NONPROFITS: CALIFORNIA ATTORNEY GENERAL

New Reporting Duties for CA Charitable Trustees

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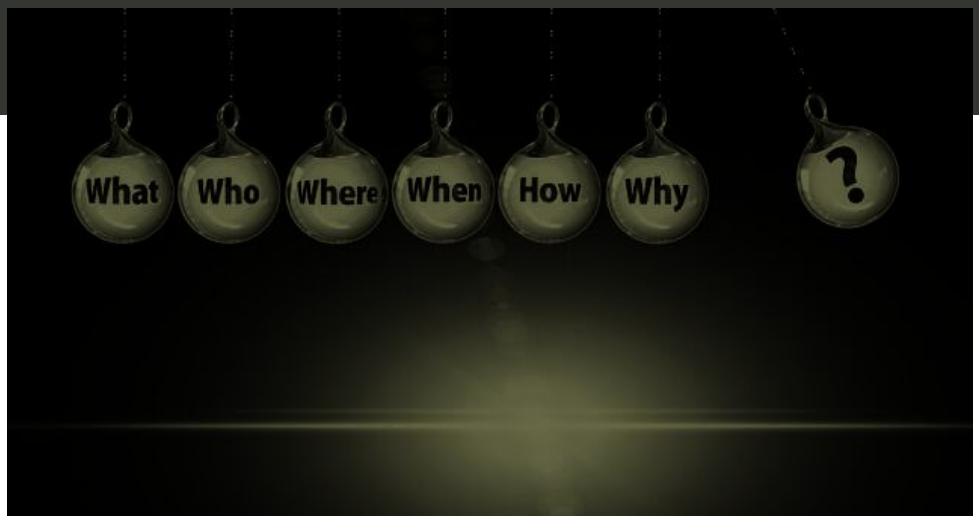

In 2021, the California legislature made a simple fix for an inadvertent loophole in the state law on the reporting duties of charitable trustees. See *CA Legislative Wrap-Up: Nonprofits & Charitable Trusts* (October 14, 2021), *FPLG Blog*.

By approval of AB 900, effective July 1, 2022, lawmakers added a new Section 16106 to the Probate Code "requiring trustees holding charitable assets to give written notice to the Attorney General at least 20 days before the trustee sells, leases, conveys, exchanges, transfers, or otherwise disposes of all or substantially all of the charitable assets."

Previously – and separately – the legislature had imposed such an advance-reporting duty on officials of 501(c)(3) charitable organizations; that is, California "public benefit" corporations. Once the governor signed AB 900 into law in early October 2021, the result was the desired parity and consistency between the obligations of charitable trusts and charitable organizations.

The sole remaining matter was to pinpoint and define the meaning of "all or substantially all" of the charitable assets. Just recently, on June 19, 2023, the California Attorney General's office published final regulations with those definitions.

Definitions Needed

There was broad support among legislators as well as the nonprofit community and the general public for AB 900.

The California Association of Bankers, while generally in favor of the new law, asked that the term "all or substantially all" be further explained or defined. Many charitable trusts are administered by institutional fiduciaries, notably from banks.

This "substantially all" language pops up regularly in statutes all around the United States, but it's a notoriously squishy and imprecise term. The compromise solution adopted by lawmakers here was to add a new subsection (b) to the final version of AB 900, specifying that the Attorney General must "establish rules and regulations necessary to administer this section" beginning on and after January 1, 2022."

Following the close of the legislative session, when the bill was signed into law by Governor Gavin Newsom in early October 2021, the AG's office promptly undertook this task of drafting regulations, first by inviting public comment and input in developing proposed regulations.

The next step was issuing proposed regulations including the customary period for public comment. The Attorney General's office tweaked them a bit, and then issued final regulations based on those modifications.

New Final Regs

For the last twenty years or so, state attorneys general around the nation have jump-started their traditional (but largely dormant) roles as the primary regulators of charities and charitable trusts. See *Restatement of the Law, Charitable Nonprofit Organizations* § 5.01 (Am. L. Inst., 2021). California is among the leading jurisdictions in this effort to beef up the investigative and enforcement activities.

According to the key legislative sponsor of new AB 900, Assembly Majority Leader Eloise Gomez Reyes, there was good cause to step up the reporting duties of charitable trustees. The Attorney General's Office, she explained, "has investigated several matters involving self dealing trustees in recent years. See, e.g. *People of the State of California v. Bishop,* (Super. Ct. Napa. County, 2014) No. 26-65141, "Petition for Removal of Trustees, Appointment of Receiver or Temporary Trustee, an Accounting, and to Void the Transfer of Trust Property to Trustee."

As usual, the "People of the State of California" drafted a clear and excellent 16-page Complaint describing the outrageous abuses and malfeasance of these two co-trustees. But it was hard to resist creating our own tongue-in-cheek narrative version of these shenanigans. *A Recipe for How To Get Noticed by the California Attorney General* (May 1, 2015), was one of the earliest FPLG blog posts and remains a favorite.

What is "Substantially All"?

The new regulations define the fuzzy phrase – "substantially all" of the assets…." so that now there is clearer guidance on when the notice duty is triggered. That change will help the AG regulators to take "proactive enforcement action, including legal action to halt misuse or diversion of charitable assets."

It also creates a standard for the Attorney General to evaluate requests to waive the notice requirements; that is, if and when there is a determination that "the transaction poses no risk to the public interest and the financial cost to the charitable corporation, trust, or mutual benefit corporation of providing notice to the Attorney General outweighs the potential benefit to the public interest."

The new final regulation is section 328.1, titled: "Notice of Transactions Involving All or Substantially All Assets of Charitable Corporation or Trust, or Assets in Charitable Trust Held by a Nonprofit Mutual

Benefit Corporation."

Subsection (a) defines "'substantially all' of the charitable assets" as "an asset or assets equal to or exceeding 75% of the value of all assets held by the charitable corporation or trust at the time of the notice or at any time during the six-month period before submitting the notice. Notice must be provided if the transaction involves 'substantially all' assets under either book value or fair market value."

Subsection (b) makes clear that this "... duty to give notice may not be avoided by structuring a single transaction into multiple transactions to avoid triggering the 75% threshold." Moreover, if a transaction "... "is part of or related to a series of transactions, all of the related transactions shall be considered and analyzed as a single transaction for purpose of giving notice."

If there is a question about whether a "series of transactions will be considered a single transaction for purposes of this section, the Attorney General will consider the surrounding circumstances, including, but not limited, to any of the following factors:

(1) whether the parties to the transaction are the same parties in another transaction, or related to or affiliated with parties in another transaction;

(2) whether the completion of one transaction is conditioned upon the completion of another transaction;

(3) whether the membership, officers, or governing board of the charitable corporation or trust has taken any action to wind down or dissolve the charitable corporation or trust; and

(4) whether the liabilities of the charitable corporation or trust significantly outweigh its assets."

Subsection(c) explains the possible availability of, and conditions to receive, a waiver of the notice requirements. To support a waiver request, the applicant must provide "all material facts."

Conclusion

The California Attorney General "is vested with significant oversight of charitable assets, including the authority to bring *not only* an action against a person who misuses charitable assets, but also an action seeking to stop the diversion of charitable assets."

But "without forewarning of major liquidations of charitable assets, the Attorney General is limited to prosecuting malfeasance after it has occurred."

The simple legislative fix of AB 900 was both reasonable and necessary.

– Linda J. Rosenthal, J.D., FPLG Information & Research Director