Chapter 10 (Disposition of Assets) of the
MNCA Fourth Edition December 13, 2019 Exposure Draft

compared with

MNCA Third Edition Chapter 12 (Disposition of Assets)
(with amendments adopted through those published at 70 Bus. Law 467 (Spring 2015) and
also includes amendments approved on second reading
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Additions in Exposure Draft shown in blue with double underline
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[Chapter] 1210
DISPOSITION OF ASSETS

§ 12.011001. Disposition of assets not requiring member approval.

§ 12.021002. Member approval of certain dispositions.

§ 12.031003. Restrictions on dispositions of assets.

12.01§ 1001. DISPOSITION OF ASSETS NOT REQUIRING MEMBER APPROVAL

(a) Approval of the members of a nonprofit corporation is not required, unless the articles of incorporation or bylaws otherwise provide, no approval of the members of a membership corporation is required:

(1) to sell, lease, exchange, or otherwise dispose of any or all of the corporation’s assets:

(i) in the usual and regular course of its activities; or

(ii) if the corporation and its consolidated subsidiaries any entities in which the corporation owns 80% or more of the outstanding interests, retain an activity that represented or was supported by at least 33 percent of total assets at the end of the most recently completed fiscal year;

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(2) to mortgage, pledge, dedicate to the repayment of indebtedness (whether with or without recourse), or otherwise encumber any or all of the corporation’s assets, whether or not in the usual and regular course of business its activities; or

(3) to transfer any or all of the corporation’s assets to one or more corporations or other entities all of the memberships or interests of which are owned by the corporation.

(b) See Section 12.031003 (restrictions on dispositions of assets).


CROSS-REFERENCES

Director standards of conduct, see § 8.30830.
Distributions to members, see § 6.40640.
Member approval of certain dispositions, see § 12.021002.

OFFICIAL COMMENT

Section 12.01 provides that no approval of the members is required for dispositions of assets of the types described therein, unless the articles of incorporation or bylaws otherwise provide. Dispositions other than those described in Section 12.01 require member approval if they fall within Section 12.02.

Section 1001 provides generally that member approval is not required for a sale, lease, exchange or other disposition by a nonprofit corporation that would leave the corporation with a significant continuing activity.

Section 12.01(a) provides that member approval is not required for a sale, lease, exchange or other disposition by a corporation that would leave the corporation with a significant continuing activity. The test employed in Section 12.01(a) for whether a disposition of assets requires member approval differs verbally from the prior test, which centered on whether a sale involves “all or substantially all” of a corporation’s assets. In practice, courts have commonly employed a test comparable to that embodied in 12.01(a). For example, in Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch.), aff’d, 316 A.2d 619 (Del. 1974), the court stated that “While it is true that [the all or substantially all] test does not lend itself to a strict mathematical standard to be applied in every case, the qualitative factor can be defined to some degree. . . . If the sale is of assets quantitatively vital to the operation of the corporation and is out of the ordinary [course]
and substantially affects the existence and purpose of the corporation then it is beyond the power of the Board of Directors.” In *Thorpe v. Cerbco, Inc.*, 676 A.2d 436 (Del. 1996), a major issue was whether the sale by a corporation, CERBCO, of one of its subsidiaries, East, would have been a sale of all or substantially all of the corporation’s assets, and therefore would have required shareholder approval under the Delaware statute. The court, quoting *Oberly v. Kirby*, 592 A.2d 445 (Del. 1991), stated:

“[T]he rule announced in *Gimbel v. Signal Cos.*, Del. Ch., 316 A.2d 599, aff’d, Del. Supr., 316 A.2d 619 (1974), makes it clear that the need for shareholder approval is to be measured not by the size of a sale alone, but also by its qualitative effect upon the corporation. Thus, it is relevant to ask whether a transaction ‘is out of the ordinary and substantially affects the existence and purpose of the corporation.’ [*Gimbel*, 316 A.2d] at 606.

“In the opinion below, the Chancellor determined that the sale of East would constitute a radical transformation of CERBCO. In addition, CERBCO’s East stock accounted for 68 [percent] of CERBCO’s assets in 1990 and this stock was its primary income generating asset. We therefore affirm the decision that East stock constituted “substantially all” of CERBCO’s assets as consistent with Delaware law.”


Section 12.011001(a)(1)(ii) provides a safe harbor under which member approval is not required if a nonprofit corporation retains a continuing activity that represents at least 25 percent of the total assets of the *company* corporation and its subsidiaries on a consolidated basis for the most recent full fiscal year. Adoption of that safe harbor represents a policy judgment that a greater measure of certainty than is provided by interpretations of the current case law is highly desirable. The application of this bright-line safe-harbor test should, in most cases, produce a reasonably clear result substantially in conformity with the approaches taken in the better case law developing the “quantitative” and “qualitative” analyses. The test is to be applied to assets for the most recent fiscal year ended immediately before the decision by the board of directors to make the disposition in question.

If a nonprofit corporation disposes of assets for the purpose of reinvesting the proceeds of the disposition in substantially the same activity in a somewhat different form (for example, by selling the corporation’s only building for the purpose of buying or building a replacement building), the disposition and reinvestment should be treated together, so that the transaction should not be deemed to leave the corporation without a significant continuing activity.

In determining whether member approval of a disposition of assets is required, the subsidiaries of a nonprofit corporation that are or should be consolidated with the parent under generally accepted accounting principles are included in the calculation of whether the safe harbor in Section 12.011001(a)(1)(ii) is met.
The board of directors may base a determination that a retained activity falls within the 2533 percent bright-line test of the safe harbor embodied in Section 12.0110.01(a)(1)(ii) either on accounting principles and practices that are reasonable in the circumstances or on a fair valuation or other method that is reasonable in the circumstances.

The utilization of the specific 2533 percent safe harbor test for purposes of this section should not be read as implying a standard for the test of significance or materiality for any other purposes under the act or otherwise.

Under Section 12.0110.01(a)(1)(i), member approval is not required for a disposition of the nonprofit corporation’s assets in the usual and regular course of its activities, regardless of the size of the transaction.

Under Section 12.0110.01(a)(2), member approval is not required before a nonprofit corporation encumbers its assets, whether or not in the usual and regular course of business its activities. Such a transaction often involves a bank or some other lender requiring a corporation to pledge its property as collateral for a loan. Subject to a contrary provision in a corporation’s articles of incorporation or bylaws, an encumbrance may be authorized by the board of directors alone.

Section 12.01(a)(3) provides that no approval of members is required to transfer any or all of the corporation’s assets to a wholly owned subsidiary or other entity. This provision may not be used as a device to avoid a vote of members by a multistep transaction because of Section 12.02(h) which treats assets of subsidiaries as assets of their parent.

12.02 § 1002. MEMBER APPROVAL OF CERTAIN DISPOSITIONS

(a) Except as provided in the articles of incorporation or bylaws, a sale, lease, exchange, or other disposition of assets, other than a disposition described in Section 12.0110.01 (disposition of assets not requiring members approval), requires approval of the corporation’s members of a membership corporation.

(b) A sale, lease, exchange, or other disposition that requires approval of the members under subsection (a) must be initiated by a resolution by the board of directors authorizing the disposition. After adoption of the resolution, the board of directors must first approve the disposition. The disposition shall then be approved by the members. In submitting the disposition to the members for approval, the board of directors must submit the proposed disposition to the members for their approval. The board of directors must also transmit to the members a recommendation that the members approve the proposed disposition, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors must transmit to the members the basis for that determination.
The board of directors may condition its submission set conditions for the approval by the members of a disposition to or the members under subsection (b) on any basis effectiveness of the disposition.

If a disposition is required to be approved by the approval of the members under subsection (a), and if the approval is to be given at a meeting, the nonprofit corporation shall notify each member entitled to vote of the meeting of members at which the disposition is to be submitted for approval. The notice must state that the purpose, or one of the purposes, of the meeting is to consider the disposition and must contain a description of the disposition, including the terms and conditions thereof of the disposition and the consideration to be received by the corporation.

Unless the articles of incorporation or bylaws, or the board of directors acting pursuant to subsection paragraph (eb)(3), requires a greater vote, or a greater number of votes to be present, the approval of a disposition by the members requires the approval of the members at a meeting at which a quorum exists, and, if any class of members is entitled to vote as a separate group on the disposition, the approval of each such separate voting group at a meeting at which a quorum of the voting group exists.

After a disposition has been approved by the members under subsection paragraph (eb)(5), and at any time before the disposition has been consummated, it may be abandoned by the nonprofit corporation without action by the members, subject to any contractual rights of other parties to the disposition.

A disposition of assets in the course of dissolution under [Chapter] 1411 (dissolution) is not governed by this section.

The assets of a direct or indirect consolidated subsidiary are deemed to be the assets of the parent nonprofit corporation for the purposes of this section.

In addition to the approval of a disposition of assets by the board of directors and members as required by this section, the disposition must also be approved in the form of a record by any person or group of persons whose approval is required under Section 10.30930 to amend the articles of incorporation or bylaws.

See Section 12.031003 (restrictions on dispositions of assets).

from two-thirds to a majority of the votes cast.
(2016 Revision), § 12.02.

CROSS-REFERENCES

Director standards of conduct, see § 8.30830.
Disposition of assets not requiring member approval, see § 12.011001.
Dissolution, see § 14.
Notice generally, see § 1.41103.
Notice of meeting of members, see § 7.05705.
Supermajority quorum and voting requirements, see § 7.26726.
Voting by voting group, see §§ 7.24724 and 7.25725.
“Voting group” defined, see § 1.40102.

OFFICIAL COMMENT

Section 12.021002(b) requires the board of directors, after having adopted a resolution
authorizing approved a disposition that requires member approval, to submit the disposition to the
members for approval. When submitting the disposition to the members, the board of directors
must make a recommendation to the members that the disposition be approved, unless the board
makes a determination that because of conflicts of interests or other special circumstances it
should not make a recommendation. For example, the board of directors may make such a
determination where there is not a sufficient number of directors free of a conflicting interest to
approve the transaction or because the board of directors is evenly divided as to the merits of a
transaction but is able to agree that members should be permitted to consider the transaction. If
the board of directors makes such a determination, it must describe the conflicts of interests or
special circumstances, and communicate the basis for the determination, when submitting the
disposition to the members. The exception for conflicts of interest or other special circumstances
is intended to be sparingly available. Generally, members should not be asked to act on a
disposition in the absence of a recommendation by the board of directors. The exception is not
intended to relieve the board of directors of its duty to consider carefully the proposed
transaction and the interests of members.

Section 12.021002(eb)(2) permits the board of directors to condition its submission of a
proposed disposition to the members. Among the conditions that a board might impose are that
the disposition will not be deemed approved unless it is approved by a specified percentage of
the members, or by one or more specified classes of members, voting as a separate voting group,
or by a specified percentage of disinterested members.

Section 12.021002(eb)(3) provides that approval of a disposition requires approval of the
members at a meeting at which at least a majority of the votes entitled to be cast on the
disposition is present. In lieu of approval at a meeting of the members, approval can be given by
the consent of all the members entitled to vote on the transaction, under the procedures set forth
in Section 7.04704.
The term “subsidiary” or “subsidiaries,” as used in Section 12.021002, includes both corporate and noncorporate subsidiaries. Accordingly, for example, a limited liability company or a partnership may be a subsidiary for purposes of Section 12.021002.

§ 12.031003. RESTRICTIONS ON DISPOSITIONS OF ASSETS

(a) Property held in trust or that is otherwise dedicated to a charitable asset purpose may not be diverted from its purpose by a transaction described in Section 12.01 or 12.021001 (disposition of assets not requiring member approval) or 1002 (member approval of certain disposions) unless the nonprofit corporation obtains an appropriate order from [court] [the attorney general] to the extent required by and pursuant to the law of this state on cy pres or otherwise dealing with the nondiversion of charitable assets.

(b) A person who is a member or otherwise affiliated with a charitable corporation may not receive a direct or indirect financial benefit in connection with a disposition of assets unless the person is a charitable corporation or an unincorporated entity that has a charitable purpose. This subsection does not apply to the receipt of reasonable compensation for services rendered.

Source Note: Subsection (a) patterned after 15 Pa.C.S. § 5547(b). Derived from Revised Model Nonprofit Corporation Act (1987), 3rd Ed. (2008), § 12.02(g) 12.03.

CROSS-REFERENCES

“Charitable corporation” defined, see § 1.40140.

OFFICIAL COMMENT

Section 12.031003(a) protects property held in trust or that is a charitable asset from being diverted by in a disposition of assets from its restricted purposes. Section 12.031003(a) applies does not apply to all nonprofit corporations; only those that hold charitable assets or are established for a charitable purpose. A state adopting Section 12.031003(a) should consider what restrictions and procedures should apply in a proceeding under that provision.
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