

Memorandum 76-66

Subject: Study 77.255 - Nonprofit Corporations (Conversion)

Attached to this memorandum is a draft of a procedure for converting nonprofit into business corporations and business into nonprofit corporations, which has been drafted in response to the Commission's decision at the May meeting. A copy of the Pennsylvania conversion statute is attached as an exhibit.

The draft is based on the Pennsylvania conversion provisions. Some procedural matters follow the pattern of Chapter 11 (Merger and Consolidation). The conversion provisions have been placed in Division 4 (Provisions Applicable to Corporations Generally) since they apply to both nonprofit and business corporations.

Several additional questions are considered under the discussion of particular sections:

§ 14800. Conversion authorized

Section 14800 makes clear that only nonprofit corporations that are neither organized for charitable purposes nor hold assets on charitable trust may be converted into business corporations. This differs from the Pennsylvania approach; Section 7956(b) (see Exhibit I) provides that after conversion the business corporation is entitled to all assets it had as a nonprofit corporation except that property committed to charitable purposes may not be diverted. It should also be remembered that fundamental changes under Pennsylvania nonprofit corporation law are supervised by a court. The discussion at the May meeting indicated that the Commission was not inclined to recommend a statute permitting the conversion of nonprofit corporations organized for charitable purposes or holding assets on charitable trust even if notice to the Attorney General was required. The draft of Section 14800 reflects this view.

It should be noted that a nonprofit corporation holding assets on charitable trust could follow the procedures of Chapter 12 in order to divide into a nonprofit corporation holding assets on charitable trust and a nonprofit corporation not holding such assets. Then the conversion procedures of this chapter (Chapter 3 of Division 4) could be utilized to convert the new nonprofit corporation resulting from the

division into a business corporation. If the division and conversion provisions are acceptable, this prospect does not seem objectionable. Should Section 14800 be revised to permit a nonprofit corporation to conduct the division and conversion proceedings simultaneously? This would, in effect, permit the division of a nonprofit corporation other than one organized for charitable purposes into a nonprofit corporation (perhaps one holding assets on charitable trust) and a business corporation.

§§ 14807, 14808, 14814-14816. Notice; dissenters' rights; action to enjoin or rescind conversion

Consistent with the Commission's decisions at the May meeting concerning the rights of members who dissent from a merger or consolidation, Section 14807 provides that notice of the approval of the conversion must be given to members of a nonprofit corporation that converts to a business corporation. A member whose property rights would be infringed could bring an action to enjoin or rescind the conversion as provided in Section 14815. There would be no dissenting member's right to require the converting nonprofit corporation to purchase his membership at its fair market value. However, a shareholder of a converting business corporation would be afforded the right to require the corporation to purchase his shares at their fair market value by Section 14808 which incorporates the dissenters' rights provisions of the General Corporation Law. Under those provisions, only certain dissenting shareholders would receive notice of approval of the plan of conversion. Such shareholders would not be permitted to bring an action to enjoin or rescind the conversion except pursuant to Section 14814 to test whether the plan was approved by the proper number of shares.

Respectfully submitted,

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EXHIBIT I

Pennsylvania Nonprofit Corporation Law of 1972

SUBCHAPTER D

CONVERSION

- Sec.
7951. Conversion authorized.
7952. Proposal and adoption of plan of conversion.
7953. Articles of conversion.
7954. Filing of articles of conversion.
7955. Effective date of conversion.
7956. Effect of conversion.

§ 7951. Conversion authorized

(a) **Business to nonprofit.**—Any business corporation may, in the manner provided in this subchapter, be converted into a nonprofit corporation, hereinafter designated as the resulting corporation.

(b) **Nonprofit to business.**—Any nonprofit corporation may, in the manner provided in this subchapter, be converted into a business corporation, hereinafter designated as the resulting corporation.

(c) **Exceptions.**—

(1) This subchapter shall not authorize any conversion involving:

(i) A cooperative corporation.

(ii) Beneficial, benevolent, fraternal or fraternal benefit societies having a lodge system and a representative form of government, or transacting any type of insurance whatsoever.

(iii) Any corporation which by the laws of this Commonwealth is subject to the supervision of the Department of Banking, the Insurance Department or the Pennsylvania Public Utility Commission.

(2) Paragraph (1) of this subsection shall not be construed as repealing any statute which provides a procedure for the conversion of a nonprofit corporation into an insurance corporation.

§ 7952. Proposal and adoption of plan of conversion

(a) **Preparation of plan.**—A plan of conversion shall be prepared, setting forth:

(1) The terms and conditions of the conversion.

(2) The mode of carrying the conversion into effect.

(3) A restatement of the articles of the resulting corporation, which articles shall comply with the requirements of:

(i) the Business Corporation Law,¹ if the resulting corporation is to be a business corporation; or

(ii) this article, if the resulting corporation is to be a nonprofit corporation.

(4) Such other details and provisions as are deemed desirable.

(b) **Proposal and adoption.**—The plan of conversion shall be proposed and adopted, and may be terminated, in the manner provided for the proposal, adoption and termination of a plan of merger in Article IX of the Business Corporation Law² (relating to merger and consolidation), in the case of a business corporation which proposes to convert into a nonprofit corporation, or in Subchapter B of this chapter (relating to merger, consolidation and sale of assets), in the case of a nonprofit corporation which proposes to convert into a business corporation.

(c) **Rights of dissenting shareholders.**—If any shareholder of a business corporation which adopts a plan of conversion into a nonprofit corporation shall object to such plan of conversion and shall comply with the provisions of section 515 of the Business Corporation Law³ (relating to rights of dissenting shareholders), such shareholder shall be entitled to the rights and remedies of dissenting shareholders therein provided, notwithstanding anything to the contrary in subsection I. of said section. There shall be included in, or enclosed with, the notice of meeting of shareholders of the business corporation called to act upon the plan of conversion a copy or a summary of the plan and a copy of this subsection and of section 515 of the Business Corporation Law.

¹ 15 P.S. §§ 1001 to 2203.

² 15 P.S. §§ 1901 to 1909.

³ 15 P.S. § 1615.

§ 7953. Articles of conversion

Upon the adoption of a plan of conversion by the corporation desiring to convert, as provided in this subchapter, articles of conversion shall be executed under the seal of the corporation by two duly authorized officers thereof, and shall set forth:

(1) The name of the corporation and the address, including street and number, if any, of its registered office.

(2) The statute under which the corporation was incorporated and the date of incorporation.

(3) If the plan is to be effective on a specified date, the hour, if any, and the month, day and year of such effective date.

(4) The manner in which the plan was adopted by the corporation.

(5) The plan of conversion.

§ 7954. Filing of articles of conversion

The articles of conversion shall be filed in the Department of State.

§ 7955. Effective date of conversion

Upon the filing of articles of conversion in the Department of State, or upon the effective date specified in the plan of conversion, whichever is later, the conversion shall become effective.

§ 7956. Effect of conversion

(a) **Business to nonprofit.**—Upon the conversion becoming effective the corporation, if theretofore a business corporation, shall be deemed to be a nonprofit corporation for all purposes, shall cease to be a business corporation and shall not thereafter operate in any manner resulting in pecuniary profit, incidental or otherwise, to its members or shareholders. The corporation shall remain liable for all existing obligations, public or private, taxes due the Commonwealth or any other taxing authority for periods prior to the effective date of the conversion, and, as such nonprofit corporation, it shall continue to be entitled to all assets theretofore pertaining to it as a business corporation.

(b) **Nonprofit to business.**—Upon the conversion becoming effective the corporation, if theretofore a nonprofit corporation, shall be deemed to be a business corporation for all purposes, shall cease to be a nonprofit corporation, and may thereafter operate for a purpose or purposes resulting in pecuniary profit, incidental or otherwise, to its members or shareholders. The corporation shall issue share certificates to each shareholder entitled thereto. The corporation shall remain liable for all existing obligations, public and private, taxes due the Commonwealth or any other taxing authority for periods prior to the effective date of the conversion, and, as such business corporation, it shall continue to be entitled to all assets theretofore pertaining to it as a nonprofit corporation except as otherwise provided by order, if any, obtained pursuant to section 7549(b) of this title (relating to nondiversion of certain property).

DIVISION 4. PROVISIONS APPLICABLE TO
CORPORATIONS GENERALLY

CHAPTER 8. CONVERSION

§ 14800. Conversion authorized

14800. A domestic nonprofit corporation which is not organized for charitable purposes and does not hold assets on charitable trust may be converted into a domestic business corporation and a domestic business corporation may be converted into a domestic nonprofit corporation as provided in this chapter.

Comment. Section 14800 is new. Prior law did not provide for the conversion of corporations. Chapter 8 is based in large part on Sections 7951-7956 of the Pennsylvania Nonprofit Corporation Law of 1972, Pa. Stat. Ann., Tit. 15, §§ 7941-7946 (Supp. 1975).

§ 14801. Converting corporation

14801. As used in this chapter, "converting corporation" means the nonprofit or business corporation which intends to convert into a business or nonprofit corporation, respectively.

Comment. Section 14801 defines "converting corporation" as used in this chapter.

§ 14802. Plan of conversion

14802. A plan of conversion shall be prepared which states the following:

- (a) The terms and conditions of the conversion.
- (b) The name of the converting corporation.
- (c) The manner of converting memberships into shares or shares into memberships.
- (d) A restatement of the articles of the converting corporation which, in the case of the conversion of a nonprofit corporation into a business corporation, shall satisfy the requirements of Section 202 and, in the case of a conversion of a business corporation into a nonprofit corporation, shall satisfy the requirements of Section 5250.
- (e) Other details and provisions as are desired, if any.

Comment. Section 14802 is based on the Pennsylvania Nonprofit Corporation Law of 1972, Pa. Stat. Ann., Tit. 15, § 7952(a) (Supp. 1975). Compare Sections 6111 (agreement of merger or consolidation) and 6212 (plan of division).

404/165

§ 14803

§ 14803. Approval of plan of conversion by board

14803. (a) The board of the converting corporation shall approve the plan of conversion.

(b) Upon approval, the plan of conversion shall be signed on behalf of the converting corporation by (1) the chairman of the board, president, or a vice president and (2) the secretary, chief financial officer, treasurer, an assistant secretary, or an assistant treasurer.

Comment. Section 14803 is similar to the first sentence of Section 1101 and Section 1102 of the General Corporation Law and Section 6120 of the General Nonprofit Corporation Law.

§ 14804. Approval of plan of conversion by members or shareholders

14804. (a) Except as provided by Section [6122], the plan of conversion shall be approved by the members of a converting nonprofit corporation entitled to exercise a majority of the voting power.

(b) The plan of conversion shall be approved by the outstanding shares of each class, regardless of limitations or restrictions on the voting rights thereof, of a converting business corporation.

Comment. Section 14804 is derived from the provisions of Divisions 1 and 2 concerning approval of a merger agreement. See Sections 1201 (shareholder approval of reorganization of business corporation) and 6121 (member approval of merger or consolidation of nonprofit corporation). Compare Pa. Stat. Ann., Tit. 15, § 7952(b) (Supp. 1975).

§ 14805. Members' or shareholders' approval before or after board's approval

14805. The approval of the plan of conversion by the members or the shareholders of the converting corporation may be given either before or after the approval of the plan by the board.

Comment. Section 14805 is analogous to the first sentence of subdivision (f) of Section 1201 and to Section 6123.

§ 14806. Execution of certificate of approval; contents

14806. (a) After the plan of conversion has been approved as provided in Sections 14803 and 14804, the officers shall execute an officers' certificate of approval.

(b) The officers' certificate of approval shall set forth the following:

(1) A statement that the plan of conversion was approved by the board.

(2) A statement that the plan of conversion was approved by the vote of the members or shareholders which equaled or exceeded that required.

Comment. Section 14806 is comparable to Sections 1103 (certificate of approval of merger of business corporation) and §124 (certificate of approval of merger or consolidation of nonprofit corporation).

404/169

§ 14807

§ 14807. Notice of approval of plan of conversion

14807. When the plan of conversion has been approved by the board and the members of a converting nonprofit corporation, notice of the approval shall be given each member in the manner provided for giving notice of meetings.

Comment. Section 14807 corresponds to Section 6125 (notice to members of nonprofit corporation of approval of agreement of merger or consolidation).

404/170

§ 14808

§ 14808. Rights of dissenting shareholders

14808. (a) In the case of a converting business corporation, dissenting shareholders may, by complying with Chapter 13 (commencing with Section 1300) of Division 1, require the converting business corporation to purchase the dissenting shares.

(b) The converting business corporation shall follow the applicable procedures provided in Chapter 13 (commencing with Section 1300) of Division 1.

(c) For the purposes of this section, "reorganization" as used in Chapter 13 (commencing with Section 1300) of Division 1 means a conversion pursuant to this chapter.

Comment. Section 14808 adopts the principle of the Pennsylvania Nonprofit Corporation Law of 1972, Pa. Stat. Ann., Tit. 15, § 7952(c) (Supp. 1975). Subdivision (a) provides dissenting shareholders with the right to require the converting business to purchase their shares. Subdivision (b) requires the corporation to follow the provisions of Chapter 13 of Division 1 relating, for example, to notice (Section 1301(a)) and to the payment of the agreed price (Section 1303(b)).

404/171

§ 14809

§ 14809. Amendment of plan of conversion

14809. An amendment to the plan of conversion may be adopted and approved and shall be signed and the approval of the board and of the members or shareholders shall be certified in the same manner as the original plan.

Comment. Section 14809 is similar to Sections 1104 (amendment to agreement of merger of business corporation) and 6130 (amendment of agreement of merger or consolidation of nonprofit corporation).

404/172

§ 14810

§ 14810. Abandonment of conversion

14810. The board of the converting corporation may, in its discretion, abandon the conversion, subject to the contractual rights of

third parties, without any action by the members or shareholders, at any time before the conversion has become effective.

Comment. Section 14810 is similar to Sections 1105 (abandonment of merger by business corporation) and 6131 (abandonment of merger or consolidation by nonprofit corporation).

404/173

§ 14811

§ 14811. Filing copy of plan of conversion and officers' certificate

14811. (a) A copy of the plan of conversion and the officers' certificate of approval shall be filed.

(b) Subject to Section [14831], the conversion is effective upon filing the copy of the plan of conversion and the officers' certificate of approval.

(c) The Secretary of State may certify a copy of the plan of conversion separate from the officers' certificate attached thereto.

Comment. Section 14811 is similar to portions of Section 1103 (filing copy of agreement of merger by business corporation) and Section 6140 (filing copy of agreement of merger or consolidation by nonprofit corporation). Compare Pa. Stat. Ann., Tit. 15, §§ 7954, 7955 (Supp. 1975).

404/174

§ 14812

§ 14312. Effect of conversion

14312. On the effective date of a conversion:

(a) A corporation which has been a nonprofit corporation becomes a business corporation for all purposes and ceases to be a nonprofit corporation.

(b) A corporation which has been a business corporation becomes a nonprofit corporation for all purposes and ceases to be a business corporation.

Comment. Section 14812 is derived from the Pennsylvania Nonprofit Corporation Law of 1972, Pa. Stat. Ann., Tit. 15, § 7956 (Supp. 1975).

404/175

§ 14813

§ 14813. Rights of creditors and liens preserved

14813. The rights of creditors against, and liens upon the property of, a corporation which converts pursuant to this chapter are preserved unimpaired.

Comment. Section 14813 is analogous to subdivision (b) of Section 1107 and the first sentence of Section 6145.

404/176

§ 14814

§ 14814. Limitation on action to test validity of conversion

14814. Except as provided in Section 14815, no member of a nonprofit corporation or shareholder of a business corporation has a right in law or in equity to attack the validity of a conversion or to have the conversion set aside or rescinded except in an action to test whether the number of memberships or shares required to approve the plan of conversion have been legally voted in favor thereof.

Comment. Section 14814 is comparable to a portion of subdivision (a) of Section 1312 and Section 6160.

§ 14815. Action to enjoin or rescind conversion

14815. An action to enjoin or rescind a conversion of a nonprofit corporation into a business corporation which is manifestly unfair to the property rights of a member or a class of members of the nonprofit corporation may be brought by a member whose rights are or will be affected and who holds a membership that satisfies both of the following requirements:

(a) The membership was held of record on the date for the determination of memberships entitled to be voted on the plan of conversion.

(b) The membership was not voted in favor of the plan of conversion.

Comment. Section 14815 is analogous to Section 6161.

§ 14816. Limitation on action

14816. No action pursuant to Section 14815 to enjoin or rescind a conversion may be commenced more than 60 days after the effective date of the conversion.

Comment. Section 14816 is analogous to Section 6162.