

## RESOLUTION 11-07-2017

### DIGEST

#### Non-Profit Corporations: Conforms Standards for Removal of Directors

Amends Corporations Code section 9223 to provide that directors of non-profit religious corporations can be removed for fraudulent or dishonest acts or for gross abuse of authority.

### RESOLUTIONS COMMITTEE RECOMMENDATION

APPROVE IN PRINCIPLE

#### History:

No similar resolutions found.

#### Reasons:

This resolution amends Corporations Code section 9223 to provide that directors of non-profit religious corporations can be removed for fraudulent or dishonest acts or for gross abuse of authority. This resolution should be approved in principle because it brings the standard for removing a director of a non-profit religious corporation in-line with non-profit public and mutual benefit corporations.

Within the chapter pertaining to non-profit corporations, Corporations Code sections 5223 (non-profit public benefit corporation) and 7223 (non-profit mutual benefit corporation), both provide that a director may be removed in the case of “*fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation or breach of any duty arising [under this chapter]*”, and may bar from reelection any director so removed for a period prescribed by the court.” (Emphasis added.) Currently, however, section 9223 (non-profit religious corporation), only provides that directors may be removed “in case of fraudulent acts.” Thus, a director in a corporation organized under section 9200 et seq., may remain in his or her position of power even if they commit acts which breach his/her fiduciary duties, as long as it does not amount to fraud. Where some such non-profit corporations receive hundreds of thousands, if not millions, of dollars of money donated by the public, the standard should be more than just assurance that the directors are not intentionally defrauding the corporation.

That said, this resolution may overstate the issue in that breaches of fiduciary duty usually constitutes constructive fraud. “[C]onstructive fraud comprises any act, omission or concealment involving a breach of legal or equitable duty, trust or confidence which results in damage to another, even though the conduct is not otherwise fraudulent.” (*Salahutdin v. Valley of California, Inc.* (1994) 24 Cal.App.4th 555, 562; 2 Miller & Starr, Cal. Real Estate (2d ed. 1989), § 3:20, p. 120-121; Civ. Code, § 1573, subd. (1).) If a fiduciary relationship exists, any concealment of material fact is fraud. (*Byrum v. Brand* (1990) 219 Cal.App.3d 926, 937-938; *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1997) 67 Cal.App.3d 19, 32.) Unlike actual fraud, constructive fraud does not require an intentional deception, an “intent to deceive” being implied from the failure to disclose. (*Mary Pickford Co. v. Bayly Bros., Inc.* (1939) 12 Cal.2d 501, 525.) Further, reasonable reliance is presumed upon a nondisclosure of the fiduciary, absent direct evidence of lack of reliance. (*Estate of Gump* (1991) 1 Cal.App.4th

582, 601.) “The failure of the fiduciary to disclose a material fact to his principal which might affect the fiduciary’s motives or the principal’s decision, which is known (or should be known) to the fiduciary, may constitute constructive fraud.” (*Salahutdin v. Valley of California, Inc.* (1994) 24 Cal.App.4th 555.)

Although directors of religious non-profits are subject to other sanctions, besides removal, for engaging in self-dealing transactions, the text of the statute should be updated to avoid any ambiguity about the duties of directors of non-profit religious corporations.

## **TEXT OF RESOLUTION**

**RESOLVED** that the Conference of California Bar Associations recommends that legislation be sponsored to amend Corporations Code section 9223 to read as follows:

### § 9223

(a) The superior court of the proper county may, at the suit of a director, or twice the authorized number (Section 5036) of members, remove from office any director in case of fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation or breach of any duty arising under Article 3 of this chapter (commencing with § 9230) and may bar from reelection any director so removed for a period prescribed by the court. The corporation shall be made a party to such action.

(b) The Attorney General may bring an action under subdivision (a), may intervene in such an action brought by any other party and shall be given notice of any such action brought by any other party.

(Proposed new language underlined; language to be deleted stricken)

**PROPONENT:** Sacramento County Bar Association

## **STATEMENT OF REASONS**

The Problem: Within the chapter pertaining to non-profit corporations, Corporations Code sections 5223 (non-profit public benefit corporation) and 7223 (non-profit mutual benefit corporation) both provide that a director may be removed in the case of “fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation or breach of any duty arising [under this chapter], and may bar from reelection any director so removed for a period prescribed by the court.” (Emphasis added.) However, Section 9223 (non-profit religious corporation) provides that directors may be removed only “in case of fraudulent acts.” Thus, a director in a corporation organized under Sections 9200 et seq., may, with impunity, commit acts which breach his/her fiduciary duties, as long as it does not amount to fraud. The clear danger here is that such non-profit corporations are frequently receiving thousands, if not millions, of dollars of money donated by the public, who entrust the directors of such corporations to carry out the stated mission and to do so while adhering to their fiduciary duty to the corporation. The standard should be more than just assurance that the directors are not intentionally defrauding the corporation.

The Solution: The language of Section 9223 should be amended to match that of the other code sections covering removal of directors from non-profit corporations.

**IMPACT STATEMENT**

The resolution does not affect any other law, statute, or rule other than those expressly identified.

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