

HOUSE BILL REPORT

SSB 5034

As Reported by House Committee On:
Civil Rights & Judiciary

Title: An act relating to nonprofit corporations.

Brief Description: Concerning nonprofit corporations.

Sponsors: Senate Committee on Law & Justice (originally sponsored by Senators Pedersen, Padden and Mullet; by request of Washington State Bar Association).

Brief History:

Committee Activity:

Civil Rights & Judiciary: 3/10/21, 3/19/21 [DPA].

Brief Summary of Substitute Bill
(As Amended By Committee)

- Adopts a new Washington Nonprofit Corporation Act that makes comprehensive changes to the law governing nonprofit corporations.

HOUSE COMMITTEE ON CIVIL RIGHTS & JUDICIARY

Majority Report: Do pass as amended. Signed by 17 members: Representatives Hansen, Chair; Simmons, Vice Chair; Walsh, Ranking Minority Member; Gilday, Assistant Ranking Minority Member; Graham, Assistant Ranking Minority Member; Abbarno, Davis, Entenman, Goodman, Kirby, Klippert, Orwall, Peterson, Thai, Valdez, Walen and Ybarra.

Staff: Edie Adams (786-7180).

Background:

The Washington Nonprofit Corporation Act (WNCA) provides procedures and requirements for the formation, organization, and operation of nonprofit corporations and

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not part of the legislation nor does it constitute a statement of legislative intent.

the relationship between members, directors, and officers of the corporation. Nonprofit corporations may form by filing articles of incorporation with the Secretary of State. Nonprofit corporations may form for any lawful purpose, including charitable, benevolent, educational, civic, patriotic, political, religious, and social purposes. A nonprofit corporation is governed by its articles of incorporation and bylaws and managed by a board of directors and officers. Many provisions of the WNCA provide default rules governing the organization and operation of nonprofit corporations that may be altered in the corporation's articles of incorporation or bylaws.

The WNCA was originally adopted in 1967 and has not been comprehensively revised since that time. The Nonprofit Corporations Committee of the Business Law Section of the Washington State Bar Association has undertaken a review of the WNCA and recommends adoption of a new act, based loosely on the American Bar Association's Model Nonprofit Corporation Act, that provides comprehensive changes to update and improve the law governing nonprofit corporations.

Summary of Amended Bill:

The existing chapter of law governing nonprofit corporations is repealed and a new Washington Nonprofit Corporations Act (new WNCA) is established. The new WNCA is organized into four parts that address: formation and general conditions, including purposes and powers, filing requirements, books and records, public benefit corporations, and foreign corporations; governance, including membership, meetings and voting, and directors and officers; fundamental transactions, including amendment of the articles of incorporation or bylaws, merger or conversion, disposition of assets, and dissolution; and actions involving nonprofit corporations, including supervision of property held for charitable purposes and contested corporate actions.

General Provisions and Formation.

The new WNCA applies to every domestic nonprofit corporation in existence on January 1, 2022, that was incorporated under the existing act governing nonprofit corporations or that elected to have the existing act apply to it. An entity organized under other laws governing nonprofit entities may elect to be governed by the new WNCA. A foreign nonprofit corporation registered as of December 31, 2021, is subject to the new WNCA.

Standards are provided governing methods of providing notice and when notice is deemed effective. Updated standards governing electronic communications and notices are provided, including allowing electronic notices and communications by default. Revised venue rules are established for actions arising under the new WNCA.

The principles of law and equity supplement the new WNCA unless displaced by particular provisions. If religious doctrine or canon law governing the internal affairs of a nonprofit corporation is inconsistent with the act, the religious doctrine or canon law controls to the

extent required by the United States Constitution or the Washington Constitution.

Standards and requirements are provided for records delivered to the Secretary of State (SOS) for filing, including electronic filings under rules adopted by the SOS. Specifically listed major changes by charitable corporations must be reported on the next annual report delivered to the SOS for filing, and the SOS must deliver a copy to the Attorney General.

Provisions governing incorporation and the purposes, powers, and limitations of nonprofit corporations are established. Procedures are established governing how a corporation may modify its purposes through amendment of its articles or bylaws. More specific provisions addressing limitations on corporate powers are provided, and specific emergency powers are established for a board of directors where a catastrophic event prevents a quorum of the directors from being able to readily assemble.

More detailed requirements governing a corporation's books and records are provided. Procedures for inspection of records are established, including allowing the corporation to not disclose certain confidential records, and establishing a requirement that a request for certain records be made in good faith and for a proper purpose, and that the member agrees to reasonable restrictions on the use or distribution of the records.

Members, Directors, and Officers.

More specific standards are established distinguishing membership corporations and nonmembership corporations. A membership corporation must provide in its articles of incorporation for members that have the right to select or vote for the election of directors or at least one fundamental transaction. More comprehensive provisions are established addressing members, including: how they are admitted; member rights, including matters subject to membership vote and meeting and notice requirements; standards of conduct for members; and procedures for resignation and termination of membership. A nonprofit corporation may provide in its articles of incorporation or bylaws for delegates who may be elected or appointed to vote for the election of directors or on other matters.

A nonprofit corporation must have a board of directors and all corporate powers must be exercised by or under the authority of the board of directors. Provisions are established setting forth the qualifications, manner of election, terms of service, and method of removal of directors. Additional provisions set forth the powers and duties of the board of directors, including standards of conduct and fiduciary duties of directors, as well as the liability of a director for breach of duty or misconduct.

A nonprofit corporation must have officers consisting of a president, secretary, and treasurer, who have the authority and duties established in the articles or bylaws. Standards of conduct and fiduciary duties of officers are provided, as well as procedures for resignation or removal of officers.

Liability of directors and officers is established with respect to the approval of unauthorized

loans or guarantees of a director's or officer's obligations, and with respect to consent to or approval of unlawful distributions. Standards are provided regarding the validity of contracts or transactions where an interested director or officer is present or participates in the meeting where the contract or transaction is authorized.

Fundamental Transactions.

Comprehensive provisions governing requirements with respect to fundamental transactions are established, including new provisions governing domestication and conversion of nonprofit corporations. Other fundamental transactions include amendments to the articles of incorporation or bylaws, mergers, disposition of assets, and dissolution. Provisions are established setting forth the required procedures for proposing and taking action on fundamental transactions, including member notice and voting requirements.

Procedures and requirements are provided for amendment of the articles of incorporation and bylaws, including when approval of the members is required. Amendments to the articles of incorporation of a charitable corporation to include substantially different purposes for the corporation must be reported on the corporation's next annual report.

Procedures are established for the merger of nonprofit corporations with other nonprofit corporations or other eligible entities, and for two or more foreign nonprofit corporations or eligible entities to merge into a domestic nonprofit corporation. New provisions governing domestication are established, allowing a foreign nonprofit corporation to become a Washington nonprofit corporation, or a Washington nonprofit corporation to become incorporated in another state. New provisions are also established governing conversion, which allows a nonprofit corporation to convert into a different form of entity or for an unincorporated entity to become a nonprofit corporation. Different standards are established for conversion to a for-profit entity and conversions to or from an unincorporated entity.

Requirements for a nonprofit corporation to dispose of its assets are provided, including specific requirements relating to disposition of assets not in the ordinary course of business. Procedures and requirements are provided governing the voluntary dissolution of a nonprofit corporation, as well as grounds and procedures for administrative or judicial dissolution. A dissolving corporation must comply with specific distribution requirements where the corporation holds property for charitable purposes.

With respect to fundamental transactions, new provisions are established to protect any property held for charitable purposes and to prevent members, directors, officers, and others associated with a charitable corporation or other eligible entity with a charitable purpose from receiving direct or indirect financial benefit in connection with the transaction unless the person is itself a charitable corporation, governmental entity, or entity organized exclusively for charitable purposes.

Charitable Corporations and Charitable Assets.

New provisions are established governing charitable corporations and corporations that hold property for charitable purposes. "Property held for charitable purposes" includes all property held by a charitable nonprofit corporation and property held by a nonprofit corporation that is subject to a charitable-use restriction. A number of provisions are established that protect charitable assets of nonprofit corporations.

Standards are provided for how donors create unrestricted gifts or restricted gifts. A restricted gift is created when a gift to a nonprofit corporation, that is not in trust, is subject to material restrictions contained in the gift instrument. A corporation is bound by the material restrictions. Procedures are established under which a term of a gift instrument may be modified or released when enforcement of the restriction becomes impracticable or wasteful or impairs the management or investment of the gift, or where modification will further the charitable purposes of the gift. Modification or release may be obtained through donor consent, procedures for approval of the modification by the Attorney General and interested parties, or through a court proceeding.

The board of directors may not make distributions of charitable assets to directors, officers, or members of the corporation, or others in a position to exercise substantial influence over the corporation's affairs. Distributions to entities that are charitable corporations or government entities for a public purpose are allowed. Upon dissolution of a charitable nonprofit corporation or a nonprofit corporation that holds property for charitable purpose, specific provisions governing distributions are provided to protect charitable assets from being diverted from charitable purposes.

For fundamental transactions, nonprofit corporations that hold property for charitable purposes must provide notice of the proposed transaction to the Attorney General and obtain approval of the Attorney General, or approval of the court in a proceeding in which the Attorney General is made a party.

Attorney General Authority.

Specific provisions are established defining the authority of the Attorney General to supervise and protect property held for charitable purposes by nonprofit corporations. The Attorney General may institute investigations upon a reasonable suspicion of a violation of requirements relating to charitable assets. The Attorney General may issue civil investigative demands, prior to commencing a civil action, for the discovery of material information relevant to its investigation upon reasonable suspicion of a violation. The Attorney General may commence a civil action to ensure compliance with requirements governing charitable assets or to secure the proper administration of a charitable corporation or property held for charitable purposes.

Restrictions are imposed with respect to the Attorney General's authority to investigate, issue investigative demands, and bring or intervene in actions against a religious corporation. The Attorney General may exercise this authority only where:

- the Attorney General has knowledge of facts or circumstances that property held by

- the religious corporation for charitable purposes has been or is about to be distributed in violation of the act;
- the board of directors of the religious corporation has requested the Attorney General's involvement in the action or investigation; or
 - the Attorney General has knowledge of facts or circumstances indicating the religious corporation has no directors in office, in which case the Attorney General may investigate the matter and appoint one or more directors following specified procedures.

In an action by the Attorney General, civil penalties are established for violations of provisions governing requirements with respect to property held for charitable purposes or violations of injunctions issued in actions to secure property held for charitable purposes.

The Washington State Attorney General Charitable Asset Protection Account (Account) is created in the custody of the State Treasurer. Moneys in the account may be used only to fund education and supervision and enforcement programs by the Office of the Attorney General with respect to charitable corporations and charitable assets. The SOS must collect a charitable asset protection fee on the following nonprofit corporation filings: annual reports; articles of incorporation of newly formed corporations; articles of domestication; and articles of domestication and conversion. The fee is \$50 per year, reduced to \$10 if the corporation's total gross revenue in the most recent fiscal year was less than \$500,000. Ninety-five percent of the revenue from the fee must be deposited into the Account and 5 percent of the revenue from the fee must be deposited into the SOS's revolving fund to cover the costs of assessing the fee.

Other Provisions.

Procedures are established addressing contested corporate actions. These procedures generally allow for a court proceeding to address the failure of a nonprofit corporation to hold a meeting to take corporate action or to address the validity of any corporate action taken.

The Charitable Trust Act is amended to indicate that the term "trustee" does not include a Washington nonprofit corporation, or a registered foreign nonprofit corporation, that does not meet specific requirements defining who is a trustee.

The Uniform Business Organizations Code is amended to require a nonprofit corporation to include specified information in its annual report and to indicate a nonprofit corporation's name may not be deceptively similar to that of another entity which is not then administratively dissolved.

Numerous technical changes are made throughout the Revised Code of Washington to update references to provisions repealed by the act.

Amended Bill Compared to Substitute Bill:

The amended bill:

- removes the requirement that board members must be at least 16 years of age;
- dedicates 5 percent of the charitable asset protection fee to the SOS's revolving fund to cover costs of assessing the fee; and
- removes a requirement for expedited court review of an application for a court order to compel disclosure of corporate records.

The amended bill also makes numerous technical and clarifying amendments, including updating dates to reflect the January 1, 2022, effective date of the act and correcting erroneous cross references.

Appropriation: None.

Fiscal Note: Available. New fiscal note requested on March 19, 2021.

Effective Date of Amended Bill: The bill takes effect January 1, 2022, except for section 5204, relating to professional services corporations, which due to a prior delayed effective date takes effect July 1, 2022.

Staff Summary of Public Testimony:

(In support) This bill is the result of many years of work by volunteer lawyers of the Washington State Bar Association to provide a much-needed update and improvement of nonprofit corporation law. There are three main goals of the legislation. The first is to provide a general modernization of the Washington Nonprofit Corporations Act, which has not been comprehensively updated since its adoption in 1967, so that it reflects current practices in nonprofit law. The second goal is to provide better protection for charitable assets by providing guidance to nonprofit corporations on how to manage and use charitable assets and guidance to the Attorney General regarding its supervisory role with respect to charitable corporations and charitable assets. The third goal is to provide more comprehensive and clearer provisions governing members and the relationship between members and the corporation.

Nonprofit corporations are vital to our economy and support communities across the state. These changes will benefit nonprofit corporations across the state by providing best practices and clear policies. The bill authorizes electronic notices and communications, and allows for remote meetings. This is an important modernization for nonprofit corporations. It also clarifies the Attorney General's longstanding role in supervising charitable corporations and protecting charitable assets. The bill provides a clear process and guidance for the Attorney General regarding how, when, and to what extent the Attorney General exercises this role, and it provides dedicated funding for education and enforcement

purposes.

(Opposed) None.

Persons Testifying: Senator Pedersen, prime sponsor; David Lawson, Nonprofit Corporations Committee and Washington State Bar Association; Daniel Parkhurst and Trudy Soucoup, Washington Nonprofits; Karl Johanson, Non Profit Insurance Program; Jodi Nishioka, Communities Rise; David Beard, School's Out Washington; Lynda Atkins, Washington State Office of the Attorney General; and Judith Andrews, Washington State Bar Association Nonprofit Corporations Committee.

Persons Signed In To Testify But Not Testifying: None.