



LEGISLATIVE ALERT: NEW CALIFORNIA LAW AFFECTS NONPROFIT GOVERNANCE PRACTICES

Recently enacted California AB 1233 amends several provisions of the Nonprofit Corporation Law. These amendments become effective January 1, 2010 and may require California nonprofit corporations to review and modify their articles, bylaws or governance practices. While many of these amendments apply to all types of California nonprofit corporations, the following summary covers only those changes that affect public benefit corporations. If you are a board member or officer of a California nonprofit public benefit corporation, you should familiarize yourself with these changes so that you can help ensure your organization's compliance with California law. Should your organization require further assistance to review and possibly amend its corporate policies to comply with or make use of this new law, please call Public Counsel's Community Development Project at (213) 385-2977, extension 200. Our attorneys provide free legal assistance to qualifying nonprofit organizations.

This alert should not be construed as legal advice. This alert is designed as a highlight of the new law and will not be updated. This alert does not provide a comprehensive discussion of all provisions of the new law that may be applicable to your organization. Please contact an attorney if you need legal advice about the topics discussed in this alert.

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Nonprofit corporations may not have non-voting directors

Many nonprofit corporations give titles to advisors or major donors that suggest they are directors (e.g., "honorary directors," "directors emeritus," "advisory directors," etc.). Additionally, many nonprofit corporations have "non-voting directors" that have the same rights and responsibilities as the other directors, except the power to vote. AB 1233 clarifies that a director is a person who has been elected (or designated or appointed, as provided in the bylaws) to act as a member of the board and vote on actions or decisions taken by the board. Thus, a nonprofit corporation may not have non-voting members on its board of directors.

One of the rationales for this change was to clarify the use of ambiguous titles that include the word "director." The word "director" has a specific legal definition with associated rights and

obligations. Knowing which persons are directors and the total number of directors is also relevant in dealing with a number of critical issues ranging from quorum requirements for a board meeting to the limit on interested persons who may serve on the board. A corporation that wishes to involve non-directors in its board meetings may treat these individuals as guests or appoint them to a separate advisory committee. For more information about how non-directors can continue to participate in board meetings, see the section below.

Ex officio directors have all the same rights and duties as other directors, including the right to vote

Some nonprofit corporations choose to fill one or more of the director positions “*ex officio*,” which means by virtue of a title or position that individual holds. For example, it is not uncommon for a nonprofit’s chief executive to serve as a member of the board by reason of office, rather than through election. Moreover, many organizations limit the voting rights of *ex officio* directors. AB 1233 clarifies that *ex officio* directors have all the same rights and duties as other members of the board, including the right to vote. A nonprofit corporation with non-voting (or limited-voting) *ex officio* directors will need to amend its governing documents to either remove the positions or give the *ex officio* directors full rights as directors.

As a practical matter, however, a corporation may continue to involve non-directors in its board meetings. For example, a corporation may include in its bylaws a provision that the chief executive is required and has the right to attend every board meeting, unless specifically excused by the board. Such a person would be able to express opinions about matters up for discussion, present reports and be involved in the logistics of organizing board meetings, such as notification and setting the agenda. However, a non-director would not be counted toward meeting voting requirements, quorum requirements, etc.

Only directors may serve as members of committees that exercise board power

Nonprofit corporations at times invite individuals who are not directors either to serve as members or participate on committees established by the board. AB 1233 clarifies existing law by expressly prohibiting any committee exercising the authority of the board (a “board committee”) from including persons who are not directors as members of the committee. Thus, an executive committee or other board committee that includes any “non-voting” directors or other non-directors cannot be delegated authority to act on behalf of the board. Corporations, though, may continue to create advisory committees, which do not have authority to act for the board, and both directors and non-directors may serve on these committees.

There is also nothing in the law that prohibits a nonprofit corporation from allowing non-members to be present as guests at board committee meetings, or from giving input and participating in board committee work and deliberations, so long as the non-member does not have membership rights (e.g., voting rights) on the board committee.

Directors may not vote by proxy

Consistent with the fiduciary duties imposed on directors by current California law, AB 1233 expressly forbids directors from voting by proxy on matters presented for action at a board or board committee meeting. Thus, although directors as a group may delegate authority, an individual director may not appoint a substitute or alternate to act in his or her place.

Each director has one vote

Constituents of nonprofit corporations sometimes wish to permit certain directors to possess more than one vote. However, that practice is inconsistent with current law and a director's fiduciary duties. AB 1233 clarifies that each director may have only one vote on matters presented for action at a board or board committee meeting.

Bylaws or articles may require specific directors to be present to conduct business at board meetings

Nonprofit corporations may include in their articles or bylaws a provision that would require the presence of one or more specified directors in order to constitute a quorum and to transact business. This requirement may be in addition to the general quorum requirements contained in the bylaws or articles. This may be useful to nonprofit corporations whose directors represent various constituencies and wish to ensure those constituencies are represented when the board takes action.

New default rule allows boards to bypass the right of a third party to approve or reject amendments to articles and bylaws if the specified person ceases to exist or is unresponsive

Some nonprofit corporation's articles or bylaws contain a provision that requires the written approval from a person or entity other than the board of directors to amend or repeal the articles or bylaws. These approval rights are problematic, however, if the specified person (or entity) ceases to exist, disappears, or declines to participate in the governance of the corporation and act on proposed amendments. To resolve these issues, the new law states that third party approval requirements will not apply if (i) the specified person(s) have died or ceased to exist, or (ii) the right to approve is in the capacity of an officer or other status and the office or status has ceased to exist.

The law also creates a default rule that allows boards to sidestep third party approval requirements if the specified person(s) have become unresponsive for a certain period of time. AB 1233 states that such requirements shall not apply if (i) the corporation has a specific proposal for amendment or repeal and (ii) the corporation has sent written notice of that proposal, including a copy of the proposal, to the specified person(s) at their most recent address,

and (iii) the corporation has not received written approval or non-approval within the period of time specified in the notice. The period of time to respond must be between 10 and 30 days and it must start at least 20 days after the corporation provides notice.

The right of a third party designator to designate directors terminates if the designator ceases to exist

AB 1233 creates a new default provision that is applicable to nonprofit corporations that have provisions in their articles of bylaws that allow a person, persons or entity not on the board to appoint individuals to the nonprofit's board of directors and to remove directors that the third party has previously designated. The new law creates a default rule that the that third party right of designation and removal will not apply if (i) the specified person(s) have died or ceased to exist, or (ii) the right to approve is in the capacity of an officer or other status and the office or status has ceased to exist.

Nonprofit corporations may determine the size of their boards by a formula

Current California law requires that a nonprofit corporation's bylaws state either a number of authorized directors or a range establishing a minimum and maximum number of permitted directors. AB 1233 creates a third option by allowing the bylaws to state the method of determining the number of directors. This change allows a corporation to determine the number of directors on its board by a formula tied to specific objective factors (e.g., one director position for every 25 registered members of the organization).

Volunteer directors and officers are immune from negligence lawsuits only if the nonprofit corporation's insurance policy covers the type of claim made against these persons

The law provides volunteer directors and officers of nonprofit corporations immunity from lawsuits for monetary damages where the alleged negligent acts or omissions (i) arise out of those individuals' exercise of policy-making judgment as officers or directors and (ii) are made in good faith and in the best interests of the corporation. However, this immunity applies only if (i) the claim can also be made directly against the corporation, (ii) the corporation maintains a liability insurance policy that covers the claim, and (iii) the policy is found to cover the damages.

Previously, the law required a *general* liability insurance policy that was in force at the time of the injury and at the time of the claim is made to qualify a volunteer director or officer for immunity from suit. However, general liability insurance policies often do not cover employment-related or other claims that are brought against directors and officers. Instead, these claims are usually covered by directors and officers liability policies or employment practices liability policies. This change in the law allows nonprofit corporations with such coverage to assure their volunteer directors and officers that this statute provides the liability protection they expect. Nonprofit corporations should carefully review their insurance policies to determine what types of claims they cover and consider revising their coverage as necessary.

A board may vote to dissolve a nonprofit corporation even if it lacks enough directors to make up a quorum

By the time a nonprofit corporation is ready to dissolve, it may not have enough directors left to meet its bylaws quorum requirements (“quorum” is the minimum number of directors required to be present at a meeting for a valid action to be taken). To formally dissolve, the board would then have to elect additional directors just to have enough directors to hold a meeting to approve the dissolution. AB 1233 allows a corporation’s remaining directors to vote to voluntarily wind up and dissolve the corporation even if there are not enough directors to meet quorum, but only if the corporation is already authorized to dissolve by approval of the board. The law allows a board to vote to wind up and dissolve by any of these following ways: (i) the unanimous consent of the directors then in office; (ii) the affirmative vote of a majority of the directors then in office at a board meeting; and (iii) the vote of a sole remaining director.

The elimination of a director seat may be effective immediately if the reduction specifies the removal of that director

The law clarifies that when a board reduces its number of directors by eliminating a seat on the board, the director currently in that seat may be removed from the board immediately without waiting for the expiration of that director’s original term of office if the reduction provides for the removal of that director. Otherwise, the director shall finish out his or her term of office.

In exercising their fiduciary duties, directors may rely on information prepared or presented by advisory committees composed of certain non-directors

AB 1233 widens the group of committees that a director may rely on in discharging his or her fiduciary duties. A director may now rely on information prepared or presented by advisory committees, so long as they are exclusively composed of (i) officers and employees of the corporation, (ii) people with relevant professional expertise (e.g., attorneys and accountants), and/or (iii) other directors. Practically, this eliminates one facet of liability concern for directors and enables nonprofit corporations to have more diverse and competent advisory committees, especially when certain technical expertise may be necessary or desired (e.g., audit and compensation committees).

Nonprofit corporations can now use the terms “Chair,” “Chairperson” or “Chairwoman” instead of “Chairman” of the Board

AB 1233 allows a nonprofit corporation to change the title of the “chairman of the board” to the alternative title of “chairwoman of the board” or a gender-neutral title, such as “chair of the board” or “chairperson of the board.” Previously, the Secretary of State would reject documents signed under a title did not exactly match “chairman of the board.”

A nonprofit corporation must have as officers a Treasurer or Chief Financial Officer, or both

AB 1233 clarifies that a corporation must have either a treasurer or a chief financial officer, or both. Previously, the law stated only that corporations must have a chief financial officer. If there is no chief financial officer, then the treasurer is deemed the chief financial officer. This rule gives nonprofit corporations additional flexibility in organizing their officers and executive staff members. Nonprofit corporations will not need to make any changes to their officer hierarchy or their governing instruments to comply with this new law.

Unincorporated nonprofit associations are no longer required to incorporate before merging with nonprofit corporations

Unincorporated nonprofit associations may now merge directly with nonprofit corporations. This streamlined process replaces the previous two-step method whereby an unincorporated nonprofit association first had to incorporate before merging with a corporation. The law also changes the previous rule that an unincorporated association could only merge *into* other entities, and now allows them to merge *with* other entities.

Public Counsel's Community Development Project provides free legal assistance to qualifying nonprofit organizations serving low-income communities and addressing issues of poverty within Los Angeles County. If your organization needs legal assistance, visit http://www.publiccounsel.org/practice_areas/community_development or call (213) 385-2977, extension 200.