

THE HEALTH LAWYER TOOLKIT: TIME FOR A BYLAWS CHECKUP?



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Many healthcare providers in California (including hospitals and clinics) are organized under, or are otherwise subject to, the California Nonprofit Public Benefit Corporation Law.¹ As with any corporation, the articles of incorporation, as amended or restated from time to time (collectively, the “articles”), are the primary governing document of a California nonprofit public benefit corporation.² The articles must include certain mandatory provisions and basic information about the corporation, including the corporation’s name and address.³

All nonprofit public benefit corporations must also adopt bylaws to establish procedures for the management and conduct of the corporation’s activities and affairs.⁴ Most California corporate lawyers would likely agree that bylaws serve three general purposes:

1. To alter specific statutory default rules that would control absent a contrary bylaw;
2. To address matters that are not covered by statute; and
3. To provide a “ready reference” to certain key provisions of statutory governing law for the benefit and awareness of the corporation’s directors and officers (by restating – or at least referring to – specific provisions of the California Corporations Code).

Despite their importance from a nonprofit corporate governance perspective, all too often bylaws are consigned to a file or shelf and left to languish, without being reviewed or updated as the corporation (and the laws that apply to it) continues to evolve and change. Or, bylaws get reviewed and revised without due consideration for other relevant factors or documents.

The purpose of this Health Lawyer Toolkit article is to highlight some issues/problem areas commonly encountered when reviewing bylaws of healthcare organizations formed or treated as California nonprofit public benefit corporations, and to offer model bylaws provisions for consideration by legal advisers to those organizations.

1. PURPOSE CLAUSE

Normally, the purposes of a California nonprofit public benefit corporation (both general and specific) are stated in the articles.⁵ The purposes may be – and often are – restated in the bylaws as a reminder to the corporation’s directors and other constituents. As a general matter, any change to a corporation’s purpose clause should be carefully considered. Among other reasons, this is because a corporation’s federal and/or state tax-exempt status is often dependent on the purposes for which the corporation is organized and operated. But corporations should be especially cautious when including or revising a purpose statement in the bylaws – since a purpose clause in the bylaws is only effective to the extent it is consistent with the purposes set forth in the articles.⁶

To avoid inconsistency between the two governing documents, consider the model bylaws provision set forth below. This simple clause refers the reader to the articles, reinforcing the primacy and controlling authority of the articles and serving as an implicit reminder that any changes to the purpose clause would need to be made via the articles.

Purposes. The purposes of this corporation shall be as set forth in the corporation’s articles of incorporation.

2. MEMBERS

Nonprofit corporations in California can, but are not required to, have statutory members.⁷ In the healthcare context, it is not uncommon for a parent corporation in a nonprofit health system to be the sole statutory member of one or more subsidiary nonprofit corporations.

It is important for the corporation’s legal advisers to know whether the corporation has statutory members. This is because members have certain rights with respect to the corporation, including the right to vote on the election of the corporation’s directors, as well as the right to vote on significant corporate changes (such as mergers, dissolutions, dispositions of substantially all of the corporate assets, and amendments to the articles).⁸ Certain bylaws changes also require membership approval, and the articles or

bylaws may require member approval of other, or any, amendment to the bylaws.⁹ In addition, members have certain inspection and other rights with regard to corporate records.¹⁰

Unless its articles or bylaws provide for members, a California nonprofit public benefit corporation is deemed to have none.¹¹ If the corporation has no members, actions that would otherwise require membership approval require only board approval, and rights that would otherwise vest in the members are vested in the directors.¹²

If the corporation is a non-member corporation, consider the following bylaws provision, which makes clear that the corporation does not have statutory members – even if (as permitted by California Corporations Code §5332) the corporation refers to persons associated with it as “members.”

No Statutory Members. This corporation shall not have voting members within the meaning of Section 5056 of the California Corporations Code, and nothing in these bylaws shall be construed or interpreted to constitute anyone a member of this corporation for purposes of the California Nonprofit Public Benefit Corporation Law. This corporation may refer to persons or entities associated with it as “members,” but no such reference shall constitute anyone as a member within the meaning of Section 5056 of the California Corporations Code.

3. NUMBER OF DIRECTORS

Unless a provision addressing the number of directors of the corporation is set forth in the articles (in which case it may only be changed by an amendment of the articles), the bylaws of a California nonprofit public benefit corporation must set forth the number of directors of the corporation, or the method of determining the number of directors of the corporation, or that the number of directors shall be not less than a stated minimum nor more than a stated maximum with the exact number of directors to be fixed, within the limits specified, by approval of the board or the members.¹³ Corporations often opt for the bylaws to set forth a range to allow for

flexibility in the size of the board over time; in such case, consider the model bylaws provision set forth below (which also requires that the authorized number of directors be an odd number to avoid deadlock).

Number of Directors. The number of directors of this corporation shall be an odd number that is not less than *[minimum]* nor more than *[maximum]*. The exact authorized number of directors shall be *[exact number within foregoing range]* until changed, within the limits specified, by resolution of the board.

Legal advisers to corporations whose bylaws set forth a variable (rather than a fixed) number of directors should be mindful of the need for board (or member) action whenever the corporation desires to change the exact authorized number of directors.¹⁴

4. EX OFFICIO DIRECTORS

One enduring area of confusion for California nonprofit corporations is the status of directors who hold office by virtue of occupying a specified position within (or outside) the corporation – so-called *ex officio* directors. The California legislature has made several updates to the law in recent years that have helped clarify that, unless the articles or bylaws limit the voting rights of a person designated as an *ex officio* director, that person is a director for all purposes and has the same rights and obligations, including voting rights, as the corporation’s other directors.¹⁵

The following model bylaws provision can be considered for nonprofit public benefit corporations whose boards include *ex officio* directors:

Ex Officio Directors. The individual serving as the *[insert specific description of position within or outside the corporation, e.g., president of ABC Hospital]* from time to time shall serve *ex officio* as a director (with the right to vote) for so long as he or she remains in such office.

Corporations that choose to limit the voting rights of an *ex officio* position should consider referring to the individual who occupies the position as something other than an “*ex officio* director” to

avoid confusion – since by virtue of such limitation, the individual is not a director.¹⁶

5. PROXY VOTING BY DIRECTORS

Another persistent area of confusion for leaders of California nonprofit public benefit corporations is proxy voting. It is not uncommon for the bylaws of a California nonprofit public benefit corporation to expressly allow directors to vote by proxy – that is, to permit a director to authorize another individual to vote on the director’s behalf. In corporations with statutory members,¹⁷ it is the case that members may vote by proxy unless proxy voting rights are limited or withdrawn by the articles or bylaws.¹⁸ Proxy voting by directors, however, is not permitted.¹⁹ Accordingly, as a reminder to and to reinforce this prohibition for the corporation’s constituents, it is recommended to include a provision such as the following in the bylaws:

Director Voting. Each director shall have one vote on each matter presented to the board of directors for action. A director shall not vote by proxy.

6. MANNER IN WHICH THE BOARD MAY ACT

The board of a California nonprofit public benefit corporation may act in one of two ways: at a meeting, or by unanimous written consent without a meeting.²⁰ Board meetings may be held in the traditional fashion, with the directors physically gathering at a designated time and place, but directors may also (and increasingly do) participate in meetings through use of conference telephone, electronic video screen communication, or electronic transmission by and to the corporation.²¹

As noted, to take action outside of a meeting, *all* directors must consent in writing to the action.²² The written consent may be in the form of one or more documents signed by the directors, facsimiles of those documents, or telegraphic or other electronic communications.²³

Given all of this, the question often arises, can directors hold a meeting, or submit

their votes, by email?²⁴ In the opinion of the author, email is not an appropriate way to hold a meeting. An argument could be made that email – which permits discussion/ deliberation to occur over an extended period of time (and potentially via different strings/ threads addressed to different subsets of the board) – does not allow for the type of “real time” discussion and debate that the directors are expected to engage in in the proper exercise of their fiduciary duties.²⁵ Nor, in the author’s opinion, would it be valid for a director to submit a vote by email, and have that vote be counted at a meeting that the director does not actually attend.²⁶ On the other hand, in the context of an action by unanimous written consent without a meeting, the corporation could solicit consent from a director by email, and the director could provide such consent by email, as long as certain additional requirements are met.²⁷

Model bylaws provisions addressing telephone and electronic meetings, action by written consent, and general requirements applicable to electronic transmissions by and to the corporation, are offered below.

Telephone and Electronic Meetings. Directors may participate in a meeting through use of conference telephone, electronic video screen communication, or other electronic transmission in compliance with *[insert reference to “Electronic Transmissions” section]* of these bylaws so long as both of the following apply:

- (i) each director participating in the meeting can communicate with all of the other directors concurrently; and
- (ii) each director is provided with the means of participating in all matters before the board, including the capacity to propose, or to interpose an objection to, a specific action to be taken by the corporation.

Action Without a Meeting. Any action required or permitted to be taken by the board may be taken without a meeting if all directors consent to such action in writing, provided that all requirements of Section 5211(b) of the California Nonprofit Public Benefit Corporation Law are met. A director may provide

such written consent by email or other electronic transmission, provided that the requirements of *[insert reference to “Electronic Transmissions” section]* of these bylaws are met. Such written consents shall be filed with the minutes of the proceedings of the board and shall have the same force and effect as the unanimous vote of such directors.

Electronic Transmissions. Unless otherwise provided in these bylaws, and subject to any guidelines and procedures that the board may adopt from time to time, the terms “written” and “in writing” as used in these bylaws include any form of recorded message in the English language capable of comprehension by ordinary visual means, and may include electronic transmissions, such as facsimile or email, provided (i) for electronic transmissions from the corporation, the corporation has obtained an unrevoked written consent from the recipient to the use of such means of communication; (ii) for electronic transmissions to the corporation, the corporation has in effect reasonable measures to verify that the sender is the individual purporting to have sent such transmission; and (iii) the transmission creates a record that can be retained, retrieved, reviewed, and rendered into clearly legible tangible form.

CONCLUSION

What’s the takeaway for legal advisers to healthcare organizations subject to the California Nonprofit Public Benefit Corporation Law? Add “review bylaws” to the list of periodic compliance checkups you conduct for your public benefit corporation clients. It’s possible (and perhaps even likely) that there are updates worth making.

END NOTES

1 California nonprofit corporations are governed by Division 2 of Title 1 of the California Corporations Code (Cal. Corp. Code §§5000-10841) (the “Nonprofit Corporation Law”). Pursuant to the Nonprofit Corporation Law, which took effect on January 1, 1980, nonprofit corporations in California are divided into three main types: public benefit, mutual benefit, and religious. In addition to the Nonprofit Corporation Law’s general provisions (Cal. Corp. Code §§5002-5080), each type of California nonprofit corporation is governed by a separate, self-contained part, known respectively as the Nonprofit Public Benefit Corporation Law (Cal. Corp. Code §§5110-6910), the Nonprofit Mutual Benefit Corporation Law (Cal. Corp. Code §§7110-8910), and the Nonprofit Religious Corporation Law (Cal. Corp. Code §§9110-9690). California nonprofit corporations formed before January 1, 1980, became subject to the Nonprofit Public Benefit Corporation Law, the Nonprofit Mutual Benefit Corporation Law, or the Nonprofit Religious Corporation Law on and after January 1, 1980, as specified in transition provisions set forth in Part 5 of the Nonprofit Corporation Law (Cal. Corp. Code §§9910-9928).

A California nonprofit corporation’s classification usually relates to its purposes. Nonprofit public benefit corporations, the focus of this article, are formed for public or charitable purposes. (See Cal. Corp. Code §5130(b).) Since, in the general law of charity, the promotion of health can be considered a charitable purpose (see, e.g., Rev. Rul. 69-545, 1969-2 C.B. 117), California healthcare providers organized as nonprofit corporations are typically incorporated under – or, if formed before January 1, 1980, are subject to – the Nonprofit Public Benefit Corporation Law.

2 Articles are filed with the California Secretary of State and are public documents. Through its Business Search portal (accessible at <https://businesssearch.sos.ca.gov/>), the Secretary of State’s office makes free pdf copies of imaged business entity documents, including articles, available; articles documents that are not available via the Business Search portal can be requested for a fee by submitting a Business Entities Records Request Form (see <https://bpd.cdn.sos.ca.gov/pdf/be-records-requests.pdf>).

3 See California Corporations Code §5130. In order for the corporation to be eligible for tax-exempt status under Internal Revenue Code §501(c)(3), the articles must also include certain additional provisions that limit the corporation's purposes, and that permanently dedicate the corporation's assets to appropriate purposes. (See 26 C.F.R. §1.501(c)(3)-1(b).)

4 California Corporations Code §§5150-5153 set forth the general substantive requirements for bylaws of California nonprofit public benefit corporations.

5 See California Corporations Code §5130(b).

6 As noted earlier, as between the articles and the bylaws, the articles (as the corporation's primary governing document) control.

7 The term "member" is defined in California Corporations Code §5056. Members (as defined in Cal. Corp. Code §5056) are sometimes referred to as "statutory members."

8 See California Corporations Code §5056(a).

9 See California Corporations Code §5150.

10 See California Corporations Code §§6330-6338.

11 See California Corporations Code §5310(a).

12 See California Corporations Code §5310(b).

13 See California Corporations Code §5151(a).

14 See California Corporations Code §5151(a). Note also, however, that any reduction of the authorized number of directors does not remove any director prior to the expiration of the director's term of office unless the reduction also provides for the removal of one or more specified directors. (See Cal. Corp. Code §5222(c).)

15 See California Corporations Code §§5047, 5220(f).

16 See California Corporations Code §5047, stating, in pertinent part: "A person who does not have authority to vote as a member of the governing body of the corporation, is not a director as that term is used in this division regardless of title."

17 See discussion at Section 2, above.

18 See California Corporations Code §5613(a).

19 See California Corporations Code §5211(c), stating: "A director shall not vote by proxy."

20 See California Corporations Code §5211.

21 See California Corporations Code §5211(a)(6); see also California Corporations Code §20 (for definition of "electronic transmission by the corporation") and §21 (for definition of "electronic transmission to the corporation").

22 See California Corporations Code §5211(b). Note that consents used to approve a transaction involving an "interested director" (as defined in California Corporations Code §5233(a)) or a "common director" (as described in California Corporations Code §5234) must satisfy additional conditions.

23 See California Corporations Code §5079; see also California Corporations Code §§8, 20, and 21.

24 Email is one type of "electronic transmission by and to the corporation"; see California Corporations Code §§20 and 21.

25 California Corporations Code §5211(a)(6), the statutory default rule addressing director participation in meetings through use of electronic transmission by and to the corporation, states, in pertinent part:

Participation in a meeting through use of electronic transmission by and to the corporation, other than conference telephone or electronic video screen communication, pursuant to this subdivision constitutes presence in person at that meeting if both of the following apply:

(A) Each director participating in the meeting can communicate with all of

the other directors concurrently.

(B) Each director is provided the means of participating in all matters before the board, including, without limitation, the capacity to propose, or to interpose an objection to, a specific action to be taken by the corporation.

In the author's opinion, email does not meet this standard.

26 See discussion above regarding the prohibition on proxy voting by directors.

27 Specifically, (i) in order for the corporation to use email to request consent to an action by written consent from a director, the corporation must have obtained an unrevoked consent from the director to the use of email for corporate communications; and (ii) in order for the corporation to accept a director's consent to an action by written consent sent via email, the corporation must have placed in effect reasonable measures to verify that the sender is the director purporting to have sent such transmission. See California Corporations Code §§8, 20, and 21.