

Memorandum 76-47

Subject: Study 77.30 - Nonprofit Corporations (Directors and Management)

Attached to this memorandum is the staff draft of the chapter dealing with the board of directors, committees of the board, corporate officers, and related matters. Selected provisions of the staff draft, which generally follows the new business corporation law, are discussed below.

§ 5310. Control of corporate affairs by board

Existing Section 9500 of the nonprofit corporation law provides that the affairs of a nonprofit corporation are "conducted" by the board of directors. Section 5310 makes clear that the management of corporate affairs and the exercise of corporate powers may be under the direction of the board. Any ambiguity as to the ability of the board to delegate the day-to-day operations of the corporation is thus eliminated.

This approach is identical with that of the new business corporation law. As the Assembly Select Committee on Revision of the Corporations Code notes, "Active involvement by the board in day-to-day affairs of the corporation does not accord with the realities of contemporary business practices, other than perhaps in a relatively closely held corporation. The role of the board in this context is the formation of major management policies rather than direct involvement in day-to-day management."

§ 5311. Number of directors

The minimum number of directors of a nonprofit corporation is three. This is also the rule for business corporations, except that a business corporation having only one or two shareholders may limit the number of directors to one or two. The Commission discussed the possibility of permitting a small board of directors for the closely-held nonprofit corporation at the June 1974 meeting. The minutes for that meeting note that "after extensive discussion of possibly requiring only one director if the nonprofit corporation has only one member", the Commission determined that the minimum number in all cases should be three. The staff has embodied this decision in Section 5311(d).

The staff notes that the minimum number of directors provision does not apply to corporations sole. The staff will propose an appropriate disposition of the corporation sole provisions after we have completed the basic work on the general nonprofit corporation law.

Existing law permits a nonprofit corporation to have a variable board of directors, with a minimum of not less than five and a maximum not to exceed the minimum by more than three, the precise number to be set by a bylaw. At the June 1974 meeting the Commission determined to liberalize the minimum and maximum limits, deciding on a minimum of three and not providing a maximum. Since that time the new business corporation law has been enacted, providing a minimum of three and a maximum of not more than twice the minimum minus one. In the interest of uniformity, the staff has followed the scheme of the new business corporation law.

§ 5312. Term of directors

Nonprofit corporations, unlike business corporations, may have terms of directors running longer than one year, as well as staggered terms. Uniform terms are unnecessary absent a requirement of cumulative voting. Section 5312 contains a provision new to nonprofit corporation law that absent a specification of terms of office in the articles or bylaws, the term of office is one year.

One feature of Section 5312 that deserves special note is the portion of subdivision (a) that requires a bylaw affecting the term of office of a director to be adopted by the members. This concept was adopted by the Commission at the June 1974 meeting, apparently on the hypothesis that the directors should not be able to perpetuate themselves in office without the consent of the members.

§ 5320. Nomination of directors

At the March 1976 meeting the Commission tentatively determined that the members should have a reasonable means of getting persons nominated for election as director. After giving the matter some thought, and after searching in vain for a model from another jurisdiction, the staff has concluded that it would be futile to attempt to specify what is a reasonable means, given the variety of types and sizes of nonprofit corporation. The staff has drafted Section 5320 to provide

an express statutory statement of the "reasonable means" requirement, and absent such a reasonable provision by the nonprofit corporation, to permit a single director or 50 members or 10 percent of the voting power to nominate candidates. This draft is comparable to one tentatively approved by the Commission at the June 1974 meeting.

§ 5321. Election of directors

Existing law permits the bylaws to provide for the manner of choosing directors. Section 5321 continues this authority with the limitations that, absent a provision in the bylaws, directors are to be elected by the members at the annual meeting.

§ 5325. Removal of directors

This section generally continues existing law, which permits the articles or bylaws to provide for removal of directors, and absent such provision specifies the manner of removal. One significant change is noteworthy, however:

Existing law (Section 811) permits removal of a director by court order in cases of fraud and gross abuse of discretion on application of 10 percent of the members. The new business corporation law liberalizes this to permit court action on application of 10 percent of any class of members. The staff draft conforms to the new business corporation law.

§ 5326. Filling vacancies

Subdivision (b) of Section 5326, providing that a vacancy caused by the removal of a director is to be filled by the members rather than the board, is new to nonprofit corporation law. It is based on a comparable provision of the new business corporation law, which made the innovation, according to the initial working papers of the State Bar Committee, because:

Recent statutory provisions grant shareholders the right to remove directors without cause on the theory that since the shareholders are the owners of the corporation they should have complete power to control management. This concept is the basis for providing that only the shareholders may fill vacancies resulting from the removal of a director without cause unless otherwise provided in the articles or a by-law adopted by the shareholders.

This is consistent with Section 9502 of the existing nonprofit corporation law, which provides that vacancies on the board are to be filled by

the remaining directors where the vacancies are "caused by death, resignation, or any disability."

§ 5327. Special election of entire board

Section 5327 is based on a new provision found in the business corporation law. It permits a special meeting for election of the entire board of directors where more than half the board is composed of directors not elected by the members. The purpose of this provision, according to the report of the Assembly Select Committee on the Revision of the Corporations Code, is "to enable the shareholders to determine whether vacancies filled by a minority of the authorized number of directors have been filled satisfactorily to a majority of the shareholders."

Evidently the reason for requiring an election of the entire board, rather than just the positions occupied by directors appointed by the board, is to effectuate the cumulative voting provisions. Whether this can be applied to nonprofit corporations, many of which have staggered terms of directors, will depend on the Commission decision with regard to the terms of office.

The staff draft makes application of Section 5327 optional with the nonprofit corporation. This continues the present philosophy that permits the nonprofit corporation to determine the manner of selection and removal of directors. Thus Section 5327 will apply to nonprofit corporations absent a contrary scheme in the bylaws.

§ 5331. Call of meetings

This section continues existing law applicable to nonprofit corporations. It should be noted that the business corporation law has quite a different scheme for calling meetings of directors, which may be done by the chairman of the board, the president, any vice president, the secretary, or any two directors. The reason given for this broad range of persons authorized to call meetings is to "increase the flexibility" of the call procedure, and to "facilitate operation of the board."

§ 5332. Notice of meeting

This provision is the same as the comparable provision of the new business corporation law. The report of the Assembly Select Committee on the Revision of the Corporation Code states that:

The provisions relating to the time within which notice must be given, if required, and the manner of giving notice change prior law by shortening the time period for notice and by permitting telephonic notice. The time periods specified are sufficient to insure adequate prior notice of a board meeting given contemporary methods of communication.

§ 5337. Meeting by conference telephone

This provision is a new one added by the business corporation law. The report of the Assembly Select Committee on Revision of the Corporations Code states:

The physical presence of a board member at a meeting is not required for the conduct of business so long as all participating members can hear one another. For that reason, this subdivision permits board members to participate in a meeting by use of conference telephone or similar communications equipment.

When the Commission first considered the possibility of providing for meetings by conference telephone about two years ago, it noted that a telephonic meeting is somewhere between a regular meeting and written consent to action without a meeting. The Commission was concerned with several policy questions, including whether:

- (1) Board members participating should be identified and given an opportunity to participate in debate.
- (2) The meeting must be recorded or otherwise memorialized.
- (3) The participating directors should know that they are engaging in a meeting of the board.

Since that time the new business corporation law has been enacted, with the only limitation being that the board members be able to hear each other. In light of this precedent, the staff has not addressed the sorts of problems raised by the Commission.

§ 5338. Quorum of directors

Existing law permits nonprofit corporations to set a quorum of directors at greater or less than a majority, without limitation. The business corporation law, on the other hand, provides lower limits for a quorum: not less than 1/3 the authorized number of directors or two, whichever is larger. The staff draft retains the full flexibility of the existing nonprofit corporation law, and imposes no minimum limits on the quorum size.

§ 5339. Acts of the board

Subdivision (b) of this section is a new provision added by the business corporation law. The report of the Assembly Select Committee on Revision of the Corporations Code states:

The second sentence is similar to Cal. § 2212 relating to action taken at shareholders' meetings. A duly called and noticed board meeting at which a quorum is initially present should be able to continue the transaction of business notwithstanding the withdrawal of a sufficient number of directors to break a quorum provided any action taken is approved by at least a majority of the required quorum for such a meeting. This provision is intended to reduce the disrupting of board meetings possible under prior law which allows a quorum to be broken for the purpose of stopping the transaction of business regardless of the fact that board members sufficient to constitute a majority of the quorum remain.

§ 5340 et seq.

The provisions for appointment of a provisional director in cases of deadlock are continued from existing law. Existing law does not apply, however, to corporations organized under the Bank Act, the Public Utilities Act, or the Savings and Loan Association Law. The staff has not yet determined with certainty the extent to which nonprofit corporations may be organized to operate under those statutes. However, even if nonprofit corporations may operate under all of them, the staff has been able to discover no reason to deny to those types of corporations the right to have a provisional director appointed in case of deadlock. For this reason, the staff has omitted any limitations on the application of Article 4.

Under Section 5241, application for appointment of a provisional director requires 50 members or 10 percent of the membership. This changes the 1/3 of the membership requirement of existing law, consistent with a decision made by the Commission at the June 1974 meeting.

Section 5242 is new. It is parallel to a provision that would be added by the business corporation law clean-up bill.

§ 5350 et seq. Committees of the board

Both the existing nonprofit corporation law and the old business corporation law provide rather perfunctory provisions to the effect that the bylaws may provide for committees of the board. The new business corporation law provides a more detailed set of provisions. See Section

311. The report of the Assembly Select Committee on Revision of the Corporations Code states:

In light of the increased use and importance of board committees, this section provides a more extensive treatment of committees by specifying procedures for their creation and defining the proper scope of board responsibilities which may be delegated to committees. Other provisions of the new law govern the operation of board committees. [§§ 307 and 309]

Specific corporate actions are enumerated which may not be delegated to a committee of the board. These limitations are intended to reserve matters of fundamental importance to the existence and operation of the corporation for full board consideration, as well as provide appropriate safeguards concerning the delegation of board authority.

The staff draft of the nonprofit corporation provisions follows the new business corporation law with one major exception. Whereas the new business corporation committee provisions apply to all business corporations automatically, the comparable nonprofit corporation committee provisions will apply to all nonprofit corporations automatically unless the bylaws provide otherwise. This will give the nonprofit corporation the opportunity to preclude action by committees, but absent such preclusion will validate their creation.

§ 5370. Duty of care of directors

The duty of care of directors of nonprofit corporations may vary. There is no specific statutory provision governing nonprofit corporation directors, so Corporations Code Section 820, setting a standard for business corporations ordinarily will apply. Section 820 provides that, "Directors and officers shall exercise their powers in good faith, and with a view to the interests of the corporation." This standard is subject to case law imposition of a stricter standard where charitable assets are involved. The individual trustee of either a charitable trust or a director of a nonprofit charitable corporation is a fiduciary in performing his duties. See Holt v. College of Osteopathic Physicians & Surgeons, 61 Cal.2d 750, 40 Cal. Rptr. 244 (1964); St. James Church v. Superior Court, 135 Cal. App.2d 352, 287 P.2d 387 (1955). See discussion in C.E.B., California Nonprofit Corporations § 7.23 (1969).

The new business corporation law adds to former Section 820 the requirement that in addition to acting in good faith, a director must

perform his duties "with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances." Whether this new language adds to, detracts from, or simply codifies case law under the old standard, the staff has not researched. Moreover, the meaning of the new language is uncertain, and is intended to vary with the circumstances. The report of the Assembly Select Committee on Revision of the Corporations Code gives a fairly careful discussion of this provision, which is attached as Exhibit I (pink).

The main question faced by the Commission is whether to adopt the new business corporation law standard for nonprofit corporations. The staff in Section 5370 has drafted a provision to preserve the fiduciary standard in case of charitable property, but to apply the new business corporation standard to ordinary nonprofit corporations. The New York Not-for-Profit Corporation Law applies a similar standard to nonprofit corporations. To the extent that the members of a nonprofit corporation deserve the same sorts of protection against damage to the corporate assets as the shareholders of a business corporation receive, the two standards should be the same.

The staff notes, however, that an argument can be made for having a lesser standard of care for directors of nonprofit corporations. Mr. Robert Sullivan, in a memorandum sent to the Commission in June 1974, states that higher standards:

would make it more difficult for such corporations to attract public spirited citizens to their governing boards. After all, in most cases, these corporations do not have much money. Sometimes they have permanent staffs which are frequently not subject to the same supervision and control as are the staffs in a profit making corporation. It would be interesting to find out if any case against directors of non-profit corporations has been lost because they were able to hide behind something analagous to the business judgment rule articulated by the California courts in Finley v. Garrett.

§ 5373. Loans to directors and officers

Section 823 of the old business corporation law permits corporations to make loans to officers or directors only on approval of two-thirds of the shareholders. This section is applicable to nonprofit corporations by virtue of Section 9002.

The modern trend of nonprofit corporation law appears to be to prohibit all loans to officers and directors of a nonprofit corporation. See, e.g., N.Y. N-PCL § 716; ALI-ABA Model N-PCA § 27. Mr. Robert Sullivan has addressed this point in a memorandum sent to the Commission about two years ago:

I believe this is entirely too harsh and in some cases serves no purpose. In certain cases, non-profit corporations, such as private foundations, are founded and managed by one person. Aside from tax problems that may be involved, I see no compelling reason why such a person should not be able to borrow from the corporations since he would be able to provide the consent of all members and all directors to the action. Assuming in other cases there may be more than one person involved in the corporation or as members, I see no reason why loans can not be made, assuming some requisite consent of the members and directors is obtained.

The staff believes that the new business corporation law provides a standard that is adequate for nonprofit corporations. The new law, Section 315, precludes loans to officers or directors unless (i) approved by a majority of the members (excluding the interested officer or director), (ii) made pursuant to an employee benefit plan approved by the members, or (iii) made in the form of an advance for travel or other reimbursable expenses. The staff believes that these are reasonable restrictions to impose on nonprofit corporations, which may well have the same need to make loans that business corporations have. In the case of charitable corporations, where the concept of precluding loans is more attractive, the staff believes that adequate protection is provided by the high standard of care imposed on directors and by oversight by the Attorney General.

§§ 5380-5389. Indemnification of corporate agents

The new business corporation law substantially revises the indemnification provisions of the Corporations Code. The scheme of the new law is discussed in the report of the Assembly Select Committee on Revision of the Corporations Code, the relevant portion of which is excerpted as Exhibit II (yellow). The staff draft follows closely the new business corporation law scheme.

§ 5391. Validity of corporate instruments signed by officers

Section 833 of the old business corporation law, which applies to nonprofit corporations, provides that affixation of a corporate seal to

an instrument is prima facie evidence that the execution of the instrument was within the authority of the corporate officer signing it. The new business corporation law replaces this provision with Section 313, which provides that any instrument in writing entered into between a corporation and any other person, when executed by the specified officers, is not invalidated as to the corporation by any lack of authority of the signing officers if the other person is without actual knowledge that the signing officers had no authority to execute the other instrument. The purpose of this provision, as stated in the report of the Assembly Select Committee on Revision of the Corporations Code, "is to allow third parties to rely upon the assertive authority of various senior executive officers of the corporation concerning the execution of any instrument on behalf of the corporation."

The staff believes this revision is a good one, and has followed it in Section 5391.

Respectfully submitted,

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EXHIBIT I

[Report of the Assembly Select Committee on the Revision of the Corporations Code, pp. 48-54.]

5. §309. Director's Standard of Care

SOURCE: ABA §35 (proposed revision). The duties of a director are specified in subdivision (a) of §300. The purpose of this section is to establish a standard by which the performance of a director in the exercise of his duties shall be judged. It is intended that a person who performs his duties as a director in accordance with this standard shall have no liability by reason of being or having been a director.

(a) This subdivision provides a standard of care applicable to directors. Comments to the proposed revision of ABA §35 indicate that it is the intent of the draftsmen of this provision, by combining the requirement of good faith within the standard of care, to incorporate "the familiar concept that, these criteria being satisfied, a director should not be liable for an honest mistake of

business judgment."²

The Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association arrived at a number of decisions in formulating the standard of care:

(1) The reference to "ordinarily prudent person" emphasizes long traditions of the common law, in contrast to standards that might call for some undefined degree of expertise, like "ordinarily prudent business man"; the phrase is not intended to establish the preservation of assets as a priority for the corporate director, but, rather, to recognize the need for innovation as an essential of profit orientation and, in short, to focus on the basic director attributes of common sense, practical wisdom and informed judgment.

(2) The phrase "under similar circumstances" is intended both to recognize that the nature and extent of oversight will vary, depending upon such factors as the size, complexity and location of activities carried on by the particular corporation and to limit the critical assessment of a director's performance to the time of action or nonaction and thus prevent the harsher judgments which can invariably be made with the benefit of hindsight...

(3) The phrase "in a like position" simply recognizes that the "care" under consideration is that which would be used by the "ordinarily prudent person" if he were director of the particular corporation.³

While the new law adopted in general the language of ABA §35, in subdivision (a) of Section 309 of the new law the words "including reasonable inquiry" were inserted in the phrase "with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

This change was made because some members of the State Bar Committee desired to make explicit what the majority

2. Committee on Corporate Laws, Changes in the Model Business Corporation Act, 29 Bus. Lawyer 951 (1974).

3. Id. at 954.

of members considered to be implicit in the original language, i.e., that reasonable care under some circumstances could include a duty of inquiry. In other words, a director may not close his eyes to what is going on about him in the conduct of the corporate business and, if he is put on notice by the presence of suspicious circumstances, he may be required to make such "reasonable inquiry" as an ordinarily prudent person in his position would make under similar circumstances. There was no intention of imposing upon any director a duty to make an inquiry regardless of the circumstances, such as the duty imposed by Section 11 of the United States Securities Act of 1933 in connection with a public offering of securities, or to add a separate requirement of inquiry apart from a director's general duty of care.

Also, in subdivision (b) of this same section, the word "reasonably" was deleted in three places where it appeared in the ABA §35 language before the word "believes." The reason for this deletion was the concern expressed by some members of the State Bar Committee that the phrase "reasonably believes" to be competent or reliable would impose upon each director the duty in all cases of making an investigation or inquiry regarding the competence and reliability of the employees and advisers of the company. In lieu of the phrase "reasonably" believes, there was inserted in this subdivision (b) the language towards the

end: "after reasonable inquiry when the need therefor is indicated by the circumstances."

The phrase "including reasonable inquiry" in subdivision (a) was intended to mean precisely the same thing as the language substituted in subdivision (b), i.e., that the duty of inquiry only arises if the circumstances indicate the need therefor.

The standard of care does not include officers.

The Committee on Corporate Laws concluded that:

...it was not appropriate in connection with a revision of Section 35 to deal with those officers who were not also directors of the corporation. Although a non-director officer may have a duty of care similar to that of a director as set forth in Section 35, his ability to rely on factual information, reports or statements may, depending upon the circumstances of the particular case, be more limited than in the case of a director in view of the greater obligation he may have to be familiar with the affairs of the corporation.⁴

Section 300 (also derived from the proposed revision of ABA §35) provides that the business and affairs of the corporations shall be exercised by or under the direction of the board. In formulating a proper standard of care for a director in the performance of his duties, the Committee on Corporate Laws considered the nature of the duties of a director.

It is generally recognized that the board of directors may delegate to appropriate officers of the corporation the authority to exercise those powers not required by law to be exercised by the board itself. While such a delegation will not serve to relieve the board from its responsibilities of oversight, it is

4. Id. at 953.

believed appropriate that the directors not be held personally responsible for actions or omissions of officers, employees or agents of the corporation so long as the directors, complying with the enunciated standard of care, have relied reasonably upon such officers, employees or agents.⁵

(b) Under prior law, a director has the right to rely in limited situations upon certain materials.⁶ This subdivision, due to the number and complexity of the matters considered by directors, enlarges the right of reliance to encompass all matters for which the board is responsible and broadens the range of materials upon which a director may rely. The statutory right of reliance is not intended to be exclusive.

The purpose of these provisions were the subject of comment by the Committee on Corporate Laws. A director will be entitled to rely:

...upon factual information, opinions reports or statements, including financial statements and other financial data, in each case prepared or presented by (a) one or more officers or employees of the corporation whom he reasonably believes to be reliable and competent in the matters presented, (b) counsel, public accountants or other persons as to matters which he reasonably believes to be within such person's professional or expert competence, or (c) a board committee (upon which he does not serve), provided that he reasonably believes confidence therein is merited, so long as in any such case he shall be without knowledge concerning the matter

5. Id. at 952.

6. Cal. B829

in question which would cause such reliance to be unwarranted. Inherent in the good faith standard is the requirement that, in order to be entitled to rely on such reports, statements, opinions and other matters, the director must have read, or been present at the meeting at which is orally presented, the report or statement in question and must not have any pertinent knowledge which would cause him to conclude that he should not rely thereon.

The provision permitting reliance upon a committee of the board is intended to permit reliance upon the work product of a board committee resulting from a more detailed investigation undertaken by that committee and which forms the basis for action by the board.⁸

Additionally, the provisions contemplate reliance upon a committee where only a supervisory responsibility is exercised (e.g. a corporate audit committee with respect to its role of oversight concerning accounting and audit functions).⁹

See the discussion above regarding the changes made in this subdivision from the language in ABA §35 to make crystal clear that no duty of inquiry comparable to that contained in Section 11 of the United States Securities Act of 1933 was intended to be imposed upon directors in judging the competence and reliability of the persons on whom they rely, unless there are circumstances which would cause any reasonable man in a

7. Committee on Corporate Laws, supra at 954.

8. Id. at 955.

9. Id.

like position to make such an inquiry. As Lord Halsbury stated in Dovey v. Cory¹⁰:

"I cannot think that it can be expected of a director that he should be watching either the inferior officers of the bank or verifying the calculations of the auditors himself. The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details of management."

(c) The purpose of this subdivision is to relieve a person from any liability by reason of being or having been a director of a corporation, if that person has exercised his duties in the manner contemplated by this section.

10. [1901] A.C. 477.

EXHIBIT II

[Report of the Assembly Select Committee on the Revision of the Corporations Code, pp. 61-63.]

11. B317. Indemnification of Corporate Agents.

SOURCES: ABA §5; Del. §145; New York §§721 and 726.

Prior law permits a corporate director, officer or employee to be indemnified for his reasonable expenses in any derivative action only where such indemnity is approved by the court after the case is concluded.¹⁴ In a non-derivative action indemnification for expenses is permitted if authorized by the board. In that case, the board must determine that the person seeking indemnification was acting in good faith within what he reasonably believed to be the scope of his employment or authority and for a purpose which he reasonably believed to be in the best interests of the corporation or its shareholders.

The practical effect of these restrictive provisions is to force an official or employee of the corporation who is being sued as such to enter into some settlement of the action regardless of how confident he and the corporation may be that the action is without merit. In the case of a derivative action, this is particularly true due to the large fees and expenses which may be incurred by him in defense of the action since indemnifi-

14. Cal. §830

cation is only available at the conclusion of the action. This may also be true in non-derivative actions since expenses (to the extent an advance of expenses pending determination of the matter is permitted under prior law) may only be paid during the course of the litigation if the board is prepared to make the findings required before all the facts are known.

There is no provision in prior law for disqualifying the directors sued from participating in the decision to reimburse themselves. The extent to which this conflict of interest is governed by Cal. §820 is not entirely clear.

The purpose of the indemnification provisions in the new law is to provide sufficient flexibility to afford reasonable protection for directors and officers while imposing safeguards which adequately protect the shareholders in the granting of indemnification. In general, this section provides that a corporation may advance "expenses" incurred by a corporate "agent" in defending any "proceeding" prior to the final disposition of such proceeding upon the receipt of an undertaking that the agent will reimburse the corporation unless it is ultimately determined that the agent is entitled

to indemnification.¹⁵

Indemnification where permitted by this section may be made upon a determination that indemnification of the agent is proper because the agent has met the specified standard of conduct in the circumstances. Such a determination may be made in either a derivative or non-derivative action by a majority vote of a quorum of the board (consisting of directors who are not parties to such proceeding), by the shareholders (where the shares owned by the person to be indemnified are not entitled to a vote thereon) or by the court.

If a corporate agent has been successful on the merits with respect to any issue, this section expressly provides that he shall be indemnified against expenses actually and reasonably incurred by him.

15. "Expenses", "agent" and "proceeding" are defined terms for the purposes of this section. "Expenses" includes attorneys' fees and any expenses of establishing a right to indemnification pursuant to this section where the agent has been successful on the merits in defense of any proceeding or where the indemnification is authorized by the court. "Agent" includes any person who is or was a director, officer, employee or other agent of the corporation, or serving at the request of the corporation in such capacity for another corporation or other enterprise or was serving in such capacity for a corporation which was a predecessor corporation of the corporation or other enterprise at the request of such predecessor corporation. "Proceeding" includes any threatened, pending or completed action or proceeding, whether civil, criminal, administrative or investigative.

Rough Outline

GENERAL NONPROFIT CORPORATION LAW

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APPENDIX

Part 1 of Division 2 of the Corporations Code (repealed)
General Nonprofit Corporation Law (§§ 9000-9802)

§ 5155. Board

5155. "Board" means the board of directors of the nonprofit corporation.

Comment. Section 5155 is the same in substance as Section 155 (General Corporation Law).

§ 5164. Directors

5164. "Directors" includes the following persons and their successors:

(a) Persons named in the articles to act in the capacity of initial directors.

(b) Persons designated, elected, or appointed by any other name or title to act as directors.

Comment. Section 5164 is the same in substance as Section 164 (General Corporation Law). It continues former Section 110 which was applicable to nonprofit corporations through former Section 9002.

§ 5189. Subsidiary

5189. "Subsidiary" of a nonprofit corporation means a business or nonprofit corporation, of which the nonprofit corporation owns directly or indirectly through one or more subsidiaries, shares or memberships entitled to cast more than 50 percent of the votes for directors.

Comment. Section 5189 is comparable to Section 189(a). The term defined in this section is used in the following provisions:

§ 5372 (loans to officers and directors)

§ 5386 (indemnification of directors or officers)

§ 5265. Bylaws relating to directors

5265. Subject to this division, the bylaws may make provisions for:

(a) The number, time, and manner of choosing and removal from office, qualifications, terms of office, official designations, powers, duties, and compensation of the directors and other officers.

(b) The appointment and authority of executive or other committees of the board.

Comment. Section 5265 continues former Section 9302 and subdivisions (c) and (d) of former Section 9401. The bylaws may make provisions relating to directors and officers subject to the articles and to the provisions of this division. See Section ____.

For provisions relating to the number of directors, see Section 5311.

For provisions relating to time and manner of choosing and removal from office, see Sections 5320-5324.

For provisions relating to terms of office, see Section 5312.

For provisions relating to official designations, see Section 5164.

For provisions relating to the appointment and authority of executive or other committees of the board, see Sections 5350-5355.

CHAPTER 3. DIRECTORS AND MANAGEMENT

Article 1. General Provisions Relating to Directors§ 5310. Control of corporate affairs by board

5310. (a) Subject to the provisions of this division and any limitations in the bylaws relating to action required to be approved by the members, the activities and affairs of the nonprofit corporation and all corporate powers shall be exercised by or under the direction of the board.

(b) The board may delegate the management of the day-to-day operation of the activities of the nonprofit corporation to a management company or other person provided that the activities and affairs of the nonprofit corporation shall be managed and all corporate powers shall be exercised under the ultimate direction of the board.

Comment. Section 5310 is the same in substance as Section 300(a) (General Corporation Law). It continues the portion of former Section 9500 that provided that the board of directors exercises the powers, controls the property, and conducts the affairs of a nonprofit corporation.

§ 5311. Number of directors

5311. (a) The bylaws shall set forth the number of directors of the nonprofit corporation.

(b) The bylaws may provide that the number of directors shall be

not less than a stated minimum nor more than a stated maximum (which in no case shall be greater than two times the stated minimum minus one), with the exact number of directors to be fixed, within the limits specified, by the board or the members in the manner provided in the bylaws.

(c) Subject to subdivision (b), a bylaw relating to the number of directors may be adopted, amended, or repealed only by the members.

(d) Notwithstanding any other provision of this section, the number or minimum number of directors shall be not less than three.

Comment. Section 5311 is comparable to Section 212(a) (General Corporation Law). See also Section 5265 (bylaws).

Subdivision (a) continues portions of former Sections 9302 and 9401(c) that permitted the bylaws to specify the number of directors of a nonprofit corporation and supersedes the portion of former Section 9300(e) that provided for the number of directors to be specified in the articles. The number of directors may be specified in the articles (Section 5251), in which case it may only be changed by an amendment of the articles.

Subdivision (b) supersedes the portion of former Section 9300(e) that permitted a nonprofit corporation to specify a variable number of directors. Subdivision (b) broadens the permissible limits of variation and liberalizes the specification procedure in the same manner as Section 212(a) (General Corporation Law).

Subdivision (c) continues portions of former Sections 9300(e) and 9400(c) which provided for adoption by the members of bylaws relating to the number of directors. Before any members have been admitted, or where a nonprofit corporation has no members, the directors may take any action required of members. Section 5402 (directors as members).

Subdivision (d) continues portions of former Sections 9300(e) and 9500 that provided for a minimum of three directors of a nonprofit corporation.

§ 5312. Term of directors

5312. Unless the articles or a bylaw adopted by the members provide otherwise:

(a) The term of office of directors is one year.

(b) Each director, including a director elected to fill a vacancy, holds office until the expiration of the term for which elected and until a successor has been elected and qualified.

(c) A reduction of the authorized number of directors does not remove a director from office prior to the expiration of the term for which elected.

Comment. The introductory portion of Section 5312 continues portions of former Sections 9302 and 9401(c) which permitted the articles or bylaws to regulate the terms of directors. See Section 5265. See also 56 Ops. Atty. Gen. 317 (1973).

Subdivision (a) is comparable to Section 301(a) (General Corporation Law).

Subdivision (b) is the same as Section 301(b) (General Corporation Law).

Subdivision (c) is the same in substance as Section 303(b) (General Corporation Law). It continues a portion of former Section 809 which was applicable to nonprofit corporations through former Section 9002.

§ 5313. Initial directors

5313. (a) Persons named in the articles to act in the capacity of initial directors are subject to all laws of this state relating to directors.

(b) Notwithstanding subdivision (a):

(1) The manner of selection of initial directors is by naming persons in the articles.

(2) The number of initial directors is the number of persons named in the articles.

(3) The term of office of initial directors is until the selection of their successors.

Comment. Section 5313 continues portions of former Section 9300(e). The initial directors perform all the duties of directors until the election of their successors, including whatever actions are necessary and proper to perfect the organization of the nonprofit corporation, such as adoption and amendment of bylaws and election of directors and officers. Contrast Section 210 (General Corporation Law) which vests this authority in the incorporators absent the naming of first directors.

§ 5314. Personal liability of directors

5314. A director of a nonprofit corporation is not personally liable for the debts, liabilities, or obligations of the nonprofit corporation.

Comment. Section 5314 continues former Section 9504.

Article 2. Selection and Removal of Directors

§ 5320. Nomination of directors

5320. (a) The provisions of the section apply unless the bylaws provide a reasonable means of nominating persons for election as director of a nonprofit corporation.

(b) A person may be nominated for election as director by any of the following:

(1) A director.

(2) Members holding 10 percent of the votes entitled to be cast for directors.

(3) Fifty members entitled to vote for directors.

(c) Nomination shall be by written petition delivered to the nonprofit corporation not less than 10 days prior to an election of directors.

Comment. Section 5320 is new.

§ 5321. Election of directors

5321. Except as otherwise provided in this division or in the bylaws, directors of a nonprofit corporation shall be elected by the members at a meeting of the members.

Comment. Section 5321 supersedes portions of former Sections 9302 and 9401(a), which permitted the bylaws to specify the time and manner

of choosing directors. It is comparable to Section 301(a) (General Corporation Law), which provides for election of directors at the annual meeting of members. See also Sections 5611 (annual meeting of members of nonprofit corporation for election of directors) and 5265 (bylaws relating to directors).

Under this section, the bylaws may specify a procedure for selection of directors by classes of members, by persons other than members, or by means other than election at a meeting of members. Compare former Section 10202 (Corporations for Charitable or Eleemosynary Purposes), which permitted the articles to provide for selection of trustees by specified associations or corporations, or by their officers, and by public officials. See also Sections 5610(), 5633 (consents required to elect directors), and 5700 (voting rights and manner of voting).

404/091

§ 5322

§ 5322. Vacancies of directors

5322. (a) A vacancy on the board of a nonprofit corporation exists when the authorized position of a director is not then filled by a duly elected and acting director.

(b) A vacancy may exist regardless whether it is caused by:

(1) The death, resignation, or removal of a director.

(2) A change in the authorized number of directors, whether by the board or the members.

(3) A declaration of vacancy by the board pursuant to Section 5323.

(4) Any other cause.

Comment. Section 5322 is the same in substance as Section 192 (General Corporation Law). It continues portions of former Section 806

that were applicable to nonprofit corporations through former Section 9002. For provisions relating to resignation of directors, see Section 5324. For provisions relating to removal of directors, see Section 5325. For provisions relating to a change in the authorized number of directors, see Sections 5311 and 5312. For provisions relating to a declaration of vacancy by the board, see Section 5323.

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§ 5323. Declaration of vacancy by board

5323. The board may declare vacant the office of a director in either of the following cases:

(a) The director has been declared of unsound mind by an order of court.

(b) The director has been convicted of a felony.

Comment. Section 5323 is the same in substance as Section 302 (General Corporation Law). It continues a portion of former Section 807, which was applicable to nonprofit corporations through former Section 9002.

§ 5324. Resignation of directors

5324. (a) A director of a nonprofit corporation may resign by giving written notice to the board, the chairman of the board, the president, or the secretary.

(b) Unless the notice specifies a later time for the effectiveness of the resignation, the resignation is effective upon giving the notice.

(c) If the resignation is effective at a future time, a successor may be elected to take office when the resignation becomes effective.

Comment. Section 5324 is the same in substance as Section 305(d) (General Corporation Law). It continues portions of former Section 809 which were applicable to nonprofit corporations through former Section 9002.

§ 5325. Removal of directors

5325. Except to the extent the bylaws provide for removal of directors, a director may be removed from office:

(a) Without cause, by vote of members holding a majority of the votes entitled to be cast for directors.

(b) In case of fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the nonprofit corporation, by the superior court of the proper county on petition by 10 percent of the members of any class in an action to which the nonprofit corporation is

made a party. The court may bar from reelection a director so removed for a period prescribed by the court.

Comment. The introductory portion of Section 5325 continues a portion of former Section 9302 (articles or bylaws may provide manner of removal of directors).

Subdivision (a) is comparable to a portion of Section 303(a) (General Corporation Law). It continues a portion of former Section 810 that was applicable to nonprofit corporations through former Section 9002.

Subdivision (b) is the same in substance as Section 304 (General Corporation Law). It continues former Section 811, which was applicable to nonprofit corporations through former Section 9002, except that only 10 percent of the members of a class, as opposed to 10 percent of the whole membership, is required.

404/095

§ 5326

§ 5326. Filling vacancies

5326. (a) Unless otherwise provided in the bylaws, vacancies on the board may be filled by a majority of directors then in office, whether or not less than a quorum, or by a sole remaining director.

(b) Notwithstanding subdivision (a), a vacancy occurring by reason of the removal of a director may be filled only by the members unless the articles or a bylaw adopted by the members provides that the board may fill such a vacancy.

(c) The members may elect a director at any time to fill a vacancy not filled by the directors.

Comment. Subdivision (a) of Section 5326 is the same in substance as the first sentence of Section 305(a)(General Corporation Law). It continues former Section 9502. See Cavin Memorial Corp. v. Regua, 5 Cal. App.3d 345, 85 Cal. Rptr. 107 (1970).

Subdivision (b) is the same in substance as the second sentence of Section 305(a)(General Corporation Law). It is new to nonprofit corporation law.

Subdivision (c) is the same in substance as the first sentence of Section 305(b)(General Corporation Law). It continues a portion of former Section 809, which was applicable to nonprofit corporations through former Section 9002.

404/096

§ 5327

§ 5327. Special election of entire board

5327. (a) Unless the bylaws provide otherwise, if after the filing of a vacancy by the directors of a nonprofit corporation the directors then in office who have been elected by the members constitute less than a majority of the directors then in office, a special election of members to elect the entire board may be called in the manner provided in this section. The term of office of a director not elected by the members at the special election shall terminate upon election of a successor.

(b) Members holding not less than five percent of the votes entitled to be cast for directors may call the special election.

(c) Members holding not less than five percent of the votes entitled to be cast for directors may apply to the court of the proper

county, and the court shall summarily order the special election, upon the following procedure:

(1) The hearing on the application shall be held on not less than 10 business days' notice to the nonprofit corporation.

(2) If the nonprofit corporation intends to oppose the application, it shall file with the court a notice of opposition not later than five business days prior to the date set for the hearing.

(3) The application and any notice of opposition shall be supported by appropriate affidavits, and the court's determination shall be made on the basis of the papers in the record. For good cause shown, the court may receive and consider at the hearing additional evidence, oral or documentary, and additional points and authorities.

(4) The hearing shall take precedence over all other matters not of a similar nature pending on the date set for the hearing.

Comment. Section 5327 is the same in substance as Section 305(c) (General Corporation Law). It is new to nonprofit corporation law.

Subdivision (a) makes clear that this section applies only in the absence of a contrary provision in the bylaws. This continues portions of former Sections 9302 and 9401 giving nonprofit corporations authority to specify the manner of choosing and removing directors from office. The second sentence of subdivision (a) relating to the term of office of a director not elected by the members is an exception to Section 5312 (term of directors).

§ 5328. Appointment of directors by court

5328. If a nonprofit corporation has no members other than the directors and all the directors resign, die, or become incompetent, the superior court of any county may appoint directors of the nonprofit corporation upon application of any party in interest.

Comment. Section 5328 is the same in substance as Section 306 (General Corporation Law). It continues the portion of former Section 809.5 that applied to nonprofit corporations except that (1) application may be made to the superior court of any county rather than the county in which the principal office of the nonprofit corporation is located and (2) application may be made by any party having an interest in the nonprofit corporation rather than a creditor or the personal representative of a deceased director or the guardian or conservator of an incompetent director.

Article 3. Meetings of Directors

§ 5330. Bylaws control

5330. The provisions of this article apply to meetings of the board unless otherwise provided in the bylaws.

Comment. Section 5330 is the same in substance as the introductory portion of Section 307 (General Corporation Law). It continues former Section 9401(a) which permitted the bylaws of a nonprofit corporation to make provisions for the time, place, and manner of calling, giving notice of, and conducting regular and special meetings of directors and to dispense with notice of all regular directors' meetings. It continues former Section 9401(b) which permitted the bylaws of a nonprofit corporation to provide for the requirements of a quorum of directors, which could be greater or less than a majority. See also former Section 9503 (meetings of directors called and held as ordered by directors, subject to the articles or bylaws). For an exception to Section 5330, see Section 5334 (validation of defectively noticed meeting).

§ 5331. Call of meetings

5331. Meetings of the board shall be called and held as may be ordered by the directors.

Comment. Section 5331 is comparable to Section 307(a) (General Corporation Law). It is the same in substance as former Section 9503. It should be noted that Section 5331 is subject to Section 5330 (bylaws control).

§ 5332. Notice of meetings

5332. (a) Regular meetings of the board may be held without notice if the time and place of such meetings are fixed by the bylaws or the board.

(b) Special meetings of the board shall be held upon four days' notice by mail or 48 hours' notice delivered personally or by telephone or telegraph.

(c) Notice of a meeting need not be given to any director who signs a waiver of notice, whether before or after the meeting, or who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice.

(d) A notice or waiver of notice need not specify the purpose of any regular or special meeting of the board.

Comment. Section 5332 is the same in substance as Section 307(b) and (c) (General Corporation Law). Subdivision (a) supersedes the second sentence of former Section 9401(a) (bylaws may dispense with notice of all regular directors' meetings). It should be noted that Section 5332 is subject to Section 5330 (bylaws control).

§ 5333. Adjournment of meetings

5333. (a) A majority of the directors present, whether or not a quorum is present, may adjourn a meeting to another time and place.

(b) If a meeting is adjourned for more than 24 hours, notice of the

adjournment to another time or place shall be given prior to the time of the adjourned meeting to the directors who were not present at the time of adjournment.

Comment. Section 5333 is the same in substance as Section 307(d) (General Corporation Law). It is new to nonprofit corporation law. It should be noted that Section 5333 is subject to Section 5330 (bylaws control).

405/956

§ 5334

§ 5334. Validation of defectively noticed meeting

5334. Notwithstanding any other provision of this article, the transactions of a meeting of the board, however called and noticed or wherever held, are as valid as though had at a meeting duly held after regular call and notice if all of the following conditions are satisfied:

(a) A quorum is present.

(b) Either before or after the meeting, each director not present signs a written waiver of notice, a consent to holding the meeting, or an approval of the minutes of the meeting.

(c) All waivers, consents, and approvals are filed with the corporate records or made a part of the minutes of the meeting.

Comment. Section 5334 is the same in substance as Section 307(e) (General Corporation Law). It continues provisions of former Section 814 which were applicable to nonprofit corporations through former

Section 9002. It should be noted that Section 5334 is not subject to Section 5330 (bylaws control).

Note. The clean-up bill would make this provision of the General Corporation Law not subject to the provisions of the bylaws.

405/957

§ 5335. Written consent to action without a meeting

5335. (a) Any action required or permitted to be taken by the board may be taken without a meeting if all directors individually or collectively consent in writing to the action.

(b) The written consents shall be filed with the minutes of the proceedings of the board.

(c) Action by written consent has the same force and effect as a unanimous vote of the directors.

Comment. Section 5335 is the same in substance as Section 307(f) (General Corporation Law). It continues former Section 9503.1, with the exception of the last sentence which is not continued in order to eliminate needless complexity in the articles or bylaws. It should be noted that Section 5335 is subject to Section 5330 (bylaws control).

Note. The clean-up bill would make this provision of the General Corporation Law not subject to the provisions of the bylaws.

§ 5336. Place of meetings

5336. Meetings of the board may be held at any place within or without the state which has been designated in the notice of the meeting or, if not stated in the notice or there is no notice, designated in the bylaws or by resolution of the board.

Comment. Section 5336 is the same in substance as Section 307(g) (General Corporation Law). It continues the portion of former Section 9401(a), which provided for the bylaws to specify the place of meetings of directors and permitted meetings to be held outside the state. It should be noted that Section 5336 is subject to Section 5330 (bylaws control).

§ 5337. Meeting by conference telephone

5337. (a) Directors may participate in a meeting of the board through use of conference telephone or similar communications equipment so long as all directors participating in the meeting can hear one another.

(b) Participation by a director in a meeting pursuant to this section constitutes presence in person by the director at the meeting.

Comment. Section 5337 is the same in substance as Section 307(h) (General Corporation Law). It is new to nonprofit corporation law. It should be noted that Section 5337 is subject to Section 5330 (bylaws control).

Note. Subdivision (b) would be added to the business corporation law by the clean-up bill. The staff believes that it is essential to implement the section.

§ 5338. Quorum of directors

5338. (a) A majority of the authorized number of directors constitutes a quorum of the board for the transaction of business.

(b) The bylaws may provide that a quorum of directors is greater or less than a majority.

Comment. Subdivision (a) of Section 5338 is the same in substance as the first sentence of Section 307(1) (General Corporation Law). Subdivision (b) continues the portion of former Section 9401(b) that applied to a quorum of directors.

§ 5339. Acts of the board

5339. (a) Except as otherwise provided in this division, every act or decision done or made by a majority of the directors present at a meeting duly held at which a quorum is present is the act of the board.

(b) A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for the meeting.

Comment. Section 5339 is the same in substance as Section 307(j) (General Corporation Law). It continues former Section 817, which was applicable to nonprofit corporations through former Section 9002, with the addition of subdivision (b) which is intended to preclude disruption of meetings by withdrawal of a sufficient number of directors to leave

less than a quorum. It should be noted that Section 5339 is subject to Section 5330 (bylaws control) and to contrary provisions of this division. See, e.g., Sections 5371 (contracts approved without counting vote of interested or common director) and 5384 (indemnification approved by majority vote of a quorum not including director to be indemnified).

Article 4. Provisional Directors

Comment. Article 4, commencing with Section 5340, supersedes former Section 819, which was applicable to nonprofit corporations through former Section 9002. It is comparable to Section 308 (General Corporation Law).

§ 5340. Superior court may appoint provisional directors

5340. The superior court of the proper county may, notwithstanding any provisions of the bylaws, appoint a provisional director pursuant to this article.

Comment. Section 5340 is new.

§ 5341. Deadlock among directors

5341. (a) Appointment of a provisional director may be made if all of the following conditions are satisfied:

- (1) The nonprofit corporation has an even number of directors.
- (2) The directors are equally divided and cannot agree as to the management of the affairs of the nonprofit corporation.

(3) As a result of the inability of the directors to agree, the activities of the nonprofit corporation can no longer be conducted to advantage or there is danger that the property and activities of the nonprofit corporation will be impaired or lost.

(b) Petition for appointment under this section may be made by a director or by 50 members entitled to vote for directors or by members holding not less than 10 percent of the votes entitled to be cast for directors.

(c) This section applies whether or not an action is pending for an involuntary winding up or dissolution of the nonprofit corporation.

Comment. Section 5341 is the same in substance as Section 308(a) (General Corporation Law) except that 50 members or 10 percent may petition for appointment.

405/447

§ 5342

§ 5342. Deadlock among members

5342. (a) Appointment of a provisional director may be made if both of the following conditions are satisfied:

(1) The nonprofit corporation has an uneven number of directors.

(2) The members are deadlocked so that they cannot elect a successor board at an election of directors.

(b) Petition for appointment under this section may be made by members holding not less than 50 percent of the votes entitled to be cast for directors.

(c) The court may order such other equitable relief under this section as it deems appropriate.

Comment. Section 5342 is the same in substance as Section 307(b) (General Corporation Law).

Note. This provision would be added to the business corporation law by the cleanup bill.

405/448

§ 5343

§ 5343. Qualifications of provisional directors

5343. A provisional director shall be an impartial person who is neither a member nor a creditor of the nonprofit corporation nor related by consanguinity or affinity within the third degree according to the common law to any of the other directors of the nonprofit corporation or to any judge of the court by which the provisional director is appointed.

Comment. Section 5343 is the same in substance as the first sentence of Section 307(c) (General Corporation Law).

§ 5344. Rights and powers of provisional directors

5344. A provisional director shall have all the rights and powers of a director until the deadlock in the board or among the members is broken or until removed by order of the court or by members holding a majority of the votes entitled to be cast for directors.

Comment. Section 5344 is the same in substance as the second sentence of Section 307(c)(General Corporation Law).

§ 5345. Compensation of provisional directors

5345. A provisional director is entitled to such compensation as is fixed by the court unless otherwise agreed with the nonprofit corporation.

Comment. Section 5345 is the same in substance as the third sentence of Section 307(c)(General Corporation Law).

Article 5. Committees of the Board

§ 5350. Authority for committees

5350. Unless the bylaws provide otherwise, a nonprofit corporation may have executive or other committees of the board pursuant to this article.

Comment. Section 5350 supersedes former Section 9401(d) which permitted the bylaws to make provisions for the appointment and authority of executive or other committees of the board of directors.

§ 5351. Designation of committees

5351. (a) The board may, by resolution adopted by a majority of the authorized number of directors, designate one or more committees.

(b) A committee shall consist of two or more directors.

Comment. Section 5351 is the same in substance as the first portion of the first sentence of Section 311 (General Corporation Law).

§ 5352. Designation of committee members

5352. (a) The board may designate directors to serve as members of a committee.

(b) A committee member serves at the pleasure of the board.

Comment. Section 5352 is the same in substance as the last portion of the first sentence of Section 311 (General Corporation Law).

§ 5353. Designation of alternate committee members

5353. (a) The board may designate one or more directors as alternate members of a committee.

(b) An alternate committee member may replace an absent committee member at a meeting of the committee.

Comment. Section 5353 is the same in substance as the second sentence of Section 311 (General Corporation Law).

§ 5354. Authority of committees

5354. (a) A committee of the board, to the extent provided in the resolution of the board or in the bylaws, shall have all the authority of the board.

(b) Notwithstanding subdivision (a), a committee of the board shall not have authority to do any of the following acts:

(1) Approve any action for which this division also requires approval of the members.

(2) Fill vacancies on the board or in a committee.

(3) Fix compensation of the directors for serving on the board or on a committee.

(4) Amend or repeal bylaws or adopt new bylaws.

(5) Amend or repeal a resolution of the board which by its express terms is not so amendable or repealable.

(6) Appoint other committees of the board or committee members.

Comment. Section 5354 is the same in substance as Section 311(a)-(g) (General Corporation Law) except that Section 311(f) is not duplicated since a nonprofit corporation cannot make distributions to members. See Section 5236.

§ 5355. Meetings of committees

5355. Article 3 (commencing with Section 5330) applies to meetings of a committee of the board and to action by the committee, *mutatis mutandis*.

Comment. Section 5355 is the same in substance as Section 307(d) (General Corporation Law).

Note. The reference in the Comment to Section 307(d) is to the section as it would be amended by the cleanup bill.

Article 6. Officers§ 5360. Corporate officers

5360. A nonprofit corporation shall have all of the following officers:

(a) A chairman of the board or a president, or both.

(b) A secretary.

(c) A chief financial officer.

(d) Other officers with such titles and duties as (i) are stated in the bylaws, (ii) are determined by the board, or (iii) may be necessary to enable the nonprofit corporation to sign instruments.

Comment. Section 5360 is the same in substance as the first sentence of Section 312(a)(General Corporation Law). It supersedes the first sentence of former Section 821, which was applicable to nonprofit corporations through former Section 9002. See also former Section 9401(c)(bylaws may make provisions for the number, official designations and duties of directors and other officers).

§ 5361. Chief executive officer

5361. Unless otherwise provided in the bylaws, the president, or if there is no president the chairman of the board, is the general manager and chief executive officer of the nonprofit corporation.

Comment. Section 5361 is the same in substance as the second sentence of Section 312(a)(General Corporation Law). It is new to non-profit corporation law.

Note. This provision would be added by the cleanup bill for business corporations. It is necessary in light of the fact that several sections refer to action by "the chief executive officer."

405/837

§ 5362

§ 5362. Selection of officers

5362. Except as otherwise provided by the bylaws or a resolution of the board:

(a) Officers are chosen by the board and serve at the pleasure of the board.

(b) Any number of offices may be held by the same person.

Comment. Subdivision (a) of Section 5362 is the same in substance as the first sentence of Section 312(b)(General Corporation Law). It continues a portion of the first sentence of former Section 821 which was applicable to nonprofit corporations through former Section 9002. See also former Section 9401 (bylaws may make provisions for the manner of choosing and terms of office of directors and other officers).

Subdivision (b) supersedes the third sentence of former Section 821, which was applicable to nonprofit corporations through former Section 9002, and which permitted a person to hold two or more offices except those of president and secretary.

§ 5363. Resignation of officers

5363. (a) An officer may resign at any time upon written notice to the nonprofit corporation.

(b) Resignation of an officer is without prejudice to the rights, if any, of the nonprofit corporation under a contract to which the officer is a party.

Comment. Section 5363 is the same in substance as the second sentence of Section 312(b)(General Corporation Law). It is new to nonprofit corporation law.

Note. Subdivision (b) would be added by the cleanup bill for business corporations; some such provision is obviously necessary.

Article 7. Standards of Conduct by Management

§ 5370. Duty of care of directors

5370. (a) Subject to Section 5560, a director shall perform the duties of a director, including duties as a member of a committee of the board upon which the director serves, in good faith, in a manner the director believes to be in the best interests of the nonprofit corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

(b) In performing the duties of a director, a director shall be entitled to rely on information, opinions, reports, or statements, including financial statements and other financial data, so long as the director acts in good faith, after reasonable inquiry when the need therefor is indicated by the circumstances and without knowledge that would cause such reliance to be unwarranted, where the information, opinion, report, or statement is prepared or presented by any of the following:

(1) One or more officers or employees of the nonprofit corporation whom the director believes to be reliable and competent in the matters presented.

(2) Counsel, independent accountants, or other persons as to matters the director believes to be within the person's professional or expert competence.

(3) A committee of the board upon which the director does not serve, as to matters within its designated authority, which committee the director believes to merit confidence.

(c) A person who performs the duties of a director in accordance with this section shall have no liability based upon an alleged failure to discharge the person's obligations as a director.

Comment. Section 5370 is the same in substance as Section 309 (General Corporation Law). It sets a standard of care for directors of nonprofit corporations generally. This standard is subject to fiduciary obligations in the case of assets held on charitable trust or by a nonprofit corporation organized for charitable purposes. See Section 5560.

405/840

§ 5371

§ 5371. Contracts involving interested directors

5371. (a) This section applies to a contract or other transaction between a nonprofit corporation and (i) a director of the nonprofit corporation or (ii) a business or nonprofit corporation, firm, or association in which a director of the nonprofit corporation has a material financial interest. A mere common directorship does not constitute a material financial interest within the meaning of this subdivision.

(b) No contract or other transaction described in subdivision (a) is either void or voidable because (i) the director or the other business or nonprofit corporation, firm, or association are parties or (ii) the director is present at the meeting of the board or a committee of the board which authorizes, approves, or ratifies the contract or transaction, if any of the following circumstances exist:

(1) The material facts as to the contract or transaction and as to the director's interest are fully disclosed or known to the members and the contract or transaction is approved by the members in good faith, with the interested director not being entitled to vote thereon.

(2) The material facts as to the contract or transaction and as to the director's interest are fully disclosed or known to the board or committee, and the board or committee authorizes, approves, or ratifies the contract or transaction in good faith by a vote sufficient without counting the vote of the interested director, and the contract or transaction is just and reasonable as to the nonprofit corporation at the time it was authorized, approved, or ratified.

(3) The person asserting the validity of the contract or transaction sustains the burden of proving that the contract or transaction was just and reasonable as to the nonprofit corporation at the time it was authorized, approved, or ratified.

(c) An interested director may be counted in determining the presence of a quorum at a meeting of the board or a committee of the board which authorizes, approves, or ratifies a contract or transaction.

(d) A director is not interested within the meaning of this section in a resolution fixing the compensation of another director as a director, officer, or employee of the nonprofit corporation, notwithstanding the fact that the first director is also receiving compensation from the nonprofit corporation.

Comment. Section 5371 is the same in substance as Section 310(a) (General Corporation Law). It supersedes provisions of former Section 820 which were applicable to nonprofit corporations through former Section 9002.

Note. The cleanup bill would add a provision comparable to subdivision (d) for business corporations.

§ 5372. Contracts involving common directors

5372. (a) This section applies to a contract or other transaction between a nonprofit corporation and business or nonprofit corporation or association of which a director of the nonprofit corporation is a director. This section does not apply to a contract or transaction described in Section 5371.

(b) No contract or other transaction described in subdivision (a) is either void or voidable because the director is present at the meeting of the board or a committee of the board which authorizes, approves, or ratifies the contract or transaction, if any of the following circumstances exist:

(1) The material facts as to the contract or transaction and as to the director's other directorship are fully disclosed or known to the board or committee, and the board or committee authorizes, approves, or ratifies the contract or transaction in good faith by a majority vote of a quorum without counting the vote of the common director.

(2) The contract or transaction is approved by the members in good faith.

(3) The contract or transaction is just and reasonable as to the nonprofit corporation at the time it is authorized, approved, or ratified.

(c) A common director may be counted in determining the presence of a quorum at a meeting of the board or a committee of the board which authorizes, approves, or ratifies a contract or transaction.

Comment. Section 5372 is the same in substance as Section 310(b) (General Corporation Law). It supersedes provisions of former Section 820 which were applicable to nonprofit corporations through former Section 9002.

§ 5373. Loans to directors and officers

5373. A nonprofit corporation shall not make a loan of money or property to, or guarantee the obligation of, a director or officer of the nonprofit corporation or of the parent or a subsidiary of the nonprofit corporation unless the provisions of one of the following subdivisions are satisfied:

(a) The loan or guarantee is approved by a majority of the members of all classes (other than the benefited director or officer), regardless of limitations or restrictions on voting rights.

(b) The loan or guarantee is pursuant to an employee benefit plan approved by the members after disclosure of the right to include officers or directors under the plan if the board determines that the loan or guaranty may reasonably be expected to benefit the nonprofit corporation. The loan or guaranty may be with or without interest and may be unsecured or secured in a manner the board approves.

(c) The loan is an advance for expenses reasonably anticipated to be incurred in the performance of the duties of the director or officer, for which the director or officer would be entitled to reimbursement by the nonprofit corporation.

Comment. Section 5373 is comparable to Section 315 (General Corporation Law). It supersedes former Section 823, which was applicable to nonprofit corporations through former Section 9002.

§ 5374. Creditor derivative actions against directors

5374. (a) This section applies to the following corporate actions:

- (1) A distribution to members contrary to Section 5236.
- (2) A distribution of assets contrary to Section 7030.
- (3) A loan or guaranty contrary to Section 5373.

(b) Subject to Section 5370, a director of a nonprofit corporation who approves, or who is present, abstains from voting at a meeting of the board or committee which approves a corporate action described in subdivision (a) is liable to the nonprofit corporation for the benefit of all creditors entitled under subdivision (c) to institute an action. Liability of directors under this subdivision is joint and several.

(c) An action may be brought under this section in the name of the nonprofit corporation by a creditor whose debt or claim is prior to the time of the corporate action described in subdivision (a) and who has not consented to the corporate action, whether or not the creditor's claim is reduced to judgment.

(d) The damages recoverable from a director under this section are the lesser of the following:

- (1) The amount of the illegal distribution or the loss suffered by the nonprofit corporation as a result of the illegal loan or guaranty.
- (2) The liabilities of the nonprofit corporation owed to nonconsenting creditors at the time of the violation.

(e) A director liable under this section is entitled to be subrogated to the rights of the nonprofit corporation against a person who received the illegal distribution, loan, or guaranty.

(f) A director who is a defendant in an action under this section may do all of the following:

- (1) Join other directors.
- (2) Compel contribution, either in the action or in an independent action, against directors not joined in the action.
- (3) Cross-complain or proceed in an independent action against the person who is liable to the director under subdivision (e).

Comment. Section 5374 is the same in substance as Section 316 (General Corporation Law) except that it is limited to actions by creditors. Liability of a director to members in the circumstances covered by this section may be enforced either by a direct action or, in a proper case, by a derivative action subject to Chapter 8 (commencing with Section 5810). Section 5374 supersedes former Sections 823-829, which were applicable to nonprofit corporations through former Section 9002.

Subdivision (a) continues existing law. A director may be liable to persons other than creditors for approval of corporate actions listed in subdivision (a), but Section 5374 provides the exclusive means of action for creditors to enforce the liability of directors. See also Section 7037 (action by creditor in name of nonprofit corporation to enforce recovery of improper distribution to members).

Subdivision (c) removes the limitation of prior law that only judgment creditors might bring an action in the name of the nonprofit corporation. Compare former Section 826.

Article 8. Indemnification of Corporate Agents

Comment. Article 8 (commencing with Section 5380) supersedes former Section 830, which was applicable to nonprofit corporations through former Section 9002. It is comparable to Section 317 (General Corporation Law).

§ 5380. Definitions

5380. For the purposes of this article:

(a) "Agent" means a person who is or was a director, officer, employee, or other agent of any of the following entities:

(1) The nonprofit corporation or a predecessor nonprofit corporation.

(2) Another nonprofit corporation, a business corporation, a partnership, a joint venture, a trust, or other enterprise at the request of the nonprofit corporation or a predecessor nonprofit corporation.

(b) "Proceeding" means a threatened, pending, or completed action or proceeding, whether civil, criminal, administrative, or investigative.

(c) "Expenses" includes without limitation attorney's fees and any expenses of establishing a right to indemnification under Section 5383 or subdivision (c) of Section 5384.

Comment. Section 5380 is the same in substance as Section 317(a) (General Corporation Law).

§ 5381. Indemnification in proceedings other than derivative actions

5381. (a) A nonprofit corporation may indemnify a person who was or is a party or is threatened to be made a party to a proceeding (other than an action by or in the right of the nonprofit corporation) by reason of the fact that the person is or was an agent, against expenses, judgments, fines, settlements, and other amounts actually and reasonably incurred in connection with the proceeding.

(b) Indemnification under subdivision (a) may not be made unless both of the following conditions are satisfied:

(1) The person acted in good faith and in a manner the person reasonably believed to be in the best interests of the nonprofit corporation.

(2) In the case of a criminal proceeding, the person had no reasonable cause to believe the conduct was unlawful.

(c) The termination of a proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent shall not, of itself, create a presumption that the conditions of subdivision (b) are not satisfied.

Comment. Section 5381 is the same in substance as Section 317(b) (General Corporation Law).

§ 5382. Indemnification in derivative actions

5382. (a) A nonprofit corporation may indemnify a person who was or is a party or is threatened to be made a party to a threatened, pending, or completed action by or in the right of the nonprofit corporation to procure a judgment in its favor by reason of the fact that the person is or was an agent, against expenses actually and reasonably incurred by the person in connection with the defense or settlement of the action.

(b) Indemnification under subdivision (a) may not be made unless the person acted in good faith, in a manner the person believed to be in the best interests of the nonprofit corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.

(c) No indemnification may be made under subdivision (a) for any of the following:

(1) Amounts paid in settling or otherwise disposing of a threatened or pending action, with or without court approval.

(2) Expenses incurred in defending a threatened or pending action which is settled or otherwise disposed of without court approval.

(3) Expenses incurred in connection with a claim, issue, or matter as to which the person is adjudged liable to the nonprofit corporation in the performance of the person's duty to the nonprofit corporation except to the extent that the court in which the action was brought determines upon application that, in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for such expenses as the court determines.

Comment. Section 5382 is the same in substance as Section 317(c) (General Corporation Law).

Note. The provisions of this section relating to court approval depend on the content of the derivative action provisions.

968/621

§ 5383

§ 5383. Indemnification where agent prevails on merits

5383. A nonprofit corporation shall indemnify a person who has been successful on the merits in defense of a proceeding described in Section 5381 or 5382, or in defense of a claim, issue, or matter therein, against expenses actually and reasonably incurred by the person in connection therewith.

Comment. Section 5383 is the same in substance as Section 317(d) (General Corporation Law).

406/207

§ 5384

§ 5384. Corporate action required for indemnification

5384. Except as provided in Section 5383, indemnification may be made under this article by the nonprofit corporation only if, upon a determination that the conditions prescribed in Section 5381 or 5382 are satisfied, indemnification is authorized by one of the following:

(a) A majority vote of a quorum consisting of directors who are not parties to the proceeding.

(b) Approval of the members, with the person to be indemnified not being entitled to vote thereon.

(c) Order of the court in which the proceeding is or was pending, upon application made by (1) the nonprofit corporation or (2) the agent, attorney, or other person rendering services in connection with the defense, whether or not opposed by the nonprofit corporation.

Comment. Section 5384 is the same in substance as Section 317(e) (General Corporation Law).

968/622

§ 5385

§ 5385. Authority to advance expenses

5385. (a) Expenses incurred by an agent in defending a proceeding may be advanced by the nonprofit corporation prior to final disposition of the proceeding.

(b) The advance shall be conditioned on receipt of an undertaking by or on behalf of the agent to repay the amount of the advance unless it is determined ultimately that the agent is entitled to be indemnified as authorized in this article.

Comment. Section 5385 is the same in substance as Section 317(f) (General Corporation Law).

§ 5386. Indemnification other than pursuant to this article

5386. (a) No provision made by a nonprofit corporation to indemnify its or its subsidiary's directors or officers for the defense of any proceeding, whether contained in the articles, bylaws, a resolution of members or directors, an agreement, or otherwise, is valid unless consistent with this article.

(b) Nothing contained in this article affects the right to indemnification to which persons other than those described in subdivision (a) may be entitled by contract or otherwise.

Comment. Section 5386 is the same in substance as Section 317(g) (General Corporation Law).

§ 5387. Limitation on indemnification

5387. Except as provided in Section 5383 or subdivision (c) of Section 5384, no indemnification or advance may be made under this article where either of the following appears:

(a) It would be inconsistent with the bylaws, a resolution of the members, or an agreement in effect at the time of accrual of the cause of action asserted in the proceeding, which prohibits or otherwise limits indemnification.

(b) It would be inconsistent with a condition expressly imposed by a court in approving a settlement.

Comment. Section 5387 is the same in substance as Section 317(h) (General Corporation Law).

§ 5388. Insurance for corporate agents

5388. A nonprofit corporation may purchase and maintain insurance on behalf of a person against a liability asserted against or incurred by the person as an agent or arising out of the person's status as an agent, whether or not the nonprofit corporation would have the power under this article to indemnify the person against the liability.

Comment. Section 5388 is the same in substance as Section 317(i) (General Corporation Law).

§ 5389. Application of article to fiduciary of employee benefit plan

5389. (a) Notwithstanding subdivision (a) of Section 5380, this article does not apply to a proceeding against a person in the capacity of a trustee, investment manager, or other fiduciary of an employee benefit plan.

(b) Nothing in this article affects a right to indemnification to which a person described in subdivision (a) may be entitled by contract or otherwise.

Comment. Section 5389 is the same in substance as Section 317(j) (General Corporation Law).

Note. This provision would be added by AB 2849 (cleanup bill).

Article 9. Authentication of Corporate Instruments

§ 5390. Certified copy of corporate action

5390. (a) An officer shall record or cause to be recorded actions taken at meetings of the members, directors, and committees.

(b) The original or a copy, if certified to be a true copy by a person purporting to be the secretary or an assistant secretary of the nonprofit corporation, is prima facie evidence:

(1) As to bylaws, of the adoption of the bylaws.

(2) As to the minutes of a meeting, of the due holding of the meeting and of the matters stated therein.

(3) As to a resolution adopted by the members, board, or a committee, of the adoption of the resolution.

Comment. Subdivision (a) of Section 5390 is the same in substance as the first portion of Section 312(c) (General Corporation Law). The last portion of Section 312(c), relating to the keeping of the record of the corporate action, is not duplicated since it is covered by Sections 6510-6511 (books and records).

Subdivision (b) is the same in substance as Section 314 (General Corporation Law). It continues former Section 832, which was applicable to nonprofit corporations through former Section 9002.

§ 5391. Validity of corporate instruments signed by officers

5391. (a) This section applies when a note, mortgage, evidence of indebtedness, contract, conveyance, or other instrument in writing, or an assignment or endorsement thereof, is signed by both of the following officers:

(1) The chairman of the board, the president, or any vice president.

(2) The secretary, chief financial officer, treasurer, or any assistant secretary or assistant treasurer.

(b) An instrument described in subdivision (a) which is executed or entered into between the nonprofit corporation and any other person is not invalidated as to the nonprofit corporation by any lack of authority of the signing officers unless (subject to subdivision (a) of Section 5231) the other person has actual knowledge that the signing officers had no authority to execute the instrument.

Comment. Section 5391 is the same in substance as Section 313 (General Corporation Law). It is not intended to create an inference that instruments not signed by both the officers described in subdivision (a) are invalid; other validating concepts such as apparent authority and inherent agency may be applicable to preclude a defense against enforcement of a contract or conveyance on grounds of lack of authority. See Section 5231(a). It should be noted that even actual knowledge of lack of authority may not be a defense in certain cases. See Section 5231(a).

APPENDIX

Corporations Code § 9300 (repealed)

Comment. Portions of the first two sentences of subdivision (e) of former Section 9300 are continued in Section 5250 (required contents of articles). The remainder of subdivision (e) is continued in Sections 5311-5313 (directors).

Corporations Code § 9302 (repealed)

Comment. Former Section 9302 is continued in Section 5265.

Corporations Code § 9401 (repealed)

Comment. The portion of the first sentence of subdivision (e) of former Section 9401 that permitted the bylaws to make provisions for meetings of members and directors is continued in Section 5264(a). The portion permitting meetings to be held outside the state is continued in Sections 5610 (members' meetings) and 5336 (directors' meetings). The second sentence of subdivision (a) is continued in Sections 5620 (members' meetings) and 5332 (directors' meetings).

Subdivision (b) is continued in Section 5264(b).

Subdivision (c) is continued in Section 5265(a).

Subdivision (d) is continued in Section 5265(b).

Corporations Code § 9500 (repealed)

Comment. The portion of former Section 9500 vesting control of corporate affairs in the board of directors is continued in Section 5310. The portion specifying a minimum of three directors is continued in Section 5311.

Corporations Code § 9502 (repealed)

Comment. Former Section 9502 is continued in Section 5326(a).

Corporations Code § 9503 (repealed)

Comment. Former Section 9503 is continued in Sections 5330 (articles or bylaws control) and 5331 (call of meetings).

Corporations Code § 9503.1 (repealed)

Comment. Former Section 9503.1 is continued in Section 5335 with the exception of the last sentence, which is not continued in order to eliminate needless complexity in the articles or bylaws.

Corporations Code § 9504 (repealed)

Comment. Former Section 9504 is continued in Section 5314.