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Memorandum 76-101

Subject: Study 77 - Nonprofit Corporations (Curative Provision)

Several commentators have suggested the need for a curative provision to validate corporate acts notwithstanding procedural irregularities, and to permit the corporation to act when a quorum of directors or members cannot be located. This memorandum discusses the extent to which such problems are already dealt with under existing law and in the Commission's proposed Nonprofit Corporation Law, and suggests a solution to unsolved aspects of the problem.

Irregularities in Proceedings of the Board or Members

In many instances, action by the board of directors may be validly taken other than at a formal board meeting. For example, under Section 5339 of the Commission's proposed Nonprofit Corporation Law, board action may be taken without a meeting (subject to the articles or bylaws) if all directors consent in writing. The courts may also apply the rule applicable to a closely held business corporation, upholding decisions reached at informal conferences of all the directors and shareholders when this has been the corporation's customary way of operating. See 1 H. Ballantine & G. Sterling, California Corporation Laws § 52, at 104 (4th ed. 1976).

The cases are not consistent with respect to the question of whether procedurally defective action by the board of directors is void or voidable. See 1 H. Ballantine & G. Sterling, supra, §§ 73, 76. A number of cases hold that action taken at a special meeting of the board without notice to all directors is void. See, e.g., Richman v. Bank of Perris, 102 Cal. App. 71, 80, 282 P. 801, ___ (1929). On the other hand, it has been held that action taken by the board without a quorum is not void, but is merely "voidable at the behest of the corporation or its stockholders." Robertson v. Hartman, 6 Cal.2d 408, 412, 57 P.2d 1310, ___ (1936). But see Olinco v. Merle Norman Cosmetics, Inc., 200 Cal. App.2d 260, 273, 19 Cal. Rptr. 387, ___ (1962). An action which is

voidable is cured if not challenged within the applicable limitation period. See 2 B. Witkin, California Procedure, Actions §§ 352, 361 (2d ed. 1970).

Defective action by the board or members may subsequently be cured with retroactive effect. Under Section 5338, a defectively noticed meeting of the board may be validated by the absent directors, if a quorum was present at the meeting, by waiving notice, consenting to the meeting, or approving the minutes. And board action which would otherwise be invalid for lack of a duly held meeting may subsequently be ratified and made binding by the board by formal or informal action. Meyers v. El Tejon Oil & Refining Co., 29 Cal.2d 184, 186-187, 174 P.2d 1, ___ (1946).

Similarly, under Section 5631 the members may consent (subject to the articles or bylaws) to action that would otherwise be required to be taken at a meeting of members. The members may validate action taken at a defectively called or noticed meeting if a quorum was present. Section 5627.

It thus appears that there are adequate means for validating corporate action taken without compliance with procedural requirements. To go beyond this and validate all such actions (whether previously classed as void or voidable) after lapse of a certain period of time might adversely affect minority interests, would be difficult to apply in many instances (to be validated, corporate act should have some colorable claim of legitimacy), and would not appear to be sound as a matter of policy.¹

1. The staff has reviewed the nonprofit corporation laws of a number of other jurisdictions, and has found no provisions dealing with the problem of procedurally defective board or member action, or the problem of inability to obtain a quorum of directors or members. New York law contains a provision, however, validating volunteer memberships in certain fire corporations. See N.Y. Not-for-Profit Corp. Law § 1402(h) (McKinney 1970). And both Pennsylvania and Delaware have provisions validating corporate acts defective for failure properly to record a certificate or document required to be recorded. See Pa. Stat. Ann. tit. 15, §§ 109-110 (Purdon 1972); Del. Corp. Law Ann. § 392 (1969).

Inability to Take Board or Member Action

The second aspect of the problem raised by the commentators concerns the situation where the corporation is unable to locate sufficient directors or members to take corporate action, with resulting corporate paralysis.

Vacancies on the board of directors should pose no problem. Subject to the bylaws, vacancies may be filled by a majority of directors then in office, whether or not less than a quorum, or by a sole remaining director. Section 5326. If there are no voting members and all directors resign, die, or become incompetent, the superior court may appoint directors to fill the vacancies. Section 5327.

There is a potential problem where there are incumbent directors, but either their identities are unknown or they cannot be located. See, e.g., Wood Estate Co. v. Chanslor, 209 Cal. 241, 246-247, 286 P. 1001, ____ (1930) (whereabouts of director unknown). However, since a director's term is one year² absent a contrary provision in the articles or bylaws (Section 5312), and since members holding a majority of the voting power can remove a director without cause (Section 5325), the problem would appear to be a real one only where the articles or bylaws provide for directors' terms of long duration and it is impossible to obtain the vote necessary for removal.

The most serious problem appears to be where the corporation cannot locate enough members for a quorum for a meeting of members or for the vote necessary to effect organic changes in the corporation. See, e.g., Sections 5920 (amendment of articles), 6011 (sale of all assets), 6121 (merger or consolidation), 6220 (division), 6720 (voluntary dissolution). Under Section 5612, if a nonprofit corporation has failed to hold an annual meeting for a certain period of time, the court may order such a meeting on application of 50 members or 10 percent of the membership, whichever is smaller, and those who attend the meeting are deemed to

2. Although a director whose term has expired continues to serve until a successor has been elected and takes office (Section 5312), a successor director may, unless the articles or bylaws provide otherwise, be elected by a majority of the votes represented at a meeting of members (Sections 5321, 5713).

constitute a quorum. Under Section 5612, the court is empowered to "issue such orders as may be appropriate," which arguably may include authority to reduce the extraordinary vote requirement for organic changes. However, Section 5612 will not be helpful if the articles or bylaws provide that no annual meeting is required (see Section 5611) or if the corporation is unable to determine who its members are.

Under Section 5625, if a nonprofit corporation fails to call a special meeting after a request to do so by a person entitled to call a special meeting (see Section 5613), the court may order it to be held. Unlike Section 5612, there is no express provision in Section 5625 that those who attend such a meeting shall constitute a quorum. The court does have authority under Section 5625, however, to "issue such orders as may be appropriate," which arguably may include the authority to provide for a smaller quorum requirement and to reduce the vote required for organic changes.

Professor Hone has suggested a section authorizing the court to order a meeting of members or directors, or to authorize a "mail ballot or other form of obtaining the consent of members or directors," on application of "a director, a member, or the Attorney General." The application could be made "[i]f for any reason it is impractical or impossible for any nonstock corporation to call or conduct a meeting of its members or directors, or otherwise obtain their consent" The court would have express authority to "dispense with the quorum requirements . . . and with any other requirements that would otherwise be imposed by the articles, bylaws, or this division" See attachment (green) to Memorandum 76-102, at 21.

The staff is of the view that this provision goes too far, and that the problems discussed above may adequately be dealt with by a provision allowing the court to determine who the known members of the nonprofit corporation are, and to provide that such members will constitute the membership of the nonprofit corporation for the purpose of determining a quorum and the vote required for organic changes. This could be accomplished by the following provision:

§ 5455. Identities or whereabouts of members unknown

5455. (a) The court may make the determination authorized by this section if the court determines that action which requires

approval of the members should be taken in the interest of the nonprofit corporation or in the public interest, and such action cannot be taken because the identities or whereabouts of one or more members are unknown.

(b) Upon application by a director, a member, or the Attorney General, after notice to the nonprofit corporation giving it an opportunity to be heard and such other notice as the court determines is appropriate under the circumstances, the superior court of the proper county may determine the number of voting members of the nonprofit corporation whose identities and whereabouts are known. Such determination shall be solely for the purpose of computing the following:

(1) The number of members required to constitute a quorum at a meeting of members.

(2) The minimum number of votes or consents required for action by the members.

(3) The number of persons who may commence an action for involuntary dissolution pursuant to paragraph (2) of subdivision (a) of Section 6710.

(c) Nothing in this section shall otherwise affect the rights of any member, whether or not such member's identity or whereabouts is known, including the right to receive notice of the meeting as provided in Section 5623, to attend any meeting of members, to vote, or to share in the assets of the nonprofit corporation on dissolution. If persons in addition to the known members included in the determination made pursuant to subdivision (b) appear at the meeting and establish their membership to the satisfaction of the nonprofit corporation, such persons shall be added to the number of voting members for the purpose of determining the number of votes required for action by the members.

(d) The court may retain jurisdiction to resolve any disputes concerning who may be entitled to vote at a meeting of members.

Comment. Section 5455 is new, and is intended to enable the nonprofit corporation to take action which requires approval of the members but where it cannot locate enough members to obtain a quorum or the required vote. See Sections 5614 (quorum), 5920 (amendment of articles), 6011 (sale of all assets), 6121 (merger or consolidation), 6220 (division), 6720 (voluntary dissolution). Section 5455 is permissive; it need not be used where the nonprofit corporation is able to take action requiring approval of the members even though the identities or whereabouts of some members may be unknown. See, e.g., Section 5623 (notice of members' meeting where one or more members cannot be located).

If under subdivision (b) the court finds that there are ten known voting members of the nonprofit corporation having one vote each, five of such members may approve a voluntary dissolution of the corporation (see Section 6720) unless additional persons appear

at a meeting and establish their membership. If, for example, four additional members having one vote each appear at a meeting to approve a voluntary dissolution, then seven affirmative votes would be required to approve such action.

Additional alternatives which the Commission may consider include:

1. Authorizing the court to replace a director whose identity or whereabouts is unknown.
2. Authorizing the court to reduce the quorum requirements and the vote required for organic changes when the corporation is unable to act.
3. Authorizing the court to compel the directors to meet or to order a meeting of members with concomitant changes in quorum or voting requirements.

These alternatives take control away from the members and place it in the hands of the court to a greater degree than under proposed Section 5455 above. The proposed section would appear to address the main problem while preserving member control over corporate affairs.

Respectfully submitted,

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