

Memorandum 76-39

Subject: Study 77.200 - Nonprofit Corporations (General Provisions Relating to Dissolution)

Attached to this memorandum is a staff draft of Chapter 20 (General Provisions Relating to Dissolution) of the new Nonprofit Corporation Law. Chapters 18 (Involuntary Dissolution) and 19 (Voluntary Dissolution) have been previously distributed with Memorandum 76-28 but have not yet been considered by the Commission.

Proposed Chapter 20 is subdivided into five articles as follows:

- Art. 1. Avoidance of Dissolution by Purchase; Procedures
- Art. 2. Directors and Officers
- Art. 3. Distribution of Assets
- Art. 4. Continuation After Dissolution
- Art. 5. Conditions for Dissolution of Regulated Nonprofit Corporations

Article 3 has been previously submitted to the Commission with Memorandum 76-10 and Memorandum 76-17. Article 3 in the attached draft has been revised in accordance with the Commission's decisions at the February 1976 meeting. Only Section 7034 has not been previously approved. The Commission should examine this section with care since it attempts to capture the scheme proposed by the Commission at the February meeting and is new to nonprofit corporation law. Articles 1, 2, 4, and 5 have not been previously reviewed by the Commission

Discussion of Individual Sections

Article 1. Avoidance of Dissolution by Purchase; Procedures

§ 7010. Application of article

Article 1 (Sections 7010-7015) corresponds to Section 2000 of General Corporation Law. Section 2000 was derived from Sections 4658 and 4659 of

the old law. Article 1 provides a procedure for the members holding half or more of the voting power to avoid a voluntary or involuntary dissolution by purchasing the memberships of those initiating the proceeding at their "fair value." Since, under Section 5407, memberships are not transferable unless the articles or bylaws so provide, Section 7010 makes the purchase procedure applicable only if there is such a provision in the articles or bylaws. This appears to be existing law. See California Nonprofit Corporations § 9.50, at 343-344 (Cal. Cont. Ed. Bar 1969). There is no similar purchase procedure under the Model Nonprofit Corporation Act or under the nonprofit corporation law of Illinois, New York, or Pennsylvania.

§ 7011. Avoidance of dissolution by purchase

Section 7011 is the same in substance as subdivision (a) of Section 2000 of the General Corporation Law, which, in turn, was derived from Section 4658 of the old law. Section 2000 made the following changes from the old law:

1. Under the old law, only involuntary dissolution proceedings could be avoided through the statutory buy-out procedure; Section 2000 expanded this to include voluntary proceedings initiated by the holders of exactly half of the voting power, but limited it by making the procedure "subject to any contrary provision in the articles."

2. Section 2000 added a provision giving the corporation the first right to purchase the shares of the parties initiating the dissolution proceeding.

3. Section 2000 added a provision for offsetting against the fair value of the shares any damages resulting from a breach by the parties initiating dissolution of any agreement with the purchasing parties. The purpose of this provision was "to eliminate multiple litigation with respect

to related issues." Report of the Assembly Select Committee on the Revision of the Corporations Code 104-105 (1975).

4. Section 2000 added a provision that the determination of "fair value" takes into account the possibility of a sale of the entire business as a going concern.

§ 7012. Stay of court proceedings and valuation of memberships

Section 7012 is the same in substance as subdivision (b) of Section 2000, which, in turn, was derived from the second sentence of Section 4658 of the old law. Section 2000 changed the purpose of the required bond. Under Section 4658, the bond was "to protect the interests and rights of the plaintiffs and to assure to the plaintiffs the payment of the value of their shares" Under Section 2000, the bond is to secure "the expenses (including attorneys' fees)" of the parties initiating dissolution.

§ 7013. Appraisal of memberships

Section 7013 is the same in substance as the first three sentences of subdivision (c) of Section 2000, which, in turn, is the same in substance as the first two and a half sentences of Section 4659 of the old law.

§ 7014. Alternative decree; appeal

Section 7014 is the same in substance as the last three sentences of subdivision (c) of Section 2000, which, in turn, is derived from the third through sixth sentences of Section 4659 of the old law. Section 2000 changed the purpose of the bond requirement from security for payment of the value of the shares to security for expenses including attorney's fees.

§ 7015. Time for payment; transfer of memberships

Section 7015 is the same in substance as subdivision (d) of Section 2000, which, in turn, is the same in substance as the last two sentences of Section 4659 of the old law.

Subdivision (e) of Section 2000 ("shareholder" includes beneficial owner of shares of close corporation who has made a shareholders' agreement) is not carried over into nonprofit corporation law.

Article 2. Directors and Officers

§ 7020. Powers and duties of directors and officers during dissolution

Section 7020 is the same in substance as Section 2001. Section 2001 is the same in substance as Section 4801 of the old law, except that Section 4801 describes the powers and duties of directors, while Section 2001 describes the powers and duties of directors and officers.

The bracketed sections in subdivision (g) of Section 7020 have to do with the requirement of approval by the membership when all or substantially all of the assets are to be disposed of.

§ 7021. Filling a vacancy on board of directors

Section 7021 is the same in substance as Section 2002. Section 2002 was derived from Section 4803 of the old law. Under the old law, a vacancy in the board of directors during dissolution could be filled by the remaining directors, pending approval by the shareholders. Under Section 2002 (which incorporates Section 305), such a vacancy may (unless otherwise provided in the articles or bylaws) be filled by the remaining directors unless the vacancy was created by removal of a director. In the latter case, the vacancy may be filled only by the shareholders.

§ 7022. Petition to determine or appoint directors

Section 7022 is the same in substance as Section 2003, which, in turn, is the same in substance as Section 4804 of the old law.

Article 3. Distribution of Assets

As noted above, all the sections in Article 3 have been tentatively approved by the Commission, except Section 7034 and Section 7035.5.

§ 7034. Disposition of assets held on trust or by charitable corporation

Subdivisions (a) and (b) of Section 7034 continue the substance of the second paragraph of Section 9801. Subdivision (c) is new and allows the

Attorney General to waive any objection to disposition of charitable assets without court decree, provided that other interested parties may seek such a decree.

§ 7035.5. Plan of distribution of securities or assets in kind

Section 7035.5 was adapted from Section 2007 of General Corporation Law. Section 2007 applies only to a corporation having "both preferred and common shares outstanding," and permits the adoption of a "plan of distribution" by approval of the board and each class of shares pursuant to which the preferred shareholders who do not file a written demand for cash payment may be distributed securities or assets in kind in lieu of their cash distribution preference.

The threshold question is whether any provisions comparable to Section 2007 should be included in nonprofit corporation law. It would appear to be an unusual case where a nonprofit corporation will have two or more classes of membership with one class having a cash liquidation preference akin to a preferred shareholder in a business corporation. Nonetheless, the staff has drafted proposed Section 7035.5 for the Commission's consideration.

It is not clear whether Section 2007 is intended merely to permit a nonmoney distribution despite a cash liquidation preference, or is additionally intended to permit a distribution which is not strictly pro rata. Compare Corp. Code §§ 2006 (distribution may be in money, property, or securities, but must be done "ratably," i.e., proportionally) with § 2007 (plan of distribution may provide for distribution "which is not in accordance with the liquidation rights of the preferred shares"). The staff has drafted proposed Section 7035.5 to allow distribution of assets in kind but not to allow a distribution which is not pro rata. This is consistent with prior general corporation law which allowed distribution of assets

in kind, but said nothing about a distribution "not in accordance with the liquidation rights of the preferred shares." See Corp. Code §§ 5003-5005.

It should also be noted that Section 2007 is the only place in California corporation law which refers to a "plan of distribution"; no provision is made for a plan of distribution in connection with voluntary or involuntary dissolution proceedings generally. Under the Model Nonprofit Corporation Act, a plan of distribution is required before charitable assets may be distributed, and is optional in all other cases. Under the Model Act, the plan of distribution is recommended by the board of directors and is approved by a two-thirds vote of the voting members.

§ 7037. Recovery of improper distribution to members

At the February 1976 meeting, the Commission requested further information relating to subdivision (b) which grants a creditor the right to bring an action in the name of a nonprofit corporation to recover improper distributions of assets to members.

Section 7037 is based on new Business corporation law Section 2009. Section 2009, in turn, is based on existing Corporations Code Section 5012, which applies to nonprofit as well as to business corporations by virtue of Section 9800. Existing Section 5012 has no provision comparable to subdivision (b); subdivision (b) was apparently added to the new law to overcome case decisions that:

The creditor is not given a right of action by Section 5012.

Section 5012 imposes no obligation upon the corporation or the persons empowered by statute to act in its behalf to bring such an action.

Section 5012, Corporations Code, makes no mention of a request by a creditor. Since it neither does that nor imposes any duty on the corporation to bring action, it is not interpreted by us as limiting any right a creditor might otherwise have. [Zinn v. Bright, 9 Cal. App:3d 188, 87 Cal. Rptr. 736 (1970).]

Under the Zinn decision, the creditor is relegated to a creditor's bill in equity to reach the corporate asset wrongfully distributed.

Under the new right of a creditor to bring an action in the name of the corporation, the statute of limitations will be three years from the time the liability is created. See Code Civ. Proc. §359:

359. This title does not affect actions against directors or stockholders of a corporation, to recover a penalty or forfeiture imposed, or to enforce liability created by law; but such actions must be brought within three years after the discovery by the aggrieved party of the facts upon which the penalty or forfeiture attached, or the liability was created.

See also Hoover v. Galbraith, 7 Cal.3d 519, 498 P.2d 981, 102 Cal. Rptr. 733 (1972)(applying statute of limitations in action against directors for improper distribution of assets on dissolution). Incidentally, the staff recommends that Section 359 be amended to read:

359. This title does not affect actions against directors or ~~stockholders~~ , shareholders, or members of a corporation,

This amendment will make clear that the section applies to nonprofit as well as business corporations; it also conforms to the terminology of the new business corporation law.

The problems relating to control of litigation under new subdivision (b) are the same as those in a derivative action, and would be resolved in the same way.

The Commission also requested at the February 1976 meeting that the staff write to the State Bar Committee on Corporations to inquire what was meant in subdivision (c) by members who have been "compelled" to return a distribution may "require" that the nonprofit corporation may recover the distribution to others. The staff notes that this language is taken from

existing Section 5012 and has been in the law since 1933. So far as the staff is aware, there are no cases construing this language. The staff believes that the State Bar Committee would be unable to enlighten the Commission as to the precise meaning of the language. The staff has not attempted to substitute more precise language for fear of inadvertently narrowing the possible scope of the reimbursement requirement.

Article 4. Continuation After Dissolution

§ 7040. Continued existence for some purposes of dissolved nonprofit corporation

Section 7040 is the same in substance as Section 2010, which, in turn, is the same in substance as Sections 5400-5402 of the old law.

§ 7041. Suits against dissolved corporation

Section 7041 is the same in substance as Section 2011 (General Corporation Law). Section 2011 is the same in substance as Sections 3305, 3305.1, 3305.2, and 3306 of the old law, except that Section 2011(a) allows suit against the shareholders in the corporate name on any cause of action arising prior to dissolution in "all cases where a corporation has been dissolved," while Section 3305.2 allowed such suit in "all cases where a corporation has forfeited its charter or right to do business, or has dissolved" The language of Section 3305.2 which was omitted from Section 2011(a) would appear to have been surplusage because, until a final order of dissolution is made, the directors continue to act as trustees, their acts are done in the name of the corporation, and suits are brought by or against the corporation. See H. Ballantine & G. Sterling, California Corporation Laws § 277 (4th ed. 1975).

Article 5. Conditions for Dissolution of Regulated
Nonprofit Corporations

§ 7050. Conditions for dissolution of regulated nonprofit corporations

Section 7050 is adapted from subdivision (d) of Section 1800 (involuntary dissolution), which provides that Section 1800 "does not apply to any corporation subject to the Bank Act, the Public Utilities Act, the Savings and Loan Association Act or Article 14 (commencing with Section 1010) of Chapter 1 of Part 2 of Division 1 of the Insurance Code." The Bank Act, the Savings and Loan Association Act, and the cited provisions of the Insurance Code all provide separate procedures for involuntary dissolution of corporations subject to such acts. See Fin. Code §§ 3100-3132, 3220-3225 (banks); 9000-9132 (savings and loan associations); Ins. Code §§ 1010-1062 (insolvent or delinquent insurer).

Proposed Section 7050 omits any reference to banks or savings and loan associations. The Bank Act appears to contemplate that banks will be organized for profit. See, e.g., Fin. Code §§ 350 ("common shares" subject to assessment), 640 (bank may declare dividends out of net profits). There have been banks organized in California as membership (nonstock) corporations. See, e.g., Bennett v. Hibernia Bank, 47 Cal.2d 540, 546-548, 305 P.2d 20, ___ (1956). Although the Hibernia Bank was organized as a membership corporation, it "was organized as a business and profit-making organization." Id. at 551, 305 P.2d at ___. Although Sections 670-671.17 of the Financial Code were enacted in 1951 to allow a bank having no capital stock to "elect to have a capital stock" (see Cal. Stats. 1951, Ch. 377), those sections were repealed in 1973 (see Cal. Stats. 1973, Ch. 963, § 21). Finally, under existing law, if the Superintendent of Banks commences a proceeding under the Bank Act for involuntary liquidation of a bank, the court in which such proceedings are pending has "exclusive original jurisdiction." Fin. Code § 3108.

Although savings and loan associations may or may not be "organized to issue stock" (see Fin. Code § 5502), they must be incorporated (Fin. Code § 5001), are organized under General Corporation Law (Fin. Code § 5500), and may pay dividends (see Fin. Code §§ 6517-6517.1, 6906-6907, 7405-7410).

A nonprofit corporation may, however, operate an insurance business, see Maloney v. American Independent Medical & Health Ass'n, 119 Cal. App.2d 319, 259 P.2d 503 (1953), or a public utility business, see Mesa Electric Cooperative, Inc., 47 Cal. P.U.C. 118 (1947); Public Utilities of California Corp., 45 Cal. R.R. Comm'n 462 (1944). The General Nonprofit Corporation Law must therefore mesh with the regulatory provisions of the Public Utilities Act and the Insurance Code.

Although a public utility may not dispose of its assets without consent of the Public Utilities Commission, (see Pub. Util. Code § 851; Grover v. Sharp & Fellows Contracting Co., 82 Cal. App.2d 515, 518, 186 P.2d 682, ___ (1947)), once such consent is obtained, the corporation may dissolve. Slater v. Shell Oil Co., 39 Cal. App.2d 535, 548, 103 P.2d 1043, ___ (1940). It appears therefore that the provision of the General Corporation Law that the section authorizing involuntary dissolution "does not apply" to a corporation subject to the Public Utilities Act is too broadly drafted. Proposed Section 7050 provides instead that, except for an action brought by the Attorney General, "[n]o proceedings may be maintained . . . for the voluntary or involuntary dissolution of a nonprofit corporation which is subject to . . . the Public Utilities Act unless an order is obtained from the Public Utilities Commission"

Similarly, an insolvent or delinquent insurer is subject to involuntary dissolution under the Insurance Code upon application of the Insurance Commissioner. See Ins. Code §§ 1016-1017.

The provisions of the General Corporation Law making involuntary dissolution proceedings inapplicable to any corporation "subject to" the Insurance Code, whether solvent or insolvent, seems too broad. Proposed Section 7050 merely prohibits voluntary or involuntary dissolution under the Corporations Code if the Insurance Commissioner has filed an application for involuntary dissolution under the Insurance Code and withholds consent for such other proceedings.

Respectfully submitted,

Robert J. Murphy III
Legal Counsel

OUTLINE

CHAPTER 20. GENERAL PROVISIONS RELATING TO DISSOLUTION

Article 1. Avoidance of Dissolution by Purchase; Procedures

- § 7010. Application of article
- § 7011. Avoidance of dissolution by purchase
- § 7012. Stay of court proceedings and valuation of memberships
- § 7013. Appraisal of memberships
- § 7014. Alternative decree; appeal
- § 7015. Time for payment; transfer of memberships

Article 2. Directors and Officers

- § 7020. Powers of directors and officers during dissolution
- § 7021. Filling a vacancy on board of directors
- § 7022. Petition to determine or appoint directors

Article 3. Distribution of Assets

- § 7030. When distribution may be made
- § 7031. Adequate provision for payment of debts and liabilities
- § 7032. Distribution among members or in accordance with articles or bylaws
- § 7033. Return of assets held on condition
- § 7034. Disposition of assets held on trust or by charitable corporation
- § 7035. Manner of distribution
- § 7035.5. Plan of distribution of securities or assets in kind
- § 7036. Deposit of distribution to creditors, members, and other persons

§ 7037. Recovery of improper distribution to members

Article 4. Continuation After Dissolution

§ 7040. Continued existence for some purposes of dissolved nonprofit corporation

§ 7041. Suits against dissolved corporation

Article 5. Conditions for Dissolution of Regulated
Nonprofit Corporations

§ 7050. Conditions for dissolution of regulated nonprofit corporations

CHAPTER 20. GENERAL PROVISIONS RELATING TO DISSOLUTION

Article 1. Avoidance of Dissolution by Purchase; Procedures§ 7010. Application of article

7010. The provisions of this article apply only to a nonprofit corporation whose articles or bylaws provide that its memberships are transferable.

Comment. Section 7010 is new. Subdivision (a) of Section 5407 provides that memberships in nonprofit corporations are not transferable unless the articles or bylaws so provide. If the articles or bylaws do not so provide, then the provisions of this article are inapplicable.

§ 7011. Avoidance of dissolution by purchase

7011. (a) Subject to any contrary provision in the articles, in any suit for involuntary dissolution, or in any proceeding for voluntary dissolution initiated by the vote of members representing only 50 percent of the voting power, the nonprofit corporation or, if it does not elect to purchase, the members holding 50 percent or more of the voting power (the "purchasing parties") may avoid the dissolution of the nonprofit corporation and the appointment of any receiver by purchasing for cash the memberships owned by the members initiating the proceeding (the "moving parties") at their fair value.

(b) The fair value shall be determined on the basis of the liquidation value but taking into account the possibility, if any, of sale of any business conducted by the nonprofit corporation as a going concern in a liquidation. In fixing the value, the amount of any damages resulting if the initiation of the dissolution is a breach by any moving party or

§ 7012

parties of an agreement with the purchasing party or parties may be deducted from the amount payable to such moving party or parties, unless the ground for dissolution is that specified in subdivision (d) of Section 6821.

(c) The election of the nonprofit corporation to purchase may be made by the approval of members holding a majority of the voting power excluding the voting power of the moving parties.

Comment. Section 7011 is the same in substance as subdivision (a) of Section 2000 (General Corporation Law).

405/973

§ 7012

§ 7012. Stay of court proceedings and valuation of memberships

7012. If the purchasing parties elect to purchase the memberships of the moving parties, are unable to agree with the moving parties upon the fair value of such memberships, and give bond with sufficient security to pay the expenses (including attorney's fees) of the moving parties if such expenses are recoverable under Section 7013, the court upon application of the purchasing parties, either in the pending action or in a proceeding initiated in the superior court of the proper county by the purchasing parties in the case of a voluntary election to dissolve, shall stay the winding up and dissolution proceeding and shall proceed to ascertain and fix the fair value of the memberships of the moving parties.

Comment. Section 7012 is the same in substance as subdivision (b) of Section 2000 (General Corporation Law). The term "proper county" is defined in Section [177 of new General Corporation Law].

§ 7013. Appraisal of memberships

7013. (a) The court shall appoint three disinterested appraisers to appraise the fair value of the memberships of the moving parties, and shall make an order referring the matter to the appraisers so appointed for the purpose of ascertaining such value.

(b) The order shall prescribe the time and manner of producing evidence, if evidence is required.

(c) The award of the appraisers or of a majority of them, when confirmed by the court, shall be final and conclusive upon all parties.

Comment. Section 7013 is the same in substance as the first three sentences of subdivision (c) of Section 2000 (General Corporation Law).

§ 7014. Alternative decree; appeal

7014. (a) The court shall enter a decree which shall provide in the alternative for winding up and dissolution of the nonprofit corporation unless payment is made for the memberships within the time specified in the decree.

(b) If the purchasing parties do not make payment for the memberships within the time specified, judgment shall be entered against them and the surety or sureties on the bond for the amount of the expenses (including attorney's fees) of the moving parties.

(c) Any member aggrieved by the action of the court may appeal therefrom.

Comment. Section 7014 is the same in substance as the last three sentences of subdivision (c) of Section 2000 (General Corporation Law).

§ 7015. Time for payment; transfer of memberships

7015. (a) If the purchasing parties desire to prevent the winding up and dissolution, they shall pay to the moving parties the value of their memberships ascertained and decreed within the time specified pursuant to Section 7014, or, in case of an appeal, as fixed on appeal.

(b) On receiving such payment or the tender thereof, the moving parties shall transfer their memberships to the purchasing parties.

Comment. Section 7015 is the same in substance as subdivision (d) of Section 2000 (General Corporation Law).

Article 2. Directors and Officers

§ 7020. Powers of directors and officers during dissolution

7020. The powers and duties of the directors (or other persons appointed by the court pursuant to Section 6843) and officers after commencement of a dissolution proceeding include, but are not limited to, the following acts in the name and on behalf of the nonprofit corporation:

(a) To elect officers and to employ agents and attorneys to liquidate or wind up its affairs.

(b) To continue the conduct of the activities of the nonprofit corporation insofar as necessary for the disposal or winding up thereof.

(c) To make and carry out contracts and collect, pay, compromise, and settle debts and claims for or against the nonprofit corporation.

(d) To defend suits brought against the nonprofit corporation.

(e) To sue, in the name of the nonprofit corporation, for all sums due or owing to the nonprofit corporation or to recover any of its property.

(f) To collect any amounts remaining unpaid on membership fees, dues, or assessments, or to recover unlawful distributions.

(g) To sell at public or private sale, exchange, convey, or otherwise dispose of all or any part of the assets of the corporation for cash in an amount deemed reasonable by the board without compliance with the provisions of Section [6001], or (subject to compliance with the provisions of Sections [6001, 6200, and 6201], but Chapter 13 shall not be applicable thereto) upon such other terms and conditions and for such other considerations as the board deems reasonable or expedient and to execute bills of sale and deeds of conveyance in the name of the corporation.

§ 7021

(h) In general, to do any and all things in the name of the nonprofit corporation which may be proper or convenient for the purposes of winding up, settling, and liquidating the affairs of the nonprofit corporation.

Comment. Section 7020 is the same in substance as Section 2001 (General Corporation Law).

405/978

§ 7021

§ 7021. Filling a vacancy on board of directors

7021. A vacancy on the board may be filled during a winding up proceeding in the manner provided in Section [305 of General Corporation Law].

Comment. Section 7021 is the same in substance as Section 2002 (General Corporation Law). The term "vacancy" is defined in Section [192 of General Corporation Law].

405/979

§ 7022

§ 7022. Petition to determine or appoint directors

7022. When the identity of the directors or their right to hold office is in doubt, or if they are dead or unable to act, or they fail or refuse to act or their whereabouts cannot be ascertained, any interested person may petition the superior court of the proper county to determine the identity of the directors or, if there are no directors, to appoint directors to wind up the affairs of the nonprofit corporation, after hearing upon such notice to such persons as the court may direct.

Comment. Section 7022 is the same in substance as Section 2003 (General Corporation Law). The term "proper county" is defined in Section [177].

Tentatively Approved
February 1976

Article 3. Distribution of Assets

§ 7030. When distribution may be made

7030. (a) After determining that all the known debts and liabilities of a nonprofit corporation in the process of winding up have been paid or adequately provided for, the board shall distribute all the remaining corporate assets in the manner provided in this article.

(b) If the winding up is by court proceeding or subject to court supervision, the distribution shall not be made until after the expiration of any period for the presentation of claims which has been prescribed by order of the court.

Comment. Subdivision (a) of Section 7030 is the same in substance as the first sentence of Section 2004 (General Corporation Law). It continues the portion of the first paragraph of former Section 9801 that related to payment or adequate provision for debts and obligations of the nonprofit corporation. Payment of a debt or liability has been adequately provided for if the conditions of Section 7031 are satisfied. For recovery of assets distributed to members without compliance with this section, see Section 7037.

Subdivision (b) is the same in substance as the second sentence of Section 2004 (General Corporation Law).

Distribution of assets of a nonprofit corporation on dissolution may be made only after the requirements of Section 7030 are satisfied. Distribution of assets generally is provided for in Section 7032 (distribution among members or in accordance with articles). There are special rules for assets held on condition requiring return (Section 7033), assets held on trust or by a charitable corporation (Section 7034), and assets held by a subordinate body (Section 5214).

Tentatively Approved
February 1976

§ 7031. Adequate provision for payment of debts and liabilities

7031. (a) The payment of a debt or liability, whether the whereabouts of the creditor is known or unknown, has been adequately provided for if the payment has been provided for by either of the following means:

(1) Payment thereof has been assumed or guaranteed in good faith by one or more financially responsible persons or by the United States government or any agency thereof, and the provision (including the financial responsibility of such persons) was determined in good faith and with reasonable care by the board to be adequate at the time of any distribution of the assets by the board pursuant to this article.

(2) The amount of the debt or liability has been deposited as provided in Section 7036.

(b) This section does not prescribe the exclusive means of making adequate provision for debts and liabilities.

Comment. Section 7031 is the same in substance as Section 2005 (General Corporation Law). It continues provisions applicable to non-profit corporations by former Section 5001 through former Section 9800. "Financially responsible persons" includes financially responsible corporations. See Section 18 ("person" includes "corporation").

Tentatively Approved
February 1976

§ 7032. Distribution among members or in accordance with articles
or bylaws

7032. Unless otherwise provided in this division, assets held by a nonprofit corporation shall be distributed on dissolution among the members in accordance with their respective rights therein or disposed of in such other manner as may be provided in the articles or bylaws.

Comment. Section 7032 continues the substance of that portion of the first paragraph of former Section 9801 that related to distribution of assets to members or as otherwise provided in the articles, with the addition of a provision permitting provision otherwise in the bylaws. For a comparable provision, see Section 2004 (General Corporation Law) (distribution of remaining corporate assets among shareholders according to their respective rights and preferences). Section 7032 governs distribution of the remaining assets of a nonprofit corporation on dissolution unless the assets fall within the terms of Section 7033 (return of assets held on condition), 7034 (disposition of assets held on trust or by charitable corporation), or 5214 (delivery of assets held by subordinate body).

The respective rights of the members are determined by reference to the articles and bylaws. Absent relevant classifications, the property rights of members are equal. See Section 5401. The articles or bylaws may, however, provide a disposition of assets other than distribution to members.

It should be noted that, if assets of a nonprofit corporation are distributable to members on dissolution, the nonprofit corporation will not qualify for income tax exemption under Revenue and Taxation Code Section 23701d or Internal Revenue Code Section 501(c)(3). Moreover, the memberships will be "securities" within the meaning of the Corporate Securities Law of 1968 and may not be exempt from the qualification requirements of that law. See Sections 25019 and 25100(j); see also California Corporations Commissioner, Release 15-C (May 15, 1970).

404/369

§ 7033

Tentatively Approved
January 1976

§ 7033. Return of assets held on condition

7033. Assets held by a nonprofit corporation upon condition requiring return, transfer, or conveyance, which condition occurs by reason of the dissolution, shall be returned, transferred, or conveyed in accordance with such requirements.

Comment. Section 7033 is new. It is comparable to Section 46 of the ALI-ABA Model Nonprofit Corporation Act. Section 7033 is consistent with the common law in California. See In re Los Angeles County Pioneer Society, 40 Cal.2d 852, 866, 257 P.2d 1, 9 (1953), cert. denied, 346 U.S. 888 (1953).

404/363

§ 7034

Substance Tentatively
Approved February 1976

§ 7034. Disposition of assets held on trust or by charitable corporation

7034. (a) Those assets held by a nonprofit corporation on a charitable trust and all of the assets held by a nonprofit corporation organized for charitable purposes shall be disposed of on dissolution in conformity with the purposes of the charitable trust or the charitable purposes for which the nonprofit corporation was organized.

(b) Except as provided in subdivision (c), the disposition required in subdivision (a) shall be made by decree of the superior court of the proper county in proceedings to which the Attorney General is a party. The decree shall be made upon petition therefor by the Attorney General

or, upon thirty days' notice to the Attorney General, by any person concerned in the dissolution.

(c) The disposition required in subdivision (a) may be made without the decree of the superior court, subject to the rights of persons concerned in the dissolution, if the Attorney General makes a written waiver of objections to the disposition.

Comment. Section 7034 continues the substance of the second paragraph of former Section 9801. The disposition of assets provided in Section 7034 applies only where the assets are not held on condition requiring return, transfer, or conveyance. See Section 7033.

Subdivision (a) applies both to assets received on express trust for charitable purposes and to assets received by a charitable corporation whether or not on trust. A nonprofit corporation organized exclusively for charitable purposes holds its assets in trust for the purposes enumerated in its articles of incorporation even though they were not otherwise expressly ear-marked for charitable trust purposes when acquired by the corporation. See, e.g., Pacific Home v. County of Los Angeles, 41 Cal.2d 844, 257 P.2d 1 (1953). Whether a nonprofit corporation is deemed to be a charitable corporation for the purposes of subdivision (a) is a question of fact to be determined by reference not only to its articles of incorporation but also to the manner of conducting its activities. See, e.g., Lynch v. Spilman, 67 Cal.2d 251, 62 Cal. Rptr. 12, 431 P.2d 636 (1967); In re Los Angeles County Pioneer Society, 40 Cal.2d 852, 257 P.2d 1, cert. denied, 346 U.S. 888 (1953). Charitable purposes are not defined by statute but left to judicial development.

Subdivision (a) also has the effect of preserving the doctrine of cy pres. Former Section 9801 was silent as to this point, but case law required application of the cy pres doctrine. See, e.g., In re Veterans' Industries, Inc., 8 Cal. App.3d 902, 88 Cal. Rptr. 303 (1970); Metropolitan Baptist Church of Richmond, Inc. v. Younger, 48 Cal. App.3d 850, 121 Cal. Rptr. 899 (1975).

Subdivision (b) continues the provision of former Section 9801 that required a court decree of distribution. The decree is made upon petition therefor by the Attorney General or by an interested party after 30 days' notice to the Attorney General. It should be noted that, although the Attorney General is a party to the court proceeding, the ultimate responsibility for the proper application of the standard of subdivision (a) rests with the court. In re Veterans' Industries, Inc., supra.

Subdivision (c) is new. It permits disposition of charitable assets without court decree upon waiver of objections by the Attorney General. A nonprofit corporation may seek a court decree even though the Attorney General has waived objections, and the waiver of objections binds only the Attorney General and not other interested parties, such as the donor or other potential distributees.

Note. The question whether provisions governing corporations sole should be integrated with this section is deferred.

The question whether a scheme such as that provided in this section should be applied to mergers and sale of assets is deferred until consideration of those subjects.

404/359

§ 7035

Tentatively Approved
February 1976

§ 7035. Manner of distribution

7035. (a) Unless the articles or bylaws otherwise provide, distribution of assets may be made either in money or in property or securities and either in installments from time to time or as a whole, if this can be done fairly and ratably and in conformity with the rights of the distributees.

(b) Distribution of assets shall be made as soon as reasonably consistent with the beneficial liquidation of corporate assets.

Comment. Section 7035 is the same in substance as Section 2006 (General Corporation Law). It continues provisions applicable to non-profit corporations by former Sections 5002 and 5003 through former Section 9800. Section 7035 applies only to distributions among members or other distributees where there are no contrary requirements in the articles or bylaws. Where the articles or bylaws provide otherwise, the distribution is not made pursuant to Section 7035 but is made in accordance with the requirements of the articles or bylaws.

Note. Provisions relating to a plan of distribution, if any, have not yet been drafted.

405/980

§ 7035.5

§ 7035.5. Plan of distribution of securities or assets in kind

7035.5. (a) Notwithstanding any provision in the articles for two or more classes of membership with one or more classes of membership having a liquidation preference payable in cash upon distribution of the assets, a plan of distribution of any assets other than money which provides that such distribution is in complete or partial satisfaction of the members' rights pursuant to such liquidation preference may be adopted if approved by the board and by the members of each class regardless of any limitation or restriction of voting rights.

(b) A plan of distribution so approved shall be binding on all the members except as provided in subdivision (c). The board shall cause notice of the adoption of the plan to be given by mail within 20 days after its adoption to all members having a liquidation preference.

(c) Members having a liquidation preference who dissent from the plan of distribution are entitled to be paid the amount of their liquidation preference in cash if they file written demand for payment with the nonprofit corporation within 30 days after the date of mailing of the

notice of the adoption of the plan of distribution, unless the plan of distribution is abandoned. The demand shall state the member's liquidation preference and the amount of the cash distribution to which the member is entitled.

(d) If any such demand for cash payment is filed, the board in its discretion may abandon the plan without further approval by the membership, and all members shall then be entitled to distribution according to their rights and liquidation preferences.

Comment. Section 7035.5 is similar to Section 2007 (General Corporation Law). Under Section 7035, distribution of assets may be made "in property or securities" if it can be done "in conformity with the rights of the distributees." Section 7035.5 contemplates that the articles may provide for more than one class of membership, with one class having preferred rights on distribution payable in cash, and authorizes a procedure for distribution in kind notwithstanding such a provision in the articles. The requirement of approval "by the members of each class" means approval by majority vote unless a greater proportion is required by the articles or by any voting agreement. Corp. Code § [152 of General Corporation Law].

Note. If the Commission determines to retain the substance of Section 7035.5, it should be renumbered as should the succeeding sections of Article 3.

404/358

§ 7036

Tentatively Approved
February 1976

§ 7036. Deposit of distribution to creditors, members, and other persons

7036. (a) This section applies to a creditor, members, or other person entitled to assets of a nonprofit corporation in all of the following cases:

(1) The person is unknown or fails to accept a payment or distribution.

(2) The person cannot be found after diligent inquiry.

(3) The existence or amount of the person's claim is contingent, contested, or not determined.

(4) The ownership of the person's membership is in dispute.

(b) In cases described in subdivision (a), the nonprofit corporation may deposit the payment or distribution or the maximum amount of the claim with the State Treasurer or with a bank or trust company in this state in trust for the benefit of the person lawfully entitled thereto. The payment or distribution shall be paid over by the depository to the lawful owner, the owner's representative, or assigns upon satisfactory proof of title.

(c) For the purpose of providing for the transmittal, receipt, accounting for, claiming, management, and investment of all amounts deposited in the State Treasury under the provisions of subdivision (b), the deposit shall be deemed to be paid or delivered for deposit in the State Treasury under the provisions of Chapter 7 (commencing with Section 1500) of Title 10 of Part 3 of the Code of Civil Procedure and may be recovered in the manner prescribed therein.

Comment. Section 7036 is the same in substance as Section 2008 (General Corporation Law). Subdivisions (a) and (b) continue provisions applicable to nonprofit corporations by former Sections 5009 and 5010 through former Section 9800. Subdivision (c) continues provisions applicable to nonprofit corporations by former Section 5011 through former Section 9800.

Not Approved; See Minutes
February 1976

§ 7037. Recovery of improper distribution to members

7037. (a) Whenever in the process of winding up a nonprofit corporation any distribution of assets has been made, otherwise than under an order of court, without prior payment or adequate provision for payment of any of the debts and liabilities of the nonprofit corporation, any amount so improperly distributed to any member may be recovered by the nonprofit corporation. Any of such members may be joined as defendants in the same action or brought in on the motion of any other defendant.

(b) Suit may be brought in the name of the nonprofit corporation by any one or more creditors of the nonprofit corporation, whether or not they have reduced their claims to judgment, to enforce the liability under subdivision (a) against any or all members receiving the distribution.

(c) Members who satisfy any liability under this section shall have the right of ratable contribution from other members similarly liable. Any member who has been compelled to return to the nonprofit corporation more than the member's ratable share of the amount needed to pay the debts and liabilities of the nonprofit corporation may require that the nonprofit corporation recover from any or all of the other members such proportion of the amounts received by them upon the improper distribution as to give contribution to those held liable under this section and make the distribution of assets fair and ratable, according to the respective rights of the members, after payment or adequate provision for payment of all the debts and liabilities of the nonprofit corporation.

(d) As used in this section, "process of winding up" includes proceedings under Chapters 18 and 19 and also any other distribution of assets to members made in contemplation of termination or abandonment of the corporate activities.

Comment. Section 7037 is the same in substance as Section 2009 (General Corporation Law). It continues provisions applicable to nonprofit corporations by former Section 5012 through former Section 9800. Although a nonprofit corporation may make distributions to persons or groups other than members (see Sections 7032-7034), Section 7037 is limited to recovery of distributions made to members. The directors may be liable for improper distributions to members or other distributees pursuant to Section [316]. For the obligation to pay or adequately provide for debts and liabilities, prior to distribution, see Section 7030. Adequate provision for debts and liabilities is defined in Section 7031.

Note. The staff has not yet drafted provisions relating to the liability of directors.

Article 4. Continuation After Dissolution§ 7040. Continued existence for some purposes of dissolved nonprofit corporation

7040. (a) A nonprofit corporation which is dissolved nevertheless continues to exist for the purpose of winding up its affairs, prosecuting and defending actions by or against it, and enabling it to collect and discharge obligations, dispose of and convey its property, and collect and divide its assets, but not for the purpose of continuing its activities except so far as necessary for the winding up thereof.

(b) No action or proceeding to which a nonprofit corporation is a party abates by the dissolution of the nonprofit corporation or by reason of proceedings for winding up and dissolution thereof.

(c) Any assets inadvertently or otherwise omitted from the winding up continue in the dissolved nonprofit corporation for the benefit of the persons entitled thereto upon dissolution of the nonprofit corporation and on realization shall be distributed accordingly.

Comment. Section 7040 is the same in substance as Section 2010 (General Corporation Law).

§ 7041. Suits against dissolved corporation

7041. (a) In all cases where a nonprofit corporation has been dissolved, the members may be sued in the corporate name of such nonprofit corporation upon any cause of action against the nonprofit corporation arising prior to its dissolution. This section is procedural in nature and is not intended to determine liability.

(b) Summons or other process against such a nonprofit corporation may be served by delivering a copy thereof to an officer, director, or person having charge of its assets or, if no such person can be found, to any agent upon whom process might be served at the time of dissolution. If none of such persons can be found with due diligence and it is so shown by affidavit to the satisfaction of the court, then the court may make an order that summons or other process be served upon the dissolved nonprofit corporation by delivering a copy thereof, together with a copy of the order, to the Secretary of State or an assistant or deputy secretary of state. Service in this manner is deemed complete on the tenth day after such delivery.

(c) Every such nonprofit corporation shall survive and continue to exist indefinitely for the purpose of being sued in any quiet title action. Any judgment rendered in any such action shall bind each and all of its members or other persons having any equity or other interest in such nonprofit corporation, to the extent of their interest therein, and such action shall have the same force and effect as an action brought under the provisions of Sections 410.50 and 410.60 of the Code of Civil Procedure. Service of summons or other process in any such action may be made as provided in Chapter 4 (commencing with Section 413.10) of Title 5 of Part 2 of the Code of Civil Procedure or as provided in subdivision (b).

(d) Upon receipt of such process and the fee therefor prescribed in the Government Code, the Secretary of State forthwith shall give notice to the nonprofit corporation as provided in Section [6702].

Comment. Section 7041 is the same in substance as Section 2011 (General Corporation Law).

Article 5. Conditions for Dissolution of Regulated
Nonprofit Corporations

§ 7050. Conditions for dissolution of regulated nonprofit corporations

7050. No proceedings may be maintained by any person specified in Sections 6820, 6920, or 6921 for the voluntary or involuntary dissolution of a nonprofit corporation which is subject to:

(a) The Public Utilities Act unless an order is obtained from the Public Utilities Commission authorizing the nonprofit corporation either to dispose of its assets as provided in Section 851 of the Public Utilities Code or to dissolve; or

(b) The provisions of Article 14 (commencing with Section 1010) of Chapter 1 of Part 2 of Division 1 of the Insurance Code when the application authorized by Section 1011 of the Insurance Code has been filed by the Insurance Commissioner unless the consent of the Insurance Commissioner has been obtained.

Comment. Section 7050 supersedes the provisions of former Section 4650 which authorized proceedings for involuntary dissolution of a corporation "other than" one subject to the regulatory provisions of certain enumerated statutes. Compare Section 1800(d)(General Corporation Law).

Subdivision (a) restates existing law. A nonprofit corporation which is operating a public utility business may not dispose of such business without the consent of the Public Utilities Commission. See Pub. Util. Code § 851; Grover v. Sharp & Fellows Contracting Co., 82 Cal. App.2d 515, 518, 186 P.2d 682, ___ (1947); Slater v. Shell Oil Co., 39 Cal. App.2d 535, 548, 103 P.2d 1043, ___ (1940). Once such consent has been obtained, however, the corporation may dissolve in the same manner as any other corporation. See Slater v. Shell Oil Co., supra.

Subdivision (b) applies a similar rule to a nonprofit corporation operating an insurance business when the Insurance Commissioner has commenced a proceeding to obtain control of its assets as provided in Section 1011 of the Insurance Code. When the conditions specified in Section 1011 exist, the Insurance Commissioner is empowered to commence a court proceeding, to take possession of all of the property of the corporation, and to apply for an order, which the court "shall make," dissolving the corporation. Ins. Code §§ 1011, 1017. Under subdivision (b), when such proceedings have been commenced, the Insurance Commissioner's consent must be obtained before the nonprofit corporation may undertake voluntary or involuntary dissolution proceedings.