

8199 Liberty



HENRY McMASTER
ATTORNEY GENERAL

August 2, 2006

The Honorable John David Hawkins
Senator, District No. 12
Post Office Box 5048
Spartanburg, South Carolina 29304

Dear Senator Hawkins:

We received your letter requesting an opinion from this Office in response to an issue raised by one of your constituents, Gordon Summey. Attached to your letter, you provided a copy of a letter from Mr. Summey addressed to Attorney General Henry McMaster. In this letter, Mr. Summey states:

Several years ago, a few Optimist [Club] members formed a new charity and remained in the Optimist Club. Now these members are a member of the Optimist board and the new charity's board (I am assuming the Security Blanket which is the name of the new charity is registered in South Carolina as a charity). These things can slip by even the most diligent of enforcement practices.

Several weeks ago, (May 18-19), this board held an e-mail type meeting, telephone etc. and voted to allocate 80% plus of the Optimist Club's treasury to the Security Blanket's treasury.

My problems and questions are: 1. Being on both boards, does this constitute a conflict of interest? I, frankly, think it is blatant. 2. Since the funds were raised by the Optimist Club members for children with cancer and other debilitating diseases, does this constitute a misallocation of funds? (I believe that by giving funds to another charity instead of to the children and families this is another definite). 3. Since the funds were raised under the by-laws and auspices of the Optimist Club does this not constitute a misrepresentation by a charity to raise these funds?

Request Letter

Law/Analysis

Based on a conversation with Mr. Summey, we were informed that the Greater Spartanburg Optimist Club (the "Optimist Club") is a registered South Carolina nonprofit corporation.¹ Thus, we find the South Carolina Nonprofit Corporation Act of 1994 (the "Nonprofit Corporation Act") applicable in answering Mr. Summey's first two questions.

First, we address Mr. Summey's concern that a conflict of interest arose due to the Optimist Club's board members serving on Security Blanket's board. We were unable to locate a legal principle implying that service on the boards of two charitable organizations is per se a conflict of interest. However, the Nonprofit Corporation Act contains a provision that describes transactions in which a director may have a conflict of interest making the transaction voidable. S.C. Code Ann. § 33-31-831 (2006). This provision defines a "conflict of interest transaction" as "a transaction with the corporation in which a director of the corporation has a direct or indirect interest." *Id.* § 33-31-831(a). The statute clarifies an "indirect conflict of interest" exists if:

- (1) another entity in which the director has a material interest or in which the director is a general partner is a party to the transaction; or
- (2) another entity of which the director is a director, officer, or trustee is a party to the transaction.

Id. Furthermore, section 33-31-831(g) also states: "The articles, bylaws, or a resolution of the board may impose additional requirements on conflict of interest transactions." If, as you state, Optimist Club board members are directors or officers for Security Blanket, then a transaction entered into by the Optimist Club and Security Blanket will create an indirect conflict of interest per section 33-31-831(d)(2).²

However, presuming a conflict of interest transaction exists, this provision of the Nonprofit Corporation Act provides "[a] conflict of interest transaction is not voidable or the basis for imposing liability on the director if the transaction was fair to the corporation at the time it was entered into or is approved as provided in subsections (b) or (c)." S.C. Code Ann. § 33-313-831(a). Subsection (b) describes transactions involving directors of public benefit corporations, which we believe to be applicable to the Optimist Club. This section states that such a transaction may be:

¹In issuing this opinion, we were not able to verify the registration status of the Greater Spartanburg Optimist Club.

²We do not have copies of the Optimist Club's articles or incorporation or bylaws and, therefore, this conflict may be in addition to any other conflict provided for in such documents.

The Honorable John David Hawkins

Page 3

August 2, 2006

(1) authorized, approved, or ratified by the vote of the board of directors or a committee of the board if:

(I) the material facts of the transaction and the director's interest are disclosed or known to the board or committee of the board; and

(ii) the directors approving the transaction in good faith reasonably believe that the transaction is fair to the corporation; or

(2) approved before or after it is consummated by obtaining approval of the:

(I) Attorney General; or

(ii) the circuit court for Richland County in an action in which the Attorney General is joined as a party;

S.C. Code Ann. § 33-31-831(b). Subsection (e) of section 33-31-831 provides further guidance on the approval and authorization of conflict of interest transactions. This section states as follows:

(e) For purposes of subsections (b) and (c) a conflict of interest transaction is authorized, approved, or ratified if it receives the affirmative vote of a majority of the directors on the board or on the committee who have no direct or indirect interest in the transaction, but a transaction may not be authorized, approved, or ratified under this section by a single director. If a majority of the directors on the board who have no direct or indirect interest in the transaction vote to authorize, approve, or ratify the transaction, a quorum is present for the purpose of taking action under this section. The presence of, or a vote cast by, a director with a direct or indirect interest in the transaction does not affect the validity of any action taken under subsections (b)(1) or (c)(1) if the transaction is otherwise approved as provided in subsection (b) or (c).

S.C. Code Ann. § 33-31-831(e) (emphasis added). Based on these provisions, if the conflict of interest transaction is deemed to be fair at the time it was entered into or is approved by a majority of the directors on the board who do not constitute interested directors, it is not voidable. Otherwise, the nonprofit corporation must seek the approval of this Office or a court to deem the transaction not voidable. Accordingly, assuming the Optimist Club's donation of funds to Security Blanket is a conflict of interest transaction due to their common directors, such a transaction is not voidable if it was properly approved under subsections (b) and (e).

The Honorable John David Hawkins

Page 4

August 2, 2006

Second, we address your concern that transferring funds from the Optimist Club, which were raised by the Optimist Club, to Security Blanket constitutes a misallocation of funds. The Nonprofit Corporation Act contains a provision listing the general powers afforded to nonprofit corporations, unless the corporation's articles state otherwise. S.C. Code Ann. §33-31-302 (2006). Included in this list is the power "to make donations not inconsistent with law for the public welfare or for charitable, religious, scientific, or educational purposes and for other purposes that further the corporate interest . . ." Id. § 33-31-302(13). Moreover, this statute provides nonprofit corporations with the power "to do all things necessary or convenient, not inconsistent with law, to further the activities and affairs of the corporation." Id. § 33-31-302(18).

"All rules of statutory construction are subservient to the one that the legislative intent must prevail if it reasonably can be discovered in the language used, and the language must be construed in the light of the intended purpose of the statute." City of Sumter Police Dep't v. One (1) Blue Mazda Truck VIN No., 330 S.C. 371, 375, 498 S.E.2d 894, 896 (Ct. App. 1998). Thus, from the plain wording of these provisions, the Legislature specifically allows a nonprofit corporation to make donations to other organizations, presuming such donations are within the nonprofit's purposes. However, if the nonprofit's articles limit or eliminate a nonprofit corporation's donation power, if the donation of the nonprofit corporation's funds is "inconsistent with law for the public welfare or for charitable, religious, scientific, or educational purposes, or if the donation is outside of the nonprofit corporation's purposes, such acts may be deemed ultra vires by a court. See Lovering v. Seabrook Island Property Owners Ass'n, 289 S.C. 77, 82, 344 S.E.2d 862, 865 (1986) (stating "[a] corporation may exercise only those powers which are granted to it by law, by its charter or articles of incorporation, and any by-laws made pursuant thereto" and finding actions beyond those powers granted by law are ultra vires).

We presume a court would look to the nonprofit corporation's articles and bylaws to determine its purpose. We do not have access to this information for the Optimist Club. In addition, we do not have information as to Security Blanket's purpose. Therefore, we cannot comment on whether the Optimist Club's decision to allocate its funds to Security Blanket serves the Optimist Club's purpose. However, presuming the donation of funds to Security Blanket serves the purpose of the Optimist Club, under the general provisions of the Nonprofit Corporation Act such a donation is within the Optimist Clubs powers. However, if the Optimist Club's articles of incorporation limit or exclude this power or if by donating such funds to Security Blanket, the Optimist Club is acting outside of the scope of its purpose, a court may deem the Optimist Club's actions as ultra vires.

In addition to potential conflicts of interest and limitations on an organization's authority, the nonprofit corporation's directors are limited by their own fiduciary duties. Section 33-31-830 of the Nonprofit Corporation Act (2006) sets forth the standards for nonprofit directors. This provision states: "(a) A director shall discharge his duties as a director, including his duties as a member of a committee: (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the director reasonably believes to be in the best interests of the corporation." S.C. Code Ann. § 33-31-830. A director's duty of good faith, according to the Reporters Comments to the Revised Model Nonprofit

The Honorable John David Hawkins

Page 5

August 2, 2006

Corporation Act, upon which this statute is based, explains this section involves looking “to the director’s state of mind to see if it is evidenced honesty and faithfulness to the director’s duties and obligations, or whether there was an intent to take advantage of the corporation.” S.C. Code Ann. 33-31-830 R. 5 cmt. Furthermore, the last requirement, commonly referred to as a director’s duty of loyalty, requires “that directors act in good faith in a manner they reasonably believe to be in the best interest of the corporation.” Id. 33-31-830 R. 4.

In Summers v. Cherokee Children & Family Services, Inc., 112 S.W.3d 486 (Tenn. Ct. App. 2002), the Tennessee Court of Appeals addressed the fiduciary duties of a nonprofit corporation’s directors.

A nonprofit public benefit corporation’s reason for existence, however, is not to generate a profit. Thus, a director’s duty of loyalty lies in pursuing or ensuring pursuit of the charitable purpose or public benefit which is the mission of the corporation.

...

The central purpose of fiduciary duties of officers and directors of nonprofit corporations is to ensure that a corporation’s resources are used to achieve the corporation’s purposes and not to enrich the directors. In particular, the duty of loyalty requires that a director or officer faithfully pursue the interest of the organization, and its nonprofit purpose, rather than his or her own financial or other interests, or those of another person or organization. Thus, nonprofit directors and officers must be principally concerned about the effective performance of the nonprofit’s mission

Id. at 504 (quotations and citations omitted).

The New York Supreme Court considered the fiduciary duties of a charitable corporation’s board in Manhattan Eye, Ear & Throat Hosp. v. Spitzer, 715 N.Y.S.2d 575 (1999). That Court described a charitable corporation’s board’s duties in light of its version of the Nonprofit Corporation Act and those established by common law. Id.

A charitable Board is essentially a caretaker of the not-for-profit corporation and its assets. As caretaker, the Board has the fiduciary obligation to act on behalf of the corporation and advance its interests in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions

The Honorable John David Hawkins

Page 6

August 2, 2006

It is axiomatic that the Board of Directors is charged with the duty to ensure that the mission of the charitable corporation is carried out. This duty has been referred to as the "duty of obedience." It requires the director of a not-for-profit corporation to "be faithful to the purposes and goals of the organization," since unlike business corporations, whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives: perpetuation of particular activities are central to the *raison d'être* of the organization.

Id. at 593 (quotations and citations omitted).

Even if the donation of funds to Security Blanket does not constitute a conflict of interest transaction and the Optimist Club has the requisite authority to make the donation, such action by the board members must be consistent with their fiduciary duties. Accordingly, we advise the decisions of the Optimist Club's board must be the best interest of the Optimist Club and its purposes.

Lastly, we address your concern regarding funds raised "under the by-laws and auspices of the Optimist Club" and whether or not this activity constitutes "a misrepresentation by a charity to raise funds?" Because this matter involves the solicitation of charitable funds, we will view it in light of the South Carolina Solicitation of Charitable Funds Act (the "Solicitation of Charitable Funds Act"). S.C. Code Ann. §§ 33-56-10 *et seq.* This act requires "a charitable organization which intends to solicit contributions within this State or have contributions solicited on its behalf must file a registration statement with the Secretary of State . . ." S.C. Code Ann. § 33-56-30(A) (2006). It also requires the statement contain, among numerous things, "the purpose for which it was organized" and "the general purpose for which the solicited contributions are to be used." Id. § 33-56-30(B). Section 33-56-50 of the South Carolina Code (2006), also under the Solicitation of Charitable Funds Act, provides a list of organizations exempt from registration, thereby excusing such organizations from filing registration statements with the Secretary of State's Office. S.C. Code Ann. § 33-56-50. However, even if a charitable organization believes it is exempt from registration it is still required to submit forms to the Secretary of State's Office claiming the exemption. Id. § 33-56-50(B).

We are not privy to whether or not the Optimist Club or Security Blanket is registered with the Secretary of State's Office pursuant to the Solicitation of Charitable Funds Act. Furthermore, we do not have enough information about either of these entities to determine whether or not they are exempt from registration. However, assuming the Optimist Club is required to register, the Solicitation of Charitable Funds Act requires the solicitations made on its behalf be used to further the purpose for which the organization is organized and be used for the purpose the organization stated the contributions would be used for in its registration statement. See S.C. Code Ann. § 33-56-145 (2006) (providing penalties for "[a] person that knowingly and wilfully gives false or misleading information to the Secretary of State in a registration, filing statement, or report required by [chapter 56 of title 33] . . .").

The Honorable John David Hawkins

Page 7

August 2, 2006

Regardless of whether a charitable organization is registered or not, section 33-56-120(A) of the Solicitation of Charitable Funds Act (2006) provides: "In connection with the solicitation of contributions for or the sale of goods or services, a person shall not misrepresent or mislead, knowingly and wilfully, a person by any manner, means, practice, or device." This portion of the act also specifically prohibits a person from misrepresenting or misleading a person to believe another person or sponsor endorses the solicitation when that person or sponsor did not given his or her consent. S.C. Code Ann. § 33-56-120(C). Furthermore, this statute prohibits "use or display any emblem, device, or printed matter belonging to or associated with a charitable organization for the purpose of soliciting or inducing contributions from the public without first being authorized to do so by the charitable organization." Id. § 33-56-120(D).

The Solicitation of Charitable Funds Act does not expressly prohibit a charitable organization from soliciting funds to give to another charitable organization. Thus, we presume a charitable organization may do so. Moreover, we believe, based on the information contained in your letter, that if the Optimist Club is soliciting funds on behalf of Security Blanket, such activity was with the consent of the Optimist Club. However, if the Optimist Club solicited funds for purposes beyond the scope of its stated purpose, a court could find such action constitutes a misrepresentation in the solicitation of charitable funds. For instance, if a donor believes he or she was giving money for a particular purpose, when in fact these funds were allocated to support a different purpose, a court may find such actions on the part of the charitable organization are a misrepresentation in violation of section 33-56-120. However, given that this determination rest on fact, only a court, not this Office, may make the ultimate decision as to whether the Optimist Club made misrepresentations in violation Solicitation of Charitable Funds Act. See Op. S.C. Atty. Gen., January 26, 2006 ("Because this Office may not investigate or determine facts, we must leave this factual determination to the courts.").

If the Optimist Club is a registered charitable organization and you believe it acted outside of the scope of its purpose as provided in its registration statement or regardless of whether it is registered and you believe it knowingly and willingly misrepresented or mislead people in its solicitation of funds, we suggest you contact the South Carolina Secretary of State's Office. Section 33-56-140 of the South Carolina Code (2006) provides the Secretary of State's Office with authority to investigate charitable organizations believed to be in violation of the Solicitation of Charitable Funds Act.

Conclusion

Based on our review of the applicable law, we do not find service by the same person on the boards of two charitable organizations constitutes a per se conflict of interest. However, the Nonprofit Corporation Act provides a conflict of interest transaction may arise if the nonprofit enters into a transaction in which one of its directors also serves as a director for the other organization. If the transaction constitutes a conflict of interest transaction, it is voidable unless the board follows the procedures set forth in the Nonprofit Corporation Act to validate the transaction. Additionally, we find the donation of funds by a Nonprofit Corporation to another organization is allowed under

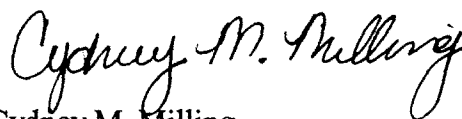
The Honorable John David Hawkins

Page 8

August 2, 2006

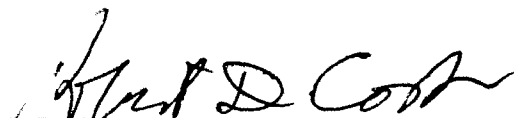
the authority given to nonprofit corporations under the Nonprofit Corporation Act, so long as the donation is consistent with law for the public welfare or for charitable, religious, scientific, or educational purposes and is in furtherance of the nonprofit corporation's purpose. Finally, we do not believe that a charitable organization's decision to donate funds raised by it to another organization constitutes a per se misrepresentation under the Solicitation of Charitable Funds Act. But, the final determination of whether the Optimist Club misrepresented to its donors in soliciting funds is factually intensive and ultimately must be decided by a court.

Very truly yours,



Cydney M. Milling
Assistant Attorney General

REVIEWED AND APPROVED BY:



Robert D. Cook
Assistant Deputy Attorney General