owned during marriage and is not subject to division upon divorce in most community property states. A few of the community property states have a general rule providing for a fifty-fifty distribution of community property upon divorce; however, most permit an equitable distribution of the community property and at

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237. "Community property law has traditionally been associated with eight contiguous American states. Moving geographically from northwest to southeast, they are: Washington, Idaho, Nevada, California, Arizona, New Mexico, Texas, and Louisiana." BLUMBERG, COMMUNITY PROPERTY, supra note 225, at 6. In 1983 Wisconsin adopted the Uniform Marital Property Act, establishing a community property system. Id. at 7.

238. See generally Becker, supra note 225, passim (reviewing the statutes in both common law and community property jurisdictions).

239. BLUMBERG, COMMUNITY PROPERTY, supra note 225, at 4; Becker, supra note 225, §§ 3.02-3.03.

240. VERRALL & BIRD, supra note 225, at 3; Becker, supra note 225, § 3.03[1].

241. VERRALL & BIRD, supra note 225, at 3; Becker, supra note 225, § 3.03[2] (noting that marital property is generally defined to exclude gifts, inheritances, and premarital acquisitions). See generally McKnight, supra note 225, at 194-97 (observing that some of the jurisdictions that subject all property to division make no distinction between marital and non-marital assets, while others distinguish between marital and non-marital property but permit inclusion of some nonmarital assets in the divisible marital estate if equity considerations warrant).

242. BLUMBERG, COMMUNITY PROPERTY, supra note 225, at 6; Becker, supra note 225, §§ 3.01[3], 3.04[1]-[2].
least one allows the divorce court to equitably distribute the parties' separate property as well. For convenience herein, the terms "divisible property or estate" or "divisible assets" will refer to both community and marital property as well as any nonmarital or separate property subject to division.

Although equitable distribution and community property jurisdictions vary in their respective definitions of marital, community, or divisible property, all treat value or "property" acquired during marriage that is paid for from earnings or attributable to labor efforts during the marriage as community, marital, or divisible property. Since Capital Films stock falls within these core parameters, it would be classified as divisible property regardless of jurisdiction. For the same reasons, Joe's business interests in Quality Films would be classified as a divisible asset if it satisfies the above-described conditions regarding its classification as property and its ownership.

3. Valuation

After classification of the property held by divorcing spouses into nondivisible or divisible categories, a divorce court must value the divisible assets. With a large, publicly held company whose stock is traded on the securities markets, the trading value of the stock generally provides the operative value. However, with closely held

243. California, New Mexico, and Louisiana have 50-50 rules. See BLUMBERG, COMMUNITY PROPERTY, supra note 225, at 6; Bruch, Definition and Division, supra note 225, at 777 n.38. Washington allows access to the separate property, and Arizona and Nevada only allow access to a limited class of separate property. Becker, supra note 225, § 3.01[3].

244. See discussion supra part IV.B.1.

245. See generally Becker, supra note 225, passim (providing an overview of state positions on property distributions).

246. If Sue had used an inheritance or funds saved before marriage to purchase the stock, a portion of the business would be her separate or nonmarital property and the community or marital property percentage would be reduced. In some jurisdictions, the inception of title would control completely and there would be no marital property component. See generally McKnight, supra note 225, at 201-10 (describing the components of marital property). However, for the purposes of this Article it is not necessary to delve into the complicated tracing or characterization issues attendant to the treatment or division in the various states of property with mixed community or marital/separate aspects. The issue explored in this Article still would be applicable to the community or marital property component in most states. Accordingly, I have constructed the hypothetical to avoid the distractions of the mixed-asset complications.

247. See supra notes 228-36 and accompanying text.

248. See generally Becker, supra note 225, §§ 3.07-3.08 (discussing valuation requirements and determinations of "equitable" distributions).
corporations, no similar market mechanism exists. Thus, valuation can be quite a complex task, especially for divorce purposes, requiring the application of sophisticated accounting methodologies. If a recent offer to purchase the closely held business has been received from a willing buyer in an arms-length negotiation, the purchase offer might serve as an alternative value-setting mechanism for the total value of the business. However, if no such offer or data on sales of comparable businesses exists, as is usually the case, accountants must consider a number of factors and use various methodologies to value the closely held business. The total of these separate values then provides a beginning reference for valuation of the closely held stock.

Typically, the final valuation will be based on some combination of the measure of value of all the tangible and intangible assets, plus a goodwill factor representing the accumulated value of a business beyond that of its assets, as reflected by earnings. Accountants generally apply the label "goodwill" to the difference between the price...

249. Taylor, supra note 225, at 222. See generally SHANNON P. PRATT, VALUING SMALL BUSINESS AND PROFESSIONAL PRACTICES (1986) (describing the problems associated with valuing closely held corporations); Haynsworth, supra note 225, at 459-60 (same); Skoloff, supra note 225, § 21.06 (same).

250. As an initial matter, recognizing that the purpose of the valuation is for divorce allocations is extremely important. Different purposes will provide different values and different valuation methods. See PRATT, supra note 249, at 19, 24 (emphasizing that the valuation process and conclusion is influenced significantly by the purpose of the valuation and that, in the case of divorce valuations, reference must be made to the specific divorce law of the applicable jurisdiction). Unfortunately, the legal context for valuations for divorces is more nebulous than the legal context for almost any other valuation purpose. For one thing, unlike valuations for taxes or dissenting stockholder actions, the various state statutes do not specify any particular standard of value to be applicable, such as fair market value, fair value, or intrinsic value.

Furthermore, the . . . deficiencies in . . . statutory law, in general, are not clearly addressed in the states' case law. Virtually no states have resolved the question of the standard of value.

Id. at 367.

251. See infra notes 258-63 and accompanying text.

252. See Haynsworth, supra note 225, at 468-70 (discussing sales of comparable companies and of interests in the subject company). There may be shareholder agreements or other documents outlining purchase options or withdrawal rights which also present value-setting mechanisms that a divorce court might consider in the valuation process. These arrangements, however, are not necessarily determinative. Id. at 501-506; Blumberg, Intangible Assets, supra note 225, § 23.05[2][c].

253. See Rev. Rul. 59-60, 1959-1 C.B. 237 (setting forth guidelines for valuing closely held businesses for tax purposes upon which many appraisers rely in divorce situations); PRATT, supra note 249, at 223; Haynsworth, supra note 225, at 470-73; Zipp, supra note 225, at 99.
offered for a business and the net value of its assembled assets.\textsuperscript{254} In the divorce setting, when there is no purchase offer or comparable indicator of accumulated value, accountants must determine the value of the assembled assets and the goodwill. Goodwill can be particularly difficult to value. As explained by Professor Grace Blumberg:

Goodwill is widely understood today as a constellation of inseparable intangible assets that inhere in a business ... and enable it to realize supernormal earnings. The earnings are supernormal in the sense that they exceed the sum of the market value of the manager's labor and a reasonable return on all tangible assets and individually quantifiable intangible assets. The supernormal earnings are usually characterized as excess earnings: their existence is both an indicator of goodwill and an important factor in the measurement of its value.\textsuperscript{255}

A small minority of jurisdictions take a restrictive view and recognize only forms of business goodwill that can be transferred in the market, engendering considerable dispute over the inclusion of professional goodwill in these jurisdictions.\textsuperscript{256} Since Capital Films is a corporation, rather than a professional practice, it is not the type of entity that generally raises disputes about goodwill transferability in the minority jurisdictions. Moreover, the large majority of states

\textsuperscript{254} Blumberg, Community Property, supra note 225, at 343; see also Pratt, supra note 249, at 295 n.1 (noting that "going concern" value represented by assembled assets is often lumped with goodwill value under one heading of "goodwill"). Discrete assets, particularly tangible assets, have a separate intrinsic value and thus are distinguishable from goodwill. Assets like desks, storage bins, typewriters and Xerox equipment can be sold in the open market for a price relating to the value of used equipment. When these same assets are assembled into a working enterprise, their collective value may be greater than the sum of their individual values. There is a hidden cost of assembling the needed assets in a going concern. Zipp, supra note 225, at 98. Accordingly, even "[a] brand new business which has yet to make its first sale has a value greater than the sum total of the values of its tangible assets. A buyer of a newly created business should be willing to pay a price in excess of the cost of replacing all the assets since there is an intangible value, measured in both time and money, which represents the the cost of assembling the assets into an operational store, factory, or office." Id., at 99. This additional value is generally referred to as "going concern value." See Fred M. Adams, Is Professional Goodwill Divisible Community Property?, 6 COMM. PROP. J. 61, 62-63 (1973) (contrasting goodwill value with going concern value). In addition to going concern value, being in a good location, having a fine reputation, credit history and satisfied customers also increases the profitability of a business. The total increased profitability above the aggregate value of the discrete assets as a whole represents goodwill value. See also infra note 254 and accompanying text.

\textsuperscript{255} Blumberg, Goodwill, supra note 225, at § 25.01[1].

\textsuperscript{256} Id. § 25.02. Professional goodwill is the chief form of goodwill engendering debates over market transferability. See id.
include all forms of business goodwill in the divisible estate.\textsuperscript{257} Thus, it is highly likely that Capital Films' entire determined value, including its goodwill value, will be included in the divisible estate.

Still, valuation generally will be subjective, relying on the judgment of the appraiser.\textsuperscript{258} Although commonly accepted factors and valuation methods determine the outside parameters and narrow the acceptable range of a given valuation,\textsuperscript{259} valuation methods are not discrete,\textsuperscript{260} vary among the states, and generally rely on standard assumptions.\textsuperscript{261} Accordingly, sometimes overall values are discounted to adjust for special circumstances involved in a case.\textsuperscript{262} On the other hand, depending upon the chosen valuation method, some special circumstances may already be accounted for in the basic methodology used to determine the overall value or may even be irrelevant given the selected methodology.\textsuperscript{263} If so, no separate discount would be necessary. If not, then a discount may be appropriate.

The hypothetical sets the values of Capital Films and Quality Films at $100,000 each, and the validity of the values assigned to the various business assets of the companies is assumed. In reality, the respective values of Capital Films and Quality Films might be found

\begin{itemize}
\item \textsuperscript{257} Id. § 25.02; see also PRATT, supra note 249, at 294 (noting that professional goodwill is sometimes called "personal goodwill" and that practice goodwill is sometimes called "business goodwill").
\item \textsuperscript{258} "Estimating the value of a business or professional practice is much more than a mechanical exercise—it requires large doses of informed judgment, distilled out of years of experience and extensive continuing education . . . ." PRATT, supra note 249, at 223.
\item \textsuperscript{259} Skoloff, supra note 225, § 21.06, at 21-82.
\item \textsuperscript{260} Shannon Pratt urges caution when one hears references to a finite number of valuation methods, emphasizing that the various methods "are not discrete, but rather variations of each other, with considerable overlap." PRATT, supra note 249, at 223.
\item \textsuperscript{261} See generally Blumberg, Goodwill, supra note 225, §§ 25.03-25.04 (discussing the fair market valuation approach and the capitalization of excess earnings approach, as well as modifications on each).
\item \textsuperscript{262} See Blumberg, Goodwill, supra note 225, § 25.05 (discussing the argument that covenants not to compete and promises to continue in the practice or business incident to the sale of goodwill should cause a portion of goodwill value to be treated as separate and indivisible); Haynsworth, supra note 225, at 488 (discussing possible discounts for lack of marketability, minority interests, restrictions on resale, or the loss of a key person who is the driving force behind a business); Taylor, supra note 225, at 227 (focusing on key person discounts).
\item \textsuperscript{263} For example, if a capitalization approach is used, the appraiser might have used a lower than usual capitalization rate to adjust for the special circumstances. See Blumberg, Goodwill, supra note 225, § 25.04[3] (noting that selection of the applicable rate for a given situation is probably the most difficult problem in the entire process of business valuation); see also Zipp, supra note 225, at 114-16 (discussing how to determine and apply an appropriate capitalization rate).
\end{itemize}
to be $100,000 in one jurisdiction and $120,000 in another. However, by assuming the validity of a $100,000 valuation for both businesses, this Article's comparative analysis of the divorce law treatment of the two entities is tailored to allow for the vagaries of, and thus is made applicable to, any jurisdiction, based on a total valuation standard. This is because the assumption obviates the necessity of examining the various valuation methods and the disputes about the appropriate method to be used in specific contexts; avoids examination of the component assets of the businesses with respect to any property-versus-personal-right distinction or other threshold test from the applicable jurisdictions; and allows the conclusion that final valuation of Capital Films probably would be near the $100,000 total value. However, in Joe's case there is a special circumstance—the nondistribution constraint. This warrants consideration of a possible discount of the overall value of Quality Films. Accordingly, this is another issue highlighted for examination in the comparative analysis of Joe's situation in Part V.

4. Distribution

Regardless of which spouse acquired the business interest, if that interest is determined to be divisible property, its value is subject to distribution upon divorce. A court may divide the stock or assets of the business between the spouses in proportion to the value of their respective interests in the overall marital estate. In common-law states the proportions are variable, but presumptive fifty-fifty norms

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264. See generally Blumberg, Goodwill, supra note 225, §§ 25.03-25.06 (analyzing the implications of different valuation methods with respect to goodwill).

265. An asset-by-asset examination of the components of the valuation is eliminated and differences among jurisdictions as to the includability of various component assets can be disregarded. This is warranted because the characterization or recognition of a given component asset by any jurisdiction should not change simply because the business is operated as a nonprofit rather than a for-profit; if the nonprofit form would be an impediment to recognition in any jurisdiction, it would be an impediment to recognition of all of the value of the nonprofit, not simply some component portion of its value. Accordingly, for example, it is assumed for purposes of the comparison undertaken in this Article that the assigned goodwill value of $30,000 is business goodwill (which attaches to the business) rather than reputational goodwill (which attaches to the individual) in jurisdictions which make these distinctions in the recognition of goodwill in divorce valuations. In other words, to the extent any value, for goodwill or otherwise, is assigned to Capital Films, it is assumed to meet the applicable standards of a particular jurisdiction for inclusion in the total valuation.

266. Smith, supra note 225, at 163.
are becoming more frequent.\(^{267}\) Although several community property states provide for a fifty-fifty distribution, in most of these states the portion also is variable and subject to a divorce court's equitable distribution.\(^{268}\)

Moreover, as previously noted, actual division of the asset is not mandatory. Divorce law seeks finality in dissolving a marriage. Continued co-ownership of property and business interests by divorced spouses hampers this result. Accordingly, courts routinely distribute business interests to the spouse most actively involved in the business's operation and make an off-setting or equalizing distribution to the other spouse from other property.\(^{269}\) This operates like a forced purchase/buy-out by the operator/spouse of the interest of the other.\(^{270}\)

Thus, a court presented with Sue's case probably would utilize the allocation-of-value approach, rather than the in-kind-distribution approach, with respect to Capital Films. In that likely event, a distribution of all of the stock of Capital Films would be awarded to Sue, with her husband receiving an off-setting distribution of other marital or community assets, or an equalizing promissory note, equivalent in value to his proportionate interest in the $100,000 business.

In Joe's case, the allocation-of-value approach offers a solution to the nondistribution constraint impediment. Thus, the non-distribution constraint's prohibition against an in-kind distribution is

\(^{267}\) BLUMBERG, COMMUNITY PROPERTY, supra note 225, at 5; see also Becker, supra note 225, § 3.08 (discussing a variety of cases and statutes that address the equitable distribution of property); Bruch, Definition and Diversion, supra note 225, at 777 n.38 (surveying various property division statutes in several community property states).

\(^{268}\) See supra note 243 and accompanying text.

\(^{269}\) See WILLIAM W. BASSETT, CALIFORNIA COMMUNITY PROPERTY HANDBOOK § 10.03[E][1] (3d ed. 1991); Becker, supra note 225, § 3.09.

\(^{270}\) One court commented:

[\text{W}henever the court is called on to value a [closely held] business, neither any corporate asset nor any fraction of the shares of the corporation will actually be sold to an outsider. Generally ... the corporate shares are awarded to the spouse more actively engaged in the business of the corporation, and the management and operation of the business continue essentially unchanged. In this context the establishment of a fair market value contemplates nothing more than the assignment of a fair and reasonable value to the family business as a whole to allow equitable apportionment of the marital property.]

Nardini v. Nardini, 414 N.W.2d 184, 189 (Minn. 1987); see also Smith, supra note 225, at 162 (arguing that an equitable distribution system seeks finality upon divorce, and "[e]ven when both spouses are active in a business, the court may grant purchase options to each of the spouses"); Taylor, supra note 225, at 223 (noting that a court's valuation for equitable distribution purposes is tantamount to a forced sale).
eliminated as a justification for not considering Quality Films in his divorce proceeding. Divorce courts can and do distinguish between the includability of an asset and its divisibility.

5. Summary of the Treatment

Clearly, Sue’s case presents a fairly traditional and uncomplicated scenario for divorce courts, even though Capital Films undertakes nonprofit projects and engages in sector straddling. There are no substantive matters implicating questionable issues or possible differences in the way states would handle the matter, except for differences in the selected methods used for valuation.

C. Fairness Issues

Sue’s situation offers an easy-case, standard measure treatment for assessing whether divorce laws should be applied to entrepreneurs of closely held commercial nonprofits. The only difference between Sue’s case and Joe’s is the applicability of the nondistribution constraint. Although this constraint technically prevents Joe from being a shareholder in Quality Films, in all other respects the rights of Sue and Joe and the operations of the companies are identical. Joe is operating a commercial enterprise, albeit a nonprofit one. His motivations for organizing the company included profit goals similar to Sue’s. Were it not for the nondistribution constraint, a simple mechanical extension of the divorce law guidelines would dictate that Joe’s spouse, like Sue’s, should have an equitable claim to a portion of the value of the enterprise. Is it fair for the two spouses to be treated differently?

If divorce laws were not applied to nonprofit business interests, Sue’s spouse would likely receive $50,000271 in a property distribution on account of Capital Films, while Joe’s spouse would receive nothing on account of Quality Films. Yet, both spouses have made sacrifices for and have directly and indirectly supported the success of both enterprises. Both Joe and Sue can continue to control the respective enterprises and reap the benefits of this control. Clearly, Joe’s spouse could be allocated value without violating the nondistribution constraint. If no value is allocated, Joe reaps a windfall not available to Sue upon divorce because his business activities are cloaked in the nonprofit form, even though his activities are just as

271. This assumes the proportionate share of Sue’s spouse is 50% and that the final valuation of Capital Films is set at the full $100,000 amount.
commercial in nature as Sue's. Is such differential treatment justified in light of the predominance of sector-blurring in our society today?

Since the nondistribution constraint is not an impediment to an allocation of value to Joe's spouse, justification for such differential treatment must turn on the nondistribution constraint's confining impact on the scope of Joe's interest in Quality Films. The discussion in this Part has highlighted the is-it-property issue, the ownership issue, and the valuation discount issue as areas that warrant focus in the comparative analysis of a case like Joe's. Essentially, each of these issues represents a different angle on the same problem—examination of the existence of proprietary value. Is Joe's interest sufficiently proprietary to give rise to attributable value subject to allocation? Or does the nondistribution constraint prevent the attribution to individuals of all proprietary value in nonprofits? I submit that nonprofit entrepreneurs like Joe do have sufficient proprietary interests in commercial nonprofits to justify the attribution and allocation of at least some of the enterprise's value upon divorce. The reasons for this conclusion are discussed in Part V.

V. COMPARATIVE ANALYSIS: EXAMINING PROPRIETARY VALUE AND DE FACTO OWNERSHIP

A. Proprietary Rights of Close Corporation Shareholders

For purposes of divorce allocations, the proprietary value assigned to Sue's shares in Capital Films is based on the incidents of ownership Sue enjoys as the sole shareholder of Capital Films. Determining the appropriate divorce law treatment of Joe's situation requires a comparison of Sue's underlying ownership rights in Capital Films with Joe's status at Quality Films. Understanding Sue's ownership rights is the first task of the comparative analysis. This requires, as a preliminary matter, an understanding of the corporate model in general and of the closely held corporation in particular. 272

272. See generally CLARK, supra note 124, §§ 1.3, 18.1-18.4 (1986) (discussing the special nature of close corporations and commenting specifically on the special line of cases and charter provisions for close corporations that developed because the corporate law norms designed to fit the public corporation model were "unsuitable" and "clumsy" for close corporations); O'KELLEY & THOMPSON, supra note 62, ch. 5 (same). For a thorough examination of close corporations, see F. HODGE O'NEAL & ROBERT B. THOMPSON, O'NEAL'S CLOSE CORPORATIONS (3d ed. 1992).
1. Corporate Norms and the Distinctive Nature of Close Corporations

Corporate law norms are based on a separation of ownership rights that facilitates specialization of human and money capital investment. The corporate form provides a mechanism for business ownership by a large group of investors when it is impractical for all of them to be actively involved in the operation of the business or when they lack the skill or time to engage in active operation. As one commentator explains:

Under the separation norm (1) shareholders are able to provide money capital while investing human capital elsewhere; (2) officers are able to specialize in day-to-day management without making money capital investment in the firm; and (3) the board of directors serves both as a check on officers' diligence and loyalty and as a buffer against inefficient shareholders' interference in management.273

Shareholders remain the ultimate owners of the corporations;274 however, they ordinarily delegate their ownership rights to agents charged with the task of maximizing the corporation's returns. Thus, shareholders exercise their ownership rights indirectly.275

Corporate law norms were designed to accommodate the operational needs of publicly held corporations276 or broadly held corporations with a significant number of shareholders. However, it is now widely recognized that closely held corporations are fundamentally different.277 These are corporations with a small number of individual shareholders whose shares are not traded on a recognized securities exchange or on the over-the-counter market.278 In closely

274. Id. at 150 (noting that the ownership interests of shareholders are represented by shares, which are ownership units in the corporation that entitle shareholders to a percentage of the firm's capital and dividends and to voting rights); see also CLARK, supra note 124, at 13 (detailing the typical voting and other rights of holders of corporate stock).
275. See Ben-Ner & Van Hoomissen, Governance, supra note 17, at 396.
276. See O'KELLEY & THOMPSON, supra note 62, at 359.
278. CLARK, supra note 124, § 1.3, at 24. State statutes that attempt to define closely held corporations differ in the details of their definitions. Id. § 1.3, at 24 n.1; see also
held corporations, the separation of identity between owners and managers often is limited or virtually nonexistent, except as a matter of corporate formality. Even though close corporations traditionally have been chartered under the same business corporation statutes as publicly held corporations, they operate more like incorporated partnerships or sole proprietorships. In the typical close corporation, shareholders actively participate in all phases of the management and operation of the business, as is the case with the hypothetical Sue Capital. Also, significant illiquidity results from the lack of a national securities market for close corporation shares. Accordingly, most close corporation shareholders eventually expect either to pass their shares on to a son or daughter or to sell their shares back to the corporation or a fellow shareholder.

The differences between the functioning of publicly held and closely held corporations provide a perspective for analyzing the ownership rights of shareholders, particularly those of close corporation shareholders like Sue Capital.

2. Analysis of Shareholder Ownership Rights

A shareholder of a for-profit corporation enjoys the following three ownership rights:

a. the right to ultimate control over the legally permissible activities of the business enterprise exercised through control of the selection of the corporation's board of directors, either exclusively—if she is the sole shareholder—or collectively with other shareholders (the control right);

O'KELLEY & THOMPSON supra note 62, §§ 1.02-1.04 (detailing the various distinctions between "closely held," "close," "closed," and "statutory close" corporations). For example, some set the number of shareholders at a maximum of 30 while others use a different number. See CLARK, supra note 124, § 1.3, at 24.

279. Most jurisdictions now have special close corporation statutes that recognize the differences in closely held corporations. Still, most close corporations continue to be chartered under general corporations laws. See CLARK, supra note 124, at 24 n.1, 24-25; see also O'NEAL & THOMPSON, supra note 272, §§ 1.18-1.19 (comparing the close corporation statutes of different states).

280. See CLARK, supra note 124, § 1.3, at 24-25.

281. See O'KELLEY & THOMPSON, supra note 62, at 359.

282. See generally Ben-Ner & Van Hoomissen, Governance, supra note 17, at 395 (articulating a similar summary of ownership rights).

283. Sue's control of the Board of Directors of Capital Films is limited by legal constraints against illegal actions and breaches of fiduciary duty. However, since all fiduciary duty is owed ultimately to her as the sole shareholder, illegality is the principal constraining force.
b. the right, as residual claimant\(^{284}\) of the entity, to receive the corporation’s economic returns, either exclusively—if she is the sole shareholder—or jointly if there are other shareholders (the residual claimant right); and

c. the right to transfer the previous two rights through assignment of all or a portion of her ownership interests (the transfer right).

For shareholders of publicly or broadly held corporations, each of the three rights is significant and valuable, but the control right has the least significance and value because it is diluted by the equal control rights of a large number of other shareholders (unless, of course, the shareholder holds a controlling block of shares). Accordingly, for a divorcing shareholder of a publicly held corporation, the proprietary value of her ownership interest is principally derived from the residual claimant right and the transfer right, rather than from the control right.

In contrast to publicly or broadly held corporations, in closely held corporations, the control right is usually the key right of ownership. Of course, if the corporation is to be sold or liquidated, the residual claimant and transfer rights are more important because the shareholder’s control right is being terminated. But before such termination, the residual claimant right and the transfer right have value or significance to the close corporation shareholder only if the corporation has profits. This requires residual returns above those that the shareholder needs or chooses to use to finance future operations of the business. By the most frequently used definition, profits are the excess of income over reasonable expenses, including salaries and employee benefits.\(^{285}\) A close corporation may have residual returns, which can either be taken as profit and paid as dividends to shareholders pursuant to their residual claimant rights or reinvested in the enterprise to finance future operations, including increased salaries and employee benefits for the shareholder-employees. The control right gives close corporation shareholders the

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284. Shareholders are referred to as “residual claimants” because they have a right to the residual assets of corporations remaining after creditors are paid. If such assets are insufficient to pay the corporate debts and liabilities, they receive no return and may risk losing their initial investment. If the business is profitable, however, they are entitled to this return on investment, generally without cap. O’KELLEY & THOMPSON, supra note 62, at 20-21, 150.

285. This is the standard definition of profit in the general accounting sense. See HOPKINS, supra note 14, § 12.3, at 257.
right to choose how to dispose of such returns. Many shareholders of close corporations consider the business successful when returns are sufficient to provide them a reasonable salary and to finance continuation of the business.\(^{286}\) For most close corporations, returns rarely reach profitability levels that trigger the residual claimant right.\(^{287}\)

This low profitability in turn depresses market opportunities for exercise of the transfer right and results in the widely acknowledged illiquidity problems of shareholders of closely held corporations.\(^{288}\) When profits reach a level sufficient to attract outside investors, closely held corporations usually become more broadly held and move into another life cycle. As profitability rises, market values for the transfer by a shareholder of a share of her residual claimant status become more attractive, relative to the risks, than closely held control. At this point, shareholders of closely held corporations are more willing to trade some control and residual return rights for an assured amount of money, not subject to business risks. Of course there are exceptions and holdouts. At some point, however, the market forces are so strong that, given business risks, continuation of closely held control becomes economically imprudent.

Thus, if a corporation is very closely held, the control right is probably the most valuable and important right. In fact, it often is the only right that has any practical proprietary significance. As

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286. As one commentator has noted:

Many businesses cannot even generate enough earnings to justify their purchase at net tangible asset value. If the earning power justifies a price less than the adjusted net tangible asset value but more than the liquidation value, it is rational to expect the value determined by the earning power to predominate. . . .

Some owners who wish to sell cannot accept the notion that the economic value of the entity could be less than the replacement cost of its assets. The fact is, however, that there are many such businesses that would never be worth replacing if they did not already exist. They are worth only their economic value based on what they can earn, not what it would cost to replace a business that nobody would choose to replace in its existing form and location. PRATT, supra note 249, at 227.

287. If returns consistently reach high profitability levels, the market forces compelling the close corporation to become more broadly held begin to operate. Most close corporations remain "closely held" precisely because profitability levels are relatively low, although profitability may be adequate for the life cycle and basic income needs of the owning stockholders.

observed by Professor Robert B. Thompson and the late Dean F. Hodge O'Neal in their leading treatise on close corporations:289

Unlike the typical shareholder in a publicly held corporation, who may be simply an investor or a speculator and does not desire to assume the responsibilities of management, the shareholder in a close corporation considers himself or herself as a co-owner of the business and wants the privileges and powers that go with ownership. Employment by the corporation is often the shareholder's principal or sole source of income. Providing for employment may have been the principal reason why the shareholder participated in organizing the corporation. Even if shareholders in a close corporation anticipate an ultimate profit from the sale of shares, they usually expect... to receive an immediate return in the form of salaries as officers or employees of the corporation rather than in the form of dividends on their stock. Earnings of a close corporation often are distributed in major part in salaries, bonuses and retirement benefits.290

Thus, for most close corporation shareholders, the business provides a means for self-generated livelihood.291 The control right, rather than the residual claimant right or the transfer right, is the essential incident of ownership for this purpose.292 When this reality

289. See O'NEAL & THOMPSON, supra note 62.
290. Id. § 1.08, at 31-32.
291. See id. § 1.08, at 31; see also Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 514 (Mass. 1975) (stating that a close corporation shareholder typically has a substantial percentage of his personal assets invested in the corporation, anticipating that the corporation will be his livelihood); Lawrence E. Mitchell, Close Corporations Reconsidered, 63 TUL. L. REV. 1143, 1176 (1989) (noting that shareholders of close corporations typically draw cash from the corporation in a form other than dividends, such as in salaries and perquisites, so that a true understanding of the profitability of the corporation may be difficult to obtain); supra note 286 and accompanying text (noting that many shareholders of close corporations consider their business successful when returns are sufficient to provide them a reasonable salary and to finance continuation of the business).
292. For this reason, minority shareholders of closely held corporations are considered to be particularly vulnerable. In fact, much of the literature on closely held corporations focuses on the plight of the minority shareholder in a close corporation. When the control power is diluted in closely held corporations, the limitations of the residual claimant and transfer rights become even more evident. Illiquidity problems are significant and lead to exploitation of minority shareholders. See generally CLARK, supra note 124, § 18.4 (summarizing illiquidity and exploitation problems and discussing solutions offered by commentators and some courts); O'KELLEY & THOMPSON, supra note 62, § 8.07 (discussing the ways in which minority shareholders in close corporations can be oppressed); Hetherington & Dooley, supra note 288, at 50-59 (proposing a statutory reform granting an automatic buyout right to disgruntled close corporation shareholders).
is appreciated, a comparison of Sue's proprietary rights in Capital Films with Joe's powers of control over Quality Films reveals few practical differences.

B. Comparative Analysis of Entrepreneurial Control Power in Closely Held Nonprofits

In the hypothetical, Joe Quality is the founder, principal operator, and sole permanent employee of Quality Films as well as the creative force behind its operations. The control power of nonprofit entrepreneurs like Joe over the nonprofit's operations is equivalent, if not greater than, the ownership rights of shareholders of for-profit entities except for two limitations: Ultimate legal control of the nonprofit reposes in the nonprofit's board of directors, and the entrepreneur's rights are subject to the nondistribution constraint. As discussed below, the first legal difference is without practical substance, and the second correlates more to the incidents of ownership derived from a shareholder's residual claimant and transfer rights than to his control right, thus having limited significance when its implications are evaluated on a comparative basis with the rights of close corporation shareholders.

1. Impact of Nonprofit Boards of Directors

It is true that shareholders of a for-profit corporation have ultimate legal authority over its board of directors, because the shareholders control the election of board members. In contrast, the board of directors of a commercial nonprofit is usually self-perpetuating and thus theoretically could usurp the control power of the entrepreneur. This is unlikely, however. Typically, the entrepreneur selects the initial members of the self-perpetuating board, and because the entrepreneur generally appoints individuals with strong allegiance to the entrepreneur and her goals, this allegiance also tends to be self-perpetuating. Accordingly, the entrepreneur's informal influence over nonprofit directors is often as extensive as the voting rights of shareholders with respect to for-profit directors.

The members of nonprofit boards are volunteers who usually have no other affiliation with the nonprofit. They serve without com-

293. See discussion supra part IV.A.
294. See discussion supra part V.A.2. (discussing the limited import of the residual claimant and transfer rights in the close corporation setting).
295. See supra note 116 and accompanying text.
pensation because they, like the entrepreneur, are would-be patrons of the product or service provided by the nonprofit. Yet, unlike the entrepreneur, they do not have the skills, time, or desire to resort to patron self-help, so they support and applaud her efforts. 

“Because [nonprofit] directors . . . have no direct financial stake in the organization, and because . . . they can partake of the organization’s benefits without participating in control, . . . [they] tend to invest . . . little time and effort as principals . . .” Since they cannot sell their interests in the nonprofit upon their departure, they know “they cannot reap the benefits of [such] investment of time and energy beyond their direct involvement with the organization.” Thus, nonprofit directors lack incentive to commit their resources to controlling and second-guessing the decisions of entrepreneurs and managers. “As a result, . . . the managers and other employees of the organization . . . often enjoy more freedom of action than do managers and employees of for-profit firms.”

Nonprofit directors do have a responsibility to which they often commit significant energies—that of insuring purpose accountability. Aside from their common regard for the purposes for which the nonprofit was formed, the directors are motivated to ensure purpose accountability because of the funding problems and the personal legal sanctions for breach of fiduciary duty that can result from noncompliance. However, I believe the entrepreneur is similarly motivated—even more so than the members of his board and probably even more than managers of more broadly held nonprofits. The entrepreneur’s investment of human capital in the closely held nonprofit is greater, and his identity is more intertwined with the organization. Failures of purpose accountability will reflect more negatively upon him and jeopardize his chosen means of livelihood to a greater degree. Even if the state attorney general (the state officer usually charged with monitoring nonprofit activity) conducts limited

296. See discussion supra part II.C.2.b.; see also Ben-Ner & Van Hoomissen, Governance, supra note 17, at 403-06 (discussing the residual governance problems of nonprofit organizations).
297. See discussion supra part II.C.2.b.
298. Ben-Ner & Van Hoomissen, Governance, supra note 17, at 405.
299. Id.
300. Id.; see also Ben-Ner, Who Benefits, supra note 17, at 754-55 (commenting that “nonprofit . . . management and staff may enjoy considerably more latitude in the pursuit of their own objectives”).
301. See Oleck, supra note 17, at 746, 763-72 (generally discussing the fiduciary status of directors of nonprofits, standards of diligence and care, and personal liability).
oversight reviews, institutional funders and grantors of nonprofit organizations are generally quite diligent in seeking regular accountings of the specific uses of their grants and contributions.

For all these reasons, directors of closely held nonprofits rarely desire or need to usurp or even to check the control power or operating preferences of the nonprofit’s entrepreneur. Accordingly, as a practical matter, entrepreneurs like Joe Quality enjoy power with respect to “their” nonprofits at least comparable to the control right of shareholders of for-profit corporations. Such entrepreneurs usually have even the ability to cause the liquidation and cessation of the nonprofit’s business because they are so vital to its operation.

To appreciate this last point, remember that the focus here is on a commercial nonprofit providing products or services competitive with those offered by for-profits and operated principally by one or only a few entrepreneurs. If such an entrepreneur chooses to depart, the nonprofit’s volunteer Board of Directors probably will not even seek a replacement. But for the entrepreneur’s initiative, the closely held commercial nonprofit would likely not have existed. Its assets, upon liquidation, may be valuable to others, or even to the departed entrepreneur(s), for similar purposes in another form. But the particular nonprofit came into being to serve specific motivations and needs of the entrepreneur. If the nonprofit becomes more broadly held during the tenure of the entrepreneur(s), this uniqueness is altered and the nonprofit entity may well continue despite the departure. Otherwise, it likely will terminate with the

302. OLECK, supra note 17, at 158, 1217; Fishman, supra note 17, at 669.

303. Foundation funders generally impose stringent monitoring requirements in order to ensure that they satisfy operation requirements imposed on nonprofits. See, e.g., Howard Tuckman, supra note 165, at 213 (observing that foundation funders of nonprofits require that their grantees furnish a proposal of how funds will be used and an accounting of how funds are spent).

304. Professor Ben-Ner’s statements about the role of controllers in the formation of nonprofits support the argument that these same controllers may also play a significant role in a nonprofit’s demise: “[I]n many nonprofit organizations only a few . . . serve as nonprofit controllers. . . . Low participation may prevent nonprofit formation in the first place, or may allow management a large role in the determination of the organization’s objectives.” Ben-Ner, Who Benefits, supra note 17, at 755; see also infra note 307 and accompanying text.

305. See discussion supra parts I.B.3.b. and I.B.4. (discussing the dual motivations of nonprofit entrepreneurs); see also Ben-Ner, Who Benefits, supra note 17, at 753 (emphasizing that many nonprofit organizations “[are] controlled by . . . [stakeholder] demanders, who play the role of owners”).

306. This could occur due to expansion of management staff or increased participation by nonprofit board members.
entrepreneur's change in needs that precipitates his departure. The power to cause termination of an entity is the ultimate indication of control. This raises issues relevant to, and brings us to discussion of, the implications of the second difference noted above—the nondistribution constraint.

2. Impact of the Nondistribution Constraint

As previously posited, a realistic analysis of the motivations of nonprofit entrepreneurs like Joe Quality demonstrates that they begin and operate commercial nonprofit entities for both for-profit and for-purpose goals. As long as the entrepreneur can achieve both her for-profit and for-purpose goals through the nonprofit form, it is sensible to do so. When the profit goal is principally that of providing the entrepreneur with a livelihood by means of a reasonable salary, no significant impediment arises to serving the dual goals. It is important to emphasize that the nondistribution constraint does not prohibit the making of profit. It restricts only the distribution of profit to insiders. This means that an entrepreneur of a closely held nonprofit cannot exercise power equivalent to the residual claimant right or transfer right enjoyed by shareholders of for-profit corporations. Any residual returns must be retained and re-employed in the operations of the nonprofit corporation.

As we have seen, however, since shareholders of many closely held for-profit corporations rarely have sufficient profits to implicate their residual claimant and transfer rights, their control right is the key incident of ownership. The corporations can be successful without being "profitable" because shareholders can use their control power to dispose of a certain amount of residual returns for future operations, including increased compensation and perquisites to the owner-shareholders within "reasonable" limits.

307. See generally Billis, supra note 12, at 252-53 (offering the "closure test," which determines who can close a nonprofit organization down or sell it, as a possibly revealing and fruitful means of examining sector parentage).

308. See discussion supra part II.C.2.b (arguing that nonprofit entrepreneurs choose the nonprofit, rather than the for-profit, medium because of the combined force of the need for subsidy and the consistency and commonality of their profit and purpose goals).

309. See discussion supra part II.A.

310. See discussion supra part II.A.

311. Expenses for salary and the like are not deductible for tax purposes unless they are reasonable in amount. I.R.C. § 162(a)(1) (1988). Salaries to owner-shareholders in excess of the reasonable standard run the risk of being recharacterized as a dividend, includable in the income of the recipient shareholder but not deductible by the corporation. See Marvin A. Chirelstein, FEDERAL INCOME TAXATION § 6.04, at 119-21.
if not most, closely held commercial nonprofits rarely have sufficient
profits to implicate the nondistribution constraint. When residual
returns reach a sufficiently high level, the entrepreneur no longer
needs the subsidy factor. He then is motivated to depart and
continue the same operations in a for-profit medium where he is not
subject to the nondistribution constraint. But until residual
returns reach such a level, the entrepreneur can use his control power
in exactly the same manner as the control right is exercised by close
corporation shareholders; that is, the entrepreneur can direct residual
returns towards future operations, including increased compensation
and employee benefits for the entrepreneur.

An entrepreneur can operate a commercial nonprofit, even a
successful one, for some time without the nondistribution constraint
becoming an issue. Most commercial nonprofits begin with modest
goals and financing, and their entrepreneurs, like the hypothetical Joe
Quality, start off undercompensated. If the nonprofit is unsuccessful
in generating some residual returns within a relatively short period of
time, the entrepreneur will likely end the operation because it is not
meeting his minimum profit goal of providing him with a livelihood.
However, if the operation successfully generates residual returns,

(6th ed. 1991) (discussing reasonable compensation as it relates to small, closely held
corporations); see also supra notes 86-87 and accompanying text.

312. In 1989, over 70% of nonprofits, excluding religious organizations and foundations,
had total revenue below $25,000 and, therefore, did not have to provide financial data to
the IRS. The majority of organizations reporting financial data (30% of all organizations)
had annual expenditures less than $100,000 and median assets of $158,000. HODGKINSON,
ALMANAC, supra note 25, at 11-12. This Article focuses on the nonprofits from this group
that are reasonably successful; otherwise, divorce valuation would be moot. However, the
above averages and medians indicate that the profitability of even successful small
nonprofits is not substantial in relative terms.

313. This phenomenon is most evident when large nonprofits convert to for-profit
status, because of the publicity received upon such conversions. See, e.g., Jayne Garrison,
The New Prince of Health Care, CAL. LAW., Dec. 1994, at 32 (detailing the history of
lucrative conversions of California health maintenance organizations and the efforts of
California's new Corporations Commissioner—who oversees HMOs—to require larger
charitable contributions on account of built-up nonprofit value when such HMO
conversions occur); Eric M. Katz, Note, Dissolution of Public Charity Corporations:
that although many nonprofits fade out of existence because they run out of funds, the
hospital industry is converting to for-profit status because of high profitability potential);
Donna Alvarado, Blue Cross May Owe State Billions For Tax Exemptions, SACRAMENTO
BEE, Sept. 12, 1994, at B5 (detailing the furor created by Blue Cross of California's
attempt to avoid the termination payment requirements of the nondistribution constraint
by "restructuring" the organization using a new for-profit affiliate rather than converting
into a for-profit). Unfortunately, except for the few high visibility cases, little data is
available on conversions.
future operations can expand because of the financing provided by re-employed residual returns. In this event, unless the business's success is meteoric—which is unlikely—it probably will enjoy a gradual ascendance in residual returns. The nondistribution constraint will be of concern only when residual returns reach a level beyond that which can be captured by the entrepreneur in the form of "reasonable" compensation and benefits. As future operations expand, however, so too does the standard of "reasonableness" by which the salary and benefits payable to the entrepreneur are measured. The reasonableness of employee expenses is a relative concept based on the scope of the operations and responsibilities undertaken by an employee. Thus, the life span of a nonprofit can be quite long before the nondistribution constraint is implicated.

Even when a closely held commercial nonprofit is terminated and dissolved, the nondistribution constraint may have little substantive impact. Under most state nonprofit laws, a nonprofit complies with the nondistribution constraint by transferring its assets to another nonprofit with similar purposes. If a small commercial nonprofit is dissolved because it is unsuccessful, there probably will be few significant assets to transfer after the satisfaction of the nonprofit's liabilities. On the other hand, if the nonprofit is successful, dissolution probably is prompted by the fact that the nonprofit's residual returns are reaching a level at which the nondistribution constraint presents a dilemma for the nonprofit entrepreneur. In this case, the entrepreneur can plan the dissolution to occur before returns reach the critical level.

Moreover, the entrepreneur can use his control power to select and direct the method of dissolution. Nonprofits, like for-profits, can be dissolved either by sale of the ongoing business (including

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314. See, e.g., JODY BLAZEK, TAX AND FINANCIAL PLANNING FOR TAX-EXEMPT ORGANIZATIONS 313 (1990) (noting use of the same tests as applicable under I.R.C. § 162 to judge the reasonableness of business deductions); HOPKINS, supra note 14, at 278; see also supra note 311 and accompanying text (discussing I.R.C. § 162).

315. See, e.g., 26 C.F.R. §§ 1.501(c)(3)-1(b)(1) to (4) (1994) (mandating that nonprofit organizing documents make this dissolution restriction clear); CAL. CORP. CODE § 6716 (West 1990) (setting forth this method of compliance); see also HOPKINS, supra note 14, at 112-14 (discussing the federal tax law requirements to this effect which serve as the impetus for the state nonprofit laws governing termination distributions); OLECK, supra note 17, at 1191, 1195, and 1220 (generally discussing dissolution procedures of different types of nonprofits under typical statutes, including the requirement that assets of charitable nonprofits be transferred to other, similar charities).
conversion in the case of nonprofits\textsuperscript{316}) or by sale of the assets of the business in a liquidation. In either case, sale proceeds remaining after satisfaction of liabilities can be transferred to a selected successor nonprofit entity to satisfy the nondistribution constraint. However, if a liquidation sale is chosen, an entrepreneur, who arguably now has the ability to meet his dual for-purpose and for-profit goals using a for-profit form, can purchase necessary assets from the liquidating nonprofit for use in a new for-profit entity. Through his control power over the nonprofit, he can obtain the used assets at minimal relative cost,\textsuperscript{317} subject, of course, to good faith standards

\footnotesize{316. A conversion of a nonprofit into a for-profit is analogized to a sale of an on-going business because the entity issues stock to purchasers (generally "insiders") who invest in the on-going business.}

\footnotesize{317. California's experience with HMO conversions is illustrative of the potential for such bargain acquisitions in other nonprofit dissolution settings. See Garrison, supra note 313, at 32, 85. Until 1994, when the California Department of Corporations began to increase the scrutiny it gave to HMO conversion plans, a number of HMOs converted from nonprofit to for-profit status for what many saw as a bargain. As the Garrison article reported:}

\footnotesize{\textbf{[H]ealth plan conversions to for-profit status had become unbelievably lucrative. Typically, the companies would donate to charity the value of their assets, which was well below market because of their nonprofit status. After conversion, the companies' book value would triple or quadruple, making instant millionaires of their largest stockholders. . . . Insiders could buy their own companies for a penny on the dollar. . . .}}

\footnotesize{\textit{Id.} at 85.}

\footnotesize{HMO conversions such as those described in Garrison's article have received significant publicity in California because of the significant dollars and public health care issues involved. In particular, political outcry over a cleverly designed 1993 conversion plan by Blue Cross of California has caused the California Department of Corporations to pay greater attention to these conversions. The original Blue Cross plan allegedly would have enabled Blue Cross to shift to for-profit status without contributing an estimated $2.5 billion that consumer groups argued should have been donated for public purposes under the nondistribution constraint requirements. \textit{Id.} at 32. News reports detailing the Blue Cross case generated significant political pressure, resulting in an unprecedented reversal of the California Department of Corporations' initial approval of Blue Cross's plan and renewed negotiations with Blue Cross over the amount owed to the public trust. Although Blue Cross's plan had differed from the usual type of HMO conversions in its use of what some termed a "legal loophole," the Blue Cross case brought attention to other HMO conversions that had resulted in less egregious, but still sizeable, bargain acquisitions. Accordingly, the California Department of Corporations is now increasing its oversight efforts on HMO conversions to insure that the conversion prices it approves more accurately reflect the true value of the HMO. \textit{Id.} at 85-86. However, HMOs, because they are health care providers, often are supervised by government agencies different from those that oversee other types of nonprofits. \textit{Id.} at 34 (describing the California law enacted in 1975 to bring HMOs under the supervision of the California Department of Corporations rather than the office of the attorney general, which oversees other types of nonprofits).}
for such liquidating sales. He potentially could even continue using the name of the dissolved nonprofit by adopting it for the new for-profit operations, thus capturing much of the goodwill of the nonprofit enterprise at no additional cost.

3. De Facto Ownership Conclusion

Although Professor Hansmann made the following comments on the economies of scale of nonprofits in the context of an unrelated point, they echo the themes discussed in this section:

The distinction between the for-profit and nonprofit forms becomes blurred when the organizations in question are small in scale . . . . Consider, for example, a lawyer in solo practice who bills his clients by the hour. Since he only gets paid at what is presumably the going rate for his labor services, his law office is, in a sense, conducted on a nonprofit basis. Thus, his business might not operate much differently if he were to establish it formally as a nonprofit rather than as a [for-profit] sole proprietorship. Similarly, if

Accordingly, such intense scrutiny of dissolutions by other types of nonprofits is still not typical. Even if attorneys general across the country were to give heightened scrutiny to nonprofit dissolutions, it is doubtful that oversight energies would be focused on small dissolving nonprofits because they have significantly lower values, relatively speaking, than HMOs. Furthermore, the dissolution of any such nonprofit generally would not implicate statewide public policy issues like those associated with health care providers. Also, when the dissolution of a small nonprofit is achieved by means of a piecemeal liquidation, rather than by conversion, the oversight authority to question valuation matters arguably is more limited as long as the price paid for each asset is commercially reasonable. Thus, even if scrutiny like that currently given to HMO conversions in California eventually trickles down to the small nonprofit, it is likely that entrepreneurs of closely held commercial nonprofits will still be able to effect bargain acquisitions of the assets of their dissolving nonprofit.

318. See HOPKINS, supra note 14, at 288-91 (discussing IRS private letter rulings containing good faith standards for sales of assets to insiders).

319. Much of an entity's built-up goodwill is embodied in its name. Generally, once an entity is incorporated under a particular name, the office of the Secretary of State of a particular jurisdiction thereafter reserves it for exclusive use by that entity to avoid the confusion of the public that might be engendered by another corporation using this name. See, e.g., CAL. CORP. CODE § 5122 (West 1990). Once a corporation, including a nonprofit, dissolves and terminates, the applicable name generally again becomes available for selection and use by any newly incorporating entity desiring the name, at no or minimal cost. The nonprofit entrepreneur who is re-incorporating as a for-profit could time the incorporation of his new for-profit entity to coincide with the termination of the nonprofit, ensuring that he could select the name of the old nonprofit for his new for-profit entity. If the entrepreneur is the principal purchaser of the assets of a nonprofit at a piecemeal liquidating sale, he potentially can use his control power over the liquidation process to capture even the goodwill value of the nonprofit in a new for-profit venture at the same locale and under the same name.
a person operates a small day care center out of his own home, employing few or no persons other than himself, the flow of funds and even the bookkeeping might look much the same whether the organization is formally created as a nonprofit or a for-profit entity. The nondistribution constraint that characterizes the nonprofit form has real meaning only when an enterprise is of sufficient scale to develop large earnings that cannot easily and plausibly be paid out simply as reasonable salaries to the individuals in control of the enterprise.\(^{320}\)

The control power held by an entrepreneur like Joe Quality often is essentially equivalent to the ownership rights actually available to a close corporation shareholder like Sue Capital. The key incident of ownership for Sue is her control right, with her residual claimant and transfer rights only becoming of superior importance in limited circumstances.\(^{321}\) The control power available to Joe is comparable to this control right. The nondistribution constraint prevents entrepreneurs like Joe from having residual claimant and transfer rights like those available to shareholders. However, as in the case of the close corporation shareholder, the circumstances in which such rights would have significance are limited and arise infrequently in the small, commercial nonprofit context. When they do arise, the control power offers the means for diminishing, and even deflecting, the nondistribution constraint's impact.

There is little difference between Sue Capital and Joe Quality with respect to their business operations. Entrepreneurs of commercial nonprofits often are like Joe Quality. They have sufficient power to make themselves de facto owners of the business interests they control in the nonprofit form. This is not to suggest that there is anything inappropriate or wrong about the control power held by nonprofit entrepreneurs. As long as a nonprofit entrepreneur adheres to the nonprofit purposes for which the entity was formed and does not use the corporation or its assets fraudulently or otherwise engage in impermissible dealings with the nonprofit or its assets, the control power is not abused.\(^{322}\) However, the fact that the control power is

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320. Hansmann, The Role, supra note 17, at 870-71 (footnote omitted).
321. See discussion supra part V.A.2.
322. Future reform measures may seek to curtail this control power, but currently it is quite broad. See, e.g., Ben-Ner, Who Benefits, supra note 17, at 756-61 (arguing that the lack of broad-based participation by nonprofit demanders can lead to a decline in public goodwill towards nonprofits, which, in turn, may result in nonprofits serving as a less complete solution to the market failures to which they respond). On the other hand, it is
legitimate has no relevance to its proprietary implications. In the context of the closely held commercial nonprofits, upon which this Article focuses, a nonprofit entrepreneur’s control power makes him a de facto owner of the nonprofit. Moreover, for the reasons set forth in the next section, when nonprofit entrepreneurs divorce, it is not only fair, but also appropriate, to include their business “holdings” in the divorce deliberations.

C. Implications of the Control Power in the Divorce Law Context

1. Importance of Context to Proprietary Determinations

As previously acknowledged, nonprofit entrepreneurs do not “own” the assets of the nonprofits they control, at least as the term is commonly understood. This fundamental fact engenders intuitive concern about including the value of business interests held in nonprofit form in divorce allocations. But one must consider what gives rise to ownership: a stock certificate with an individual’s name on it or the powers of ownership? A stock certificate is merely an indication of a particular set of ownership rights—those of a shareholder of a for-profit corporation. Even the standard set of ownership rights typically flowing to shareholders may be altered by preferences and limitations set forth in incorporation documents, bylaws, or shareholder agreements. A shareholder is still considered to have ownership or proprietary rights even if her voting, distribution, or other usual rights are significantly circumscribed by such documents.

The bundle of possible property rights recognized in this country is multi-dimensional. Incidents of ownership flow from even the most tenuous hold on any right in the bundle if appropriate to the legal context in which “ownership” is examined.323 The purposes of particular laws are equally broad; some emphasize the protection of private personal rights and the fostering of societal welfare, while others facilitate the efficient functioning of capitalism by emphasizing private property and freedom of contract rights. Thus, “ownership”

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323. For examples of interests that are designated property for some purposes but not for others, see infra notes 324-30 and accompanying text. See also Oldham, supra note 225, at 1120 (making a general observation about the different meanings of property).
is a term that has no single meaning; its breadth, limitations, and implications are defined by the operative legal context of its reference. Proprietary rights are constrained in some contexts and expanded in others, depending on the economic and societal purposes to be served.

An adverse possessor does not own the property she possesses but is given superior rights of ownership in the property relative to all but the true owner. A news service does not own the news it packages in news reports but is protected from its usurpation by competitors. The holder of a contingent future interest in property has sufficient present ownership rights to prevent waste by the present possessory holder. A provider of gametes, such as frozen sperm or embryos, cannot claim a broad property interest founded in general property law in such neither-property-nor-person material, but is said to have interests "in the nature of ownership," representing an "interim category" of property in divorce and probate situations. A child has a mere expectancy in the property of a parent, but is given standing to bring a will contest if the expectancy is dashed by a will that disinherits the child. An enterprise may have only a potential business opportunity in a particular project, but may have sufficient expectancy to thwart the efforts of another to compete unfairly for the opportunity. Corporate assets are technically owned by corporations, yet shareholders are said to own corporations because, acting collectively and through the intermediary of a board of directors, they have proprietary rights over the corporate assets.

The foregoing examples illustrate how the proprietary force of rights, claims, or interests existing in one context vary when such rights are viewed in another context. Proprietary rights are extended

325. See, e.g., International News Serv. v. Associated Press, 248 U.S. 215, 236 (1918) (holding that news gatherer had a "quasi-property" interest in its gathered news, entitling it to stop competitors from using the information until its commercial value as news had passed away).
327. See Hecht v. Superior Court, 20 Cal. Rptr. 2d 275, 281 (Cal. App. 1993) (holding that a decedent had an interest in his frozen sperm that fell within the broad definition of property for purposes of probate of his will); Davis v. Davis, 842 S.W.2d 588, 597 (Tenn. 1992) (concerning the disposition of frozen pre-embryos in a divorce case), cert. denied, 113 S. Ct. 1259 (1993).
329. See CLARK, supra note 124, §§ 7.1-7.9 at 223-62.
330. See authorities cited supra parts IV.A.1.-IV.A.2.
when, and to the extent, necessary or appropriate for the underlying purposes of the legal rules at issue. Stated differently, the purposive legal context in which rights or interests are examined generally determines the proprietary implications of the rights or interests. Some rights or interests might not be sufficiently proprietary for certain purposes, but may be more than adequate for others. With regard to the divorce context examined in this Article, the adequacy standard for proprietary attribution does not require the existence of all the traditional incidents of property ownership.\(^{331}\)

2. Specific Divorce Law Context: Broad Standards for Proprietary Attribution

Divorce laws increasingly view marriage as a partnership.\(^{332}\) The purpose of property-division allocation laws is to divide the accumulated acquisitions of the marital partnership fairly between the spouses upon its termination.\(^{333}\) However, unlike typical commercial partnerships, the marital partnership concept assumes the mutual support of the labor and efforts of each spouse in both commercial and non-commercial endeavors.\(^{334}\) The partnership contemplates long-term investment in the economic and non-economic well-being of the individual marriage partners rather than in any specific asset or endeavor.\(^{335}\) The partnership is premised on the notion that marital efforts that improve the well-being of one partner will be shared by, and inure to the benefit of, the other.\(^{336}\) Given this distinction, divorce courts routinely must consider expanding the scope of economic interests divisible upon divorce beyond the borders of rights traditionally viewed as fully proprietary in order to effect fair allocation of assets.\(^{337}\)

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331. See generally Da Silva, supra note 225, § 18.02 (discussing the broad concept of "property" in divorce law).
332. See, e.g., Bruch, Of Work, supra note 225, at 101; Oldham, supra note 225, at 1084; Smith, supra note 227, at 696, 730-38 (arguing that the partnership theory may be a realistic approach to marriage but is flawed as an approach to divorce).
333. See Oldham, supra note 225, at 1084; Smith, supra note 227, at 732.
334. See Smith, supra note 227, at 732-34.
335. Id.; see also Bruch, Of Work, supra note 225, at 101.
336. See Blumberg, Marital Property, supra note 225, at 1251-52; Da Silva, supra note 225, § 18.02; see also Heyman, supra note 225, at 4 n.13 ("[T]he very existence of marital property schemes eventually forced courts to rethink what is meant by property rights.").
337. In commercial partnerships, the parties identify the scope of shared assets and rights. Investors in the venture risk that it will not mature. Hence, the scope of includable assets is defined by the focus and narrow purposes of the venture. The marital partnership is not so defined by purpose or duration. For divorce law purposes, "[g]enerally speaking, the mere fact that an item is difficult to identify with specificity does not preclude its
In fact, what constitutes "ownership" of assets rarely is discussed directly as a problematic or ambiguous issue in connection with the divorce allocation process. For the most part, the question of whether one or both spouses "owns" an asset appears to be treated as a non-issue in divorce cases, except when there are competing ownership claims by third parties or between the spouses. Courts seem to pay more attention to the issue of the nature of the asset or right rather than to the technicalities of its ownership anchorings. It appears that spousal representations about the ownership of assets generally are accepted and supported by possession, clear title documents, or contractual, trust, or employment arrangements giving a spouse beneficial rights. Even when an asset, such as an nonvested pension right, is not owned in the full legal sense of the term, differing inclusion rules center on the nature of the right as property rather than on its ownership. The fact that financial benefits flow in the direction of one or both spouses appears potential in being classified as 'property.' " Da Silva, supra note 225, § 18.02[2]. Dictionary definitions of 'property' provide little value in the overall concepts of equitable distribution of marital property." Id. § 18.02[1]. "While state courts have been confounded by many... intangible interests, the trend is to accord them 'property' status for marital property purposes." Blumberg, Intangible Assets, supra note 225, § 23.01[1]. Accordingly, no relevant cases or legal commentary generally discuss "ownership" as a prerequisite to the inclusion of an asset in divorce allocations. It appears that the discussion of includability is simply not addressed in these terms.

One case in which ownership is addressed directly is Allen v. Allen, 702 S.W.2d 819, 821 (Ark. Ct. App. 1986); cf. supra note 66. Allen is the only case that deals with the question of whether a nonprofit's value should be included in divorce allocations. In Allen, the court resolved the issue in the negative because the nonprofit involved in the case was a membership club, owned by its members rather than by the divorcing entrepreneur who controlled it. Allen, 702 S.W.2d at 821-22. This membership-type nonprofit stands in contrast to the type of nonprofits upon which this Article focuses. Thus, even Allen dealt with a competing claim of ownership by third parties, which was determinative.

In some cases, a spouse may claim that he has acquired an interest in the property of the other spouse by virtue of a spousal agreement, contributions to improvement of the asset, or other facts. See generally Da Silva, supra note 225, § 18.07, at 18-85 to 18-99 (discussing statutes and case law concerning transmutation of property caused by spousal agreements, commingling, gifts, and other actions).

See, e.g., In re Marriage of Graham, 574 P.2d 75, 77 (Colo. 1978) (analyzing how an educational degree lacks the attributes of property); In re Marriage of Washburn, 677 P.2d 152, 162 (Wash. 1984) (Rosellini, J., dissenting) (arguing that the crucial inquiry in a marital property question is whether a property interest is found in an intangible); see also Heyman, supra note 225, at 4 (noting that "marital property exists without reference to title").

See, e.g., Ball v. Ball, 445 S.E.2d 449, 450 (S.C. 1994) (concluding that participation right in pension plan is "property" whether vested or nonvested); see also infra notes 350-51 and accompanying text.
to be sufficient to corral the source of that wealth into their divorce deliberations.

Thus, ownership questions have not spawned the same interpretative disputes and differences in approach as the question of whether certain intangibles are property. Accordingly, it appears that divorce courts would likely frame the issue of inclusion of nonprofit business interests as an "is-it-property" issue rather than as an "is-it-owned" issue. This distinction may seem to be only a slight substantive shift in perspective. However, such framing significantly facilitates the required analysis, because it focuses the relevant divorce law guidelines.

Divorce courts have had to grapple with the appropriateness of inclusion of a wide variety of intangible and inchoate rights in divorce allocation. Exclusion is particularly troublesome when intangible or inchoate rights have significant value or may be the most valuable asset of the marital partnership. When the labor and efforts of one or both spouses result in acquisitions of tangible business property or defined shareholder or partnership holdings in a business corporation or partnership, the proprietary nature of the assets is clear. However, marital efforts often produce valuable economic prospects or opportunities that have not yet matured into fixed proprietary rights in particular property or have not yet been captured in recognizable proprietary form, such as a contract right or an active business operation. Such opportunities and prospects span a broad spectrum of possible rights, claims, and interests based on a spouse's status, skills, talents, labor, and experience developed, risked, or expended during the marriage. For example, economic prospects based on an idea for an invention, a professional education, legal causes of action, established reputation or goodwill, an executory contract, or accrued salary all would be included in the opportunity spectrum. At one end of the opportunity spectrum lie sheer hope and expectancy in yet undefined and amorphous property. These

343. The valuation of such assets may be problematic, but they are clearly includable in the divisible estate. See Da Silva, supra note 225, § 18.02[3].

344. Each of these examples represents the prospect or opportunity of earning or otherwise acquiring future wealth. However, the likelihood that such wealth will be realized depends on speculation about future events, gratuities, or the enforceability of rights.

345. See, e.g., In re Brown, 544 P.2d 561, 565 (Cal. 1976) (distinguishing a mere expectancy from a nonvested pension right). The court stated:

The term expectancy describes the interest of a person who merely foresees that he might receive a future beneficence, such as the interest of an heir apparent of
prospects warrant no proprietary attribution to the marital partnership or either spouse. At the other end of the spectrum lie fully matured or developed interests, which reasonably insure the eventual realization of possessory rights by the marital partnership to distinct assets that meet all traditional definitions of property. These prospects warrant unquestionable proprietary attribution.

Between the two ends of the opportunity spectrum lies a legal "gray" area. Divorce courts often must determine whether, on the one hand, the proprietary value of an economic prospect is attributable to the marital partnership or, on the other hand, it is so personally intertwined with the identity or indivisible rights of one spouse, so dependent on post-marital efforts of that spouse, or so contingent on future events, that no attribution to the other spouse is appropriate. Generally, a case-by-case determination is required. States disagree about controlling determinants or the characterization of certain facts. Despite such disagreements, however, the dividing line for inclusion of economic prospects in divorce allocations lies somewhere within, rather than outside or at the far edges of, the economic opportunity spectrum.

For example, most divorce courts now include the value of nonvested pensions as allocable property upon divorce. For a beneficiary designated by a living insured who has a right to change the beneficiary. As these examples demonstrate, the defining characteristic of an expectancy is that its holder has no enforceable right to his beneficence.

Id.

346. Accrued salary and vested pension rights would lie at this end of the opportunity spectrum because they are fully earned and are based on clear contractual rights. They are fixed receivables and their collection generally only is subject to the ability of the employer to make payment when due.

347. See, e.g., Blumberg, Marital property, supra note 229, at 1255 (stating the view that "the entirety of marital property law . . . represent[s] an accommodation between the competing claims of marital partnership and personal autonomy").

348. See, e.g., Blumberg, Goodwill, supra note 225, §§ 25.02-25.03, 25.06 (summarizing state differences in analyzing goodwill); Da Silva, supra note 225, § 18.03[3], at 18-20 (emphasizing that the definitions of intangibles are in a constant state of flux from jurisdiction to jurisdiction and even within given jurisdictions); McKnight, supra note 225, at 199-201 (noting that there is no standard definition of property and describing specific inconsistencies between states on this issue).

349. Even though the law of intangible inclusion is fraught with ambiguity, "certain types of intangible property are considered to such a frequent extent by courts . . . that certain accepted guidelines have been established." Da Silva, supra note 225, § 18.03[3], at 18-20.

350. Blumberg, Intangible Assets, supra note 225, § 23.02[1] (noting that a majority of states recognize any type of pension right as marital property and providing an overview of the various state positions on pensions); see also, e.g., Ohm v. Ohm, 431 A.2d 1371, 1375 (Md. Ct. Spec. App. 1981) (holding pension rights includable, whether vested or not);
years, however, a number of these same jurisdictions characterized nonvested pensions as mere expectancies. Courts previously characterized pensions in this way because pensions may be lost if an employee-spouse leaves employment or is fired before vesting. Similarly, commercial goodwill of a business has been viewed as an includable asset for a considerable number of years despite its distinct intangible nature. A majority of jurisdictions also includes professional goodwill in divorce allocations, although a few maintain that in personal service businesses the goodwill is inseparable from the person of the spouse or nontransferable. A few jurisdictions even go so far as to include the value of "star" or celebrity status as allocable celebrity goodwill. In these jurisdictions, the incremental value of celebrity status is recognized, even though it is not captured in an established proprietary form, separate from the celebrity, by being either part of the goodwill of an independent enterprise or commodified in a long-term service contract.

In summary, divorce courts often attribute proprietary value to intangible and inchoate economic rights or interests that lack formal incidents of ownership or lack independent form as distinct property. Imperfections in, or restrictions on, ownership rights and amorphousness of form can be accounted for by discounts in the valuation process rather than by wholesale exclusion from the divisible estate. Accordingly, it is not necessary that assets or interests in assets be fully "owned" in the traditional sense or be captured in a recognized proprietary form in order for divorce laws to find sufficient


351. See, e.g., Basset, supra note 270, § 3.04[B] (citing 13 California decisions overturned by the California Supreme Court when it ruled in In Re Marriage of Brown, 544 P.2d 561, 563 (Cal. 1976), that non-vested pension rights are divisible contingent property interests rather than "mere expectancies").

352. Da Silva, supra note 225, § 18.03[3][c], at 18-31.


354. See supra notes 256-57 and accompanying text.

355. See Blumberg, Goodwill, supra note 225, § 25.06[6] (discussing cases finding for inclusion of celebrity goodwill).


357. See supra notes 233, 259-63 and accompanying text.
proprietary value to warrant attribution and allocation. This is the operative context for analyzing the question of whether a nonprofit entrepreneur’s business interests are subject to value allocation. A nonprofit entrepreneur’s control power in an on-going nonprofit is an existing present-day interest. Compare this interest to the myriad types of significantly contingent, future interests that divorce courts have classified as includable. The nonprofit entrepreneur’s control right clearly meets the proprietary standards of existing divorce laws. If nonprofit business holdings of a divorcing entrepreneur would otherwise qualify as divisible assets were they held in the for-profit form, the nature of the corporate form should not result in different treatment. The value of the business holdings should be included in divorce allocations, even though the nondistribution constraint prevents the in-kind division of the holdings. Given this conclusion, the first issue for a divorce court presented with a case involving a manager of a closely held, commercial nonprofit should be proof of control.

D. Proof of Requisite Control: Replacing Assumption with Rebuttable Presumption

Not every manager/operator of a closely held commercial nonprofit will have sufficient control to qualify as a de facto owner. Given the predominance of sector-blurring, however, such managers should not automatically be assumed to have mere employee status simply because their operations are carried on through a nonprofit. At a minimum, the predominance of sector-blurring necessitates changing this assumption to at least a rebuttable presumption against de facto ownership. A case-by-case analysis is required to discern the true status of these “employees.”

Judicial guidelines for such a determination can be fashioned by adapting already familiar standards. For example, institutional lenders commonly require that closely held businesses purchase key-person insurance coverage on employees considered essential to the continued success of the business of operations. Similarly, key-

358. See supra notes 350-57 and accompanying text.
359. The term “key-person” is the gender neutral version of “key-man,” which is still sometimes used. See, e.g., In re Marriage of Brown, 608 N.E.2d 967, 970 (Ill. App. Ct. 1993) (noting valuation of husband’s closely held corporation based on evidence of key person insurance policy taken out on the husband in the amount of $200,000, which named the corporation as beneficiary). See generally Taylor, supra note 225 (discussing the use of the concept to justify a valuation discount in divorce cases that involve issues different from those upon which this Article focuses).
person discounts are employed regularly by accountants to determine the going-concern sale value of a for-profit business in which an essential employee will be departing.\textsuperscript{360} Courts are accustomed to applying such key-person discounts in divorce valuations of closely held for-profits.\textsuperscript{361} The standards for determining key-person status in these for-profit contexts could easily be modified and adapted for a de facto ownership determination in the nonprofit context. If a nonprofit employee is so essential to the operation of the nonprofit that extensive key-person insurance would be required by a lender of the nonprofit, de facto ownership status seems appropriate. Similarly, the current judicial standards used for determining satisfaction of the alter ego requirements in corporate-veil-piercing cases, modified to eliminate inapplicable elements,\textsuperscript{362} also hold promise as a beginning basis for fashioning de facto ownership testing criteria.\textsuperscript{363} Alternatively, courts might choose to frame completely new criteria. Regardless of the criteria used, if the testing for de facto ownership is positive, valuation of the interests will be the next significant task.

E. Valuation in Light of the Nondistribution Constraint, with Emphasis on Goodwill

The value assigned to a nonprofit entrepreneur’s interest in a closely held commercial nonprofit arguably should be less than that assignable to a comparable interest in a for-profit. This is because the nondistribution constraint deprives a nonprofit entrepreneur of residual claimant and transfer rights. If the selected valuation method and assumptions used for a comparable for-profit rely in any way on the existence of these rights, and the same basic method is used to value the nonprofit, then the nonprofit’s valuation should incorporate

\textsuperscript{360} See Pratt, supra note 249, at 35-36, 101-02; Haynsworth, supra note 225, at 496-97.

\textsuperscript{361} See authorities cited supra note 262.

\textsuperscript{362} A nonprofit entrepreneur need not act inappropriately to be considered as having de facto ownership of the nonprofit for divorce law purposes. Accordingly, the veil-piercing standards would need to be modified to do away with the notion of wrong or fault, since the purpose of de facto ownership standards would be to determine value attribution, while veil-piercing standards are applied to determine liability. For discussions of veil piercing, see David H. Barber, Piercing the Corporate Veil, 17 WILAMETTE L. REV. 371 (1981); Frank H. Easterbrook & Daniel R. Fischel, Limited Liability and the Corporation, 52 U. CHI. L. REV. 89 (1985); Robert Thompson, Piercing the Corporate Veil: An Empirical Study, 76 CORNELL L. REV. 1036 (1991).

\textsuperscript{363} At least one court has already suggested that nonprofit insiders who became owners of an HMO upon its conversion were the “alter egos” of the nonprofit. See Maillie v. Greater Delaware Valley Health Care, Inc., 628 A.2d 528, 531 (Pa. 1993).
a discount to account for the nondistribution constraint ("NDC discount").\textsuperscript{364} Accountants and appraisers are familiar with valuing stock subject to shareholder-imposed restrictions, which have impact similar to that of the nondistribution constraint.\textsuperscript{365} They can draw upon the techniques and factors used in these for-profit settings to design an NDC discount methodology. One approach in particular might be useful: to view the control power of the divorcing entrepreneur as comparable to a leasehold right in the assets of the nonprofit business.\textsuperscript{366} This leasehold approach, which is explained below, is offered as a theoretical basis for understanding how valuation of a nonprofit entity might differ from that of a comparable for-profit entity. It is offered as a concept rather than as an actual methodology to assist those who, like myself, are untrained in valuation practice in comprehending how the applicable determinants might be translated. I hope not to offend those trained in valuation practice by the use of terminology or assumptions that may seem awkward or inappropriate to them given their experience. In any case, possible disagreements with my conceptual approach or conclusions regarding valuation should not obscure this Article's fundamental conclusion about de facto ownership of closely held commercial nonprofits.

1. Suggested Leasehold Analogy Discount

Control power essentially provides the entrepreneur the ability to use and enjoy the assets of a business as long as she chooses to be in control and as long as she is not ousted by the board of directors. The traditional real property analogue to such use and enjoyment rights is the leasehold estate—specifically the periodic tenancy.\textsuperscript{367}

\textsuperscript{364} This depends on the valuation method and assumptions that might be selected for use in a comparable for-profit in the divorce context. As previously stated, valuation methods vary and so do assumptions used within methods. See supra notes 259-63 and accompanying text. If residual claimant and transfer rights are not considered in the selected methodology, no discount seems necessary. However, the discussion in this section assumes use of a basic valuation method that incorporates these rights. Since the arguments in this Article have been presented from a comparative perspective, this assumption is appropriate to complete the comparative analysis.

\textsuperscript{365} See PRATT, supra note 249, at 381-83 (discussing various types of shareholder agreements that restrict marketability); Haynsworth, supra note 225, at 488-92, 501-06 (explaining valuation factors used by appraisers to take account of lack of marketability, restricted securities, and buy/sell arrangements).

\textsuperscript{366} See PRATT, supra note 249, at 50.

\textsuperscript{367} Under a periodic tenancy the leasehold estate is automatically renewed for successive periods unless either party gives timely notice of an intent to terminate it. See, e.g., DUKEMINIER & KRIER, supra note 326, at 426.
Accordingly, the entrepreneur's control over the assets of the nonprofit may be equivalent to having a lease of the underlying assets of the nonprofit. The value of the leasehold right in each asset could then be determined by using a reasonable lease term comparable to the capitalization period that might be employed to value a for-profit business. This technique could be utilized easily for tangible assets, including equipment and office space, because market rental values for such assets are likely to be readily available. Moreover, as with many for-profits, the nonprofit actually may lease, rather than own, some of the assets used in the business. In this case, the valuation is no different than it would be if the leased assets were being used by a for-profit. The intangible leasehold value of the underlying tangible assets would be the operative value.

Admittedly, other types of non-leasehold intangibles, such as service, supply, or consulting contract rights, will present greater valuation difficulties. However, using the leasehold approach also offers a useful conceptual perspective for valuing these assets in a manner that recognizes a discount for the limitations attending the nondistribution constraint. These intangibles could be valued in the same manner as they would be valued in a for-profit context. Appraisers could then overlay and apply familiar leasehold valuation methodologies as a single additional step in the valuation of the intangible.

Thus, the closely held nonprofit could first be valued in the same manner as would a for-profit close corporation in the applicable jurisdiction. This establishes a benchmark reference value for determining the value of the business interests "held" by the nonprofit.

368. Alternatively, as suggested by one reader of a draft of this Article, the entrepreneur's interest might be more like a revocable license than a leasehold interest because the entrepreneur's access to the assets is not supported by the legal protection afforded to lease rights. In this instance it is doubtful such an alternative characterization would result in a significant difference in valuation, because the matters that would cause revocation of the nonprofit "license" are almost totally within the control of the entrepreneur. See also DUKEMINIER & KRIER, supra note 326, at 437-38 (presenting the difficulties of distinguishing leases from licenses in certain situations).

369. Conceptually, the control power can be viewed as giving the entrepreneur a sublease in the same tangible assets on the same terms and conditions as the nonprofit entity's leases.

370. Even if the conceptual difficulties are overcome, evidentiary problems may remain. However, evidentiary problems exist in varying degrees in all valuations, appraisers are accustomed to addressing them, and divorce courts are accustomed to assessing the testimony.

371. See supra text accompanying note 253 and the comments supra note 265 regarding the jurisdictional differences in the treatment of various component assets.
entrepreneur that should be includable in the allocations on divorce (the “includable nonprofit value”). The benchmark value would be the maximum value potentially assignable to the includable nonprofit value. The minimum value potentially assignable would be determined by applying a full NDC discount, of either the leasehold-type suggested or another appropriate discounting method, to the entirety of the benchmark value. In fact, if certain adjustments, discussed below, were not necessary, this minimum value theoretically would be the appropriate amount of the includable nonprofit value using a basic conceptual formula that equates the includable nonprofit value to the benchmark value minus the NDC discount. However, the actual includable nonprofit value would likely be an amount falling within these maximum and minimum conceptual parameters when adjustments are made.

2. Adjustments to the Conceptual Formula

First, the full NDC discount must be adjusted downward to the extent it is based on factors common to, and overlapping with, factors already considered in determination of the benchmark value. For example, it is highly likely that the benchmark value already reflects a discount factor for lack of marketability, because the benchmark is theoretically determined by treating the nonprofit as a closely held, for-profit corporation. Interests in closely held corporations usually have reduced marketability; this reduced marketability is normally considered as a factor in the basic valuation of closely held corporations. If so, application to the benchmark value of a full NDC discount, to account for the nondistribution constraint's restrictions on transfer rights, might overcompensate for these transfer restrictions. Appraisers should make adjustments to the NDC discount to avoid this overcompensation.

Second, an adjustment must be made when the total benchmark value includes the value of an asset of the nonprofit not significantly affected by the nondistribution constraint. Unlike the first adjustment, this adjustment to the basic conceptual formula is not dependent on the specifics of a particular appraiser’s methodology, but rather should always be applied when implicated by a given component asset. In particular, persuasive arguments exist to treat goodwill value as such an asset. These arguments, articulated below,

372. See supra notes 357-58 and accompanying text.
373. See supra notes 249-53, 262, and accompanying text.
support a conclusion that whenever goodwill value is a part of the benchmark value it should be exempted from the NDC discount. In other words, instead of using the minimum value determined under the basic conceptual formula, only the benchmark value exclusive of goodwill should be discounted. This should result in a more accurate valuation.

3. Case for Exempting Goodwill Value from Discount

Why exempt the goodwill value of the business from the NDC discount? There are two reasons. One is based on jurisdictional practice. The other, more important reason is based on the essential nature of goodwill.

a. Jurisdictional Practice

As previously stated, the large majority of jurisdictions includes the goodwill value of business interests in divorce valuations regardless of whether the goodwill is marketable or transferable.\footnote{See supra notes 254-57 and accompanying text.} If the standards established in any of these jurisdictions for valuing unmarketable goodwill in these for-profit settings do not differ from those established for valuing marketable goodwill, then no NDC discount of goodwill value in the nonprofit setting seems warranted. If, however, the standards do differ, then the same standards used in these jurisdictions for valuing unmarketable goodwill in the for-profit setting should be applied in these jurisdictions rather than the NDC discount. But the primary reason for exempting goodwill from an NDC discount urges caution in the wholesale application of such differing standards in these jurisdictions and similar caution in jurisdictions that do not recognize unmarketable goodwill.

b. Nature of Goodwill

The primary reason to exempt goodwill from the NDC discount is that the nondistribution constraint has no—or only minimal—application to the goodwill value. Thus, discounting this asset is unwarranted.

Goodwill is the intangible aspect of a business relating to reputation and patronage. “Goodwill . . . really means those factors that tend to bring customers back to the business.”\footnote{PRATT, supra note 249, at 188.} Elements of goodwill include business name, proprietary product, and the proba-
bility that the old customers will resort to the old place of business.\textsuperscript{376} The nondistribution constraint prohibits the distribution of profits or assets owned by the nonprofit to insiders.\textsuperscript{377} But goodwill is the capacity for profit, rather than profit itself and, further, is not a distinct and independent type of asset within the traditional meaning of the term.

As to this latter point, while goodwill is generally referred to as an "asset," it is an intangible different from other types of assets. In fact, goodwill is usually defined as that portion of a business's value exceeding the value of its assets.\textsuperscript{378} This definition is intended to contrast goodwill with discretely identifiable assets that have a value separate from the business activities of an enterprise. Valuation methodologies analyze the sources of value in a business. "The business as an operating activity has a value based on its income profitability. The profitability of the business includes income created from two distinct sources, ..., assets and goodwill."\textsuperscript{379} In this context, the term "assets" is used to refer to assets, both tangible and intangible, other than goodwill, that is, "discrete" assets.\textsuperscript{380}

Since goodwill is a conglomerate of factors creating additional value, as opposed to a discrete asset, it is not capable of being distributed or assigned by itself as an isolated, separate asset. This means goodwill value can only be accessed through use of an owner's control rights, because goodwill has no independent value separate from business activities. It has value only insofar as it attaches to a

\textsuperscript{376} Smith, supra note 225, at 164.

\textsuperscript{377} See supra notes 76-81 and accompanying text.

\textsuperscript{378} Zipp, supra note 225, at 101. Professor Blumberg notes:

Since goodwill is a residuum of assets we are otherwise unable to quantify individually, any listing of goodwill constituents is necessarily illustrative rather than exhaustive. In addition to reputation and repeat patronage, goodwill may include, inter alia, strategic location, effective advertising, the value of a skilled, trained, efficient work force, assemblage of property, plant and equipment in a productive unit, and systems, controls and methods developed as part of the operation.

Blumberg, Goodwill, supra note 225, at 25-26 (internal citations omitted).

\textsuperscript{379} Zipp, supra note 225, at 100.

\textsuperscript{380} Note, however, that a business appraiser might use what is termed the "big pot" approach. Under this approach, he would not attempt to identify the specific values attributable to individual intangible assets, but would lump all value over and above net tangible asset value into one big pot and loosely refer to it collectively as goodwill. If the amount of the intangible assets is relatively small, the big pot approach results in reasonable accuracy in valuing true goodwill. However, if intangible asset value in the business is substantial, the intangibles should be identified and appraised individually. See PRATT, supra note 249, at 188; Zipp, supra note 225, at 99.
continuing business. As already revealed by the comparative analysis in Sections A and B of this Part, the control right is the principal ownership right in close corporations and the control rights of nonprofit entrepreneurs of closely held commercial nonprofits are essentially equivalent to those of shareholders of close corporations. Accordingly, since goodwill is an asset that has value only as part of control rights, a nonprofit entrepreneur generally has the same ability to access goodwill value as does a close corporation shareholder. As controller of a closely held commercial nonprofit, he has full use and enjoyment of the entity’s goodwill. In translating a closely held entity’s value from a for-profit setting to a nonprofit setting, it would be inappropriate to adjust for the absence of rights that have little relevance to the benchmark value assigned in the for-profit context.

The rationale for the NDC discount is to adjust for the lack of the residual claimant and transfer rights resulting from the non-distribution constraint. However, the absence of residual claimant and transfer rights detracts little from the ability to access goodwill value. In comparison to shareholder rights in a for-profit business, the residual claimant and transfer rights with respect to this “asset” only have value isolated from the control right in two situations of limited applicability: when profitability attributable to goodwill is relatively high, implicating the residual claimant right; or when the ongoing business is sold, implicating both the residual claimant and transfer rights. However, for reasons already discussed in this Article and briefly reviewed at this juncture, an NDC discount is not necessarily warranted in order to account for the possibility of these two situations.

As previously noted, closely held corporations rarely achieve the sorts of high profits that make the residual claimant right attractive. When high profits are achieved, closely held corporations usually become more broadly held. Until profitability reaches

381. See supra text accompanying note 265. One commentator argues:
If goodwill exists, its exists only as a value which attaches to the business as a whole. Consequently, the value of the goodwill can only be measured indirectly by first determining the value of the business as a whole and then comparing this value to the net values of the various separate assets and property rights of the business. If an excess value of the business as a whole exists, then this difference must represent the intangible known as goodwill.
Zipp, supra note 225, at 96-97; see also Hanson v. Hanson, 738 S.W.2d 429, 433 (Mo. 1987) (holding that saleable goodwill is property that attaches to a business entity, not an individual, and that goodwill is valuable only as an incident of a continuing business).
382. See supra notes 285-89 and accompanying text.
383. See supra notes 285-89 and accompanying text.
such levels, a close corporation shareholder generally relies on her control power to access profits by increasing her salary and employee benefits. Similarly, a nonprofit entrepreneur can use his control power to access goodwill value. As long as he controls the nonprofit entity, the goodwill value inures to his personal benefit to the extent that it results in increased residual returns that he uses to finance additional salary and employee benefits for himself. The only limitation on this indirect ability to capture the entity’s profits attributable to goodwill in the high profitability situation is that compensation and perquisites must be “reasonable” relative to the expanding operations of the entity. Accordingly, unless the goodwill valuation in a divorce setting is based on projected profitability attributable to accumulated marital goodwill that would violate the reasonableness standard, a valuation discount because of this limitation is unwarranted.

On the other hand, if the divorce valuation is based on projected profitability attributable to goodwill that cannot reasonably be calculated in the described manner, then it is likely, as previously noted, that the nonprofit entrepreneur will be motivated to abandon the nonprofit form and continue the business in a for-profit form. If this is the case, then observations made in this Article about the entrepreneur’s ability to use his control power to dictate the method of dissolution of the nonprofit entity still mitigate against applying an automatic NDC discount to goodwill value. Moreover, these same observations also mitigate against applying an NDC discount to account for the second situation referenced above as implicating residual claimant and transfer rights, that is, a sale of the on-going business.

With respect to this situation, the relevance of the nondistribution constraint’s negation of residual claimant and transfer rights may not be eliminated but is significantly diminished. This situation exists because the termination options for nonprofits operate to give the nonprofit entrepreneur rights that are almost comparable to that of the residual claimant and transfer rights held by close corporation shareholders upon sale of a for-profit entity.

When a for-profit business is sold as an on-going concern, the control right terminates, as does the continuing benefit of the goodwill of the business. It is true that a shareholder’s residual claimant and

384. See supra notes 85-87, 312-14, and accompanying text.
385. See supra notes 315-19 and accompanying text.
transfer rights then become relevant, because shareholders are able to capture the built-up goodwill value existing as of the date of sale in the form of any premium paid by the purchaser for goodwill.\textsuperscript{386} It is also true that the nondistribution constraint depriv \nonprofit entrep\non eyes of a similar ability to capture goodwill value via sale of the nonprofit entity because, as previously noted, the proceeds of any such sale must be distributed to another nonprofit. However, as previously discussed, a nonprofit entrepreneur desiring to re-incorporate in a for-profit form also has the potential to capture most, if not all, of the goodwill of the nonprofit.

In order to comply with the nondistribution constraint, a terminating nonprofit usually must donate and transfer to another nonprofit either its assets or the proceeds of a liquidation sale of the business.\textsuperscript{390} Typically, a terminating nonprofit will liquidate its operations by selling its assets to one or several for-profit or nonprofit entities and then distribute the sales proceeds to another nonprofit in order to comply with the nondistribution constraint. These liquidation sales would not, and could not, include a sale of something called the nonprofit’s goodwill as a discrete asset since goodwill cannot be sold as a separate asset.\textsuperscript{391}

If the entrepreneur uses his control power to select piecemeal liquidation, rather than sale of the on-going business, as the method of dissolution, and he is the principal purchaser of the assets at the liquidation sale, he can continue the business in a new for-profit

\textsuperscript{386} PRATT, supra note 249, at 188-89.
\textsuperscript{387} However, absent a sale of an on-going business (as contrasted to a piecemeal liquidation of the assets of a terminating for-profit), the residual claimant and transfer rights have no relevance to goodwill value because goodwill, unlike discrete assets, cannot be sold separately. See supra notes 254-55, 381 and accompanying text.
\textsuperscript{388} See supra note 315 and accompanying text.
\textsuperscript{389} See supra notes 315-19 and accompanying text.
\textsuperscript{390} See supra text accompanying note 315.
\textsuperscript{391} Similarly, if termination is effected by donation and direct transfer of specific assets to a successor nonprofit, the list of assets transferred would not and need not include goodwill in order for the terminating nonprofit to comply with the nondistribution constraint. Such direct asset transfers are essentially the same as a piecemeal liquidation of the assets of the nonprofit, even when all the assets are transferred directly to one entity. In such a situation, involving the transfer of all the assets to one successor entity, much of the goodwill value of the terminating nonprofit could well be captured by the successor, since it is receiving all the discrete assets at the same time. But this would be a by-product rather than a required component of the transfer. When all the assets of a business are sold or transferred to one entity, there can be the appearance of a transfer of an on-going business even if there is no actual cessation of operations. This is particularly true if the successor entity adopts the name of the terminated entity.
venture at the same locale and potentially under the same name.\textsuperscript{392} Few suppliers and independent contractors who do business with a commercial nonprofit are likely to even be aware of its nonprofit status. This is also true of many customers. Hence, if the principal representative/operator of a terminated nonprofit entity with whom such suppliers, contractors, and customers dealt continues doing the same business, in the same locale, and under the same name, but in a for-profit rather than a nonprofit form, he can capture the nonprofit's goodwill in a for-profit form at minimal cost.\textsuperscript{393}

4. Valuation Analysis Summary

The includable nonprofit value can be based on a conceptual formula that first uses a benchmark value equal to the value that would be given a comparable for-profit entity. An NDC discount, based on a leasehold analogy or comparable methodology, could then be applied to the benchmark value to determine a minimum value for the includable nonprofit interest. This value is suggested as only a minimum value, however, because adjustments to the formula are likely to be warranted in order to prevent double discounting and to adjust for the special dignity of any component asset value upon which the benchmark value might be based.

In particular, it is argued that the full goodwill value of the nonprofit should be included without discount, because goodwill is not a discrete "asset" to which anyone can hold legal title. Unlike discrete assets, it cannot be "owned." Rather, it "inures in benefit" to whoever controls the business to which it attaches. Goodwill reflects real economic value. When that economic value has been built up during the course of a marriage and is solely in the control of a divorcing entrepreneur, it is marital property that should be divided. There is no competing ownership claim for the goodwill value. Its benefit flows totally in the direction of the controller of a business. Accordingly, in the case of an entrepreneur of a closely held commercial nonprofit, the goodwill of the business is essentially

\textsuperscript{392} See supra notes 315-19 and accompanying text.

\textsuperscript{393} In contrast, a shareholder of a for-profit business has no reason to capture goodwill value for use in another for-profit form continuing the same business unless she shares this value with other shareholders and wants to eliminate the interest of a co-owner. In the latter situation, she likely will pay a significant goodwill-value premium to the co-owner being bought out via a sale of the on-going business or a sale of the co-owner's stock. Unlike the nonprofit entrepreneur, the ability of the purchasing shareholder to manipulate a piecemeal sale of assets that preserves the full goodwill value is limited by both the shared control power of the co-owner and fiduciary obligations.
hers. Moreover, a nonprofit entrepreneur of a closely held commercial nonprofit has virtually the same privileges of access to the goodwill of the enterprise as close corporation shareholders have to access the goodwill of a for-profit enterprise.\textsuperscript{394} For all of the above reasons, the full value of the nonprofit’s goodwill should be included without an NDC discount, because the rationale for the discount is inapplicable to the goodwill value.

F. Summary of all Comparative Findings

Let us return to the comparative analysis of the hypothetical. Joe Quality’s control power over Quality Films makes him a de facto owner of the nonprofit, subject only to the implications of the nondistribution constraint. Accordingly, the value of the assets of Quality Films should be considered for purposes of property-division allocations upon Joe’s divorce. In light of the nondistribution constraint, the $70,000 value of the specific assets discussed in the hypothetical—for example, equipment, furnishings, contract rights, and accounts receivable—should be reduced by an NDC discount. This may result in a significant reduction in value depending upon the chosen discount methodology. On the other hand, the full $30,000 value of the goodwill should be included without an NDC discount because goodwill is an asset that is insignificantly impacted by the nondistribution constraint. The benefit of the goodwill’s present value inures almost entirely to Joe, as controller of Quality Films. However, even if valuation experts disagree with the valuation specifics offered in this Article, any such disagreement should not detract from the fundamental conclusion that the interests held by controllers of closely held commercial nonprofits should be considered in divorce deliberations.

VI. Conclusion

The realities of sector-blurring dictate inclusion of the value of closely held commercial nonprofits in value allocations upon divorce

\textsuperscript{394} Since an entrepreneur does not “own” the commercial nonprofit in the traditional sense, a claim to any goodwill value might be countered by a mechanical argument that there is no business owned by the entrepreneur to which the goodwill attaches. But in the case of the goodwill value assigned to an entrepreneur of a nonprofit, commercial enterprise, the goodwill is attached to a business. It is simply that the entirety of the proprietary value of the business cannot be attributed to the nonprofit entrepreneur because of the nondistribution constraint. Neither can it be argued that the nonprofit is not a business. The information regarding sector-blurring and the increase in the number of commercial nonprofits set forth at the beginning of this Article destroys this myth.
of nonprofit entrepreneurs as a matter of fairness. The typical control powers held by the nonprofit entrepreneurs of these entities are essentially equivalent to the key incidents of ownership enjoyed by close corporation shareholders. Similar circumstances warrant similar legal treatment. Moreover, the parameters of existing divorce laws for the attribution of proprietary value are sufficiently broad to embrace the inclusion. Substance should predominate over form in this situation.

Proof that a given nonprofit entrepreneur has the requisite control power to be considered a de facto owner of the nonprofit entity will be necessary. This Article has suggested standards for such proof in this regard. If de facto ownership is established, then, at a minimum, the full, undiscounted value of the nonprofit's goodwill should be included in the divorce allocations. In addition, the value of the other assets of the nonprofit, discounted for the implications of the nondistribution constraint, also should be included.

This Article has examined the narrow issue of the appropriate treatment of divorcing nonprofit entrepreneurs of closely held commercial nonprofits. Although this is a limited focus, the realities of sector-blurring indicate that the subset of nonprofits and nonprofit entrepreneurs to which this Article potentially may apply is significant. Further, this Article's limited focus has served as a magnifying glass for examining a number of matters of even broader applicability, such as form versus substance, the control power in closely held corporations (both for-profit and nonprofit), the relevance of context to the meaning of property, and the need to consider the different sizes of nonprofits and the varying focus of their commercial activities as principal or ancillary activities in designing nonprofit laws and norms.