

## Memorandum 76-40

Subject: Study 77.100 - Nonprofit Corporations (Sales of Assets)

Attached to this memorandum is a staff draft of Chapter 10 (Sales of Assets) of the new Nonprofit Corporation Law. This chapter is adapted from the corresponding chapter (Chapter 10) of the new General Corporation Law.

The policy questions presented by any consideration of a sale or disposition of all or substantially all of the corporate assets fall into two main categories: (1) when and to whom notice of the proposed transaction should be given and (2) when and how shareholder approval should be required. The subject is closely related to merger and consolidation "because these transactions have important elements in common." H. Ballantine & G. Starling, California Corporation Law § 312, at 552 (4th ed. 1973).

Basic Scheme of Chapter 10 of General Corporation Law

Chapter 10 of the new General Corporation Law (Corp. Code §§ 1000-1002) basically provides that any sale, lease, conveyance, exchange, transfer, or other disposition of "all or substantially all" of the corporation's property must be approved by the board and, unless the transaction is in the usual and regular course of business, by a majority of the outstanding shares entitled to vote. Corp. Code § 1001(a). No shareholder approval is necessary, unless the articles so require, for a mortgage or other pledge of corporate property for the purpose of securing payment or performance of any contract or obligation. Corp. Code § 1000. A certificate of the secretary or assistant secretary of the corporation setting forth the facts indicating compliance with the statutory requirements "is prima facie evidence" of the existence of such facts and is "conclusive evidence in favor of any innocent purchaser or encumbrancer for value." Corp. Code § 1002. If shareholder approval is to be obtained at a meeting, notice of the meeting must be given and, in the case of a special meeting, notice of "the general nature of the business to be transacted" must be given. Corp. Code § 601. If approval is obtained by written consent which is "less than unanimous," prompt notice after the fact must be given to nonconsenting shareholders who have not been solicited in writing. Corp. Code § 603(b).

### Changes Made to Old General Corporation Law

Chapter 10 of the new General Corporation Law was derived from old Sections 3900-3904. The provision that no shareholder approval is necessary when the sale is "in the usual and regular course" of business is new to the statute but is a codification of a judicially-developed exception. See Jeppi v. Brockman Holding Co., 34 Cal.2d 11, 206 P.2d 847 (1949), 9 A.L.R.2d 1297 (1950). This codification was recommended by the Law Revision Commission in 1959. See 2 Cal. L. Revision Comm'n Reports at G-7 (1959). This permits corporations whose very purpose is to sell its assets (e.g., a corporation organized to buy and sell real property) to conduct such sales in the discretion of management (id. at G-6) and allows other sales in the usual and regular course of business, such as a sale of major assets in connection with modernization of capital assets, Report of the Assembly Select Committee on the Revision of the Corporations Code 91 (1975).

Also new is a provision allowing the board to abandon the proposed transaction without further approval by the shareholders (subject to contract rights of third parties). See id. See also Corp. Code § 1105 (board may abandon a merger without further approval by the shareholders).

Expressly excluded from Chapter 10 are reorganizations under Chapter 12. See Corp. Code § 1001(a). Under Chapter 12, however, board and shareholder approval of a reorganization are usually required. See Corp. Code § 1201.

Chapter 10 makes two changes in the requirement of notice to shareholders. First, under prior law, if the transaction was to be considered at an annual or special meeting, notice had to be given of "the general nature of the business" to be transacted. Corp. Code §§ 2201 (annual meeting), 2207 (special meeting). Under the new law, written notice of any annual or special meeting must be given whenever any shareholder action may be taken, but notice of "the general nature of the business to be transacted" need be given only for a special meeting. See Corp. Code § 601. The absence of such a requirement for an annual meeting is a change from prior law.

Second, under prior law, where approval was by written consent, no notice to nonconsenting shareholders was required. 2 Cal. L. Revision Comm'n Reports at G-14 (1959). Such notice had been required prior to

1933 but, in 1933, was deleted by the Legislature. Id. The Law Revision Commission studied the matter and, in 1959, recommended that this notice requirement not be restored. Id. at G-5. The Commission observed that:

[t]he self-interest of the majority and their fiduciary duty to the minority provide reasonably adequate protection for the interests of the latter. Moreover, a requirement that all shareholders be given formal notice might in some cases seriously handicap a corporation in effecting such a transaction because of the delay or publicity involved.

Although prior notice is not required under the new law where approval is by written consent, prompt notice after the fact must now be given to nonconsenting shareholders unless the consent of all shareholders has been solicited in writing. Corp. Code § 603. Section 603, therefore, does what the Commission recommended against and, in effect, restores pre-1933 law.

#### Discussion of Individual Sections in Staff Draft

##### § 6000. Hypothecation of assets to secure corporate obligation

Section 6000, the same in substance as Section 1000 of the General Corporation Law, allows the board of directors to authorize a "mortgage, deed of trust, pledge or other hypothecation" of all or part of the corporate assets as security for any obligation without approval of the members unless the articles require such approval. The policy underlying this section is discussed in H. Ballantine & G. Sterling, California Corporation Laws § 311, at 552 (4th ed. 1975)[hereinafter cited as Ballantine], as follows:

There was some discussion by the Corporation Committee prior to 1931 as to whether a mortgage or deed of trust of all or substantially all of the assets of a corporation should require the vote or consent of the shareholders. It was felt that the incurring of indebtedness, whether secured or unsecured, is properly the responsibility of the management rather than the shareholders, and therefore it is provided that no vote or consent of shareholders is necessary to authorize a mortgage or deed of trust to secure bonds or other obligations, unless the articles otherwise provide.

##### § 6001. Sale or transfer of all or substantially all of assets; approval of members

Section 6001 is the same in substance as subdivision (a) of Section 1001. The requirement of shareholder or member approval of a sale of

all the assets may not be dispensed with in the articles although approval by an extraordinary majority may be required. See Corp. Code § 204(a)(5); Ballantine, supra § 312, at 554. When the transaction lacks the requisite authorization, its validity may be attacked by shareholders or members of the selling corporation; the cases are in conflict, however, as to whether its validity may be attacked by creditors. Ballantine, supra § 312, at 555-556.

The sale of assets procedure is frequently used in lieu of consolidation to avoid the need to obtain consent of the shareholders of the acquiring corporation. Ballantine, supra § 312, at 552 n.5. If the corporation is in the process of winding up and dissolution, the statutory provisions for winding up and dissolution apply instead of Chapter 10, and the board may sell or dispose of all the assets without specific approval of the shareholders or members. See In re Mayellen Apartments, Inc., 134 Cal. App.2d 298, 307, 285 P.2d 943, \_\_\_ (1955); Corp. Code § 2001(g) (in winding up, board may dispose of all assets without complying with Chapter 10).

#### § 6002. Abandonment of proposed transaction

Section 6002 is the same in substance as Section 1001(b) which was added to the new General Corporation Law to "provide flexibility." Report of the Assembly Select Committee on the Revision of the Corporations Code 91 (1975). A similar provision allows abandonment of a merger without further shareholder action. See Corp. Code § 1105.

#### § 6003. Terms and conditions of, and consideration for, the transaction

The first sentence of Section 6003 is the same in substance as the first sentence of Section 1001(c). The second sentence of Section 6003 is similar to the second sentence of Section 1001(c) except that express authorization is added to allow memberships of the purchasing corporation or other nonprofit corporation to serve as consideration for the transaction.

Under the General Corporation Law, if the acquiring corporation gives its equity securities as all or part of the consideration for all or substantially all of the assets of the selling corporation, the transaction is a "sale-of-assets reorganization" (Corp. Code § 181(c)),

and the additional approval of the shareholders of the acquiring corporation is required (Corp. Code - 1201).

§ 6004. Certificate of resolution and approval; effect as evidence

Section 6004 is the same in substance as Section 1002.

Respectfully submitted,

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## CHAPTER 10. SALES OF ASSETS

§ 6000. Hypothecation of assets to secure corporate obligation

6000. (a) The board may approve any mortgage, deed of trust, pledge or other hypothecation of all or any part of the corporation's property, real or personal, for the purpose of securing the payment or performance of any contract or obligation.

(b) Unless the articles otherwise provide, no approval of the members shall be necessary for such action.

Comment. Section 6000 is the same in substance as Section 1000 (General Corporation Law).

Note. The language "approval of the members" as used in subdivision (b) should be reexamined after sections comparable to Sections 152 and 153 have been drafted.

§ 6001. Sale or transfer of all or substantially all of assets; approval of members

6001. (a) A nonprofit corporation may sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of its property and assets when the principal terms are approved by the board and, unless the transaction is in the usual and regular course of its activities, approved by members holding a majority of the voting power, either before or after approval by the board and before or after the transaction.

(b) A transaction constituting a reorganization is subject to the provisions of Chapter 12 and not this section.

Comment. Section 6001 is the same in substance as subdivision (a) of Section 1001 (General Corporation Law). The term "activities" is used in lieu of the term "business" of Section 1001 as being more appropriate to a nonprofit corporation. The phrase "approved by members holding a majority of the voting power" is used in lieu of the phrase "approved by the outstanding shares" of Section 1001.

999/551

§ 6002

§ 6002. Abandonment of proposed transaction

6002. Notwithstanding approval by the members holding a majority of the voting power, the board may abandon the proposed transaction without further action by the members, subject to the contractual rights, if any, of third parties.

Comment. Section 6002 is the same in substance as subdivision (b) of Section 1001 (General Corporation Law).

968/991

§ 6003

§ 6003. Terms and conditions of, and consideration for, the transaction

6003. The sale, lease, conveyance, exchange, transfer, or other disposition authorized by Section 6001 may be made upon such terms and

conditions and for such consideration as the board may deem in the best interests of the nonprofit corporation. The consideration may be money, property, securities, or memberships of any other business or nonprofit corporation, domestic or foreign, or any of them.

Comment. Section 6003 is the same in substance as subdivision (c) of Section 1001 (General Corporation Law) except that express authorization is given in Section 6003 for memberships in another nonprofit corporation to suffice as consideration for the transaction.

Note. The second sentence of Section 6003 should be reexamined when provisions have been drafted for "sale-of-assets" reorganizations. See Corp. Code §§ 181(c), 1200(c).

968/992

§ 6004

§ 6004. Certificate of resolution and approval; effect as evidence

6004. (a) Any deed or instrument conveying or otherwise transferring any assets of a nonprofit corporation may have annexed to it the certificate of the secretary or an assistant secretary of the nonprofit corporation, setting forth that the transaction has been validly approved by the board and stating either of the following:

(1) That the property described in said deed or instrument is less than substantially all of the assets of the nonprofit corporation or that the transfer is in the usual and regular course of the activities of the nonprofit corporation, if such be the case.

(2) If such property constitutes all or substantially all of the assets of the nonprofit corporation and the transfer is not in the usual

... of the corporation, the  
... has been approved by the members holding a majority of the  
... pursuant to Section 6001 or Chapter 12, as the case may be,  
... that such approval is not required by Chapter 12.

(b) Such certificate is prima facie evidence of the existence of  
the facts authorizing such conveyance or other transfer of the assets  
and is conclusive evidence thereof in favor of any innocent purchaser or  
encumbrancer for value.

Comment. Section 6004 is the same in substance as Section 1002  
(General Corporation Law).