

California Proposals Would Rewrite Rules for Many Nonprofit Institutions

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As discussed in two prior posts ([Part I](#) and [Part II](#)) in our series about proposed bills in the California Assembly, a group of six Assembly members have coordinated in authoring a legislative package of seven bills impacting higher education in a state that represents one-fifth of the US economy.

Part III in our series recaps two bills (AB1341 and AB1342) that would significantly affect both in-state and out-of-state nonprofit institutions and institutions considering a conversion to nonprofit status. These bills would deliver a one-two punch to many nonprofit institutions that must work with the Bureau for Private Postsecondary Education to obtain authorization to operate, verification of exemption from authorization requirements or registration for out-of-state institutions or that contract with BPPE for student complaint purposes. These bills would also broaden the role of the California Attorney General in determining how the BPPE will recognize the tax status of institutions.

These bills, along with the other five bills introduced as part of this legislative package, are scheduled for a hearing before the Assembly's Higher Education Committee on April 9, 2019. We strongly encourage nonprofit institutions (or any institutions considering a conversion to nonprofit status) seeking to operate or enroll students in California to either attend or stream the April 9 hearing and to continue to monitor these bills as the legislative process moves forward.

[AB1341](#)

Although [comments](#) by AB1341's sponsor indicate the legislation is intended to target institutions converting to nonprofit status, their proposed review and approval procedures, including the expansive role of the AG, appear to affect any nonprofit institution seeking to operate in California or enroll students located in California, not just those that have recently converted.

Significantly, this bill would prohibit BPPE from approving, verifying the exemption of, or contracting to handle complaints for, any nonprofit institution that has not previously been (1) approved or determined to be exempt by BPPE or (2) determined by the AG to be a nonprofit corporation of higher education unless and until (a) BPPE provides public notice of the institution's request and holds an advisory meeting to consider that request, and (b) the AG determines the institution meets a new definition of "nonprofit corporation" for higher education purposes. An institution determined by the Internal Revenue Service to be a 501(c)(3) tax-deductible organization would meet the new definition of nonprofit corporation *unless* the AG independently determines otherwise.

An institution would not qualify as a nonprofit if the AG determines that (1) the institution engaged in any activity in which the net earnings benefit any person (i.e., private inurement); (2) the institution acquired assets from another entity or previously operated as a for-profit institution, and the assets were acquired for more than their value; (3) a core function of the institution is conducted or controlled by a for-profit entity; *or* (4) a substantial share of the institution's assets are committed to a joint venture with a for-profit entity.

Under these highly discretionary standards, many nonprofits that have converted from for-profit status in recent years, or nonprofits that contract for substantial services from for-profit service providers, may find that they no longer qualify as a nonprofit in California and may be unable to offer online courses to students in California under their current model. For instance, this could be the case if the AG concludes that the service provider is conducting or controlling a "core function," which is not a defined term, or that their servicing agreement is a "joint venture" in the AG's view of the world.

The AG already has oversight authority for nonprofit organizations domiciled or registered in the state. However, this bill would significantly entangle the AG in BPPE decisions impacting not only for-profit institutions converting to nonprofit status, but also out-of-state institutions that are currently exempt from BPPE's registration requirement and in-state nonprofits that qualify as California "independent institutions" and seek to contract with BPPE for student complaint purposes.

Out-of-state nonprofit institutions: Since July 2017, the BPPE rules have required out-of-state private institutions to register with BPPE to offer distance education courses to students in California, with an automatic exemption for nonprofit

degree-granting institutions. However, AB1341 would restrict the exemption to nonprofit institutions that are operated by entities that meet the new definition of nonprofit corporation as determined by the California AG. This creates the distinct possibility that out-of-state nonprofit institutions that have previously qualified for the automatic exemption will find that they have to satisfy new standards implemented and interpreted by the AG. That may be quite burdensome, especially as the AG construes concepts such as “core functions” or makes an independent judgment as to the valuation of assets conveyed in a prior transaction. If these institutions cannot meet these new standards, or conclude that it is just not worth the struggle, they could be forced to register and come under the BPPE’s oversight or forgo enrolling California students altogether.

As noted in our [earlier post](#), another proposed bill ([AB1344](#)) would materially change the registration process to require full compliance with the entirety of the California Private Postsecondary Education Act with respect to any California resident attending an out-of-state institution. Thus, depending on the fate of AB1344, these provisions in AB1341 could be even more impactful on out-of-state institutions offering online courses in California.

In-state independent institutions: Under current law, a WASC-accredited California nonprofit institution (an “independent institution”) is exempt from BPPE jurisdiction but still must comply with certain state and federal consumer protection laws, including the federal state authorization rule. Independent institutions may contract with BPPE to handle consumer complaints to satisfy one element of the state authorization rule. AB1341 would prohibit BPPE from entering into a new contract with any such independent institution unless the AG has confirmed its nonprofit status. Absent such AG approval, that institution would be subject to the new review procedures when contracting with BPPE and ultimately might be required to seek authorization to operate from the BPPE.

[AB1342](#)

While AB1341 would create barriers for new nonprofit institutions seeking approval or exemption in California, AB1342 would impose new requirements on all nonprofit corporations that operate or control private postsecondary institutions in the state.

Under current law, a California nonprofit corporation is required to notify the AG at least 20 days before transferring all or substantially all of its assets to another entity. This bill would carve out a new process for nonprofit corporations (whether domiciled in California or another jurisdiction) that operate postsecondary educational institutions in the state and require them to obtain the AG’s consent before completing transactions or entering into certain agreements with a for-profit entity or mutual benefit entity.

Specifically, this bill would grant the AG authority to approve agreements to sell, transfer or otherwise convey assets to a for-profit, as well as agreements to transfer control or responsibility to a for-profit entity. The AG would have authority to scrutinize the agreements between nonprofit and for-profit entities and could contract with outside entities to provide additional review assistance, all which could add up to a protracted and expensive process.

Among other things, the AG would make highly discretionary judgments to determine if the agreement or transaction (1) is fair and reasonable to the nonprofit, (2) will result in private inurement, (3) is at a fair market value, (4) would significantly affect the availability or accessibility of educational services to a community and (5) is in the public interest.

The manner in which these bills are being framed by their sponsors – necessary protection from allegedly unscrupulous nonprofits – distracts from the very serious implications for all nonprofit institutions. While the bills are still very early in the legislative process and may well undergo substantive amendments, their scope and tone raise concerns for a wide swath of institutions that offer residential or online programs in California.

Based on the first Assembly hearing on April 9, we should be able to better assess their potential impact. We will continue to monitor these issues as these bills progress through the California Legislature.

Kate Lee Carey focuses on the legal, accreditation, administrative and regulatory aspects of regionally and nationally accredited higher education institutions and companies that provide services to the education industry.

Caitlyn Shelby advises postsecondary institutions, K-12 schools and education companies on matters involving accreditation, state authorization and the provision of online education, and monitors legislative and regulatory developments in these areas.

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