

Item #4

This document is a copy of the initial letter from the attorney.
Dated November 17, 2009
17 pgs.

MEMORANDUM

TO: Ms. Cheryl L. [redacted]
FROM: [redacted] Esq.
DATE: November 17, 2009
RE: Chesapeake and Potomac Regional Convention, Incorporated: Analysis of
Organizational and Operational Documents

Issues

You have asked us to review the organizational and operational documents of the Chesapeake and Potomac Regional Convention, Incorporated¹, a Maryland non-stock corporation exempt from taxation under section 501(c)(3) of the Internal Revenue Code (the "CPRC"). You wish us to advise principally whether the control exercised over the CPRC by the Chesapeake and Potomac Regional Service Committee of Narcotics Anonymous, a Maryland unincorporated association (the "Service Committee"), might expose the CPRC and/or its members to potential liability for the debts of the CPRC and/or jeopardize the CPRC's tax exempt status. You have also asked that, in the event that we conclude that there may be substantial risks to the Service Committee of financial liability or jeopardy to CPRC's exempt status, we recommend changes to

¹ See comments to section 1.01 of the bylaws, below, for a discussion of the name of the corporation.

lessen those risks. Finally, you have asked for our advice regarding changes to the bylaws recommended by an ad hoc bylaw revision committee and regarding any other changes to the organizational and operational documents that we might suggest for the purposes of improving the efficiency or accountability of the CPRC's operations.

Conclusions

For the reasons set forth below in this conclusions section and in the discussion section of this memorandum which follows, we conclude that the Service Committee does face some risk that it could be found liable for obligations incurred by or on behalf of the CPRC and that the CPRC tax exemption could be at jeopardy due to the control exercised by the Service Committee, directly and indirectly, over the CPRC's operations. To address these risks, we recommend certain actions discussed below. We also have a number of suggestions regarding the bylaw changes proposed by the ad hoc committee and regarding the CPRC's bylaws more generally.

1. Incorporation of the Service Committee as a Maryland non-stock corporation.

We recommend incorporation of the Service Committee as a Maryland non-stock corporation. Such an action will help assure that, if the Service Committee is found liable for any obligations of the CPRC (or any other obligations for that matter), the liability will remain that of the Service Committee and not become the obligation of any individual officials or members of the Service Committee.

In the absence of incorporation, the Service Committee would most likely be deemed at law to be an unincorporated association. A Maryland statute does provide that "a money judgment against [an unincorporated association which has a recognized group name] is

enforceable only against the assets of the group as an entity, but not against the assets of any member." Maryland Code, Courts and Judicial Proceedings Article, § 11-105. Non-binding language ("dictum") in Maryland case law, however, suggests that individual members of an unincorporated association could be held liable for the derelictions of the association. *See Rubin v. Weissman*, 59 Md.App. 392, 406-07, 475 A.2d 1235 (1984) ("individual members [of an unincorporated association] may be liable for the torts of the association"); *quoted approvingly in Himelstein v. Arrow Club*, 113 Md.App. 530, 539, 688 A.2d 491 (1997).

Members and officials of a corporation are not routinely liable for the debts of the corporation (but, see, discussion of exceptions to this immunity from liability under "4" below.) Incorporation of the Service Committee should accordingly eliminate much of the risk that anyone other than the Service Committee will be found to bear liability for the Service Committee's debts.

2. Application by the new Service Committee corporation for recognition of tax exemption as a 501(c)(3) organization.

Having a newly incorporated Service Committee obtain recognition of tax exemption should accomplish three objectives.

First, recognition of tax exempt status should insulate the Service Committee from having to pay federal and state income tax on any net income earned as a corporation as long as the application for recognition of exemption is filed within 27 months following the date of incorporation. It will also enable the Service Committee to obtain exemption from Maryland sales and use tax.

Recognition should also eliminate the risk that any control exercised by the Service

Committee over the CPRC would be viewed as impermissible private benefit, i.e., the conferring by a tax exempt 501(c)(3) organization of some benefit upon a private, non-tax-exempt organization. The enjoyment by a non-charity of any substantial private benefit from a charity puts the charity's tax-exempt status at risk. Treas. Reg. 1.501(c)(3)-1(d)(1)(ii).

Finally, recognition by the IRS of exempt status for the Service Committee will assure that the Service Committee can succeed to the net assets of the CPRC upon the latter's dissolution as contemplated by the CPRC Bylaws. Bylaws, Section 5.15. IRS rules require that, upon a charity's dissolution, its assets be distributed exclusively for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code (or be distributed to government for a public purpose). See "Tax Exempt Status for Your Organization, IRS Publication 557 (Rev. May 2003), at 20; see, also, Treas. Reg. § 1.501(c)(3)-1(b)(4). In the absence of recognition of its exempt status, the Service Committee may well not be an eligible recipient of CPRC's assets upon dissolution.

3. Application of the Service Committee unincorporated association for recognition of exemption retroactively as a 501(c)(4) tax exempt organization.

The Service Committee, as an unincorporated association, would likely qualify for an exemption from taxes under section 501(c)(4) of the Internal Revenue Code. This exemption is available to community social welfare organizations. While 501(c)(4) organizations are not eligible to receive tax deductible contributions, they have an important virtue for current purposes unavailable to 501(c)(3) organizations, i.e., they can be recognized at any time as exempt retroactively to the date of the adoption by them of Articles of Association or their equivalent.

Retroactive recognition, if possible, could accomplish a dual mission. First, it should prevent the Service Committee from being taxed on past earnings. Second, it should help to avoid any imputation that the work of the CPRC conferred an impermissible private benefit on the Service Committee. Section 501(c)(3) organizations such as CPRC are barred from benefitting private parties except as an incident to the accomplishment of their charitable purposes. If the Service Committee were recognized as exempt, even if its exemption were as a section 501(c)(4) organization, any benefit conferred by the CPRC on the Service Committee would more likely be viewed as having been incident to the accomplishment by CPRC of its charitable mission.

The Service Committee can however obtain retroactive recognition of tax exemption only to the date of its adoption of a Constitution or similar document that could be construed to be the equivalent of Articles of Association. We are unaware whether the Service Committee has such a document and, if it does, what may have been the date of the document's adoption.

4. Revision of the CPRC organizational and operational documents to increase the CPRC's independence from the Service Committee.

To the extent that the CPRC can be made to operate more independently of the Service Committee and any other entities (e.g., the Host Committee), the risk will be reduced (a) that any other entities or individuals can be found liable for CPRC's debts (that CPRC's existence separate from its members and agents will not be disregarded) and (b) that the CPRC will be found ineligible for continued tax exempt status by virtue of its conferring an impermissible private benefit upon any such entities or individuals. Of particular concern is the provision of the CPRC bylaws that recites that "The Corporation shall be subject to the decisions and actions of the

[Service Committee]." Bylaws, Section 2.02. Also of special concern are (a) the position accorded the Service Committee as the final interpreter of the provisions of the Twelve Traditions by which the CPRC's operations are to be guided (Bylaws, Section 2.03), (b) the role of the Host Committee as the coordinator and supervisor of the Convention while operating as a subcommittee of the Service Committee (Procedures Manual, p. 1), and (c) the ultimate succession of the chair of the Host Committee to the Presidency of the CPRC. (Bylaws, Section 4.09). Additional indicia of control by the Service Committee over the CPRC's operations are set forth in the discussion below of the bylaws and are troublesome principally for the cumulative impression of influence that they create.

The scope of control exercised by the Service Committee over the CPRC would be less worrisome from the perspective of preserving the CPRC's tax exemption, if the Service Committee were itself to become exempt as a 501(c)(3) organization as recommended above. The extent of control might, however, continue to pose issues for keeping the Service Committee from being potentially liable for the CPRC's liabilities.

Since the CPRC's Board can remain structured so that its membership is broadly drawn from Service Committee personnel, it might be unnecessary to have bylaw provisions that so explicitly subject CPRC policy to Service Committee direction and that give the Service Committee the predominant authority to interpret the Twelve Traditions. The provisions relating to the control over the CPRC exercised by the Service Committee through the Host Committee might best be addressed through the rather simple device of having the Host Committee become a committee of the CPRC rather than of the Service Committee. The CPRC already has responsibility to "provide oversight and guidance to the Host Committee." Accordingly, having

the Host Committee be a committee of the CPRC should not much alter the actual operation of the Convention.

A more complete review of the bylaws addressing not only the issues of private benefit and control treated above but also matters of consistency, redundancy, and effectiveness follows. This review discusses, where relevant, the changes recommended by the ad hoc committee in its evaluation of the bylaws.

Frankly, given the numerous alterations apparently made to the bylaws over the years and the extensive changes that might be required if some of the following recommendations were to be adopted, this might be an occasion for a wholesale amendment and restatement of the bylaws. We have a template for the bylaws of a Maryland nonstock corporation such as the CPRC that we think could be adapted to meet the CPRC's special needs. In the end, such a restatement could result in a more uniform and workable set of bylaws than the CPRC currently has.

Bylaw Comments

1.01 There seems to be some confusion over the name of the corporation. The bylaws refer to the name as "Chesapeake and Potomac Regional Convention, Incorporated" The records of the Maryland Department of Assessments and Taxation (SDAT) show the name with the word "Incorporated" abbreviated as "Inc." On the Form 990 for 2006, the name is shown, presumably due to the space limitations of the form, as CPRC Inc. Most seriously, the official IRS name, as listed in the IRS's Publication 78 for the use of donors, shows the name as "Chesapeake Potomac Regional Conv of Narcotics Anonymous, Inc." If the organization changed its name following the application to the IRS for recognition of tax exemption, as it may have done when reviving its charter with the State of

Maryland, the organization should notify the IRS of the new name and include a copy of the Articles of Revival or other document by which the name was changed.

- 1.02 The ad hoc committee inquires whether the principal office of the corporation is indeed a particular post office box. The SDAT, it should be noted, takes the position that the principal office of a corporation must be a street address, and the SDAT website shows what I understand to be Jim Stuart's office address as the principal office.**
- 2.02 This provision subjecting the operations of the CPRC to the "decisions and actions" of the Service Committee poses problems as discussed above. As for the specific ad hoc committee language repeating the name of the Service Committee in somewhat abbreviated form in the third sentence of this bylaw section, this should be unnecessary since CPRC is defined in the second sentence of the section.**
- 2.05 This provision purports to have the CPRC serve as the manager of the Convention's finances. Yet, as noted above, persons who are not members of the CPRC Board or appointed by the Board can control the convention funds. See p. 10 of the Procedures Manual. The bylaw provision also refers vaguely to additional purposes for the CPRC that "may later be assigned." Who does the assigning? If it is intended to be the Service Committee, then the problems posed by the Service Committee's control are magnified. Further, is there any reason why this provision mentions the Twelve Steps and section 2.03 does not?**
- 3.02 The ad hoc committee report incorrectly lists the Host Committee Treasurer as a member of the Board, although it correctly notes that the total number of board members is twenty. The range in the number of directors in this bylaw provision (5 to 22) is**

confusing since the bylaws themselves prescribe more than 5 directors even without consideration of any area representatives (5 officers, 2 Service Committee representatives, and the Host Committee chair). Moreover, the bylaws are unclear as to what would happen if the number of areas came to exceed 12, since that would cause the Board to have more than 22 members. As for two "at-large" board members who are reported to have attended and voted at a meeting according to the ad hoc committee report, these positions could not have been created by the Board despite the availability of two places within the range in numbers prescribed by the bylaws. For the board of a Maryland corporation to have the authority to alter the number of directors, the Maryland corporate statute (§ 2-402(c)(2)) requires that the bylaws prescribe that such authority be exercised only by a majority of the full board, a limitation absent from the CPRC bylaws.

- 3.04 The provision allowing the Board broadly to delegate its authorities runs afoul of Maryland corporate statute (§ 2-411(a)) which forbids any delegation at all of certain powers of the Board of Directors and allows delegation of others only to committees composed of one or more directors.
- 3.05 If this provision were amended, as suggested by the ad hoc committee, to permit removal of Board members for "ethical" lapses, the enforceability of such a provision would require that the scope of such lapses be defined with great specificity.
- 3.16 Consistent with the recommendation of the ad hoc committee that the reference to conflicts of interest be supported by a more specific delineation of such conflicts, the IRS encourages each exempt organization to adopt a formal conflict of interest policy, although this policy need not be incorporated in the bylaws and can be simply the subject

of a board resolution.

- 4.02 As noted by the ad hoc committee, the reference to "at large" members of the board in this provision is unclear. Moreover, in prescribing that directors who serve by virtue of being officers or at large members may not serve more than four consecutive 1 year terms, this provision seems to allow an unlimited number of terms to those Board members who serve by virtue of nomination by the areas or the Service Committee. One wonders whether this distinction is warranted, if the concern is over the longevity of board service.
- 4.03 It is unclear what this bylaw provision means by a "meetings of the Corporation" as opposed to meetings of the Board since the CPRC does not have members.
- 4.07 As the ad hoc committee noted, the reference to those who must give bond as "we" is unclear. The word may simply be replaced with "The Treasurer and Vice Treasurer."
- 4.08 Notwithstanding the concerns voiced by the ad hoc committee, there should be no statutory objection to a provision authorizing Board members to elect additional officers and thereby expand the size of the Board, assuming that the total number does not thereby exceed the 22 allowed by section 3.02. The language proposed by the ad hoc committee is objectionable on two counts. First, having the additional officers be "ex-officio" members of the Board does not solve the problem posed by the cap on members. An "ex-officio" member of a Board has, unless the articles or bylaws provide otherwise, the same privileges as any other Board members. Second, giving authority to the Service Committee to nominate additional Board members compounds the Service Committee control difficulties discussed above.

- 4.09** The issues respecting having the President of the Board be someone initially selected under the supervision, direct or indirect, of the Service Committee is discussed above. The last sentence of this section is redundant of section 4.01.
- 5.12** The requirement that the Treasurer's signature be required on all CPRC checks seems to be violated by the process contemplated for signing checks by the Procedures Manual at p. 10 (§ 3 of the "Treasurer and Vice Treasurer" section) wherein the Treasurer is only one of five officials listed from which any two signatories may be drawn.
- 5.13** As the ad hoc committee notes, the required annotations to the original bylaws to show changes do not seem to have been made.
- 5.15** The IRS prescribes that certain language be included in the Articles of Incorporation of a charity that restricts the ability of members, directors, officers, and other corporate agents to benefit from the charity's operations and that requires that any net assets remaining after dissolution go to organizations in a position to further the charity's charitable mission. This language may be repeated, if the charity wishes, in its bylaws. The language of this section does not comport with the IRS prescribed language. As for the new section 5.16 proposed by the ad hoc committee to have the Service Committee "if possible" receive a distribution of any net assets remaining after dissolution, this is not likely to be possible until the Service Committee itself gets recognized as a tax exempt charity.
- 6.01** See the discussion of the organizations's name in connection with the review of section 1.01 above.
- 6.02** Notwithstanding some concerns expressed by the ad hoc committee to the language

permitting the use of a facsimile in lieu of the seal, bylaws do often prescribe that, in place of the actual seal, a facsimile may be used. This can facilitate the completion of certain forms that prescribe the use of a corporate seal but that allow the requirement to be met through the use of a facsimile.

8.01 The recommendation of the ad hoc committee for seven days' prior notice of any proposal to change the bylaws is fine., although the text, as with others recommended by the ad hoc committee, could benefit from some editing, e.g., by making clear that the 2/3rds requirement applies not only to amendments but also to repeals and new bylaws. It is also unclear what is meant by the "Chesapeake and Potomac Region" to which notice of a proposed bylaw revision is to be given under the ad hoc committee's suggested language.

8.02 This section appears to be redundant of section 5.13.

Discussion

Exposure to Liability of Service Committee and/or Members

As a general proposition, a Maryland non-stock corporation enjoys an existence independent of its members such that its members have no responsibility for the corporation's liabilities and nor rights to its assets. *See. e.g., U.S. v. 0.01 Acre of Land, More or Less, in Cecil County, State of Md.*, 310 F.Supp. 1379, 1387 (D.C. Md. 1970). Under certain circumstances, however, a court may conclude that this wall (or "veil") of separation should be pierced. *Id.*

Maryland courts have not dealt with the precise circumstances that might warrant disregard of the corporate form in the case of a non-stock as opposed to the case of a stock corporation. Courts in other states have determined, however, that the circumstances should be no different for non-stock corporations as for stock corporations. *See. e.g., Medlock v. Medlock,*

263 Neb. 666, 678, 642 N.W.2d 113 (2002). Assuming, as is likely, the same rule obtains in Maryland, then those in close association with a non-stock corporation such as the CPRC cannot be "held liable for debts or obligations of the corporation except, as with stock corporations, where it is necessary to prevent fraud or enforce a paramount equity." *Edenbaum v. Schwarcz-Osztreicherne*, 165 Md.App. 233, 253, 885 A.2d 365, 376 (2005) (citation omitted).

The term "paramount equity" has received concrete expression in varying ways in Maryland court decisions. In general, however, the principal factor tending to establish the existence of paramount equity so to hold one closely associated with a corporation liable for the corporation's debts arising from a particular transaction is "complete domination, not only of the finances, but of policy and business practice in respect to the transaction so that the corporate entity as to this transaction had at the time no separate mind, will or existence of its own." *Hildreth v. Tidewater Equipment Co., Inc.*, 378 Md. 724, 735, 838 A.2d 1204, 1210 (2003).

As for specific criteria reflecting improper domination of a corporation such that the principals of a corporation may be held liable for its debts (otherwise stated that a corporation may be considered a mere "alter ego" of others), courts recite the following (not all being relevant in a non-stock corporation context): "(1) whether the corporation is inadequately capitalized, fails to observe corporate formalities, fails to issue stock or pay dividends, or operates without a profit, (2) whether there is commingling of corporate and personal assets, (3) whether there are non-functioning officers or directors, (4) whether the corporation is insolvent at the time of the transaction, and (5) the absence of corporate records." *Id.* (citation omitted).

Several features of the relationship between the Service Committee and the CPRC could conceivably be interpreted so as to have the CPRC construed as merely the alter ego of the

Service Committee: Of greatest concern, the Bylaws explicitly recite that the CPRC "shall be subject to the decisions and actions of the [Service Committee]." Bylaws, Section 2.02. Also of special concern are (a) the position accorded the Service Committee as the final interpreter of the provisions of the Twelve Traditions by which the CPRC's operations are to be guided (Bylaws, Section 2.03), (b) the role of the Host Committee as the coordinator and supervisor of the Convention while operating as a subcommittee of the Service Committee (Procedures Manual, p. 1), and (c) the ultimate succession of the chair of the Host Committee to the Presidency of the CPRC. (Bylaws, Section 4.09) Indicia of control that are of consequence principally because of the reinforcement they give to the overall impression of influence are provisions of the Bylaws that authorize the Service Committee to appoint two people to the CPRC Board (Bylaws, Section 3.10), that mandate that notice of CPRC Board meetings be given to the Service Committee (Bylaws, Sections 5.04 and 5.05), that require that the Service Committee be given an annual statement of the "conditions" of the CPRC (Bylaws, Section 5.07), that dictate that, upon dissolution, the CPRC distribute any net assets to the Service Committee, "if possible" (Bylaws, Section 5.15.), and that afford the Host Committee and its subcommittees to make numerous decisions regarding the operation of the Convention without the concurrence of the CPRC. Notable among the last is the ability of personnel other than officers of the CPRC to disburse Convention funds (Procedures Manual, p. 10)).

It should also be noted that, according to the list of Service Committee resolutions entitled "Chesapeake & Potomac Region Policy, as of February 2008," the CPRC was created by the Service Committee through having the Service Committee "allow the 1st C&P Convention Subcommittee to incorporate as to provide structure for future committees to follow." (Region

Policy Handbook, at 11 (Oct-86)). Indeed, even after incorporation, the CPRC continues to be referred to in the Service Committee Region Policy Handbook as the "Convention Subcommittee." *Id.* This evidences a further intention, at least on the part of the Service Committee, that the CPRC function merely as an adjunct of the Service Committee and not genuinely as a separate entity.

While none of these provisions alone might warrant a conclusion that the CPRC is the mere alter ego of the Service Committee, their totality could be construed to suggest that the CPRC was established simply to try to avoid Service Committee liability for convention obligations without there being a real intention to remove the convention from Service Committee control. Such a finding could lead to a determination in a particular instance that the CPRC's separate existence should be disregarded for liability purposes.

Risk of Repeal of Exempt Status

In order to retain its exempt status, a 501(c)(3) organization like the CPRC must be operated for exempt charitable purposes. It cannot confer any substantial benefit on any organization that is not similarly exempt other than in fulfillment of its charitable mission. Treas. Reg. 1.501(c)(3)-1(d)(1)(ii). "When an organization operates for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests, the organization by definition does not operate exclusively for exempt purposes. Prohibited private benefits may include an 'advantage; profit; fruit; privilege; gain; [or] interest.'" (Citations omitted.). *American Campaign Academy v. C.I.R.* 92 T.C. 1053, 1065 -1066 (1989). The enjoyment by a non-charity of any substantial private benefit from a charity puts the charity's tax-

exempt status at risk.

Since the Service Committee is not recognized as tax exempt under section 501(c)(3), it will be considered as a private entity for purposes of the rule barring the conferring of private benefit. To the extent accordingly that the Service Committee could be construed to control the operations of the CPRC, it will arguably be enjoying a benefit conferred upon a private party by a tax-exempt charity.

It may not be a sufficient defense against a claim of private benefit that the control exercised by the Service Committee is diffuse and not exercised directly as by full control over appointments to the CPRC Board. The impermissible control can be indirect. In *est of Hawaii v. Commissioner*, 71 T.C. 1067 (1979), for example, several for-profit "est" organizations that had no formal structural control over the nonprofit entity in question were found, by virtue of exercising "considerable control" over the non-profit to be receiving impermissible private benefit. In that instance, the for-profit organizations set fees that the nonprofit charged the public for training sessions, required the nonprofit to carry on certain types of educational activities, and provided management personnel to the non-profit who were paid for and responsible to one of the for-profits. *Id.* These kinds of controls are not unlike the kinds of controls that the Service Committee can exercise over the CPRC.

In addition, it is no defense to a claim of private benefit that the private entity does not actually use its authority to alter the non-profit's charitable activities. As one court stated in denying tax exemption to a charitable hospital that was found to be controlled by a private party, "To the extent that [the non-profit] cedes control over its sole activity to for-profit parties having an independent economic interest in the same activity and having no obligation to put charitable

purposes ahead of profit-making objectives, petitioner cannot be assured that the partnerships will in fact be operated in furtherance of charitable purposes." *Redlands Surgical Services v. C.I.R.*, 113 T.C. 47, 78 (U.S. Tax Ct. 1999), *aff'd*, 242 F.3d 904 (9th Cir. 2001).