



NON-PROFIT MANAGEMENT UPDATE

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CASE DEVELOPMENTS

Provided by

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LEGISLATIVE DEVELOPMENTS

REVISED IRS FORM 990

For the first time since 1979, the IRS has completed a major redesign of IRS Form 990. According to the IRS, the redesigned form enhances transparency among filers, promotes tax compliance and minimizes the burden on filing organizations. A draft of the redesigned form was released by the IRS for public comment on June 14, 2007. The comment period closed on September 14, 2007. On December 20, 2007, the IRS released the final version of the redesigned form. For organizations with gross receipts over \$1 million, or total assets over \$2.5 million, the redesigned form will be used for the 2008 tax year (returns filed in 2009). For smaller organizations, the IRS has announced a two year graduated transition period. During the graduated transition period, qualifying organizations will be allowed to file Form 990-EZ, instead of Form 990. The IRS has not yet released the instructions for the redesigned form. The IRS anticipates releasing the instructions in early 2008. The redesigned form, as well as related information, including information related to the graduated transition period, is available at the IRS website, www.irs.gov/eo.

CASE DEVELOPMENTS

NON-PROFIT BOARD MEMBER LIABILITY

Individual board members of a non-profit corporation may be held individually liable for violations of the federal Fair Housing Act ("FHA"), despite a Florida state statute providing that directors and officers of non-profit corporations are generally immune from personal liability for corporate acts. After a non-profit condominium homeowners association announced that it would enforce a four person occupancy restriction, a number of community residents and a local fair-housing agency filed suit under the FHA against the homeowners association and its individual board members. Based on the Florida statute, the defendant non-profit board members argued they could not be held individually liable. After first concluding that the FHA allows claims against individuals, the court found that a state statute cannot bar federal causes of action. Additionally, the court concluded that the state statute did not protect against willful violations of rights protected by the FHA. Because the suit against the directors alleged that they each personally and intentionally discriminated against families, the court allowed the suit against the board

members to proceed. See *Housing Opportunities Project for Excellence, Inc. v. Key Colony No. 4 Condo. Ass'n*, 510 F. Supp.2d 1003 (S.D. Fla. 2007).

NON-PROFIT OWNER LIABILITY

A majority owner of a non-profit corporation could be held personally liable for a non-profit corporation's debts under the alter-ego doctrine or by piercing the corporate veil, despite an Iowa statute limiting the liability of non-profit corporations' directors, officers, employees, members, and volunteers, because the statute did not clearly preempt these common law doctrines. Accordingly, after concluding that the doctrines could apply, the court found that a non-profit corporation's veil may be pierced and liability imposed on majority owner where the non-profit: (1) was undercapitalized in the context of the business it was conducting, which was similar to a for-profit business engaging in commercial transactions; (2) failed to follow corporate formalities and did not hold meetings; and (3) failed to keep its finances separate from the finances of two other business entities controlled by the majority owner. Additionally, liability could be imposed under the alter ego theory where the majority owner, who was also the proprietor of a for-profit business, established the non-profit corporation to assume a liability or risk that would otherwise have been assumed by the for-profit business, and the non-profit accrued liabilities without any means to satisfy them. See *HOK Sport, Inc. v. FC Des Moines, L.C.*, 495 F.3d 927 (8th Cir. 2007).

INSPECTION AND COPYING OF CORPORATE RECORDS

A non-profit shareholder's right to inspect a non-profit corporation's records includes the right to copy those records. Although the Louisiana non-profit corporation statute regarding inspection of records did not explicitly include the right to copy, while the for-profit corporate statute did, an appellate court concluded that "[f]or the right to examine to have any meaning, the right to copy,

duplicate, and extract must necessarily be included in the term, unless [the shareholders] can find a savant graduate of a memory course." While the court found the statutory language puzzling, it stated that the right to copy "is a no-brainer, logically." See *Owens v. Southwest Ouachita Waterworks, Inc.*, 960 So.2d 1243 (La. Ct. App. 2007).

BUSINESS JUDGMENT RULE

The business judgment rule applies equally to non-profit corporations and for-profit corporations. The rule bars judicial review of actions taken in good faith and in exercise of honest judgment. See *In re Midway Jewish Center*, 838 N.Y.S.2d 879 (N.Y. Sup. Ct. 2007).

When board members do not act in good faith, they are not insulated by the business judgment rule. Failure to exercise reasonable diligence in deciding that non-profit committee members should not be indemnified for costs of a suit was not *protected by business judgment rule*. See *American Society for Testing & Materials v. Corpro Companies*, 478 F.3d 557 (3d Cir. 2007).

DERIVATIVE ACTIONS

Members of a California non-profit cooperative association, organized under the California Food and Agriculture Code, could bring derivative suit on behalf of the cooperative if they alleged compliance with the requirements of the California Corporations Code. Members of the non-profit cooperative were required to allege either that they made a demand on the board of directors, or that it would be futile to make such a demand. Because they alleged neither, the members' suit was dismissed with leave to amend the complaint. See *Lopes v. Vieira*, 488 F. Supp. 2d 1000 (E.D. Cal. 2007).

CONFLICT OF INTEREST TRANSACTIONS

No conflict-of-interest transaction occurred between a church and district council when

church members voted to close the church and its property reverted to the district council pursuant to the church's bylaws. Glad Tidings church was a Nebraska non-profit corporation that owned certain property, including real estate. Its constitution and bylaws provided that all of its property reverted to the district council if Glad Tidings ever ceased to function as a church. At a meeting to address long-standing difficulties the church was having, the congregation voted, by all standing, to close the church. Two of Glad Tidings' board members also held positions with the district council. Glad Tidings subsequently alleged that, because the district council received Glad Tidings' property when it closed, it was "a transaction with the corporation in which a director of the corporation has a direct or indirect interest," proscribed by Nebraska statute. The court concluded, however, that church policy mandated that the property revert, and that there was no "transaction" under Nebraska statute because there were "no negotiations, no bilateral agreement, and no 'deal'" between Glad Tidings and another party. Accordingly, the unilateral action by the "corporation" did not expose the directors to liability for a conflict of interest. See Glad Tidings Assembly of God v. Nebraska Dist. Council of the Assemblies of God, Inc., 734 N.W.2d 731 (Neb. 2007).

SUBSCRIBERS' STANDING TO CHALLENGE CORPORATE ACTION

Pennsylvania's Nonprofit Corporation Law grants anyone with rights or duties similar to those of a corporation's members standing to challenge corporate actions that may affect their rights. The law provides that "[u]pon petition of any person whose status as, or whose rights or duties as, a member, director, member of an other body, officer or otherwise of a nonprofit corporation are or may be affected by any corporate action, the court may hear and determine the validity of such corporate action" (emphasis added). When evaluating the standing of a non-profit health plan's subscribers, the court concluded the word "otherwise" in the statute expanded the class of persons covered beyond those expressly listed. The court then looked at the

articles of incorporation of Independence Blue Cross ("IBC"), which gave its subscribers (those insured under the plan) rights to elect board members, remove board members, amend the articles of incorporation and bylaws, and to dissolve the corporation, among other things. The rights IBC granted subscribers were similar to those typically given to a corporation's members. Accordingly, the court concluded that the subscribers had standing under the statute to challenge IBC's corporate action of failing to apply its profits to the corporation's lawful activities and its accumulation of a surplus of reserves for conversion to a for-profit corporation or merger, an action which could affect the subscribers' rights in IBC. See Ciamaichelo v. Independence Blue Cross, 928 A.2d 407 (Pa. Commw. Ct. 2007)

CONSOLIDATION OF MEMBERS OF PUBLIC BENEFIT NON-PROFIT

Members of a Missouri "public benefit corporation" cannot transfer their membership, or any rights arising from it, to anyone else. Accordingly, when Freeman and Tri-State, two member hospitals of a three-member emergency medical services non-profit corporation consolidated, Tri-State's corporate existence ceased and its membership in the emergency medical services corporation was extinguished, rather than transferring to Freeman or its successor, the consolidated hospital FHS. FHS was therefore not entitled to two-thirds of the board seats. Rather, consistent with the provision in the by-laws that equal representation be maintained, the newly consolidated hospital and St. John's, the other original member hospital, were each entitled to appoint three seats on the six-member board. See St. John's Regional Medical Center v. Freeman Health System, 235 S.W.3d 46 (Mo. Ct. App. 2007).

MEMBER VOTING RIGHTS

Amendments to non-profit corporation's bylaws, granting members (the four families occupying the residential building owned by the non-profit) more than one vote were invalid

under New York statute that provides at all meetings of members, “each member ‘shall have no more than, nor less than, one vote.’” The non-profit’s bylaws were amended to give each of the four families a membership certificate that would entitle them to three votes with respect to any issue to be voted upon by the members. The bylaws further gave one of the four families, which occupied an additional 300 square feet of the building, an additional vote. After two families challenged election of the board in court, the court invalidated the new bylaw as violating the New York Non-Profit Corporations statute’s one-person one-vote rule. It reinstated the former bylaws which had granted one vote to each member-resident and which deemed all members of the corporation to be members of the board when there are fewer than ten members. Thakur v. 210 Forsyth Street Housing Development Fund Corp., 844 N.Y.S.2d 686 (N.Y. Sup. Ct. 2007)

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