



NON-PROFIT MANAGEMENT UPDATE

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CASE DEVELOPMENTS

Provided by

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CASE DEVELOPMENTS

RECREATIONAL IMMUNITY FOR NONPROFITS

Nonprofit organizations are entitled to immunity under the Wisconsin recreational immunity statute. Accordingly, when the parents of two children who drowned at a hunt and sportsman club appealed the dismissal of their lawsuit against the club, the club's insurer, and a club employee, the Wisconsin Supreme Court found that the club was entitled to immunity. Although the club was incorporated under a for-profit statute and could amend its articles of incorporation to become a for-profit corporation in the future, it had been governed by articles of incorporation that defined it as a nonprofit, had been documented by state agencies as a nonprofit, and had been in compliance with IRS regulations as a nonprofit. The court explained that the recreational immunity statute "does not define nonprofits by referencing the chapter under which they were incorporated." In addition, although the club had taken in more revenues than expenses, the court explained that adopting a rule limiting nonprofit status to organizations operating at a deficit would "strip any solvent § 501(c)(7) organization of its nonprofit status." See *De La Trinidad v. Capitol Indem. Corp.*, No. 2007AP45, 2009 Wisc. LEXIS 3 (Jan. 23, 2009).

A Massachusetts statute provides that nonprofit associations conducting sports or sailing programs shall not be liable "to any person for any action in tort as a result of any acts or failures to act" in conducting such programs. However, nonprofit associations are subject to liability for "acts or failures to act relating to the care and maintenance of real estate" which such associations "own, possess or control and which is used in connection with a sports program . . . or any other nonprofit association activity." When a child was injured when a soccer goal post flipped over and broke his leg, he

filed a negligence action against the nonprofit youth soccer associations that had acquired the goal posts. The Massachusetts Supreme Court found that the goal posts used by the associations were not "real estate" under the statute, and concluded that "improper placement of sports equipment atop the real estate," as plaintiff alleged, was not a deficiency in the care and maintenance of real estate. Thus, the alleged failure to secure the goal posts fell within the broad immunity conferred on nonprofits by the statute. See *Welch v. Sudbury Youth Soccer Ass'n*, 453 Mass. 352 (2009).

CONFLICT OF INTEREST

No conflict of interest existed when spouses of public officials who oversaw competitive financial grant processes were affiliated with nonprofit corporations competing for the grants, according to a Pennsylvania state court. When asked whether the affiliation of certain public officials' spouses with nonprofits created a conflict of interest, the State Ethics Commission had concluded that the public officials would have a conflict of interest, and recommended that the officials "designate someone not within [their] chain of command to perform [their] role as to the prospective grants in question, as well as the grant applications of competitors . . ." On appeal, the court found that a nonprofit organization was not a "business" under the Pennsylvania Ethics Act ("Act"), where Pennsylvania Supreme Court precedent limited the definition of "business" under the Act to only for-profit entities. Because the spouses were affiliated with nonprofits, the officials did not have conflicts of interest under the Act. See *Rendell v. Pa. State Ethics Comm'n*, 961 A.2d 209 (Pa. Commw. Ct. 2008).

UNENFORCEABLE AGREEMENTS

Under the New York Non-For-Profit Corporation Law ("N-PCL"), a nonprofit corporation is expressly

prohibited from issuing shares and “shall conduct no activities for pecuniary profit or financial gain . . . except to the extent that such activity supports its other lawful activities then being conducted.” Furthermore, nonprofit corporations that receive tax exempt status under the Internal Revenue Code (“IRC”) cannot lawfully transfer equity or “allow their wealth to inure to the benefit of private individuals.” Therefore, a federal court concluded that an agreement by which a telecommunications company would receive a 20% equity interest in a nonprofit college’s sale of its online university would violate N-PCL, as it was analogous to granting the company an equity interest in the college itself. In addition, the agreement would violate the N-PCL since, if enforced, it would allow the distribution of proceeds from the sale to the company for its goods and services. Finally, the agreement would violate the IRC, as it would allow the college to transfer wealth to the benefit of a private entity. Because the court found the agreement between the college and the telecommunications company violated the law and therefore was unenforceable, the plaintiff company failed to demonstrate the existence of a contract, and the court granted the defendant college’s motion to dismiss for failure to state a claim. See *IDT Corp. v. Touro Coll.*, No. 07-6080, 2008 U.S. Dist. LEXIS 101949 (D.N.J. Dec. 16, 2008).

SUBSCRIBERS’ STANDING TO CHALLENGE CORPORATE ACTIONS

In Pennsylvania, whether a party has standing to sue over corporate decisions is governed by the Pennsylvania Nonprofit Corporation Law (the “Nonprofit Law”). Under the Nonprofit Law, the affairs of a corporation, unless stated otherwise in its bylaws, are under the direction of its board of directors. An express limitation in the Nonprofit Law provides that the only parties who are capable of challenging the validity of nonprofit corporate action are a “member, director, member of an other body, officer or otherwise of a nonprofit corporation.” Subscribers with specific governance rights set forth in the articles of incorporation and bylaws are the only ones qualified to maintain actions under the term “or otherwise.” Therefore, a Pennsylvania state court concluded that where no provisions in a nonprofit medical insurer’s articles of incorporation or bylaws gave individual subscribers, groups of subscribers, or policyholders any rights, including rights that would otherwise be exercised by the Board of Directors, they did not have standing under the Nonprofit Law to bring a class action lawsuit against the insurer alleging violations of the Nonprofit Law, breach of contract, and breach of fiduciary duty. The court further found that the subscribers and policyholders lacked common law standing since they failed to state exactly how they were aggrieved. See *Petty v. Hosp. Serv. Ass’n of Northeastern Pa.*, 967 A.2d 439 (Pa. Commw. Ct. 2009).

ECCLESIASTICAL MATTERS

The United States Supreme Court has embraced a deference rule to discourage interference with the free exercise of religion by civil courts when courts are presented with a controversy involving the internal governance or administration of a religious association. The Pennsylvania Supreme Court has acknowledged the deference rule, but also has stated that not all disputes among members of a congregation are doctrinal. With respect to non-doctrinal issues, the “neutral principles approach” has evolved, and such issues are amenable to judicial review by civil courts because they are “not predicated on any religious doctrine.” However, where issues are inextricably entangled with the internal rules of churches, courts have applied the deference rule. Consequently, where a plaintiff nonprofit church’s breach of contract claims were based on the internal decision of a defendant synod (council convened to discuss ecclesiastical business) to close the church due to the church’s diminished attendance, financial strength, and lack of representation in congregation leadership, a Pennsylvania state court concluded that the thrust of the complaint did not concern neutral principles regarding property ownership, and was instead intimately linked to the defendant’s internal criteria used to decide such concerns. The court therefore dismissed the suit for lack of subject matter jurisdiction. See *Evangelical Lutheran Church of the Redeemer v. Se. Pa. Synod of the Evangelical Lutheran Church in Am.*, No. 3906, 2008 Phila. Ct. Com. Pl. LEXIS 233 (Sept. 22, 2008).

The “United States Supreme Court has held that in the case of hierarchical religious entities . . . the civil courts must accept as binding and defer to decisions by religious tribunals with respect to religious doctrine, practice, faith, ecclesiastical rule, discipline, custom, law, and religious entity governance and administration.” A diocese, bishop, and members of an Episcopal parish church brought an action against parish members who had resigned their membership in the Episcopal Church, seeking a declaratory judgment that the remaining members were the true and lawful directors of the parish. The trial court found in favor of the defendant board members, concluding that the defendants were the lawful directors. On appeal, the appellate court explained that the trial court failed to recognize “that religious corporations are, in their basic sense, different from ordinary corporations,” and that “[t]he corporation is a subordinate factor in the life and purposes of the church proper.” The appellate court first concluded that, applying neutral principals of law, the defendant dissident members lacked authority to amend the bylaws and articles of incorporation of the parish. Second, it concluded that due to their resignation, defendants were no longer a part of the Episcopal Church and could not

be lawful directors of the parish. Third, the appellate court found it was required to defer to the Episcopal Church and diocese's determination that the remaining loyalist members of the parish constituted the true members of the parish. Fourth, it concluded that applying neutral principles of law to the actions of the Episcopal Church and the diocese resulted in the same outcome: a finding of the current parishioners to be the lawful directors. See *New v. Kroeger*, 84 Cal. Rptr. 3d 464 (Cal. Ct. App. 2008).

BYLAWS CONFLICTING WITH RELIGIOUS CORPORATIONS LAW/NON-USAGE OF BYLAWS

The New York Religious Corporations Law ("Religious Law") provides rules for governance of religious bodies, but does not include articles applicable to the Hindu faith. Therefore, as with other groups not provided for under the Religious Law, a Hindu group seeking to incorporate may do so under Article 9 ("Free Churches") or Article 10 ("Other Denominations") of the Religious Law. An important difference between the two articles is that trustees of Article 10 corporations are elected by members, while Article 9 corporations are governed by self-perpetuating boards. A Hindu nonprofit religious society incorporated under Article 9 in 1970, and adopted bylaws that same year. The court found that provisions of the society's 1970 bylaws requiring members to elect its trustees contradicted Article 9 and were therefore invalid from their inception. The appellate court also found that the lower court had erred in upholding petitioner members' demand that an election pursuant to these provisions take place. The record showed that the 1970 bylaws had never been implemented, had been forgotten for three decades, and had been replaced with bylaws that were adopted in 1978. The court cited precedent stating that "nonusage of a by-law . . . will work its abrogation," and explained that allowing petitioner members "to resuscitate the 1970 bylaws when they finally rediscovered them would be unwise and unfair." See *Matter of Venigalla v. Nori*, 892 N.E.2d 850 (N.Y. 2008).

STANDING TO SUE INDIVIDUAL MEMBERS OF PRIVATE NONPROFIT CLUB

Connecticut has a strong policy favoring non-interference with the actions of private clubs. However, Connecticut courts have the power to hear cases alleging: violations of a nonstock corporation's bylaws; that the bylaws were unreasonably applied; or that the bylaws were *per se* unreasonable. Accordingly, courts may hear cases alleging that a member has been sanctioned or expelled in violation of the club's bylaws. After plaintiff, a former member and treasurer of a private, nonprofit yacht club, was expelled following his inquiry into the club's tax return, he filed suit against members of the club's board of governors. The plaintiff brought claims for,

among other things, retaliatory termination, failure to disclose, and failure to account for funds. The court found that the plaintiff pled sufficient facts to show that he was challenging the legality of the club's bylaws and the procedure under which his membership was terminated, and denied the defendants' motion to dismiss on this basis. It further found, however, that the plaintiff lacked standing to bring the claim for failure to disclose, explaining that he had failed to cite any cases allowing emotional damages resulting from the defendants' alleged violation of a federal disclosure statute. The court also found that the plaintiff lacked standing to bring the claim for failure to account for funds, concluding that the state legislature never intended private parties to sue under the provisions of the Connecticut Revised Nonstock Corporation Act that impose a duty on nonstock corporations to file a report with the secretary of state. The court therefore granted the motion to dismiss with respect to the failure to disclose and failure to account for funds. See *Marcinszyk v. Miamogue Yacht Club*, No. CV075012273S, 2008 Conn. Super. LEXIS 3286 (Dec. 19, 2008).

FAIR DEALERSHIP LAW APPLIED TO NONPROFITS

A nonprofit organization may qualify as a "dealer" under Wisconsin state fair dealership laws. The Wisconsin Fair Dealership Law ("WFDL") protects dealers who wish to "terminate, cancel, fail to renew or substantially change the competitive circumstances of a dealership agreement without good cause." In addition, the WFDL provides for a presumption of irreparable harm when its terms are violated. It "expresses no concern for the 'mission' or other motivation underlying sales in question": it "asks only whether sales occur" and does not distinguish between "for-profit" and "not-for-profit" entities. Girl Scouts of the United States of America ("GUSA") chartered Girl Scouts of Manitou Council, Inc. ("Council") in 1950. Almost sixty years later, GUSA began merging many of its local councils to form regional councils, and the Council declined to participate in the proposed restructuring. GUSA subsequently sought to unilaterally reduce the Council's chartered territory. The Seventh Circuit Court of Appeals held that the district court erred in denying injunctive relief after GUSA took steps to remove 60% of the jurisdiction belonging to the Council. The court found that the Council qualified as a "dealer" within the meaning of the statute, as it met the WFDL's requirements of a contractual relationship between the parties, the right to use protected marks or to sell or distribute goods or services, and the existence of a community of interest between the parties. The court explained that "both GSUSA and [the Council], notwithstanding their status as nonprofits, are multimillion-dollar businesses possessing substantial assets and

liabilities.” Furthermore, the court concluded that the Council established that it would suffer irreparable harm absent an injunction, including potential loss of its entire business, property, employees, and damage to goodwill. Accordingly, the Court of Appeals reversed the district court’s decision and enjoined the organization from changing or interfering with the Council’s jurisdiction pending final resolution in the district court. See *Girl Scouts of Manitou Council, Inc. v. Girl Scouts of the U.S.A., Inc.*, 549 F.3d 1079 (7th Cir. 2008).

INTERFERENCE WITH NONPROFIT’S INTERNAL AFFAIRS

New York courts may not interfere with the internal affairs of nonprofits. A New York appellate court found that a trial court committed reversible error when it *sua sponte* appointed a receiver to run a nonprofit corporation, supervise and schedule a new election for the corporation, and effectively suspend the powers of the corporation’s current officers. The trial court erred “by, in effect, interfering with the internal affairs of the subject corporation.” In addition, the appellate court found that the trial court acted without the benefit of a hearing or proof. The appellate court therefore reversed the lower court’s decision. See *Ugiri Progressive Cmty., Inc. v. Ukwuozo*, 870 N.Y.S.2d 64 (N.Y. App. Div. 2008).

STANDING TO BRING DERIVATIVE ACTIONS/NOTICE TO MEMBERS

Procedural requirements for standing to bring derivative actions apply to members of nonprofit corporations under Ohio law. The president of a nonprofit cultural organization was found by an Ohio appellate court to have standing to bring a shareholder derivative action against the organization and other officers to challenge the validity of sale of organization property. The court concluded the president’s complaint met all procedural requirements for standing, and that the plaintiff was entitled to maintain a derivative action. In addition, the court found that the purchase contract was not authorized by the defendant’s members in accordance with the organization’s own constitution and an Ohio statute governing the sale or disposition of assets by nonprofit corporations, and that members were entitled to notice of the vote or a copy or summary of the terms of the proposed sale transaction. See *Niehaus v. The Columbus Maennerchor*, No. 07AP-1024, 2008 Ohio App. LEXIS 3438 (Aug. 12, 2008).

OPEN MEETINGS AND PUBLIC RECORDS LAWS

Nonprofit corporations can be found to be quasi-governmental corporations subject to open meetings and public record laws within the meaning of a Wisconsin statute if, based on the totality of the circumstances, they resemble a governmental corporation in function, effect, and status. Therefore,

a nonprofit corporation was found by the Wisconsin Supreme Court to be a quasi-governmental corporation where numerous circumstances indicated that it resembled a governmental corporation: the corporation was funded exclusively by public tax dollars or interest on those funds; its office was located in a city municipal building and listed on the city’s website; the city provided clerical support and office supplies to the corporation; two city officials served on the corporation’s board; all of the corporation’s assets were to revert to the city in the event the corporation ceased to exist; the corporation was obligated to both open its books for city inspection and submit an annual management plan to the city; and its exclusive function was to promote economic development in and around the city. The Wisconsin Supreme Court applied its determination prospectively such that the corporation was not subject to forfeitures for past violations of the open meetings laws, and it declined to void any actions taken at past meetings that were not open to the public. The Supreme Court reversed the circuit court’s decision finding that the corporation was not a quasi-governmental corporation, and remanded to the circuit court to address the remaining request for attorney fees and costs. See *State of Wis. v. Beaver Dam Area Dev. Corp.*, 752 N.W.2d 295 (Wis. 2008).

LEGISLATIVE DEVELOPMENTS

TEMPORARY INCOME TAX REGULATIONS

On September 9, 2008 the IRS issued temporary Income Tax Regulations eliminating the advance ruling process for a section 501(c)(3) organization’s status as a public charity and not a private foundation. See 26 C.F.R. Parts 1 and 602 at <http://www.irs.gov/charities/charitable/article/0,,id=185568,00.html>. These regulations simplify the process for nonprofits to qualify for tax-exempt status. Effective immediately, the IRS will automatically classify a new 501(c)(3) organization as a public charity for its first five years if it can demonstrate in its application that it can reasonably be expected to be publicly supported.

HIGHER EDUCATION OPPORTUNITY ACT

The Higher Education Opportunity Act (“HEOA”) became law on August 14, 2008. See Pub. L. No. 110-315. The HEOA reauthorizes the Higher Education Act of 1965 (“HEA”), as amended. The HEOA makes a number of changes to programs authorized under the HEA, authorizes new programs, and changes other laws with the goal of keeping down college costs. The HEOA increases the maximum authorized level for Pell grants for low-income students from \$5,800 to \$8,000 a year by the 2014-15 academic year, and allows the grants to be used year-round by part-time students. Provisions particularly relevant to some nonprofits create a \$10,000 student loan forgiveness program

for graduates who take jobs in high-need fields such as nursing, early childhood education, teaching, and other public services.

REPORTS

GAO REPORT

In February 2009, the United States Government Accountability Office (“GAO”) released a report on federal funds and the nonprofit sector, titled “Significant Federal Funds Reach the Sector through Various Mechanisms, but More Complete and Reliable Funding Data are Needed.” See <http://www.gao.gov/new.items/d09193.pdf>. The GAO assessed: “(1) the mechanisms through which federal dollars flow to nonprofits, and (2) what is known about the federal dollars flowing through them to nonprofit organizations in fiscal year 2006.” To ensure that accurate information on federal funding provided to nonprofits is available, the GAO recommended that the Office of Management and Budget (“OMB”) ensure that its funding information on the USAspending.gov website is categorized with a consistent definition of nonprofit organizations. OMB commented that this recommendation, while likely ensuring more consistent data, could be burdensome for states tracking subaward data. The GAO stated that it believed “[a]s USAspending.gov is developed . . . this is an opportune time to explore ways to improve the reliability of subaward data.”

IRS EXAMINATION OF NONPROFIT WEBSITE LINKS

In a July 2008 “Memorandum for all EO Revenue Agents,” the IRS said it will look at a nonprofit website’s links to other organizations to determine whether the organization has participated or intervened in a political campaign through its internet activities. See <http://www.irs.gov/pub/irs-tege/internetfielddirective072808.pdf>

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