Changes in Nonprofit Law and Essentials that Every Lawyer Needs to Know

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Topics to be Covered

- Governing Laws, Governance, Memberships
- Fiduciary Duties of Directors
- Liability, Indemnification and Insurance
- Nonprofit Integrity Act of 2004
- Intermediate Sanctions and Self-Dealing
- AB 1233
- Governance in the new Form 990

Governing Laws

- California Corporations Code
  - Nonprofit Public Benefit (§§5110-6910)
  - Nonprofit Mutual Benefit (§§7110-8910)
  - Nonprofit Religious (§§9110-9690)
- Other California Statutes (NIA, UPMIFA, fundraising and solicitation laws, etc.)
- State and Federal Tax Statutes
- Charitable Trust Law

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Directors' Responsibilities

- Planning and directing management of nonprofit and its activities
- Acting as a board (one unit)
- Governance and policy setting: e.g.
  - Broad corporate policies
  - Strategic plan
  - Annual budget and monitoring

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Board Composition and Meetings

- How many directors
  - Minimum
  - Related consequences
- Qualifications of directors
  - Age
  - Experience
  - Commitment to organization
  - Talents and/or skills

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Board Composition and Meetings

- Mix of directors
  - Continuity
  - Compatibility
- Other qualities
  - Common sense and good judgment
  - Respect for group processes
  - Humor
  - "Centeredness"- personal self-awareness and acceptance

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Board Composition and Meetings

- Number of board meetings
  - Statute
  - Needs of organization
- Procedural
  - Notice
  - Quorum
  - Telephonic conference
  - Electronic
- Unanimous written consents

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Fiduciary Duties

- Duty of Care
  - Standard of Care
  - Duty to Investigate
  - Delegation and limitations
- Duty of Loyalty
  - Basic rule
  - Self dealing

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Standard of Care

- Prudent Person Rule
- "A director shall perform the duties of a director . . . in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

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Standard of Care

- Same treatment
  - Inside versus outside
  - Paid versus unpaid
  - Professionals versus non-professionals
- Separate standard for investment of assets
  - Prudent Investment Management

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Standard of Care

- Practical suggestions
  - Attend board meetings
  - Prepare for meetings by reviewing materials submitted for consideration
  - Ask questions, become informed, participate in discussions
  - Follow-up
  - Document decisions in minutes

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Standard of Care

- Practical suggestions
  - Obtain and review organizational documents: articles and bylaws
  - Look at financials and Form 990
  - Review long-range plan
  - Attend board training
  - Meet with executive director / executive staff

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Standard of Care

- Application
  - Selection, nominations and election of Directors
  - AB 1233
- Resources
  - *ABA Guidebook for Directors of Nonprofit Corporations* (800) 285-2221
  - Attorney General's *Guide for Charities*
    - *http://ag.ca.gov/charities/publications/guide_for_charities.pdf*

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Duty to Investigate

- Follow up on unanswered questions
- Between board meetings
- Dove-tails with delegation
- Oversight role
  - Monitoring
  - Review
  - Supervision
- Designated "devil's advocate" director

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Delegation and Limitations

- Permissible reliance upon
  - Information
  - Reports
  - Statements, including financial statements, prepared by others
- Persons, if reliable and competent
  - Officers
  - Employees

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Delegation and Limitations

- Reliance on Board Committee reports where director does not serve, but director believes merits confidence
  - Director must act in good faith,
  - after reasonable inquiry when the need for same is indicated by the circumstances, and
  - without knowledge that would cause reliance to be unwarranted

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Delegation and Limitations

- Outside parties
  - Lawyers; Accountants
  - Other experts
- Total abdication improper
  - Board may delegate management activities to persons, management company or committee
  - Provided all affairs are managed and all powers under ultimate direction of board
- Statutory limitations: Corp § 5212(a)

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Members

- Members
  - Rights
  - Meetings
- Other considerations

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Governance and AB 1233

- Selected AB 1233 Provisions
  - Definition of director
  - Approvals of specified persons
  - One director One Vote
    - No proxy voting
  - Board committees and advisory committees

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Duty of Loyalty

- Duty of Care: **Act prudently**
- Duty of Loyalty: **Put the corporation's interests before your own**
  - Avoid conflicts of interest
    - Financial (governed by specific laws) and
    - Non-financial (governed by general principles)

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Duty of Loyalty

- Basic Rule
  - Good faith
  - Best interests of corporation
  - Trustee relationship

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Restrictions on "Interested Directors"

- Board Composition: 49% Rule
  - Cal. Corp. Code. §5227
  - No more than 49% of the Board can be "interested directors"
    - Any person compensated by the corporation within past 12 months
    - Any member of such person's family

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Self-Dealing

- A transaction in which the corporation is a party and in which a **director has a material financial interest** is a potential self-dealing transaction
- Not self-dealing transactions:
  - Board action fixing compensation of director as an officer or director
  - Part of a public or charitable program which benefits director or her family because they are class of beneficiaries intended to be benefited, if approved by corporation in good faith without unjustified favoritism
  - Interested director has no actual knowledge and value of transaction is equal to or less than the lesser of $100,000 or 1% of previous year's gross receipts

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Self-Dealing

- A self-dealing transaction is an interested director transaction not approved pursuant to the terms of §5233
- Approval may be made by Board of Directors **in advance of transaction**, if it is shown that:
  - Charity entered transaction for its own benefit
  - Transaction was fair and reasonable to charity at the time
  - Transaction was approved in good faith by majority of disinterested directors (interested directors count for quorum) with knowledge of material facts and director's interest in transaction
  - Prior to approval, Board considered in good faith and determined after reasonable investigation that under the circumstances or in fact the corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances

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Self-Dealing

- Approval may also be made
  - By a committee or person authorized by Board, ***if***
    - Approval occurs in advance of transaction,
    - In a manner consistent with §5233 standards,
    - It was not reasonably practical to obtain Board approval prior to entering transaction, and
    - Board, after determining in good faith that above conditions were satisfied, ratifies the transaction at next meeting by majority vote of directors in office (without counting vote of interested directors)
  - By Court, before or after transaction
  - By Attorney General, before or after transaction

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Self-Dealing

- Who can sue the interested director on behalf of the corporation?
  - The Attorney General
  - The corporation
  - A director of the corporation
  - An officer of the corporation
  - A member
  - Others granted relator status by the Attorney General
- Court may approve any or all of the following damages, payable to the corporation:
  - Profits made by interested director in the transaction
  - Value of use of corporation's property used in transaction
  - Return or replace property lost as a result of transaction, including any income or appreciation lost
  - Account for and pay to corporation proceeds of any sale of corporation's property, including interest
  - Punitive damages if violation was fraudulent or malicious

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Self-Dealing

- Statute of limitations for actions against interested director for self-dealing
  - Must be brought within 2 years after notice to Attorney General or within 3 years if no notice
  - Attorney General has 10 years after transaction to bring suit
  - Court may allow suit to be brought even later

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Director Liability

- Liability protection: even if fail to discharge obligations
- To Corporation
  - Breach of duty of care
  - Joint and several liability with recipients for distributions, or improper loans or guarantees
    - At meeting where action approved, abstention is consent

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Director Liability

- Who can sue (in corporation's name)?
  - Member
  - Creditors
  - Attorney General
- Injured persons:
  - Making or publishing materially false statements; false entries, minutes, records, altering entries with intent to deceive

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CA Statutory Protection

- Corp. Code Sect. 5239
  - No personal liability to third party
  - Volunteer director or officer
  - Caused by negligent act or omission
  - In performance of duties
- 4 conditions
  - All four must be met

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CA Statutory Protection

- Corp. Code Sect. 5239
  - Act/omission within scope of duties
  - Act/omission performed in good faith
  - Act/omission not reckless, wanton, intentionally or grossly negligent
  - Damages covered by general or D & O liability insurance policy or policy issued personally to Director or Officer

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CA Statutory Protection

- Corp. Code Sect. 5239
  - If no insurance
    - Board and person made "all reasonable efforts" in good faith to obtain insurance
    - For 501(c)(3) organizations, with budgets less than $25,000, "all reasonable efforts" met if get quote for policy with at least $500,000 in coverage and policy not available at cost less than 5% of previous annual budget

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CA Statutory Protection

- Corp. Code Sect. 5239
  - Uncompensated directors
  - Officers: president, secretary, treasurer or in like capacity
- Does not limit
  - Liability of corporation
  - Liability of director or officer for action by Attorney General

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CA Statutory Protection

- Corp. Code Sect. 5047.5
  - For 501(c)(3) and 501(c)(6)
  - No cause of action for monetary damages
  - Against any person serving without compensation as director or officer
  - On account of any negligent act or omission
  - 5 conditions
    - 1. Within the scope of duties acting as such

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CA Statutory Protection

- Corp. Code Sect. 5047.5
  - 5 conditions
    - 2. in good faith
    - 3. in a manner person believes to be in best interests of organization
    - 4. in exercise of his/her policymaking judgment
    - 5. if corporation maintains general liability insurance of at least
      - $500,000 if budget less than $50,000
      - $1,000,000 if budget $50,000 or greater

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CA Statutory Protection

- Corp. Code Sect. 5047.5 does not apply
  - Self dealing transactions
  - Loan/guaranty transactions
  - Conflict of interest transactions (Mutual benefit)
  - Action by beneficiary against trustee of charitable trust
  - Any action by Attorney General

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Statutory Protection

- Corp. Code Sect. 5047.5 does not apply
  - Intentional, wanton or reckless acts, gross negligence, or action based on fraud
  - Actions involving restraint of trade
  - Corporations that unlawfully restrict membership services or benefits on the basis of race, religion, color, national origin, ancestry, sex, marital status, disability, political affiliation or age

CA Statutory Protection

- Code Civil Proc. Sect. 425.15
  - For 501(c)(1) (except credit unions)
  - 501(c)(4) welfare
  - 501(c)(5) labor
  - 501(c)(7) social clubs
  - 501(c)(19) veterans organizations
- No cause of action for monetary damages against uncompensated officer or director due to negligent act or omission w/in duties

Statutory Protection

- Code Civil Proc. Sect. 425.15
  - Procedural hurdle: no cause of action unless court orders claim can be filed after evidence presented establishing claim
  - No immunity to corporations that unlawfully restrict membership services or benefits on the basis of race, religion, color, national origin, ancestry, sex, marital status, disability, political affiliation or age

CA Statutory Protection

- Code Civil Proc. Sect. 425.15
  - May still have personal liability for his/her intentional acts
    - Alter-ego doctrine where director controls corporation to further his own interests, for personal gain or to conceal assets from third parties
    - May still be liable for unpaid federal employment taxes (if sufficiently involved in day to day operations)

Volunteer Protection Act of 1997

- 42 U.S.C §§ 14501- 14505
- For organizations exempt under 501(c)(3) or any other nonprofit organization other nonprofit organization organized and conducted for public benefit and operated primarily for charitable, civic, educational, religious, welfare, or health purposes (and which does not practice any hate crime)

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Volunteer Protection Act of 1997

- Applies to individuals, including director, officer, trustee, or direct service volunteer)
- Performing services for a nonprofit organization or governmental entity who does not receive compensation (other than reasonable reimbursement of expenses actually incurred), or any other thing in lieu of compensation in excess of $500 per year

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Volunteer Protection Act of 1997

- Preempts inconsistent state law, but not any additional state law protections
- State may enact a statute to make an election that this section is non-applicable

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Volunteer Protection Act of 1997

- Volunteer not liable for harm caused by act or omission (complete defense) if:
  - acting within scope of his or her responsibilities
  - volunteer was properly licensed, certified, or authorized for the activity
  - harm not caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed

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Volunteer Protection Act of 1997

- Volunteer not liable for harm caused by act or omission (complete defense) if:
  - harm not caused by volunteer operating motor vehicle, vessel, aircraft or other vehicle for which state requires either an operator's license or insurance
- Harm includes physical, nonphysical, economic and non-economic

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Volunteer Protection Act of 1997

- Does not exclude action against volunteer by nonprofit organization or a government entity
- Does not affect liability of organization for acts of volunteer
- No punitive damages unless there is showing of proximate cause by willful or criminal misconduct or flagrant indifference to rights or safety of individual

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Volunteer Protection Act of 1997

- Exceptions to protection if a State limits volunteer liability
- Limitations do not apply to
  - convictions for either crimes of violence or terrorism, hate crimes, sexual offenses, civil rights violations, or alcohol/drug offenses
- Liability for noneconomic loss is limited to amount allocated to volunteer's proportion to percentage of responsibility for harm

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Nonprofit Integrity Act of 2004: Audit Committee

- May include non-board members
- May include members of finance committee
  - Caution: overlapping members must be less than half of audit committee
  - Caution: chair of audit committee may not be member of finance committee
  - Caution: neither President nor Treasurer may serve on audit committee
- 2 of specified duties subject to board supervision
  - retention/termination and compensation of auditors

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Nonprofit Integrity Act of 2004

- Compensation review
  - Applies to all charities, whether exempt from reporting or not
  - Not required when executives not paid by charity
  - CEO and CFO: determined by duties, not by title

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Nonprofit Integrity Act of 2004

- Public Charities: intermediate sanctions
  - "Disqualified persons" (persons tend to have substantial influence)
  - Presumption of Reasonableness
    - Approved by authorized body
    - Comparability data
    - Documentation of deliberation
  - Same procedure will probably satisfy AG

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Nonprofit Integrity Act of 2004

- Audited Financial Statements: Receives or accrues gross revenues of $2 million or more in any fiscal year
  - Governmental grant or contract revenue not included as long as governmental entity requires accounting of funds
  - Accrued amounts that are not included in line 12 of Form 990 are not counted
  - Provide to AG when requested
- Audit Committee not required if no audit required

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Selected Federal Tax Issues

- Private Benefit & Private Inurement
- Excess Benefit Transactions & Intermediate Sanctions
  - 501(c)(3) public charities
  - 501(c)(4) social welfare organizations
- Self-Dealing
  - 501(c)(3) private foundations

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Private Benefit & Private Inurement

- From definition of 501(c)(3):

  "…organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes…no part of the net earnings of which inures to the benefit of any private shareholder or individual…."
- Private Benefit
  - Part of operational test
  - "Exclusively" means "no more than an insubstantial part"
  - Not just economic benefits, not just insiders
- Private Inurement
  - Subset of private benefit: **economic** benefit to **insiders**
  - For public charities:
    - Then: Risk of losing exempt status
    - Now: "Intermediate sanctions"

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Excess Benefit Transactions

- IRC §4958, applicable to
  - 501(c)(3) public charities and
  - 501(c)(4) social welfare organizations
- "Excess benefit transaction" =
  - A transaction in which an economic benefit provided by the organization
  - Directly or indirectly, to or for the use of, any disqualified person ("DP")
  - Exceeds the consideration (i.e., the value of the goods or services) received for providing such benefit

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Excess Benefit Transactions

- "Disqualified persons"
  - Persons in a position to exercise substantial influence over organization
  - At any time during 5 year period ending on date of transaction
- Deemed to be DPs:
  - Directors, certain officers (president, CEO, COO, treasurer, CFO)
  - Family of those directors and officers (spouses, ancestors, children, grandchildren, great-grandchildren, and siblings, and spouses of children, grandchildren, great-grandchildren and siblings)

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Excess Benefit Transactions

- Deemed to be DPs, *continued*
  - Entities where DP holds more than 35% control:
    - Corporations: 35% of voting power
    - Partnerships: 35% of profits interest
    - Trusts: 35% of beneficial interest

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Excess Benefit Transactions

- Other persons are DPs if so determined by the Board based on facts and circumstances, *e.g.*,
  - Founders
  - Substantial contributors
  - Person with managerial authority
  - Person's compensation is primarily based on revenues derived from activities that the person controls
  - Person with significant control over a significant portion of budget

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Excess Benefit Transactions

- Rebuttable presumption of reasonableness
  - Compensation or terms of transfer are **approved**
  - **In advance** of transaction
  - By organization's **governing body**, composed of persons who **do not have a conflict of interest** with respect to the transaction,
  - Who has obtained and relied upon **appropriate comparability data**, and
  - Has **adequately documented** the basis of its decision

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Excess Benefit Transactions

- Types of comparability data
  - If transaction involves compensation:
    - Availability of similar services in geographic area
    - Compensation survey prepared by independent firm
    - Competent written offer from other charities
  - If transaction involves property transfers:
    - Independent appraisals of value of property to be transferred
    - Offers received as part of open and competitive bidding process
- Content of comparability data:
  - Compensation levels paid by similarly situated organizations and functionally comparative positions
  - For-profit organization data can be appropriate, depending on facts and circumstances
  - Factors may support upward or downward deviation

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Excess Benefit Transactions

- Adequate documentation
  - Terms of transaction and date approved
  - Members who were present and those who voted
  - Comparability data relied upon and how obtained
  - Actions taken to exclude directors with a conflict of interest, if any
  - Timing
    - Record of meeting prepared before later of (1) next meeting (2) 60 days after action taken
    - Record must be approved within a reasonable time after preparation

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Excess Benefit Transactions

- Penalties
  - On the disqualified person:
    - 25% of excess benefit
    - 200% if not corrected in period specific in statute
  - Board member, if knowing participant
    - 10% of excess benefit - maximum of $20,000
    - Not knowing exception
      - Full disclosure of facts and circumstances
  - Must disclose in organization's Form 990

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Private Foundations & Self-Dealing

- IRC §4941, applicable only to c3 private foundations
- 3 elements
  - Disqualified person
    - As defined in IRC §4941
    - Not the same definition as in §4958
  - Private foundation
  - Act of self-dealing as defined in IRC
- Immaterial if transaction beneficial or detrimental to foundation
- Can be direct or indirect
  - Indirect: transaction between disqualified person and entity controlled by foundation

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Disqualified Persons (§4946)

- Substantial contributors
- 20% owner of substantial contributor
- Foundation managers
- Family member of any of above
- Entity in which any of above own >35% of voting power, profits interest or beneficial interest
- Certain government officials (for §4941)

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Substantial Contributor

Person who has given:

1. An aggregate amount of more than $5,000, and
2. >2% of private foundation's total contributions since formation of private foundation (i.e. for its entire existence)

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Foundation Manager

- Officer, director, trustee
  - Or person with equivalent responsibilities or powers
- If an act or omission, an employee who has authority regarding that act or omission

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Family Member

- Spouse
- Ancestors through grandparents
- Children, grandchildren, great grandchildren
- Spouses of children, grandchildren, and great grandchildren
- *Difference from §4958: not siblings or spouses of siblings*

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Self-Dealing Transactions

- Sales, exchanges, leases
- Loans, extensions of credit
- Furnishing of goods, services, facilities
- Compensation or expense reimbursement

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Self-Dealing Transactions

- Transfer to, use by or for benefit of, a disqualified person of income or assets of a private foundation
- Payments of money, transfers of property to a government official

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Sales, Exchanges, Leases: Exceptions

- DP can provide free use of property, including office space
  - ***for no compensation***
- DP can donate property
  - ***for no compensation***
- PF may not assume mortgage as part of otherwise uncompensated transfer

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Loans or Extensions of Credit: Exceptions

- DP may loan money to PF if:
  - loan is *free* (without interest, fees)
  - $$ used exclusively for 501(c)(3) purposes

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Furnishing of Goods, Services, Facilities: Exceptions

- From DP to PF: DP provides goods, services, facilities for *free*
- From PF to DP: PF furnishes goods, services, or facilities to DP on a basis *no more favorable* than to public
- If facilities provided by PF to foundation manager and
  - value is reasonable and
  - necessary for execution of manager's duties

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Compensation or Expense Reimbursement: Exceptions

- If for
  - "personal services" (see definition)
  - that are reasonable and necessary and where
  - amount of compensation or reimbursement is not excessive

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Personal Services

- Professional or managerial in nature
  - Not ministerial or, e.g., janitorial
- Includes:
  - investment counseling
  - legal, accounting, tax
  - banking
  - grant administration
  - payments to entities as well as to individuals

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Expense Reimbursements Only For Personal Services

- No reimbursements for expenses not connected to personal services, including rent, equipment, supplies
- Careful about dual purpose expense reimbursement
- Document expenses and reason

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Sharing Employees

- PF can pay for time of DP employee
  - Need careful record-keeping
- PF employee can't work for DP
  - Even if paid fair market value
- Be careful about DP employees volunteering for PF:
  - Keep different hats straight
- DP can volunteer *(free)*

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Self-Dealing: Timing & Amount

- Self-dealing occurs when all terms and conditions of transaction and liabilities of parties have been fixed
- Amount involved is greater of
  - Amount of money or property given
  - Amount of money or property received
- Correction:
  - Rescission; undoing the transaction
  - In no case may PF's financial position be worse than if DP dealing under highest fiduciary standards

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Self-Dealing Excise Taxes

- Self-dealer tax
  - First tier
    - 10 percent of the amount involved
    - In each year self-dealing not corrected
  - Second tier
    - 200 percent of the amount involved imposed if a timely correction is not made
- Third tier tax on PF for failure to undo
- PF must report to IRS all self-dealing transactions
  - Disclosure is public
  - Possible adverse publicity and diminution of goodwill

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Self-Dealing Excise Taxes

- Foundation manager tax
  - 5 percent of the amount involved on persons who approved the transaction if
    - Initial tax imposed on self-dealer
    - Foundation manager knows the act is act of self-dealing
    - Manager's participation is willful and not due to reasonable cause
  - Participation includes affirmative actions and silence or inaction where under duty to speak

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Self-Dealing Excise Taxes

- Foundation manager tax
  - Jointly and severally liable
  - Maximum amount of $20,000
  - Not imposed if:
    - Full disclosure of facts to counsel
    - Reasoned legal opinion was issued
    - Managerial reliance on the opinion that no sanctions violated

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AB 1233

- Effective January 1, 2010
- Amended numerous sections of Corporation Code
  - Primarily clarified existing law
  - Made limited additions to existing law
- In most cases and where applicable, parallel changes made to public benefit, mutual benefit, religious, etc. sections of Corp Code

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AB 1233

- Directors
  - Definition clarified, §5047
    - If you are not a voting member of the Board, you are not a director, regardless of title
  - Method of determining authorized number, §5151
    - Bylaws can specify a formula
  - No director vote by proxy; one vote per director, §5211(c)

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AB 1233

- Directors, *continued*
  - Reliance by directors, §5231(b)(3)
    - Expands list of reliance persons; adds committees composed of directors and/or individuals upon whom director could rely under (b)(1) and (b)(2)
    - Does not change to whom board can delegate management under §5210 or board authority under §5212
  - No change to existing law: No such thing as "alternative directors"

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AB 1233

- Permits one-step merger of Unincorporated Nonprofit Associations
- Presence for quorum (§5211(a)(7)) or approval of certain actions by specified persons
- Composition and authority of Board and advisory committees (§5212) clarified
- Officer titles: clarification and consistency (§§5039.5, 5213(a))
- Miscellaneous other provisions (see August 2009 *Request for Signature* from drafting committee)

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Governance: Tax Compliance Principles

- "Well-governed charity is more likely to obey tax laws, safeguard charitable assets and serve charitable interest than one with poor or lax governance."
- Clearly articulated purposes describing mission
- Knowledgeable and committed management
- Sound management practices

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Governance: Tax Compliance Principles

- No statutory authority
- Draft of Good Governance Practices for 501(c)(3) Organizations 2/8/07
- Life cycle of a public charity
  - Governance and related topics (replaced draft)

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Governance: Tax Compliance Principles

- Mission
- Organizational documents
- Governing Body
- Governance and Management Policies
- Financial Statements and Form 990 Reporting
- Transparency and Accountability

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Mission Statement

- Disclosed Part III, line 1 on Form 990
- Not defined in glossary
- Elements
  - Why charity exists
  - What are its goals
  - What are its activities and where do they done
  - Who does charity serve
- Different from purposes in Articles
- Up-to-date?

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Governing Body

- Question 10, Part VI, Form 990
- If organization has local chapters, branches, or affiliates
- Written policies governing activities of such chapters to ensure are consistent with the policies/procedures of charity
- IRS definition of “independent member of governing body”

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Governance and Management Policies

- 1. Policy for consistent operation of chapters, branches & affiliates – line B10b
- 2. Conflict of interest – line B12a
- 3. Whistleblower policy – line B13
- 4. Document Retention and Destruction Policy – line B 14
- 5. Compensation policy – lines B15 a, b
  - CEO, Executive Director, top management
  - Other key employees

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Governance and Management Policies

- 6. Policy for reimbursement of business, travel and entertainment – Schedule J
- 7. Policy on participation in Joint Ventures – line B16b
- 8. Financial information review policy – line B11, 11A
- 9. Policy on disclosure – line C18

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			Yes	No
9a	Does the organization have local chapters, branches, or affiliates?	9a		
b	If "Yes," does the organization have written policies and procedures governing the activities of such chapters, affiliates, and branches to ensure their operations are consistent with those of the organization?	9b		
10	Was a copy of the Form 990 provided to the organization's governing body before it was filed? All organizations must describe in Schedule O the process, if any, the organization uses to review the Form 990	10		
11	Is there any officer, director or trustee, or key employee listed in Part VII, Section A, who cannot be reached at the organization's mailing address? *If "Yes," provide the names and addresses in Schedule O*	11		

Section B. Policies

			Yes	No
12a	Does the organization have a written conflict of interest policy? *If "No," go to line 13*	12a		
b	Are officers, directors or trustees, and key employees required to disclose annually interests that could give rise to conflicts?	12b		
c	Does the organization regularly and consistently monitor and enforce compliance with the policy? *If "Yes," describe in Schedule O how this is done*	12c		
13	Does the organization have a written whistleblower policy?	13		
14	Does the organization have a written document retention and destruction policy?	14		
15	Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision?			
a	The organization's CEO, Executive Director, or top management official?	15a		
b	Other officers or key employees of the organization? Describe the process in Schedule O (see instructions).	15b		
16a	Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement with a taxable entity during the year?	16a		
b	If "Yes," has the organization adopted a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law, and taken steps to safeguard the organization's exempt status with respect to such arrangements?	16b		

Section C. Disclosure

17 List the states with which a copy of thisForm 990 is required to be filed ▶

18 Section 6104 requires an organization to make its Forms 1023 (or 1024 if applicable), 990, and 990-T (501(c)(3)s only) available for public inspection. Indicate how you make these available. Check all that apply.

☐ Own website ☐ Another's website ☐ Upon request

19 Describe in Schedule O whether (and if so, how), the organization makes its governing documents, conflict of interest policy, and financial statements available to the public.

20 State the name, physical address, and telephone number of the person who possesses the books and records of the organization:

SCHEDULE J (Form 990)
Department of the Treasury
Internal Revenue Service

Compensation Information

For certain Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

▶ Attach to Form 990. To be completed by organizations that answered "Yes" to Form 990, Part IV, line 23.

OMB No. 1545-0047
2008
Open to Public Inspection

Name of the organization | Employer identification number

Part I Questions Regarding Compensation

			Yes	No
1a	Check the appropriate box(es) if the organization provided any of the following to or for a person listed in Form 990, Part VII, Section A, line 1a. Complete Part III to provide any relevant information regarding these items. ☐ First-class or charter travel ☐ Housing allowance or residence for personal use ☐ Travel for companions ☐ Payments for business use of personal residence ☐ Tax indemnification and gross-up payments ☐ Health or social club dues or initiation fees ☐ Discretionary spending account ☐ Personal services (e.g., maid, chauffeur, chef)			
b	If line 1a is checked, did the organization follow a written policy regarding payment or reimbursement or provision of all of the expenses described above? If "No," complete Part III to explain	1b		
2	Did the organization require substantiation prior to reimbursing or allowing expenses incurred by all officers, directors, trustees, and the CEO/Executive Director, regarding the items checked in line 1a?	2		

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Conflict of Interest Policy

- Duty of Loyalty
  - Owed by directors to charity
  - Requires director to act in the interest of charity
  - Not in personal interest of director or other person or organization
- Sample policy
  - Form 1023, Appendix A

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Conflict of Interest Policy

- Elements of Good Policy
  - Requires directors and staff to act solely in the interests of the charity without regard for personal interests
  - Includes written procedures for determining whether relationship, financial interest or business affiliation results in conflict of interest
  - Prescribes course of action in case conflict is identified

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Whistleblower Policy

- Handles employees complaints or unethical conduct
- Anonymous and/or confidential
  - To allay fears of retaliation or demotion

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Whistleblower Policy

- Considerations in formulating policy:
- Who is protected by policy
- What protection is provided
- How broad should policy be
- What is the reporting mechanism
- Who resolves complaints

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Document Retention and Destruction Policy

- Policy for systematic review, retention and destruction of documents
- Rationales:
  - – Promotes efficiency and frees up storage space
  - – Protection in litigation
- Cease destruction upon notification of investigation by law enforcement

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Document Retention and Destruction Policy

- What documents covered?
  - Employment records
  - Accounting and tax records
  - Legal records
  - Electronic records
- Coordinate with archiving and back-up procedures
- Sample Policy:
  - http://www.publiccounsel.org/cdp/records_policy.pdf

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Compensation Policy

- Prohibition on Excess Benefits
  - – Private inurement – IRC 501(c)(3)
    - Absolute prohibition
  - – Improper private benefit
    - Exception: Qualitatively and quantitatively incidental
  - – Reasonable compensation: compensation must be reasonable for the services rendered

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Reimbursement Policy

- Schedule J for Form 990
- Was an “accountable plan” used
  - – Business connection or reason for expense
  - – Adequate accounting by employee to employer within reasonable period of time
  - – Employee must return excess allowance within reasonable period of time
    - Page 10 of Instructions for Schedule J
  - – If reported outside reasonable time: IRS view that amount should includible in income

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Policy on Joint Ventures

- JV may jeopardize exempt status
- Policy should safe-guard exempt status:
  - JV must permit charity to act exclusively in furtherance of exempt purpose
  - JV only function incidentally for benefit of for-profit partners
  - Effective control over JV should be with charity
  - Charity should have authority over operations to further charitable purposes

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Financial Information Review Policy

- Does organization's governing body review Form 990 prior to filing?
- Procedure to be described on Schedule O
- Sarbanes Oxley requirement for nonprofits?

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Policy on Disclosure

- Transparency and accountability
- Question 18: IRS encourage posting of Form 990 and annual reports to website and to be made available on public request – IRC Section 6104
- Question 19: IRS inquiry whether governing documents, conflict of interest policy and financial statements available to public

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Other Policies

- Not requested but may be advisable Investment policy
- Fundraising policy
- Gift acceptance policy
- Policy regarding independent auditor
  - Audit committee
  - Rotation

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Other Laws

- Sarbanes-Oxley Law (2002) (SOX)
  - Most provisions apply to issuers (publicly traded companies)
  - Applicable provisions to nonprofits
    - Prohibition on destruction of evidence
    - Protection of whistleblowers
    - Prohibition on interfering with official proceedings
    - Provisions on conspiracies to commit fraud
    - Increased penalties for mail and wire fraud

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Best practices from SOX

- Procure/maintain director and officer liability insurance
- Written conflict of interest policies
  - Code of ethics
  - Policy regarding loans to officers and directors
- Independent audit committee
- Independent auditor
- Review of internal controls by CEO and CFO
- CEO should review and sign tax returns

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Gramm-Leach-Bliley Act

- Effective July 1, 2001: G-L-B Act is an overhaul of the regulations that apply to financial institutions
- Requires corporations engaging in "financial activities" to give notices to their customers about privacy practices with respect to nonpublic personal information
  - Designed to protect the privacy of individuals who use financial services

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"Financial activities"

- Defined broadly
- Includes:
  - Safeguarding money
  - Issuing annuities
  - Providing financial, investment or economic advisory services
  - Tax planning or tax preparation services

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How does G-L-B Act affect non-profits?

- Non-profits may be required to give notice to their "customers" if, for example:
  - The organization engages in financial activities, e.g. offers charitable annuities AND
  - The organization discloses nonpublic personal information to third parties

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G-L-B Notice

- Customers must receive
  - Written notices at the initiation of the relationship
  - Regarding privacy practices/policies with respect to nonpublic personal information
- Notice must include
  - Types of information the institution collects
  - What third parties the information was shared with
  - Steps customer needs to take if does not want information to be shared

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MEMBERSHIP: Does it make sense for your organization?

Introduction. There are three basic options for structuring the governance of a California nonprofit public benefit corporation, turning on the key question of how the Board of Directors is chosen. Many variations and combinations of these basic themes are possible. The most common form is a self-perpetuating Board, where the incumbents elect their successors. A second option is to have one or more individuals or entities hold the power to designate directors to the Board. The third option is to have a voting membership that elects directors, which is the focus of this overview. The other two forms of corporate governance are discussed briefly thereafter, for purposes of comparison.

Context. Before 1980, the voting membership form was required by law, and among older organizations, one may still encounter arrangements where the only membership is, by definition, the Board of Directors, which was the closest one could legally come to avoiding membership entirely. In our practice today, we rarely see situations where the voting membership form is worth the added expense and difficulty in administration, and we generally recommend against it for new organizations. In fact, we are often consulted by groups who wish to terminate their voting membership structure in favor of a different option. Termination can be expensive, time consuming, and difficult, especially if there are many members and their current status is uncertain. On the other hand, a non-member organization can convert to a voting membership form quite easily, provided the Board agrees on what the membership structure should look like.

Role of membership in governance. In a voting membership corporation, individuals or organizations who have the status of members have the right to elect the directors. (California law also allows a membership corporation to provide for delegates having some or all of the authority of members, for various classes of members having different rights, and for voting on the basis of chapters, regions, or other groupings. These add complexity to the corporate structure, and are recommended only if the size and specific characteristics of the constituency require it, and are beyond the scope of this overview.)

The Board of Directors collectively holds the legal responsibility to manage the corporation's affairs, just as it does in a corporation without members. Members do not have fiduciary duties to the corporation; directors do. Members' role in day-to-day corporate governance is usually quite limited, which makes sense since obtaining a valid membership vote to make decisions, whether at a meeting or by written ballot, is often slow, cumbersome, and expensive. The membership's power over corporate affairs is indirect, residing primarily in its ability to choose and remove directors, or to dissolve the corporation.

Rights of members. If a corporation has voting members who elect the Board, the members automatically have a number of other rights by statute, including:

- ✓ to vote on certain corporate actions, such as
  - amendments to the articles of incorporation
  - amendments to the bylaws
  - dissolution
  - merger
- ✓ to notice of and to attend membership meetings
- ✓ to call special meetings by petition
- ✓ to due process in the termination of membership status
- ✓ to inspect corporate records and minutes of Board meetings
- ✓ to receive certain annual reports
- ✓ standing to sue the directors for breach of fiduciary duty

While some of these rights can be granted without thereby creating members, the right to vote in director elections cannot be granted without also giving those so empowered these other rights, under statute. California corporate law is designed to be highly protective of the rights of members, and any Board decisions that disregard or usurp member rights will be vulnerable to a challenge from the any individual member. In particular, member rights are protected by requiring that the corporation strictly adhere to various procedures set out in the statute (some of which may be modified in the bylaws) for calling, noticing, and holding meetings, voting at meetings or by written ballot, use of proxies, etc. In addition, since members have all these rights, a membership organization must have a means to determine who is a valid member at all times, and must maintain accurate membership records.

Disadvantages of membership. As a result of the extensive rights of members and the procedural protections imposed on membership corporations, proper administration of a membership corporation is generally more complex, more time-consuming, and more expensive than administration of a corporation without voting members. If factions develop within the membership, the corporation's operations can more easily be disrupted or paralyzed. The demands of due process to expel a single member can be traumatic for an organization; by contrast, Board-elected directors serve at the pleasure of the Board and can be removed without proof of wrongdoing. As noted above, voting members have legal rights but virtually no fiduciary duties, as directors do, which allows disgruntled members to use their rights to pursue a private agenda with no countervailing duty to act in the best interests of the organization as a whole. It is also not uncommon to find situations where members confuse themselves with an organization's charitable beneficiaries, which can be particularly problematic for a public benefit corporation tax-exempt under Section 501(c)(3). Finally, procedural missteps can expose the corporation to lawsuits even when no underlying wrong has been done.

Alternative: the self-perpetuating Board. This is the most common governance structure under the California Nonprofit Public Benefit Corporations Law today, and much simpler to administer than a voting membership corporation. In this option, the sitting Board of Directors elects directors' successors as vacancies are created, whether by resignation, removal, death, or expiration of term. A non-member corporation can still have dues-paying members, but its bylaws should state clearly that they do not have the right to vote for directors or upon other major corporate decisions. If some participation in governance is desired, dues-paying members can be asked to respond to internal opinion surveys or can be polled on nominations for the Board. To increase engagement with the corporation's mission by various outside constituencies without resorting to a voting membership structure, organizations and individuals can participate by serving on a broad advisory council which does not have the legal right to vote but may advise the Board and help carry out the corporation's mission. Other organizations respond to the need to involve a large number of participating groups by having a huge Board of Directors that meets once or twice a year, with a smaller executive committee empowered to make almost all corporate decisions.[1] All directors, no matter how large the Board may be, have fiduciary duties of care and loyalty to the organization in addition to their rights to elect directors, to elect executive committee members, and to amend the articles and bylaws of the corporation.

Alternative: designation of directors. In addition to member-elected directors and self-perpetuating directors, California law permits all or a portion of the directors to be chosen by a process set forth in the article or bylaws called "designation." The power to designate one or more directors is usually vested in a "person or persons" outside of the Board itself. Designation power may be held by an individual or by an organization. One person may designate the entire Board, or each designator may fill a specified number of slots; other variations are possible, such as setting up a "Designator Council" of organizations who collectively (by majority vote among them) designate a certain number of directors. Status as a designator does not confer the legal rights of a voting member on the designator. They only have the right to select and, unless eliminated by the governing documents, to remove one or more directors according to the procedures set forth in the bylaws. Designated directors may only be removed by the Board or members, if any, with the designator's consent. Designators could also be given certain advisory functions, but care should be taken not to give them any of the rights associated with voting membership or to give them the impression that they are voting members. The advantage of a designated-director structure is that it allows the corporation to respond to an external constituency by conferring designation powers on various representatives of that constituency, without triggering voting membership rights and procedures. The Board then has complete authority to handle all the affairs of the corporation, including amendment of articles and bylaws, which may include the identity and composition of the designator themselves. The ultimate check on the Board's authority is that whoever the designators

[1] The U.S. Olympic Committee, which has hundreds on its Board and an executive committee of about 20, is an example.

are at a particular time, they usually have the power to remove the directors they selected and replace them with other directors, following the procedures in the bylaws.

Conclusion. In general, public benefit nonprofit organizations should demonstrate strong imperatives before adopting a voting membership structure, such as needing to prove collective political clout or cementing financial or volunteer commitment to the organization,[2] to justify the added difficulties and expense of administering a voting membership. Otherwise, a self-perpetuating Board of Directors with fiduciary duties and potential personal liability for misuse of charitable assets will often be more nimble and efficient. Where certain outside constituencies need to be engaged with a corporation's mission at the governance level, a designated director structure may achieve some of the benefits of membership without its burdens on the corporation's operations.

[2] For these reasons, memberships are the norm in mutual benefit corporations operating as trade and professional associations.

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INSIDER TRANSACTIONS:
An Introduction

Ingrid Mittermaier
Adler & Colvin
May 2007

1. OVERVIEW.

California corporate law imposes obligations on directors of nonprofit corporations for the disclosure and advance approval of certain actions and operations where there could be a conflict of interest – that is, a situation where the charity's interests and the interests of a director could be expected to diverge. For public charities, federal tax law extends this obligation to transactions involving anyone in a position to influence the charity's activities.

Conflicts of interest do not always, or even often, arise from improper motives. In some circumstances, a charity may be better off dealing with an insider than dealing with an outsider, even though there may be a potential conflict of interest for the insider. For example, a charity may prefer to hire a consultant who sits on its board of directors, not only because she knows the charity's operations but because she is more likely to offer a significant discount due to her commitment to the organization. For this reason, neither federal nor California law forbids charities to hire or contract with board members or other insiders for goods or services which the charity needs in order to carry out its public benefit activities.[1] Instead, federal tax law and California corporate law prescribe various procedures through which the directors with no financial interest in the transaction may review and approve a transaction with an insider if, upon inquiry, the transaction is in the charity's best interests.

2. FEDERAL TAX LAW.

Federal tax law addresses conflicts of interest in Section 4958 of the Internal Revenue Code, which prohibits excess benefit transactions between insiders in a charity (such as its directors, officers and key employees) and the charity.

a. *Excess benefit transactions.* Excess benefit transactions are transactions in which an excessive economic benefit is provided by a public charity to a disqualified person. A benefit is excessive if the value of the benefit exceeds the value of what the charity received from the disqualified person. Typically, excess benefit transactions involve compensation of insiders, but

[1] This memorandum discusses the law applicable to publicly-supported charities. A different and more strict set of rules applies to private foundations.

they can also involve the sale or other transfer of a charity's property, and they can involve the use by a disqualified person of a charity's property, including intellectual property.

b. *Disqualified persons.* Disqualified persons are persons who are, or in the previous five years have been, in a position to exercise substantial influence over the charity's affairs. The following persons are deemed to have substantial influence: each member of the Board of Directors; the president, chief executive officer, chief operating officer, treasurer, and chief financial officer; such persons' spouses, ancestors, children, grandchildren, great-grandchildren, brothers, and sisters; the spouses of the children, grandchildren, great-grandchildren, brothers, and sisters; and any entity in which such persons hold more than 35 percent of the control. For a corporation, this means more than 35 percent of the voting power, for a partnership it means more than 35 percent of the profit interest, and for a trust it means more than 35 percent of the beneficial interest. In addition, the Board may determine that other persons exercise substantial influence over the charity's activities based on facts and circumstances. Such persons could include the founder of the charity, a substantial contributor to the charity, a person with managerial authority over the charity, or a person with control over a significant portion of the charity's budget.

c. *Establishing the presumption of reasonableness.* Normally, when a charity engages in a transaction with a disqualified person (such as a major donor or a board member), the charity must be prepared to demonstrate that it has taken appropriate steps to ensure that it is not providing an excess benefit to the insider.

Regulations to Section 4958 (the "Regulations"), released in January 2002, describe the steps an organization may take to create a presumption that no excess benefit transaction occurs and to shift the burden of proof onto the IRS. Under Section 53.4958-6 of the Regulations, payments under a compensation arrangement will be presumed to be reasonable, and a transfer of property or services between a charity and a disqualified person is presumed to be at fair market value, if the following conditions are satisfied:

- The compensation arrangement or terms of transfer are approved in advance by the charity's governing body, or by a committee of the governing body composed entirely of individuals who do not have a conflict of interest with respect to the arrangement or transaction; <u>and</u>

- The governing body or committee obtained and relied upon appropriate data as to comparability before making its decision; <u>and</u>

- The governing body or committee adequately documented the basis for its decision concurrently with making that decision.

In order to ensure that the Board of Directors is not inappropriately influenced by a director with a conflict of interest, the Regulations provide that a director with a conflict of interest can meet with other members of the Board only to answer questions. The director should otherwise recuse him- or herself from the meeting and should not be present during debate and voting on the transaction in question.

The Regulations provide some examples, but not an exhaustive list of the type of data that is considered appropriate when considering comparability. In the case of compensation, relevant information includes compensation levels paid by similarly situated organizations for functionally comparable positions; the availability of similar services in the geographic area; independent compensation surveys compiled by independent firms; and actual written offers from similar institutions competing for the services of the disqualified person. In the case of property, the Regulations provide that relevant information includes, but is not limited to, current independent appraisals of the value of all property to be transferred; and offers received as part of an open and competitive bidding process. Treas. Reg. Section 53.4958-6(c)(2).

For the decision to be documented adequately, the written records of the governing body or committee must note (1) the terms of the transaction that was approved and the date it was approved; (2) the members of the Board or committee who were present during the debate on the transaction or arrangement that was approved and those who voted on it; (3) the comparability data obtained and relied upon by the Board or committee and how the data was obtained; and (4) the actions taken in order to appropriately exclude directors with a conflict of interest while the transaction was considered. The records must be prepared by the later of the next meeting of the Board or committee or 60 days after the final action regarding the transaction was taken, and must be approved within a reasonable time after that.

d. *Penalty taxes.* Section 4958 creates a two-tier excise tax structure on excess benefit transactions. The initial tax is 25% of the excess benefit resulting from each excess benefit transaction. The 25% tax is payable by the disqualified person. If the 25% tax is imposed on an excess benefit transaction and the disqualified person does not correct the excess benefit within a certain amount of time, a second tier tax of 200% of the excess benefit is imposed on the disqualified person. For example, if a Section 501(c)(3) organization was found to have paid $150,000 to a disqualified person in a transaction for which $100,000 was fair market value, the disqualified person would have to pay a tax of 25% of $50,000, or $12,500 to the IRS. In addition, the disqualified person would have to return the excess benefit of $50,000 to the organization, or be subject to the added 200% penalty tax (of $100,000).

Finally, a 10% tax is imposed on the Board of an organization if the Board knowingly and willingly participated in the excess benefit transaction, up to a total of $20,000 for each excess benefit transaction. The Board will not be considered to have knowingly participated if, (1) after making full disclosure of the facts to an appropriate professional, the Board relies on the professional's reasoned written opinion regarding the elements of the transaction within the professional's expertise, or, (2) the Board relies on the fact that the requirements for the rebuttable presumption of reasonableness have been satisfied. Treas. Reg. Section 53.4958-1(d)(4)(iii) and (iv).

3. California Corporate Law.

In California, Section 5233 of the Corporations Code governs conflict of interest situations. Section 5233 prescribes a very specific set of procedures which must be followed if a director has a material financial interest in a transaction of a charity. This law only applies to

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transactions with directors, while federal tax law also addresses transactions with other insiders. Both California law and federal law reach direct transactions, such as when a charity employs one of its directors, and also indirect transactions, such as the charity's purchase of goods or services from a firm partially owned by a director. Under California law, such transactions are termed *self-dealing*.

A self-dealing transaction, under California law, is a transaction to which the charity is a party and in which one or more directors has a material financial interest. A self-dealing transaction is only proper if *all* of the following conditions are met and documented in the charity's records:

- The charity entered into the transaction for its own benefit; and
- The transaction was fair and reasonable to the charity at the time it entered into the transaction; and
- Before implementing the transaction or any part of it, all material facts regarding the transaction and the director's interest in it were disclosed to the Board; and
- A majority of the disinterested directors then in office (without counting the vote of the financially interested director) determined, after reasonable inquiry in the circumstances, that the charity could not have obtained a better arrangement with reasonable effort, and formally approved the transaction.[2]

4. Conclusion.

The federal and state conflict-of-interest rules reflect the importance of recognizing a potential conflict of interest *before* a transaction is approved. They also emphasize the importance of documenting the response of an organization to a conflict of interest in contemporaneous corporate records. The evidence of a Board's due diligence in reviewing the reasonableness of a proposed transaction, the minutes of a meeting showing that the interested director did not participate in the debate or the vote, and similar items of information, form the Board's first line of defense if the Internal Revenue Service or the California Attorney General challenges the propriety of a transaction. Please contact us if you would like our help in drafting Board resolutions or minutes on these issues.

IRS Circular 230 Disclosure Notice: Any tax advice contained in this memo is not intended to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under federal tax law. A taxpayer may rely on our advice to avoid penalties only if the advice is reflected in a more formal tax opinion that conforms to IRS standards. Please contact us if you would like to discuss the preparation of a legal opinion that conforms to these rules.

[2] The statute also provides for approval by the Attorney General or by a committee of the Board as an alternative procedure. Cal. Corp. Code § 5233(d)(3).

California Registry of Charitable Trusts

NONPROFIT INTEGRITY ACT OF 2004

SUMMARY OF KEY PROVISIONS

Effective January 1, 2005

Applies To

- **Charities**
- **Commercial Fundraisers**
- **Fundraising Counsels**
- **Unincorporated Associations**
- **Trusts**

Attorney General
Bill Lockyer

October 2004

1. Charitable Organizations Have 30 Days, Instead Of Six Months, To Register And File Articles Of Incorporation With The Attorney General's Registry Of Charitable Trusts *[Government Code section 12585]*

►Charitable corporations, unincorporated associations and trusts must file with the Attorney General articles of incorporation, or other documents governing the organization's operations, (e.g., articles of association or trust instrument) within 30 days after initial receipt of property.

2. Independent Audit Of Annual Financial Statements Now Required For Charities With Gross Revenues Of $2 Million Or More *[Government Code section 12586(e)(1)]*

►Charitable corporations with gross revenues of $2 million or more must prepare annual financial statements audited by an independent certified public accountant (CPA). The statements must use generally accepted accounting principles. The independent CPA must follow generally accepted auditing standards.

►If the accounting firm and CPA performing the audit also provides non-audit services to the nonprofit, the accounting firm and CPA must follow the independence standards in the Yellow Book issued by the U.S. Comptroller General.

► The audited financial statements must be made available for inspection by the Attorney General and the public no later than nine months after the close of the fiscal year covered by the financial statement.

►The audit requirement applies to charitable corporations, unincorporated associations and trustees required to register and file reports with the Attorney General, whenever such organizations accrue $2 million or more in gross revenue in any fiscal year.

►The $2 million-threshold excludes grants received from governmental entities, if the nonprofit must provide an accounting of how it used the grant funds.

California Registry of Charitable Trusts

Nonprofit Integrity Act of 2004

Summary of Key Provisions

Find the statutes and regulations under CHARITIES on the Attorney General's web site http://www.ag.ca.gov

3. Charities With Gross Revenues Of $2 Million Or More Must Establish And Maintain An Audit Committee *[Government Code section 12586(e)(2)]*

► Requirements for an audit committee apply only to charitable corporations that must register and file reports with the Attorney General, whenever such organizations accrue $2 million or more in gross revenue in any fiscal year.

►$2 million-threshold excludes grants received from governmental entities, if the nonprofit must provide an accounting of how it uses the grant funds.

►Governing boards must appoint an audit committee. The audit committee may include persons who are not members of the governing board.

►The audit committee cannot include staff members, the president or chief executive officer, the treasurer or chief financial officer of the organization. If an organization has a finance committee, members of that committee may serve on the audit committee, but cannot comprise 50 percent or more of the audit committee.

►The audit committee, under the governing board's supervision, is responsible for making recommendations to the board on the hiring and firing of independent certified public accountants (CPAs). The audit committee can negotiate the independent CPA's compensation, on behalf of the governing board.

► The audit committee must:

- Confer with the auditor to satisfy committee members that the financial affairs of the nonprofit organization are in order;
- Review the audit and decide whether to accept it; and
- Approve non-audit services by the independent CPAs accounting firm, and ensure such services conform to standards in the Yellow Book issued by the U.S. Comptroller General.

4. Executive Compensation By Charitable Corporations, Unincorporated Associations And Charitable Trusts Must Be Review And Approved *[Government Code section 12586(g)]*

► Charitable corporations and unincorporated associations must have their governing board or authorized board committee review and approve the compensation of the Chief Executive Officer or President, and the compensation of the Chief Financial Officer or treasurer, to ensure that the payment is "just and reasonable."

► All trustees of a charitable trust must review and approve any executive compensation to ensure it is “just and reasonable.”

► The review and approval must occur at the time of initial hiring, when the term is renewed or extended, and when the compensation is modified.

► Compensation includes benefits.

5. Commercial Fundraisers Must Notify Attorney General Before Starting A Solicitation Campaign *[Government Code section 12599(h)]*

► Commercial fundraisers for charitable purposes must report to the Attorney General’s Registry of Charitable Trusts the start of a solicitation campaign or event. This notice must be filed not less than 10 working days prior to the start of a solicitation campaign or event.

► If proceeds are intended for victims of disasters or emergencies, the commercial fundraiser must file the required disclosure report no later than the date on which the campaign begins. The report must include:

- The Identity of the commercial fundraiser;
- The name of the organization for whom donations are being solicited;
- The name of the person directing and supervising the fundraiser’s work within the commercial fundraising company; and
- Projected start and end dates for the commercial fundraiser’s work.

6. Commercial Fundraisers Must Have Written Contracts With The Charitable Organizations For Whom They Are Working *[Government Code section 12599(i)]*

► For every solicitation campaign or event produced by a commercial fundraiser for a charitable organization, there must be a written contract between the fundraiser and the charitable organization.

► The written contract must contain or state:

- The charitable purpose for which the solicitation campaign or event is being conducted.
- The respective obligations of the commercial fundraiser and charitable organization.

California Registry of Charitable Trusts

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- If the commercial fundraiser will be paid a fixed fee, the amount of the fee and a good faith estimate of what percentage of the total contributions the fee will comprise. The contract must clearly set forth the assumptions on which the good faith estimate is based.
- If the commercial fundraiser will be paid a percentage fee, the percentage of total contributions the charitable organization will retain. If the solicitation involves the sale of goods or services, or sale of admission to an event, the contract must state the percentage of the purchase price the charitable organization will retain. The percentage must be calculated by subtracting from total contributions and sales receipts not only the commercial fundraiser’s fee, but also any additional fundraising costs the charitable organization must pay.
- The effective date and terminate date of the contract, and the date the solicitation will start in the state.
- A provision setting forth the requirement that all contributions received by the commercial fundraiser must, within five working days of receipt, either be deposited in a bank account controlled by the charitable organization or delivered in person to the charitable organization.
- The charitable organization controls and approves the content and frequency of any solicitation.
- The maximum amount the commercial fundraiser plans to pay individuals or entities to secure any person’s attendance at, or approval, sponsorship or endorsement of, a fundraising event.
- Provisions specifying that the charitable organization has a right to cancel the contract without liability for 10 days following the date the contract is executed. The organization may cancel the contract with 30-days notice and payment for services provided by the commercial fundraiser for up to 30 days after the notice is served.
- Provisions specifying that after the initial 10-day period, the charitable organization has a right to cancel the contract for any reason without liability if the commercial fundraiser or its agents make material misrepresentations, harm the charitable organization’s reputation or are found to have been convicted of a crime arising from charitable solicitations.
- Any other information required by regulations adopted by the Attorney General.

► The contract must be signed by the commercial fundraiser’s authorized contracting officer and an official of the charitable organization authorized to sign by the governing board.

7. Charitable Organizations Can Void Contracts With Unregistered Commercial Fundraisers *[Government Code section 12599.3(a)]*

► Contracts between commercial fundraisers for charitable purposes and charitable organizations are voidable unless the commercial fundraiser is registered with the Attorney General's Registry of Charitable Trusts prior to the start of the solicitation campaign or event.

8. FUNDRAISING COUNSEL MUST NOTIFY ATTORNEY GENERAL BEFORE STARTING SOLICITATION CAMPAIGN

[Government Code section 12599.1(e)]

► Fundraising counsel must file a notice with the Attorney General's Registry of Charitable Trusts not less than 10 working days prior to the start of a solicitation campaign or event; or if the purpose is to raise funds for victims of disasters or emergencies, no later than the date on which the campaign begins.

► The form of notice will be specified by the Attorney General's Registry of Charitable Trusts.

► The information that must be reported includes: the commercial fundraiser's name, address and telephone number; the name, address and telephone number of the organization with whom the fundraising counsel has contracted; the name, address and telephone number of the person who will direct and supervise the work of the fundraising counsel; and the projected dates when the contract will begin and end.

9. Fundraising Counsel Must Have Written Contracts With Charitable Organizations *[Government Code section 12599]*

► For every solicitation campaign or event, there must be a written contract between the fundraising counsel and the charitable organization. The contract must be signed by the fundraising counsel's authorized contracting officer and an official of the charitable organization authorized to sign by the governing board.

► The written contract must contain or state:

- The charitable purpose for which the solicitation campaign or event is being conducted.
- The respective obligations of the fundraising counsel and charitable organization.

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- A statement that the fundraising counsel will neither solicit, receive nor control donated funds, assets and property, or employ any other person to do so.
- A statement that the charitable organization exercises control and approval over the content and frequency of solicitation.
- A clear statement of the fees and any other forms of compensation that will be paid to the fundraising counsel.
- The effective date and terminate date of the contract, and the date the solicitation will start in the state.
- Provisions specifying the charitable organization's right to cancel the contract without liability for 10 days following the date the contract is executed; and right to cancel the contract after the initial period by giving 30-days notice and payment for services provided by the fundraising counsel up to the effective date of the notice.
- Any other information required by regulations adopted by the Attorney General.

10. Charitable Organizations Can Cancel Contracts With Commercial Fundraisers *[Government Code sections 12599.3(b)(f)(g)]*

► Charitable organizations have the right to cancel a contract with a commercial fundraiser without liability for 10 days following the date the contract is executed.

► Following the initial 10-day period, charitable organizations have the right to cancel a contract with a commercial fundraiser by providing 30-day notice. The charitable organization is liable for services provided by the commercial fundraiser up to 30 days after the notice is served.

► Following the initial 10-day period, a charitable organization has the right to cancel a contract with a commercial fundraiser without liability if the commercial fundraiser or its agents make material misrepresentations during a solicitation, harm the charitable organization's reputation during a solicitation, or are found to have been convicted of a crime arising from fundraising activities.

11. Charitable Organizations And Commercial Fundraisers For Charitable Purposes Have Specific Obligations When Fundraising

[Government Code sections 12599.6(a)(b)(c)(d)(e)]

► Charitable organizations and commercials fundraisers cannot misrepresent the purpose of a charitable organization, or the nature or purpose of the beneficiary of a solicitation.

► Charitable organizations must establish and exercise control over fundraising activities conducted for their benefit. This obligation includes approving all written contracts and agreements, and assuring fundraising activities are conducted without coercion.

► Charitable organizations cannot enter into any contract or agreement with a commercial fundraiser that is not registered with the Attorney Generals Registry of Charitable Trusts.

► Charitable organizations cannot raise funds for any charitable organization required to be registered with the Attorney Generals Registry of Charitable Trusts unless the charitable organization is so registered or, if not, agrees to register prior to the start of a solicitation.

► Commercial fundraisers must, within five working days, either deposit in a bank account controlled by the charitable organization or deliver personally to the charitable organization all contributions received on behalf of the charitable organization.

12. Charitable Organizations And Commercial Fundraisers For Charitable Purposes Are Prohibited From Engaging In Misrepresentation And Certain Other Acts When Soliciting Donations *[Government Code section 12599.6(f)]*

► The following acts are prohibited in the planning, conduct or execution of solicitation campaigns:

- Operating in violation of the Supervision of Trustees and Fundraisers for Charitable Purposes Act [Govt. Code sec. 12580 et seq.], regulations and orders issued by the Attorney General.
- Committing unfair or deceptive acts, or engaging in fraudulent conduct.
- Using any name, symbol, emblem or other information that falsely suggests or implies a contribution is for a particular charitable organization.
- Falsely telling donors that a contribution is for a charitable organization or will be used for a charitable purpose.
- Telling donors that a person sponsors, endorses or approves a charitable solicitation when that person has not agreed in writing to have their name used for such a purpose.
- Misrepresenting that goods or services have endorsements, sponsorships, approvals, characteristics or qualities they do not have.
- Misrepresenting that a person has endorsements, approvals, sponsorships, status or affiliations they do not have.

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- Misrepresenting that registration with the Attorney Generals Registry of Charitable Trusts constitutes an endorsement or approval by the Attorney General.
- Representing that a charitable organization will receive an amount greater than the reasonably estimated net proceeds from a solicitation campaign or event.
- Issuing cards, stickers, emblems, plates or other items that can be used for display on a motor vehicle, and which suggest an affiliation with, or endorsement by, public safety personnel or a group of public safety personnel.
- Representing that any portion of contributions solicited by a charitable organization will be given to another charitable organization unless the second charitable organization provides prior written consent for such use of its name.
- Representing that tickets to events will be donated for use by another person or entity unless: the charitable organization or commercial fundraiser has obtained written commitments from charitable organizations that they will accept a specific number of donated tickets; and the donated tickets, when combined with other ticket donations, do exceed either the ticket donations received from charitable organizations or the total capacity of the event site.

13. Commercial Fundraisers Must Keep Records Of Solicitation Campaigns For At Least 10 Years [Government Code section 12599.7(a)]

► Commercials must maintain for at least 10 years following each solicitation campaign records that contain:

- The date and amount of each cash contribution.
- The date, amount, name and address of each non-cash contributor.
- The name and address of each employee or agent involved.
- Documentation of all revenue received and expenses incurred.
- For each account into which the fundraiser deposited revenue, the account number and name and location of the bank or other financial institution in which the account was maintained.

Charities, Commercial Fundraisers, Fundraising Counsels, Unincorporated Associations and Trusts with Questions About the New Law Can Contact The Attorney General's Charitable Trust Staff by e-mail:

belinda.johns@doj.ca.gov - Deputy Attorney General Belinda Johns

james.cordi@doj.ca.gov - Deputy Attorney General James Cordi

BUSINESS LAW SECTION

NONPROFIT & UNINCORPORATED ORGANIZATIONS COMMITTEE
THE STATE BAR OF CALIFORNIA
180 Howard Street
San Francisco, CA 94105-1639
http://www.calbar.org/buslaw/nonprofits/

To: The Honorable Arnold Schwarzenegger
Governor, State of California
State Capitol
Sacramento, CA 95814

From: Nonprofit and Unincorporated Organizations Committee of the Business Law Section

Date: August 27, 2009

Re: AB 1233 (Silva), as amended on May 6, 2009 – Request for Signature

I. STATEMENT OF POSITION

The Nonprofit & Unincorporated Organizations Committee (the "Committee") of the Business Law Section of the State Bar of California (the "Section") urges you to sign into law Assembly Bill 1233 by Assembly Member Jim Silva ("AB 1233" or the "Bill"). The Committee is the sponsor of the Bill, which passed the Assembly and Senate with no "no" votes and without opposition.

A. Description of AB 1233

This Bill seeks to clarify various sections of the Corporations Code so that nonprofit and consumer cooperative corporations may have more certainty in their operations. The amendments clarify: 1) director voting rights, 2) authorized number of directors, 3) quorum, 4) board committees, 5) officer titles, and 6) board reliance. They also provide for 1) streamlined merger and liquidation processes, 2) provisions for approvals by specified persons or designators, 3) procedures for board reductions, 4) requisite private foundation restrictions, and 5) appropriate insurance for volunteer protection.

B. The Committee's Position

The Committee fully supports the enactment of AB 1233 for the following reasons:

Defining Director

Many nonprofit corporations utilize titles, including the word "director", although such persons are not part of the governing body of the corporation as specified in Corporation Code Sections 5047 and 12233. AB 1233 would amend the definition of "director" in Sections 5047 and 12233 to clarify that (1) persons who have a title suggesting they are directors (e.g., "honorary directors," "directors emeritus," "advisory directors") but who have not been designated, elected or appointed to act as members of the corporation's governing body and vote on actions or decisions taken by it on behalf of the corporation are not directors for purposes of the code, and (2) persons who become directors by reason of having a particular status or holding a specified position ("ex officio directors") are directors for all purposes. This would eliminate common misperceptions and confusion about the ability of a nonprofit or consumer cooperative corporation to have nonvoting directors and about the voting rights of "ex officio" directors.

Unincorporated Nonprofit Association Mergers

Under present law, unincorporated nonprofit associations may not merge into nonprofit or consumer cooperative corporations due to the exclusion of nonprofit associations from the definition of "other business entity" in Corporation Code Sections 5063.5 and 12242.5. As a consequence, such mergers presently occur in a two-step process: the nonprofit association is first incorporated and then the merger is consummated.

To authorize a one-step merger process for nonprofit unincorporated associations and streamline their merger with nonprofit or consumer cooperative corporations, it is recommended that Sections 5063.5 and 12242.5 be amended to delete "other than a nonprofit association" so that all unincorporated associations are included in the definition of "other business entity."

AB 1233 would also remove the restriction which limits unincorporated associations to one-way mergers "into" a corporation, limited or general partnership, or limited liability company under Corporations Code Section 18360. It would remove the word "into" and replace it with the word "with", which is used in the other sections of the Corporations Code permitting two-way mergers by for-profit corporations, nonprofit corporations, partnerships and limited liability companies. See Corporations Code Sections 1100, 6010(a), 8010, 9640(b), 12530, 16910, and 17550.

Provisions for Approvals by Specified Persons or Designators

The Nonprofit Public Benefit Corporation Law has the following provisions allowing approvals or designations in a capacity as an individual or entity or other designated body, whether or not a director or member: Corporations Code Section 5132(c)(4) allows the articles of incorporation to provide that amendment or repeal of the articles of incorporation or bylaws must be approved by a specified person or persons other than the board or members. Section 5150(d) allows for the bylaws to provide that amendment of the bylaws must be approved by a specified person or persons other than the board or members. Section 5220(d) allows for

designation of directors rather than election. In all cases, the approving or designating person(s) may be either an entity or other designated body or an individual.

Internal changes and turnover at an institution with authority to designate a director all too frequently results in no response at all when requests are made for appointment of a replacement director. And, if the person with designating authority is an individual rather than an entity or other designated body, death will result in no response when requests are made for appointment of a replacement director. In those situations, failure to appoint a replacement director can have the effect of preventing the corporation from conducting its business in the ordinary course of events.

AB 1233 provides provisions that clarify when this power to designate directors or approve amendments to the bylaws or articles ceases, if the articles or bylaws do not otherwise provide. Section 5222(f), relating to removals of directors, is also amended to mesh with Section 5220(d) as amended. Sections 7132(c)(5), 7150(d), 7220(d), and 7222(f) in the Nonprofit Mutual Benefit Corporation Law and Sections 12330(d), 12360(d), and 12362(g) in the Consumer Cooperative Corporation Law are amended similarly. Section 9132(c)(4) in the Nonprofit Religious Corporation Law is amended to correspond with Section 5132(c)(4); there is no Religious Corporation Law provision similar to Sections 5150(d) or 5220(d).

The changes to these sections are clarifying in nature and do not change existing law with regard to articles or bylaws or rights of members or directors.

Method of Determining Authorized Number of Directors

Nonprofit corporations sometimes wish to determine the size of the board of directors by a formula tied to specific objective factors. The Corporations Code currently provides that (i) the bylaws may **fix** the number of authorized directors within a range specified by them, or (ii) the board may determine the number of directors within that range by resolution. However, there is no provision clearly permitting the number of directors to be determined by a formula set forth in the bylaws.

AB 1233 would amend Sections 5151, 7151, 9151, and 12331 to allow the bylaws to provide for a method of determining the number of directors.

Quorum; One Director One Vote; No Proxy Voting by Directors

Nonprofit corporations may wish to ensure that certain board actions may not be taken without the presence, at the meeting where such action is taken, of certain directors or constituencies who are on or represented on the board. Sections 5211(a)(7), 7211(a)(7), 9211(a)(7), and 12351(a)(7) do not expressly provide that the requisite quorum may require inclusion of certain specified directors. This practice is relatively common and expressly permitted in some other states. The Corporations Code should state expressly that the articles or bylaws may specify that certain directors must be present for a quorum to exist as long as that

does not prevent efficient decision-making for the corporation when those directors die or the person or persons authorized to appoint or elect them have died or ceased to exist.

In addition, Sections 5211(a)(7), 7211(a)(7), 9211(a)(7), and 12351(a)(7) refer to the authorized number of directors as stated in the articles or bylaws. In many cases, the bylaws provide for a range of directors (for example from three to nine), and the authorized number is set by the board in a resolution. AB 1233 adds the language "or pursuant to" before the articles or bylaws to clarify that the authorized number may be the number authorized by resolution and not the highest end of a range in the articles or bylaws.

Constituents of nonprofit corporations sometimes wish to permit certain directors to possess more than one vote. However, that is inconsistent with the Corporations Code and a director's fiduciary duties. While the existing provisions suggest that an action or decision taken by a board of directors is determined by a headcount of directors present rather than a vote cast by them, that subtlety is not always clearly recognized by volunteers trying to manage the affairs of a corporation. This can be readily clarified. In addition, although the code does not expressly forbid a director from participating in a decision by proxy, this restriction should be made clear as such volunteers may not recognize the risk of that being inconsistent with fiduciary duties. AB 1233 adds a new subdivision (c) to Sections 5211, 7211, 9211, and 12351 to state that each director has only one vote and no director may vote by proxy.

Board Committees; Board and Advisory Committees

Sections 5212(a), 7212(a), 9212(a), and 12352(a) list restrictions on the authority of board committees, including "the approval of any action for which this part also requires approval of the members … or approval of a majority of all members." This restriction applies to actions the law states require approval by members as defined in Sections 5034 and 5033 (and Sections 12224 and 12223), regardless of whether the corporation has or does not have members. Because of some confusion that periodically arises, AB 1233 would add language clarifying that the restriction applies regardless of whether the corporation has members.

It is common practice to provide in bylaws for the creation of both "board" committees – committees comprised entirely of directors, to whom the board of directors may delegate its authority, except as provided in Sections 5212, 7212, 9212, and 12352 – and "advisory" committees – committees that may be partially or wholly comprised of nondirectors, and which advise the board or board committees or implement their decisions, but do not hold the authority of the board. AB 1233 amends Sections 5212(b), 7212(b), 9212(b), and 12352(b) to clarify that board committees may only have directors as members but that other committees with nondirector members may be created as long as they do not exercise the authority of the board.

Officer Titles: Chairman of the Board and Chief Financial Officer

Section 5213(a) of the California Corporations Code currently sets forth the required officers for a nonprofit public benefit corporation. This section requires that the corporation have

a "chairman of the board or a president or both." It also requires that the corporation have a "chief financial officer" and a secretary. The same requirements apply to mutual benefit corporations (Section 7213(a)), religious corporations (Section 9213(a)), and consumer cooperative corporations (Section 12353(a)). For nonprofit corporations in existence on December 31, 1979, which are currently subject to the transition rule of Section 9916, and consumer cooperative corporations subject to Section 12694, the "treasurer" is deemed to be the "chief financial officer."

Section 5062 defines an officers' certificate as a document signed and verified by the chairman of the board or president (or any vice president), and the secretary, chief financial officer or treasurer (or any assistant secretary or treasurer). This definition applies to public benefit, mutual benefit and religious corporations. The same definition is found in section 12241 for consumer cooperative corporations.

The language of the current law allows titles of "other officers" to be at the board's discretion, but does not expressly allow the board to change the title given to the "chairman of the board." Many corporations prefer to use a gender-neutral term for this officer, such as "chair of the board" or "chairperson of the board," or to grant the alternative title of "chairwoman of the board" when the person holding this office is female. In recent years, the Secretary of State's office has rejected officers' certificates signed under a title that does not exactly match the statutory text ("chairman of the board"). AB 1233 would add Sections 5039.5 and 12228.5, and amend Sections 5213(a), 7213(a), 9213(a) and 12353(a) to state that a corporation may use any of these four titles to designate the individual who serves in this statutory officer role.

The "chief financial officer" is a named and required office in Section 5213(a), 7213(a), 9213(a), and 12353(a), but a "treasurer" is not. This language is inconsistent with the treatment of the office of "president" and role of "chief executive officer" in the same code section. This language also causes confusion because many nonprofit corporations have both a "treasurer" and a "chief financial officer," where the treasurer is a board officer and the chief financial officer is an executive staff member. To provide consistency in officer titles in a manner that conforms to many corporations' existing practices, these sections would be changed to permit a corporation to have a "treasurer or a chief financial officer or both." These sections and the transition rule in section 9916 would also be changed to note that unless otherwise provided in the corporation's articles or bylaws, the treasurer will fulfill the role of "chief financial officer" if there is no separate chief financial officer.

Board Reduction

Occasionally, a nonprofit corporation will be engaged in a board dispute whereby the board wishes to reduce the size of the board, and the director occupying the seat that will be terminated looks to the language "until a successor has been elected and qualified" in Section 5220(b) as evidence that unless that director is actually removed from the board, the director continues to serve. Section 5222(c) further states that any reduction of the authorized number of directors does not remove any director prior to the expiration of that director's term of office.

To remedy this problem, AB 1233 amends Sections 5220(b) to state that the director remains in office until his successor is elected unless the director has been removed from office, and Section 5222(c) to state that reducing the authorized number of directors does not remove the director prior to the expiration of the director's term unless the director has been removed from office. The corresponding sections in the Religious, Mutual Benefit and Consumer Cooperative Corporation Law, i.e., Sections 7220(b), 7222(c), 9220(c), 9222(c), 12360(b), and 12362(d) would also be amended.

Reliance

Under Sections 5210, 7210, 9210, and 12350, the board may delegate the management of the activities of the corporation to anyone, although it retains ultimate responsibility. Under Sections 5212, 7212, 9212, and 12352, the board may delegate board authority, within specified limits, to committees of the board composed only of two or more directors. Under subsection (b)(3) of Sections 5231, 7231, 9241, and 12371, in discharging their fiduciary duties, directors may rely on "information, opinions, reports or statements prepared or presented by" a "committee of the board upon which the director does not serve," as to matters within its designated authority. As drafted, it is unclear how to read these three sections together. It is assumed in practice the only committee on which a director may rely is a committee that complies with Section 5212 (and its parallel sections), but Section 5231(b)(3) does not expressly provide this limitation.

The proposed amendment to Sections 5231(b)(3), 7231(b)(3), 9241(b)(3), and 12371(b)(3) clarifies what committees can be relied upon by substituting the ambiguous phrase, "committee of the board," with a description of committees composed entirely of directors. AB 1233 also widens the reliance category to include advisory committees composed of (i) those with fiduciary duties to the corporation (e.g., officers and employees), (ii) those with relevant professional expertise (e.g., attorneys and accountants), and (iii) directors. It is expected that subsection (b)(3) as amended will apply to most Audit Committees.

Dissolution

California Corporations Code Section 6610 currently requires "approval of the board" for voluntary dissolution of a nonprofit public benefit corporation if there are no members and in certain other situations. Similar rules apply to mutual benefit and religious corporations in Sections 8610 and 9680 and to consumer cooperative corporations in Section 12630.

By the time corporations find it appropriate to dissolve, it is often impossible to find a sufficient number of directors to make up the quorum necessary for that approval. Although Section 5224 of the Code (and similar provisions in Sections 7224, 9224 and 12364) would allow the remaining directors to elect new directors to create a quorum in order to make this election, it can be difficult to find directors willing to join a board for the limited purpose of

dissolving and winding up the corporation. This technical step should not be necessary before dissolving.

AB 1233 would revise the requirement for board approval of a voluntary dissolution under Section 6610, by adding a new Subsection 6610(c). Under subsection (c), if the corporation would be permitted to dissolve by approval of the board, but the number of directors then in office is less than a quorum, an action by the board to elect to dissolve could be taken by the same vote as would be required under Section 5224 for the election of additional directors (that is, by a unanimous consent of all remaining directors, a vote of a majority of the remaining directors at a meeting, or the approval of the sole remaining director). Furthermore, after such an election to dissolve, any actions by the board during the period of winding up and dissolving, including an election to revoke the dissolution, would also require only the same vote that was required for the dissolution. AB 1233 eliminates the need for a board that is less than a quorum to recruit and elect more board members to operate the corporation during this period.

Corresponding changes would be made to Sections 8610, 9680, and 12630 to apply the same rules to mutual benefit corporations, religious corporations and consumer cooperative corporations.

Private Foundation Restrictions

A private foundation is not tax exempt under federal law unless its governing instrument contains special provisions in addition to those required of all other organizations holding tax-exempt status under Internal Revenue Code Section 501(c)(3). A private foundation's governing instrument is considered to satisfy this requirement if applicable state law obligates it: (i) to act or refrain from acting so as not to subject the foundation to the taxes imposed on prohibited transactions, or (ii) to treat the mandatory provisions as contained in the foundation's governing instrument. Currently, Corporations Code Section 5260 allows a public benefit corporation that is a private foundation as described in that section to satisfy the IRS requirement without including this language in its governing instrument. AB 1233 creates a new Section 9260 which makes the provisions of Section 5260 applicable to religious corporations.

Required Insurance

Sections 5047.5 and 24001.5 of the Corporations Code provide a limitation of personal liability for officers and directors of nonprofit corporations and associations. Both sections apply only if the corporation or association maintains a "general liability" insurance policy that is in force both at the time of injury and at the time that the claim is made. In point of fact, "general liability" insurance policies often do not cover employment-related or other claims that are brought against directors and officers. These claims frequently are covered by director's and officer's liability policies or employment practices liability policies. Also, it is not necessary in many cases that a policy be in effect both at the time of injury and at the time of claim. The key measurement need only be that the policy covers the claim. AB 1233 would make it possible for

nonprofit corporations and associations to assure their directors and officers that this statute provides the type of protection the legislature intended.

II. GERMANENESS

The Committee believes that its members have the special knowledge, training, experience and technical expertise to provide helpful comments on the Bill and that the positions advocated herein are in the best interests of California nonprofit and for-profit corporations and their members and shareholders.

III. CAVEAT

This position is that only of the Committee. The positions expressed herein have not been adopted by the Section or its overall membership or by the State Bar's Board of Governors or its overall membership, and are not to be construed as representing the position of the State Bar of California. There are currently more than 8,800 members of the Section. Membership in the Section is voluntary and funding for its activities, including all legislative activities, is obtained entirely from voluntary sources.

Very truly yours,

Nonprofit & Unincorporated Organizations Committee

Lani Meanley Collins, Chair

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