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Changes in the California Nonprofit Corporation Law Affecting Public Benefit Corporations

On October 11, 2009, Governor Schwarzenegger signed AB 1233 that amends the California Nonprofit Corporation Law (the "Nonprofit Law") effective January 1, 2010. While many of these amendments will apply to all three types of California nonprofit corporations (public benefit, mutual benefit and religious), the following summary covers only those changes that will affect public benefit corporations.

Definition of Director. In general, directors are natural persons designated in the articles of incorporation or bylaws, elected by the incorporators or designated, elected or appointed by any other name or title (e.g., trustees) to act as members of the governing body of a corporation. Many nonprofit corporations utilize titles that include the word "director," although these persons are not designated, elected or appointed as members of the governing body. Examples are "honorary director," "director *emeritus*," and "advisory director." The definition of "director" is amended by AB 1233 to clarify that a person who does not have authority to act as a member of the governing body, through voting rights or otherwise, is not a director for purposes of the Nonprofit Law regardless of that person's title. (Section 5047)

The articles or bylaws of some corporations provide that persons holding specified positions within that corporation or in another organization automatically become directors. For example, the president of the corporation or of a related corporation might be designated as a director or an "*ex officio* director." "*Ex officio*" is a Latin term meaning "by virtue of office or position." In general, *ex-officio* directors, therefore, are persons who are directors by virtue of some other office or position they hold, and have the same rights and privileges as do all other members of the governing body. AB 1233 makes it clear that such persons are directors of the corporation for all purposes and have the same rights and obligations, including voting rights, as the other directors. (Section 5047)

Authorized Number of Directors. Under current law, the articles or bylaws may set forth the number

of directors, or provide that the number of directors shall be not less than a stated minimum nor more than a stated maximum, with the exact number to be fixed, within the limits specified, by approval of the board or members. AB 1233 permits the articles or bylaws, as an alternative, to provide for a "method of determining the number of directors." This will allow the use of a formula or similar method of determining the size of the board, which may provide greater flexibility in dealing with changes in circumstances. (Section 5151)

Quorum of the Board. Current law provides that "a majority of the number of directors authorized in the articles or bylaws constitutes a quorum of the board for the transaction of business." Recognizing that this quorum requirement can be changed in the articles or bylaws, it further provides that a quorum cannot be less than one-fifth of the number of directors authorized in the articles or bylaws. There has been some confusion as to how these provisions are to be applied where the articles or bylaws set forth a range of directors, with the exact number within that range to be fixed by approval of the board or members in the manner provided in the articles or bylaws. AB 1233 amends the quorum requirement to apply to the "number of directors authorized in or pursuant to the articles or bylaws." This makes it clear that, where there is a range in the articles or bylaws, a quorum is to be determined with reference to the exact number of directors from time to time fixed by the board or members, and not the number of directors at the top of the range. (Section 5211(a)(7))

The articles or bylaws sometimes require the presence of one or more specified directors in order to constitute a quorum. AB 1233 expressly permits this type of provision, but it will be effective only as long as the death of a director or the death of the individual or nonexistence of the entity otherwise authorized to appoint or designate that director does not prevent the corporation from transacting business in the normal course of events. (Section 5211(a)(7))

Titles of Officers. Current law provides that a corporation shall have "a chairman of the board or a

president or both, a secretary, a chief financial officer and such other officers with such titles and duties as shall be stated in the bylaws or determined by the board" In recognition of the fact that many corporations prefer to use a gender-neutral term for the chairman of the board, the term "chair of its board" is substituted for "chairman of the board," and the chair may be given the title "chair of the board," "chairperson of the board," "chairman of the board" or "chairwoman of the board." (Sections 5039.5 and 5213(a)) These new titles may be used in filing an "officer's certificate" under the Nonprofit Law. (Section 5062)

Many corporations by tradition continue to use the title "treasurer" in lieu of "chief financial officer," and some use both titles. AB 1223 now requires a corporation to have "a treasurer or a chief financial officer or both." For corporations without a chief financial officer, the treasurer is designated as the chief financial officer, unless the articles or bylaws provide otherwise. For purposes of transition when the Nonprofit Law became effective on January 1, 1980, the "treasurer" in then-existing corporations was deemed to be the "chief financial officer." This has been amended to add "unless otherwise provided in the articles or bylaws." (Sections 5213(a) and 9916)

Current law provides that any number of offices may be held by the same person unless the articles or bylaws provide otherwise, except that neither the secretary nor the chief financial officer may serve concurrently as the president or chairman of the board. AB 1233 adds "treasurer" to the officers who may not serve concurrently as the president or chairman of the board. (Section 5213(a))

Board and Advisory Committees.

Current law authorizes the creation of committees, each consisting of two or more directors, that have all the authority of the board, with certain exceptions. One of the exceptions is for actions requiring approval of members. AB 1233 makes it clear that this exception applies regardless of whether the corporation has members. (Section 5212(b))

Boards often create committees of directors to which they delegate their authority, as well as committees of directors and/or nondirectors, to advise the board or implement decisions and do not have the authority of the board. No clear distinction is made in the current law between committees that consist only of directors and those that include nondirectors. AB 1223 provides that committees exercising the authority of the board may not include persons who are not directors, but that the board may create other committees that do not exercise authority of the board and that include persons who are not directors. (Section 5212(b))

Voting by Directors. Permitting directors to have more than one vote is considered inconsistent with the Nonprofit Law, and permitting directors to vote by proxy would be inconsistent with the exercise of their fiduciary duties. AB 1233 adds a provision making it clear that each director present and voting at a meeting has only one vote on each matter presented for a vote, and no director may vote by proxy. (Section 5211(c))

Approvals or Designations by Others.

Under current law, the articles or bylaws can provide that amendments must be approved by a specified individual or entity other than the board or members. In addition, all or any portion of the directors can hold office by virtue of designation or selection by a specified individual or entity as provided in the articles or bylaws rather than by election, and may also be removed by the specified individual or entity. These provisions can pose a problem if that individual or entity with the power to approve, designate, select or remove dies or ceases to exist. AB 1233 adds that, unless otherwise provided in the articles or bylaws, any such right to approve amendments or entitlement to designate or remove directors shall cease if the specified individual has died or the entity has ceased to exist or if the right or entitlement is in the capacity of an officer, trust or other status that ceases to exist. (Sections 5132(c)(4), 5150(d), 5220(d), 5222(f))

In an effort to deal with inaction, AB 1233 provides a procedure for obviating the

need to obtain the approval of a specified individual or entity for amendments of the articles or bylaws if notice of a proposal is given, and the corporation has not received written approval or nonapproval, within specific time periods. (Sections 5132(c)(4)(C) and 5150(d)(3))

Removal of Directors. Interestingly, due to some inconsistencies in the Nonprofit Law, there has been some confusion as to whether a director removed from the board continues to serve until a successor has been elected and qualified or, in the event of a reduction in the number of directors, for the remainder of the term for which elected. AB 1233 makes it clear that a director remains in office until a successor is elected unless the director has been removed from office, and that reducing the authorized number of directors will not remove a director prior to the expiration of that director's term unless the director has been removed from office. (Sections 5220(b) and 5222(c))

Director Reliance. Current law provides that, in discharging their duties, directors are entitled to rely on:

information, opinions, reports or statements, including financial statements and other financial data, in each case prepared or presented by: (1) One or more officers or employees of the corporation whom the director believes to be reliable and competent in the matters presented; (2) Counsel, independent accountants or other persons as to matters which the director believes to be within such person's professional or expert competence; or (3) A committee of the board upon which the director does not serve, as to matters within its designated authority, which the director believes to merit confidence

AB 1233 eliminates use of the ambiguous phrase "committee of the board" in (3), and expands the circumstances in which a director can rely on committees by substituting the following:

Offices

Atlanta

Austin

Chicago

Dallas

Houston

London

Los Angeles

New Orleans

New York

Sacramento

San Francisco

Washington, DC

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(3) a committee upon which the director does not serve that is composed exclusively of any or any combination of directors, persons described in paragraph (1), or persons described in paragraph (2), as to matters within the committee's designated authority, which committee the director believes to merit confidence. . . .

As is currently the case, the director must also act "in good faith, after reasonable inquiry when the need therefore is indicated by the circumstances and without knowledge that would cause that reliance to be unwarranted." (Section 5231(b)(3))

Dissolution. Current law requires "approval of the board" for voluntary dissolution if there are no members. Often when corporations seek authority to dissolve there is no longer a sufficient number of acting directors to constitute a quorum and it would be difficult to find directors who would be willing to join the board. AB 1233 adds a provision so that, if the number of directors in office is less than a quorum, action by the board in electing to wind up and dissolve can be taken by the remaining directors then in office. This also will apply to actions by the board during the period of wind up and dissolution. (Section 6610(c) and (d))

Director and Officer Liability. Current law provides for a limitation of personal liability for monetary damages of directors and officers of tax-exempt corporations who serve without compensation, on account of certain acts or omissions, if (i) the corporation maintains a "general liability" insurance policy with a specified amount of coverage, (ii) the claim against the director or officer may also be made directly against the corporation and (iii) a "general liability" insurance policy is in force both at the time of injury and at the time the claim against the corporation is made, so that a policy is applicable to the claim. This language has been amended to require that the claim against the director or officer can also be made directly against the corporation and a "liability" insurance policy is applicable to the claim. Consequently, the claim need not be covered by a "general liability" policy, but could be covered by an employment practices or a director's and officer's liability policy. Furthermore, the policy need not be in force both at the time of injury and the time the claim is made. While the corporation is still required to maintain an insurance policy with the

required coverage, a "liability" policy will satisfy this requirement. These changes made by AB 1233 do not affect another section of the Nonprofit Law that limits the personal liability of volunteer directors and executive officers to third parties for negligence. That section requires that the damages be covered by a liability insurance policy issued to the corporation, either in the form of a general liability policy or a director's and officer's liability policy, or personally to the director or executive officer, or that the board of directors and the person had made reasonable efforts in good faith to obtain available liability coverage. (Sections 5047.5 and 5239)

Mergers With Unincorporated Nonprofit Associations. Mergers of unincorporated nonprofit associations into public benefit corporations are currently prohibited. AB 1233 will permit these mergers, so there will no longer be a need to incorporate an association and then merge it into the public benefit corporation. (Section 5063.5)

Most of the changes made by AB 1233 are for purposes of clarification or to provide how certain matters are to be dealt with in the absence of specific article and bylaw provisions. It is typical for bylaws to incorporate the exact language of certain sections of the Nonprofit Law in an effort to provide guidance to officers and directors without them having to review the Nonprofit Law or consult with counsel. Consideration should be given to whether any of the amendments made by AB 1233 might require changes to the articles or bylaws or in the processes by which the corporation is governed.