

IX.

Nonprofit Corporations

A. Introduction

California nonprofit corporations fall into three categories: Nonprofit Public Benefit Corporations, Nonprofit Mutual Benefit Corporations and Nonprofit Religious Corporations. Although each of the three types share common traits, the California Corporations Code contains significant distinctions as to the rights and obligations of directors, officers and members of each. This chapter generally discusses formation and operation of nonprofit corporations in California.¹

Nonprofit Public Benefit Corporations (Public Benefit Corps) are governed by §§ 5110–6910 of the California Corporations Code. Public Benefit Corps are formed for “public or charitable purposes.”² Charitable organizations incorporated in California, other than religious organizations, are organized as Public Benefit Corps. Certain healthcare facilities are also organized as Public Benefit Corps.

Nonprofit Mutual Benefit Corporations (Mutual Benefit Corps) are governed by §§ 7110–8910 of the California Corporations Code and may be formed for any lawful purpose. However, if (i) all of the assets of the corporation are dedicated to charitable, religious or public purposes, and (ii) upon dissolution, the corporation must distribute its assets to persons carrying on a charitable, religious or public purpose, the corporation may not be considered a Mutual Benefit Corp.³ Automobile clubs, private clubs, fraternal organizations, homeowners’ associations, trade organizations and other organizations incorporated in California with a mandate to serve the “mutual benefit” of their members are typically organized as Mutual Benefit Corps.

Nonprofit Religious Corporations (Religious Corps) are governed by §§ 9110–9690 of the California Corporations Code. Religious Corps must be formed primarily or exclusively for religious purposes.⁴

California nonprofit corporations are subject to a number of regulations beyond the scope of this chapter. This chapter does not discuss federal and state tax provisions relating to nonprofit corporations, the tax-exemption application process with the Internal Revenue Service and California Franchise Tax Board, or the organizational and operational requirements for nonprofit corporations under California Revenue and Taxation Code § 23701. This chapter also does not discuss the formation of general cooperative corporations, Mutual Benefit Corps formed as savings and loan associations, credit unions or other, similar organizations which are subject to greater regulation, or requirements specific to Public Benefit Corps formed as health facilities.

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² CAL. CORP. CODE § 5111.

³ CAL. CORP. CODE § 7111.

⁴ CAL. CORP. CODE § 9111.

B. Formation

Formation of a California nonprofit corporation requires the steps outlined below.

1. *Choosing a name*

The nonprofit corporation’s name may not be the same as or similar to that of an existing California corporation or foreign corporation authorized to do business in California, and may not be misleading to the public.⁵ In addition, the nonprofit corporation’s name may not include the words “bank,” “trust,” “trustee” or related words absent a certificate of approval issued by the Commissioner of Business Oversight.⁶ Mutual Benefit Corps may not contain a name which creates the impression that the purpose of the Mutual Benefit Corp is public, charitable or religious, that it is a charitable foundation,⁷ or that it is in the thrift or industrial loan business.⁸

In California, when determining name availability, the Secretary of State will only check the proposed name against names of other entities registered in California.⁹ There is no subjective assessment on whether the proposed name is likely to mislead the public. Applicants should check that their desired names are not already trademarked by a third party¹⁰ or registered as a “fictitious name” in the county where the nonprofit will operate.¹¹

Comment: Applicants may submit a “Name Availability Inquiry Letter” form¹² or a “Name Reservation Request”¹³ by mail, along with a self-addressed envelope, to the Secretary of State, Name Availability Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814. The Name Reservation Request also requires a \$10 payment. A prepaid priority telephone service is available to persons who frequently reserve corporate names.

2. *Preparing and filing articles of incorporation*

In order to establish a nonprofit corporation in California, applicants will need to submit the articles to the Secretary of State. The articles are the constitutive document of the corporation, and form the foundation for its governance, but may be simple documents. Applicants have the option of either preparing their own articles or using a one-page form document created by the Secretary of State.¹⁴ Those forming Public Benefit Corps or Religious Corps are well advised to utilize a tax

⁵ CAL. CORP. CODE § 5122; CAL. CORP. CODE § 7122; CAL. CORP. CODE § 9122.

⁶ CAL. CORP. CODE § 5122; CAL. CORP. CODE § 7122; CAL. CORP. CODE § 9122.

⁷ CAL. CORP. CODE § 7122(b).

⁸ CAL. CORP. CODE § 7122.3.

⁹ Cal. Sec’y of State, Name Availability, <http://www.sos.ca.gov/business-programs/business-entities/name-availability/>.

¹⁰ The United States Patent and Trademark Office’s searchable database is available online at <http://www.uspto.gov/trademarks-application-process/search-trademark-database>.

¹¹ Searchable fictitious name databases are typically provided by the applicable county clerk.

¹² See <https://www.bloomberglaw.com/document/XAI0KNHC>.

¹³ See <https://www.bloomberglaw.com/document/XAHTGB9C>.

¹⁴ Cal. Sec’y of State, Articles of Incorporation of a Nonprofit

attorney to review formation documents and assist in obtaining tax exempt status.

The articles for each of Public Benefit Corps, Mutual Benefit Corps and Religious Corps must contain the name of the corporation, the initial street address of the corporation (and mailing address, if different), and the corporation's agent for service of process in the state of California.

The following provisions governing California nonprofits are optional, but will not be effective unless they are included in the articles:

- (1) A provision limiting the duration of the corporation's existence.
- (2) For subordinate corporations (i.e., corporations created under the authority of a "head-organization," such as local chapters of national organizations), a provision that the corporation (a) shall dissolve whenever the charter is surrendered to, taken away by, or revoked by the head organization granting it, or (b) that in the event of dissolution, the assets of the corporation will be distributed to the head organization.
- (3) In addition, Mutual Benefit Corps must include the following provisions in the articles in order for them to be effective: (a) a provision allowing the corporation's creditors the right to vote in the election of directors and on any other matters on which the members may vote; and (b) a provision granting the corporation's members the right to determine the consideration for which memberships are issued.

The articles may also specify the names and addresses of the initial directors, any membership classes, any matters that would allow any member to have more or less than one vote in matters presented to the members, provisions for amending the articles or bylaws,¹⁵ and "any other provision, not in conflict with law, for the management of the activities and for the conduct of the affairs of the corporation."¹⁶

Lastly, each of the three types of California nonprofits must contain the applicable statement below in its articles:

Public Benefit Corp: The articles of a Public Benefit Corp must include the following statement: "This corporation is a nonprofit public benefit corporation and is not organized for the private gain of any person. It is organized under the Nonprofit Public Benefit Corporation Law for (public or charitable [*insert one or both*]) purposes."¹⁷ If the purpose of the Public Benefit Corp includes "public" purposes, the articles must include a further description of the corporation's purpose.

Mutual Benefit Corp: The articles of a Mutual Benefit Corp must include the following statement: "This corporation is a nonprofit mutual benefit corporation organized under the Nonprofit Mutual Benefit Corporation Law. The purpose of this corporation is to engage in any lawful act or activity, other than credit union business, for which a corporation may be organized under such law."¹⁸

Religious Corp: The articles of a Religious Corp must include the following statement: "This corporation is a religious corporation and is not organized for the private gain of any person. It is organized under the Nonprofit Religious Corporation Law (primarily or exclusively [*insert one or both*]) for religious purposes."¹⁹

Comment: California Secretary of State standard form articles are available online.²⁰ In lieu of drafting original articles, Public Benefit Corps may submit form ARTS-PB-501(c)(3), Mutual Benefit Corps may submit form ARTS-MU, and Religious Corps may submit form ARTS-RE. Filing articles requires payment of a \$30 filing fee (with a separate, nonrefundable \$15 service fee if the fee is dropped off by hand rather than mailed).

For all California nonprofit corporations, amendments to the articles may be adopted if approved by the board and approved by the members (as well as any additional persons required by the articles, if any). The articles may also specify that the approval of a particular class of members or a larger proportion of the votes of directors or certain classes is required.²¹ Each class must approve an amendment which would materially and adversely affect the rights of that class (and for Mutual Benefit Corps, class voting is required if the amendment would increase the number of memberships in the same or any other class, authorize a new class of members, or effect an exchange, reclassification or cancellation of all or part of the memberships of a class).²²

Upon the adoption of an amendment to the articles, each California nonprofit must file a certificate of amendment with the Secretary of State.²³ The wording of the amendment must specify:

- (i) that it was approved by the board;
- (ii) if the amendment is one for which the approval of the members or the approval of 100 percent of the voting power is required, that the amendment was approved by the required vote of members;
- (iii) if the amendment is one which may be adopted with approval by the board alone, a statement of the facts entitling the board alone to adopt the amendment; and

Religious Corporation, <http://bpd.cdn.sos.ca.gov/corp/pdf/articles/arts-re.pdf>.

¹⁵ CAL. CORP. CODE § 5132, CAL. CORP. CODE § 7132 and CAL. CORP. CODE § 9132 specify limitations for amendments to the Articles of Incorporation in cases where approval rights are held by specified persons who have died, persons whose authority has ceased to exist, or amendments that do not follow specified procedures.

¹⁶ CAL. CORP. CODE § 5132(c)(6); CAL. CORP. CODE § 7132(c)(6); CAL. CORP. CODE § 9132(c)(6).

¹⁷ CAL. CORP. CODE § 5130.

¹⁸ CAL. CORP. CODE § 7130.

¹⁹ CAL. CORP. CODE § 9130.

²⁰ Cal. Sec'y of State, Forms, Samples and Fees, <http://www.sos.ca.gov/business-programs/business-entities/forms>.

²¹ CAL. CORP. CODE § 5812; CAL. CORP. CODE § 7812; CAL. CORP. CODE § 9620.

²² CAL. CORP. CODE § 5813; CAL. CORP. CODE § 7813; CAL. CORP. CODE § 9620.

²³ CAL. CORP. CODE § 6210; CAL. CORP. CODE § 8210; CAL. CORP. CODE § 9660.

(iv) if the amendment is one for which the approval of a person or persons other than the incorporators, directors or members is required, that the approval of such person or persons has been obtained.²⁴

Comment: The Certificate of Amendment form required by the Secretary of State can be found online.²⁵ The fee for filing a Certificate of Amendment is \$30.00.

3. *Preparing bylaws*

California Corporations Code §§ 5150, 7150 and 9150 set forth restrictions on what provisions may be included in a California nonprofit corporation's bylaws. These restrictions vary greatly between Public Benefit Corps, Mutual Benefit Corps and Religious Corps.

For both Public Benefit Corps and Mutual Benefit Corps, the bylaws may not materially and adversely affect the voting rights of members.²⁶ The bylaws may be adopted, amended or repealed by approval of the members or the board, or, if certain conditions are met,²⁷ with the approval in writing of a specified person or persons other than the board or members. Additional restrictions apply to the adoption, amendment or repeal of the bylaws when there are separate classes of members. In addition, the bylaws of a Mutual Benefit Corp may not (i) materially and adversely affect the rights of members as to dissolution or redemption; (ii) increase or decrease the number of members authorized in total or in any class; (iii) effect an exchange, reclassification or cancellation of all or part of the memberships; or (iv) authorize a new class of membership.²⁸

For each type of California nonprofit corporation, the bylaws may restrict or eliminate the powers of the board to unilaterally adopt, amend or repeal bylaws in the future. Once members have been admitted, a bylaw specifying or changing a fixed number of directors, setting a maximum or minimum number of directors, or changing from a fixed to a variable board (or vice versa) may only be adopted by approval of the members.²⁹ Either the articles or the bylaws must set forth the number of directors of the corporation or the method of determining the number of directors of the corporation.³⁰ If the corporation is organized without members, decisions ordinarily reserved for the members require approval by the board.

In contrast to the statutes governing bylaws of for-profit corporations, each California nonprofit corporation may specify that delegates may have some or all of the authority of members, provided that the bylaws specify the delegates' terms of office, any reasonable method for the delegates' selection and removal, and any reasonable method for calling, noticing

and holding meetings of delegates.³¹ Each California nonprofit corporation may also provide in its bylaws for voting by its members or delegates on the basis of chapter or other organizational unit, or by region or other geographic grouping.³²

4. *Statement of information*

All California nonprofit corporations are required to file a "Statement of Information" with the Secretary of State³³ within 90 days after the filing of the initial articles and every other year thereafter³⁴ during the calendar month during which the initial articles were filed and the immediately preceding five calendar months. The Statement of Information is required even for inactive corporations, and failure to file may result in the assessment of a \$50 penalty.

Comment: The Statement of Information form required by the Secretary of State can be found online.³⁵ The fee for filing the Statement of Information is \$20.00. Statements of Information may be submitted online using the Secretary of State's online business portal.³⁶

5. *Charitable trusts*

Nonprofit corporations formed in California for "charitable or eleemosynary"³⁷ purposes, defined in the California Government Code as "charitable corporations," are subject to oversight by the California Attorney General. Charitable corporations must submit an initial registration form, under oath, in accordance with rules and regulations of the Attorney General, within 30 days after initially receiving property.³⁸ In addition, charitable corporations must file with the Attorney General periodic written reports, under oath, setting forth information as to the nature of the assets held for charitable purposes and the administration of the assets. Charitable corporations that receive or accrue gross revenue of \$2 million or more in a fiscal year must also provide audited financial statements and appoint an audit committee of the board of directors.³⁹

Comment: California nonprofit corporations that double as charitable trusts are required to file Form CT-1⁴⁰ with the California Attorney General within 30 days of initially receiving assets, in addition to any IRS filing requirements.

²⁴ CAL. CORP. CODE § 5814; CAL. CORP. CODE § 7814; CAL. CORP. CODE § 9620.

²⁵ Cal. Sec'y of State, Forms, Samples and Fees, <http://www.sos.ca.gov/business-programs/business-entities/forms>.

²⁶ CAL. CORP. CODE § 5150(b); CAL. CORP. CODE § 7150(b).

²⁷ Such conditions are set forth in CAL. CORP. CODE § 5150.

²⁸ CAL. CORP. CODE § 7150(b).

²⁹ CAL. CORP. CODE § 5151; CAL. CORP. CODE § 7151; CAL. CORP. CODE § 9151.

³⁰ CAL. CORP. CODE § 5151; CAL. CORP. CODE § 7151; CAL. CORP. CODE § 9151.

³¹ CAL. CORP. CODE § 5152; CAL. CORP. CODE § 7152; CAL. CORP. CODE § 9152.

³² CAL. CORP. CODE § 5153; CAL. CORP. CODE § 7153; CAL. CORP. CODE § 9153.

³³ CAL. CORP. CODE § 6210; CAL. CORP. CODE § 8210.

³⁴ Credit unions and general cooperative corporations are required to file every year.

³⁵ Cal. Sec'y of State, Forms, Samples and Fees, <http://www.sos.ca.gov/business-programs/business-entities/forms>.

³⁶ Cal. Sec'y of State, Statement of Information - Corporations, <https://businessfilings.sos.ca.gov/>.

³⁷ CAL. GOV'T CODE § 12582.1.

³⁸ CAL. GOV'T CODE § 12585.

³⁹ CAL. GOV'T CODE § 12586.

⁴⁰ <https://oag.ca.gov/sites/all/files/agweb/pdfs/charities/charitable/ct1-form.pdf>.

Financial solicitation reports on Form CT-694⁴¹ are required annually thereafter. Forms CT-1 and CT-694 are available online,⁴² and Form CT-1 requires payment of a \$25 filing fee.

6. Recordkeeping requirements

Each California nonprofit corporation must keep a copy of its articles and bylaws at its principal office to be open to inspection by the members.⁴³ Each California nonprofit corporation is also required to keep (1) adequate and correct books and records of account, (2) minutes of the proceedings of its members, board and committees of the board, and (3) a record of its members giving their names and addresses and the class of membership held by each.⁴⁴

C. Management of the Corporation

1. Board composition and term

Each California nonprofit corporation is required to have a board of directors, although the board may delegate management of day-to-day affairs (provided any authority delegated by the board remains under the ultimate direction of the board).⁴⁵ Unless otherwise provided in the articles or bylaws, the procedures governing regular and special board meetings are set forth in §§ 5211, 7211 and 9211 of the California Corporations Code for Public Benefit Corps, Mutual Benefit Corps and Religious Corps, respectively.

Unless otherwise set forth in the articles or bylaws, directors are elected for one-year terms. For Public Benefit Corps and Mutual Benefit Corps, however, director terms may not exceed four years (or up to six years if there are no members). Also, for Public Benefit Corps and Mutual Benefit Corps, all or any portion of the directors may be selected by a specified “designator” as provided by the articles or bylaws, rather than by election.⁴⁶ For Public Benefit Corps, no more than 49 percent of the persons serving on the board (or a close family member of such persons) may be compensated by the corporation for services rendered within the previous 12 months, excluding reasonable compensation paid for the performance of director duties.⁴⁷

2. Removal of directors

For all California nonprofit corporations, directors may be removed without cause by the members; however, directors elected by vote of a certain class, certain organizational unit or geographic grouping of members may only be removed by the

applicable vote of members of that class.⁴⁸ For Public Benefit Corps and Mutual Benefit Corps with cumulative voting, no director may be removed (unless the entire board is removed) if the votes cast against removal, or not consenting in writing to the removal, would be sufficient to elect the director.⁴⁹ Directors may also be removed for cause in cases of fraud or abuse through an action brought in superior court by another director or a number of members exceeding the statutory threshold.⁵⁰ Unless otherwise specified in the articles or bylaws, vacancies on the board (except for those created by the removal of a director) may be filled by the remaining directors or, if the vacancy is not filled by the remaining directors, by the members.⁵¹

3. Board meetings and duties of directors

Meetings of the board may be called by the chair of the board, the president, any vice president, the secretary or any two directors, and regular meetings of the board may be held without notice if the time and place of the meetings are fixed by the bylaws or the board. Special meetings of the board will be held upon four days’ notice by first-class mail, or 48 hours’ notice delivered personally or by telephone or by electronic transmission. The articles or bylaws may not dispense with the notice requirement for special meetings.⁵²

Similar to the statutes governing for-profit corporations, directors may participate in meetings of the board through the use of conference telephone or electronic video screen communications, and, unless the articles or bylaws specify otherwise, a majority of the board constitutes a quorum for the transaction of business. The use of electronic communications is permissible only if each director participating in the meeting can communicate with all of the other directors concurrently, and each director is provided the means of participating in all matters before the board.⁵³ In addition, the board may take action by written consent if all directors agree in writing to the action and the number of directors then in office constitutes a quorum.

The board may also delegate responsibilities to committees of board members, except for those responsibilities that (i) require approval of the members, (ii) relate to the filling of vacancies on the board or any committee, (iii) fix the compensation of directors for serving on the board or on any committee, (iv) amend or repeal the bylaws or adopt new bylaws, (v) amend or repeal any resolution of the board which “by its express terms is not amendable or repealable,” or (vi) appoint

⁴¹ <https://oag.ca.gov/sites/all/files/agweb/pdfs/charities/charitable/ct694.pdf>.

⁴² Cal. Dep’t of Just., Off. of the Atty. Gen., Forms, <https://oag.ca.gov/charities/forms>.

⁴³ CAL. CORP. CODE § 5160; CAL. CORP. CODE § 7160; CAL. CORP. CODE § 9160.

⁴⁴ CAL. CORP. CODE § 6320; CAL. CORP. CODE § 8320; CAL. CORP. CODE § 9510.

⁴⁵ CAL. CORP. CODE § 5210; CAL. CORP. CODE § 7210; CAL. CORP. CODE § 9210.

⁴⁶ CAL. CORP. CODE § 5220; CAL. CORP. CODE § 7220; CAL. CORP. CODE § 9220.

⁴⁷ CAL. CORP. CODE § 5227.

⁴⁸ CAL. CORP. CODE § 5222; CAL. CORP. CODE § 7222; CAL. CORP. CODE § 9222.

⁴⁹ CAL. CORP. CODE § 5222; CAL. CORP. CODE § 7222; CAL. CORP. CODE § 9222.

⁵⁰ CAL. CORP. CODE § 5223; CAL. CORP. CODE § 7223; CAL. CORP. CODE § 9223.

⁵¹ CAL. CORP. CODE § 5224; CAL. CORP. CODE § 7224; CAL. CORP. CODE § 9224.

⁵² CAL. CORP. CODE § 5211; CAL. CORP. CODE § 7211; CAL. CORP. CODE § 9211.

⁵³ CAL. CORP. CODE § 5211; CAL. CORP. CODE § 7211; CAL. CORP. CODE § 9211.

a separate board committee.⁵⁴ Only committees having at least two directors and consisting entirely of directors may exercise board powers. Public Benefit Corp and Mutual Benefit Corp board committees are also restricted from expending corporate funds to support a particular board candidate in a contested election, or from approving any self-dealing transactions.⁵⁵

4. Director duties

Directors of California nonprofit corporations have similar fiduciary duties and protections as directors of for-profit corporations.⁵⁶ Moreover, volunteer directors of California nonprofit corporations will not be subject to monetary liability based on the failure to discharge their duties if such duties were performed in good faith, with the belief that they are in the best interests of the corporation, and with the same care that an “ordinarily prudent person in a like position would use under similar circumstances.”⁵⁷

In order to carry out their duties, each director of a California nonprofit corporation has the “absolute right” to “inspect and copy all books, records and documents of every kind and to inspect the physical properties of the corporation.”⁵⁸ Directors of Religious Corps are further allowed to take into account the religious purposes of the corporation, and applicable religious tenets, canons, laws, policies and authority when making decisions binding the corporation.⁵⁹

In contrast to for-profit corporations, California nonprofit corporations have strict rules governing the sale of the corporation’s assets. Public Benefit Corps and Mutual Benefit Corps, for instance, must give notice to the Attorney General 20 days before selling or otherwise disposing of assets held in charitable trust.⁶⁰ Other requirements apply to transfers of assets for California nonprofits that are classified as health facilities.⁶¹ In addition to the foregoing, Public Benefit Corp boards must avoid speculation when managing the corporation’s investments.⁶² Lastly, all California nonprofits holding assets in charitable trusts have the restrictions on officer compensation set forth below.

⁵⁴ CAL. CORP. CODE § 5212; CAL. CORP. CODE § 7212; CAL. CORP. CODE § 9212.

⁵⁵ CAL. CORP. CODE § 5212(a)(7)–(8); CAL. CORP. CODE § 7212(a)(7)–(8); for Mutual Benefit Corps, this restriction is limited to “assets held in charitable trust.” Restrictions on interested party transactions for Public Benefit Corps and Religious Corps are set forth in CAL. CORP. CODE § 5233 and CAL. CORP. CODE § 9243, respectively. Conflicts of interest generally for Public Benefit Corps, Mutual Benefit Corps and Religious Corps are set forth in CAL. CORP. CODE § 5234, CAL. CORP. CODE § 7233 and CAL. CORP. CODE § 9244, respectively. Additional limitations for interested party transactions and self-dealing of Public Benefit Corp directors are set forth in CAL. CORP. CODE § 5233 and CAL. CORP. CODE § 5260.

⁵⁶ CAL. CORP. CODE § 5231; CAL. CORP. CODE § 7231; CAL. CORP. CODE § 9212.

⁵⁷ CAL. CORP. CODE § 5231; CAL. CORP. CODE § 7231.5; CAL. CORP. CODE § 9247.

⁵⁸ CAL. CORP. CODE § 6334; CAL. CORP. CODE § 8334; CAL. CORP. CODE § 9513.

⁵⁹ CAL. CORP. CODE § 9240.

⁶⁰ CAL. CORP. CODE § 5913; CAL. CORP. CODE § 7913.

⁶¹ CAL. CORP. CODE § 5914; CAL. CORP. CODE § 7914; CAL. CORP. CODE § 9634.

⁶² CAL. CORP. CODE § 5240.

In addition, the California Corporations Code contains the following additional restrictions applicable to Religious Corps: (a) no assets of a Religious Corp are or shall be deemed to be held in trust unless specified by board resolution, the articles or bylaws, or expressly imposed in writing by the donor,⁶³ and (ii) if donors who are affiliated with a Religious Corp contribute funds or property to the Religious Corp based on an “affirmative representation” that the funds or property “would be used for a specific purpose other than the general support of the corporation,” those donors have a cause of action against the Religious Corp if the funds or property are used for a different purpose, subject to the defense that the directors or members of the Religious Corp determined that it was “impractical or impossible” for the funds to be devoted to their stated purpose.⁶⁴

5. Officers

Each California nonprofit corporation is also required to have, at minimum, a chair of the board or a president (or both), a secretary, and a treasurer or chief financial officer (or both).⁶⁵ Offices may be held by the same person unless the articles or bylaws provide otherwise, except that for Public Benefit Corps, no person serving as the secretary, the treasurer or the chief financial officer may serve concurrently as the president or chair of the board. Unless the articles or bylaws of a Public Benefit Corp provide for the election of officers by the members, each term of office is one year (and in any event, an officer’s term may not exceed three years).⁶⁶

For nonprofit corporations that hold assets in charitable trust, the board of directors or an authorized committee of the board must review and approve the compensation, including benefits, of the president or chief executive officer, and the treasurer or chief financial officer, to ensure that the compensation is just and reasonable.⁶⁷

6. Indemnification

California nonprofit corporations have the power to indemnify officers and directors, and advance expenses on their behalf, if they acted in good faith and in a manner reasonably believed to be in the best interests of the corporation (and, in the case of a criminal proceeding, where they had no reasonable cause to believe their conduct was unlawful). California nonprofit corporations may also purchase and maintain insurance on behalf of officers and directors to protect against liability arising out of the officers’ or directors’ status. Indemnification of expenses actually and reasonably incurred by an officer or director is mandatory where the officer or director has been successful on the merits in its defense.⁶⁸

⁶³ CAL. CORP. CODE § 9140(c).

⁶⁴ CAL. CORP. CODE § 9143(b).

⁶⁵ CAL. CORP. CODE § 5213; CAL. CORP. CODE § 7213; CAL. CORP. CODE § 9241.

⁶⁶ CAL. CORP. CODE § 5213.

⁶⁷ CAL. GOV’T CODE § 12586(g).

⁶⁸ CAL. CORP. CODE § 5238; CAL. CORP. CODE § 7237; CAL. CORP. CODE § 9246.

D. Memberships

1. Admission of members

California nonprofit corporations may admit members, as provided in their articles or bylaws,⁶⁹ and membership may be issued for consideration as determined by the board (or for no consideration).⁷⁰ Members will not, solely by virtue of their membership, be personally liable for the debts, liabilities or obligations of the corporation,⁷¹ although a corporation may levy membership dues or fees. A corporation may issue memberships having different rights, privileges, preferences, restrictions or conditions if authorized by its articles or bylaws.⁷² No person may hold more than one membership or a fractional membership, except two or more persons may hold an indivisible interest in a single membership, and the articles or bylaws may permit a person to hold a membership in one or more classes. For Mutual Benefit Corps based on property ownership, such as homeowner's associations, or mutual water companies, memberships may be determined based on property ownership.⁷³ With a limited exception for memberships in "limited equity housing corporations," members of Public Benefit Corps may not receive distributions from the corporation.⁷⁴

Membership certificates issued by Mutual Benefit Corps must contain the following statements:

- (1) The corporation is a nonprofit mutual benefit corporation which may not make distributions to its members except upon dissolution, or, if the articles or bylaws so provide, may not make distributions to its members during its life or upon dissolution.
- (2) If there are restrictions upon transferability, a statement that a copy of the restrictions are on file with the secretary of the corporation and are open for inspection by a member on the same basis as the records of the corporation.

Unless otherwise provided in the articles or bylaws, memberships in California nonprofit corporations may not be transferred (for Public Benefit Corps and Religious Corps, memberships may not be transferred for value in any event), and all rights as a member of the corporation cease upon the member's death.⁷⁵ Members may resign their memberships, however,⁷⁶ and memberships in Public Benefit Corps and Mutual Benefit

Corps may be suspended or terminated in a "fair and reasonable" manner if certain formalities are complied with.⁷⁷

2. Member meetings

For each California nonprofit corporation, special meetings for any lawful purpose may be called by 5 percent or more of the members, as well as by the board, the chairman of the board or the president. For Public Benefit Corps and Mutual Benefit Corps, membership meetings are required to be held each year in which directors are to be elected, and to transact any other proper business. For Religious Corps, where board seats are not subject to term limits, regular and special meetings only need to be held "as may be ordered by the board."⁷⁸ Member meetings, similar to board meetings, may be held by electronic transmission.⁷⁹ Statutory notice and record date requirements for member meetings are set forth in CAL. CORP. CODE §§ 5510–5511 and 5611, CAL. CORP. CODE §§ 7510–7511 and 7611, and CAL. CORP. CODE § 9411 for each of Public Benefit Corps, Mutual Benefit Corps and Religious Corps, respectively.

For all California nonprofit corporations, one-third of the voting power of members, represented in person or by proxy, constitutes a quorum at a meeting of members, although for Public Benefit Corps and Mutual Benefit Corps, a bylaw may set a different quorum.⁸⁰ For Public Benefit Corps and Mutual Benefit Corps, however, if a bylaw authorizes a quorum of less than one-third of the voting power, the "general nature" of the matters to be voted upon must be given to the members in advance pursuant to the statutory notice requirements referenced above.⁸¹ For all California nonprofits, action may be taken by written consent without a meeting by written ballot or written consent,⁸² and members may vote by proxy.⁸³ However, voting agreements or voting trust agreements entered into by members of a Public Benefit Corp will not be enforced.⁸⁴

3. Member rights

In addition, for all California nonprofits, members have the right (i) to inspect and copy the record of all the members' names, addresses and voting rights, at reasonable times, upon five business days' prior written demand upon the corporation,⁸⁵ and (ii) to inspect the accounting books and records and minutes of proceedings of the members and the board and

⁷⁷ See CAL. CORP. CODE § 5341; CAL. CORP. CODE § 7341.

⁷⁸ CAL. CORP. CODE § 5510; CAL. CORP. CODE § 7510; CAL. CORP. CODE § 9411.

⁷⁹ CAL. CORP. CODE § 5510; CAL. CORP. CODE § 7510; CAL. CORP. CODE § 9411.

⁸⁰ CAL. CORP. CODE § 5512; CAL. CORP. CODE § 7512; CAL. CORP. CODE § 9412.

⁸¹ CAL. CORP. CODE § 5512; CAL. CORP. CODE § 7512; CAL. CORP. CODE § 9412.

⁸² CAL. CORP. CODE § 5513; CAL. CORP. CODE § 5516; CAL. CORP. CODE § 7513; CAL. CORP. CODE § 7516; CAL. CORP. CODE § 9413; CAL. CORP. CODE § 9420.

⁸³ CAL. CORP. CODE § 5613; CAL. CORP. CODE § 7613; CAL. CORP. CODE § 9613.

⁸⁴ CAL. CORP. CODE § 5614.

⁸⁵ CAL. CORP. CODE § 6330; CAL. CORP. CODE § 8330; CAL. CORP. CODE § 9511; the member's request, however, must be for a "purpose

⁶⁹ CAL. CORP. CODE § 5310; CAL. CORP. CODE § 7310; CAL. CORP. CODE § 9310.

⁷⁰ CAL. CORP. CODE § 5311; CAL. CORP. CODE § 7311; CAL. CORP. CODE § 9311.

⁷¹ CAL. CORP. CODE § 5350; CAL. CORP. CODE § 7350; CAL. CORP. CODE § 9350.

⁷² CAL. CORP. CODE § 5330; CAL. CORP. CODE § 7330; CAL. CORP. CODE § 9330.

⁷³ CAL. CORP. CODE § 5312; CAL. CORP. CODE § 7312; CAL. CORP. CODE § 9312.

⁷⁴ CAL. CORP. CODE § 5410.

⁷⁵ CAL. CORP. CODE § 5320; CAL. CORP. CODE § 7320; CAL. CORP. CODE § 9320.

⁷⁶ CAL. CORP. CODE § 5340; CAL. CORP. CODE § 7340; CAL. CORP. CODE § 9340.

committees of the board.⁸⁶ Additional inspection rights applicable only to Public Benefit Corps and Mutual Benefit Corps are as follows:

- The right to receive the results of any vote of members taken at a meeting (including the number of memberships voting for, against, abstaining or withheld from voting).
- The right to receive an annual report, which must be prepared not later than 120 days after the close of the corporation's fiscal year.⁸⁷ The annual report requirement does not apply to Public Benefit Corps that received less than \$25,000 in gross revenues during the fiscal year or Mutual Benefit Corps that received less than \$10,000 in gross revenues during the fiscal year. The annual report requirements for Public Benefit Corps and Mutual Benefit Corps are slightly different as set forth below.⁸⁸

Public Benefit Corps are required to include the following information in "appropriate detail" in their annual reports:

- (1) The assets and liabilities, including the trust funds, as of the end of the fiscal year.
- (2) The principal changes in assets and liabilities, including trust funds, during the fiscal year.
- (3) The revenue or receipts of the corporation, both unrestricted and restricted to particular purposes, for the fiscal year.
- (4) The expenses or disbursements of the corporation, for both general and restricted purposes, during the fiscal year.
- (5) A statement of any transaction with any director, officer or holder of more than 10 percent of the voting power involving more than \$50,000 (individually or in the aggregate), or any indemnifications or advances made to any officer or director over \$10,000.
- (6) An independent accountant's report or, if there is none, a certificate of an authorized officer that the financial statements were unaudited.

Mutual Benefit Corps are required to list in "appropriate detail" the following:

- (1) A balance sheet as of the end of that fiscal year, an income statement and a statement of cash flows for that fiscal year.
- (2) A statement of the place where the names and addresses of the current members are located.

reasonably related to the member's interest as a member."

⁸⁶ CAL. CORP. CODE § 6333; CAL. CORP. CODE § 8333; CAL. CORP. CODE § 9152.

⁸⁷ Pursuant to CAL. CORP. CODE § 6321, the annual report requirements vary for Public Benefit Corps that do not elect directors annually, as well as for Public Benefit Corps that solicit contributions from 500 or fewer members.

⁸⁸ CAL. CORP. CODE §§ 6321–6322; CAL. CORP. CODE §§ 8321–8322.

(3) A statement of any transaction (excluding compensation of officers and directors) with any director, officer or holder of more than 10 percent of the voting power involving more than \$50,000 (individually or in the aggregate), or any loans or guaranties, indemnifications or advances made to any officer or director of over \$10,000.

(4) An independent accountant's report or, if there is none, a certificate of an authorized officer that the financial statements were unaudited.

For Public Benefit Corps and Mutual Benefit Corps, the default statutory rules regarding director eligibility,⁸⁹ nomination,⁹⁰ publication⁹¹ and mailing⁹² vary depending on the number of members.

E. Electronic Communications

Should a corporation choose to send communications electronically, such as via e-mail, it must first ensure that the recipient of the communication has provided an unrevoked consent to receive electronic transmissions from the corporation. Use of electronic communications by the corporation is not authorized unless the consent has been preceded by or includes a clear written statement to the recipient as to (a) any right of the recipient to have the record provided or made available on paper or in non-electronic form, (b) whether the consent applies only to that transmission, to specified categories of communications, or to all communications from the corporation, and (c) the procedures the recipient must use to withdraw consent.⁹³ For electronic transmissions sent to the corporation by members or directors, the corporation is further required to place in effect reasonable measures to verify that the sender is the member or director purporting to send the transmission.⁹⁴

Notice of a meeting of members of Public Benefit Corps and Mutual Benefit Corps given by electronic transmission will not be valid if (1) the corporation is unable to deliver two consecutive notices to the member by that means or (2) the inability to deliver the notices to the member becomes known to the secretary, any assistant secretary, the transfer agent or other person responsible for the giving of the notice.⁹⁵

F. Consolidation, Merger and Transfer of Assets

California nonprofit corporations may merge with any domestic or foreign corporation or other business entity, although additional considerations must be taken into account for mergers with other business entities.⁹⁶ In addition, prior written consent of the Attorney General is required where: (i) a Mutual Benefit Corp is merging with a Religious Corp or a Public

⁸⁹ CAL. CORP. CODE § 5521; CAL. CORP. CODE § 7521.

⁹⁰ CAL. CORP. CODE § 5522; CAL. CORP. CODE § 7522.

⁹¹ CAL. CORP. CODE § 5523; CAL. CORP. CODE § 7523.

⁹² CAL. CORP. CODE § 5524; CAL. CORP. CODE § 7524.

⁹³ CAL. CORP. CODE § 20.

⁹⁴ CAL. CORP. CODE § 21.

⁹⁵ CAL. CORP. CODE § 5511; CAL. CORP. CODE § 7511.

⁹⁶ CAL. CORP. CODE § 6010; CAL. CORP. CODE § 6019.1; CAL. CORP. CODE § 8010; CAL. CORP. CODE § 8019.1; CAL. CORP. CODE § 9640.

Benefit Corp,⁹⁷ (ii) a Public Benefit Corp or a Religious Corp is merging with a for-profit business entity,⁹⁸ or (iii) for Public Benefit Corps, members of the constituent corporation will receive consideration other than a membership interest in the surviving corporation.⁹⁹ For Public Benefit Corps, the Attorney General also must be provided with a copy of the proposed merger agreement at least 20 days prior to consummation of the merger.¹⁰⁰

For each California nonprofit that desires to merge into another nonprofit, the board, the members and each other person or persons whose approval would otherwise be required for an amendment to the articles is required to approve the merger agreement.¹⁰¹ Member approval is also required in the case of Public Benefit Corps and Mutual Benefit Corps that wish to amend the merger agreement in a way that changes any of the principal terms.¹⁰² For Public Benefit Corps and Mutual Benefit Corps, the board may abandon a merger at any time before it is effective without further approval by the members.¹⁰³

The merger agreement must also set forth the terms and conditions of the merger, any amendments to the articles or bylaws of the surviving corporation, the name and place of incorporation of each constituent corporation (and which corporation is the surviving corporation), and the manner, if any, that memberships of the constituent corporations will be converted into memberships of the surviving corporation (or, in the case of Mutual Benefit Corps, other securities or other arrangements).¹⁰⁴

Upon approval of any merger, the surviving corporation is required to file a copy of the agreement of merger, including an officers' certificate certifying the vote of the membership. Both the surviving corporation and each disappearing corporation are required to file a Certificate of Merger.

Comment: The Certificate of Merger required by the Secretary of State, as well as a sample officers' certificate, are available online.¹⁰⁵ The filing fee is \$100.

G. Dissolution

1. Involuntary dissolution

With certain exceptions, a complaint for involuntary dissolution may be filed in superior court by one half or more of the directors in office, persons holding 33 1/3 percent of the voting power,¹⁰⁶ any other person authorized by the articles, the Attorney General or the head organization, if authorized by

the articles.¹⁰⁷ Statutory grounds for involuntary dissolution include abandonment of its activities for more than one year, an evenly divided board that cannot agree as to the management of the corporation's affairs, division of membership into deadlocked factions, failure to elect successor directors,¹⁰⁸ persistent and pervasive fraud, mismanagement or abuse of authority (or, for Mutual Benefit Corps, persistent unfairness toward any member), misapplication or waste of corporate property by the directors or officers, necessary liquidation (in the case of Public Benefit Corps, because the corporation is failing to carry out its purpose, and in the case of Mutual Benefit Corps, to protect the rights or interests of the complaining members), termination of the period for which the corporation was formed, or as provided in the articles, for subordinate corporations of a head organization.¹⁰⁹

The Attorney General may bring a petition for involuntary dissolution where the corporation "seriously offends" statutes regulating corporations (or, for Public Benefit Corps and Religious Corps, statutes or regulations governing charitable organizations), cases of fraudulent abuse or usurpation of corporate privileges or powers, and certain violations of law or failure to pay taxes.¹¹⁰

2. Voluntary dissolution

California nonprofits may elect to voluntarily wind up and dissolve by approval of a majority of all members, or by approval of the board and approval of the members.¹¹¹ However, the board may unilaterally elect to voluntarily dissolve corporations subject to an order of relief in bankruptcy, corporations that have disposed of all assets and have not conducted any activity for a period of five years, corporations with no members, and subordinate corporations of head organizations required to dissolve pursuant to their articles.¹¹²

Whenever a corporation has elected to wind up and dissolve, a certificate evidencing that election signed and verified by at least a majority of the directors must be filed with the attorney general. With certain exceptions, if the dissolving corporation is a Public Benefit Corp or Religious Corp, the Certificate of Dissolution must be accompanied by a letter from the Attorney General that either waives objections to the distribution of the corporation's assets or confirms that the corporation has no assets. Dissolving Mutual Benefit Corps with assets in charitable trusts also requires approval from the At-

¹⁰⁷ CAL. CORP. CODE § 6510; CAL. CORP. CODE § 8510; CAL. CORP. CODE § 9680.

¹⁰⁸ During any four-year period or when all voting power has been exercised at two consecutive meetings or in two written ballots for the election of directors, whichever period is shorter.

¹⁰⁹ CAL. CORP. CODE § 6510; CAL. CORP. CODE § 8510; CAL. CORP. CODE § 9680.

¹¹⁰ CAL. CORP. CODE § 6511; CAL. CORP. CODE § 8511; CAL. CORP. CODE § 9680.

¹¹¹ CAL. CORP. CODE § 6610, CAL. CORP. CODE § 8610 and CAL. CORP. CODE § 9680 cite CAL. CORP. CODE § 5034, which defines "approval of the members" as "ratified by the affirmative vote of a majority of the votes represented and voting at a duly held meeting at which a quorum is present (which affirmative votes also constitute a majority of the required quorum)."

¹¹² CAL. CORP. CODE § 6610; CAL. CORP. CODE § 8610; CAL. CORP. CODE § 9680.

⁹⁷ CAL. CORP. CODE § 8010.

⁹⁸ CAL. CORP. CODE § 6010; CAL. CORP. CODE § 9640.

⁹⁹ CAL. CORP. CODE § 6010.

¹⁰⁰ *Id.*

¹⁰¹ CAL. CORP. CODE § 6012; CAL. CORP. CODE § 8012; CAL. CORP. CODE § 9640.

¹⁰² CAL. CORP. CODE § 6015; CAL. CORP. CODE § 8015.

¹⁰³ CAL. CORP. CODE § 6016; CAL. CORP. CODE § 8016.

¹⁰⁴ CAL. CORP. CODE § 6011; CAL. CORP. CODE § 8011; CAL. CORP. CODE § 9640.

¹⁰⁵ Cal. Sec'y of State, Forms, Samples and Fees, <http://www.sos.ca.gov/business-programs/business-entities/forms>.

¹⁰⁶ Exclusive of memberships held by persons who have personally participated in any alleged fraud.

torney General prior to distribution of any assets. The board, instead of filing the certificate of dissolution, may petition the superior court for an order declaring the corporation duly wound up and dissolved.¹¹³

Comment: The Secretary of State's form certificate of dissolution for California nonprofits (Form DISS NP) is available online.¹¹⁴ The Secretary of State also maintains a "short-form" certificate of dissolution which may be used in limited circumstances where a corporation has not issued any memberships and the certificate of dissolution is filed within 24 months from the date the articles were filed with the Secretary of State.¹¹⁵ To dissolve without court proceedings, the corporation must file a "Certificate of

Election to Wind Up and Dissolve" (Form ELEC NP)¹¹⁶ prior to or together with a Certificate of Dissolution (Form DISS NP). If the election to dissolve is made by the vote of all the members, or if the corporation has no members, by the vote of all the directors, only the Certificate of Dissolution is required to be filed.

Comment: In addition to the requirements of the Secretary of State pursuant to the California corporations code, dissolving nonprofit corporations must comply with the requirements of the Franchise Tax Board. Although beyond the scope of this chapter, the Franchise Tax Board's forms and requirements are available online.¹¹⁷

¹¹³ CAL. CORP. CODE § 6617; CAL. CORP. CODE § 8617; CAL. CORP. CODE § 9680.

¹¹⁴ Cal. Sec'y of State, Forms, Samples and Fees, <http://www.sos.ca.gov/business-programs/business-entities/forms>.

¹¹⁵ CAL. CORP. CODE § 6610.5; CAL. CORP. CODE § 8610.5; CAL. CORP. CODE § 9680.5.

¹¹⁶ Cal. Sec'y of State, Forms, Samples and Fees, <http://www.sos.ca.gov/business-programs/business-entities/forms>.

¹¹⁷ Cal. Franchise Tax Bd., Charities and Nonprofits (Exempt Organizations), https://www.ftb.ca.gov/businesses/exempt_organizations/.