

Nonprofit Forum

Standing

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For almost 15 years -- first as Assistant Attorney General in charge of the New York Attorney General's Charities Bureau and then as a lawyer in private practice representing both plaintiffs and defendants in litigations implicating fiduciary management -- I have focused a good deal of my professional attention and energies on the duties and liabilities of directors and officers of charities and other nonprofit organizations. During this extensive involvement I have been increasingly intrigued by the issue of who may enforce the duties of directors which, after all, is the key to their accountability for the stewardship of nonprofit organizations.

Neither a full scholarly paper, with all the apparatus of modern legal scholarship, nor, indeed, a "nugget" lacking, perhaps, only necessary length and comprehensive quality of scholarly effort, I call this piece a rumination, which, I hope, will stimulate some thinking into its immediate subject as well as our deeper views about what we expect from nonprofits and the role(s) they play in our society.

The conventional view of standing in non-tax matters (see Harvey Dale's excellent paper, Standing to Challenge Another's Tax Benefits: Abortion Rights Mobilization Revisited, Nonprofit Forum, February 14, 1991, No. 3, for an insightful discussion of standing in federal tax matters) is not difficult to ascertain. In general, standing to enforce directors' and officers' duties and to hold accountable directors and officers for their breach is limited to directors, officers, members, if any, and the Attorney General and, in certain situations, those with a special interest or stake in an organization.

Why this is so, in fact, is far from clear, but there are some plausible but unarticulated explanations which seem apparent. Directors and officers, like trustees, have firm legal duties concerning both governance and mission imposed upon them by law. They, of course, are exposed if they fail to fulfill these duties and some resulting harm befalls the organization they serve. Members are perceived as having, if not "duties" with respect to governance and "mission", at least some semblance of responsibility -- they elect governors and, ultimately, may affect the mission. And, those with a special interest are seen, I believe, as having a proprietary interest to protect (members, too, in some cases are seen as having such an interest) which, typically, the law is much more comfortable with and, in a wide range of situations, recognizes as conveying sufficient basis for invoking the judicial machinery

of the state (in other words, you can bring a claim concerning damage to your home but not, generally, your neighbor's home). There is, of course, nothing unusual or surprising about this summary analysis; the resolution of disputes affecting property rights and the redress of legal duties are main currents in our legal system.

Nonprofits, of course, occupy an anomalous situation in American life and law. They do not fit neatly into conventional categories of ownership and the standard property law analysis of interests falls short in the nonprofit context. To be sure, the prudential policies implicated in constrained notions of standing possess substantial merit. We want disputes resolved by the judicial system, especially ones implicating (or affecting) important public institutions, to be fully and fairly (and, perhaps, finally) resolved. But, the law allows individuals in the widest variety of situations to seek redress for interests and causes which have an impact far beyond the modest claims of the individual. While many of these actions are brought in a representative capacity, the moving force still may be an individual with at least a minuscule proprietary or personal stake in the outcome, yet capable, through the invocation of the state's judicial machinery, of, for example, altering the course of an industry. These cases -- antitrust, products liability, securities -- all reflect, however, some personal material

interest, however easy it may be to acquire the cognizable interest demanded by the law.*

There is an equally large (or larger) body of law in which issues of the greatest moment may be resolved by individuals with no economic stake in the outcome. These, of course, involve the panoply of constitutional rights which are the entitlement of every individual -- not merely citizens -- and where there are no barriers to seeking redress that are measured in economic terms, no matter how great the consequences. And, while now discredited, private individuals in a broad range of situations have been allowed to enforce many rights where no personal or constitutional question is at issue, but where public grievances otherwise would go unredressed. Alyeska Pipeline Serv. v Wilderness Soc., 421 U.S. 240 (1975) (despite general goal of encouraging private action to implement public policy, court held it inappropriate for the Judiciary, without legislative guidance, to award attorneys' fees where there was no statutory authority).

Looked at simply, we allow matters affecting private projects to be resolved only by those "interested" (subject, of course, to procedural constraints). And, we allow questions of

* Leaving for another day the interests not of plaintiffs, but their lawyers.

the greatest public impact -- separation of powers, religion, race, etc. -- to be resolved by almost anyone without regard to property because the latter is protected. Nonprofits, however, seem to fall somewhere in between these two polar paradigms and, thus, may be susceptible to strikingly different but logically compelling approaches. I thought it might be productive to scrutinize the typical rationales proffered by courts in examining questions of standing in light of our current and growing appreciation of the nature and role of nonprofit organizations.

Perhaps the most striking phenomenon is how "thin" those rationales are. I do not, however, mean to suggest that my views are predetermined on the standing issue. Indeed, the conventional "constrained" view of standing may well be the "right" outcome because it reflects other important, although unarticulated values and policies. I only mean that reasoning -- to the extent there is any real explication -- in most of the cases on nonprofit non-tax standing is unpersuasive and unconvincing and, largely, unexamined and creates manifold opportunities to present convincing contrary arguments. I hope to review these before concluding these discussions by suggesting whether or not we should really liberalize standing and, if so, how we might do that.

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Probably the dominant rationale for limiting standing to the Attorney General is that the "beneficiaries" of charitable organizations' activities are the "public" or some other large, undefinable class that needs representation through the state in a parens patriae role. Scott v. Harding Museum, 58 Ill. App. 3d 408, 374 N.E.2d 756 (1978). Apart from the obvious fact that the mere iteration of "beneficiaries" tells us we are talking trust, not corporate, law, the rationale proffered is both unenlightening and unconvincing. That "the state is the only party having a legal interest in enforcement", Id. at 417, 374 N.E.2d at 763, is only because courts have so defined standing and, as discussed below, in other contexts (unlike here) courts have been more than willing to encourage or, at least, tolerate, important representative actions.

Another refrain supporting the Attorney General's almost exclusive role in calling nonprofit directors and officers to account is the view that such an approach reduces "vexatious" litigation or, perhaps, the threat of such actions. Miami Retreat Foundation v. Ervin, 62 So. 2d 748 (Fla. 1952); Weigand v. Barnes Foundation, 374 Pa. 149, 97 A.2d 81 (1953); Application of Herman in re Ten Broeck Free Academy, 177 Misc. 276, 30 N.Y.S.2d 448 (1941). By allowing standing only to the Attorney General, a court can "meet the issue and dispose of it, rather than leave it dangling for further

litigation". Miami Retreat Foundation v. Ervin, 62 So.2d at 752. This, of course, suggests, perversely, I believe, that plaintiffs would be inclined to commence a succession of lawsuits with the result that inconsistent results could be produced, multiple litigation would engender substantial, presumably wasteful, expenses (see Kania v. Chatham, 297 N.C. 290, 254 S.E.2d 520 (1979)), and, finally, that the mere threat of such litigation might deter volunteers from serving in leadership capacities on nonprofit boards. The latter assertion, apart from a couple of limited surveys conducted, I believe, by Deloitte & Touche and, perhaps, Korn, Ferry, is virtually unprovable. Certainly, there appears to be almost no evidence in the case law of harassing or vexatious litigation. But, cf. Grace v. Grace Institute, 53 Misc. 2d 599, 279 N.Y.S.2d 307 (1967) (court upheld trustees' decision to remove from the Board, a trustee who filed a series of lawsuits against the corporation for the purpose of harassing the institute and its members). In any case, as suggested below, courts have the tools to insure the preclusive effects of such litigation by casting plaintiffs in a representative capacity.

In addition to the foregoing, efforts by plaintiff-beneficiaries are often thwarted because of the size of the benefitted class (too small) or the lack of a distinct interest asserted. Miller v. Alderhold, 228 Ga. 65, 184 S.E.2d 172 (1971); American Center for Education v. Cavnar, 80 Cal. App.

3d 476, 145 Cal. Rptr. 736 (1978). In the former, for example, the court seemed concerned that college students as plaintiffs, in a case involving the college's governance and financial affairs, represented too fluid a class, i.e., the student body always was fluctuating. Of course, that is an accurate description of potential plaintiffs in innumerable class or representative actions and does not seem to present a serious bar to judicial cognizance of such claims generally.

Yet another theme is the lack of a "vested" financial interest. That, of course, is true, but, if applied consistently, would bar virtually any suit but those by the Attorney General. Even directors and voting members, of course, typically have no property* right in a charity's assets although these two classes almost always are given standing. This suggests strongly, therefore, that the absence of a property right is not determinative of the requisite interest or status needed to ensure full, vigorous, fair and efficient resolution of a dispute. Here again, the most compelling refutation is the substantial body of law in which "vested" interests or "property" rights do establish standing, although

* Directors, of course, have legal duties and may suffer if a breach occurs, while voting members are sometimes put in the Procrustean bed of "property" or "contract" analysis. See McDaniel v. Frisco Hospital Ass'n, 510 S.W.2d 752 (Mo. 1974); O'Leary v. Howard Young Medical Center, 89 Wis. 2d 156, 278 N.W.2d 217 (1978).

those interests may be fluid and relatively insignificant as a predicate for resolving issues of economic significance. Here, of course, I am referring to the substantial body of shareholder litigation and the well-developed body of law on derivative actions.*

Indeed, the lack of coherence and consistency can be seen in those cases which allow standing by members. The cases, I believe, have significance far beyond their number (only a very small percentage of nonprofits, in fact, have voting members), but in their argumentation. These cases either analogize members to shareholders (thereby eliminating the property interest issue), as in Kirtley v. McClelland, 562 N.E.2d 27 (Ind. App. 1990), or permit members to sue, noting a lack of personal benefit, and conclude that the members, in fact, have standing by elevating corporate by-laws into a kind of contract right, as in McDaniel, 510 S.W.2d 752, and O'Leary, 89 Wis. 2d 156.**

* Omitted from this discussion are those cases involving "special" circumstances but where no systemic issues are raised (e.g., Stern v. Lucy Webb Hayes Nat'l Training School, 367 F. Supp. 536 (D.D.C. 1973) because of the absence within the District of Columbia of regulation by "any public authority", or the drastic nature of the trustees' challenged action (imminent dissolution) in Alco Gravure, Inc. v. Knapp Foundation, 64 N.Y.2d 458, 479 N.E.2d 752, 490 N.Y.S.2d 116 (1985)).

** Many states, but not all, obviate the need for such reasoning by explicitly recognizing derivative actions by statute.

Directors and trustees, of course, have unquestioned standing as merely one expression of their unequivocal obligation to fulfill their own duties to the organization they serve so that an explication of the varied rationales for directors' and officers' standing is not terribly enlightening. And, in any case, the inhibitions of directors in suing one another (cf., e.g., the United Way of America fiasco) suggest this is not an important avenue to explore (similarly, John v. John, 253 Wis. 2d 343, 450 N.W.2d 795 (1989), and Scheuer Family Foundation v. 61 Associates, 179 A.D.2d 65, 582 N.Y.S.2d 662 (1992), both involving, inter alia, internecine family disputes).

Lawsuits by donors, which also crop up on occasion, are analyzed similarly. Donors, of course, once clearly had a property interest. However, unless they retain a reversion, they are considered not to possess any greater or more distinctive interest in an organization's activities than would a member of the general public, Brown v. Memorial Nat'l Home Foundation, 162 Cal. App. 2d 513, 329 P.2d 118 (1958); Denckla v. Independence Foundation, 41 Del. Ch. 247, 192 A.2d 538 (1963), notwithstanding, the donor's presumptively greater incentive, to set things right (and, perhaps knowledge about what may be wrong) when contrasted with that of a member of the general public. But, perhaps, this may say something more about the "dead hand" in matters of devolution than it does about nonprofit governance.

While this is not a comprehensive survey, it is more than suggestive of the range of arguments used to support limits on standing to challenge the conduct of directors and officers. And, what is striking is both the consistency of the arguments proffered and their weakness. Indeed, perhaps the most striking point about them is their wholly perfunctory character and their almost total lack of any extended analysis.

So, what, then, is really happening here, empirically? Are courts so entirely unrealistic? Perhaps. Yet, in dealing with these issues, courts, at times, actually seem to have a fairly good appreciation of the practical limits and consequences of conventional enforcement and standing, through the Attorney General or other parens patriae figure (Paterson v. Paterson General Hospital, 97 N.J. Super. 514, 235 A.2d 487 (1967); San Diego County Council Boy Scouts v. Escondido, 14 Cal. App. 3d 189, 92 Cal. Rptr. 186 (1971); even Stern v. Lucy Webb, 367 F. Supp. 536). But they don't seem willing to inject the same note of realism in most disputes and we are left with a curious disjunction between what they say (unconvincing, at best) and what they do (which may be intuitively correct). In other words, we want to make it very tough to sue nonprofit directors and officers, but we have countervailing reasons for obfuscating an appropriate desire for lenient treatment.

Occasionally, we are offered some glimpses into what may be the legitimate and even powerful concerns that tend to limit such claims (beyond the obvious that, lawyers and lawsuits, like Willie Sutton, go where the money is). Thus, for example, in the Kania case, 297 N.C. 290, where a plaintiff from a class that was neither indeterminate nor excessively large was denied standing, the expressed concern was precisely the burden on directors, and there, I believe, what was not articulated was that such directors, undoubtedly, were volunteers.

In other words, the courts in this area, as in others, are outcome-directed and do not have the intellectual paraphernalia to justify the outcomes that we, and they, as our speakers, seek (although, with nonprofit law's new intellectual respectability and stronger underpinnings, this may be changing). We do not, in fact, want directors to be sued very much because we fear the long-term harm arising from such litigation. The disincentives to volunteer service need only be minimal or remote to have a profound negative impact on the culture of giving and leadership. That certainly is one conclusion. And, it is supported by the alacrity with which virtually every state enacted one (or more) volunteer protection statutes in the 80s. I believe, in these cases, that we may be reflecting a strong collective desire to keep an important sphere of activity free from certain kinds of intrusion in what otherwise is an increasingly rights-oriented

society -- a notion that has particular resonance in the context of an area of human endeavor that encompasses an alternative, communitarian vision for ordering social and community values in an atomistic, legalistic, highly individualistic, increasingly mobile, heterogeneous world.

However, such caution should be tempered as the nonprofit world continues to evolve to resemble, to many, the business world in terms of organization, compensation, etc. Change, therefore, even under the banner of improved governance and accountability, should be tempered by a keen appreciation of our admitted ignorance in this area. Proceeding with bold changes such as those suggested by some critics of the United Way of America situation, might disrupt the carefully nuanced relationships that have developed over time. I would suggest instead broader experimentation with relaxed standing requirements, akin to the statutes in New Jersey (see Township of Cinnaminship v. First Camden National Bank, 99 N.J. Super. 115, 238 A.2d 701 (1968)) and, I believe, Wisconsin. Revisiting notions of fee-sharing raises much more serious concerns, both for nonprofit governance and American law, generally, and before creating such powerful litigation incentives to remedy a limited evil, I would vigorously pursue other less explosive remedies.*

* Rule 11 is a profound cautionary tale of a remedy based on an inadequate, anecdotal record, as, I suspect, are much of the claims for nonprofit misconduct.