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November 18, 2011

### The New D.C. Nonprofit Corporation Act Takes Effect on Jan. 1, 2012: Everything You Need to Know to Comply

Related Topic Area(s): Corporate Governance

The coming New Year will soon usher in a new legal landscape for District of Columbia nonprofit corporations. On January 1, 2012, the new District of Columbia Nonprofit Corporation Act of 2010 goes into effect. To ensure that your organization is ready to comply, now is the time to review your organization's articles of incorporation, bylaws, and governance policies and practices for any necessary changes.

As a general rule, the 2010 Act provides D.C. nonprofit corporations with considerable flexibility to structure their corporate governance, and for the most part will not require changes to day-to-day operations. However, numerous default rules have changed under the 2010 Act and new, more detailed provisions governing matters like director standards of conduct and liability, indemnification, member voting rights and ballot voting procedures, and numerous other topics require D.C. nonprofit corporations to familiarize themselves with the new law, and determine whether changes to their governing documents or practices will be necessary to comply. The following highlights many of the significant changes that are in store.

#### GENERAL PROVISIONS AND APPLICABILITY

##### Location of General Provisions (D.C. Code, Title 29, Chapters 1 and 4)

- The new Business Organizations Code—Title 29 of the D.C. Code—is a hub-and-spoke structure. Chapter 1 of the Code contains one set of general provisions and definitions that govern all business organizations in the District on matters such as filing of corporate reports and requirements for registered agents. Separate chapters then govern matters unique to each type of business entity. Nonprofit corporations must look to Chapter 1 of Title 29 for important general provisions and definitions and to Chapter 4 for the rules specifically applicable to nonprofit corporations.

##### Biennial Reports Filing Deadline (D.C. Code § 29-102.11)

- Biennial reports will now be due every two years on or before April 1 instead of January 15. According to unofficial agency guidance, organizations should continue to follow their existing two-year cycle for filing the biennial report, and should simply begin using the new April 1 filing deadline in the year their report is due (i.e., organizations that last filed in January 2010 have until April 1, 2012 to file their next-due biennial report).

##### Corporate Records (D.C. Code §§ 29-413.01 to .05)

- The new law specifies expanded record-keeping requirements for D.C. nonprofit corporations and permits such records to be kept in digital form. Minutes of all meetings of and records of all actions taken by the board, members, and any designated body must be maintained permanently. Appropriate accounting records and membership lists must be maintained. Additionally, numerous records must be maintained at the corporation's principal office, including the articles, bylaws, minute books for the most recent three years, all formal notices or other communications to members for the most recent three years, a current list of the names and business addresses of the corporation's directors and officers, and a copy of the corporation's most recent biennial report.

##### "Old Act" Corporations (D.C. Code §§ 29-107.01(b); 414.01)

- The new law appears to be intended to phase out so-called old act corporations—those incorporated in the District prior to the 1962 enactment of the District of Columbia Nonprofit Corporation Act. See D.C. Council Committee on Public Services and Consumer Affairs, Committee Report on Bill 18-500, at 18 (explaining that § 29-107.01 "includes a provision designed to phase out 'old-Code' corporations"). Technically, old act corporations have two years from the new law's applicability date in which to file a notice with the District that includes the corporation's articles of

incorporation or other public organic record and the names and street addresses of its current directors and officers. Any old act corporation that fails to provide the required notice within the required time period shall be thereafter barred from asserting that it is not subject to the requirements of the new law. However, despite this provision, any old act corporation that desires to do business in the District must file articles of incorporation and comply with the provisions of the new law.

## **BOARD AND OFFICER PROVISIONS**

### **Board Quorum** (D.C. Code § 29-406.24)

- Default quorum is now a majority of directors in office before a meeting begins. A different quorum may be established by the articles or bylaws, provided it is not lower than the minimum quorum requirement.
- Minimum quorum is now 1/3 of the directors in office or two directors, whichever is greater.
- *Previous default quorum was a majority of the number of directors fixed in the articles or bylaws. Previous minimum quorum was 1/3 of the number of directors fixed in the articles or bylaws.*

### **Board Committees** (D.C. Code § 29-406.25)

- A board committee may now consist of one or more directors (previously at least two directors were required).

### **Minimum Officers** (D.C. Code § 29-406.40)

- Two separate officers are required at minimum—one officer responsible for management (e.g., a “president”), and one officer for finances (e.g., a “treasurer”). The president and treasurer positions cannot be held by the same individual. One of the officers must be assigned the duties of a secretary.
- *Previously a president, secretary, and treasurer were required, and the president and secretary positions could not be held by the same person.*

### **Standards of Conduct** (D.C. Code §§ 29-406.30, 406.32, 406.42, 406.70, 406.80)

- The new law codifies traditional common law concepts of director and officer fiduciary duties (e.g., the duties of care and loyalty). An individual director or officer must discharge his or her duties in good faith, in a manner that he or she reasonably believes is in the best interests of the corporation, and with either the care that a person in a like position would reasonably believe appropriate under similar circumstances (directors) or with the care an ordinarily prudent person in a like position would exercise under similar circumstances (officers).
- The new law provides procedures by which potential conflict of interest transactions can be processed.
  - *Conflicted Interest Transactions.* Transactions between the corporation and any director, officer, or member having an interest in the transaction shall not be void or voidable solely for that reason, provided the transaction is fair to the corporation at the time it is authorized or provided the material facts as to the relationship or interest are disclosed and the transaction is then approved in good faith by vote of the disinterested directors or the members.
  - *Business Opportunities.* A director may avoid liability for taking for himself, directly or indirectly, a business opportunity in which the nonprofit corporation may be interested, provided the director first brings the opportunity to the corporation’s attention and the corporation disclaims its interest in the opportunity pursuant to the procedures for a conflicted interest transaction (i.e., the material facts as to the relationship or interest are disclosed and the opportunity is disclaimed in good faith by vote of the disinterested directors or the members).
- Loans to directors and officers continue to be prohibited; however, the new law carves out exceptions for particular permissible advances (e.g., for reimbursable expenses or pursuant to employee benefit plans) and loans (e.g., those secured by the principal residence of an officer or to pay relocation expenses of an officer).

### **Liability** (D.C. Code §§ 29-402.02(c), 406.31, 406.90 to .91)

- The new law codifies specific standards for director liability to the corporation or its members.
  - *General Standard.* As a general rule, a director will not be liable to the corporation or its members unless the party asserting liability establishes that the director failed to meet the required standards of conduct for directors (i.e., the prescribed standards of good faith, loyalty, and care) in discharging his or her duties.
  - *Limited Liability for Money Damages.* The new law automatically limits the liability of a director of a charitable corporation for money damages in connection with certain actions or inactions of the director. Directors of non-charitable corporations may only qualify for similar limited liability

protections if the limitation is specified in the corporation's articles. For purposes of the new law, a charitable corporation is one that is eligible for exempt status under Section 501(c)(3) of the Internal Revenue Code. A trade association or other non-501(c)(3) corporation should consider amending its articles if providing these protections to the corporation's directors is desired.

- The new law retains provisions of existing law that provide volunteers of nonprofit corporations (e.g., directors, officers, and others who perform services for the corporation without compensation) with limited immunity from civil liability to third-parties in connection with their volunteer service, provided that the corporation maintains a minimum level of liability insurance (i.e., not less than \$200,000 per individual claim and \$500,000 per total claims arising from the same occurrence). The exception from the minimum insurance requirement is retained for 501(c)(3)s having annual total functional expenses, exclusive of grants and allocations, of less than \$100,000.

#### **Indemnification** (D.C. Code §§ 29-406.50 to .58)

- The new law includes detailed provisions governing when a corporation must, may, and may not indemnify a director or officer. Specific procedures are now required to be followed before indemnification may be made under non-mandatory circumstances. Under the new law, a corporation may not indemnify a director or officer unless indemnification is authorized for a specific proceeding after a determination is made by the disinterested members of the board, by the members, or by special legal counsel that indemnification is permissible because the director or officer has met the applicable standard of conduct. The corporation may authorize permissible indemnification in advance through an obligatory provision of the articles or bylaws or by resolution of the board. However, the determination of permissibility must be made in each specific instance. Similarly, detailed procedures are required before a corporation may advance expenses to a director or officer in connection with a proceeding. Finally, the corporation may provide for broader indemnification under a provision of its articles (within specific limits), or may limit any indemnification rights provided by statute under a provision of its articles or bylaws.

#### **MEMBERSHIP PROVISIONS**

##### **"Member" Definition** (D.C. Code § 29-401.02)

- A member is any person that has the right to select or vote for the election of directors or delegates, or to vote on any type of fundamental transaction. Other persons may be referred to by the corporation as "members" but those who do not have voting rights are not members for purposes of the statute.

##### **Membership Meetings** (D.C. Code §§ 29-405.01 to .09)

- If authorized by the articles or bylaws, meetings of members may now be held by means of the Internet or other electronic communications technology that permits members to read or hear the proceedings substantially concurrently with their occurrence, to vote on matters submitted, to pose questions, and to make comments.
- Special meetings may be called by at least 10 percent of the voting members or such other amount up to 25 percent as the articles or bylaws may specify.
- *Previously, special meetings could be called by at least five percent of the voting members, unless otherwise provided in the articles or bylaws, with no cap on the minimum percentage required to call the meeting.*

##### **Notice** (D.C. Code §§ 29-101.02(39); 401.03; 405.05)

- Notice may be communicated in person or by delivery, including by electronic transmission, no fewer than 10 nor more than 60 days before each meeting of the members, unless otherwise provided in the articles or bylaws.
- *Previously, the default notice period was no fewer than 10 nor more than 50 days before each meeting and no particular provision was made for oral or electronic notice.*

##### **Action by Ballot** (D.C. Code § 29-405.09)

- A new provision governing ballot voting permits members to act without a meeting provided the corporation follows specific procedures pertaining to ballots. The corporation must deliver a ballot to every member entitled to vote on the matter; the ballot must be in the form of a record (which could include an electronic ballot or email), set forth each proposed action, provide an opportunity to vote for or withhold a vote for each candidate in the case of a director election, and provide an opportunity to vote for or against each other proposed action. All solicitations for votes by ballots must indicate the number of responses needed to meet the quorum, state the percentage of approvals necessary to approve each matter other than the election of directors, and specify the time by which a ballot must be received by the corporation to be counted. Approval by ballot shall

be valid only when the number of votes cast equals or exceeds the quorum required to be present at a meeting authorizing the action, and the number of approvals equals or exceeds the number of votes that would be required to approve the matter at a meeting at which the total number of votes cast was the same as the number of votes cast by ballot.

**Voting Entitlement** (D.C. Code § 29-405.21)

- Each member is entitled to one vote on each matter voted on by the members, except as otherwise provided in the articles or bylaws.
- *Previously, members were not entitled to vote except as the right to vote was granted in the articles. The new default is the opposite—members are entitled to vote unless otherwise limited by the articles or bylaws.*

**Member Quorum** (D.C. Code § 29-405.24)

- Default quorum is now a majority of votes entitled to be cast on a matter. A different quorum (greater or lesser) may be established by the articles or bylaws.
- *Previous default quorum was 1/10 of the votes entitled to be cast on a matter.*

**Voting for Directors** (D.C. Code §§ 29-405.27; 414.03)

- Directors shall be elected by a plurality of the votes cast by the members entitled to vote in the election at a meeting at which a quorum is present, unless otherwise provided in the articles or bylaws.
- Members shall not have the right to cumulate their votes, unless permitted by the articles or bylaws. However, members that were entitled to cumulate their votes for election of directors prior to the effective date of the 2010 Act may continue to do so until otherwise provided in the organization's articles or bylaws.
- *Previously, by default, directors were elected by majority vote and members were entitled to cumulate votes in director elections.*

**Delegates; Designated Body** (D.C. Code §§ 29-404.30; 406.12)

- Under the new law, a nonprofit membership corporation may provide in its articles or bylaws for delegates, which may exercise some or all of the rights of members in governing the corporation. Additionally, a group of delegates may be a “designated body” authorized to exercise some, but less than all, powers of the board, to the extent provided in the articles or bylaws.

**Amendments to Articles and Bylaws** (D.C. Code §§ 29-408.01 to .09)

- Amendments to the articles proposed by the board must be approved by the board and submitted for approval to any members entitled to vote on the amendments. The board need not obtain approval of the members, however, to adopt certain administrative amendments or to restate the articles without revision. Members entitled to vote on amendments to the articles may also propose and adopt amendments without approval of the board—such amendments may be proposed by 10 percent or more of the members entitled to vote on articles amendments, or by such greater or lesser number as specified in the articles.
- Members may amend or repeal the corporation's bylaws, except as otherwise provided in the articles or bylaws. The board of directors may also amend or repeal the corporation's bylaws, unless the articles or bylaws reserve that power exclusively to the members or a designated body, in whole or in part. However, unless otherwise provided by the articles or bylaws, certain amendments affecting the rights of members may only be adopted by the members (e.g. members' respective rights and obligations with respect to voting; levying dues, assessments or fees on some or all members; requiring cause to remove a director). Only the members may amend the articles or bylaws to alter the members' exclusive statutory right to adopt such amendments.
- *Previously, the members did not have an independent right to amend the articles without approval of the board, and the power to amend the bylaws was vested solely in the board, unless otherwise provided in the articles or bylaws. Also, the new law permits a nonprofit corporation to restate its articles, which was not previously an option.*

**Inspection of Membership List** (D.C. Code § 29-405.20)

- The corporation must prepare a list of members entitled to notice of a particular meeting of members, showing the address of each member and the number of votes that each member is entitled to cast at the meeting. The list must be made available to members for inspection beginning two business days after notice of the meeting is given and continuing through the meeting. Upon written demand and a showing of proper and relevant purpose, the member must also be allowed to copy the list. Instead of making the list available for inspection, the corporation may state in the meeting notice that the corporation has elected to proceed under D.C. Code § 29-

405.20(f), which requires a member's demand for inspection to state a proper purpose for inspection, and which permits the corporation to offer, within 10 business days of receiving the demand, a reasonable alternative method for achieving the purpose. Refusal or failure to prepare or make the list available shall not affect the validity of action taken at the meeting; however, a member is entitled to seek enforcement of his or her right to inspect or copy the list by court order.

**Inspection of Records; Financial Statements** (D.C. Code §§ 29-413.02; 413.20)

- Members are granted the right to inspect and copy any of the corporate records required to be maintained by the corporation under the new law upon written demand, and in some circumstances, upon a showing of proper and relevant purpose. Members may not use the member list, however, for any commercial purpose, or to solicit money or property (unless the money or property will be used to solicit votes of the members in connection with an election to be held by the nonprofit corporation). The new law currently states that the members' right to inspect corporate records may be abolished or limited in the articles or bylaws. However, indications have been made that this was a drafting error which may soon be corrected in a package of technical amendments to the new law.
- Separately, the corporation's latest annual financial statements, which shall include a balance sheet and a statement of operations for the most recent fiscal year, must be furnished to members upon written request.

**FUNDAMENTAL TRANSACTIONS**

**Domestication** (D.C. Code § 29-407.01 to .06)

- The new law provides for a domestication process, which permits a nonprofit corporation to transfer its jurisdiction of incorporation without having to create or merge into a different legal entity, provided that domestication is authorized by the laws of both the new and old jurisdictions.

**Notice of Charitable Dissolution** (D.C. Code § 29-412.02)

- A charitable corporation must now provide notice to the Attorney General of the District of Columbia that it intends to dissolve prior to delivering articles of dissolution to the D.C. Department of Consumer and Regulatory Affairs. This notice requirement shall not, however, delay or otherwise affect the dissolution process.