



## **BUSINESS LAW SECTION**

NONPROFIT ORGANIZATIONS COMMITTEE  
THE STATE BAR OF CALIFORNIA  
180 Howard Street  
San Francisco, CA 94105-1639  
<http://www.calbar.org/buslaw>

### ***CONFORMING CALIFORNIA'S INVESTMENT STANDARD TO THE UNIFORM PRUDENT MANAGEMENT OF INSTITUTIONAL FUNDS ACT***

#### **LEGISLATIVE PROPOSAL (BLS-2015-01)**

**TO:** Office of Governmental Affairs

**FROM:** Joel S. Corwin, Chair, and Carol A. Bradford, Vice Chair-Legislation, Business Law Section (the "Section") Nonprofit Organizations Committee (the "Committee")

**DATE:** April 17, 2014

**RE:** Proposal to amend Corporations Code Sections 5240 and 9250

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#### **Section Action and Contacts**

Date of Approval by Section Executive Committee (the "Executive Committee"): July 11, 2014  
Approval Vote:

For: 13      Against 0

<b>Executive Committee Contact:</b>	<b>Committee Contact:</b>
Peter C. Califano, Esq. Cooper, White & Cooper LLP 201 California Street, Suite 1700 San Francisco, CA 94111 Tel: (415) 433-1900 <a href="mailto:pcalifano@cwclaw.com">pcalifano@cwclaw.com</a>	Joel S. Corwin, Chair of the Nonprofit Organizations Committee Law Offices of Joel S. Corwin 11661 San Vicente Blvd., Suite 500 Los Angeles, CA 90049 Tel: (310) 721-7320 <a href="mailto:jcorwin@corwin-law.com">jcorwin@corwin-law.com</a>

#### **HISTORY, DIGEST AND PURPOSE**

This Proposal would clarify California law with respect to the investment of funds by California nonprofit public benefit and religious corporations.

## **History and Reasons for the Proposal and Cross Reference to UPMIFA**

California regulatory requirements as they relate to the investments of nonprofit public benefit corporations have been confusing and unclear. Corporations Code Section 5240 subjects a nonprofit public benefit corporation to certain investment standards applicable to all assets held by the corporation for investment. Section 5240 requires that, in the course of managing the nonprofit public benefit corporation's investments, the board of directors must do the following:

- (1) Avoid speculation, looking instead to permanent disposition of the funds, considering both the probable income and the probable safety of the investment; and
- (2) Comply with any additional standards imposed by the articles, bylaws, or express terms of the agreement by which the assets were contributed to the corporation. Corp. Code § 5240(b).

Notwithstanding a body of case law, there appears to be no precise legal definition of "speculation." There have been attempts by courts to categorize investments as speculative but no clear or uniform guidance to assist fiduciaries with respect to their prospective investment decisions. Accordingly, fiduciaries, concerned with "avoiding speculation" and "preserving capital" have tended to emphasize long-term government and corporate bonds and "safer" equity investments (e.g., issuers with a track record of positive earnings and large capitalization) and to avoid "riskier" investment vehicles. To address this concern, most investment policies include some conservative standards around stocks and bonds and often include a list of "prohibited investments," which cannot be invested in, such as private placements, limited partnerships, tangible assets (such as silver and gold), bankruptcies and unseasoned companies. Obviously, certain investments not listed as "prohibited investments" could potentially prove to be inherently speculative or imprudent upon later review.

Effective January 1, 2009 California adopted Probate Code Section 18500 et seq., the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"). UPMIFA departs from the standard in Section 5240 above in at least the following two ways: (1) UPMIFA clearly articulates a focus on the overall fund rather than a particular investment, and (2) rather than "avoid speculation", UPMIFA specifies a variety of factors including a consideration of the risk and the appropriateness thereof with respect to the institution .

## **Proposal for Amendment to Nonprofit Public Benefit Corporation Law**

Because of the confusing and uncoordinated interplay between Section 5240(b)(1) and UPMIFA, in most cases, practitioners advise clients to attempt to comply with both – resulting in an overly conservative investment approach. The Committee does not believe that this is the right result and would instead suggest a coordination of the two sections by allowing compliance with UPMIFA to satisfy Section 5240(b)(1).

## **Proposal for Amendment to Nonprofit Religious Corporation Law**

The Committee suggests a similar coordination of Corporations Code Section 9250 with UPMIFA.

### **Additional Background**

Since 2010, California has followed the trend of most states and adopted UPMIFA. UPMIFA is the law in every state or U.S. territory except for Pennsylvania and Puerto Rico. (See News- Mississippi newest state to enact UPMIFA, UNIFORM LAW COMMISSION, <http://www.uniformlaws.org/NewsDetail.aspx?title=Mississippi%20newest%20state%20to%20enact%20UPMIFA>; see also Uniform Law Commission, Enactment Status Map, <http://uniformlaws.org/Act.aspx?title=Prudent%20Management%20of%20Institutional%20Fund%20Act> (last visited Oct. 17, 2013)).

However, the additional “avoid speculation” standard from Corporations Code Section 5240 is not that common. In a survey of five selected states, we found no laws that referenced a prohibition on “speculative investments” as it applied to nonprofit corporations generally – i.e., Oregon, Washington, Massachusetts, New York and Illinois. In 2010, New York adopted a version of UPMIFA and it applies to nonprofit corporations (See Tracey Drury, Paterson signs charity-endowment law, ALBANY BUSINESS REVIEW, Sept. 22, 2010, <http://www.bizjournals.com/albany/stories/2010/09/20/daily21.html>).

### **APPLICATION**

If enacted in 2015, the proposed legislation would become effective on January 1, 2016.

### **PENDING LITIGATION**

We are not aware of any specific pending litigation that would be affected by this Proposal.

### **LIKELY SUPPORT AND OPPOSITION**

We anticipate support from organizations that are subject to the California Nonprofit Public Benefit Corporation Law or the California Nonprofit Religious Corporation Law, which this change would impact. We are unaware of any specific segments that might oppose this proposal.

### **FISCAL IMPACT**

None.

### **GERMANENESS**

The matters addressed in this Proposal require the special knowledge, training, experience or technical expertise of the Section and of members of the Committee. The position advanced would promote clarity, consistency, and comprehensiveness in the law.

### **DISCLAIMER**

This position is only that of the Nonprofit Organizations Committee of the Business Law Section of the State Bar of California. This position has not been adopted by the State Bar's Board of Trustees or overall membership, and is not to be construed as representing the position of the State Bar of California.

Membership in the Nonprofit Organizations Committee and in the Business Law Section is voluntary and funding for their activities, including all legislative activities, is obtained entirely from voluntary sources.

### **TEXT OF PROPOSAL**

Corporations Code Sections 5240 and 9250 are amended to read as follows. Added text is indicated by underline. Deleted text is ~~lined out~~.

#### **5240.**

(a) This section applies to all assets held by the corporation for investment. Assets which are directly related to the corporation's public or charitable programs are not subject to this section.

(b) Except as provided in subdivision (c), in investing, reinvesting, purchasing, acquiring, exchanging, selling and managing the corporation's investments, the board shall do the following:

(1) Avoid speculation, looking instead to the permanent disposition of the funds, considering the probable income, as well as the probable safety of the corporation's capital.

(2) Comply with additional standards, if any, imposed by the articles, bylaws or express terms of an instrument or agreement pursuant to which the assets were contributed to the corporation.

(c) No investment violates this section where it conforms to provisions authorizing the investment contained in an instrument or agreement pursuant to which the assets were contributed to the corporation. No investment violates this section or Section 5231 where it conforms to provisions requiring the investment contained in an instrument or agreement pursuant to which the assets were contributed to the corporation.

(d) In carrying out duties under this section, each director shall act as required by subdivision (a) of Section 5231, may rely upon others as permitted by subdivision (b) of Section 5231, and shall have the benefit of subdivision (c) of Section 5231, and the board may delegate its investment powers as permitted by Section 5210.

(e) ~~[Delete Text Begins]Nothing in this section shall be construed to preclude the application of the Uniform Prudent Management of Institutional Funds Act (Part 7 (commencing with Section 18501) of Division 9 of the Probate Code) if that act would otherwise be applicable, but nothing in the Uniform Prudent Management of Institutional Funds Act alters the status of governing boards, or the duties and liabilities of directors, under this part.[Delete Text Ends]~~ [Insert Text Begins]Compliance with the Uniform Prudent Management of Institutional Funds Act (Part 7 (commencing with Section 18501) of Division 9 of the Probate Code), if that act would otherwise be applicable, will be deemed to be compliance with subdivision (b) hereof.[Insert Text Begins]

## 9250

(a) In investing, reinvesting, purchasing, acquiring, exchanging, selling, and managing a corporation's investments, the board shall meet the standards set forth in Section 9241.

(b) ~~[Delete Text Begins]Nothing in this section shall be construed to preclude the application of the Uniform Prudent Management of Institutional Funds Act, Part 7 (commencing with Section 18501) of Division 9 of the Probate Code, if that act would otherwise be applicable. However, nothing in the Uniform Management of Institutional Funds Act alters the status of governing boards, or the duties and liabilities of directors, under this part.[Delete Text Ends]~~ [Insert Text Begins]Compliance with the Uniform Prudent Management of Institutional Funds Act (Part 7 (commencing with Section 18501) of Division 9 of the Probate Code), if that act would otherwise be applicable, will be deemed to be compliance with subdivision (b) hereof.[Insert Text Ends]

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