

**COMMONWEALTH OF KENTUCKY
COURT OF APPEALS
Case No. 2011-CA-000232-MR**

**AMERICAN SADDLEBRED
HORSE ASSOCIATION, INC.**

APPELLANT

v.

**Appeal from Fayette Circuit Court
Civil Action No. 09-CI-05292
Judge James D. Ishmael, Jr.**

EDWARD BENNETT, ET AL.

APPELLEES

**MOTION OF CENTER FOR NONPROFIT EXCELLENCE, INC.
FOR LEAVE TO FILE AMICUS BRIEF**

The Center for Nonprofit Excellence, Inc. ("CNPE"), hereby moves the Court, pursuant to Rule 76.12(7) of the Kentucky Rules of Civil Procedure, for permission to file the amicus curiae brief tendered with this motion. This brief is timely filed, within fifteen days of the filing of Appellant's brief.

1. NATURE OF MOVANT'S INTEREST

CNPE's interest in this case arises from the fact that CNPE's mission is to advance the interests of the nonprofit community. It is of the view that an expansive interpretation of the right of the members of a Kentucky nonprofit corporation to review the records of the corporation under KRS 273.233 will have an adverse impact on that community.

2. POINTS TO BE PRESENTED

CNPE contends that giving members what amounts to an unlimited right, under KRS 273.233, to review virtually all documents and information in the possession of the

corporation is an overly broad reading of the statute. Such an interpretation is inconsistent with the express terms of the statute, with the statutory scheme as it relates to Kentucky membership nonprofit corporations, and with common practice in Kentucky. In addition, a broad interpretation of the scope of a member's access to records under KRS 273.233 will adversely impact the nonprofit community. Finally, such a broad interpretation will lead to additional litigation over the "proper purpose" standard as that phrase is used in KRS 273.233.

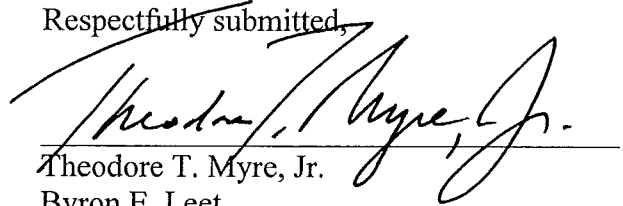
3. RELEVANCE TO DISPOSITION OF CASE

CNPE believes the points presented are relevant because at least a portion of the case involves the scope of a member's access to the records of a Kentucky nonprofit corporation under KRS 273.233.

4. CONCLUSION

Therefore, and for the foregoing reasons, CNPE asks the Court to grant it leave to file the tendered amicus curiae brief that is attached hereto.

Respectfully submitted,



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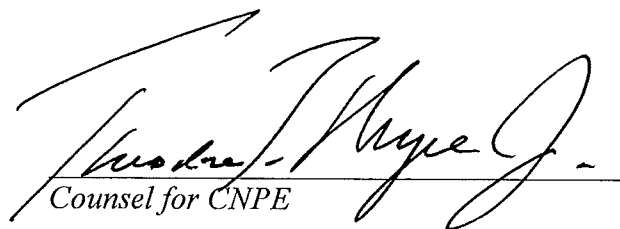
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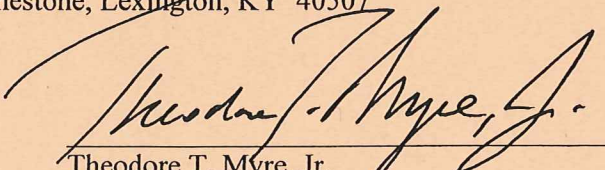
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Theodore T. Myre, Jr.

INTRODUCTION

This brief is submitted by the Center for Nonprofit Excellence, Inc. (“CNPE”), which is a Kentucky nonprofit corporation organized in 1999 with its principal office located in Louisville, Kentucky. CNPE, formed with the assistance of the Donors Forum of Kentuckiana, Metro United Way, and Metro Louisville, is dedicated to supporting nonprofit organizations in and around the Louisville region by serving as a central point for accessing information, best practices, professional development, and hands-on consultation to help the nonprofit sector reach its individual and collective aspirations. CNPE is largely funded through grants and gifts, as well as program service fees.

Having become aware of this litigation, and the pending appeal before this Court, CNPE has determined that it should weigh in from the perspective of the nonprofit community. In that regard, CNPE urges the Court to interpret KRS 273.233 more narrowly than did the Fayette Circuit Court. CNPE believes a more restrictive reading of that statute is the correct one (and consistent with the time-honored practice in this area), but also submits that an expansive reading of KRS 273.233 will have a materially adverse impact on the nonprofit community. Such an expansive reading will, CNPE submits, also lead to increased litigation. CNPE has no other interest in this litigation, and is not affiliated with or related to any of the parties. Its only interest is in the Court’s interpretation of the scope of KRS 273.233 and how that interpretation might affect the community that CNPE serves.

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ARGUMENT

I. Potential Harm to Kentucky Nonprofits

The Fayette Circuit Court appears to have interpreted the directive in KRS 273.233 providing that “[a]ll books and records of a corporation may be inspected by any member, or his agent or attorney, for any proper purpose at any reasonable time” as being without limitation. Yet that sentence is intended to encompass only the items specifically described in the preceding portion of the statute. Thus, while the first sentence of KRS 273.233 does in fact refer to “books and records of account,” it also refers to meeting minutes and to a record of the names and addresses of members entitled to vote. These, collectively (*i.e.*, books and records of account, certain meeting minutes, and membership information) represent the “books and records” referred to in that statute.

If this Court were to interpret KRS 273.233 as giving any member of any Kentucky nonprofit corporation ready access to each and every document, letter, file, email, and other writing in the possession of the corporation, it would place membership nonprofits, as well as their boards of directors, officers, and even non-officer employees in a difficult and untenable position. Well outside of the scope of information accessible by a member under KRS 273.233 should be attorney-client privileged documents, human resources information, trade secrets, agreements that are subject to confidentiality requirements, and information that is otherwise protected by law, including health information (whether or not protected under HIPAA). Other documents, files, and communications held or accessible by the nonprofit corporation that do not directly

pertain to the organization's financial books, meeting minutes, or membership records should also be off limits.¹

The ability of an organization to subject certain matters to confidentiality restrictions, by contract or otherwise, is essential to that organization's ability to conduct its affairs, resolve potential litigation, and comply with privacy laws. A third party contracting with a membership nonprofit may have important reasons for requiring the nonprofit to subject an arrangement to a confidentiality provision. It may have trade secrets, secret processes, pricing information, and a variety of other information that it does not want disclosed to competitors or even to other customers (and, in fact, the nonprofit corporation may possess some of these itself). A membership nonprofit corporation would run a perpetual risk of being unable to honor such restrictions if one or more members can gain free access to confidential documents. Consequently, it might have to refrain from entering into otherwise beneficial arrangements. Actual or threatened litigation is often resolved by way of confidential agreements. If an organization cannot assure confidentiality in such matters, it may interfere with its ability to resolve them. This concern carries over into the employment setting. Human resources information, including performance reviews and matters pertaining to raises, promotions, and terminations, are all highly confidential. Exposing these matters to possible member inspection may cripple the organization's human resources function in a variety of ways, including the ability to hire good employees who have an expectation

¹ It is believed that this has been treated as the scope of this provision by common practice in this state for decades and should not now be changed by judicial fiat.

that those records will remain confidential.² If the records access provision were to be used successfully to pry open the attorney-client privilege (and gain information otherwise protected under the attorney work product doctrine), the consequent harm to the organization does not need to be detailed to this Court.

CNPE posits that if KRS 273.233 were to be broadly construed, individuals will be less likely to serve on the boards of certain membership organizations and those who do will be hamstrung in their ability to engage in open and candid decision-making with respect to a variety of matters. The operations of an organization that is subject to “open book” member examinations would most certainly be hampered, with directors, officers, and employees always having to consider the impact of unlimited member review, and subsequent disclosure to others by an individual who may owe no (or at least an ill-defined) duty to the corporation whose books he or she has inspected.

II. Status of Member under the Kentucky Nonprofit Corporation Acts.

The rights and status of a member of a Kentucky nonprofit corporation are established entirely by the organizer or board of directors of the corporation, and not by statutory mandate. Members do not have broad inherent rights as do, for instance, stockholders of a KRS Chapter 271B organization. Unlike shareholders, members do not have a financial stake in the enterprise; they do not have an investment in the corporation that warrants the types of statutory protections afforded by KRS Chapter 271B to shareholders. For that reason, the organizer and board of directors of a Kentucky

² If the ability to inspect is as broad as the Fayette Circuit Court indicates, then one wonders how far the inquisitive member might go in connection with human resources information. Does a member have a right to review “protected health information,” as that phrase is used under the so-called “HIPAA” law, of employees of the nonprofit corporation? Where is the bright line that cannot be crossed?

nonprofit corporation have ultimate flexibility in determining the attributes of member status. Interpreting KRS 273.233 to bestow virtually unfettered record review rights upon all members of all membership nonprofit corporations formed in Kentucky would create a right that is well out of all proportion with the minimal rights (or no rights at all) that can otherwise be afforded to members of a Kentucky nonprofit corporation.

A Kentucky nonprofit corporation can choose to have no members at all. The Act also allows the flexibility for a nonprofit corporation to create members, or classes of memberships, with little or no rights. If the governance documents are so written, members can be removed either singly or entirely by vote of the board of directors. Membership voting rights are not prescribed by statute. A nonprofit corporation can bestow any voting rights on its members that it chooses, or bestow none at all. That decision, typically made at the formation stage, is entirely within the province of the organizer or the board of directors. KRS 273.291.³

If a nonprofit corporation chooses to have members, it can establish any standards for membership that it deems appropriate. It has similarly unlimited discretion in establishing member removal standards. It can establish dues of any amount, or it can dispense with them entirely. KRS 273.187 codifies the broad discretion that an organization has in defining the very nature of its members, if it is to have them at all. Subsection (1) of that statute reads, in part, as follows: “A corporation may have one or more classes of members or may have no members. If the corporation has one or more

³ KRS 273.210(1) provides that “The right of the members, or any class or classes of members, to vote may be limited, enlarged or denied to the extent specified in the articles of incorporation or bylaws.” KRS 273.210(4) provides that “If a corporation has no members or its members have no right to vote, the directors shall have the sole voting power.”

classes of members, the designation of such class or classes, the manner of election or appointment and the qualification and rights of the members of each class shall be set forth in the articles of incorporation or the bylaws” of the corporation. It would be incongruous for the Act to allow an organization the freedom to afford no rights to its members, as KRS 273.187 clearly permits, and then to read KRS 273.233 as granting a broad and sweeping membership right that far exceeds the inspection rights given to shareholders under KRS Chapter 271B (see KRS 271B.16-020) and to the public under the Kentucky Open Records Act (KRS 61.870 to KRS 61.884).

The directors of a nonprofit corporation do generally have access to all corporate information. This ability allows those directors to discharge their fiduciary duty, but access to sensitive information also carries with it certain duties, including confidentiality requirements and the duty of a director to refrain from using any such information to his or her personal advantage. These all spring from the director fiduciary duty standards set out in KRS 273.215. There are no similar statutory provisions relating to the conduct of a member of a Kentucky nonprofit corporation. Thus, while both directors and officers (KRS 273.229) owe a statutorily defined fiduciary duty to the corporations they serve, the duty of a member is not so clearly defined; certainly there is no duty expressly imposed under the Act. Accordingly, if the Circuit Court’s broad reading of KRS 273.233 is sustained, individuals who have no statutorily defined duty to the organization (perhaps including the duty of confidentiality) will be able to freely and readily access its most sensitive information. Surely, the statutes were not intended to work in that fashion.

The broad flexibility regarding membership under the Act is manifested in the many different types of membership organizations that operate in this state. In some

cases, members are ceremonial or honorary, or their participation is very limited. Sometimes membership merely signifies support for the organization's cause. Some organizations have large membership bases, but charge nominal membership dues or none at all. Others have large and strong dues-paying membership bases. The membership provisions are also flexible enough to allow complex nonprofit corporations to affiliate through what are often referred to as "sole members." It is even possible for an individual to be a member without knowing it, as when individuals are made automatic members of an organization by reference to a particular category (in, for example, a neighborhood association, by virtue of a person's address).

The foregoing discussion illustrates the common theme of the Act. Members have the rights and privileges that the organizer or board of directors chooses to give them. They do not have a right to distributions, they do not have an inherent right to vote, there is no requirement that members make an investment in the corporation, nor is there any requirement that the member even be aware that he or she or it is a member. Thus there is nowhere else in the Act where a member has an unfettered right to participate in the organization's activities. To read KRS 273.233 as broadly as has the Circuit Court is to create a right that is contrary to the general scheme of the Act.

III. Potential Increase in Litigation.

Where a member requests those items specifically described in KRS 273.233 (i.e., books and records of account, meeting minutes, and membership information), the nonprofit corporation in question is apt to honor the request without resistance. Where the request is more far reaching, greater pressure will be placed upon the "proper purpose" standard, with the likelihood of litigation over the meaning of that phrase. In addition, if the request is for highly sensitive information, the nonprofit corporation may

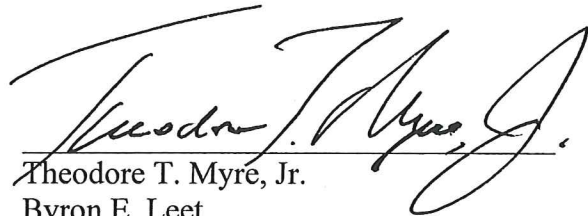
prefer that that issue be resolved in court in order to seek a protective order with respect to such information.

CONCLUSION

In the nonprofit community, and especially in the case of Section 501(c)(3) charitable organizations, “transparency” has become an important concept, and one that CNPE fully endorses. The concept, however, does not denote giving free access to all information possessed by a tax-exempt organization. After years of careful deliberation, the IRS settled on the appropriate level of transparency by broadening the level of information reportable on an organization’s annual Form 990 (that document must, by law, be made available to the public). If read broadly, KRS 273.233 would go much further than do these federal public disclosure rules for charitable organizations (though such disclosure would be limited to the membership rather than to the public). CNPE believes that such an expansive interpretation of KRS 273.233 will hurt the nonprofit community, and in particular that segment of the nonprofit community that involves membership nonprofits. From a good governance standpoint, it will chill the candor that board members and senior officers otherwise should exercise to ensure that the organization is well run. It will expose those officers and directors to personal liability if information is compulsorily disclosed that causes harm to others or where such disclosure is found to have violated agreements or privacy laws. It could well limit the organization’s ability to make and document honest assessments of employee performance, and therefore make it more difficult to conduct its critical human resources function according to best practices. Good executives and other employees may be dissuaded from working for a membership nonprofit if they are disturbed by the very real concern that their files could be open to near-public inspection rights. And certainly, it

would not behoove most membership organizations to assess and treat its membership as potentially hostile, and take actions to protect themselves from wide-ranging inspections, where the typical objective of those organizations is to engender good will amongst their membership.

For the foregoing reasons, CNPE requests the Court to limit the scope of the statutory right of members of a Kentucky nonprofit corporation to access the “books and records” of the corporation under KRS 273.233 and reject the expansive interpretation which the trial court ordered.



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