

Memorandum 76-53

Subject: Study 77.120 - Reorganizations (De Facto Mergers)

Attached to this memorandum is a staff draft of Chapter 12 (Reorganizations) of the General Nonprofit Corporation Law, and three draft sections defining terms used in Chapter 12 and several related chapters.

The courts in several jurisdictions other than California have developed a "de facto merger doctrine" to protect the shareholders of a corporation involved in the sale or exchange of assets or control that has the effect of a merger but is not technically a merger. The doctrine has typically been applied where the sale or exchange has resulted in a significant change in the nature of the dissenting shareholder's investment and a reduction in the value of his shares. Such shareholders are afforded the right to require the corporation to purchase their shares at their value before the de facto merger. See H. Ballantine & G. Sterling, California Corporation Laws § 315 (4th ed. 1976); 15 W. Fletcher, Private Corporations §§ 7045.1, 7165.5 (perm. ed. rev. vol. 1973); H. Henn, Corporations § 349 at 725-726 (2d ed. 1970).

Chapter 12 (Sections 1200 and 1201) and Section 181 (defining "reorganization") of the new General Corporation Law are intended to codify the de facto merger doctrine. See Report of the Assembly Select Committee on the Revision of the Corporations Code 93 (1975). Section 1201 contains several complex provisions which qualify the right of approval and the right of appraisal depending, for example, on whether preferred shareholders' rights are impaired, whether the shareholders' control is reduced to less than five-sixths of the total voting power after the reorganization, and whether shareholders in a close corporation receive shares of a non-close corporation in the reorganization.

The staff does not believe that this codification of the de facto merger doctrine translates very easily from the case of business corporations to that of nonprofit corporations. However, we have drafted for your consideration the attached draft of Chapter 12 of the General Nonprofit Corporation Law and the relevant definitions which would forward the basic policy of the de facto merger doctrine--to permit members of nonprofit corporations engaged in certain important transactions amounting to a reorganization to exercise a power of approval and, if it is approved, to require the nonprofit corporation to purchase dissenting memberships. The draft of Chapter 12 is consistent with the drafts of Chapters 10, 11, and 13 which require membership approval of certain sales of assets, mergers, and consolidations, and give members holding memberships representing an ownership interest in the nonprofit corporation the right to require the corporation to purchase the membership.

In recognition of the fact that reorganizations, especially exchange and sale-of-assets reorganizations, are not very important where nonprofit corporations are concerned, the staff has greatly simplified Chapter 12 and has not attempted to draft provisions analogous to all the special exceptions and qualifications in Chapter 12 of the General Corporation Law concerning controlled corporations, close corporations, preferred stock, and the like. Nonprofit corporations will only infrequently desire to merge but, when they do, they will have a specific statute to follow. In the few remaining cases where the formal merger provisions are not followed, but the transaction amounts to the sort of reorganization that should involve the same sort of protections of minority interests that are reflected in the merger provisions, the relatively simple and unadorned provisions contained in the draft of Chapter 12 should be sufficient protection.

The reorganization provisions of the new General Corporation Law apparently cover only business corporations. The terms "exchange reorganization" and "sale-

of-assets reorganization" are defined in the draft to cover de facto mergers involving both business and nonprofit corporations. Section 6200 is drafted so that it applies only to nonprofit corporations; the draft does not attempt to provide for the approval of shareholders of a business corporation which is involved in a reorganization with a nonprofit corporation.

Respectfully submitted,

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Rough Outline

GENERAL NONPROFIT CORPORATION LAW

- \$ 5168. Exchange reorganization
- \$ 5181. Reorganization
- \$ 5183. Sale-of-assets reorganization

CHAPTER 12. REORGANIZATIONS

- \$ 6200. Reorganizations requiring approval of board of nonprofit corporation
- \$ 6201. Approval of reorganization by members
- \$ 6202. Greater percentage or fraction of voting power required
- \$ 6203. Members' approval before or after board approval

§ 5168. Exchange reorganization

5168. (a) "Exchange reorganization" means the acquisition by a nonprofit corporation, in exchange in whole or in part for its memberships, of memberships of another nonprofit corporation or shares (as defined by Section 184) of a business corporation if, immediately after the acquisition, the acquiring nonprofit corporation has control of the other nonprofit corporation or the business corporation.

(b) For the purposes of subdivision (a), "control" of a business corporation means "control" as that term is defined in subdivision (b) of Section 160 and "control" of a nonprofit corporation means holding memberships representing more than 50 percent of the total combined voting power of all classes of memberships entitled to vote.

Comment. Subdivision (a) of section 5168 is derived from subdivision (b) of Section 181 of the General Corporation Law. Section 5168 defines "exchange reorganization" for purposes of guaranteeing to the members of a nonprofit corporation which acquires control of another nonprofit corporation or of a business corporation the right of approval pursuant to Chapter 12 (commencing with Section 6200) and, in certain circumstances, the right to require the nonprofit corporation to purchase dissenting memberships pursuant to Chapter 13 (commencing with Section 6300). See Sections 5181 ("reorganization" defined) and 5183 ("sale-of-assets reorganization" defined).

Subdivision (b) defines "control" as that term is used in subdivision (a). The definition of "control" in subdivision (b) of Section 160 of the General Corporation Law is incorporated with reference to business corporations. The use of "control" with reference to nonprofit corporations is analogous.

§ 5181. Reorganization

5181. "Reorganization" means:

(a) A merger or consolidation pursuant to Chapter 11 (commencing with Section 6110).

(b) An exchange reorganization, as defined in Section 5168.

(c) A sale-of-assets reorganization, as defined in Section 5183.

Comment. Section 5181 is based on Section 181 of the General Corporation Law.

§ 5183. Sale-of-assets reorganization

5183. "Sale-of-assets reorganization" means (1) the acquisition by a nonprofit corporation in exchange in whole or in part for its memberships or for its debt securities which are not adequately secured and which have a maturity date in excess of five years after the consummation of the reorganization, or both, of all or substantially all of the property and assets of another nonprofit corporation or of a business corporation or (2) the acquisition by a business corporation in exchange in whole or in part for its equity securities (as defined in Section 168) or for its debt securities which are not adequately secured and which have a maturity date in excess of five years after the consummation of the reorganization, or both, of all or substantially all of the property and assets of a nonprofit corporation.

Comment. Section 5183 is derived from subdivision (c) of Section 181 of the General Corporation Law. Section 5183 defines "sale-of-assets reorganization" for the purpose of guaranteeing to the members of a nonprofit corporation involved in such reorganization the right of approval pursuant to Chapter 12 (commencing with Section 6200) and, in certain circumstances, the right to require the nonprofit corporation to purchase dissenting memberships pursuant to Chapter 13 (commencing with Section 6300). See Sections 5168 ("exchange reorganization" defined) and 5181 ("reorganization" defined).

045/104

§ 6200

CHAPTER 12. REORGANIZATIONS

§ 6200. Reorganizations requiring approval of board of nonprofit corporation

6200. The board of the nonprofit corporation shall approve the reorganization where:

(a) The nonprofit corporation is the acquiring corporation in an exchange reorganization.

(b) The nonprofit corporation is the acquiring corporation in a sale-of-assets reorganization.

(c) The nonprofit corporation is the corporation whose property and assets are acquired in a sale-of-assets reorganization.

Comment. Section 6200 is based on Section 1200 of the General Corporation Law. Section 6200, and this chapter, apply only to reorganizations (other than mergers and consolidations) involving nonprofit corporations. See Sections 5168 ("exchange reorganization" defined), 5183 ("sale-of-assets reorganization" defined). Chapter 11 (commencing with Section 6110) provides for board and member approval of mergers and consolidations. Section 6200 and the remainder of this chapter do not contain special provisions relating to controlled corporations or close corporations such as are provided in Chapter 12 (commencing with Section 1200) of the General Corporation Law.

§ 6201. Approval of reorganization by members

6201. (a) Except as provided by Section 6202, the principal terms of the reorganization shall be approved by a vote of the members entitled to exercise a majority of the voting power, or by the written consent of the members entitled to exercise two-thirds of the voting power, of any nonprofit corporation whose board is required by Section 6200 to approve the reorganization.

(b) Subdivision (a) is applicable regardless of any limitations or restrictions on the voting power of any class of memberships entitled to vote.

Comment. Section 6201 is based on subdivision (a) of Section 1201 of the General Corporation Law and Section 6121 (approval of agreement of merger or consolidation by members of constituent nonprofit corporations). See Section 6121 and Comment.

§ 6202. Greater percentage or fraction of voting power required

6202. The articles may require the vote or written consent of a greater percentage or fraction of the voting power than would otherwise be required under Section 6201.

Comment. Section 6202 applies the principle of subdivision (a) of Section 6122 concerning mergers and consolidations to other types of reorganizations.

§ 6203. Members' approval before or after board approval

6203. The approval of the reorganization by the members may be given either before or after the approval of the reorganization by the board.

Comment. Section 6203 is the same in substance as Section 6124, applicable to mergers and consolidations, and the first sentence of subdivision (f) of Section 1201 of the General Corporation Law and former Section 4108.