MINNESOTA NON-PROFIT LAW:
CASES AND MATERIALS

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REYNOLDS, Collector of Internal Revenue.

43 F.Supp. 510 (1942)

SULLIVAN, District Judge.

This is an action brought to recover social security taxes claimed to have been erroneously and illegally assessed for the years 1936, 1937 and 1938, amounting in the aggregate, with interest, to the sum of $6,296.93.

The plaintiff has filed returns and paid said taxes under protest, under the provisions of Titles VIII and IX of the Social Security Act, Sections 801 et seq., 901 et seq., 1001 et seq., and 1101 et seq., 42 U.S.C.A. Claim for refund was filed by the taxpayer and more than six months elapsed prior to the commencement of this suit, no decision having been rendered by the Commissioner on said claim for refund.

The facts in this case have been stipulated, and may be summarized as follows:

The Northern Pacific Beneficial Association, hereinafter referred to as the 'Association', is a voluntary association of persons, now or formerly working for the Northern Pacific Railway Company, hereinafter referred to as the 'Railway Company'. The object of the Association, as set out in its constitution, is 'the medical, surgical and hospital care of its members'.

The constitution of the Association provides that its membership 'shall include all employees of the Northern Pacific Railway Company', all members of the Association, and all members of such other corporations in which the Railway Company may own a majority of the stock, and such as the Board of Directors of the Association may *512 decide to receive into its membership under the rules, regulations and constitution of said Association.

The constitution of the Association also provides for membership dues of one per cent. of the employee's monthly earnings, with a minimum of 75 cents and a maximum of $1.50 monthly, and an additional assessment of 25 cents per member per month may be levied when, in the opinion of the Board of Directors the same may be deemed advisable. Provision is also made for members who are retired from the service with a pension to continue their membership in the Association on the payment of one per cent. of their monthly pension allowance, with a minimum of 50 cents and a maximum of $1.50 per month. There is provision made also for the continuance of membership in the Association of such members as may be on leave of absence, upon the payment by such persons of certain monthly assessments.

The by-laws of the Association provide that all persons who accept employment with said Railway Company or Association shall from that date be considered members of the Association, and entitled to its benefits. Membership, however, is dependent upon the payment of prescribed dues, and if members fail to pay the dues imposed upon them in advance they shall 'automatically forfeit their membership and rights to benefits.'

The by-laws also set out certain exceptions from membership, among which are persons temporarily employed by the Railway Company and persons who, before entering the service, were afflicted with chronic diseases or congenital conditions. The benefits accruing to Association members are medical and surgical care and attention, hospitalization and nursing care, in case of accident or illness. Care outside of the Railway Company's hospitals is also contemplated under certain conditions. Medical and surgical treatment is limited to six months to the members who may be incapacitated for work by illness or accident, except that in certain cases and under certain conditions the time of such care may be extended at the discretion of the Association's chief surgeon. The Association maintains a full-time staff of doctors, nurses and other employees, four general hospitals and one emergency hospital, at different locations along the line of said Railway Company. The Railway Company makes cash contributions of $5,000 each month to the Association, partially as a lump-sum payment for the care of its employees injured as the result of accidents while on duty, and partially as a pure contribution. The proportions to be allocated for each of said purposes does not appear. The Railway Company makes further contributions to the Association in the way of services of certain of its departments. The Association never distributed any money as earnings among its membership. Any money which the Association had on hand has gone into the improvement of its present properties and the extension of its service. It now has a membership of approximately 21,000 persons. It accepts some pay patients, and also some charity cases.

It is the contention of the plaintiff that the Association is organized and operated exclusively for charitable purposes, and that no part of its net earnings inures to the benefit of any private shareholder or individual, and that by reason thereof, it is exempt from making the payments required by the Social Security Act and the Revenue Act of 1936.

On the other hand, the defendant contends that the Association is not organized for charitable purposes, but is organized for the mutual benefit of its membership, and that indirectly the earnings of the Association inure to the benefit of its membership, and that by reason thereof it is not entitled to the exemption claimed.

The Revenue Act of 1936 and the Social Security Act require payments to the government, based on the earnings of employees. Certain corporations, associations and organizations are exempted from the provisions of said Acts.

Section 101(6) of the Revenue Act of 1936, 26 U.S.C.A.Int.Rev.Code, § 101(6), so far as the same is here pertinent, provides:

'The following organizations shall be exempt from taxation under this chapter--

'(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for * * * charitable * * * purposes, * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual, * * * .'

The pertinent provision of Section 811(b)(8), 42 U.S.C.A. § 1011(b)(8), relating to Title VIII of the Social Security Act (employees), and Section 907(c)(7) of *513 the same Act, 42 U.S.C.A. § 1107(c)(7), relating to Title IX (employees) of the Act, the language of each of said Sections being identical, is as follows:

'The term 'employment' means any service * * * except--

'Service performed in the employ of a corporation, community chest, fund, or foundation, organized and operated exclusively for * * * charitable * * * purposes, * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual.'

Was the Association operated exclusively for charitable purposes?

[1][2] It is reasonably accurate to state that the word 'charity' means a gift without any hope on the part of the donor, based on legal or moral right, of any material benefits being realized therefrom by him. Webster's New International Dictionary states that 'charity' means, among other things, 'Whatever is bestowed gratuitously on the needy or suffering for their relief; an eleemosynary foundation or institution; an institution founded by a gift and intended for the use of the public, as a hospital, library, school, etc.' A charity is a gift without material reward or consideration, and this holds true whether the same was prompted by ulterior motives or not. For definitions of 'charitable institution' and 'charity', see County of Hennepin v. Brotherhood of the Church of Gethsemane, 27 Minn. 460, 8 N.W. 595, 38 Am.Rep. 297, and Jackson v. Phillips et al.,

14 Allen 539, 556, 96 Mass. 539, 566. A charitable institution is one established, maintained and operated for the purpose of taking care of the sick, without any profit or view of profit, but at a loss which has to be made up by benevolent contributions.

Here the Railway Company has made appreciable contributions to the Association each year. These were gifts on the part of the Railway Company, but are the payments made each month, by the members of the Association, gifts? I think not. Under the constitution and by-laws of the Association, these monthly payments by the members purchase and entitle them to certain benefits-- medical care and attention, hospitalization and nursing, in case of injury or sickness; and in the event of the death of a member, a burial benefit is provided for. The member is entitled to the benefits as a matter of right, so long as he pays the dues required of him. But if he should fail to pay the monthly assessment or dues, his membership in the Association is automatically forfeited, along with any rights to the benefits provided for in the by-laws.

In passing on like contentions as are here made, the Board of Tax Appeals, in Appeal of Philadelphia & Reading Relief Association, 4 B.T.A. 713, 728, had this to say: 'Here, for definite contributions, paid by its members at regular recurring periods, the Association undertakes to pay its members certain definite sums in the event of sickness, accident, or death. Whatever it may be called, the scheme is that of insurance. The relation of the Association to its members is contractual, rather than charitable. Nor is it a benevolent institution. No aid is furnished from generosity or liberality. None such is pretended. On the contrary, for a pecuniary consideration the Association agrees to pay a definite sum in the cases specified.' See also Hassett v. Associated Hospital Service Corporation of Massachusetts, 1 Cir., 125 F.2d 611, reversing D.C., 37 F.Supp. 822.

This Association is a beneficial one for the benefit of its members. It was not created for the purpose of extending benevolence, nor was it created for the purpose of benefiting the public generally. Neither was it created for the purpose of extending gratuitous services and assistance to any particular class. The relationship existing between the members and the Association is based on contract. In consideration of the payment of dues by the members, and only because of the payment of such dues, the Association obligates itself to do certain things.

[3] There can be little question but that a voluntary association for the mutual benefit of its members may, without difficulty, be distinguished from a public charitable institution. These distinctions have been considered by the Courts and textwriters. See: Coe v. Washington Mills et al., 149 Mass. 543, 21 N.E. 966; Young Men's

Protestant, etc., Society v. City of Fall River, 160 Mass. 409, 36 N.E. 57; 11 Corpus Juris, p. 305; 14 C.J.S.,Charities, § 2; 7 Corpus Juris, p. 1051; 10 C.J.S.,Beneficial Associations, § 1; 19 Ruling Case Law, 1182, section 5.

[4] It clearly appears that the Association was organized for the mutual benefit *514 of its members. There is no evidence that it departed from the purposes for which it was organized, nor is there any evidence that it carried on the usual activities of a charitable institution. To be entitled to the exemptions granted by either of the statutes under consideration, an association must be organized and operated exclusively for charitable purposes, with no part of the net earnings accruing to the benefit of its members. It is the general rule of law that the objects and purposes of an organization must be determined from the purposes and objects as declared in the instrument creating it. Helvering v. Coleman-Gilbert Associates, 296 U.S. 369, 56 S.Ct. 285, 80 L.Ed. 278. The objects of the Association set out in its constitution are stated specifically as being the operation of hospitals for the care and treatment of its members, with the privilege of taking into such hospitals such other persons as may be admitted, as pay patients under certain conditions. There is no indication in its articles that its hospitals were to be conducted as charitable institutions. There is nothing in the evidence to indicate that the major part of the activities of the Association were charitable or benevolent. True, some charity cases were taken care of, but that fact does not in itself make the Association a charitable organization.

There is no evidence that the Association had any net earnings, nor is there any evidence that the members received any profits on their memberships, but these matters are not controlling. The question might be asked, did the members receive any beneficial advantage in other ways than by dividends, by reason of their membership? The members received the benefits provided for in the by-laws when needed, or were entitled to receive them at such times as the same might be required.

'Profit may inure to the benefit of shareholders in other ways than in dividends.' Northwestern Municipal Association v. United States, 8 Cir., 99 F.2d 460, 463.

[5] It appears that the Association was relieved from the payment of federal income taxes, but under what section and for what years does not appear from the stipulation. The supplemental brief filed by the defendant indicates that exemption was granted to the Association by the Commissioner of Internal Revenue under subdivision (8) of Section 101 of the Revenue Act of 1934, 26 U.S.C.A.Int.Rev.Code, § 101(8). It was not, however, granted under subdivision (6)

of that Act. To have gained exemption from the payment of taxes imposed by the Social Security Act of 1935 for the years involved, it was necessary that the taxpayer come within the exceptions set out in sections 811(b)(8) of Title VIII and Section 907(c)(7) of Title Ix of that Act, 42 U.S.C.A. §§ 1011(b)(8) and 1107(c)(7). The exemptions provided for in Section 101(6) of the Revenue Act are analogous to the exemptions allowed under the Social Security Act. However, in the Social Security Act there is no similar exemption to that of subdivision (8) of Section 101 of the Revenue Act. Whether that be material in this proceeding it does not seem necessary to determine. The taxes provided for in the Social Security Act are based on the relationship of employee and employer, and not on taxable income. While the collection of social security taxes is entrusted to the Collector of Internal Revenue, as are income taxes, they are separate and distinct forms of taxation. The exemptions allowed and permitted under Section 101 of the Revenue Act are exemptions granted to the enumerated persons and organizations from the payment of income tax, not from the payment of social security taxes, so to determine the exemptions that are permitted under the Social Security Act we must look to that Act's definition of taxable employment.

[6] The matters set out in subdivision (16) of Section 101 of Title 26 U.S.C.A. Int. Rev. Code (Revenue Act) did not become effective as an exemption in social security taxes until January 1, 1940. See Revenue Act, August 10, 1939, 26 U.S.C.A.Int.Rev.Code, § 1426(b)(10)(C), 53 Stat. 1385, 1392, Sec. 1607(c)(10)(C).

[7] It is my opinion that the tax sought to be recovered in this case was properly imposed and collected, and accordingly judgment should be for the defendant.

MEINHARD
v.
SALMON et al.

249 N.Y. 458 (1928)

***461 CARDOZO, C. J.**

On April 10, 1902, Louisa M. Gerry leased to the defendant Walter J. Salmon the premises known as the Hotel Bristol at the northwest corner of Forty-Second street and Fifth avenue in the city of New York. The lease was for a term of 20 years, commencing May 1, 1902, and ending April 30, 1922. The lessee undertook to **546 change the hotel building for use as shops and offices at a cost of $200,000. Alterations and additions were to be accretions to the land.

Salmon, while in course of treaty with the lessor as to the execution of the lease, was in course of treaty with *462 Meinhard, the plaintiff, for the necessary funds. The result was a joint venture with terms embodied in a writing. Meinhard was to pay to Salmon half of the moneys requisite to reconstruct, alter, manage, and operate the property. Salmon was to pay to Meinhard 40 per cent. of the net profits for the first five years of the lease and 50 per cent. for the years thereafter. If there were losses, each party was to bear them equally. Salmon, however, was to have sole power to 'manage, lease, underlet and operate' the building. There were to be certain pre-emptive rights for each in the contingency of death.

[1] The were coadventures, subject to fiduciary duties akin to those of partners. King v. Barnes, 109 N. Y. 267, 16 N. E. 332. As to this we are all agreed. The heavier weight of duty rested, however, upon Salmon. He was a coadventurer with Meinhard, but he was manager as well. During the early years of the enterprise, the building, reconstructed, was operated at a loss. If the relation had then ended, Meinhard as well as Salmon would have carried a heavy burden. Later the profits became large with the result that for each of the investors there came a rich return. For each the venture had its phases of fair weather and of foul. The two were in it jointly, for better or for worse.

When the lease was near its end, Elbridge T. Gerry had become the owner of the reversion. He owned much other property in the neighborhood, one lot adjoining the Bristol building on Fifth avenue and four lots on Forty-Second street. He had a plan to lease the entire tract for a long term to some one who would destroy the buildings then existing and put up another in their place. In the latter part of 1921, he submitted such a project to several capitalists and dealers. He was unable to carry it through with any of them. Then, in January, 1922, with less than four months of the lease to run, he approached the defendant Salmon. The result was a new lease to the Midpoint Realty Company, which is owned and controlled by Salmon, a lease covering the *463 whole tract, and involving a huge outlay. The term is to be 20 years, but successive covenants for renewal will extend it to a maximum of 80 years at the will of either party. The existing buildings may remain unchanged for seven years. They are then to be torn down, and a new building to cost $3,000,000 is to be placed upon the site. The rental, which under the Bristol lease was only $55,000, is to be from $350,000 to $475,000 for the properties so combined. Salmon personally guaranteed the performance by the lessee of the covenants of the new lease until such time as the new building had been completed and fully paid for.

The lease between Gerry and the Midpoint Realty Company was signed and delivered on January 25, 1922. Salmon had not told Meinhard anything about it. Whatever his motive may have been, he had kept the negotiations to himself. Meinhard was not informed even of the bare existence of a project. The first that he knew of it was in February, when the lease was an accomplished fact. He then made demand on the defendants that the lease be held in trust as an asset of the venture, making offer upon the trial to share the personal obligations incidental to the guaranty. The demand was followed by refusal, and later by this suit. A referee gave judgment for the plaintiff, limiting the plaintiff's interest in the lease, however, to 25 per cent. The limitation was on the theory that the plaintiff's equity was to be restricted to one-half of so much of the value of the lease as was contributed or represented by the occupation of the Bristol site. Upon cross-appeals to the Appellate Division, the judgment was modified so as to enlarge the equitable interest to one-half of the whole lease. With this enlargement of plaintiff's interest, there went, of course, a corresponding enlargement of his attendant obligations. The case is now here on an appeal by the defendants.

[2] Joint adventurers, like copartners, owe to one another, while the enterprise continues, the duty of the finest *464 loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions. Wendt v. Fischer, 243 N. Y. 439, 444, 154 N. E. 303.

Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.

STATE of Minnesota, Respondent,
v.
NORTH STAR RESEARCH AND DEVELOPMENT INSTITUTE, Appellant.

294 Minn 56 (1972)

KELLY, Justice.

Appeal by defendant, North Star Research and Development Institute, a nonprofit corporation, from a judgment of the Hennepin County District Court holding that defendant is not exempt from ad valorem taxes on real estate occupied and leased by it from a public school district. We reverse.

Our decision is based upon our conclusion that North Star, organized in 1963 under the Minnesota Nonprofit Corporation Act, Minn.St. c. 317, is a nonprofit corporation within the meaning of Minn.St. 317.02, subd. 5. A 'nonprofit corporation' is defined there as one (a) formed for a purpose not involving pecuniary gain to its shareholders or members, and (b) paying no dividends or other pecuniary remuneration, directly or indirectly, to its shareholders or members as such. North Star has no shareholders, and there is no way in which, under its articles or bylaws or under the laws of this state, North Star could pay any dividends or other pecuniary remuneration directly or indirectly to its 'members'; there is no way in which it could be said that North Star was formed for pecuniary gain to them; nor is there any evidence that its 'members' received any pecuniary gain.

As pointed out in plaintiff's brief, the parties stipulated to the basic facts in this case. The evidence adduced beyond the stipulated facts is for all practical purposes uncontradicted.

*58 North Star's genesis is found in a joint study conducted by Upper Midwest Research and Development Council (Upper Midwest) and the University of Minnesota. Upper Midwest was a nonprofit corporation organized to promote the economy of the area comprising the Ninth Federal Reserve District. The joint study was funded by a $350,000 grant from the Ford Foundation and by matching contributions of $220,000 raised by Upper Midwest and the University. The purpose of the study was 'to help finance and develop a continuing**413 economic study of the upper Midwest region.' Pursuant to that goal, the study fostered a proposal for the organization of a research institute. While there are approximately a dozen nonprofit research centers located around the country, none previously existed in the area comprising the Ninth Federal Reserve District.[FN1] In June 1962, Upper Midwest resolved 'jointly with the * * * University of Minnesota (to) take steps to incorporate * * * a research institute to be located in the Twin Cities metropolitan area.'

FN1. There are three large research centers: Battelle Memorial Institute in Columbus, Ohio; Stanford Research Institute in Menlo Park, California; and Illinois Technology Research Institute, Chicago, Illinois. Smaller ones include Southwest Research Institute, San Antonio, Texas; Midwest Research Institute, Kansas City, Missouri; Southern Research Institute. Birmingham, Alabama; Research Triangle Institute, Durham, North Carolina; Franklin Institute, Philadelphia, Pennsylvania; Spindletop Research Inc., Lexington, Kentucky; and Gulf South Research Institute, Baton Rouge, Louisana. The last two are substantially supported by their respective states.

The plans involving the research center came to the attention of certain officers of Minneapolis Area Development Corporation (MADC) in 1962. MADC, a profitmaking corporation, had been organized for the purpose of stimulating the economy by bringing new business into the area.[FN2] In 1956, pursuant to that goal, it had acquired from various landholders an industrial site *59 in Scott County along the Minnesota River. In 1962, the site, known as Valley Industrial Park, contained approximately 2,100 acres having a cost basis of

$710,063.15. By 1962, the fair market value of the industrial site was estimated by experienced appraisers to be over $5,000,000. This valuation was, however, subject to a discount to $3,534,250 if the land were to be sold to a single developer--even then, a gain in value of nearly 500 percent before taxes.

FN2. The impetus for MADC was the refusal of a major corporation to move to the Twin Cities area because of the lack of a large site for a plant.

The officers of MADC believed that the proposed research center served their objective of bringing new industry into the area. The president of MADC wrote a letter to MADC shareholders wherein he proposed that they donate the industrial site, their shares and debentures of MADC, and 75 percent of their tax savings [FN3] to the research institute. The proposal, subsequently reduced to an agreement, provided that all shareholders except the Chicago & North Western Railway Company donate all of their stock and debentures. The railway, the largest MADC shareholder, received no tax benefit from the donation due to its lack of taxable income,[FN4] but nonetheless it contributed 8,312 shares and sold its remaining 1,288 shares and its MADC debentures for approximately $300,000. This made the railroad North Star's largest contributor. The contributors also agreed to pledge at least $700,000 in cash to support the initiation of the research center. Additionally, certain financial institutions made low-interest loans to the institute. Finally, several companies which *60 were not MADC shareholders contributed cash to the research center. MADC then dissolved.

FN3. It was estimated that corporate shareholders of MADC in the maximum tax bracket would thereby receive a 257 percent return on their investment after the contribution of 75 percent of their tax savings. The tax benefits were the same as if the securities had been given to a church. While we do not know the tax brackets of all the contributors, it is a fair assumption that, if they had not contributed their securities but had sold them, they would have received an even larger return.

FN4. The railroad does, however, have a line which passes through the industrial site.

[1] It is important to distinguish between the contributors to and 'members' **414 of North Star. Minn.St. 317.02, subd. 5, prohibits Members and shareholders from receiving pecuniary remuneration. The statute itself does not apply to contributors.

North Star Research and Development Institute, the object of the advantageous generosity described, was thus formed. Its articles of incorporation state that it exists 'for scientific purposes in the public interest and for the public benefit.' Named as incorporators were three men associated with the University, two involved with Upper Midwest, and one from the Hill Family Foundation. There were three other incorporators, all of whom were employed by private concerns: The Minneapolis Star and Tribune Company, Northwestern National Bank of Minneapolis, and First National Bank of St. Paul. The incorporators had no power over North Star of any kind.

[2] The 'members' of the corporation were originally such persons as from time to time were regents of the University of Minnesota.[FN5] They were to hold membership in their individual capacity. Members in a nonprofit corporation organized under Minn.St. c. 317 are the 'owners' of the corporation. Although North Star has no capital stock, the members serve the same function that shareholders in a profit corporation serve. See, Minn.St. 317.22, 317.25. It is important, however, that the members of a nonprofit corporation derive no pecuniary gain from the corporation. s 317.02, subd. 5. North Star has amended its articles of incorporation to provide that the members be 12 individuals selected by the Board of Regents.

FN5. The members of the Board of Regents are elected by the state legislature. Vacancies between legislative terms are filled by the governor, in which case the appointed regent serves until the next session of the legislature. University Charter, ss 5, 6 (Terr.L.1851, c. 3, ss 5, 6).

The board of directors of North Star consists of 48 to 99 individuals*61 elected by the 'members.'[FN6] Subsequent to February **415 1969, no more than two-thirds of the directors may be associated *62 with private business. Thus, it is apparent that the 'members' can presently insure that none of the directors be associated with business as these limitations were maximums and not a requirement. The members have elected doctors, lawyers, clergymen, educators and a prominent labor leader to the board in addition to industrial and business leaders. Neither the members nor the directors receive any compensation for their services.

If North Star is dissolved, the articles provide that all assets go to the University of Minnesota or to some other nonprofit organization described in s 501(c)(3) of the Internal Revenue Code of 1954, 26 U.S.C.A. s 501(c)(3)--that is, an organization 'organized and operated exclusively for religious, charitable, *63 scientific' or other similar purposes, 'no part of the net earnings of which inures to the benefit of any private shareholder or individual.' Both the Federal and State taxing authorities have ruled that North Star is itself such an organization and that any contributions to it are deductible as 'charitable contributions' under the appropriate tax laws.

North Star has also been accorded income tax exemption by both the United States and the State of Minnesota. The Federal exemption arises under s 501 of the Internal Revenue Code, 26 U.S.C.A. s 501. The state exemption is under Minn.St. 290.05(9).[FN7]

FN7. While these rulings by Federal and State taxing authorities may not be decisive of the issues in this case, the fact that Federal and State laws and administrative rulings classify institutes such as North Star as charitable organizations should have some persuasive effect.

Voluntary dissolution of North Star must have the concurrence of three-fourths of both members and directors. It is obvious that the regents could, if they were of a mind to do so, name 12 members who could in turn elect directors all of whom might favor dissolution and the assignment of all assets to the University of Minnesota. Thus, all control over North Star has been severed from the contributors, who should be distinguished from the 'members.'[FN8]

FN8. The importance and power of a member of a nonprofit corporation is illustrated by the language used by Mr. Chief Justice Dell in Minnesota Baptist Convention v. Pillsbury Academy, 246 Minn. 46, 61, 74 N.W.2d 286, 296 (1955): 'It is doubtful if any membership * * * right is any more important than the right to vote for the election of the directors * * * of a corporation who carry on and conduct the business of the corporation, elect or appoint its officers and agents, and in a large measure, determine the manner in which the corporation operates.'

**416 The basic idea behind the creation of North Star was in accord with the Ford Foundation's suggestion that the area needed a research facility. It was believed that many companies were too small to support a research center of their own. North Star was intended to enable such businesses to have access to a research *64 center, thereby stimulating the economy. The development of new products and industrial techniques was expected to have a positive effect upon the level of business activity and employment. The presence of a research center would also induce business concerns to move into the area.

The University had an additional reason to support the creation of North Star. Certain university officials were concerned about the amount of applied research as distinguished from basic research which was conducted by university faculty and students.[FN9] The development of North Star would fulfill the need of industry for applied research and, thereby, would relax the pressure upon the University in that area.

FN9. Applied research is the second stage in the development of new products. The first step, basic research, is a general inquiry into the laws of nature and natural phenomenon. Applied research is the use of basic research toward the development of a specific product or process.

Since its inception in 1963, North Star has undertaken an impressive assortment of research projects for a variety of governmental, industrial, and other clients. Representative of its projects are studies for the cities of Fargo and Moorhead relating to opportunities for industrial development; development of a mathematical analysis technique used in surveys for the cities of Minneapolis and St. Paul concerning housing patterns; an investigation for the Minnesota State Department of Education relative to plans for implementing technical services made available by the Federal government; a study for the National Health Institute concerning the causes of uremia; development for the Department of Interior of a new film system for the desalination of sea water and brackish water; a project for the St. Paul School Board to assist in designing a new curriculum for the technical vocational school; and studies for the Minneapolis Planning Commission, as well as for numerous other governmental agencies. The scope of North Star's research included such commendable, disparate fields as the development of a new membrane *65 for an artificial kidney machine and formulation of a new police communications system utilizing computer technology. It also engaged in significant research, testing, and consultation services for private industry, including development of a machine that automatically records the dimensions of a client's product for purposes of quality control; facilitating establishment of a plan for production of corn sugar in western Minnesota; development of a process for conversion of waste materials from food industries into animal feed (sponsored jointly by a Federal agency and the Green Giant Company, Ralston Purina Company, General Mills, Inc., and Central Soya Company); analysis for F. H. Peavey & Company of an ultrasonic whistle for use in controlling rodents menacing its grain storage and processing facilities; a systems analysis of sales and billing procedures for the Dayton Company; analysis of sales for an industrial client with many sales outlets; and determining improved methods for the analysis of statistical data.

**417 North Star has served the needs of government and large businesses more than was perhaps anticipated.[FN10] In terms of dollar volume, large companies understandably accounted for a greater volume of work than small companies. However, most of North Star's 154 industrial clients for the years 1963 to 1968 appear to have been smaller businesses. Since two-thirds of North Star's receipts for services rendered were from government projects during the period, and since 59.9 percent of its approximately 200 contracts were with industrial concerns, it may be assumed that the larger projects involved the Federal government.[FN11] North Star has not displayed any preference in the manner in which it has accepted clients or assessed payment for its services. All clients have been billed on the same cost-plus fee basis. Any *66 patents which might be forthcoming from North Star's research become the property of the client who has paid for the research and any expenses incurred in securing a patent.[FN12]

[3] 1. North Star makes two separate arguments concerning why it should not have to pay the tax in question. First, both North Star and the state agree that the property is owned by the public for use as a public schoolhouse. 'Public schoolhouses' are exempt from taxation.[FN14] If the property is taxable, it must be under Minn.St. 272.01, subd. 2, which provides in part:

FN14. Minn.St. 272.02, subd. 1(2).

'When any real or personal property which for any reason is exempt from ad valorem taxes, and taxes in lieu thereof, is Leased, loaned, or otherwise made available and used By a private individual, association or corporation in connection with a business conducted for profit * * * there shall be imposed a tax, for the privilege of so using or possessing such real or personal property, in the same amount and to the same extent as though the lessee or user was the owner of such property.' (Italics supplied.)

This statute is amplified by Minn.St. 273.19, subd. 1:

'Property held under a lease for a term of three or more years, and not taxable under section 272.01, subdivision 2, * * * *68 when the property is school or other state lands, shall be considered, for all purposes of taxation, as the property of the person so holding the same.'

Thus, the first issue is whether North Star is a 'business conducted for profit.' Inquiry must also be made concerning whether North Star held the property 'under a lease for a term of three or more years.'

The second issue is whether North Star is a 'purely public charity.' North Star Research argues that, because it is an 'institution of purely public charity,' its property is 'used exclusively for any public purpose' and is exempt from taxation by virtue of Minn.Const. art. 9, s 1, and Minn.St. 272.02, subd. 1(6, 7).

While the primary issue at the trial was whether North Star was a public charity, the issue of an exemption under Minn.St. 272.01, subd. 2, was raised and ruled upon below. In its pleadings, North Star prayed that the court adjudge that the tract was exempt from real estate taxes. Thus, the trial court pointed out:

> 'The dominant issue here is the matter of the exemption from paying taxes by the defendant, so if under the evidence, the defendant's claim of exemption is clearly shown, I will hold it exempt although it may be exempt under a different category than pleaded or claimed ad hoc. (Holen vs. Mpls-St. Paul Metro Airports, 250 (Minn.) 130, 84 N.W.2d 282.) (In re: Junior Achievement of Greater Mpls. vs. State, 271 Minn. 385, 135 N.W.2d 881.)'

The trial covered areas common to both issues, such as the absence of private gain and the accessibility of the facilities to the general public. Both issues were discussed by the parties in briefs to the trial court. The trial court ruled that the property was 'not exempt from ad valorem taxation.' While the trial court's conclusions of law do not specifically refer to s 272.01, subd. 2, it is evident from his memorandum that he considered *69 that issue. In this connection, the trial court devoted about three and a half pages under the following caption: '**419 PUBLIC PROPERTY LEASED TO PRIVATE INDIVIDUAL OR CORPORATION CONDUCTED FOR PROFIT. SECTION 272.01 AND SECTION 273.19 M.S.A.' Under this caption, the court said:

> 'This, in my opinion, poses the most serious question of this case. This problem has given me the most trouble--not from the standpoint of where the equity lies, but from the standpoint of interpreting the statutes as above described.'

In this appeal North Star continues to pursue this question by seeking review of its claimed exemption under s 272.01, subd. 2.

If North Star Research is a 'corporation in connection with a business conducted for profit,' it must pay the assessed tax. Corporations properly and rightfully operated and incorporated under Minn.St. c. 317, relating to nonprofit corporations, are those corporations which are not 'businesses conducted for profit.' If North Star is entitled to incorporate under c. 317 and if it holds a lease of public lands for less than 3 years,[FN15] it is exempt from paying the assessed tax.[FN16]

FN15. See, Minn.St. 273.19, subd. 1, quoted above and discussed below.

FN16. As has already been indicated, North Star Research, in fact, did incorporate under Minn.St. c. 317.

Section 317.05 provides that nonprofit corporations may be formed for a broad number of purposes:

'A nonprofit corporation may be formed under this chapter for any lawful purpose, including, but not limited to, the following purposes: Agricultural, alleviation of emergencies, athletic, benevolent, charitable, civic, community welfare, education, eleemosynary, fraternal, general welfare, health, horticultural, labor, literary, patriotic, political, professional, recreational, religious, scientific, and social.'

The writers of the chapter have declared that '(t)his section intends to be as all inclusive as possible.' Committee Notes and *70 Comments, 20A M.S.A. p. 324. Obviously, a nonprofit corporation need not be formed for purely charitable purposes.[FN17]

FN17. Social organizations are examples of corporations which are nonprofit but are not charitable.

The legislature has specifically provided that a nonprofit corporation may have purposes which directly benefit the business community:

'A corporation may be formed under this chapter (c. 317, entitled the Minnesota Nonprofit Corporation Act) to:

'(1) acquire and disseminate useful business information;

'(2) inculcate equitable principles of trade;

'(3) establish, maintain, and enforce uniformity in the commercial usages, business transactions, and trade relations in the municipality in which it is located.' Minn.St. 317.64, subd. 1.

Thus, the fact that the business community utilized and benefited from North Star's research facilities will not, in itself, deprive North Star of its nonprofit status.[FN18]

FN18. See, Chamber of Commerce of Hot Springs v. Barton, 195 Ark. 274, 112 S.W.2d 619 (1937) (chamber of commerce held nonprofit); Burley Tobacco Growers Co-op. Assn. v. Rogers, 88 Ind.App. 469, 150 N.E. 384 (1926) (marketing association held nonprofit); Snyder v. The Chamber of Commerce, 53 Ohio St. 1, 41 N.E. 33 (1895) (chamber of commerce held nonprofit).

It is necessary to determine first of all whether North Star in reality has operated as a nonprofit corporation or whether it has in fact been a 'business conducted for profit.' The legislature no doubt intended by the phrase 'business conducted for profit' to exclude nonprofit corporations formed under Minn.St. c. 317 and operating within the requirements of that law.

**420 [4] The legislature has clearly set forth the relevant criteria for nonprofit corporations. Minn.St. 317.02, subd. 5, provides:

"Nonprofit corporation' means a corporation (a) formed for a purpose not involving pecuniary gain to its shareholders or Members and (b) paying no dividends or other pecuniary remuneration, *71 directly or indirectly, to its shareholders or members as such.' (Italics supplied.)

The test is whether or not the 'members' received any 'dividends or other pecuniary remuneration.'[FN19] Thus, the making of a profit by the corporation is of no consequence, it being essential that shareholders or members receive no profit. A Wisconsin decision aptly describes the test:

FN19. Sheren v. Mendenhall, 23 Minn. 92 (1876); State ex rel. Russell v. Sweeney, 153 Ohio St. 66, 91 N.E.2d 13 (1950).

'The fact that (taxpayer's) income exceeds its disbursements does not necessarily destroy its nonprofit character. Whether dividends or other pecuniary benefits are contemplated to be paid to its members is generally the test to be applied to determine whether a given corporation is organized for profit.' Associated Hospital Service, Inc. v. City of Milwaukee, 13 Wis.2d 447, 466, 109 N.W.2d 271, 280 (1961).[FN20]

FN20. See, also, In re Validity of Claim of Assembly Homes, Inc. v. Yellow Medicine County, 273 Minn. 197, 140 N.W.2d 336 (1966); State ex rel. Johnson v. Lally, 59 Wash.2d 849, 370 P.2d 971 (1962); Voeltzke v. Kenosha Memorial Hospital, Inc., 45 Wis.2d 271, 172 N.W.2d 673 (1969).

If the evidence here disclosed that the 'members' had received any 'pecuniary gain' from the activities of North Star, then, in spite of its declared objectives, we would have to hold that in reality it was not a nonprofit corporation as envisioned by our statutes. There is no evidence nor even suggestion that the 'members' who have been elected by the Board of Regents have acted as 'fronts' for the contributors or have in any manner not acted in good faith.

Although North Star has carried on its activities within the limitations prescribed by our Nonprofit Corporation Act, the trial court would hold nonetheless that it was conducting a business for profit. In this connection that court in its memorandum stated:

'In the business world profit means the difference between *72 material sold and the expense or overhead expense of selling the product, but generally the term means 'to reap an advantage, financial or otherwise.' There are many instances where the same stockholders own other companies that give supplemental services to the other corporation. They may operate at a loss, but for many reasons the owner is of the opinion that the loss is justified because of the benefit to the other business. It would be an easy matter to evade the purpose of this statute by having such an arrangement. It is my opinion, therefore, that the legislature had in mind and it was their intent, when they used the words 'operated at a profit', they meant the general term 'to reap an advantage financial or otherwise."

If this definition of 'profit' is to be applied to the phrase 'in connection with a business conducted for a profit,' obviously the word 'profit' is being taken out of context. Furthermore, almost any use by a lessee would result in some kind of advantage, i.e., social, physical, spiritual, etc. Such a nebulous definition would result in the conclusion that for all practical purposes the legislature intended no exemptions.

The possibility that it would be easy to evade the purposes of the statute by the arrangements suggested by the trial court has no application to this case for several reasons. Here, all control over the future of North Star was placed in the hands of the Board of Regents, and ever-changing **421 body of men and women elected by the State Legislature. Under its articles, bylaws, and as it was actually operated, North Star offered its services to all, including the competitors of contributors, for the full fair and reasonable value of such services on the same basis as if such research had been conducted by any other organization.

Furthermore, the state has a procedure for controlling any violations of the statutes controlling nonprofit corporations. Thus the attorney general may, if he finds that it is in the public interest, petition the district court requesting that the corporate affairs be liquidated and the corporate existence terminated if *73 the corporation has violated a provision of a statute regulating such corporations. Minn.St. 317.62.

The trial court's statement that most of North Star's incorporators were its clients is misleading. Only two of the nine incorporators were employed by profitmaking companies which were North Star's clients; Minneapolis Star and Tribune and the First National Bank of St. Paul. In the case of the First National Bank of St. Paul, the actual client was the First Bank

Stock Corporation. Eighty individuals, employed by 55 entities,[FN21] served on North Star's original board of directors. As nearly as can be determined from the record, only about 14 profitmaking businesses of these 55 entities have ever contracted with North Star: First Bank Stock Corporation, General Mills, Inc., Bemis Brothers Bag Company, Minneapolis Star and Tribune, Minnesota Valley Natural Gas Company, Gould-National Batteries, Inc., The Dayton Company, Green Giant Company, Josten Manufacturing Company, The Pillsbury Company, F. H. Peavey and Company, St. Paul Fire and Marine Insurance Company, Minneapolis-Honeywell Regulator Company, and The Otter Tail Power Company.

FN21. Nineteen directors were affiliated with the University of Minnesota.

While the first members of North Star were individuals serving on the Board of Regents of the University of Minnesota, the record fails to disclose the identity of subsequent members. As has been pointed out, it would be illegal for any member to receive any profit or pecuniary gain from North Star's operation, and the evidence fails to disclose any such profit or gain.

It is difficult to understand the basis for the following conclusion in the trial court's memorandum:

> 'Taking all of the evidence into consideration, including the background of the activities of the incorporators in the other corporations, most of whom were representatives if not officers of corporations that were served by North Star, I cannot escape the conclusion that primarily the North Star's purpose was to *74 serve the corporations that the incorporators represented and that the facilities of the North Star were predominantly used for that purpose.
> '* * * (T)he dominating service is given to corporations and individual parties for profit.'

Contrary to the trial court's finding, it is undisputed that most of the employers of incorporators and directors have not done business with North Star. In fact, only 15 profitmaking businesses of the 65 original contributors to North Star have contracted with it, and these 15 represent only 7 percent of its customers. Furthermore, most of North Star's contracts have been with companies and organizations which have in no way been otherwise involved with North Star. The trial court seems to attach considerable important to the relationship between incorporators and companies who later have used the services of North Star. Incorporators of nonprofit corporations lose all their significance once the corporation is created; they no longer have any control over the corporation or its affairs. All of the basic control passes to the members (in this case the members **422 of the Board of Regents) who become, in effect, the owners, not as individuals but as fiduciaries entrusted with the duties and powers imposed upon them by the articles of incorporation, bylaws, and state laws.

The temporary and current control of the affairs of the corporation is passed on to the board of directors, which is elected by the members. There is no showing here that any of the directors who were employees of companies doing business with North Star used their influence for the benefit of those companies. It perhaps would be better practice to avoid even the appearance of any conflict of interest by not having on the board any directors who are employees of companies contracting with North Star for research. But those directors were in the minority and the companies involved paid for the services on the same basis as the general public, so the presence of these individuals on the *75 board should have no bearing in this case. Furthermore, the numerous directors subsequent to the first board have actually been chosen by the members on the basis of competency and qualifications, and they are not chosen by the contributors or sponsors. By way of analogy, if a contributor to a nonprofit hospital used its facilities, would the hospital not retain its status if the contributor paid for the services on the same basis as the general public? If a 'member' or 'shareholder' of a nonprofit hospital used its facilities and paid the same fees as the general public, should the hospital lose its status? Similarly, if a director of a nonprofit hospital used its facilities, should the hospital lose its nonprofit status if the director paid the same fees as the general public?

The facts in this case are readily distinguishable from State ex rel. Clapp v. Critchett, 37 Minn. 13, 32 N.W. 787 (1887). There, the purpose of the corporation was to endow the future wives of members, and this court concluded that the members enjoyed a pecuniary gain. The instant case also differs from cases where a corporation has been formed to provide benefits for the members exclusively.[FN22]

FN22. See, e.g., Clay Sewer Pipe Assn. Inc. v. Commr. of Int. Rev., 139 F.2d 130 (3 Cir. 1943); In re Incorporation of Automatic Phonograph Owners Assn. of Pennsylvania, 45 Pa.Dist. & Co.R. 551 (1942).

The trial court's decision appears to have been based in part upon the mistaken belief that the shareholders of MADC, who contributed stock and cash to North Star Research, were deriving a pecuniary gain from their contacts with North Star. The fact that the corporations involved took a deduction for income tax purposes for a gift of stock which had increased in value cannot be equated with a pecuniary gain. Nor is there any pecuniary gain in having a right to obtain applied research for the same fee and on the same basis as one's competitors and the public. In this connection the trial court made the following findings:

'The Court finds that the clients engaging the services of North Star for all of the projects of research and development *76 paid to North Star the full fair and reasonable value of such services on the same basis as if such research had been conducted by any other organization.

'The Court finds that parties or members of North Star who entered into contracts with North Star for various projects of research and development paid the same rate as any others who would similarly contract with North Star and that the member parties received no special price consideration on their contracts.'

In the light of these findings, it can hardly be said that the incorporators, members, or, for that matter, contributors derived any pecuniary benefits from North Star.

The record indicates that the contributors gave all control over North Star to the Board of Regents of the University of **423 Minnesota. As members of North Star, the regents, who are elected by the state legislature, elect the board of directors. We presume that in doing so the regents would be acting in their individual capacity and not officially as the Board of Regents. The fact that several of the approximately 80 directors are employed by contributors is no indication that the contributors in any way control North Star's policies. The record is void of any such inference. Fifteen profitmaking businesses of the approximately 65 contributors have contracted with North Star: First Bank Stock Corporation, Minneapolis Star and Tribune, Minnesota Valley Natural Gas Company, The Pillsbury Company, Bemis Brothers Bag Company, General Mills, Gould-National Batteries, Inc., Green Giant Company, Minneapolis-Honeywell Regulator Company, International Business Machines Corporation, Josten Manufacturing Company, Otter Tail Power Company, St. Paul Fire and Marine Insurance Company, The Dayton Company, and Northern Natural Gas Company. The contributors were not given any special consideration by North Star. Moreover, their contracts did not constitute an inordinate proportion of North Star's contracts. Only about 7 percent of North Star's clients *77 were contributors. Of the approximately $3,500,000 which North Star received for services rendered, $420,000 was attributable to contracts with contributors. The contributors received only one benefit from North Star's existence--the right to purchase its services on an equal basis and at the same price as the general public, including their competitors, who were not required to contribute anything to obtain the same research.

Individuals who contribute to the establishment of a nonprofit hospital also receive a benefit. They are entitled to use the hospital's facilities along with the general public. Again, the fact that contributors to a hospital may use the hospital on the same fee basis should not deprive a hospital of its nonprofit status.

The lower court would also deny exemption to North Star on the theory that it was a corporation in '* * * connection with a business conducted for profit' as that term is used in Minn.St. 272.01, subd. 2. The court said:

> '* * * It is not too far out of line to hold that the North Star was connected with many businesses that were conducted for profit. While it is true that the many large businesses were not named as incorporators, their agents and representatives were, and it was to the interest of their companies that this arrangement was made.'

Incorporators as such have no powers or duties after the articles of incorporation are filed. Thus, any connections conjured up between North Star and its contributors were dissolved when North Star's articles were filed. If the lower court's nebulous construction of the word 'connected' were accepted, it would for all practical purposes rule out almost every nonprofit corporation. Almost every nonprofit hospital receives contributions from banks, businesses, and professional people. No doubt the banks hope to get some business from the hospital and indirectly from its employees, and at times officers of banks and businesses may serve as trustees on hospital boards. Businesses may, and probably do, consider the advantages of being near well-equipped *78 hospitals for the emergency services which they make available for employees--services that may, by timely treatment to employees injured on the job, reduce an employer's cost of doing business. Should the contribution of money to a hospital or the rendering of community services by competent businessmen sitting as unpaid directors on a hospital board be considered as being done 'in connection with a business conducted for profit'? Businesses may reap an advantage because, particularly in small communities, a hospital not only provides advantages by contributing to the health of the community, but it also tends to promote the economic well-being of the area. It is doubtful that **424 the legislature contemplated any of these 'advantages,' contributions, or connections as a connection with a business conducted for profit. Such connections should not turn a business not conducted for a profit into a business 'in connection with a business conducted for profit.'

No doubt the legislature had in mind that where a nonprofit corporation is controlled by a business conducted for profit which uses such a corporation as it might an affiliate or subsidiary, the nonprofit organization should not enjoy the advantage or a tax exemption. Here the basic controls are in the Board of Regents and a board of directors of some 80 individuals representative of the entire community, including educators, clergymen, and business, professional, and labor leaders. Employees of those using the facilities of North Star are a minority on the board of directors, and there is no evidence from which it could even be inferred that their positions were used to the advantage of their employers. Thus, there are no meaningful connections.

Our dissenting brother, Mr. Justice Murphy, is disturbed by our analogy in which we use a nonprofit hospital for illustrative purposes. A nonprofit hospital was used as an example because it is a well-known type. Any nonprofit corporation could have been used for the same illustrative purposes. There is no requirement under Minn.St. 272.01, subd. 2, or Minn.St. 273.19, subd. 1, that a lessee be organized for charitable or humanitarian purposes, *79 or that the burdens of government be lessened by the tenant's operations in order to have an exemption from real estate taxes.

In summary, North Star Research and Development Institute has satisfied its burden of proving that it is entitled to an exemption under Minn.St. 272.01, subd. 2. It is a nonprofit corporation because its members receive no pecuniary gain. Its contributors derive no benefits other than those available at the same cost, not only to the general public, but to competitors of the contributors as well. It is not connected with a business for profit. Thus, s 272.01, subd. 2, and s 273.19, subd. 1, exempt the school property rented by North Star from ad valorem real estate taxes.

Charles M. OBERLY, III, Attorney General of the State of Delaware, Allan P. Kirby, Jr., Grace K. Culbertson, and Ann K. Kirby, Plaintiffs Below, Appellants,
v.
Fred M. KIRBY, II, Walker D. Kirby, Fred M. Kirby, III, S. Dillard Kirby, Alice K. Horton, Jefferson W. Kirby, and F.M. Kirby Foundation, Inc., a Delaware corporation, Defendants Below, Appellees,
v.
Allan P. KIRBY, Jr., Grace K. Culbertson, and Ann K. Kirby, Cross-Claim-Defendants Below, Appellees.

592 A.2d 445 (DE 1990)

WALSH, Justice:

The opinion in this case dated November 19, 1990, which was released after argument before a panel of three justices and which affirmed the decision of the Court of Chancery, is withdrawn. The following opinion of the Court *en banc* is substituted.

This is an appeal from a bench ruling of the Court of Chancery that granted a motion to dismiss pursuant to Chancery Court Rule 41(b). The complex dispute revolves around the affairs of the F.M. Kirby Foundation, Inc. (the "Foundation"), a Delaware nonstock charitable corporation. The case began as a proceeding under 8 *Del.C.* § 225 and 10 *Del.C.* § 6501 to determine the identity of the directors and members of the Foundation. Allan P. Kirby, Jr. ("Allan, Jr."), Grace K. Culbertson ("Grace"), and Ann K. Kirby ("Ann") (collectively, the "Kirby plaintiffs") charge that their brother, Fred M. Kirby, II ("Fred"), illegally ousted them from their positions as directors. They base their claim primarily upon a bylaw amendment that purported to remove Fred's wife and children [FN1] from their positions as members of the Foundation and to install the Kirby plaintiffs in their place. The Kirby plaintiffs also argue that Fred breached his fiduciary duty to the Foundation by using his position to advance his personal business interests. Finally, the Kirby plaintiffs argue that Fred was never validly elected as a member of the Foundation.

FN1. Fred's wife, Walker D. Kirby, and their four children, Fred M. Kirby, III, S. Dillard Kirby, Alice K. Horton, and Jefferson W. Kirby, are named together with him and the Foundation itself as defendants. We refer to them collectively as the "appellees" or the "defendants."

After the commencement of this litigation, Charles M. Oberly, III, the Attorney General of the State of Delaware, (the "Attorney General") intervened on behalf of the public beneficiaries of the Foundation. In this appeal, the Attorney General joins the Kirby plaintiffs (collectively, the "appellants" or the "plaintiffs") in arguing that Fred had not been validly elected and that he had sought to entrench his control and to use the Foundation for personal ends. In addition, the Attorney General attacks the propriety of a 1985 transaction (the "Alleghany transaction" or the "transaction") between the Foundation and the Alleghany Corporation ("Alleghany"), charging that both Fred and the Kirby plaintiffs had breached their fiduciary duties by voting, as Foundation directors, to approve that transaction.

*452 Although we would have preferred a more formal ruling by the Court of Chancery in such a complex case, we find no error in the decision to dismiss all claims. The fundamental question underlying many of the appellants' claims is whether the defendants acted in a manner that was consistent with the charitable purposes for which the Foundation was established. Thus, even if the transaction challenged by the Attorney General is viewed as presenting a conflict of interest to the Foundation's directors, we conclude that it was a fundamentally fair transaction and therefore did not jeopardize the charitable goals of the Foundation. Similarly, while it is apparent that Fred exercised tight control over the Foundation and sought to solidify that control, none of his challenged actions impaired the work of the Foundation or were impermissible under the Certificate of Incorporation (the "Certificate") and the bylaws of the Foundation. In contrast, the bylaw amendment adopted by the Kirby plaintiffs was wholly inconsistent with the Certificate.

Because the Court of Chancery's factual findings are amply supported by the record and because its legal rulings are correct, we affirm.

I

The parties to this appeal continue to dispute several of the facts underlying the litigation. Moreover, the findings of fact of the Court of Chancery are scattered throughout several unreported opinions and a bench ruling. Therefore, an extended discussion of the events that gave rise to the case, as reflected in the record before us, is required.

The Foundation was organized in 1931 by Fred M. Kirby ("Kirby"), the grandfather of Fred and the Kirby plaintiffs. Kirby had made his fortune from a chain of five-and-dime stores that eventually became a part of the F.W. Woolworth Corporation. He donated a portion of his wealth to establish the Foundation, which, under the terms of the Certificate, is "[t]o be conducted and operated ... exclusively for religious, charitable, scientific, literary and educational purposes." The Foundation is to be managed by a board of directors, the size of which is not specified. Under Delaware law, the members of a nonstock corporation have the power to elect its directors. 8 *Del.C.* §§ 141(j)-(k), 215. The original members of the Foundation were its incorporators: Kirby; his lawyer, Walter Orr ("Orr"); and E.P. Schooley ("Schooley"), one of Kirby's employees. Article EIGHTH of the Certificate establishes the conditions of membership:

> 1--Only individuals interested in the objects and purposes of the corporation are eligible to become members. New members of the corporation, without limit as to number, may be elected by majority vote of the old members. A member may voluntarily withdraw from the corporation at any time. There shall be at all times not less than three members of the corporation, and if, at any time, the total membership shall fall below three members, whether by reason of death, voluntary withdrawal or otherwise, the two remaining members, or the one remaining member, as soon as practicable, shall elect or select a new member or members at least sufficient to bring the total membership up to three members.... [I]n the event there shall at any time cease to be any members of the corporation, then the executors or administrators of the last three members to have their membership terminated by death, shall elect three new members. If at the time there shall cease to be any members of the corporation, there shall not be as many as three former members whose membership was terminated by death, then the executors or administrators of the last two members or the last one member, as the case may be, to have their or his membership terminated by death, shall elect or select three new members....

In short, the Foundation's members are entitled to elect both directors and new members. At least three members must serve at all times.

The Foundation's first members' meeting was held on January 15, 1931. At that *453 meeting, Schooley resigned [FN2] and the remaining members elected Kirby's son, Allan P. Kirby, Sr. ("Allan, Sr."), to replace him. The three members, Kirby, Orr, and Allan, Sr., then elected themselves directors. In 1938, Kirby resigned as director and was replaced by Schooley. Kirby died two years later and Orr and Allan, Sr. served as the only members of the Foundation until May 6, 1942, at which time Schooley was again chosen to fill out the required complement of members. [FN3]

FN2. Schooley was reelected as a member in 1942 and apparently resigned again sometime prior to 1952. However, there is only one written resignation surviving in the

Foundation's records and it is undated. During discovery, the defendants temporarily contended that the undated resignation was executed following 1942. However, all parties now agree, and the lower court found, that the undated resignation was executed in 1931. Schooley's irregular service as a member, which we discuss further below, is a source of contention between the parties.

FN3. The circumstances underlying this election are still in dispute. To bolster their contention that directors as well as members may elect members, the Kirby plaintiffs argue that Schooley was elected by all three directors--Allan, Sr., Orr, and Schooley himself. The lower court found, however, that Schooley had been elected by Allan, Sr. and Orr alone.

By June 12, 1952, Schooley had apparently again resigned from his position as member. At that time, a members' meeting was called and Fred, Allan, Sr.'s son, was elected a member. On October 6, 1953, Orr and Schooley resigned as directors and the members--Allan, Sr., Orr, and Fred--elected Fred and his three siblings--now the Kirby plaintiffs--to serve as directors. In 1961, Orr died and neither Fred nor Allan, Sr. saw fit to replace him. Thus, the Foundation was left without the full slate of members required by the Certificate. In 1967, Allan, Sr. suffered a debilitating stroke that incapacitated him until his death in 1973. At the time, Fred was left as the sole member of the Foundation, while his siblings continued to serve with him as directors. This state of affairs continued unchanged until 1984.

For the first fifty years of its existence, the identity of the members and directors of the Foundation was not a point of contention. To all appearances, the Foundation carried about its business in an expeditious manner, investing its assets profitably and funding a wide variety of charitable endeavors. At first, Kirby was largely responsible for running the Foundation, later Allan, Sr. took over and eventually Fred assumed prime responsibility. The directors met infrequently, and meetings of the membership became impossible after 1973 since Fred was the sole member.

Beginning in 1981, for reasons that are not apparent, the directors, consisting of Fred and his three siblings, began to meet on a much more frequent basis. At the July 22, 1981 meeting, it was "decided that each Director may bring one blood-related child to the next meeting for the purpose of general familiarization with the affairs of the Foundation and to test the interest of the younger generation therein." In April, 1984, notwithstanding this apparent intention to involve the children of all the directors in the Foundation's governance, Fred secretly selected his wife and four children to serve as members. At trial, Fred testified that he had delayed selecting new members for such a long time because he had been uncertain who could best serve the Foundation. He claimed that his selection of his immediate family was not intended to foreclose election of other members in the future, but that he chose his wife and children because he had great confidence in their abilities. Nevertheless, he kept the enlargement of the membership secret from his fellow directors, apparently because he knew that his siblings would be upset if they knew.

Throughout Fred's tenure as sole member, the Kirby plaintiffs had periodically requested that Fred make them members as well as directors. They reiterated this request on April 1, 1986, in a letter written by Allan, Jr. Fred responded in a letter dated April 21, in which he informed his siblings of his secret decision appointing his wife and children as members. The Kirby plaintiffs reacted by demanding that Fred seek the resignation of his wife and *454 children and appoint a slate of members that fully represented the various descendants of Allan, Sr. Fred agreed only to discuss the dispute at the next directors' meeting on June 5.

At a luncheon on the day of the directors' meeting, the Kirby plaintiffs discussed strategy. They agreed that they would attempt to convince Fred to alter the Foundation's membership. However, if persuasion failed, they resolved to propose and adopt an amendment to the bylaws that purported to force out Fred's wife and children and replace them with the Kirby plaintiffs. At the subsequent meeting, Fred refused to entertain his siblings suggestions. Accordingly, Allan, Jr. introduced the following resolution:

> RESOLVED that the By-laws be amended so as to provide for the Board of Directors, and only the Board of Directors, to constitute the Members of the Corporation.

Fred argued that the resolution was contrary to the Certificate and illegal under Delaware law. Nevertheless, the Kirby plaintiffs adopted the resolution over Fred's opposition. For two months, the two factions disputed the legality and advisability of the new bylaw. Both sides sought, and received, legal opinions that supported their respective positions. On August 13, 1986, however, Fred met with his wife and children. Purporting to act as members, they removed the Kirby plaintiffs from their positions as directors and elected themselves to serve in their place. Thus, when the dust had settled, Fred and his immediate family purported to have exclusive control over the Foundation.

The Kirby plaintiffs filed this action on

August 29, 1986, in an effort to regain their positions in the Foundation and to oust Fred's family. Initially, they sought declaratory relief pursuant to 8 *Del.C.* § 225 and 10 *Del.C.* § 6501, to determine the identity of the Foundation's members and directors. The defendants moved unsuccessfully to dismiss this claim pursuant to Chancery Court Rule 12(b)(6), alleging a failure to state a claim upon which relief could be granted. Thereafter, the Kirby plaintiffs amended their complaint, primarily to argue that Fred had breached his fiduciary duties to the Foundation by seeking to entrench his control of it. The Attorney General was permitted to intervene as a party plaintiff and joined the Kirby plaintiffs in arguing that Fred had acted to solidify his control. [FN4] In addition, the Attorney General charged that both Fred and the Kirby plaintiffs had breached their duties as directors by approving an interested transaction between the Foundation and the Alleghany Corporation. We now turn to the facts relevant to this aspect of the litigation.

FN4. The Attorney General was acting pursuant to his common law power to protect the beneficiaries of charitable corporations and trusts. *See Wier v. Howard Hughes Medical Inst.,* Del.Ch., 407 A.2d 1051 (1979).

After Kirby had made his fortune in retail stores, his son, Allan, Sr., went on to achieve his own successes in the business world. The primary vehicle for his endeavors was Alleghany, originally a railroad holding company. In 1966, Allan, Sr. bequeathed approximately one million shares of Alleghany stock to the Foundation; the bulk of these shares were transferred when Allan, Sr.'s estate was settled in 1976. From that time forward, Alleghany stock was by far the Foundation's largest asset. In 1985, just prior to the transaction under challenge, the Foundation held a 15% stake in Alleghany, while Alleghany stock constituted 80% of the Foundation's assets. Large blocks of Alleghany stock also came to be held by Fred and his siblings.

After Allan, Sr.'s incapacitation, Fred took over control of Alleghany, becoming chairman of its board of directors and its chief operating officer. Under his direction, the company flourished by selling its railroad assets and assembling a diversified array of subsidiaries, including a financial services firm called Investors Diversified Services ("IDS"). In a 1984 transaction, Alleghany sold IDS to the American Express Company ("American Express") in exchange for 11.5 million shares of American Express common stock, then worth *455 $370 million. This transaction left Alleghany as the single largest shareholder of American Express and secured Fred a seat on the American Express board of directors.

Alleghany's business successes redounded to the benefit of the Foundation since the Foundation's assets were composed primarily of Alleghany stock. However, the Foundation's reliance upon the value of Alleghany stock could not continue indefinitely. In 1969, Congress had enacted section 4943 of the Internal Revenue Code as part of the Tax Reform Act of that year. Under section 4943, a tax-exempt nonprofit foundation incurs a special excise tax on so-called "excess business holdings" that it owns after a certain date. "Excess business holdings" are defined as an interest in the stock of any given corporation that exceeds a specified percentage of the corporation's outstanding shares. The purpose of this provision is to discourage the use of nonprofit foundations as a device for controlling the governance of a for-profit corporation. *See* H.R.Rep. No. 91-413, 91st Cong., 1st Sess. 1, 27-31, *reprinted in* 1969 *U.S.Code Cong. & Admin.News* 1645, 1671-75. Because the Foundation's directors themselves held large blocks of Alleghany stock, the Foundation could own no more than two percent of Alleghany's voting stock nor more than two percent of the value of all Alleghany stock. I.R.C. § 4943(c)(2). The Foundation was required to reduce its holdings to this level by 1986 or face the additional tax.

In 1985, as the Foundation's deadline for divesting its Alleghany stock approached, Alleghany's management became aware of a provision of the Internal Revenue Code that would allow it to avoid paying capital gains tax on assets used to redeem its own stock when that stock constituted "excess business holdings" in the hands of a foundation. I.R.C. § 311(d)(2)(D) (1985). [FN5] The American Express stock that Alleghany had acquired in exchange for IDS had appreciated considerably since 1984; as a result, an exchange of the Foundation's Alleghany stock for Alleghany's American Express stock immediately appeared as an attractive transaction for both entities. Both entities could realize substantial profits, but Alleghany would pay no tax and the Foundation would pay only the two-percent excise tax that applies to all profits of private foundations. There was a complicating factor, however. Fred was both the chairman of Alleghany and the president of the Foundation's board. Allan, Jr. was a director of both Alleghany and the Foundation. All four Foundation directors held substantial blocks of Alleghany stock. Thus, the proposed swap would constitute the virtual paradigm of an "interested" transaction.

FN5. I.R.C. § 311(d) was repealed by the Tax Reform Act of 1986.

Fred initially considered hiring an investment banker to negotiate on behalf of the Foundation, but ultimately decided to entrust the matter to the Foundation's long-time attorney, Harry Weyher ("Weyher"). Weyher was instructed to reach an agreement with Alleghany that would be fair to the Foundation, but was not authorized to seek out other potential buyers of the Alleghany stock. Alleghany's board, meanwhile, retained Merrill Lynch Capital Markets ("Merrill Lynch") to represent Alleghany. Negotiations began on August 1, 1985 and continued through mid-September, when a stock purchase agreement was finalized. Merrill Lynch began negotiations by suggesting that the Alleghany shares be bought at a discount below the market price, since the Foundation had to sell its shares and since possible alternative transactions all suffered from significant drawbacks. Merrill Lynch pointed out that because the Foundation was an "affiliate" of Alleghany within the meaning of Securities and Exchange Commission Rule 144, 17 C.F.R. § 230.144, and because it had received its Alleghany stock from Allan, Sr., who was also an Alleghany "affiliate," it could not sell its stock to another buyer without either registering it under the Securities Act of 1933 or complying with the "safe-harbor" provisions of Rule 144. Registration would force the Foundation to incur significant transaction costs, and a large public sale would likely drive down *456 the market price, since the number of shares to be sold was large relative to the size of the existing market. Compliance with Rule 144, on the other hand, would limit the liquidity of the shares in the hands of the buyer for a period of two years. As a result, a substantial discount would likely be demanded by any potential buyer.

Weyher countered Merrill Lynch's argument by contending that the important consideration was the fairness of any transaction to both parties, not the Foundation's supposed weak bargaining position. He suggested that because Alleghany would gain substantial tax benefits from dealing with the Foundation, it should share those benefits with the Foundation by paying a premium for the Alleghany shares. In short, Merrill Lynch insisted on a discount and Weyher demanded a premium. Price, however, was the only significant point of contention between the two sides. After several weeks of disagreement, the parties finally agreed to "split the difference" and exchange their shares at market prices: the Foundation's 1,118,826 Alleghany shares would be swapped for 2,062,940 shares of unregistered American Express stock, an exchange ratio that reflected the market price of the two stocks on August 23, 1985. Although Merrill Lynch opined that the transaction was fair to Alleghany, the Foundation never retained an investment banker to offer a fairness opinion.

The Foundation board unanimously approved the transaction on September 25, 1985. Alleghany's board had approved the transaction at a September 18 meeting in which Fred and Allan, Jr. did not participate. Alleghany shareholders approved the exchange at a meeting on November 7, 1985, and the exchange was executed shortly thereafter.

In the three years between the filing of this action and trial, the Court of Chancery ruled on a series of preliminary matters, including a motion by the Kirby plaintiffs that would have permitted them to participate in the Foundation's management *pendente lite* and various motions to dismiss by the defendants. The case eventually proceeded to trial on October 2, 1989.

The Kirby plaintiffs and the Attorney General presented evidence for five days, at the conclusion of which, the defendants moved to dismiss all claims under Chancery Court Rule 41(b). In a bench ruling, the court held that Fred was a valid member of the Foundation and that he had acted legally in appointing his wife and children as members and removing his siblings from the board. By contrast, the court found that the bylaw amendment adopted by the Kirby plaintiffs was invalid under the Foundation's Certificate. Finally, the court held that the defendants had breached none of their fiduciary duties and that the Alleghany transaction was fundamentally fair to the Foundation.

II

[1][2] Having delved deep into the records of the Foundation's early history, the appellants have crafted an unusual argument: they contend that Fred was never properly elected a member in 1952 and hence never had the power to appoint his wife and children as members or to remove his siblings from the board. This argument stems from the rather haphazard record-keeping of the Foundation during much of its history. Because Kirby, Allan, Sr., and Fred successively ran the Foundation almost single-handedly, the members and directors of the Foundation rarely met and the records of what transpired at and between meetings are quite fragmentary. As a result, it is unclear whether or not E.P. Schooley was a member in 1952 when Fred was elected a member. The appellants contend that Schooley *was* a member in 1952 and that because he was not notified of the meeting at which Fred was elected, the actions undertaken at that meeting are invalid and void. *See Schroder v. Scotten, Dillon Co.,* Del.Ch., 299 A.2d 431 (1972); *Bryan v. Western Pac. R.R.,* Del.Ch., 35 A.2d 909 (1944). The appellants' claim hinges upon the factual question of whether or not Schooley was a member in 1952. The Vice Chancellor ruled that he was not. However, because *457 the Vice Chancellor based his findings upon a limited "paper" record, we are not bound by such findings if they are clearly erroneous based on our view of the record. *Fiduciary Trust Co. of N.Y. v. Fiduciary Trust Co. of N.Y.,* Del.Supr., 445 A.2d 927, 930 (1982).

Without question, Schooley was one of the founding members of the Foundation. At its first meeting on January 15, 1931, however, he resigned and was replaced by Allan, Sr. An undated resignation was placed in the Foundation's files along with the minutes of the 1931 meeting, and all parties now agree that this resignation was executed in 1931. Eleven years later, on May 6, 1942, Schooley was once again chosen to serve as a member. There is no direct evidence, such as a letter of resignation, to indicate that Schooley ever resigned from this post. However, the minutes of the 1952 meeting at which Fred was elected recite that Allan, Sr. and Walter Orr were then the only members of the Foundation. Thus, the Vice Chancellor concluded that although no record of Schooley's resignation exists, he had in fact resigned sometime between 1942 and 1952.

[3] When called upon to base a factual determination upon such a sparse and equivocal body of evidence, a trial judge must establish some rational basis for favoring one conclusion over another and answering a question that cannot be answered with a high degree of certitude. Since Allan, Sr., Schooley, and Orr are long dead, no one can be wholly certain whether Schooley was or was not a member in 1952. However, the Vice Chancellor decided that more weight should be given to the affirmative statements of Allan, Sr. and Orr in the minutes of the meeting than to mere inferences that might be drawn from the absence of a formal resignation. Allan, Sr. was a highly successful businessman and Orr was a competent and respected lawyer; the Vice Chancellor considered it unlikely that they simply forgot that Schooley was a member. He found it to be more likely that Schooley's resignation was lost or was never formally executed or recorded. Moreover, the Vice Chancellor found it significant that Schooley never objected to the validity of the 1952 meeting, even though he served as a director of the Foundation until 1953 and would have been aware of the 1952 members' meeting.

[4] Under our standard of review, we cannot conclude that these findings are incorrect. We might perhaps question the Vice Chancellor's estimation of Orr and Allan, Sr.'s attentiveness, since they undoubtedly either forgot that Schooley was a member or forgot to insure that Schooley's resignation was duly preserved in the Foundation's records. Nevertheless, the Vice Chancellor's decision to give more weight to an affirmative statement than to a possible negative inference clearly constituted a rational basis for evaluating the available evidence. Moreover, the burden of proving the invalidity of Fred's election rested upon the appellants. *Oberly v. Howard Hughes Medical Inst.,* Del.Ch., 472 A.2d 366, 386-87 (1984). Before a court declares invalid a corporate election that was held thirty-seven years ago and thereby

upsets long-settled expectations and reliance upon assumed events, it is entitled to demand clear and convincing evidence that the election was, in fact, invalid. The appellants clearly cannot meet this burden by expecting the court to draw inferences from a *lack* of evidence. Accordingly, we accept the Vice Chancellor's finding that Fred was validly elected as a member in 1952.

III

[5] We now consider the legality of the Kirby plaintiffs' bylaw amendment. Although the bylaw amendment is the focus of the Kirby plaintiffs' claim to be directors of the Foundation, the issues involved are not overly complex. Essentially, we are called upon to interpret the Certificate of Incorporation and determine whether the bylaw amendment is permitted or forbidden by the Certificate. Because the Certificate is a document in the nature of a contract, its construction raises legal questions that are subject to *de novo* review by this Court. *Hibbert v. Hollywood Park, Inc.,* Del.Supr., 457 A.2d 339, 342-43 (1983); *458 *Rohner v. Niemann,* Del.Supr., 380 A.2d 549, 552 (1977).

[6] Article EIGHTH, Section 1 of the Certificate establishes the means by which members of the Foundation are chosen: "New members of the corporation, without limit as to number, may be elected by majority vote of the old members." The language of this provision is clear and unambiguous. Nevertheless, the Kirby plaintiffs argue that the Foundation's directors also are given the power to choose members under Article EIGHTH, Section 2:

> The corporation may establish and put into effect such further rules, regulations and orders governing admission to membership, duties and obligations of members, provisions for suspension, reprimands or expulsion from membership and classification of members as the by-laws shall from time to time provide and as shall not be inconsistent with Section 1 of this Article.

Under Article TENTH, Section 1 of the Certificate, the directors have the power to amend the Foundation's bylaws. The Kirby plaintiffs argue that their bylaw amendment, which provided that only directors could be members, was nothing more than a "further rule[ ] ... governing admission to membership." Thus, they contend that the simple expedient of amending the bylaws allows directors, as well as members, to elect the Foundation's members.

The Kirby plaintiffs' argument has some superficial appeal. The language of Article EIGHTH, Section 2 is quite expansive; it allows the directors to oversee virtually all aspects of the membership, including admission, duties and obligations, and expulsion. Nevertheless, we find that the bylaw amendment in question is inconsistent with the overall structure of the Foundation and with the specific requirements of Article EIGHTH, Section 1. [FN6]

FN6. In reality, the language of Section 2 barring inconsistency is legally redundant, since a corporation's bylaws may never contradict its certificate of incorporation. 8 *Del.C.* § 109(b); *Brooks v. State ex rel. Richards,* Del.Supr., 79 A. 790 (1911).

[7][8] The management structure of the Foundation is roughly analogous to that of a for-profit corporation. In a corporate business enterprise, the board of directors has broad authority to manage the affairs of the corporation, but the directors hold their offices at the sufferance of the shareholders. 8 *Del.C.* § 141(k). Beyond the power to vote for directors and to participate in annual meetings, shareholders have limited direct authority. But the enterprise is owned by the shareholders and they cannot be forced out of the corporation except in special circumstances, and then they must be fully compensated for their interests. *E.g.,* 8 *Del.C.* § 253 ("short form" merger statute). The directors wield more power on a day-to-day basis, but they are subordinate to the stockholders and have no control over the identify of the stockholders. [FN7]

FN7. Of course, a corporation's stockholders may elect themselves directors, but there is a fundamental distinction between the powers that they exercise in each capacity.

Under its Certificate, the Foundation is to be managed by the directors, who are elected by the members. The members, in turn, have no other duties; however, they hold their positions by virtue of being "interested in the objects and purposes of the corporation." The original members were the Foundation's founder and his handpicked associates; their successors have been the direct descendants of the founder. Thus, while the members do not "own" the Foundation in the sense of having a pecuniary interest in its existence, they have been responsible for its creation and continued endowment. They have been the Foundation's "investors."

The analogy between members and stockholders is, perhaps, an imperfect one. Notably, stockholders do not elect other stockholders. Moreover, the Foundation must be managed on behalf of its beneficiaries, not its members. In light of the role of the members in creating the Foundation and electing its directors, however, we think it clear that the members' power was intended to resemble that of stockholders.*459 [FN8] As a result, we do not believe that the Foundation's members can be ousted by the very directors whom they have elected. Any other interpretation would render the Foundation's corporate structure fundamentally unstable.

FN8. The parallel between stockholders and members is clearly contemplated in relevant statutory law. For example, 8 *Del.C.* § 141(j), which governs the relationship between the members and directors of a nonstock corporation, states "[e]xcept as may be otherwise provided by the certificate ..., section [141] shall apply to ... a [nonstock] corporation, and when so applied, all references to ... stockholders shall be deemed to refer to ... the members of the corporation...."

The rules of contractual construction also support our interpretation of the Certificate. Article EIGHTH, Section 1 unambiguously vests the members with the power to elect new members. Section 2, while giving the directors power to regulate membership, does not mention the election of members. If the drafters of the Certificate had intended to give the directors such power, they could have done so explicitly, by using language similar to that found in Section 1. Instead, Section 2 speaks in extremely general terms. Thus, we believe, as the Vice Chancellor found, that Section 2 empowers the directors to establish general criteria for membership or mechanisms for disciplining or removing members. It does not, however, empower directors to make specific decisions about which individuals should or should not be members. The Kirby plaintiffs' bylaw amendment may be cast in neutral-sounding language, but it was clearly designed to remove certain individuals from membership and replace them with others. Accordingly, it is directly in conflict with the election mechanism established by Section 1.

The Kirby plaintiffs place heavy reliance upon two decisions to support their claim. First, they cite *Denckla v. Independence Foundation,* Del.Ch., 181 A.2d 78 (1962), *aff'd,* Del.Supr., 193 A.2d 538 (1963). *Denckla* also involved a dispute over the control of a charitable corporation, the Independence Foundation ("Independence"), which had a structure similar to that of the Kirby Foundation, in that it was governed by directors who were chosen by members. At some point in the course of the *Denckla* dispute, the Independence directors met and "the By-Laws were amended to provide that the officers of the Foundation should *ex officio* be members." 193 A.2d at 540. Thus, the Kirby plaintiffs suggest that the power that they claim for themselves is permissible under Delaware law. It should be noted, however, that the validity of the bylaw amendment was not at issue in *Denckla.* More important, the bylaw amendment there did not conflict with Independence's certificate of incorporation. The method for electing members was established by Independence's bylaws, rather than by its certificate. *See Denckla,* 181

A.2d at 80-81. Thus, the directors were free to alter the method simply by amending the bylaws. By arguing that *Denckla* establishes the power of directors to elect members under Delaware law, the Kirby plaintiffs misapprehend the meaning of the lower court's ruling. Their proposed amendment is invalid not primarily because it violates Delaware law, but because it is contrary to the Foundation's Certificate. It violates Delaware law only because it is contrary to the Certificate.

The Kirby plaintiffs also rely upon a series of cases involving the affairs of the Osteopathic Hospital Association of Delaware (the "Hospital"). *In re Osteopathic Hospital Ass'n of Del.,* Del.Ch., 191 A.2d 333 (1963), *aff'd,* Del.Supr., 195 A.2d 759 (1963). There, the Hospital was governed by a board of trustees and by a large body of members who were primarily physicians. Under the explicit and unambiguous terms of the Hospital's certificate of incorporation, members elected trustees and the trustees selected physicians for admission to membership. Thus, the structure of the Hospital was quite different from that of the Foundation. Under the Hospital's bylaws, however, nonphysicians could be selected as members only with the concurrence of a majority of the members. Notwithstanding this provision, the trustees amended the bylaws to make themselves *460 members. As a result, laymen became members of the Foundation without any input from existing members. In the ensuing litigation, it was ruled that although the bylaw amendment was facially valid, it was legally unreasonable because it upset the members' settled expectation of being able to vote upon the admission of laymen. Thus, rather than supporting the Kirby plaintiffs' argument that directors of a nonstock corporation have power to elect its members, the *Osteopathic Hospital* cases stand for the principle that even where directors are given such power by a certificate of incorporation, they may not exercise it unreasonably. The case now before this Court is one in which the directors have no such power to begin with. [FN9]

FN9. The Kirby plaintiffs also cite a third *Osteopathic Hospital* case, *In re Osteopathic Hospital Ass'n of Del.,* Del.Ch., 197 A.2d 630 (1964). The recitation of the facts in that case contradicts the recitation in the earlier cases, in that it cites a certificate provision allowing members to "be elected in the manner provided by the By-laws." 197 A.2d at 631. The earlier cases quote a certificate provision that directly empowers trustees to elect members. We can only conclude that the certificate had been amended before the 1964 case. Under either provision, however, the trustees of the Hospital were given far more power to control the election of its

> members than are the directors of the Foundation. Thus, the case provides no support for the Kirby plaintiffs' argument.

The Kirby plaintiffs also point to the minutes of a meeting of the board of directors held on May 6, 1942 to support their contentions. The minutes reflect that the then-directors--Allan, Sr., Orr, and Schooley--were all present. They then recite:

> The Chairman [Allan, Sr.] stated that it was necessary to elect a new member of the Corporation. Mr. E.P. Schooley was thereupon nominated to be a member of the Corporation and upon motion duly made, seconded and unanimously carried, Mr. Schooley was declared duly elected a member of the Corporation. Mr. Schooley accepted membership in the Corporation.

The Kirby plaintiffs view these minutes as proof that all three of the directors, including Schooley himself, voted to elect Schooley as a member. They then claim that this incident supports their contention that directors may elect members. The Vice Chancellor found, however, that Allan, Sr. and Orr acted in their capacity as members to elect Schooley. We agree. If the directors had sought to exercise the power that the Kirby plaintiffs claim they enjoy, they would have had to amend the bylaws in order to elect Schooley. Article EIGHTH, Section 2 clearly states that "[t]he corporation may establish ... such further rules ... governing ... membership ... *as the by-laws shall from time to time provide.*" (emphasis added). There is no mention of a bylaw amendment in the minutes of the 1942 meeting. Thus, we can conclude either that the directors were purporting to exercise a power that even the Kirby plaintiffs do not claim they have, or that Allan, Sr. and Orr acted as members when they elected Schooley. The Vice Chancellor reached the latter conclusion, and we have no reason to disagree.

[9][10] Finally, the Kirby plaintiffs argue that the Vice Chancellor's interpretation of the Certificate was erroneous in that it contradicted an earlier ruling by another Vice Chancellor in the same case. On July 29, 1987, Vice Chancellor Berger denied the defendants' motion to dismiss under Chancery Court Rule 12(b)(6). In doing so, she found that the terms of the Certificate governing the election of members were arguably ambiguous and that they would have to be construed on the basis of evidence presented at trial. The Kirby plaintiffs contend that this ruling established the "law of the case" and that as a member of the same court that had rendered this ruling, the trial judge, Vice Chancellor Chandler, could not contradict it. We must confess to finding this argument somewhat abstruse. The procedural posture of the case when each of the Vice Chancellors examined it was quite different. Under Rule 12(b)(6), the trial court must decide whether

the plaintiffs state a claim under any possible set of facts that they might prove. Thus, Vice Chancellor Berger found that if, for example, the appellants*461 proved that Kirby had intended directors to have the power to select members, the plaintiffs might be entitled to relief. When the case came before Vice Chancellor Chandler under Chancery Court Rule 41(b), however, the trial court was called upon to decide whether, on the evidence presented, the plaintiffs had succeeded in proving that their interpretation of the Certificate was the correct one. He found that they had not and ruled that the defendants' construction of the Certificate was the only reading that was logically consistent with the overall structure of the Foundation. Thus, Vice Chancellor Chandler simply resolved the ambiguity that Vice Chancellor Berger had identified under a different procedural standard. *Cf. Farmer in the Dell Enters. v. Farmers Mut. Ins. Co. of Del.,* Del.Supr., 514 A.2d 1097, 1099 (1986). [FN10]

FN10. Even if Vice Chancellor Chandler had contradicted the "law of the case," our own standard of review would render any appeal from such error moot. We review the interpretation of the Certificate *de novo*. Thus, because we find Vice Chancellor Chandler's reading of the Certificate to be clearly correct, we could affirm that interpretation even if it had contradicted an earlier ruling of the Court of Chancery.

In sum, we find that the Vice Chancellor's decision under 8 *Del.C.* § 225 and 10 *Del.C.* § 6501 must be affirmed. Fred was validly elected a member in 1952. As a member, he clearly had the power to elect other members. Under the Certificate, the Foundation's directors have no power to elect members. Thus, the June 5, 1986 bylaw amendment was invalid as a matter of law and did not have the effect of removing Fred's wife and children from the membership or of replacing them with the Kirby plaintiffs. As validly elected members, Fred and his wife and children had the power to remove the Kirby plaintiffs from their seats as directors and to elect themselves in their place.

A.

[15] Although the Vice Chancellor made no explicit findings upon the question, it seems clear to us that Fred engaged in a course of behavior designed to enhance his immediate family's control of the Foundation. Moreover, whether or not he had a long-standing plan to exclude other branches of the Kirby clan from the Foundation, his decision to remove his siblings from the board assuredly achieved that result. Thus, if we assume that Fred's influence over his wife and children is strong, the appellants are correct in their assertion that Fred now enjoys "entrenched" control of the Foundation.

[16] In arguing that such entrenchment constitutes a breach of fiduciary duties, the Kirby plaintiffs characterize Fred's actions as a "takeover" and then cite several decisions of this Court that arose out of battles for control of large, publicly held, business enterprises. *E.g., Mills Acquisition Co. v. MacMillan, Inc.,* Del.Supr., 559 A.2d 1261 (1989); *Moran v. Household Int'l, Inc.,* Del.Supr., 500 A.2d 1346 (1985); *Unocal Corp. v. Mesa Petroleum Co.,* Del.Supr., 493 A.2d 946 (1985). However, the parties' struggle for control of the Foundation is in no way comparable to a takeover scenario. As controlling member, Fred was not called upon to evaluate the advisability of a course of action that promised an increased short-term value for beneficiaries but that posed a threat to his position in the Foundation. In electing new members and replacing the former directors, he was simply exercising one of the basic powers of membership granted to him, *qua* member, under the Certificate. Moreover, his decisions were not fundamentally financial ones; at most, they could have only an indirect effect upon disbursements to beneficiaries. Unless his conduct reflects disloyalty to the Foundation or threatens the interests of its beneficiaries, it may not be a basis for his removal.

[17] A court cannot second-guess the wisdom of facially valid decisions made by charitable fiduciaries, any more than it can question the business judgment of the directors of a for-profit corporation. However, because the Foundation was created for a limited charitable purpose rather than a generalized business purpose, those who control it have a special duty to advance its charitable goals and protect its assets. Any action that poses a palpable and identifiable threat to those goals, or that jeopardizes its assets would be contrary to the Certificate and hence *ultra vires. See Denckla,* 193 A.2d at 541. Since Fred owes fiduciary loyalty to the Foundation in his capacity as member as well as director, we must consider whether his selection of his wife and children as members and directors meets this fiduciary standard. Only by applying this standard can a court of equity fully protect the interests of the Foundation's beneficiaries. It is not clear from the Vice Chancellor's bench ruling whether he applied such a standard or whether he simply deferred to the elective power of Fred. However, because this Court reviews questions of law and equity *de novo,* we are required to apply this standard to the facts as they appear on the record.

[18] *463 The Vice Chancellor ruled that Fred's "deceits" in delaying the appointment of new members and then secretly appointing persons from his immediate family as directors created "no legally cognizable harm" sufficient to justify equitable relief. Appellants complain that even though no financial loss is attributable to Fred's machinations, his actions placed the

Foundation at risk and reflected disloyalty to the Foundation sufficient to justify his removal. We agree with the Vice Chancellor, however, that while Fred's conduct may have "harmed" the appellants' interests in continuing as directors of the Foundation, their legal entitlement to remain as directors was subject to Fred's authority to elect new members. Fred's deceit in concealing their replacement merely delayed the litigation which validated that result.

[19] We also agree with the Vice Chancellor's determination that the appellants failed to prove that Fred's conduct created any financial harm to the beneficiaries of the trust, thus justifying his removal as a director. It should be noted, however, that the absence of specific damage to a beneficiary is not the sole test for determining disloyalty by one occupying a fiduciary position. It is an act of disloyalty for a fiduciary to profit personally from the use of information secured in a confidential relationship, even if such profit or advantage is not gained at the expense of the fiduciary. The result is nonetheless one of unjust enrichment which will not be countenanced by a Court of Equity. *Brophy v. Cities Service Co.,* Del.Ch., 70 A.2d 5, 7 (1949). Although Fred's secretive acts may have advanced his personal goals and had the potential for impairing the Foundation, as the Vice Chancellor noted, the broad power bestowed upon surviving members in the articles of incorporation created that risk. In the absence of proof that the Foundation suffered financial harm or that Fred benefitted financially from his conduct as a fiduciary, there is no basis for his removal.

Viewed objectively, Fred appears to have managed the Foundation, quite capably for the past twenty-three years. Under his direction, the value of Foundation assets has grown from $15 million to $195 million, while annual disbursements have grown from $200,000 to $8 million. It is true that some of this growth was due to Allan, Sr.'s bequest of Alleghany stock and that Fred relied heavily upon an undiversified portfolio of that stock during much of his tenure. Nevertheless, Alleghany's excellent performance during that period justifies Fred's reliance. Moreover, redemption of the Foundation's Alleghany stock has now enabled Fred to diversify its holdings, a move that will certainly place it on a more stable footing. As for the possibility that Fred might die and leave the Foundation in allegedly inexperienced hands, we consider this to be an inadequate basis for finding a threat to the Foundation's well-being. Certainly, Fred was under an obligation to bring new blood into the Foundation's management to insure informed continuity. Unless we were to hold that only professionally trained asset managers are equipped to serve the Foundation, there is no basis for challenging Fred's decision to entrust his own family with the future management of the Foundation.

[20] In essence, the appellants' claim that Fred "entrenched" his family's control of the Foundation is simply a complaint that he treated his siblings unfairly. As the Vice Chancellor noted, Fred's actions may well be viewed as exhibiting "a lack of brotherly regard" but in his capacity as member and director of the Foundation, Fred owed no fiduciary duties to other directors, only to the Foundation. As long as his actions posed no threat to the Foundation, his status as member gave Fred the power to oust his siblings for any reason or even for no reason at all. *See* 8 *Del.C.* § 141(k).

[21] In an effort to suggest that Fred indeed had a legal duty to treat his siblings with greater consideration, the Kirby plaintiffs rely heavily upon a letter written by Allan, Sr. in 1966 in which he expressed his wish that "members of our family down through the generations, will be interested in managing the Foundation." Although *464 we have no doubt that Allan, Sr. would have wished for Foundation involvement as well as harmony among his children, his letter and our own estimation of what he might have wanted have no legal significance. Had either the elder Fred Kirby or Allan, Sr. been intent on ensuring a place for all Kirbys in the Foundation, either could have drafted or amended the corporate documents to reflect that intention. If the Certificate were arguably ambiguous on this point, Allan, Sr.'s letter might serve as an aid in resolving that ambiguity. However, neither the certificate nor any original bylaw reflects an attempt to guarantee a place for any Kirby in the Foundation. Thus, we can view Allan, Sr.'s letter as no more than a legally insignificant expression of his hopes for the future.

B.

[22] The appellants' charge that Fred acted illegally by serving as the Foundation's only member for eleven years is the most substantial of their claims. The Certificate clearly requires that there be at least three members at all times and that vacancies be filled "as soon as practicable." We find no merit in Fred's contention that he could not decide who was best qualified to serve the Foundation and therefore did not find it "practicable" to appoint new members. Given the mandatory language of the Certificate, eleven years was clearly too long to delay in performing his duty as the sole member.

Nevertheless, the time during which anyone could seek equitable redress for this violation has now passed. We believe that a timely action to compel Fred to appoint members would have been successful. However, since Fred has now validly appointed a full complement of members, this claim is moot. Moreover, although two individuals were deprived of the right to serve as Foundation members for eleven years, it is impossible to fashion any retrospective remedy since it cannot be said who Fred would have appointed if he had been compelled to do so. Since there is no evidence that Fred's failure to appoint new members posed any threat to the Foundation, his inaction does not raise the question of his loyalty to the Foundation.

[23][24][25] Next, the appellants contend that Fred's failure to disclose his appointment of new members for a period of two years harmed the Foundation, arguing that it posed a threat to the validity of the Foundation's sales of its Alleghany stock and later of its American Express stock. They contend that both of these transactions constituted sales of substantially all of the Foundation's assets under 8 *Del.C.* § 271, and that as such, the full membership was required to approve them. It is argued that Fred's determination to deceive his siblings prevented him from seeking the required approval and laid the transactions open to legal challenge. We find, however, that the transactions did not involve sales of substantially all of the Foundation's assets. Although the magnitude of the transactions was unquestionably large, the rule announced in *Gimbel v. Signal Cos.,* Del.Ch., 316 A.2d 599 (1974), *aff'd,* Del.Supr., 316 A.2d 619 (1974), makes it clear that the need for shareholder (or member) approval is to be measured not by the size of a sale alone, but also by its qualitative effect upon the corporation. Thus, it is relevant to ask whether a transaction "is out of the ordinary and substantially affects the existence and purpose of the corporation...." *Id.* at 606. The Foundation is in the "business" of holding investment securities and donating its profits to charity. The exchange of one portfolio of securities for another portfolio of similar value does not substantially affect this corporate purpose. Accordingly, we find that member approval was not required and that Fred's failure to seek it did not taint the transaction.

[26] Next, the appellants allege that Fred falsified the minutes of the June 5, 1986 directors' meeting at which the Kirby plaintiffs enacted their bylaw amendment. As recorded, the minutes state that "[a] majority of directors ... insisted on voting on the proposed resolution but agreed to submit it to counsel for recommendations prior to deciding what to do about the inclusion of the resolution in the minutes at *465 the next Board of Directors meeting." The Kirby plaintiffs contend that they agreed to seek advice of counsel but that they did not make adoption of the resolution contingent upon counsel's approval. The Vice Chancellor made no specific finding as to what actually transpired at the meeting; however, he ruled that no cognizable harm occurred if the minutes had been falsified, and we agree. Under appropriate circumstances, the falsification of a corporation's minutes might constitute a breach of a director's duty of candor. Here,

however, the appellants offered no evidence that anyone was or even could have been deceived by the alleged falsification or that the Foundation or its beneficiaries were harmed.

[27] Finally, the Attorney General argues that Fred breached his fiduciary duty to the Foundation by directing that the shares of stock it held in various corporations be voted in favor of his election to the boards of directors of those corporations. As the defendants point out, Fred's election to these boards was at no point contested. Moreover, the Attorney General cites no authority to support his claim, and we know of no authority that would require a corporation to abstain from voting its shares as its directors choose, in the absence of some threat or harm to the corporation's interests.

In sum, we affirm the Vice Chancellor's determination that the appellants failed to prove a cognizable claim justifying Fred's removal. Fred did violate the terms of the Certificate by failing to appoint additional members for eleven years, but any claim arising from that failure has been mooted by his appointment of his wife and children. Thus, we find no basis for questioning the right of any of the defendants to continue serving in their present offices.

SHEPHERD OF THE VALLEY LUTHERAN CHURCH OF HASTINGS, a Minnesota Non Profit Corporation, Respondent,
v.
HOPE LUTHERAN CHURCH OF HASTINGS, Minnesota, a Minnesota Non Profit Corporation, and Greg Collins, Appellants.

626 N.W.2d 436 (Minn. Ct. App. 2001)

OPINION

TOUSSAINT, Chief Judge

This lawsuit arises out of an intra-congregational dispute that resulted in the congregation of Shepherd of the Valley Lutheran Church (SOTV) voting to separate; the creation of a new church, Hope Lutheran Church (Hope); and SOTV's congregation voting to transfer SOTV's church property to Hope.

SOTV filed suit alleging that it had suffered damages as a result of a breach of fiduciary duty by its former vice president and the current president of Hope, Gregory Collins. A jury found that Collins had breached his fiduciary duty to SOTV and awarded SOTV monetary and equitable relief. Because the jury's verdict, affirmed by the trial court in its original and amended findings of fact, and conclusions of law is supported by evidence in the record, we affirm. However, we reverse and remand as to the trial court's summary denial of SOTV's taxable costs and disbursements.

FACTS

Shepherd of the Valley Lutheran Church (SOTV) was founded in 1985 and is a member of the Lutheran Church, Missouri Synod (LCMS). Congregations which affiliate themselves with LCMS agree to accept the doctrinal positions, constitution, bylaws, and resolutions of LCMS.

SOTV, as a member of LCMS, is served by a called pastor, who may be terminated only for specific reasons. In August 1997, Reverend Bruce King became SOTV's called pastor. As a part of his duties, King conducted communion. According to LCMS, King was required to allow only those who were members of LCMS to participate in communion. King's refusal to allow non-LCMS members to participate in communion became a point of contention that eventually led to a division in the congregation.

*440 In the spring of 1998, the vice president of SOTV, Gregory Collins, sought the termination of King. The board of elders unanimously determined that there was no basis to remove King. Collins's attempts to remove King continued--a severance package was offered to King, which he refused; an unsuccessful motion proposed reduction of King's salary to $0; and another unsuccessful motion proposed the amendment of the termination provisions in SOTV's constitution relating to called pastors.

Following these unsuccessful attempts to remove King, Collins and his supporters discontinued patronage and financial support of SOTV. Collins began organizing meetings that consisted of only those members of the SOTV congregation who opposed King. This group became known as the Hope faction.

Collins, leading the Hope faction, reviewed the provisions of the SOTV constitution. SOTV's constitution provides that:

> If, at any time, a separation should take place within this congregation * * * [and] a division into factions of the congregation shall occur because of doctrinal issues, the property of the congregation and all benefits therewith connected shall remain with those members who adhere in confession and practice [of LCMS].
>
> If division takes place for non-doctrinal reasons, the property shall remain with the majority of the communicant members.

After reviewing the SOTV constitution, Collins and other members of Hope faction laid the groundwork for the creation of Hope Lutheran Church by drafting the articles of incorporation, a constitution, and bylaws. Collins designated himself as president of Hope. Collins also met with an attorney to prepare a warranty deed conveying the church property located at 1450 West Fourth Street, Hastings, MN from SOTV to Hope.

Throughout this time period, Collins retained his position as vice president of SOTV. Collins did not inform other SOTV officers, or the general congregation, of his plans to seek separation and his efforts to form a new church. Collins also encouraged members of the Hope faction to remain quiet about their activities.

On November 13, 1998, Collins informed the president of SOTV, Al Johnson, that he intended to seek separation of the congregation at the annual meeting that was to be held on November 15, 1998. At the annual meeting, a motion to separate was put before the congregation. A majority of those present at the meeting voted to separate based on non-doctrinal reasons and to transfer SOTV's real estate and personal property (church property) to Hope without any payment of money or consideration to SOTV.

Following the annual meeting, Collins

changed the locks on the SOTV sanctuary and informed the SOTV faction that they would not be welcome. On November 19, 1998, Collins executed a warranty deed, signing as the vice president of SOTV. Since November 1998, Hope has operated at 1450 West Fourth Street in Hastings. SOTV, on the other hand, has been worshipping in members' homes and rented space.

SOTV subsequently filed suit, alleging a breach of fiduciary duty by Collins. SOTV sought, as remedies for the breach of fiduciary duty, monetary damages from Collins and equitable relief in the form of the return of the church property. After hearing the evidence, the jury, by special verdict, found that (1) Collins had breached his fiduciary duty owed to SOTV, for which he was liable in the amount of $7,782.99; and (2) SOTV had a present right to possess the church property, *441 thereby, ejecting Hope from the church property.

The trial court subsequently issued findings of fact, conclusions of law, additional and amended findings of fact, and denied judgment notwithstanding verdict (JNOV) motions by both parties. The trial court affirmed the jury verdict, awarding respondents equitable relief in the form of the return of the church property, plus monetary relief in the amount of $7,782.99 as compensation for Collins's breach of fiduciary duty. This appeal followed.

ISSUES

I. Whether the record supports a finding that Gregory Collins, the former vice president of Shepherd of the Valley Lutheran Church (SOTV), breached a fiduciary duty owed to SOTV, entitling SOTV to monetary and equitable relief?

II. Whether SOTV, as the prevailing party, is entitled to taxable costs and disbursements?

ANALYSIS

I.

[1] The underlying issue that gave rise to this lawsuit involves a doctrinal dispute amongst the congregation of SOTV. However, a court can apply neutral principles of law in resolving church property disputes so long as it does not determine disputes by examining the basis of the religious doctrine. *Jones v. Wolf,* 443 U.S. 595, 601-605, 99 S.Ct. 3020, 3024-3026, 61 L.Ed.2d 775 (1979); *Piletich v. Deretich,* 328 N.W.2d 696, 701 (Minn.1982). Because it is not necessary for us to examine the religious doctrine underlying this lawsuit, we may resolve the property dispute between SOTV and Hope Lutheran Church by applying neutral principles of law.

[2][3][4] Appellants argue that the trial court erred when, based on the special

verdict rendered by the jury, it ordered judgment in favor of SOTV and awarded equitable and monetary relief for the breach of fiduciary duty by Collins. It is the responsibility of a trial court to interpret a jury's special verdict and harmonize the jury's responses where possible. *Bartosch v. Lewison,* 413 N.W.2d 530, 532 (Minn.App.1987). The court "must consider the evidence in a light most favorable to the verdict and sustain that verdict if possible, on any reasonable theory of evidence." *Dang v. St. Paul Ramsey Med. Ctr.,* 490 N.W.2d 653, 659 (Minn.App.1992), *review denied* (Minn. Dec. 15, 1992) (citation omitted). Where there is a reasonable theory to reconcile the verdict, we will not disturb a trial court's decision to uphold the verdict. *Tsudek v. Target Stores, Inc.,* 414 N.W.2d 466, 470 (Minn.App.1987), *review denied* (Minn. Dec. 13, 1987).

By special verdict the jury found that (1) SOTV had a present right to the church property located at 1450 West 4th Street, Hastings, Minnesota; (2) SOTV was the proper owner of the church property; (3) Collins breached his fiduciary duty to SOTV; (4) SOTV suffered damages or losses which were caused by the breach of fiduciary duty by Collins; and (5) $7,752.99 would fairly and adequately compensate SOTV for the breach of fiduciary duty by Collins. Based on the jury's verdict, the trial court awarded SOTV both monetary damages and the right, title, and interest in the church property on the theory that SOTV was entitled to monetary and equitable relief as the result of Collins's breach of his fiduciary duty.

Appellants specifically argue (1) that the finding of breach of fiduciary duty by Collins is not supported by the weight of the evidence; and (2) that a finding of breach *442 of a fiduciary duty does not support the award of monetary and equitable relief.

A. *Fiduciary Duty*

[5] An officer of a nonprofit corporation owes a fiduciary duty to that corporation to act in good faith, with honesty in fact, with loyalty, in the best interests of the corporation, and with the care of an ordinary, prudent person under similar circumstances. Minn.Stat. § 317A.361 (2000); *see also Miller v. Miller,* 301 Minn. 207, 219, 222 N.W.2d 71, 78 (1974) (recognizing the common law principle that officers of a corporation occupy a fiduciary relationship with the corporation); *Wenzel v. Mathies,* 542 N.W.2d 634, 641 (Minn.App.1996) (same), *review denied* (Minn. Mar. 28, 1996). In order to establish a breach of fiduciary duty claim, a plaintiff must show that

> the action attacked is so far opposed to the true interests of the corporation as to lead to the clear inference that no officer thus

acting could have been influenced by an honest desire to secure such interests.

Westgor v. Grimm, 318 N.W.2d 56, 59 (Minn.1982) (quoting *Warner v. E.C. Warner Co.,* 226 Minn. 565, 573, 33 N.W.2d 721, 726 (1948)).

[6] Collins concedes that as an officer of SOTV he owed a fiduciary duty to SOTV; but Collins argues that the evidence does not support a finding that he breached his fiduciary duty because his actions were consistent with the wishes of the SOTV members who made up the Hope faction.

Contrary to Collins's argument, as the bearer of a fiduciary duty, the law imposed on Collins the highest standard of integrity in his dealings with the other officers of SOTV and the entire SOTV congregation, not just those who were members of the Hope faction. *See Wenzel,* 542 N.W.2d at 640 (holding that a fiduciary duty is owed to all persons who have equal interests and concerns in the corporation and are subject to harm). Therefore, Collins's actions must be viewed in light of the fact that as an officer of SOTV his fiduciary duty prevented him from assuming positions, and taking actions, that conflicted with the interests of SOTV and the congregation as a whole.

[7] Reviewing the evidence presented to the jury in the light most favorable to the verdict, there is sufficient evidence in the record to establish that Collins breached his fiduciary duty to SOTV. Collins admitted that while he was vice president of SOTV, he organized the Hope faction for the purpose of forming another church to directly compete with SOTV. Further, the formation of a new church was intended to be a method of circumventing the LCMS termination provisions governing King's pastoral services.

To achieve his goals, Collins held secret meetings and continuously encouraged secrecy among the Hope faction. Collins did not inform other SOTV officials and members of the SOTV faction of his plans to form Hope, separate from SOTV, and transfer the church property from SOTV to Hope without compensation. In fact, when Collins was asked on cross-examination, "[y]ou kept information from [SOTV's president] of a material nature, didn't you?"; Collins testified, "[y]es, I did." Holding secret meetings and advance preparation of legal documents is improper conduct by an officer, amounting to a breach of fiduciary duty. *Evans v. Blesi,* 345 N.W.2d 775, 779-80 (Minn.App.1984), *review denied* (Minn. June 12, 1984). Based on Collins's own testimony, we cannot say that the jury's verdict or the trial court's amended order finding that Collins *443 breached his fiduciary duty to SOTV was unsupported by the evidence.

[8][9] Moreover, Collins is not protected by the immunity provision of the Minnesota Nonprofit Corporation Act (MNCA), Minn.Stat. § 317A.257 (2000). The MNCA provides immunity from civil liability to unpaid directors of nonprofit organizations if the director (1) acts in good faith; (2) within the scope of his responsibilities as a director; and (3) does not commit reckless or willful misconduct. *Id.,* subd. 1; *Rehn v. Fischley,* 557 N.W.2d 328, 333 (Minn.1997). The party relying upon the immunity bears the burden of proving he or she fits within the scope of the immunity. *Rehn,* 557 N.W.2d at 333.

[10][11] Appellants argue, in their reply brief, that the jury instructions were improper because they failed to inform the jury of the fact that Collins is immune from a breach of fiduciary duty claim. This argument fails outright for two reasons: (1) issues not raised or argued in an appellant's brief cannot be revived in a reply brief, *McIntire v. State,* 458 N.W.2d 714, 717 n. 2 (Minn.App.1990), *review denied* (Minn. Sept. 28, 1990); and (2) immunity is not an issue for the jury, but a legal question to be decided by the court in the first instance. *Rehn,* 557 N.W.2d at 331-333.

[12] Further, Collins is not entitled to statutory immunity because his actions in bringing about the separation of the congregation and the transfer of the church property constituted "willful or reckless misconduct." It is misconduct for an officer to withhold material information from other officers and members of the corporation. *Appletree Square I Ltd. P'ship v. Investmark, Inc.,* 494 N.W.2d 889, 892 (Minn.App.1993), *review denied* (Minn. Mar. 16, 1993). Because Collins testified that he intentionally withheld material information from other SOTV officials and certain members of the SOTV congregation, Collins's actions constituted willful misconduct. *See* Black's Law Dictionary 1014 (7th ed.) 1999 (stating that the term willful misconduct is commonly understood as intentional misconduct); *cf. Maras v. City of Brainerd,* 502 N.W.2d 69, 76 (Minn.App.1993), *review denied* (Minn. Aug. 16, 1993) (denying official immunity to a police officer because officer's actions met the willful conduct exception where evidence established that he acted intentionally). Accordingly, the trial court did not err in determining that Collins was not entitled to the statutory immunity under the MNCA.

B. *Relief for Breach of a Fiduciary Duty*

[13][14] Appellants argue that it was error for the trial court to award SOTV the church property as a remedy for Collins's breach of fiduciary duty. However, a claim of breach of fiduciary duty is an equitable claim. Minn.Stat. § 317A.467 (2000); *R.E.R. v. J.G.,* 552 N.W.2d 27, 30 (Minn.App.1996).

Thus, the trial court was presented with a reasonable theory by which it could vest the right, title, and interest in the church property in favor of SOTV.

[15][16] Further, it was within the trial court's discretion to return the church property to SOTV. The purpose of fashioning an equitable remedy is to restore the injured party to the position it occupied before the breach of fiduciary duty. *R.E.R.,* 552 N.W.2d at 30. The fashioning of an equitable remedy is committed to the sound discretion of the trial court. *Nadeau v. County of Ramsey,* 277 N.W.2d 520, 524 (Minn.1979).

Prior to Collins's breach of his fiduciary duty, SOTV had a right, title, and interest in the church property. By awarding *444 SOTV the church property, SOTV was returned to the position it occupied before the breach of fiduciary duty. *See Wright v. Wright,* 311 N.W.2d 484, 485 (Minn.1981) (holding that if legal title to property is obtained through a breach of fiduciary relationship, a constructive trust arises in favor of the person equitably entitled to the property). Therefore, we will not disturb the trial court's order awarding SOTV the church property as equitable appropriate relief for the breach of fiduciary duty by Collins.

[17][18] Appellants also argue that the trial court erred when it awarded SOTV an additional $7,782.99 as monetary damages. Monetary damages may supplement a grant of equitable relief. *R.E.R.,* 552 N.W.2d at 30 (citing *Leach v. Leach,* 167 Minn. 489, 493, 209 N.W. 636, 638 (1926)). SOTV presented evidence that it suffered out-of-pocket expenses of $7,782.99 as a result of the breakup of the church. Appellants do not argue, nor do they provide any evidence that contradicts this amount. Because the trial court, which adopted the jury's findings, did not reach a conclusion contrary to evidence in the record, we will not disturb the trial court's award of monetary damages. *See Highview N. Apartments v. County of Ramsey,* 323 N.W.2d 65, 73 (Minn.1982) (reviewing courts must sustain damages if they are within the limits of credible estimates presented at trial).

In re CAREMARK INTERNATIONAL INC. DERIVATIVE LITIGATION.

698 A.2d 959 (1996)

ALLEN, Chancellor.

B. Directors' Duties To Monitor Corporate Operations

The complaint charges the director defendants with breach of their duty of attention or care in connection with the on-going operation of the corporation's business. The claim is that the directors allowed a situation to develop and continue which exposed the corporation to enormous legal liability and that in so doing they violated a duty to be active monitors of corporate performance. The complaint thus does not charge either director self-dealing or the more difficult loyalty-type problems arising from cases of suspect director motivation, such as entrenchment or sale of control contexts. [FN14] The theory here advanced is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment. The good policy reasons why it is so difficult to charge directors with responsibility for corporate losses for an alleged breach of care, where there is no conflict of interest or no facts suggesting suspect motivation involved, were recently described in *Gagliardi v. TriFoods Int'l, Inc.,* Del.Ch., 683 A.2d 1049, 1051 (1996) (1996 Del.Ch. LEXIS 87 at p. 20).

FN14. *See Weinberger v. UOP, Inc.,* Del.Supr., 457 A.2d 701, 711 (1983) (entire fairness test when financial conflict of interest involved); *Unitrin, Inc. v. American General Corp.,* Del.Supr., 651 A.2d 1361, 1372 (1995) (intermediate standard of review when "defensive" acts taken); *Paramount Communications, Inc. v. QVC Network,* Del.Supr., 637 A.2d 34, 45 (1994) (intermediate test when corporate control transferred).

[6][7] 1. *Potential liability for directoral decisions:* Director liability for a breach of the duty to exercise appropriate attention may, in theory, arise in two distinct contexts. First, such liability may be said to follow *from a board decision* that results in a loss because that decision was ill advised or "negligent". Second, liability to the corporation for a loss may be said to arise from an *unconsidered failure of the board to act* in circumstances in which due attention would, arguably, have prevented the loss. *See generally* Veasey & Seitz, *The Business Judgment Rule in the Revised Model Act ...* 63 TEXAS L.REV. 1483 (1985). The first

class of cases will typically be subject to review under the director-protective business judgment rule, assuming the decision made was the product of *a process* that was *either* deliberately considered in good faith or was otherwise rational. See *Aronson v. Lewis,* Del.Supr., 473 A.2d 805 (1984); *Gagliardi v. TriFoods Int'l, Inc.,* Del.Ch., 683 A.2d 1049 (1996). What should be understood, but may not widely be understood by courts or commentators who are not often required to face such questions, [FN15] is that compliance with a director's duty of care can never appropriately be judicially determined by reference to *the content of the board decision* that leads to a corporate loss, apart from consideration of the good faith *or* rationality of the process employed. That is, whether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through "stupid" to "egregious" or "irrational", provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in *a good faith* effort to advance corporate interests. To employ a different rule--one that permitted an "objective" evaluation of the decision--would expose directors to substantive second guessing by ill-equipped judges or juries, which would, in the long-run, be injurious to investor interests. [FN16] Thus, the business *968 judgment rule is process oriented and informed by a deep respect for all *good faith* board decisions.

FN15. *See* American Law Institute, Principles of Corporate Governance § 4.01(c) (to qualify for business judgment treatment a director must "rationally" believe that the decision is in the best interests of the corporation).

FN16. The vocabulary of negligence while often employed, *e.g., Aronson v. Lewis,* Del.Supr., 473 A.2d 805 (1984) is not well-suited to judicial review of board attentiveness, *see, e.g., Joy v. North,* 692 F.2d 880, 885-6 (2d Cir.1982), especially if one attempts to look to the substance of the decision as any evidence of possible "negligence." Where review of board functioning is involved, courts leave behind as a relevant point of reference the decisions of the hypothetical "reasonable person", who typically supplies the test for negligence liability. It is doubtful that we want business men and women to be encouraged to make decisions as hypothetical persons of *ordinary* judgment and prudence might. The corporate form gets its utility in large part from its ability to allow diversified investors to accept greater investment risk. If those in

> charge of the corporation are to be adjudged personally liable for losses on the basis of a substantive judgment based upon what an persons of ordinary or average judgment and average risk assessment talent regard as "prudent" "sensible" or even "rational", such persons will have a strong incentive at the margin to authorize less risky investment projects.

[8] Indeed, one wonders on what moral basis might shareholders attack a *good faith* business decision of a director as "unreasonable" or "irrational". Where a director *in fact exercises a good faith effort to be informed and to exercise appropriate judgment,* he or she should be deemed to satisfy fully the duty of attention. If the shareholders thought themselves entitled to some other quality of judgment than such a director produces in the good faith exercise of the powers of office, then the shareholders should have elected other directors. Judge Learned Hand made the point rather better than can I. In speaking of the passive director defendant Mr. Andrews in *Barnes v. Andrews,* Judge Hand said:

> True, he was not very suited by experience for the job he had undertaken, but I cannot hold him on that account. After all it is the same corporation that chose him that now seeks to charge him.... Directors are not specialists like lawyers or doctors.... They are the general advisors of the business and if they faithfully give such ability as they have to their charge, it would not be lawful to hold them liable. Must a director guarantee that his judgment is good? Can a shareholder call him to account for deficiencies that their votes assured him did not disqualify him for his office? While he may not have been the Cromwell for that Civil War, Andrews did not engage to play any such role. [FN17]

FN17. 298 F. 614, 618 (S.D.N.Y.1924).

In this formulation Learned Hand correctly identifies, in my opinion, the core element of any corporate law duty of care inquiry: whether there was good faith effort to be informed and exercise judgment.

2. *Liability for failure to monitor:* The second class of cases in which director liability for inattention is theoretically possible entail circumstances in which a loss eventuates not from a decision but, from unconsidered inaction. Most of the decisions that a corporation, acting through its human agents, makes are, of course, not the subject of director attention. Legally, the board itself will be required only to authorize the most significant corporate acts

or transactions: mergers, changes in capital structure, fundamental changes in business, appointment and compensation of the CEO, etc. As the facts of this case graphically demonstrate, ordinary business decisions that are made by officers and employees deeper in the interior of the organization can, however, vitally affect the welfare of the corporation and its ability to achieve its various strategic and financial goals. If this case did not prove the point itself, recent business history would. Recall for example the displacement of senior management and much of the board of Salomon, Inc.; [FN18] the replacement of senior management of Kidder, Peabody following the discovery of large trading losses resulting from phantom trades by a highly compensated trader; [FN19] or the extensive financial loss and reputational injury suffered by Prudential Insurance as a result its junior officers misrepresentations in connection with the distribution of limited partnership interests. [FN20] Financial and organizational disasters such as these raise the question, what is *969 the board's responsibility with respect to the organization and monitoring of the enterprise to assure that the corporation functions within the law to achieve its purposes?

FN18. *See, e.g., Rotten at the Core,* the Economist, August 17, 1991, at 69-70; *The Judgment of Salomon: An Anticlimax,* Bus. Week, June 1, 1992, at 106.

FN19. *See* Terence P. Pare, *Jack Welch's Nightmare on Wall Street,* Fortune, Sept. 5, 1994, at 40-48.

FN20. Michael Schroeder and Leah Nathans Spiro, *Is George Ball's Luck Running Out?,* Bus. Week, November 8, 1993, at 74-76; Joseph B. Treaster, *Prudential To Pay Policyholders $410 Million,* New York Times, Sept. 25, 1996, (at D-1).

Modernly this question has been given special importance by an increasing tendency, especially under federal law, to employ the criminal law to assure corporate compliance with external legal requirements, including environmental, financial, employee and product safety as well as assorted other health and safety regulations. In 1991, pursuant to the Sentencing Reform Act of 1984, [FN21] the United States Sentencing Commission adopted Organizational Sentencing Guidelines which impact importantly on the prospective effect these criminal sanctions might have on business corporations. The Guidelines set forth a uniform sentencing structure for organizations to be sentenced for violation of federal criminal statutes and provide for penalties that equal or often massively exceed those previously imposed on corporations. [FN22] The Guidelines offer powerful incentives for corporations today to have in place compliance programs to detect violations of law, promptly to report violations to appropriate public officials when discovered, and to take prompt, voluntary remedial efforts.

FN21. *See* Sentencing Reform Act of 1984, Pub.L. 98-473, Title II, § 212(a)(2) (1984); 18 U.S.C.A. §§ 3551-3656.

FN22. *See* United States Sentencing Commission, Guidelines Manuel, Chapter 8 (U.S. Government Printing Office November 1994).

In 1963, the Delaware Supreme Court in *Graham v. Allis-Chalmers Mfg. Co.,* [FN23] addressed the question of potential liability of board members for losses experienced by the corporation as a result of the corporation having violated the anti-trust laws of the United States. There was no claim in that case that the directors knew about the behavior of subordinate employees of the corporation that had resulted in the liability. Rather, as in this case, the claim asserted was that the directors *ought to have known* of it and if they had known they would have been under a duty to bring the corporation into compliance with the law and thus save the corporation from the loss. The Delaware Supreme Court concluded that, under the facts as they appeared, there was no basis to find that the directors had breached a duty to be informed of the ongoing operations of the firm. In notably colorful terms, the court stated that "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists." [FN24] The Court found that there were no grounds for suspicion in that case and, thus, concluded that the directors were blamelessly unaware of the conduct leading to the corporate liability. [FN25]

FN23. Del.Supr., 41 Del.Ch. 78, 188 A.2d 125 (1963).

FN24. *Id.* 188 A.2d at 130.

FN25. Recently, the *Graham* standard was applied by the Delaware Chancery in a case involving Baxter. *In Re Baxter International, Inc. Shareholders Litig.,* Del.Ch., 654 A.2d 1268, 1270 (1995).

[9] How does one generalize this holding today? Can it be said today that, absent some ground giving rise to suspicion of violation of law, that corporate directors have no duty to assure that a corporate information gathering and reporting systems

exists which represents a good faith attempt to provide senior management and the Board with information respecting material acts, events or conditions within the corporation, including compliance with applicable statutes and regulations? I certainly do not believe so. I doubt that such a broad generalization of the *Graham* holding would have been accepted by the Supreme Court in 1963. The case can be more narrowly interpreted as standing for the proposition that, absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf. *See* 188 A.2d at 130-31.

A broader interpretation of *Graham v. Allis-Chalmers*--that it means that a corporate board has no responsibility to assure that appropriate information and reporting systems *970 are established by management--would not, in any event, be accepted by the Delaware Supreme Court in 1996, in my opinion. In stating the basis for this view, I start with the recognition that in recent years the Delaware Supreme Court has made it clear--especially in its jurisprudence concerning takeovers, from *Smith v. Van Gorkom* through *Paramount Communications v. QVC* [FN26]--the seriousness with which the corporation law views the role of the corporate board. Secondly, I note the elementary fact that relevant and timely *information* is an essential predicate for satisfaction of the board's supervisory and monitoring role under Section 141 of the Delaware General Corporation Law. Thirdly, I note the potential impact of the federal organizational sentencing guidelines on any business organization. Any rational person attempting in good faith to meet an organizational governance responsibility would be bound to take into account this development and the enhanced penalties and the opportunities for reduced sanctions that it offers.

FN26. *E.g., Smith v. Van Gorkom,* Del.Supr., 488 A.2d 858 (1985); *Paramount Communications v. QVC Network,* Del.Supr., 637 A.2d 34 (1994).

[10] In light of these developments, it would, in my opinion, be a mistake to conclude that our Supreme Court's statement in *Graham* concerning "espionage" means that corporate boards may satisfy their obligation to be reasonably informed concerning the corporation, without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach

informed judgments concerning both the corporation's compliance with law and its business performance.

Obviously the level of detail that is appropriate for such an information system is a question of business judgment. And obviously too, no rationally designed information and reporting system will remove the possibility that the corporation will violate laws or regulations, or that senior officers or directors may nevertheless sometimes be misled or otherwise fail reasonably to detect acts material to the corporation's compliance with the law. But it is important that the board exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility.

Thus, I am of the view that a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances may, in theory at least, render a director liable for losses caused by non-compliance with applicable legal standards [FN27]. I now turn to an analysis of the claims asserted with this concept of the directors duty of care, as a duty satisfied in part by assurance of adequate information flows to the board, in mind.

FN27. Any action seeking recover for losses would logically entail a judicial determination of proximate cause, since, for reasons that I take to be obvious, it could never be assumed that an adequate information system would be a system that would prevent all losses. I need not touch upon the burden allocation with respect to a proximate cause issue in such a suit. *See Cede & Co. v. Technicolor, Inc.,* Del.Supr., 636 A.2d 956 (1994); *Cinerama, Inc. v. Technicolor, Inc.,* Del.Ch., 663 A.2d 1134 (1994), *aff'd,* Del.Supr., 663 A.2d 1156 (1995). Moreover, questions of waiver of liability under certificate provisions authorized by 8 *Del.C.* § 102(b)(7) may also be faced.

George JANSSEN, et al., Respondents,
v.
BEST & FLANAGAN, et al.,
Defendants,
and
Minneapolis Police Relief Association,
Petitioner, Appellant.

662 N.W.2d 876 (2003)

OPINION

MEYER, Justice.

We are called on to decide certain questions of first impression regarding the law of nonprofit corporations in Minnesota. The principal issue concerns how a nonprofit board may respond to a member's demand to commence legal action on behalf of the association. We also consider the degree of deference that a district court may give to a nonprofit board's decision to reject a member's demand to commence legal action.

The board of directors of the Minneapolis Police Relief Association (MPRA) made an improvident investment in a company known as Technimar and lost approximately fifteen million dollars. Certain members of MPRA (Janssen, et al., whom we will refer to collectively as "Janssen") brought a derivative suit on behalf of MPRA against Best & Flanagan alleging attorney malpractice with respect to the Technimar investment. MPRA appointed special counsel to review the merits of the derivative suit. Special counsel concluded that proceeding with the derivative suit would not be in the best interests of MPRA and MPRA moved to dismiss the suit. The district court treated special counsel as a special litigation committee, applied the business judgment rule to the committee's decision not to proceed with the derivative action, and dismissed Janssen's suit. The court of appeals reversed, concluding that the legislature had not granted nonprofit corporations authority to appoint special litigation committees, and the district court was precluded from deferring to the decision of MPRA's special counsel. MPRA petitioned for review, seeking a reversal of the court of appeals' decision.

MPRA is a Minnesota nonprofit corporation that administers a pension plan for Minneapolis police officers hired before June 15, 1980. Minn.Stat. § 423B.01-.04 (2002). MPRA was formed under and is subject to Minn.Stat. ch. 317A (2002), the Minnesota Nonprofit Corporation Act, and is governed by a board of nine directors. *See* Minn.Stat. § 423B.05, subd. 1 (2002).

In 1996 and 1997, MPRA lost approximately fifteen million dollars that it had invested with David Welliver in a company called Technimar. The circumstances surrounding this loss were the subject of several investigations and at least two prior lawsuits. The most important aspect of this history for the instant case is that two law firms, Jones, Day, Reavis and Pogue (Jones Day) and Dorsey & Whitney, LLP (Dorsey Whitney), had already conducted investigations surrounding some of the issues.

Janssen alleges in this action that MPRA's former attorneys, Best & Flanagan, committed malpractice in representing MPRA during and after the Welliver investments were made in 1996 and 1997. Janssen alleges, among other claims, that Best & Flanagan attorneys served as general counsel to MPRA and were negligent *880 in failing to conduct a "due diligence" inquiry into the Welliver investment. In bringing this derivative suit, Janssen did not have an attorney-client relationship with Best & Flanagan, so their suit depended upon MPRA joining them as a plaintiff.

In response to this lawsuit, MPRA appointed attorney Robert A. Murnane (Murnane) as special counsel to investigate Janssen's claims and determine whether MPRA should join the derivative suit. The MPRA board issued a resolution in June of 2000 instructing Murnane to conduct an independent review and evaluate the derivative lawsuit to determine on behalf of MPRA's board of directors whether or not MPRA should join in legal action against Best & Flanagan. The resolution specifically instructed Murnane to "not reinvestigate, verify or otherwise attempt to prove or disprove the factual findings, determinations, events or circumstances" described in the prior investigative reports of Jones Day and Dorsey Whitney and a set of discovery materials in a related lawsuit. Murnane was specifically instructed to "accept as correct" the factual findings of these reports and discovery materials. Murnane was not limited, however, by the conclusions of the previous reports.

Murnane reviewed "thousands of pages of reports, documents and deposition transcripts" over a few months in investigating the merits of a malpractice action against Best & Flanagan. However, the record does not indicate that he conducted any of his own investigation, nor did he personally speak to the Janssen claimants or their counsel. Murnane submitted his report to the MPRA board on September 26, 2000, concluding that "the totality of the materials reviewed does not support a finding that Best & Flanagan committed legal malpractice in its handling of the MPRA affairs," and that "to spend money in the pursuit of a legal malpractice claim against Best & Flanagan would not be prudent use of the MPRA funds." Following submission of Murnane's report, the MPRA board brought a motion to dismiss the instant lawsuit under the principle of law that the court should defer to the business judgment of Murnane, MPRA's special litigation committee.

In considering MPRA's motion to dismiss, the district court described the appropriate role that special litigation committees play in acting on behalf of for-profit corporations. The court determined that a nonprofit corporation is also authorized to utilize the special litigation committee procedure. The court treated Murnane as a special litigation committee and applied the business judgment rule to the committee's report. Under the business judgment rule enunciated by the court, it examined only whether the committee conducted its investigation with independence and good faith. The court concluded that "[Murnane's] investigation cannot survive even this limited review." The court could not find that Murnane was independent because "he was told by the board of directors what to believe." The court could not find good faith because there was no indication from Murnane that he sought or received input from the plaintiffs and the court was left to assume that such input was not sought because the board's instructions limited the scope of the investigation. Finally, the court could not clearly discern whether Murnane was offering legal advice or, in fact, rendering a business judgment decision.

Rather than deny MPRA's motion to dismiss the Janssen lawsuit, the district court postponed a decision on the motion *881 to allow MPRA an opportunity to remedy the deficiencies in MPRA's delegation of authority to its special litigation committee. The court instructed MPRA that if it sought deference for its committee's litigation decision, the court would not grant such deference unless and "until adequate evidence of independence and good faith is submitted by the MPRA, and until it is clear that Murnane has rendered a business judgment."

Consequently, MPRA issued a second resolution in December of 2000 to Murnane, declaring that he was to function as a special litigation committee, not being limited in any way as to how to conduct his investigation or what material he may consider: "[s]pecial counsel shall have complete independence and may undertake whatever good faith investigation he chooses." The resolution asked Murnane to exercise his "business judgment" regarding whether it was in the best interest of MPRA to join in the derivative suit. Murnane conducted an investigation that included meeting with certain of the named plaintiffs in the action and the involved attorneys at Best & Flanagan. Murnane submitted a second report and in that report concluded it would be a "poor business judgment" for MPRA to join in litigation against Best & Flanagan. MPRA renewed its motion to dismiss. The district court reviewed Murnane's second report and concluded that MPRA's special litigation committee (Murnane) had conducted an investigation that was independent and conducted in good faith. The court deferred to the committee's business judgment and granted MPRA's motion to dismiss the complaint against Best & Flanagan.

Janssen appealed and the court of appeals reversed. It concluded that a nonprofit corporation lacks the statutory authority to appoint a special litigation committee to evaluate derivative claims. Additionally, the court concluded that even if a nonprofit corporation has the authority to appoint a special litigation committee, in this case the special litigation committee failed to meet the threshold test of the business judgment rule. The court reversed and remanded for trial. This appeal followed.

I.

[1] We concern ourselves with two questions: (1) whether the Minnesota Nonprofit Corporations Act prohibits a nonprofit corporation's board of directors from establishing an independent committee with authority to make decisions about derivative lawsuits; and (2) whether Murnane, as special counsel, displayed sufficient independence and good faith to be entitled to the deference of the business judgment rule. We exercise de novo review of the primary issues in this case, as they involve statutory interpretation and novel questions of law. *State v. Loge,* 608 N.W.2d 152, 155 (Minn.2000). We also note that other states have recently held that they will review de novo a decision of a district court to dismiss a derivative suit. *See Brehm v. Eisner,* 746 A.2d 244, 253 (Del.2000); *In re PSE & G S'holder Litig.,* 173 N.J. 258, 801 A.2d 295, 313 (2002).

A. The Business Judgment Rule and Derivative Lawsuits

To resolve this case we must strike a balance between two competing interests in the judicial review of corporate decisions. *See PSE & G,* 801 A.2d at 306. On one hand, courts recognize the authority of corporate directors and want corporations to control their own destiny. *882*Stoner v. Walsh,* 772 F.Supp. 790, 796 (S.D.N.Y.1991). On the other hand, courts provide a critical mechanism to hold directors accountable for their decisions by allowing shareholder derivative suits. *See Barrett v. Southern Conn. Gas Co.,* 172 Conn. 362, 374 A.2d 1051, 1055 (1977) (remarking that " '[i]f the duties of care and loyalty which directors owe to their corporations could be enforced only in suits by the corporation, many wrongs done by directors would never be remedied' " (citation omitted)); *Brown v. Tenney,* 125 Ill.2d 348, 126 Ill.Dec. 545, 532 N.E.2d 230, 232 (1988) (stating that "[t]he derivative suit is a device to protect shareholders against abuses by the corporation, its officers and directors, and is a vehicle to ensure corporate accountability"). Because shareholder-derivative litigation is not an everyday occurrence in Minnesota's courts, we address these issues for the first time.

Courts have attempted to balance these two competing concerns by establishing a "business judgment rule" that grants a degree of deference to the decisions of corporate directors. The business judgment rule was developed by state and federal courts to protect boards of directors against shareholder claims that the board made unprofitable business decisions. "The business judgment rule is a presumption protecting conduct by directors that can be attributed to any rational business purpose." Dennis J. Block, et al., *The Business Judgment Rule: Fiduciary Duties of Corporate Directors* 18 (5th ed.1998). The business judgment rule means that as long as the disinterested director(s) made an informed business decision, in good faith, without an abuse of discretion, he or she will not be liable for corporate losses resulting from his or her decision. *Id.* at 39. Two major reasons buttress the decision to grant a degree of deference to corporate boards. First, protecting directors' reasonable risks is considered positive for the economy overall, as those risks allow businesses to attract risk-averse managers, adapt to changing markets, and capitalize on emerging trends. [FN1] Second, courts are ill-equipped to judge the wisdom of business ventures and have been reticent to replace a well-meaning decision by a corporate board with their own. *See, e.g., Auerbach v. Bennett,* 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994, 1000 (1979).

[2][3][4][5][6][7][8][9] Where the shareholders of a corporation believe the board has acted improperly, corporate law recognizes the shareholders' ability to bring a derivative lawsuit. Derivative suits allow shareholders to bring suit against wrongdoers on behalf of the corporation, and force liable parties to compensate the corporation for injuries so caused. *Tenney,* 126 Ill.Dec. 545, 532 N.E.2d at 233. A derivative action actually belongs to the corporation, but the shareholders are permitted to bring the action where the corporation has failed to take action for itself. *See id.* Because of the business judgment rule, however, not all shareholders' derivative *883 suits proceed on their merits. While derivative suits may benefit a

corporation, any benefit must be weighed against the possibility that disgruntled shareholders will bring nuisance lawsuits with little merit and that even legitimate suits may not be worth pursuing when the likelihood of victory is compared with the time, money, and hostility necessary to win. The substantive decision about whether to pursue the claims advanced in a shareholder's derivative action involves "the weighing and balancing of legal, ethical, commercial, promotional, public relations, fiscal and other factors familiar to the resolution of many if not most corporate problems." *Auerbach,* 419 N.Y.S.2d 920, 393 N.E.2d at 1002. The careful balancing of those factors is best done by the board of directors, which is familiar with the appropriate weight to attribute to each factor given the company's product and history. Thus, courts apply the business judgment rule when evaluating the decision by a board of directors whether to join or quash a derivative suit belonging to the corporation. *Block, supra,* at 1702-03.

Having established the principles by which we apply the business judgment rule to a for-profit corporate board's decision whether to join a derivative lawsuit, we consider whether to grant similar deference to nonprofit boards of directors. The parties in this case have presumed the business judgment rule will apply to MPRA. Other states have applied the business judgment rule to decisions of nonprofit corporations, explicitly or implicitly. The highest courts of Alabama, Hawaii, and South Dakota have done so, as have intermediate appellate courts of Colorado, New York, Ohio, South Carolina, Tennessee, and Wisconsin. [FN2] We find no case denying a nonprofit organization the protection of the business judgment rule.

[10] In addition to finding support in other jurisdictions for giving judicial deference to nonprofit corporate decisions, the primary rationales for applying the business judgment rule in the for-profit context apply in the nonprofit context as well. Organizations are autonomous agents that should control their own destiny. *See Auerbach,* 419 N.Y.S.2d 920, 393 N.E.2d at 1000-01. Directors of nonprofits may take fewer risks than would be optimal if they were overly concerned about liability for well-meaning decisions. *See* Daniel R. Fischel & Michael Bradley, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis,* 71 Cornell L.Rev. 261, 270 (1986). Additionally, courts are not well-equipped to scrutinize the decisions of a corporation; judges should not be caught in the middle of fighting factions of nonprofits any more than they should be thrust between dissatisfied shareholders and profit-seeking boards. *See id.* at 273. Therefore, we conclude that the boards of nonprofit corporations may

receive the protection of the business judgment rule.

B. Special Litigation Committees

We turn now to consider whether a nonprofit board of directors that is not sufficiently *884 independent to decide whether to join a member's derivative lawsuit may establish a special litigation committee with authority to make the decision. [FN3] Janssen claims a nonprofit may not appoint a special litigation committee because the Minnesota Nonprofit Corporation Act (Nonprofit Act) provides no such authority. Minn.Stat. § 317A.241 (2002). MPRA argues that the Nonprofit Act permitted them to appoint Murnane as its special litigation committee, and the district court agreed. The court of appeals concluded that the statute prohibited nonprofits from appointing special litigation committees. We agree with the district court.

FN3. Both Janssen and MPRA accepted the premise that the full MPRA board was not independent enough to merit judicial deference as a decision maker, and made no arguments about deferring to the decision of the board of directors to accept Murnane's report. Thus, we are focusing on whether Murnane's decision is entitled to deference.

[11][12][13][14] Special litigation committees are made up of disinterested board members or individuals appointed by the board who are charged with informing themselves fully on the issues underlying the derivative suit and deciding whether pursuit of litigation is in the best interests of the corporation. *See, e.g., Houle v. Low,* 407 Mass. 810, 556 N.E.2d 51, 53 (1990); *Drilling v. Berman,* 589 N.W.2d 503, 505-07 (Minn.App.1999); *PSE & G,* 801 A.2d at 303. The key element is that the board delegates to a committee of disinterested persons the board's power to control the litigation. Block, *supra,* at 1689. A mere advisory role of the special litigation committee fails to bestow a sufficient legitimacy to warrant deference to the committee's decision by the court. If the board properly delegates its authority to act to the special litigation committee, the court will extend deference to the committee's decision under the business judgment rule. *See Drilling,* 589 N.W.2d at 510; *Skoglund v. Brady,* 541 N.W.2d 17, 22 (Minn.App.1995); *Black v. NuAire, Inc.,* 426 N.W.2d 203, 211 (Minn.App.1988).

C. Minnesota Nonprofit Corporations Act

We look to the Nonprofit Act to determine whether MPRA had statutory authority to appoint its special litigation committee. The relevant part of the statute reads:

> A resolution approved by the affirmative vote of a majority of the board may establish committees having the authority of the board in the management of the business of the corporation to the extent provided in the resolution. Committees are subject at all times to the direction and control of the board.

Minn.Stat. § 317A.241, subd. 1 (2002).

The first inquiry in statutory interpretation is whether the law is ambiguous. *See* Minn.Stat. § 645.16 (2002). If the words are clear and unambiguous, "the letter of the law shall not be disregarded under the pretext of pursuing the spirit." *Id.* MPRA argues the statute unambiguously allows nonprofit boards to create independent committees. It maintains that the statute does not limit the types of committees that nonprofits can create in any way, thereby making litigation committees acceptable. In addition, MPRA posits that the phrase "subject at all times to the direction and control of the board" does not strip the committees of the independence necessary for the protection of the business judgment rule. Instead, it argues that "subject * * * *885 to" simply indicates a "possibility of control," not a necessity of constant control.

Janssen also argues that the statute is unambiguous but urges a contrary meaning: a committee that must be "subject to" the "control" of the board cannot be sufficiently independent from the board to deserve the protection of the business judgment rule. Janssen also points to subdivision 5 of the statute, noting that a director cannot fulfill his or her standard of conduct by delegating authority to the board, as an indication that nonprofit directors have to retain control over all board committees.

The language in subdivision 1 indicating that committees must be subject to the board's control and direction could reasonably be interpreted to mean either that the board must control every move of the committees, or simply that the board has a duty to oversee the work of the committees. The former interpretation would make true independence impossible, while the latter interpretation is flexible enough to allow for independent committees. As both parties' interpretations are plausible, we conclude the statute is not clear and free from all ambiguity.

If the words of a statute are not explicit, we interpret the statute's meaning by considering the intent of the legislature in drafting the law. Minn.Stat. § 645.16 (2002). There are three overarching considerations we consider in discerning legislative intent in this case: the context of the 1989 revision of the Nonprofit Act, contemporaneous legislative history, and consequences of a particular interpretation. *Id.* We will address each of these in turn. In addition, we presume that the legislature did not intend an absurd result or to violate the Constitution, and that it intended the entire statute to have effect and favor the public interest. Minn.Stat. § 645.17 (2002).

The 1989 revision of the Nonprofit Act was carried out eight years after the legislature enacted a wholesale revision of the Minnesota Business Corporation Act (Business Act), Minn.Stat. ch. 302A (2002), in 1981. *See* Minnesota Business Corporation Act of 1981, ch. 270, §§ 1-125, 1981 Minn. Laws 1141-1222. Shortly after the revised Business Act was adopted, the Minnesota State Bar Association organized a group to study the counterpart statute for nonprofits, and found it was outdated and unworkable, with many ambiguities. Hearing on H.F. 1203, H. Subcomm. Civil Law, 76th Minn. Leg., April 24, 1989 (audio tape) (comments of Kathleen Pontius). The act had not been revised since 1951, when the archetypal nonprofit in legislators' minds was a social club like the Jaycees or Rotary. Hearing on H.F. 1203, H. Subcomm. Civil Law, 76th Minn. Leg., April 24, 1989 (audio tape) (comments of Patrick Plunkett, president of Ramsey County Bar Ass'n). This original conception made the statute a poor fit for the growing number and variety of nonprofit organizations, and for the lawyers who served them. *Id.* A legislative committee drafted a new statute governing nonprofits, with three major sources: the Business Act, the ABA's Revised Model Nonprofit Act, and Minnesota's old nonprofit act. Hearing on H.F. 1203, H. Subcomm. Civil Law, 76th Minn. Leg., April 24, 1989 (audio tape) (comments of Rep. Thomas Pugh, bill's sponsor).

Minnesota Statutes § 317.241 was passed in the context of a wholesale revision of the Nonprofit Act. The legislature did not pass the statute to specifically address the committee structure of nonprofits *886 or their ability to control derivative suits. We conclude that the legislature's purpose in revising the Minnesota Nonprofit Corporations Act in 1989 had nothing to do with special litigation committees, and sheds little light on our inquiry.

We next examine the contemporaneous legislative history to determine legislative intent. In reaching its decision that the legislature did not intend to empower nonprofit boards to create special litigation committees, the court of appeals emphasized the difference between the Business Act and the Nonprofit Act on this subject. The Business Act specifically says a board of directors may establish special litigation committees of one or more directors "to consider legal rights or remedies of the corporation and whether those rights and remedies should be pursued. Committees *other than special litigation committees* * * * are subject at all times to the direction and control of the board." Minn.Stat. § 302A.241, subd. 1 (2002) (emphasis added). The court of appeals was concerned that not only does the Nonprofit Act lack a specific provision for special litigation committees, it also does not exempt any committees from board control.

The comparison between the Business Act and the Nonprofit Act does not illuminate as much legislative intent as the court of appeals derived, however. The Nonprofit Act was passed eight years after the Business Act, making any attempt to infer meaning from a comparison between the two less convincing. A careful review of the available legislative history produced no discernible indication why the special litigation committee language was dropped. The absence of the special litigation language in the nonprofit statute could mean several things, including that the drafters did not think derivative suits were an issue for nonprofits and therefore did not address litigation committees in the Nonprofit Act.

[15] Given that little legislative intent concerning section 317A.241 can be inferred from either the purpose of the 1989 revision of the Nonprofit Act or the comparison with the Business Act, we are left with one remaining consideration in discerning legislative intent under Minn.Stat. § 645.16: the consequences of a particular interpretation. On this point it becomes clear that the district court reached the correct result. The district court noted that if nonprofit corporate boards are unable to establish independent committees whose informed business judgments merit deference from the courts, the judiciary would be forced to review the merits of every lawsuit brought by a member of a nonprofit corporation. Reviewing all derivative suits for nonprofit corporations would intrude on the authority of nonprofit boards, significantly tax our court system's limited resources, and require judges to step significantly beyond their expertise. The district court concluded that "[s]uch a procedure--totally removing from the board of directors any control over litigation brought on behalf of the organization the board is supposed to govern--is clearly untenable." We agree. We see no reason to assume that the courts are better equipped to make business judgments about the merits of a lawsuit brought by a member of a nonprofit corporation than is a properly functioning board of directors whose duty it is to govern and promote the nonprofit corporation's best interests.

There are no characteristics of nonprofits that justify treating nonprofit and for-profit corporations differently in terms of their ability to delegate board authority to independent committees to review the *887 merits of derivative suits. There are nonprofits, like MPRA, that function very much like for-profit corporations and would benefit from the ability to weed out nuisance suits. In addition to pension funds, these nonprofits may include hospitals, schools, and homeowners associations. [FN4] We are not alone in reaching this conclusion; two other states have used the business judgment rule when reviewing decisions by nonprofit litigation committees: *Finley v. Superior Court,* 80 Cal.App.4th 1152, 96 Cal.Rptr.2d 128, 132 (2000); *Miller v. Bargaheiser,* 70 Ohio App.3d 702, 591 N.E.2d 1339, 1343 (1990).

FN4. *See* Peter Frumkin & Alice Andre-Clark, *Nonprofit Compensation and the Market,* 21 U. Haw. L.Rev. 425, 427 (1999) (describing a lawsuit by a trustee of an educational organization against another trustee); *Miller v. Bargaheiser,* 70 Ohio App.3d 702, 591 N.E.2d 1339, 1341 (1990) (involving a derivative suit on behalf of a nonprofit hospital); *Dockside Ass'n,* 352 S.E.2d at 714 (involving a suit against a property association).

Refusing nonprofit corporations the ability to create special litigation committees is counter to our common law tradition as well. While statutes govern certain aspects of corporate life, including the initial incorporation, corporate litigation has been largely a creature of the common law. Derivative suits developed during the nineteenth century as an equitable means of protecting corporations and minority shareholders from fraudulent directors. Block, *supra,* at 1380. The first judicial opinions to apply the business judgment rule to the decision of a special litigation committee did not rely on statutory authority, but rather relied upon case law to determine whether a committee could terminate a shareholder lawsuit. Block, *supra,* at 1690-93.

[16][17] A nonprofit corporation's power to appoint a special litigation committee, in the absence of a statutory prohibition, may also spring from the existence of corporate "incidental" powers to carry out corporate purposes. *Aiple v. Twin City Barge & Towing Co.,* 274 Minn. 38, 45, 143 N.W.2d 374, 378 (1966) (identifying corporate powers as being limited to "those actions expressly authorized by statute and such as are incidental thereto and necessary to carry them into effect"). It is now universally accepted in corporate jurisprudence that corporations have the ability to exercise incidental or necessary powers:

> Formerly, corporations were viewed as possessing only such powers as were specifically granted to them by the state. This grant of powers was found in the certificate of incorporation * * * or in the special statute granting a charter to the corporation.

> * * * *
>
> Today, in all the states, a corporation is deemed to possess all the powers of a natural person except those powers which are specifically forbidden to such corporations by the law. The old concept of a corporation as a bundle of only a few, specifically granted powers, has been replaced by the concept of a corporation as an artificial person, lacking only those powers which the law specifically denies to it.

Howard L. Oleck, *Non-Profit Corporations, Organizations, & Associations* § 168 (6th ed.1994); *see also* 13 William Meade Fletcher, et al., *Fletcher's Cyclopedia of the Law of Private Corporations* § 5963 (perm.ed., rev.vol.1984).

The untenable consequence of concluding the Nonprofit Act prohibits litigation *888 committees, in combination with the common law tradition favoring corporate control of derivative actions, leads us to conclude that nonprofit corporations have the power to create committees that are sufficiently independent to merit judicial deference. We hold the Minnesota Nonprofit Corporations Act does not prohibit corporations from appointing independent committees with the authority to decide whether the corporation should join a member's derivative suit.

II.

Having determined that nonprofit corporations have the power to create special litigation committees, the question remains whether Murnane deserved the deference of the business judgment rule. The court of appeals concluded that Murnane, as a special litigation committee, failed to meet the threshold test of independence and good faith, and ordered the lawsuit to proceed. We agree and affirm.

[18] All the state variations upon the business judgment rule as applied to committees reviewing litigation have two common elements. At a minimum, the board must establish that the committee acted in good faith and was sufficiently independent from the board of directors to dispassionately review the derivative lawsuit. *See, e.g., Grimes v. Donald,* 673 A.2d 1207, 1219 (Del.1996); *Houle,* 556 N.E.2d at 59; *PSE & G,* 801 A.2d at 312; *Auerbach,* 419 N.Y.S.2d 920, 393 N.E.2d at 1000. A key factor in evaluating independence is whether the board delegates to a committee of disinterested persons the board's power to control the litigation. Block, *supra,* at 1689. A mere advisory role of the special litigation committee fails to bestow a sufficient legitimacy to warrant deference to the committee's decision by a court. Thus, we consider whether Murnane conducted his

investigation with sufficient independence and good faith to deserve the deference of the business judgment rule. If not, the committee does not receive the court's deference and the derivative suit proceeds.

[19] In reviewing Murnane's first report, we conclude that the board failed to establish the independence and good faith of Murnane's investigation. [FN5] We agree with the district court's determination that Murnane lacked independence because the MPRA's initial resolution restricted his factual investigation. Murnane was told to rely on facts developed by law firms that had been hired to represent MPRA in lawsuits about other legal issues. Additionally, Murnane's independence is suspect because his conduct suggests that he saw his role in conformance with his title: special counsel. Murnane did not talk to Janssen or their attorneys in investigating the suit and gave a conclusion that sounds like legal advice. That behavior belies MPRA's attempt to portray Murnane as a special litigation committee; instead MPRA hired Murnane to serve as its special counsel and he acted more like a legal advisor than a neutral decision maker.

FN5. We do not adopt a particular version of the business judgment rule for use with Minnesota nonprofit organizations today. Because we hold that Murnane's investigation failed the most minimal version of a business judgment rule, requiring that a litigation committee act in good faith, with independence, we need not reach the question of whether a more exacting standard of judicial review may be appropriate for nonprofit corporations than in the case of for-profit corporations. The members of nonprofits are not akin to diversified shareholders--any risk sustained by them cannot necessarily be spread among their other investments. Nor can they necessarily protect themselves by taking their assets elsewhere.

*889 In addition, we conclude that Murnane did not engage in a good faith attempt to deduce the best interest of MPRA with respect to the litigation against Best & Flanagan. Murnane never interviewed Janssen or their attorneys, a fundamental task in reaching an informed decision about the merits of their complaints. Murnane also gave no indication that he had undertaken the careful consideration of all the germane benefits and detriments to MPRA that is indicative of a good faith business decision. Murnane opined that "the totality of the materials reviewed does not support a finding that Best & Flanagan committed legal malpractice in its handling of the MPRA affairs," and that "to spend money in the pursuit of a legal malpractice claim against Best & Flanagan would not be prudent use of the MPRA funds." The language of his conclusion hints that his decision was that of a special counsel evaluating the likelihood of a legal victory. But a much more comprehensive weighing and balancing of factors is expected in situations like this, taking into consideration how joining or quashing the lawsuit could affect MPRA's economic health, relations between the board of directors and members, MPRA's public relations, and other factors common to reasoned business decisions. *See Auerbach,* 419 N.Y.S.2d 920, 393 N.E.2d at 1002. We conclude that Murnane's initial investigation of the derivative action instituted by Janssen against Best & Flanagan lacked the independence and good faith necessary to merit deference from this court.

[20][21] Implicitly acknowledging the failures in its first resolution and investigation, the MPRA board urges us to consider the second resolution and improved investigation. [FN6] We decline to do so. Generally, when the committee authorized with making a business decision for the corporation is found to lack the independence needed to grant summary judgment, or where the independence is uncertain, the derivative suit proceeds on its merits. *See, e.g., Hasan v. CleveTrust Realty Investors,* 729 F.2d 372, 380 (6th Cir.1984); *Will v. Engebretson & Co., Inc.,* 213 Cal.App.3d 1033, 1043-45, 261 Cal.Rptr. 868 (1989); *Lewis v. Fuqua,* 502 A.2d 962, 972 (Del.Ch.1985); *Davidowitz v. Edelman,* 153 Misc.2d 853, 858, 583 N.Y.S.2d 340 (Sup.Ct.1992). *See also Houle,* 556 N.E.2d at 58-60 (reversing summary judgment in favor of defendant board of directors and remanding for an evidentiary hearing before a judge regarding a committee member's independence, and noting that "[u]nless the defendant sustains its burden of proof as to both of those questions, the case should proceed to trial."). The *Auerbach* court was blunt in its assessment of the consequences when proof of an investigation shows that the investigation is too restricted in scope or so shallow in execution as to constitute a pretext; such proof "would raise questions of good faith * * * which would *never* be shielded by that doctrine." *Auerbach,* 419 N.Y.S.2d 920, 393 N.E.2d at 1003 (emphasis added).

The practice of allowing derivative suits to proceed to trial if a corporate board's initial attempt at a business decision fails the minimal requirements for judicial deference *890 is supported by the principles underlying the application of the business judgment doctrine. We strike a balance between allowing corporations to control their own destiny and permitting meritorious suits by shareholders and members by limiting a board of directors to one opportunity to exercise its business judgment. *See, e.g., Kaplan v. Wyatt,* 484 A.2d 501, 508 (Del.Ch.1984) (explaining that if the court determines the litigation committee failed the minimal review of the business judgment rule, the "court shall deny the motion for such reason and need go no farther, the result being that the shareholder plaintiff may resume immediate control of the litigation"). If the courts allow corporate boards to continually improve their investigation to bolster their business decision, the rights of shareholders and members will be effectively nullified. We conclude that the district court erred in deferring MPRA's motion to dismiss and permitting the board to remedy defects in its first grant of authority to Murnane. We further conclude that Murnane failed to conduct his initial investigation with sufficient independence and good faith to deserve the deference of the business judgment rule and, therefore, hold that the district court erred when it granted MPRA's motion to dismiss the suit against Best & Flanagan.

Affirmed.

Eskel JOHNSON et al., objectors Appellants,
v.
Matter of the VOLUNTARY DISSOLUTION OF SOUL WINNERS MISSION SCHOOL, INC., Formerly Children's Mission School, Inc., and G. W. Busse, Petitioners, Respondents,
Gordon A. Johnson, as Receiver.

254 Minn. 317 (1959.)

MAGNEY, Commissioner.

In a proceeding involving the voluntary dissolution of a nonprofit religious corporation, objectors appeal from an order appointing a liquidating receiver and requiring objectors to vacate the premises owned by the corporation.

*318 The corporation was organized in 1947 under the name of Children's Mission School, Inc. On October 5, 1955, the articles of incorporation were amended and the name of the corporation was changed to Soul Winners Mission School, Inc. Objectors question the legality of this and other amendments adopted at the same time.

[1] The corporation operated a school for children under a license issued by the State of Minnesota. A renewal of the license was refused, and for approximately 2 years prior to the filing of the petition for dissolution it had no children at its school or under its care. The corporation was therefore unable to function as authorized by tis articles of incorporation. Furthermore, dissension of a bitter nature developed among its members. The unpleasant facts need not be recited. Dissolution is the only answer. We agree fully with the trial court when it observed: 'The entire history of this controversy indicates that dissolution is the only logical solution.'

At the time of the filing of the petition for dissolution the corporation was the owner of real estate in Dakota County valued at $25,000, and its personal property and contingent assets were valued at $700. The liabilities were listed at $2,718.

[2] 1. At a meeting of the board of directors on October 4, 1954, proposed amendments to the articles of incorporation, such as change of name, membership qualifications, and disposition of property on dissolution, were unanimously passed. At a special meeting on October 18, 1954, the board unanimously agreed that the submission of the proposed amendments be postponed until the annual meeting in 1955. Notices as to the 1955 meeting and the proposed amendments were sent out by the secretary. In the afternoon of October 1, 1955, preceding the meeting, the board

unanimously voted not to propose the amendments as a board, but one of the members reserved the right to do so at the meeting. This was done.

M.S.A. s 317.27, subd. 2(1) provides:

'* * * the board of directors shall propose the amendment to the articles * * *.'

And subd. 2(2) states:

'If notice required by clause (1) has been given, the proposed *319 amendment may be adopted at any meeting of the members.'

As stated, the amendments were proposed at the meeting of the board on October 4, 1954. The required notice had been given. The meeting was held. The amendments were unanimously adopted, as proposed or as amended. The objectors voted for the amendments. The most strenuous objection now centers on the amendment which changed the name. This was unanimously adopted without change. All the statutory requirements were fulfilled, so the amendments must be considered legally adopted. As the question before **6 us concerns the validity of the dissolution proceedings, the question of the validity or invalidity of the amendment to the articles of incorporation, so strenuously argued by objectors, may be of little or no importance.

[3] 2. On July 1, 1957, the board of directors unanimously adopted a resolution recommending the institution of voluntary proceedings for dissolution of the corporation. A notice of a meeting to be held on July 29, 1957, for the purpose of receiving and acting upon the recommendation was mailed to all persons who, according to the records of the corporation, were members in 1955, 1956, and 1957. At the meeting so held on that date, a unanimous vote recommending dissolution was recorded. The provisions of s 317.46, subd. 2, which sets out the procedure for dissolution, were fully complied with. The statute reads as follows:

'Where there are members with voting rights, application to the district court may be made only after approval by the directors and members of a resolution recommending the institution of voluntary proceedings for dissolution of the corporation. Such resolution shall be submitted, after approval by the directors, to the members with voting rights at an annual, a regular, or a special meeting of which special notice has been given. * * *'

After the board and the members had unanimously recommended the institution of voluntary proceedings for dissolution, proceedings were properly instituted by the filing of a petition dated July 30, 1957, signed 'Soul Winners Mission School, Inc., formerly Children's Mission School, Inc.,' by its proper officers. An order to show cause was issued. Notices of hearing were given as directed by the court and *320 hearings held, all in strict compliance with ss 317.46, 317.50, and 317.53. The order appealed from resulted. Since this order simply appointed a liquidating receiver with directions and required objectors to vacate the premises owned by the corporation; since more than sufficient basis for dissolution exists; and since no irregularity can be found in the proceedings, it is obvious that the order appealed from must be affirmed.

Order affirmed.

MINNESOTA BAPTIST CONVENTION, v. PILLSBURY ACADEMY.

246 Minn. 46 (1955)

DELL, Chief Justice.

This is an appeal from a judgment entered in the District Court of Hennepin County in a declaratory judgment action.

Minnesota Central University, under the patronage of the Minnesota Baptist Association, was incorporated by the Minnesota territorial legislative assembly in 1854. L.1854, c. 36. The act provided that the university should be located on the west side of the Mississippi River between the mouth of the Rum River and Lake Pepin. In 1857 the university located at Hastings where it operated until, because of economic conditions, it lost its real estate under foreclosure in 1861. The 1854 act specifically named and designated some of the trustees of the university and provided that all others should be elected by the Minnesota Baptist Association. The act was amended in 1867 so as to make the board of trustees self perpetuating. L.1867, c. 9. From 1867 to 1878 the university conducted no classes but the trustees elected their successors each year through 1877.

In 1878, under Sp.L.1878, c. 69, and in the form of an amendment to the 1854 act, there was established in the city of Owatonna an institution of learning under the name of Minnesota Academy. Eighteen persons were named and designated as trustees in the act itself and the act provided that they and their successors were created as a body politic and corporate to be styled the Trustees of Minnesota Academy and to remain in perpetual succession. It further provided that vacancies by resignation or otherwise should *48 be filled by the board. The trustees were authorized to change the name of the academy whenever authorized to do so by the Baptist State Convention of Minnesota. This corporation took over the assets of Minnesota Central University and erected a building at Owatonna where it has since been established as an academy conducting classes in secondary education. From 1878 to 1887 inclusive the trustees of the academy perpetuated themselves by electing their own successors to fill vacancies caused by expiration of terms or otherwise.

In 1887, under the provisions of the 1878 act, with the consent of the Minnesota Baptist State Convention, the name of Minnesota Academy was changed to Pillsbury Academy in honor of George A. Pillsbury who had been a benefactor of the academy. The change was confirmed by Sp.L.1887, c. 330. Since then the corporation has been known by that name.

In 1887 the legislature, by Sp.L.1887, c. 89, amended s 8 of the 1854 act as amended by Sp.L.1878, c. 69, s 6, by striking from it the following: 'Vacancies by resignation or otherwise shall be filled by the board' and amended s 10 of the 1854 act so as to read as follows:

> 'Section 10. This institution shall forever be under the patronage of the Minnesota Baptist State Convention, which convention shall, at its annual meeting, fill all vacancies in the board of trustees caused by the expiration of the term of office of any of said board, or by death, resignation, removal from the state or otherwise, and shall have power to remove any trustee from said board. Said convention shall also, at said annual meeting, elect three (3) suitable persons who shall be known **289 as a board of visitors to said academy, whose duty it shall be to attend the examination of students, look after the condition of the institution and report to the next annual meeting of the Minnesota Baptist State Convention.'[FN1]

FN1. By an amendment to its articles filed with the secretary of state on March 9, 1920, the name of Minnesota Baptist State Convention was changed to Minnesota Baptist Convention.

*49 The legislature, by Sp.L.1889, c. 133, confirmed the rights and powers granted under Sp.L.1887, c. 89.

From 1887 until 1952, a period of 65 years, the Minnesota Baptist Convention each year elected the trustees of the academy, the persons so elected having been recommended to the convention by the trustees of the academy. There were three exceptions, one in 1935 and another in 1936. It is not clear from the record as to how the vacancies were filled in those two years. The third exception occurred in 1945 due to the fact that no convention was held in that year.

Differences of opinion arose between various groups within the Baptist denomination which need not be set forth here. However, as a result of those differences, in the year 1952 the Minnesota Baptist Convention ignored the recommendations of the trustees of the academy and elected five persons as trustees of its own independent selection.

On June 10, 1953, five members of the board of trustees of the academy, purporting to act under the Minnesota Nonprofit Corporation Act, M.S.A. s 317.01 et seq., requested the president to call a special meeting of the trustees to consider a resolution amending the articles of the corporation so as to confirm the 18 persons then constituting the board as members of the trustees of Pillsbury Academy; to empower them to elect their successors and to appoint and employ all officers, teachers, and agents for the institution; to confirm the patronage of the Minnesota Baptist Convention permitting it to elect three persons as a board of visitors to attend the examination of students, look after the condition of the institution, and to report to the next annual meeting of the convention. On June 11 notice of such meeting was given by the president.

On June 24 plaintiff, Minnesota Baptist Convention, commenced this action and obtained an order to show cause returnable June 26 as to way a temporary injunction, preventing the holding of the special meeting, should not be issued. Upon the hearing of the motion, plaintiff's application for a temporary injunction was denied.

On July 13 the special meeting of the trustees was held and the amendments embodied in the resolution were purportedly adopted. *50 The purported articles of amendment were filed in the office of the secretary of state on July 17. The trustees of Pillsbury Academy held their annual meeting at Owatonna on July 29. At that meeting eight trustees were purportedly elected by them. The Minnesota Baptist Convention held its annual convention during August 1953 at which time it passed resolutions purporting to reject the provisions of the Minnesota Nonprofit Corporation Act and to disaffirm the election of trustees chosen by the trustees of the academy. The convention also purported to elect eight trustees of its own selection to act as the trustees of the academy. Thereafter the eight so purportedly elected by the convention were by stipulation joined as additional parties defendant and amended and supplemental complaints were served and issue joined. The purpose of the action in its final form was to obtain a declaratory judgment as to the status of the respective parties and the validity or invalidity of the proceedings taken by them.

Upon the trial the plaintiff prevailed and a declaratory judgment was entered substantially in accordance with its contentions. The real controversy between the parties concerns the management and control of the academy and who are its lawful **290 trustees. The answer to the problem as we see it, depends primarily upon the constitutionality of Sp.L.1887, c. 89, and Sp.L.1889, c. 133.

1. Defendants-appellants claim that Sp.L.1887, c. 89, and Sp.L.1889, c. 133, are unconstitutional. These special laws took from the trustees of Pillsbury Academy and placed in the Minnesota Baptist State Convention the right to elect the members of

the board of trustees of the academy.

**294 2. The next question for consideration is the validity of the amendment to the articles of incorporation of the academy purportedly adopted by the trustees on July 13, 1953. This amendment, among other things, provided that the 18 trustees then in office should continue to hold office until their successors were elected and qualified; that the trustees from time to time in office were to constitute the members of the corporation; that at the annual meeting of the corporation to be held in July of each year the members (the then trustees) should elect by majority vote the trustees to take the place of those whose terms expired in that year; and that the trustees should have the power to fill for the unexpired terms vacancies caused by the death, resignation, or otherwise, among them. The effect of this amendment, if valid, was to take from the Minnesota Baptist Convention the right given to it by Sp.L.1887, c. 89, and Sp.L.1889, c. 133, to, at its annual meetings, fill all vacancies in the board of trustees caused by the expiration of the term of office of any of said board, or by death, resignation, or otherwise. In attempting to adopt this amendment the trustees of the academy *58 purported to act under the Minnesota Nonprofit Corporation Act, M.S.A. c. 317, L.1951, c. 550.

In their brief defendants-appellants state 'If, as we believe we have demonstrated, the Special Acts of 1887 and 1889 are unconstitutional, it would seem to follow that the provisions of the Minnesota Non-Profit Corporation Act are applicable and proceedings had thereunder by defendant the Trustees of Pillsbury Academy are effective to amend its articles and to confirm and to assure the right of self-perpetuation given the trustees by the 1878 Act.' Most of defendants-appellants' brief, in support of the validity of the July 13, 1953, amendment is devoted to this contention. Since we hold that the special acts of 1887 and 1889 are constitutional, this phase of defendants-appellants' argument requires no discussion.

Defendants-appellants also contend--although the point is not extensively argued in their brief, nor was it upon the oral argument--that, even if the special laws of 1887 and 1889 are constitutional, still the privilege granted to the Minnesota Baptist Convention to elect the trustees of the academy and to fill all vacancies in the board of trustees is a grant to an 'outsider' and hence cannot be a 'membership right' within the meaning of the Minnesota Nonprofit Corporation Act and that accordingly the amendment is, nevertheless, valid. We shall address ourselves to this contention.

At the outset, as a background against

which the provisions of the Minnesota Nonprofit Corporation Act should be viewed, we consider the comments of the committee which drafted the act. These comments are printed as an introduction to the act in 20 M.S.A. Cumulative Annual Pocket Part, preceding section 317.02. In part they read as follows:

'* * * Recognizing inherent differences between profit and non-profit corporations, great liberality is allowed for the organizational and internal operational activities of non-profit corporations.'

In adopting the purported amendment the trustees attempted to act pursuant to the provisions of M.S.A. s 317.27 of the Minnesota Nonprofit Corporation Act. The provisions of that section pertinent here are as follows:

*59 'Subdivision 1. A domestic corporation may amend its articles in the manner prescribed by this section to include or omit any provisions which it could lawfully include or omit from the original articles at the time the amendment is made, or to extend its duration for a further definite time or perpetually. * * *

'Subd. 2. (1) Where there are members with voting rights, the board of directors shall propose the amendment to the articles by resolution setting forth the proposed amendment and directing that it be submitted for adoption at a meeting of the members. **295 Notice of the meeting of members, stating the purpose, shall be given to each member entitled to vote on the proposed amendment, and to each officer and director regardless of his voting rights.

'(2) If notice required by clause (1) has been given, the proposed amendment may be adopted at any meeting of the members.

'Subd. 4. Where there are no members with voting rights, the amendment shall be adopted at a meeting of the board of directors upon receiving a two-thirds vote, unless the articles or by laws require a greater vote, of the directors who are present at the meeting and entitled to vote on the proposed amendment. Notice of the meeting and of the proposed amendment shall be given.'

M.S.A. s 317.27 applies to all 'domestic corporations' whether they elect to come under its provisions or not. The right to reject accorded to corporations in existence at the time of the passage of the act applies only to the first 25 sections of the act.[FN8]

FN8. M.S.A. s 317.04. 'Subdivision 1. (1) Except as provided in section 317.06, and subject to clause (2), this chapter applies to all domestic corporations.

'(2) Sections 317.01 to 317.25 do not apply to a domestic corporation in existence on April 23, 1953. Every such domestic corporation may accept and come under sections

> 317.01 to 317.25 by complying with subdivision 3; and, unless it has signified its election to reject these sections in the manner provided in subdivision 2 within 15 months from April 23, 1953, it shall be deemed to accept and come under them.'

The definitions applicable to and governing the act are contained in M.S.A. s 317.02. The provisions pertinent here read:

*60 'Subdivision 1. For the purposes of this chapter, unless the context otherwise requires, the terms defined in this section shall have the meanings ascribed to them.

'Subd. 3. 'Domestic corporation' means a nonprofit corporation formed under the laws of this state, whether or not formed or coming under this chapter, for a purpose for which a corporation may be formed under this chapter.

'Subd. 5. 'Nonprofit corporation' means a corporation (a) formed for a purpose not involving pecuniary gain to its shareholders or members and (b) paying no dividends or other pecuniary remuneration, directly or indirectly, to its shareholders or members as such.

'Subd. 6. 'Notice' means a written notification of a meeting (a) stating time, place and, in the case of a special meeting, purpose, (b) properly addressed according to the last available corporate records, (c) sent or delivered by a duly authorized person to each director or member entitled to vote at the meeting, * * *.

'Subd. 9. 'Directors' means the persons vested with the general management of the affairs of the corporation, regardless of how they are designated.

'Subd. 11. 'Member' means an entity, either corporate or natural, having any membership or shareholder rights in a corporation in accordance with its articles, bylaws, or both.'

[5][6][7] Defendants-appellants contend that the trustees are the only 'members with voting rights' and that, therefore, under the provisions of s 317.27, subd. 2, they were entitled to amend the articles so as to empower the trustees of the academy **296 with the right to choose their successors. With this contention we cannot agree. As previously pointed out, M.S.A. s 317.02, subd. 11, defines member as meaning an Entity, either corporate or natural, having Any membership or shareholder Rights in a corporation in accordance with its articles, bylaws, or both. Certainly the right to elect the trustees, *61 who control and manage the affairs of the corporation, comes within the purview of this definition. It is doubtful if any membership or shareholder right is any more important than the right to vote for the election of the directors or trustees of a corporation who carry on and conduct the business of the corporation, elect or appoint its officers and agents, and in a large measure, determine the manner in which the

corporation operates. Under the liberal policy to be afforded in the operational activities of nonprofit corporations, it is not necessary that the Entity meet every recognized requirement or qualification of a member or shareholder. M.S.A. s 317.02, subd. 11, as we construe it, merely requires that the 'entity,' either corporate or natural, have some or 'any' of the 'rights' usually possessed and exercised by such a class. Under this construction it follows that the purported amendment of July 13, 1953, is ineffective and void because of the failure of the trustees to submit the resolution to the Minnesota Baptist Convention for its approval as required by M.S.A. s 317.27, subd. 2.

It would be an anomalous situation if the trustees, who were elected by the Minnesota Baptist Convention under the special acts of 1887 and 1889, which acts we hold constitutional, could defeat the rights of the very body that elected them to their positions by now asserting, after being elected under those acts, that that body no longer has Any membership or shareholder Rights under the acts sufficient to entitle it to vote upon a resolution divesting it from the authority granted to it by said acts. Without a clear indication of such legislative intention or policy such procedure should not be allowed or sanctioned.

We conclude that, even if the academy is controlled and governed by the first 25 sections of the Minnesota Nonprofit Corporation Act by virtue of the failure of the corporation to reject the same within the time prescribed by the act, which need not be determined, rather than by M.S.A. s 300.026, L.1951, c. 656, as plaintiff contends, the attempted amendment was a nullity and that the Minnesota Baptist Convention continues to have the sole and exclusive rights to elect the trustees of Pillsbury Academy.

[8] *62 Since this disposes of the case we need not consider or pass upon the various other contentions presented by the parties in their briefs, nor do we pass upon the constitutionality of M.S.A. s 300.026. Under well-settled rules the court refrains from deciding, where it is unnecessary to do so, constitutional and other legal questions. State v. One Oldsmobile Two-Door Sedan, 227 Minn. 280, 35 N.W.2d 525. For the same reason we refrain from passing upon paragraphs 4 and 8 of the judgment since the matters referred to therein, in view of the decision we have reached, are no longer of importance here.

Affirmed.

John R. JENSEN, Appellant,
v.
DULUTH AREA YMCA, a Minnesota non-profit corporation, Respondent.

688 N.W.2d 574 (2004)

KLAPHAKE, Judge.

Appellant John R. Jensen filed suit against respondent Duluth Area YMCA (the YMCA) for terminating his membership in violation of the Minnesota Nonprofit Corporation Act (the act). The district court granted summary judgment to the YMCA. Jensen challenges the dismissal of his claim under the act and his breach of contract claim. Because Jensen failed to follow the requirements necessary to bring a cause of action under Minn.Stat. § 317A.467 (2000), and because Jensen failed to establish damages to support a breach of contract claim, we affirm.

FACTS

On October 2, 2001, Jensen was running on the track at the YMCA in an attempt to finish 32 laps (two miles) in 20 minutes. Jensen was preparing to take his military physical training test for his position in the National Guard. During his second mile, a group of children came out onto the track and "essentially enveloped" Jensen. Jensen allegedly yelled at the children "get out of the way or I'll run you over."

The next two times Jensen came around the track, he found himself surrounded by children again. Unable to avoid contact, Jensen bumped into some children on the track. Jensen allegedly struck one child on the behind and pushed others out of the way.

The Executive Director of the YMCA, Jeffrey H. Palmer, notified the Board Executive Committee that he was inquiring into the incident and that he would make a decision regarding whether to terminate a member. Palmer interviewed the adults who were in the area during the altercation. He also consulted the incident reports from Jensen, the aquatics director, the swim coaches, and the gymnastics coach who were all present. After hearing Jensen's version of the incident, Palmer terminated Jensen's YMCA membership.

Jensen thereafter sued the YMCA. Following discovery, the YMCA moved for summary judgment. The district court granted summary judgment on four of Jensen's five claims; the parties agreed to dismiss the remaining claim, which alleged defamation. On appeal, Jensen only challenges the dismissal of his claim under the act and his breach of contract claim.

ISSUES

1. Did the district court err in granting summary judgment on the claim alleging a violation of the Minnesota Nonprofit Corporation Act?

2. Did the district court err in granting summary judgment on the breach of contract claim?

ANALYSIS

[1][2] On appeal from summary judgment, this court asks whether there are any genuine issues of material fact and whether the district court erred in applying the law. *State by Cooper v. French,* 460 N.W.2d 2, 4 (Minn.1990). "A motion for summary judgment shall be granted when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue of material fact and that either party is entitled to a judgment as a matter of law." *Fabio v. Bellomo,* 504 N.W.2d 758, 761 (Minn.1993).

I.

[3] Jensen argues that the district court erred in granting summary judgment *577 to the YMCA on his claim under the Minnesota Nonprofit Corporation Act (the act). Jensen argues that the YMCA violated Minn.Stat. § 317A.411 (2000), which provides that a membership may not be terminated "except pursuant to a procedure that is fair and reasonable and is carried out in good faith." *Id.,* subd. 1. The statute further provides that a procedure is fair and reasonable if it provides "not less than 15 days' prior notice" of the termination and the reason for it, and "an opportunity for the member to be heard ... not less than five days before the effective date of the ... termination." *Id.,* subd. 2(1), (2). [FN1]

FN1. We note that the YMCA's bylaws also set out a procedure for termination of a membership based on activities inimical to the best interests of the YMCA. Those bylaws only require a member to be given "10 days' notice in writing of the grounds for such termination, and [the member] shall be afforded a reasonable opportunity to be heard."

The following facts are undisputed: (1) Jensen's YMCA membership was terminated after the October 2, 2001 incident; (2) a meeting between Jensen and Palmer took place on October 3, 2001 regarding the incident and Jensen's continued membership at the YMCA; (3) Jensen received a termination letter dated October 3, 2001; and (4) the letter was accompanied by payment for Jensen's unused portion of his membership.

Minn.Stat. § 317A.467

The YMCA contends that even if it failed to follow the procedures for terminating a membership, which it does not concede, Jensen did not meet the requirements to bring a cause of action under the act. Specifically, the YMCA argues that the remedy for a violation of Minn.Stat. § 317A.411 is set out in Minn.Stat. § 317A.467 (2000), which provides:

> If a corporation or an officer or director of the corporation violates this chapter, a court in this state, in an action brought by at least 50 members with voting rights or ten percent of the members with voting rights, whichever is less, or by the attorney general, may grant equitable relief it considers just and reasonable in the circumstances and award expenses, including attorney fees and disbursements, to the members.

It is undisputed that Jensen did not meet the requirements of this statute.

Jensen argues that this statute does not apply to his cause of action because it is only meant to cover ultra vires actions of the corporation. Minn.Stat. § 317A.467, however, does not refer to ultra vires acts and is found in the section of the act addressing membership. A general comment to the act notes that the threshold number of members required "is intended to be high enough to prevent frivolous actions that drain potentially limited resources of nonprofit corporations, while still allowing a minority of members to act." Minn.Stat. Ann. § 317A.165 gen. cmt. (West 2004). Jensen insists that because this comment follows Minn.Stat. § 317A.165, the statute that specifically addresses ultra vires acts, only actions involving ultra vires acts fall within the requirement for a threshold number of members. We disagree. The comment recognizes that "this is the threshold number of members required throughout the act in order to initiate certain member actions." Thus, the fact that the comment follows Minn.Stat. § 317A.165 does not limit the threshold member requirement to suits challenging ultra vires acts.

Jensen next argues that Minn.Stat. § 317A.467 does not apply because he is not seeking equitable relief. His complaint, however, seeks relief not only in the form of damages, but also reinstatement of his membership without condition. Reinstatement *578 of his membership constitutes an equitable remedy.

Lastly, Jensen argues that this court should avoid the absurd result of not allowing a member terminated in violation of the act to bring a cause of action without support from the threshold number of members. Jensen asks that this court reconcile Minn.Stat. §§ 317A.467 and 317A.411, and grant individual members rights in such situations. Given the general comment, which indicates that the purpose behind the threshold number is to protect nonprofit corporations from frivolous lawsuits, we do not believe that the result reached here is absurd. Additionally, Minn.Stat. § 317A.467 begins with an explanation that it applies when "a corporation or an officer or director of the corporation violates this chapter." We therefore conclude that a member alleging a violation of Minn.Stat. § 317A.411 must meet the requirements of Minn.Stat. § 317A.467, in order to initiate an action against the nonprofit corporation.

The district court did not err in granting summary judgment to the YMCA on Jensen's claim that the YMCA violated the act.

Minn.Stat. § 8.31

[4] Jensen alternatively argues that he can maintain his action under Minn.Stat. § 8.31, subd. 3a (2000), which provides:

> In addition to the remedies otherwise provided by law, any person injured by a violation of any of the laws referred to in subdivision 1 [which includes violations of the Nonprofit Corporation Act] may bring a civil action and recover damages, together with costs and disbursements, including costs of investigation and reasonable attorney's fees, and receive other equitable relief as determined by the court.

This statute, referred to as the Private Attorney General Statute, has been held to apply only to claimants who demonstrate that their cause of action benefits the public. *See Ly v. Nystrom,* 615 N.W.2d 302, 313-14 (Minn.2000).

In *Ly,* 615 N.W.2d at 313, the supreme court stated that "[s]ince the Private AG Statute grants private citizens the right to act as a 'private' attorney general, the role and duties of the attorney general with respect to enforcing the fraudulent business practices laws must define the limits of the private claimant under the statute." The court further stated that "[t]he duty of the attorney general's office ... is the protection of public rights and the preservation of the interests of the state." *Id.* Consequently, claimants under the Private Attorney General Statute must show that their cause of action benefits the public. *Id.* at 314. The holding in *Ly* thus limits the scope of the Private Attorney General Statute from "any person" injured by a violation of certain laws to those "who demonstrate that their cause of action benefits the public." *Id.* (footnote omitted).

Here, Jensen challenges the termination of his individual membership. His claim relates to a single one-on-one incident that affected only him. A successful prosecution of Jensen's claim that the YMCA violated the act would not advance any state interest or be of any benefit to the public. Jensen's claim cannot be considered within the duties and responsibilities of the attorney general to investigate and enjoin. Thus, the district court did not err in granting summary judgment to the YMCA on Jensen's claim under the Private Attorney General Statute.

II.

[5][6][7] Jensen argues that the district court erred by granting summary judgment on his breach of contract claim. A breach of contract claim fails as a matter *579 of law if the plaintiff cannot establish that he or she has been damaged by the alleged breach. *See Logan v. Norwest Bank Minn., N.A.,* 603 N.W.2d 659, 663 (Minn.App.1999); *Nguyen v. Control Data Corp.,* 401 N.W.2d 101, 105 (Minn.App.1987). "[T]here can be no recovery for damages which are remote, conjectural, or speculative." *Carpenter v. Nelson,* 257 Minn. 424, 428, 101 N.W.2d 918, 921 (1960). But damages need not be proved with certainty; it is legally sufficient that a reasonable basis for approximating loss is shown. *Polaris Indus. v. Plastics, Inc.,* 299 N.W.2d 414, 419 (Minn.1980).

After the termination of Jensen's membership from the YMCA, he joined the University of Minnesota Duluth Recreation Sports Program at an annual cost of $545; his YMCA membership was $510. Jensen contends that the difference in the cost of these memberships constitutes his damages. Jensen's membership with the YMCA, however, ran for only one year; after that year, either party was free to terminate the membership. It is undisputed that the YMCA reimbursed Jensen the unused portion of his yearly membership. The cost of a membership at another health club cannot be considered consequential damages, because it was not something foreseeable at the onset of the contract. *See Kleven v. Geigy Agric. Chems.,* 303 Minn. 320, 324, 227 N.W.2d 566, 569 (1975) (stating that direct damages arise out of the breach itself, while consequential damages are damages foreseeably resulting from the breach). We therefore conclude that the district court did not err in granting summary judgment on Jensen's breach of contract claim.

DECISION

Because Jensen failed to meet the requirements to bring a cause of action under Minn.Stat. § 317A.467 (2000) or Minn.Stat. § 8.31, subd. 3a (2000), and failed to show damages to support his breach of contract claim, the district court did not err in granting summary judgment to the YMCA.

In re MINNEAPOLIS POLICE DEPARTMENT RELIEF ASS'N.
CONE
v.
WOLD et al.

85 Minn. 302 (1902)

COLLINS, J.

The Minneapolis Police Department Relief Association was a corporation organized by Minneapolis policemen under the provisions of Gen. St. 1894, c. 34, tit. 3, which authorized the organization of corporations other than those for pecuniary profit. According to its articles of incorporation, money was to be accumulated through dues, assessments, and contributions of members, and donations from other persons, to be used for the support and relief of sick, disabled, or injured members, and for the payment of a certain sum, to be fixed by the by-laws, to the widows and orphans of deceased members, or, in case a member should die without wife or child, then to a beneficiary dependent on said member for support, being of kin, and designated in his certificate of membership; any member in good standing having the right to change his beneficiary by surrendering his certificate to the secretary and obtaining a new one, in which should be named the substituted beneficiary. The money was also to be used in payment of a certain sum, to be fixed by the by-laws, to a member of the association, upon the decease of his wife, for funeral expenses, and in payment of necessary expenses incurred in the management of corporate affairs. By Sp. Laws 1891, c. 143, the legislature authorized payment to this association of 50 per cent. of all amounts collected for dog licenses in the city, for the purpose of creating and providing a fund for the use and benefit of the association; payment to be made by the city clerk as he collected the license fees. It was expressly provided in the law that 'the fund hereby created shall be used by said relief association for the purposes provided for and contemplated in its articles of incorporation, constitution and by-laws: provided, however, that *305 the city council shall, by resolution, authorize and direct the city clerk to take the action herein specified.' In January, 1892, the city council, by resolution, authorized and directed the city clerk to pay to the association the prescribed percentage of fees receiver by him, from and after June 1, 1892, and this was done, so that prior to the commencement of the present proceedings there had been paid over, under this law, and by virtue of the resolution, an amount exceeding $30,000. Meantime the members of the association accumulated, through dues, assessments, and contributions, something over $14,000, making a total fund of over $44,000; and of this amount about $7,400 had been disbursed prior to January 1, 1901, in accordance with the original articles. At that time a majority of the members, policemen in the city, were summarily discharged; and thereupon an attempt was made to amend the articles of incorporation so as to allow members to withdraw, and upon such withdrawal to receive out of the funds on hand the sum of $200 each, in addition to the amount theretofore paid as dues and assessments while members. Acting under this attempted amendment, nearly $9,000 was withdrawn. There upon the court enjoined further payments upon withdrawals, and adjudged the amendment illegal. A majority of the members then petitioned the court for a dissolution of the corporation and a closing up of its affairs; and thereafter, in due course of law, judgment was duly entered as demanded, a receiver was appointed, and all parties ordered to file claims against the corporation, if any they had. Among the parties cited to file its claim was the city. At this time there was in the hands of the receiver over $30,000, and of this the amount paid and contributed by members did not exceed $9,000. Members remaining in said association insisted in this proceeding in dissolution that they were entitled to divide the entire **979 amount in the treasury among themselves, without regard to the fact that the city had caused to be paid into the treasury, out of its own funds, more than two-thirds of the amount in the hands of the receiver. The city authorities declined to file or to assert a claim to any part of the funds, and thereupon the intervener, as a taxpayer, *306 asked leave of the court to file a complaint in intervention, upon the ground that the amount turned over by the city, and not legally disbursed, reverted to it upon dissolution of the corporation, and should be paid into its treasury. A complaint setting up the facts was served, and counsel for the receiver and for the members of the association demurred thereto upon the ground that it failed to state facts sufficient to constitute a cause of action. This demurrer was overruled by an order of the court below, and thereupon an appeal was taken.

1. Counsel for the appellants insist that, although a taxpayer, the intervener has no right to appear and be heard in behalf of the city. In this state the right of a taxpayer to prevent the appropriation of public funds to an illegal use, where the officials, whose duty it is, refuse to proceed and to protect the people, was settled many years ago, and has since been asserted a number of times. The right of a taxpayer, under some circumstances, to maintain an action to recover moneys that have been unlawfully taken from the public treasury, has also been upheld. The following cases are directly in

point: Sinclair v. Commissioners, 23 Minn. 404, 23 Am. Rep. 694; Smith v. City of St. Paul, 69 Minn. 280, 72 N. W. 104, 210; Flynn v. Water Co., 74 Minn. 185, 77 N. W. 38, 78 N. W. 106; Bailey v. Strachan, 77 Minn. 526, 80 N. W. 694. The right is now recognized everywhere. If a municipal corporation has a cause of action of this character, it is the duty of its officers to institute proceedings; and, if they refuse to perform this plain duty, a taxpayer may apply to a court and be permitted to sue in equity in behalf of himself and all others similarly situated to enforce the right. The purpose of the remedy in such cases is not to interfere with the exercise of legal discretion on the part of those charged with the primary duty of enforcing corporate rights and claims, but to furnish relief where there is an unjustifiable neglect or refusal to exercise such discretion. It is too late to question the power of a court to permit such an action, or the propriety of a judicious exercise of the power.

2. It is also contended that under no circumstances can a taxpayer intervene in proceedings to dissolve a corporation, for the purpose of enforcing a claim of this character; the only remedy *307 being by suit instituted directly against the receiver or the corporation, or both. If this be true, it follows that the city itself would have no right to file or assert its claim in proceedings taken to dissolve, but would have to bring an independent action, if it would recover any part of the fund in question. The proceeding to dissolve and end the corporation was voluntarily instituted by its members, and as said in Kalkhoff v. Nelson, 60 Minn. 284, 62 N. W. 332, the association thereby practically committed suicide, and when its estate is administered it ceases to exist. The city was cited to appear in that proceeding to dissolve and to wind up the corporation, and to file its claim, if any it had. It stood precisely as did every member of the association, and by failing to respond to the notice it could be as readily and conclusively barred from asserting its claim. That it was an artificial, instead of a natural, person, made not the slightest difference. Had the city or its representatives failed to appear and insist upon sharing in the distribution of assets, we are unable to see why it would not have been precluded, and thereafter unable to assert any rights whatever. There is no good reason why a separate action should be either necessary or proper, and there is every reason for holding that in proceedings directly instituted for the purpose of dissolving a corporation, distributing its assets, winding up its affairs, and terminating its legal existence, all parties interested in the assets should be brought into that proceeding. It is not a question whether the city might have maintained an independent action against the receiver or the corporation, but whether in this proceeding it is proper that the city should

appear and file its claim. Surely, if the city is to recover anything, it must be before final order of distribution is made in this proceeding, and the money divided among the claimants. It was cited by the officer of the court to participate and to present its claim, and this officer, the receiver, cannot insist that it or its representatives should be heard.

3. The purposes of the association were definitely fixed by the by-laws prior to the enactment of the law of 1891, and consequently at the time when the council authorized and directed the *308 clerk to pay over the money in question. This law expressly enacted that the money should be used by the association for the purposes provided for and contemplated in the articles of incorporation and the by-laws. The object and intent of the law were to promote the very commendable purposes for which the association had been organized,-- not for the profit or for the private benefit of the members, as such, but that funds might be accumulated to be preserved and used for the support and relief of the poor, the sick, the disabled and injured members, the widows or orphans of deceased members, and other beneficiaries, being of kin or dependent upon such members for support. The funds were also to be used in payment of certain sums for funeral expenses, and in addition to this, of course, the necessary expenses of managing the association,--a purely charitable **980 organization. There was no intention that private purposes were to be served by dividing the money among the members at any time. In fact, such a division was forbidden by implication quite as effectually as if forbidden in express terms. It is beyond question that the conditions found in the legislative act attached to and became a part of the resolution, and that the act of the city council, when authorizing payment of a portion of the dog-license fees, had these conditions annexed. The gift was limited by the terms of the law. When the association took the money with these limitations and conditions, the transaction was in the nature of a resulting trust; and upon failure of the trust the amount on hand which had been paid by the city would revert to it, precisely as it would if it had been the gift of a private person for the same purposes. The association declined to carry out the objects of the gift impressed upon it when made, and to distribute the money for the purposes for which it was appropriated; and, on the contrary, it committed felo de se. This it cannot do, and at the same time distribute the trust funds among its members. The object for which the city donated the money having failed, the donation reverts. A donor has a right to impress upon a gift a condition which will bind the donee to use the funds in the nature of a trust; and in section 2922 of title 3 (the section which authorized this association to accept this gift *309 from the

city) it is provided that it should not have power to divert a gift, grant, or bequest from a specific purpose designated by a donor, without his consent. It is legal for a donor to prescribe, by way of limitation, that his gift shall be kept and preserved so as to subserve a purpose which a donee corporation was created to promote. To so prescribe is nothing more than to declare that the trust fund shall be devoted to the objects which the legislature had in view when providing for the existence of the corporation. Atwater v. Russell, 49 Minn. 39, 51 N. W. 624. Fosdick v. Town of Hempstead, 125 N. Y. 581, 26 N. E. 801, 11 L. R. A. 715, is cited as authority upon the principal question here; and we also call attention to McHugh v. McCole, 97 Wis. 173, 72 N. W. 631, 40 L. R. A. 724, 65 Am. St. Rep. 106; Abels v. McKeen, 18 N. J. Eq. 462; Duke v. Fuller, 9 N. H. 537, 32 Am. Dec. 392; Easterbrooks v. Tillinghast, 5 Gray, 17; Coe v. Washington Mills, 149 Mass. 543, 21 N. E. 966,--as leading cases upon the proposition. A part of the opinion in the case last cited is so directly in point that we quote it: 'The assessments of the members and the contributions of the corporation were placed in the hands of the board of government for certain purposes prescribed in the regulations. They had no right to apply them to any other purpose. The legal title to the fund was in them, but they held it upon the trusts prescribed. When the corporation was dissolved, the society ceased to exist, and the trusts failed. The regulations made no provision for such a contingency, and we think that the board, after the failure of the trusts, held the funds, not for its own benefit, but for the contributors and donors, as a resulting trust. If the corporation had contributed the whole of the funds, not as a public charity, but for the support of this particular society during its life, it would seem to be very clear that at the death of the society the accumulated fund ought to go to it by way of a resulting trust. No one else could present any claim to it. The principle is not changed because the contributors are in fact very numerous. We are therefore of opinion that at the extinction of this society the board of government held the fund in question for the benefit of all contributors, and that they are *310 entitled to it, each in proportion to the amount contributed by him.' The acceptance of the money from the city impressed with the condition amounted to a contract on the part of the association that it would use the money for the particular purposes specified in its constitution and by-laws as then existing, and upon its refusal to proceed further the money should be returned to the city as a resulting trust. The purposes for which it was created have ceased, and the trust has failed. It is upon this principle that the members who have paid assessments and dues and otherwise contributed to the funds are entitled to have a proper proportion returned to them. They would have no rights to the fund, were it not for this doctrine.

4. Counsel for the appellants, stating the elementary proposition that the court will not permit a trust to fail for want of a trustee, urge that the intervener has no standing in court, because he is seeking to prevent the trust funds. They suggest that when such funds are about to be diverted from their proper use the court will restrain the act and appoint another trustee, and that under no circumstances will it divert the funds and deprive the beneficiaries of their rights. These propositions of law are undoubtedly true, but counsel for appellants are in no position to urge them as a reason why the complaint, fails to state a cause of action. Their clients are attempting to pervert the trust funds by appropriating all of the money to private uses, and, if the argument is sound, it applies to appellants as well as to respondent; for the former are attempting to do the forbidden acts. They are simply complaining because another party insists upon participating in an alleged illegal act of their own. We do not think these propositions of law have any bearing here; for, upon the petition of the majority of the members of the association, its legal existence has been terminated, and by the formal judgment of the court it has been so declared. The trust has failed through the deliberate and voluntary act of the beneficiaries. In any event, **981 these appellants cannot insist upon the application of the rules of law in question.

The complaint contained facts sufficient to constitute a cause of *311 action in intervention. A part of the money in the hands of the receiver reverts to the city, by virtue of the condition annexed to the gift, upon a failure of the trust; and this proportion can be determined by the court below in these proceedings.

Order affirmed.

The PROTESTANT REFORMED CHURCH OF EDGERTON, Minnesota, Appellant,
v.
John TEMPELMAN et al., Respondents.

249 Minn. 182 (1957)

NELSON, Justice.

This is an appeal from an order denying plaintiff's motion for amended findings or for a new trial.

The Protestant Reformed Church of Edgerton, Minnesota, the plaintiff here, is a religious corporation affiliated with the Protestant Reformed Church of America. It was organized April 8, 1939, under Mason St. 1927, ss 7985 and 7986, M.S.A. ss 315.21, 315.22. The Protestant Reformed Churches of America are presbyterial in the form of their church government, and the membership of the said Edgerton church is bound by the discipline, usages, orders, and regulations of the judicatories of the Protestant Reformed Church of America.

*185 The church government of the parent denomination provides for four levels of self-government within its judicatory setup, i.e., the consistory, the classis, the particular synod, and the general synod. So far as the record in this case discloses, it does not appear that a particular synod has been set up to operate above each classis before reaching the general synod, and therefore we are here concerned only with the consistory, the classis, and the general synod operating as the court of last resort within the church judicatory.

Article 3 of the Articles of Incorporation of the plaintiff church provides that its members shall labor together according to the discipline, rules, and usages of the general denomination of the Protestant Reformed Church, as from time to time authorized and declared by the classis or synod of said church denomination.

The consistory generally is composed of elders and deacons of the particular church, and in the plaintiff church, constituted seven in number. The individual churches select delegates who comprise the classis. Each classis selects delegates who comprise the general synod. Here we are therefore concerned with three governing levels, the consistory, the classis, and the general synod to which either classis can appeal directly. The donomination is divided into Classis East and Classis West and the dividing line is the Mississippi River.

The defendants are members of the congregation of plaintiff church and residents of the State of Minnesota.

The basis of the dispute here involved lies in the deposition of Rev. DeWolf of the First Protestant Reformed Church of Grand Rapids, Michigan, by Classis East. Differences in doctrinal interpretation, followed by disputes over the validity of the DeWolf deposition procedure, caused dissension among the members of the Edgerton church as well as other churches in Classis West.

On August 31, 1953, the Edgerton church consistory adopted a resolution stating that it did not recognize the deposition of Rev. DeWolf. This resolution carried by a vote of four to three. On September 2, 1953, Classis West adopted a similar resolution at its regular meeting held at Oskaloosa, Iowa. Classis East had approved the Rev. DeWolf deposition.

*186 The matter was never effectively discussed or decided by the general synod, the high judicatory of the denomination and the final authority as to both Classis East and Classis West. The general synod which duly and regularly met in June 1953 appeared to have thought the issue too important to be fully weighed, treated, and disposed of at that session without further study. Consequently the matter was set over for further hearing at a regularly **844 appointed adjourned meeting ordered to be held in March 1954 at the Fuller Avenue Church (First Protestant Reformed Church of Grand Rapids, Michigan). By that time Classis West had by its resolution taken a position opposite from that taken by Classis East. The study committee of the general synod had been scheduled to report on this matter at the adjourned meeting. When the adjourned meeting met (composed of representatives of both classes) in March 1954, the synodical delegates of Classis East met at a different church than that selected by the regular synod which had met in June 1953. Because of the division which had developed, no unified action was taken on the problem at the adjourned meeting by the duly constituted general synod.

[1] 1. Going back to the occurrences within the plaintiff church, we find that on September 11, 1953, the three members of the Edgerton consistory that voted to approve the deposition of Rev. DeWolf, even though the duly constituted Classis West had ruled otherwise, circulated a letter addressed to the members of the Edgerton congregation stating that Classis West had acted illegally in failing to recognize the deposition of Rev. DeWolf; that the majority of the church consistory had also acted illegally; and that such action rendered the majority of the consistory guilty of schism. Schism has been defined in ecclesiastical circles as a formal division within or separation from a church or religious body,

on account of some doctrinal difference of opinion with regard to matters of faith or discipline or the offense of causing or seeking to cause such a division.[FN1]

FN1. Nelson v. Benson, 69 Ill. 27; see Webster's New International Dictionary, 2d Ed. (1947) p. 2234.

*187 On September 17, 1953, the three dissenting members of the consistory met, claiming to act as the legal consistory of the plaintiff church, with the consistory of the Protestant Reformed Church of Doon, Iowa, and this collective body then took it upon themselves to depose the majority of the Edgerton consistory. In these proceedings, the three dissident members presumed to act under authority of acticle 79 of the governing church orders. This article provides:

'When ministers of the Divine Word, elders or deacons, have committed any public, gross sin, which is a disgrace to the church, or worthy of punishment by the authorities, the elders and deacons shall immediately by preceding sentence of the consistory thereof and of the nearest church, be suspended or expelled from their office, but the ministers shall only be suspended. Whether these shall be entirely deposed from office, shall be subject to the judgment of the classis, with the advice of the delegates of the (particular) synod mentioned in Article 11.'

The attempted deposition of the defendants, the majority members of the consistory of the Edgerton church, was taken by the three dissident members without any of the defendants being present and without their being notified of any action or hearing being contemplated and without the knowledge of any of the defendants of said meeting.

Let it be understood at this point that the consistory of plaintiff church was governed at the time by the discipline, rules, and usages of the Protestant Reformed Church of America and that this consistory of seven members was the governing body of the church corporation and had charge of the temporalities of said church, including building, records, and personal property.

On April 3, 1954, the three dissenting members of the consistory, declaring themselves to be the true consistory of the plaintiff church, commenced this action against the defendants to have them enjoined from representing themselves to be elders and deacons of the Edgerton church **845 as well as its legally constituted consistory and to compel them to turn over to plaintiff full charge of the temporalities of said church, including the buildings, records, and personal property. *188 In addition thereto plaintiff, by and through the efforts of the three dissident members, sought to recover a money judgment for damages which they claim plaintiff had sustained.

[2] 2. It is well-settled law in this state, as well as in other jurisdictions, that problems of church doctrine, or any problem growing therefrom implying a religious conflict, shall be settled by and within the judicial organs of the church body and in the present conflict according to the usages, orders, and regulations of the Protestant Reformed Church of America.

[3][4] 3. The civil courts should not and cannot enter into any dispute relative to doctrinal matters arising within a church organization nor can they interfere with or enter into any dispute relative to church government. It is a well-recognized rule binding upon the civil courts that, where a church congregation is divided, the group which has proceeded in accordance with the rules of its church government must be recognized as the group entitled to control of the physical property of any church belonging to that certain denomination. It is a corollary of this rule that the aggrieved parties in a church congregation must exhaust their remedies within the church judicatories of that organization before seeking relief in the civil courts.

[5] In essence the issue presented on this appeal is whether the three minority members proceeding in the name of the plaintiff, or the four defendants, whoever may be charged with that duty, have exhausted the remedies which ought to be pursued and are obtainable if pursued through the church judicatories. The constitution of the plaintiff church organization provides for appeal by aggrieved parties to the higher church orders. Under that constitution, an aggrieved party at the consistory level would have an appeal to its classis. Should the decision there be unfavorable, it could then appeal to the synod. However, in this case, since a particular synod does not appear to have been set up, the appeal from the classis would be to the general synod, the highest church judicatory. Until such course has been taken by appeal in connection with any dispute relative to any doctrinal differences or disputes within the church organization, *189 and within the jurisdiction of the church orders, an action in the civil courts would not be warranted. Therefore, the main question which presents itself, in this case, is limited to the proposition whether the minority members supporting plaintiff, or the four defendants, were originally required to appeal to a higher church order under the rules imposed by its discipline, usages, and orders. Article 31 of the church orders provides:

> 'If anyone complain that he has been wronged by the decision of a minor assembly, he shall have the right to appeal to a major ecclesiastical assembly, and whatever may be agreed upon by a

majority vote shall be considered settled and binding, unless it be proved to conflict with the Word of God or with the articles of the church order, as long as they are not changed by a general synod.'

[6] 4. The record in the instant case fails to disclose any decision issued by Classis West or a duly constituted general synod deposing the defendants as majority members of the plaintiff church consistory based upon proof that their activities and conduct within the church consistory conflict with the word of God or the articles of the church order.

Since this matter has been taken before the civil courts for determination, the aforesaid position and state of the doctrinal dispute within the forum provided by the church judicatories may be taken into account in determining contract and property rights respecting the holding, control, and **846 use or enjoyment of the church property as between the contending parties to the present action.

[7][8] 5--6. This court in one of the early church cases which came before it, namely, East Norway Lake Church v. Halvorson, 42 Minn. 503, 44 N.W. 663, clearly set out the distinction between the jurisdiction of a civil court and the conclusiveness of the decision of an ecclesiastical tribunal, pointing out that civil courts in this country have no ecclesiastical jurisdiction and therefore they do not take cognizance of a schism or division within a religious organization unless some property or civil right is involved. This approach gives rise to the rule that so long as the effects of the schism or division within the church body are confined to spiritual, religious, ecclesiastical, *190 or theological matters it furnishes no basis for interference by the civil courts at all however vitally it may affect the interests of the society as an ecclesiastical or spiritual body. The civil courts recognize that within those domains the ecclesiastical authority is paramount and its sanctions exclusive, and they may not intrude therein either for the purpose of enforcing or resisting obedience to ecclesiastical canons or decrees. It is therefore only when a civil or property right is involved of which the civil court may take jurisdiction that a civil court has any occasion at all to pass upon the conclusiveness or effect of a decision of the ecclesiastical tribunal. [FN2]

FN2. See case note--Litigation growing out of schism or division in religious society, 24 L.R.A.,N.S., 692 to 693; also see Annotations, 8 A.L.R. 105 to 133, and 70 A.L.R. 75 to 90. Cases are referred to in these annotations where a schism or division has arisen within independent religious societies as a result of which the title to, or control of, the property of the society has become involved in litigation in the civil courts.

The position of the civil courts relative to doctrinal church disputes was clearly enunciated in Watson v. Garvin, 54 Mo. 353, 378, frequently referred to in cases affecting church organizations, wherein the court in its opinion said:

'The true ground why civil courts do not interfere with the decrees of ecclesiastical courts, where no property rights are involved, is not because such decrees are final and conclusive, but because they have no jurisdiction whatever in such matters, and cannot take cognizance of them at all, whether they have been adjudicated or not by those tribunals.'

[9][10][11] Those general propositions have been sustained and adhered to in the leading cases involving church matters throughout the country. This court has made it clear beginning with the East Norway Lake Church case, supra, and others involving church disputes since that time that civil courts take up matters of religious doctrine with extreme reluctance and that they never do so--it is beyond their province to do so--for the purpose of determining the abstract truth or falsity of any religious doctrine, and the civil courts never consider them at all except where civil rights, rights of property or contract, *191 respecting the holding, control, use, or enjoyment of property are dependent on them. If by contract the right to hold, control, use, or enjoy property depends upon adherence to, or teaching of, a religious doctrine, the civil courts will examine what, as a matter of fact, the doctrine is, and whether, as a matter of fact, this or that person adheres to or teaches it. But they will go no further than is found necessary to determine the question of fact. The proposition that the civil courts will make such examination, as a matter of fact, must be understood in connection with another proposition which is that where the contract provides, or by implication contemplates, that the question what is according to, and consistent **847 with, the particular doctrine or doctrines shall be determined by some church judicatory, the determination of such judicatory, duly made when the matter is properly brought before it, will be conclusive upon the civil courts. The civil courts have held this to be true rule not because the law recognizes any authority in such bodies to make any decision touching civil rights but because the parties, by their contract, have made the right to property to depend on adherence to, or teaching of, the particular doctrines as they may be defined by such church orders. In other words, the members of the church body and the church denomination have made its judicatories the arbiter upon any and all questions that may arise as to what the doctrines are and as to what is according to them.

[12] 7. Where a number of persons associate together to form a religious congregation and incorporate for the more convenient holding and control of property acquired for its use, the constitution or body of rules which they adopt to prescribe who shall be members of the corporation and entitled to share in the control of it is the contract by which they are bound. That right to share in the government of a corporation is a civil right which the law will protect, and the court will therefore determine who are the members of the corporation.

We think it therefore clearly the rule that the church has no control over any civil right or duty; while on the other hand the civil power has no authority to secularize the church or to interfere with the exercise of its constitutional ecclesiastical jurisdiction. *192 The church alone has jurisdiction of communion, faith, or discipline and the members must submit to such rules and regulations governing these matters as may be prescribed by the church government, but the church does not always have exclusive jurisdiction over property or personal liberty or over any right which it is the duty of the civil power to rotect.

[13] It determining property rights under such circumstances, the civil courts must take into consideration the organization as well as the government of the church, and restrictions in the title to the property, to determine where the rights of property lie. These principles are always applicable whether the society involved is independent in government or is but a part of a general ecclesiastical body. It is therefore only when civil or property rights of a religious organization form the basis of the relief sought that a civil court can inquire into the ecclesiastical beliefs peculiar to the organization. Since the separation of church and state is firmly established in this country and there is a constitutional guarantee of freedom of religious profession and worship, civil courts are not therefore concerned with controversies or questions of a purely ecclesiastical nature, and this rule has been generally adhered to, the civil courts declining to intervene except where there has arisen out of such church doctrinal controversy or division an invasion or violation of the civil rights of the members.[FN3]

FN3. Thomas v. Lewis, 224 Ky. 307, 6 S.W.2d 255; Woodrum v. Burton, 88 W.Va. 322, 107 S.E. 102; Clapp v. Krug, 232 Ky. 303, 22 S.W.2d 1025; Cape v. Moore, 122 Okl. 229, 253 P. 506.

[14] 8. The courts have also held that, ordinarily, in case of factional disputes in church organizations, the civil courts will not inquire into the ecclesiastical teachings of a

pastor, or of a congregation holding church property, in order to determine which faction is entitled to the possession and use of church property. Reichert v. Saremba, 115 Neb. 404, 213 N.W. 584.

[15][16][17] 9. It is the law of all corporations that a mere majority of its members cannot divert the corporate property **848 to uses foreign to the purposes for which the corporation was formed, and there is no difference between church and other corporations in this regard. *193 If and when a church corporation is formed for the purpose of promoting certain defined doctrines of religious faith, which are set forth in its articles of incorporation, any church property which it acquires is impressed with a trust to carry out such purpose, and a majority of the congregation cannot divert the property to other inconsistent religious uses against the protest of a minority, however small. However, the manner of the use of the property of the church corporation, within the range of its corporate powers, may be determined by the majority of the congregation, but no majority, even though it embrace all members but one, can use the corporate property for the advancement of a faith antagonistic to that for which the church was established and the corporation formed.

ILLINOIS ex rel. Lisa MADIGAN, Attorney General of Illinois, Petitioner,
v.
TELEMARKETING ASSOCIATES, INC., et al.

538 U.S. 600 (2003)

*605 Justice GINSBURG delivered the opinion of the Court.

This case concerns the amenability of for-profit fundraising corporations to suit by the Attorney General of Illinois for fraudulent charitable solicitations. The controversy arises from the fundraisers' contracts with a charitable nonprofit corporation organized to advance the welfare **1833 of Vietnam veterans; under the contracts, the fundraisers were to retain 85 percent of the proceeds of their fundraising endeavors. The State Attorney General's complaint alleges that the fundraisers defrauded members of the public by falsely representing that "a significant amount of each dollar donated would be paid over to [the veterans organization] for its [charitable] purposes while in fact the [fundraisers] knew that ... 15 cents or less of each dollar would be available" for those purposes. App. 9, ¶ 34. Complementing that allegation, the complaint states that the fundraisers falsely represented that "the funds donated would go to further ... charitable purposes," App. 8, ¶ 29, when in fact "the amount ... paid over to charity was merely incidental to the fund *606 raising effort," which was conducted primarily "for the private pecuniary benefit of" the fundraisers, App. 9, ¶ 35.

The question presented is whether those allegations state a claim for relief that can survive a motion to dismiss. In accord with the Illinois trial and appellate courts, the Illinois Supreme Court held they did not. That court was "mindful of the opportunity for public misunderstanding and the potential for donor confusion which may be presented with fund-raising solicitations of the sort involved in th[is] case," *Ryan v. Telemarketing Associates, Inc.,* 198 Ill.2d 345, 363, 261 Ill.Dec. 319, 763 N.E.2d 289, 299 (2001); it nevertheless concluded that threshold dismissal of the complaint was compelled by this Court's decisions in *Schaumburg v. Citizens for a Better Environment,* 444 U.S. 620, 100 S.Ct. 826, 63 L.Ed.2d 73 (1980), *Secretary of State of Md. v. Joseph H. Munson Co.,* 467 U.S. 947, 104 S.Ct. 2839, 81 L.Ed.2d 786 (1984), and *Riley v. National Federation of Blind of N. C., Inc.,* 487 U.S. 781, 108 S.Ct. 2667, 101 L.Ed.2d 669 (1988). Those decisions held that certain regulations of charitable subscriptions, barring fees in excess of a prescribed level, effectively imposed prior restraints on fundraising, and were therefore incompatible with the First Amendment.

We reverse the judgment of the Illinois Supreme Court. Our prior decisions do not rule out, as supportive of a fraud claim against fundraisers, any and all reliance on the percentage of charitable donations fundraisers retain for themselves. While bare failure to disclose that information directly to potential donors does not suffice to establish fraud, when nondisclosure is accompanied by intentionally misleading statements designed to deceive the listener, the First Amendment leaves room for a fraud claim.

I

Defendants below, respondents here, Telemarketing Associates, Inc., and Armet, Inc., are Illinois for-profit fundraising corporations wholly owned and controlled by defendant-respondent Richard Troia. *607198 Ill.2d, at 347-348, 261 Ill.Dec., at 321, 763 N.E.2d, at 291. Telemarketing Associates and Armet were retained by VietNow National Headquarters, a charitable nonprofit corporation, to solicit donations to aid Vietnam veterans. *Id.,* at 348, 261 Ill.Dec., at 321, 763 N.E.2d, at 291. In this opinion, we generally refer to respondents, collectively, as "Telemarketers."

The contracts between the charity, VietNow, and the fundraisers, Telemarketers, provided that Telemarketers would retain 85 percent of the gross receipts from donors within Illinois, leaving 15 percent for VietNow. *Ibid.* Under the agreements, donor lists developed by Telemarketers would remain in their "sole and exclusive" control. App. 24, 93-94, 102, ¶ 65. Telemarketers also brokered contracts on behalf of VietNow with out-of-state fundraisers; under those contracts, out-of-state fundraisers retained between 70 percent and 80 percent of donated funds, Telemarketers received between 10 percent and 20 percent as a finder's fee, and VietNow received 10 percent. 198 Ill.2d, at 348, 261 Ill.Dec. at 321, 763 N.E.2d, at 291. Between July 1987 and the end of 1995, **1834 Telemarketers collected approximately $7.1 million, keeping slightly more than $6 million for themselves, and leaving approximately $1.1 million for the charity. *Ibid.* [FN1]

FN1. The petition for certiorari further alleges that, of the money raised by Telemarketers, VietNow in the end spent only about 3 percent to provide charitable services to veterans. Pet. for Cert. 2, and n. 1; see IRS Form 990, filed by VietNow in 2000, available at http:// 167.10.5.131/Ct0601_0700/0652/1 M11INDV.PDF (as visited April 10,

2003) (available in Clerk of Court's case file).

In 1991, the Illinois Attorney General filed a complaint against Telemarketers in state court. *Id.,* at 348-350, 261 Ill.Dec., at 321-22, 763 N.E.2d, at 291-292. [FN2] The complaint asserted common-law and statutory claims for fraud and breach of fiduciary duty. *Ibid.* It alleged, *inter alia,* that the 85 percent fee for which Telemarketers contracted was "excessive" and "not justified *608 by expenses [they] paid." App. 103, ¶ 72. Dominantly, however, the complaint concerned misrepresentation.

FN2. References to the complaint in this opinion include all amendments to that pleading.

In the course of their telephone solicitations, the complaint states, Telemarketers misleadingly represented that "funds donated would go to further Viet[N]ow's charitable purposes." *Id.,* at 8, ¶ 29. Affidavits attached to the complaint aver that Telemarketers told prospective donors their contributions would be used for specifically identified charitable endeavors; typical examples of those endeavors include "food baskets given to vets [and] their families for Thanksgiving," *id.,* at 124, paying "bills and rent to help physically and mentally disabled Vietnam vets and their families," *id.,* at 131, "jo[b] training," *id.,* at 145, and "rehabilitation [and] other services for Vietnam vets," *id.,* at 169. One affiant asked what percentage of her contribution would be used for fundraising expenses; she "was told 90% or more goes to the vets." *Ibid.* Another affiant stated she was told her donation would not be used for "labor expenses" because "all members are volunteers." *Id.,* at 111. [FN3] Written materials Telemarketers sent to each donor *609 represented that contributions would "be used to help and assist Viet[N]ow's charitable purposes." *Id.,* at 8, ¶ 30. [FN4]

FN3. Under Illinois law, exhibits attached to a complaint and referred to in a pleading become part of the pleading "for all purposes." Ill. Comp. Stat., ch. 735, § 5/2-606 (1992); *Pure Oil Co. v. Miller-McFarland Drilling Co.,* 376 Ill. 486, 497-498, 34 N.E.2d 854, 859 (1941); 3 R. Michael, Illinois Practice § 23.9, p. 332-333, nn. 7-9 and accompanying text (1989) (collecting Illinois cases). Telemarketers' counsel stated at oral argument that the Illinois Supreme Court had "found as a matter of law that [the] affidavits were not part of the complaint." Tr. of Oral Arg. 40. We can locate no such finding in the court's opinion. Asked to supply a citation after argument, see Tr. of

Oral Arg. 41, counsel directed us to the court's statement that "there is no allegation that [Telemarketers] made affirmative misstatements to potential donors." *Ryan v. Telemarketing Associates, Inc.,* 198 Ill.2d 345, 348, 261 Ill.Dec. 319, 321, 763 N.E.2d 289, 291 (2001); see Letter from William E. Raney to William K. Suter, Clerk of the Court (March 4, 2003). In so stating, the Illinois court overlooked, most obviously, the two affidavits attesting to Telemarketers' representations that "90% or more goes to the vets," and that there would be no "labor expenses." See App. 111, 169. In any event, the sentence fragment counsel identified falls short of showing, in the face of established Illinois case law, that the court "found" the affidavits annexed by the Illinois Attorney General *dehors* the complaint. Counsel's contention is further clouded by the Illinois Supreme Court's explicit notation that "the Attorney General ha[d] attached to his complaint the affidavits of 44 VietNow donors." 198 Ill.2d, at 352, 261 Ill.Dec., at 323, 763 N.E.2d, at 293.

FN4. Illinois law provides that "[i]n any solicitation to the public for a charitable organization by a professional fund raiser or professional solicitor[,][t]he public member shall be promptly informed by statement in verbal communications and by clear and unambiguous disclosure in written materials that the solicitation is being made by a paid professional fund raiser. The fund raiser, solicitor, and materials used shall also provide the professional fund raiser's name and a statement that contracts and reports regarding the charity are on file with the Illinois Attorney General and additionally, in verbal communications, the solicitor's true name must be provided." Ill. Comp. Stat., ch. 225, § 460/17(a) (2001).

**1835 The 15 cents or less of each solicited dollar actually made available to VietNow, the Attorney General charged, "was merely incidental to the fund raising effort"; consequently, she asserted, "representations made to donors [that a significant amount of each dollar donated would be paid over to Viet [N]ow for its purposes] were knowingly deceptive and materially false, constituted a fraud[,] and were made for the private pecuniary benefit of [Telemarketers]." *Id.,* at 9, ¶¶ 34, 35.

Telemarketers moved to dismiss the fraud claims, urging that they were barred by the First Amendment. The trial court granted the motion, [FN5] and the dismissal order was affirmed, in turn, by the Illinois Appellate Court and the Illinois Supreme Court. The Illinois courts placed heavy weight on three decisions of this Court: *Schaumburg v. Citizens for a Better Environment,* 444 U.S. 620, 100 S.Ct. 826, 63 L.Ed.2d 73 (1980); *610*Secretary of State of Md. v. Joseph H. Munson Co.,* 467 U.S. 947, 104 S.Ct. 2839, 81 L.Ed.2d 786 (1984); and *Riley v. National Federation of Blind of N. C., Inc.,* 487 U.S. 781, 108 S.Ct. 2667, 101 L.Ed.2d 669 (1988). Each of the three decisions invalidated state or local laws that categorically restrained solicitation by charities or professional fundraisers if a high percentage of the funds raised would be used to cover administrative or fundraising costs. *Schaumburg,* 444 U.S., at 620, 100 S.Ct. 826; *Munson,* 467 U.S., at 947, 104 S.Ct. 2839; and *Riley,* 487 U.S., at 781, 108 S.Ct. 2667; see 198 Ill.2d, at 359, 261 Ill.Dec. 319, 763 N.E.2d, at 297.

FN5. The parties subsequently stipulated to the dismissal of all remaining claims. App. to Pet. for Cert. 30-31.

The Illinois Supreme Court acknowledged that this case, unlike *Schaumburg, Munson*, and *Riley,* involves no prophylactic provision proscribing any charitable solicitation if fundraising costs exceeded a prescribed limit. Instead, the Attorney General sought to enforce the State's generally applicable antifraud laws against Telemarketers for "specific instances of deliberate deception." 198 Ill.2d, at 358, 261 Ill.Dec., at 326, 763 N.E.2d, at 296 (quoting *Riley,* 487 U. S, at 803, 108 S.Ct. 2667 (SCALIA, J., concurring)). "However," the court said, "the statements made by [Telemarketers] during solicitation are alleged to be 'false' only because [Telemarketers] retained 85% of the gross receipts and failed to disclose this information to donors." *Id.,* at 359, 261 Ill.Dec., at 327, 763 N.E.2d, at 297. The Attorney General's complaint, in the Illinois Supreme Court's view, was "in essence, an attempt to regulate [Telemarketers'] ability to engage in a protected activity based upon a percentage-rate limitation"--"the same regulatory principle that was rejected in *Schaumburg* [,] *Munson,* and *Riley.*" *Ibid.*

"[H]igh solicitation costs," the Illinois Supreme Court stressed, "can be attributable to a number of factors." *Ibid.* In this case, the court noted, Telemarketers contracted to provide a "wide range" of services in addition to telephone solicitation. *Ibid.* For example, they agreed to publish a newsletter and to maintain a toll-free information hotline. *Id.,* at 359-360, 261 Ill.Dec., at 327-328, 763 N.E.2d, at 297-298. Moreover, the court added, VietNow received "nonmonetary benefits by having [its] message disbursed by the solicitation process," and Telemarketers were directed to solicit "in a manner that *611 would 'promote goodwill' on behalf of VietNow." *Id.,* at 361, 261 Ill.Dec., at 328, 763 N.E.2d, at 298. Taking these factors into account, the court concluded that it would be " incorrect to presume ... [any] nexus between high solicitation costs and fraud." *Id.,* at 360, 261 Ill.Dec., at 328, 763 N.E.2d, at 298.

The Illinois Supreme Court further determined that, under *Riley,* "fraud cannot be defined in such a way that it places on **1836 solicitors the affirmative duty to disclose to potential donors, at the point of solicitation, the net proceeds to be returned to the charity." *Id.,* at 361, 261 Ill.Dec., at 328, 763 N.E.2d, at 298. [FN6] Finally, the court expressed the fear that if the complaint were allowed to proceed, all fundraisers in Illinois would be saddled with "the burden of defending the reasonableness of their fees, on a case-by-case basis, whenever in the Attorney General's judgment the public was being deceived about the charitable nature of a fund-raising campaign because the fund-raiser's fee was too high." *Id.,* at 362, 261 Ill.Dec., at 329, 763 N.E.2d, at 299. The threatened exposure to litigation costs and penalties, the court said, "could produce a substantial chilling effect on protected speech." *Ibid.* We granted certiorari. 537 U.S. 999, 123 S.Ct. 512, 154 L.Ed.2d 393 (2002).

FN6. Contracts for fundraising campaigns in Illinois must be filed with the State's Attorney General, see Ill. Comp. Stat., ch. 225, §§ 460/2(a)(10) and 460/7 (2001), and those contracts must disclose all fundraiser fees, including any "stated percentage of the gross amount raised" to be retained by the fundraiser, § 460/7(b); see § 460/7(d). The filings are open for public inspection. § 460/2(f). Illinois law also provides that fundraisers must disclose "the percentage to be received by the charitable organization from each contribution, if such disclosure is requested by the person solicited." § 460/17(b). Telemarketers did not challenge these requirements.

II

[1] The First Amendment protects the right to engage in charitable solicitation. See *Schaumburg,* 444 U.S., at 632, 100 S.Ct. 826 ("charitable appeals for funds ... involve a variety of speech interests--communication of information, the dissemination and propagation of views and ideas, and the advocacy of *612 causes--that are within the protection of the First Amendment"); *Riley,* 487 U.S., at 788-789, 108 S.Ct. 2667. But the First Amendment does not shield fraud. See, *e.g., Donaldson v. Read Magazine,*

Inc., 333 U.S. 178, 190, 68 S.Ct. 591, 92 L.Ed. 628 (1948) (the government's power "to protect people against fraud" has "always been recognized in this country and is firmly established"); *Gertz v. Robert Welch, Inc.,* 418 U.S. 323, 340, 94 S.Ct. 2997, 41 L.Ed.2d 789 (1974) (the " intentional lie" is "no essential part of any exposition of ideas") (internal quotation marks omitted). Like other forms of public deception, fraudulent charitable solicitation is unprotected speech. See, *e.g., Schneider v. State (Town of Irvington),* 308 U.S. 147, 164, 60 S.Ct. 146, 84 L.Ed. 155 (1939) ("Frauds," including "fraudulent appeals ... made in the name of charity and religion," may be "denounced as offenses and punished by law."); *Donaldson,* 333 U.S., at 192, 68 S.Ct. 591 ("A contention cannot be seriously considered which assumes that freedom of the press includes a right to raise money to promote circulation by deception of the public.").

The Court has not previously addressed the First Amendment's application to individual fraud actions of the kind at issue here. It has, however, three times considered prophylactic statutes designed to combat fraud by imposing prior restraints on solicitation when fundraising fees exceeded a specified reasonable level. Each time, the Court held the prophylactic measures unconstitutional.

In *Schaumburg,* decided in 1980, the Court invalidated a village ordinance that prohibited charitable organizations from soliciting contributions unless they used at least 75 percent of their receipts "directly for the charitable purpose of the organization." 444 U.S., at 624, 100 S.Ct. 826 (internal quotation marks omitted). The ordinance defined "charitable purposes" to exclude salaries and commissions paid to solicitors, and the administrative expenses of the charity, including salaries. *Ibid.* The village of Schaumburg's "principal justification" for the ordinance was fraud prevention: "[A]ny organization using more than 25 percent of its receipts on fundraising, *613 salaries, and overhead," Schaumburg **1837 submitted, "is not a charitable, but a commercial, for-profit enterprise"; "to permit [such an organization] to represent itself as a charity," the village urged, "is fraudulent." *Id.,* at 636, 100 S.Ct. 826.

The Court agreed with Schaumburg that fraud prevention ranks as "a substantial governmental interes[t]," *ibid.,* but concluded that "the 75-percent requirement" promoted that interest "only peripherally." *Ibid.* Spending "more than 25 percent of [an organization's] receipts on fundraising, salaries, and overhead," the Court explained, does not reliably indicate that the enterprise is "commercial" rather than "charitable." *Ibid.* Such spending might be altogether appropriate, *Schaumburg* noted, for a charitable organization "primarily engaged in research, advocacy, or public education [that uses its] own paid staff to carry out these functions as well as to solicit financial support." *Id.,* at 636-637, 100 S.Ct. 826. "The Village's legitimate interest in preventing fraud," the Court stated, "can be better served by measures less intrusive than a direct prohibition on solicitation," *id.,* at 637, 100 S.Ct. 826: "Fraudulent misrepresentations can be prohibited and the penal laws used to punish such conduct directly," *ibid.*

Four years later, in *Munson,* the Court invalidated a Maryland law that prohibited charitable organizations from soliciting if they paid or agreed to pay as expenses more than 25 percent of the amount raised. Unlike the inflexible ordinance in *Schaumburg,* the Maryland law authorized a waiver of the 25 percent limitation "where [it] would effectively prevent the charitable organization from raising contributions." 467 U.S., at 950-951, n. 2, 104 S.Ct. 2839. The Court held that the waiver provision did not save the statute. *Id.,* at 962, 104 S.Ct. 2839. "[No] reaso[n] other than financial necessity warrant[ed] a waiver," *Munson* observed. *Id.,* at 963, 104 S.Ct. 2839. The statute provided no shelter for a charity that incurred high solicitation costs because it chose to disseminate information as part of its fundraising. *Ibid.* Nor did it shield a charity *614 whose high solicitation costs stemmed from the unpopularity of its cause. *Id.,* at 967, 104 S.Ct. 2839.

"[N]o doubt [there] are organizations that have high fundraising costs not due to protected First Amendment activity," the Court recognized; it concluded, however, that Maryland's statute was incapable of "distinguish[ing] those organizations from charities that have high costs due to protected First Amendment activities." *Id.,* at 966, 104 S.Ct. 2839. The statute's fatal flaw, the Court said, was that it "operate[d] on [the] fundamentally mistaken premise that high solicitation costs are an accurate measure of fraud." *Ibid.* As in *Schaumburg,* the Court noted, fraud could be checked by "measures less intrusive than a direct prohibition on solicitation": Fraud could be punished directly and the State "could require disclosure of the finances of a charitable organization so that a member of the public could make an informed decision about whether to contribute." 467 U.S., at 961, and n. 9, 104 S.Ct. 2839.

Third in the trilogy of cases on which the Illinois Supreme Court relied was our 1988 decision in *Riley.* The village ordinance in *Schaumburg* and the Maryland law in *Munson* regulated charities; the North Carolina charitable solicitation controls at issue in *Riley* directly regulated professional fundraisers. North Carolina's law prohibited professional fundraisers from retaining an "unreasonable" or "excessive" fee. 487 U.S., at 784, 108 S.Ct. 2667 (internal quotation marks omitted). Fees up to 20 percent of the gross receipts collected were deemed reasonable; fees between 20 percent and 35 percent were deemed unreasonable if the State showed that the solicitation did not involve advocacy or dissemination of information. *Id.,* at 784-785, 108 S.Ct. 2667. Fees exceeding 35 percent were presumed unreasonable, but the fundraiser could rebut the presumption by showing either that the solicitation **1838 involved advocacy or information dissemination, or that, absent the higher fee, the charity's "ability to raise money or communicate would be significantly diminished." *Id.,* at 785-786, 108 S.Ct. 2667.

*615 Relying on *Schaumburg* and *Munson,* the Court's decision in *Riley* invalidated North Carolina's endeavor to rein in charitable solicitors' fees. The Court held, once again, that fraud may not be inferred simply from the percentage of charitable donations absorbed by fundraising costs. See 487 U.S., at 789, 108 S.Ct. 2667 ("solicitation of charitable contributions is protected speech"; "using percentages to decide the legality of the fundraiser's fee is not narrowly tailored to the State's interest in preventing fraud").

The opportunity to rebut the unreasonableness presumption attending a fee over 35 percent did not bring North Carolina's scheme within the constitutional zone, the Court explained. Under the State's law, "even where a prima facie showing of unreasonableness ha[d] been rebutted, the factfinder [still had to] make an ultimate determination, on a case-by-case basis, as to whether the fee was reasonable--a showing that the solicitation involved ... advocacy or [the] dissemination of information [did] not alone establish that the total fee was reasonable." *Id.,* at 786, 108 S.Ct. 2667.

Training on that aspect of North Carolina's regulation, the Court stated: "Even if we agreed that some form of a percentage-based measure could be used, in part, to test for fraud, we could not agree to a measure that requires the speaker to prove 'reasonableness' case by case based upon what is at best a loose inference that the fee might be too high." *Id.,* at 793, 108 S.Ct. 2667. "[E]very campaign incurring fees in excess of 35% ... [would] subject [fundraisers] to potential litigation over the 'reasonableness' of the fee," the Court observed; that litigation risk, the Court concluded, would "chill speech in direct contravention of the First Amendment's dictates." *Id.,* at 794, 108 S.Ct. 2667. Especially likely to be burdened, the *Riley* opinion noted, were solicitations combined with advocacy or the communication of information, and fundraising by small or unpopular charities. *Ibid.* The Court cautioned, however, as it did in *Schaumburg* and *Munson,* that States need not "sit idly by and allow their citizens to be defrauded." *616 487 U.S., at 795, 108 S.Ct. 2667. We anticipated that North Carolina law enforcement officers would be "ready and able" to enforce the State's antifraud law. *Ibid.*

Riley presented a further issue. North Carolina law required professional fundraisers to disclose to potential donors, before asking for money, the percentage of the prior year's charitable contributions the fundraisers had actually turned over to charity. *Id.,* at 795, 108 S.Ct. 2667. The State defended this disclosure requirement as a proper means to dispel public misperception that the money donors gave to professional fundraisers went in greater-than-actual proportion to benefit charity. *Id.,* at 798, 108 S.Ct. 2667.

This Court condemned the measure as an "unduly burdensome" prophylactic rule, an exaction unnecessary to achieve the State's goal of preventing donors from being misled. *Id.,* at 800, 108 S.Ct. 2667. The State's rule, *Riley* emphasized, conclusively presumed that "the charity derive[d] no benefit from funds collected but not turned over to it." *Id.,* at 798, 108 S.Ct. 2667. This was "not necessarily so," the Court said, for charities might well benefit from the act of solicitation itself, when the request for funds conveyed information or involved cause-oriented advocacy. *Ibid.*

The Court noted in *Riley* that North Carolina (like Illinois here) required professional fundraisers to disclose their professional status. *Id.,* at 799, 108 S.Ct. 2667; see Ill. Comp. Stat., ch. 225, § 460/17(a) (2001); *supra,* at 1835, 1836 nn. 4 and 6. That disclosure, the Court said, effectively notified contributors that a portion of the money they donated would **1839 underwrite solicitation costs. A concerned donor could ask how much of the contribution would be turned over to the charity, and under North Carolina law, fundraisers would be obliged to provide that information. *Riley,* 487 U.S., at 799, 108 S.Ct. 2667 (citing N.C. Gen.Stat. § 131C-16 (1986)). But upfront telephone disclosure of the fundraiser's fee, the Court believed, might end as well as begin the conversation: A potential contributor who thought the fee too high might simply hang up. *617*Id.,* at 799- 800, 108 S.Ct. 2667. "[M]ore benign and narrowly tailored options" that would not chill solicitation altogether were available; for example, the Court suggested, "the State may itself publish the detailed financial disclosure forms it requires professional fundraisers to file," and "[it] may vigorously enforce its antifraud laws to prohibit professional fundraisers from obtaining money on false pretenses or by making false statements." *Ibid.*

III

A

[2] The Court's opinions in *Schaumburg, Munson*, and *Riley* took care to leave a corridor open for fraud actions to guard the public against false or misleading charitable solicitations. See *Schaumburg,* 444 U.S., at 637, 100 S.Ct. 826; *Munson,* 467 U.S., at 961, and n. 9, 104 S.Ct. 2839; *Riley,* 487 U.S., at 795, 800, 108 S.Ct. 2667. [FN7] As those decisions recognized, and as we further explain below, there are differences critical to First Amendment concerns between fraud actions trained on representations made in individual cases and statutes that categorically ban solicitations when fundraising costs run high. See Part III-B, *infra.* Simply labeling an action one for "fraud," of course, will not carry the day. For example, had the complaint against Telemarketers charged fraud based solely on the percentage of donations the fundraisers would retain, or their failure to alert potential donors to their fee arrangements at the start of each telephone call, *Riley* would support swift dismissal. [FN8] A State's Attorney General surely cannot gain case-by-case ground this Court has declared off limits to legislators.

FN7. We are therefore unpersuaded by Telemarketers' plea that they lacked fair notice of their vulnerability to fraud actions. See Brief for Respondents 46, 49-50.

FN8. Although fundraiser retention of 85 percent of donations is significantly higher than the 35 percent limit in *Riley,* this Court has not yet accepted any percentage-based measure as dispositive. See *supra,* at 1838 (quoting *Riley v. National Federation of Blind of N. C., Inc.,* 487 U.S. 781, 793, 108 S.Ct. 2667, 101 L.Ed.2d 669 (1988)).

*618 Portions of the complaint in fact filed by the Attorney General are of this genre. See, *e.g.,* App. 103, ¶ 72 (asserting that Telemarketers' charge "is excessive" and "not justified by expenses [they] paid"); *id.,* at 86, ¶¶ 67H-67I (alleging statutory violations based on failure to disclose to prospective donors Telemarketers' percentage fee). As we earlier noted, however, see *supra,* at 1834, the complaint and annexed affidavits, in large part, alleged not simply what Telemarketers failed to convey; they also described what Telemarketers misleadingly represented.

Under Illinois law, similar to the Federal Rules of Civil Procedure, "[w]hen the legal sufficiency of a complaint is challenged by a ... motion to dismiss, all well-pleaded facts in the complaint are taken as true and [the court] must determine whether the allegations ..., *when interpreted in the light most favorable to the plaintiff,* are sufficient to establish a cause of action upon which relief may be granted." *Connick v. Suzuki Motor Co., Ltd.,* 174 Ill.2d 482, 490, 221 Ill.Dec. 389, 393, 675 N.E.2d 584, 588 (1997) (emphasis added). Dismissal is proper "only if it clearly appears that no set of facts can be proved under the pleadings which will entitle the plaintiff to recover." 198 Ill.2d., at 351, 261 Ill.Dec., at 323, 763 N.E.2d, at 293.

**1840 Taking into account the affidavits, and reading the complaint in the light most favorable to the Attorney General, that pleading described misrepresentations our precedent does not place under the First Amendment's cover. First, it asserted that Telemarketers affirmatively represented that "a significant amount of each dollar donated would be paid over to Viet[N]ow" to be used for specific charitable purposes--rehabilitation services, job training, food baskets, and assistance for rent and bills, App. 9, ¶ 34; *id.,* at 124, 131, 145, 163, 169, 187, 189--while in reality Telemarketers knew that "15 cents or less of each dollar" was "available to Viet[N]ow for its purposes." *Id.,* at 9, ¶ 34. Second, the complaint alleged, essentially, that the charitable solicitation was a facade: Although Telemarketers represented that donated *619 funds would go to VietNow's specific " charitable purposes," App. 8, ¶ 29, the "amount of funds being paid over to charity was merely incidental to the fund raising effort," which was made "for the private pecuniary benefit of [Telemarketers] and their agents," App. 9, ¶ 35. Cf., *e.g., Voices for Freedom,* CCH Trade Reg. Rep. ¶ 23,080 (1993) [1987- 1993 Transfer Binder] (complaint against fundraisers who, *inter alia,* represented that "substantial portions of the funds from [the sale of commemorative bracelets] would be used to support a message center for the troops stationed in the Persian Gulf," but "did not use substantial portions of the bracelet-sales proceeds to support the message center").

Fraud actions so tailored, targeting misleading affirmative representations about how donations will be used, are plainly distinguishable, as we next discuss, from the measures invalidated in *Schaumburg, Munson*, and *Riley:* So long as the emphasis is on what the fundraisers misleadingly convey, and not on percentage limitations on solicitors' fees *per se,* such actions need not impermissibly chill protected speech.

BRANCH MINISTRIES and Dan Little, Pastor, Appellants,
v.
Charles O. ROSSOTTI, Commissioner, Internal Revenue Service, Appellee.

211 F.3d 137 (2000)

Opinion for the court filed by Senior Judge bUCKLEY.

BUCKLEY, Senior Judge:

Four days before the 1992 presidential election, Branch Ministries, a tax-exempt church, placed full-page advertisements in two newspapers in which it urged Christians not to vote for then-presidential candidate Bill Clinton because of his positions on certain moral issues. The Internal Revenue Service concluded that the placement of the advertisements violated the statutory restrictions on organizations exempt from taxation and, for the first time in its history, it revoked a bona fide church's tax-exempt status because of its involvement in politics. Branch Ministries and its pastor, Dan Little, challenge the revocation on the grounds that (1) the Service acted beyond its statutory authority, (2) the revocation violated its right to the free exercise of religion guaranteed by the First Amendment and the Religious Freedom Restoration Act, and (3) it was the victim of selective prosecution in violation of the Fifth Amendment. Because these objections are without merit, we affirm the district court's grant of summary judgment to the Service.

I. BACKGROUND

A. Taxation of Churches

The Internal Revenue Code ("Code") exempts certain organizations from taxation, including those organized and operated for religious purposes, provided that they do not engage in certain activities, including involvement in "any political campaign on behalf of (or in opposition to) any candidate for public office." 26 U.S.C. § 501(a), (c)(3) (1994). Contributions to such organizations are also deductible from the donating taxpayer's taxable income. *Id.* § 170(a). Although most organizations seeking tax-exempt status are required to apply to the Internal Revenue Service ("IRS" or "Service") for an advance determination that they meet the requirements of section 501(c)(3), *id.* § 508(a), a church may simply hold itself out as tax exempt and receive the benefits of that status without applying for advance recognition from the IRS. *Id.* § 508(c)(1)(A).

The IRS maintains a periodically updated "Publication No. 78," in which it lists all organizations that have received a ruling or determination letter confirming the deductibility of contributions made to them. *See* Rev. Proc. 82-39, 1982-1 C.B. 759, §§ 2.01, 2.03. Thus, a listing in that publication will provide donors with advance assurance that their contributions will be deductible under section 170(a). If a listed organization has subsequently had its tax-exempt status revoked, contributions that are made to it by a donor who is unaware of the change in status will generally be treated as deductible if made on or before the date that the revocation is publicly announced. *Id.* § 3.01. Donors to a church that has not received an advance determination of its tax-exempt status may also deduct their contributions; but in the event of an audit, the taxpayer will bear the burden of establishing that the church meets the requirements of section 501(c)(3). *See generally id.* § 3.04; Rev. Proc. 80-24, 1980-1 C.B. 658, § 6 (discussing taxpayers' obligations in seeking a ruling or determination letter).

The unique treatment churches receive in the Internal Revenue Code is further reflected in special restrictions on the IRS's ability to investigate the tax status of a church. The Church Audit Procedures Act ("CAPA") sets out the circumstances under which the IRS may initiate an investigation of a church and the procedures it is required to follow in such an *140 **169 investigation. 26 U.S.C. § 7611. Upon a " reasonable belief" by a high-level Treasury official that a church may not be exempt from taxation under section 501, the IRS may begin a "church tax inquiry." *Id.* § 7611(a). A church tax inquiry is defined, rather circularly, as

> any inquiry to a church (other than an examination) to serve as a basis for determining whether a church-
>
> (A) is exempt from tax under section 501(a) by reason of its status as a church, or
>
> (B) is ... engaged in activities which may be subject to taxation....

Id. § 7611(h)(2). If the IRS is not able to resolve its concerns through a church tax inquiry, it may proceed to the second level of investigation: a "church tax examination." In such an examination, the IRS may obtain and review the church's records or examine its activities "to determine whether [the] organization claiming to be a church is a church for any period." *Id.* § 7611(b)(1)(A), (B).

B. Factual and Procedural History

Branch Ministries, Inc. operates the Church at Pierce Creek ("Church"), a Christian church located in Binghamton, New York. In 1983, the Church requested and received a letter from the IRS recognizing its tax-exempt status. On October 30, 1992, four days before the presidential election, the Church placed full-page advertisements in *USA Today* and the *Washington Times*. Each bore the headline "Christians Beware" and asserted that then-Governor Clinton's positions concerning abortion, homosexuality, and the distribution of condoms to teenagers in schools violated Biblical precepts. The following appeared at the bottom of each advertisement:

> This advertisement was co-sponsored by the Church at Pierce Creek, Daniel J. Little, Senior Pastor, and by churches and concerned Christians nationwide. Tax-deductible donations for this advertisement gladly accepted. Make donations to: The Church at Pierce Creek. [mailing address].

Appendix ("App.") at Tab 5, Ex. E.

The advertisements did not go unnoticed. They produced hundreds of contributions to the Church from across the country and were mentioned in a *New York Times* article and an Anthony Lewis column which stated that the sponsors of the advertisement had almost certainly violated the Internal Revenue Code. Peter Applebome, *Religious Right Intensifies Campaign for Bush,* N.Y. Times, Oct. 31, 1992, at A1; Anthony Lewis, *Tax Exempt Politics?,* N.Y. Times, Dec. 1, 1992, at A15.

The advertisements also came to the attention of the Regional Commissioner of the IRS, who notified the Church on November 20, 1992 that he had authorized a church tax inquiry based on "a reasonable belief ... that you may not be tax-exempt or that you may be liable for tax" due to political activities and expenditures. Letter from Cornelius J. Coleman, IRS Regional Commissioner, to The Church at Pierce Creek (Nov. 20, 1992), *reprinted in* App. at Tab 5, Ex. F. The Church denied that it had engaged in any prohibited political activity and declined to provide the IRS with certain information the Service had requested. On February 11, 1993, the IRS informed the Church that it was beginning a church tax examination. Following two unproductive meetings between the parties, the IRS revoked the Church's section 501(c)(3) tax-exempt status on January 19, 1995, citing the newspaper advertisements as prohibited intervention in a political campaign.

The Church and Pastor Little (collectively, "Church") commenced this lawsuit soon thereafter. This had the effect of suspending the revocation of the Church's tax exemption until the district court entered its judgment in this case. *See* 26 U.S.C. § 7428(c). The Church challenged the revocation of its tax-exempt status, alleging that the IRS had no authority to revoke its tax exemption, that the revocation *141 **170 violated its right to free speech and to freely exercise its religion under the First Amendment and the Religious Freedom Restoration Act of 1993, 42 U.S.C. § 2000bb ("RFRA"), and that the IRS engaged in selective prosecution in violation of the Equal Protection Clause of the Fifth Amendment. After allowing discovery on the Church's selective prosecution claim, *Branch Ministries, Inc. v. Richardson,* 970 F.Supp. 11 (D.D.C.1997), the district court granted summary judgment in favor of the IRS. *Branch Ministries v. Rossotti,* 40 F.Supp.2d 15 (D.D.C.1999).

[1] The Church filed a timely appeal, and we have jurisdiction pursuant to 28 U.S.C. § 1291. We review summary judgment decisions *de novo, see Everett v. United States,* 158 F.3d 1364, 1367 (D.C.Cir.1998), *cert. denied,* 526 U.S. 1132, 119 S.Ct. 1807, 143 L.Ed.2d 1010 (1999), and will affirm only if there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c).

II. ANALYSIS

The Church advances a number of arguments in support of its challenges to the revocation. We examine only those that warrant analysis.

A. The Statutory Authority of the IRS

[2] The Church argues that, under the Internal Revenue Code, the IRS does not have the statutory authority to revoke the tax-exempt status of a bona fide church. It reasons as follows: section 501(c)(3) refers to tax-exempt status for religious organizations, not churches; section 508, on the other hand, specifically exempts "churches" from the requirement of applying for advance recognition of tax-exempt status, *id.* § 508(c)(1)(A); therefore, according to the Church, its tax-exempt status is derived not from section 501(c)(3), but from the lack of any provision in the Code for the taxation of churches. The Church concludes from this that it is not subject to taxation and that the IRS is therefore powerless to place conditions upon or to remove its tax-exempt status as a church.

We find this argument more creative than persuasive. The simple answer, of course, is that whereas not every religious organization is a church, every church is a religious organization. More to the point, irrespective of whether it was required to do so, the Church applied to the IRS for an advance determination of its tax-exempt status. The IRS granted that recognition and now seeks to withdraw it. CAPA gives the IRS this power.

That statute, which pertains exclusively to churches, provides authority for revocation of the tax-exempt status of a church through its references to other sections of the Internal Revenue Code. The section of CAPA entitled "Limitations on revocation of tax-exempt status, etc." provides that the

Secretary of the Treasury may "determine that an organization is not a church which [ ] (i) is exempt from taxation by reason of section 501(a), or (ii) is described in section 170(c)." 26 U.S.C. § 7611(d)(1)(A)(i), (ii). Both of these sections condition tax-exempt status on non-intervention in political campaigns. Section 501(a) states that "[a]n organization described in subsection (c) ... shall be exempt from taxation...." *Id.* § 501(a). Those described in subsection (c) include

> corporations ... organized and operated exclusively for religious ... purposes ... which do[ ] not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Id. § 501(c)(3). Similarly, section 170(c) allows taxpayers to deduct from their taxable income donations made to a corporation

> organized and operated exclusively for religious ... purposes ... which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to ... intervene in (including the publishing *142 **171 or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

Id. § 170(c)(2)(B), (D).

The Code, in short, specifically states that organizations that fail to comply with the restrictions set forth in section 501(c) are not qualified to receive the tax exemption that it provides. Having satisfied ourselves that the IRS had the statutory authority to revoke the Church's tax-exempt status, we now turn to the free exercise challenges.

B. First Amendment Claims and the RFRA

[3] The Church claims that the revocation of its exemption violated its right to freely exercise its religion under both the First Amendment and the RFRA. To sustain its claim under either the Constitution or the statute, the Church must first establish that its free exercise right has been substantially burdened. *See Jimmy Swaggart Ministries v. Board of Equalization,* 493 U.S. 378, 384-85, 110 S.Ct. 688, 107 L.Ed.2d 796 (1990) ("Our cases have established that the free exercise inquiry asks whether government has placed a substantial burden on the observation of a central religious belief or practice and, if so, whether a compelling governmental interest justifies the burden.") (internal quotation marks and brackets omitted); 42 U.S.C. § 2000bb-1(a), (b) ("Government shall not substantially burden a person's exercise of religion" in the absence of a compelling government interest that is furthered by the least restrictive means.). We conclude that the Church has failed to meet this test.

The Church asserts, first, that a revocation would threaten its existence. *See* Affidavit of Dan Little dated July 31, 1995 at ¶ 22, *reprinted in* App. at Tab 8 ("The Church at Pierce Creek will have to close due to the revocation of its tax exempt status, and the inability of congregants to deduct their contributions from their taxes."). The Church maintains that a loss of its tax-exempt status will not only make its members reluctant to contribute the funds essential to its survival, but may obligate the Church itself to pay taxes.

[4] The Church appears to assume that the withdrawal of a conditional privilege for failure to meet the condition is in itself an unconstitutional burden on its free exercise right. This is true, however, only if the receipt of the privilege (in this case the tax exemption) is conditioned

> upon conduct proscribed by a religious faith, or ... denie[d] ... because of conduct mandated by religious belief, thereby putting substantial pressure on an adherent to modify his behavior and to violate his beliefs.

Jimmy Swaggart Ministries, 493 U.S. at 391-92, 110 S.Ct. 688 (internal quotation marks and citation omitted). Although its advertisements reflected its religious convictions on certain questions of morality, the Church does not maintain that a withdrawal from electoral politics would violate its beliefs. The sole effect of the loss of the tax exemption will be to decrease the amount of money available to the Church for its religious practices. The Supreme Court has declared, however, that such a burden "is not constitutionally significant." *Id.* at 391, 110 S.Ct. 688; *see also Hernandez v. Commissioner,* 490 U.S. 680, 700, 109 S.Ct. 2136, 104 L.Ed.2d 766 (1989) (the "contention that an incrementally larger tax burden interferes with [ ] religious activities ... knows no limitation").

In actual fact, even this burden is overstated. Because of the unique treatment churches receive under the Internal Revenue Code, the impact of the revocation is likely to be more symbolic than substantial. As the IRS confirmed at oral argument, if the Church does not intervene in future political campaigns, it may hold itself out as a 501(c)(3) organization and receive all the benefits of that status. All that will have been lost, in that event, is the advance assurance of deductibility in *143 **172 the event a donor should be audited. *See* 26 U.S.C. § 508(c)(1)(A); Rev. Proc. 82-39 § 2.03. Contributions will remain tax deductible as long as donors are able to establish that the Church meets the requirements of section 501(c) (3).

Nor does the revocation necessarily make the Church liable for the payment of taxes. As the IRS explicitly represented in its brief and reiterated at oral argument, the revocation of the exemption does not convert bona fide donations into income taxable to the Church. *See* 26 U.S.C. § 102 ("Gross income does not include the value of property acquired by gift...."). Furthermore, we know of no authority, and counsel provided none, to prevent the Church from reapplying for a prospective determination of its tax-exempt status and regaining the advance assurance of deductibility--provided, of course, that it renounces future involvement in political campaigns.

We also reject the Church's argument that it is substantially burdened because it has no alternate means by which to communicate its sentiments about candidates for public office. In *Regan v. Taxation With Representation,* 461 U.S. 540, 552-53, 103 S.Ct. 1997, 76 L.Ed.2d 129 (1983) (Blackmun, J., concurring), three members of the Supreme Court stated that the availability of such an alternate means of communication is essential to the constitutionality of section 501(c)(3)'s restrictions on lobbying. The Court subsequently confirmed that this was an accurate description of its holding. *See FCC v. League of Women Voters,* 468 U.S. 364, 400, 104 S.Ct. 3106, 82 L.Ed.2d 278 (1984). In *Regan,* the concurring justices noted that "TWR may use its present § 501(c)(3) organization for its nonlobbying activities and may create a § 501(c)(4) affiliate to pursue its charitable goals through lobbying." 461 U.S. at 552, 103 S.Ct. 1997.

[5] The Church has such an avenue available to it. As was the case with TWR, the Church may form a related organization under section 501(c)(4) of the Code. *See* 26 U.S.C. § 501(c)(4) (tax exemption for "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare"). Such organizations are exempt from taxation; but unlike their section 501(c)(3) counterparts, contributions to them are not deductible. *See id.* § 170(c); *see also Regan,* 461 U.S. at 543, 552-53, 103 S.Ct. 1997. Although a section 501(c)(4) organization is also subject to the ban on intervening in political campaigns, *see* 26 C.F.R. § 1.501(c)(4)-1(a)(2)(ii) (1999), it may form a political action committee ("PAC") that would be free to participate in political campaigns. *Id.* § 1.527-6(f), (g) ("[A]n organization described in section 501(c) that is exempt from taxation under section 501(a) may, [if it is not a section 501(c)(3) organization], establish and maintain such a separate segregated fund to receive contributions and make expenditures in a political campaign.").

At oral argument, counsel for the Church doggedly maintained that there can be no "Church at Pierce Creek PAC." True, it may not itself create a PAC; but as we have pointed out, the Church can initiate a series of steps that will provide an alternate means of political communication that will satisfy the standards set by the concurring justices in *Regan*. Should the Church proceed to do so, however, it must understand that the related 501(c)(4) organization must be separately incorporated; and it must maintain records that will demonstrate that tax-deductible contributions to the Church have not been used to support the political activities conducted by the 501(c)(4) organization's political action arm. *See* 26 U.S.C. § 527(f)(3); 26 C.F.R. § 1.527-6(e), (f).

That the Church cannot use its tax-free dollars to fund such a PAC unquestionably passes constitutional muster. The Supreme Court has consistently held that, absent invidious discrimination, "Congress has not violated [an organization's] First Amendment rights by declining to subsidize *144 **173 its First Amendment activities." *Regan,* 461 U.S. at 548, 103 S.Ct. 1997; *see also Cammarano v. United States,* 358 U.S. 498, 513, 79 S.Ct. 524, 3 L.Ed.2d 462 (1959) ("Petitioners are not being denied a tax deduction because they engage in constitutionally protected activities, but are simply being required to pay for those activities entirely out of their own pockets, as everyone else engaging in similar activities is required to do under the provisions of the Internal Revenue Code.").

Because the Church has failed to demonstrate that its free exercise rights have been substantially burdened, we do not reach its arguments that section 501(c)(3) does not serve a compelling government interest or, if it is indeed compelling, that revocation of its tax exemption was not the least restrictive means of furthering that interest.

[6] Nor does the Church succeed in its claim that the IRS has violated its First Amendment free speech rights by engaging in viewpoint discrimination. The restrictions imposed by section 501(c)(3) are viewpoint neutral; they prohibit intervention in favor of all candidates for public office by all tax-exempt organizations, regardless of candidate, party, or viewpoint. *Cf. Regan,* 461 U.S. at 550-51, 103 S.Ct. 1997 (upholding denial of tax deduction for lobbying activities, in spite of allowance of such deduction for veteran's groups).

C. Selective Prosecution (Fifth Amendment)

The Church alleges that the IRS violated the Equal Protection Clause of the Fifth Amendment by engaging in selective prosecution. In support of its claim, the Church has submitted several hundred pages of newspaper excerpts reporting political campaign activities in, or by the pastors of, other churches that have retained their tax-exempt status. These include reports of explicit endorsements of Democratic candidates by clergymen as well as many instances in which favored candidates have been invited to address congregations from the pulpit. The Church complains that despite this widespread and widely reported involvement by other churches in political campaigns, it is the only one to have ever had its tax-exempt status revoked for engaging in political activity. It attributes this alleged discrimination to the Service's political bias.

[7][8] To establish selective prosecution, the Church must "prove that (1) [it] was singled out for prosecution from among others similarly situated and (2) that [the] prosecution was improperly motivated, i.e., based on race, religion or another arbitrary classification." *United States v. Washington,* 705 F.2d 489, 494 (D.C.Cir.1983). This burden is a demanding one because "in the absence of clear evidence to the contrary, courts presume that [government prosecutors] have properly discharged their official duties." *United States v. Armstrong,* 517 U.S. 456, 464, 116 S.Ct. 1480, 134 L.Ed.2d 687 (1996) (internal quotation marks and citation omitted).

[9] At oral argument, counsel for the IRS conceded that if some of the church-sponsored political activities cited by the Church were accurately reported, they were in violation of section 501(c)(3) and could have resulted in the revocation of those churches' tax-exempt status. But even if the Service could have revoked their tax exemptions, the Church has failed to establish selective prosecution because it has failed to demonstrate that it was similarly situated to any of those other churches. None of the reported activities involved the placement of advertisements in newspapers with nationwide circulations opposing a candidate and soliciting tax deductible contributions to defray their cost. As we have stated,

> [i]f ... there was no one to whom defendant could be compared in order to resolve the question of [prosecutorial] selection, then it follows that defendant has failed to make out one of the elements *145 **174 of its case. Discrimination cannot exist in a vacuum; it can be found only in the unequal treatment of people in similar circumstances.

Attorney Gen. v. Irish People, Inc., 684 F.2d 928, 946 (D.C.Cir.1982); *see also United States v. Hastings,* 126 F.3d 310, 315 (4th Cir.1997) ("[D]efendants are similarly situated when their circumstances present no distinguishable legitimate prosecutorial factors that might justify making different prosecutorial decisions with respect to them.") (internal quotation marks and citation omitted).

Because the Church has failed to establish that it was singled out for prosecution from among others who were similarly situated, we need not examine whether the IRS was improperly motivated in undertaking this prosecution.

III. CONCLUSION

For the foregoing reasons, we find that the revocation of the Church's tax-exempt status neither violated the Constitution nor exceeded the IRS's statutory authority. The judgment of the district court is therefore

Affirm

NATIONAL ASSOCIATION FOR the ADVANCEMENT OF COLORED PEOPLE,
v.
STATE OF ALABAMA,

357 U.S. 449 (1958)

***451** Mr. Justice HARLAN delivered the opinion of the Court.

We review from the standpoint of its validity under the Federal Constitution a judgment of civil contempt entered against petitioner, the National Association for the Advancement of Colored People, in the courts of Alabama. The question presented is whether Alabama, consistently with the Due Process Clause of the Fourteenth Amendment, can compel petitioner to reveal to the State's Attorney General the names and addresses of all its Alabama members and agents, without regard to their positions or functions in the Association. The judgment of contempt was based upon petitioner's refusal to comply fully with a court order requiring in part the production of membership lists. Petitioner's claim is that the order, in the circumstances shown by this record, violated rights assured to petitioner and its members under the Constitution.

Alabama has a statute similar to those of many other States which requires a foreign corporation, except as exempted, to qualify before doing business by filing its corporate charter with the Secretary of State and designating a place of business and an agent to receive service of process. The statute imposes a fine on a corporation transacting intrastate business before qualifying and provides for criminal prosecution of officers of such a corporation. Ala.Code, 1940, Tit. 10, ss 192--198. The National Association for the Advancement of Colored People is a nonprofit membership corporation organized under the laws of New York. Its purposes, fostered on a nationwide basis, are those indicated by its name, [FN*] and it operates ***452** through chartered affiliates which are independent unincorporated associations, with membership therein equivalent to membership in petitioner. The first Alabama affiliates were chartered in 1918. Since that time the aims of the Association have been advanced through activities of its affiliates, and in 1951 the Association itself opened a regional office in Alabama, at which it employed two supervisory persons and one clerical worker. The Association has never complied with the qualification statute, from which it considered itself exempt.

FN* The Certificate of Incorporation of the Association provides that its '* * * principal objects * * * are voluntarily to promote equality of rights and eradicate caste or race prejudice among the citizens of the United States; to advance the interest of colored citizens; to secure for them impartial suffrage; and to increase their opportunities for securing justice in the courts, education for their children, employment according to their ability, and complete equality before the law.'

In 1956 the Attorney General of Alabama brought an equity suit in the State Circuit Court, Montgomery County, to ****1167** enjoin the Association from conducting further activities within, and to oust it from, the State. Among other things the bill in equity alleged that the Association had opened a regional office and had organized various affiliates in Alabama; had recruited members and solicited contributions within the State; had given financial support and furnished legal assistance to Negro students seeking admission to the state university; and had supported a Negro boycott of the bus lines in Montgomery to compel the seating of passengers without regard to race. The bill recited that the Association, by continuing to do business in Alabama without complying with the qualification statute, was '* * * causing irreparable injury to the property and civil rights of the residents and citizens of the State of Alabama for which criminal prosecution and civil actions at law afford no adequate relief

* * *.' On the day the complaint was filed, the Circuit Court issued ex parte an order restraining the Association, pendente lite, from engaging in ***453** further activities within the State and forbidding it to take any steps to qualify itself to do business therein.

Petitioner demurred to the allegations of the bill and moved to dissolve the restraining order. It contended that its activities did not subject it to the qualification requirements of the statute and that in any event what the State sought to accomplish by its suit would violate rights to freedom of speech and assembly guaranteed under the Fourteenth Amendment to the Constitution of the United States. Before the date set for a hearing on this motion, the State moved for the production of a large number of the Association's records and papers, including bank statements, leases, deeds, and records containing the names and addresses of all Alabama 'members' and 'agents' of the Association. It alleged that all such documents were necessary for adequate preparation for the hearing, in view of petitioner's denial of the conduct of intrastate business within the meaning of the qualification statute. Over petitioner's objections, the court ordered the production of a substantial part of the requested records, including the membership lists, and postponed the hearing on the restraining order to a date later than the time ordered for production.

Thereafter petitioner filed its answer to the bill in equity. It admitted its Alabama activities substantially as alleged in the complaint and that it had not qualified to do business in the State. Although still disclaiming the statute's application to it, petitioner offered to qualify if the bar from qualification made part of the restraining order were lifted, and it submitted with the answer an executed set of the forms required by the statute. However petitioner did not comply with the production order, and for this failure was adjudged in civil contempt and fined $10,000. The contempt judgment provided that the fine would be subject to reduction or remission if compliance ***454** were forthcoming within five days but otherwise would be increased to $100,000.

[1] At the end of the five-day period petitioner produced substantially all the data called for by the production order except its membership lists, as to which it contended that Alabama could not constitutionally compel disclosure, and moved to modify or vacate the contempt judgment, or stay it execution pending appellate review. This motion was denied. While a similar stay application, which was later denied, was pending before the Supreme Court of Alabama, the Circuit Court made a further order adjudging petitioner in continuing contempt and increasing the fine already imposed to $100,000. Under Alabama law, see Jacoby v. Goetter, Weil & Co., 74 Ala.

427, the effect of the contempt adjudication was to foreclose petitioner from obtaining a hearing on the merits of the underlying ouster action, or from taking any steps to dissolve the temporary restraining order which had been issued ex ****1168** parte, until it purged itself of contempt. But cf. Harrison v. St. Louis & S.F.R. Co., 232 U.S. 318, 34 S.Ct. 333, 58 L.Ed. 621; Hovey v. Elliott, 167 U.S. 409, 17 S.Ct. 841, 42 L.Ed. 215.

[2] The State Supreme Court thereafter twice dismissed petitions for certiorari to review this final contempt judgment, the first time, 265 Ala. 699, 91 So.2d 221, for insufficiency of the petition's allegations and the second time on procedural grounds. 265 Ala. 349, 91 So.2d 214. We granted certiorari because of the importance of the constitutional questions presented. 353 U.S. 972, 77 S.Ct. 1056, 1 L.Ed.2d 1135.

I.

II.

[10] The Association both urges that it is constitutionally entitled to resist official inquiry into its membership lists, and that it may assert, on behalf of its members, a right personal to them to be protected from compelled disclosure by the State of their affiliation with the Association as revealed by the membership lists. We think that petitioner argues more appropriately the rights of its members, and that its nexus with them is sufficient to permit that it act as their representative before this ***459** Court. In so concluding, we reject respondent's argument that the Association lacks standing to assert here constitutional rights pertaining to the members, who are not of course parties to the litigation.

[11] To limit the breadth of issues which must be dealt with in particular litigation, this Court has generally insisted that parties rely only on constitutional rights which are personal to themselves. Tileston v. Ullman, 318 U.S. 44, 63 S.Ct. 493, 87 L.Ed. 603; Robertson and Kirkham, Jurisdiction of the Supreme Court (1951 ed.) s 293. This rule is related to the broader doctrine that constitutional adjudication should where possible be avoided. See Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 346--348, 56 S.Ct. 466, 482--483, 80 L.Ed. 688 (concurring opinion). The principle is not disrespected where constitutional rights of persons who are not immediately before the Court could not be effectively vindicated except through an appropriate representative before the Court. See Barrows v. Jackson, 346 U.S. 249, 255--259, 73 S.Ct. 1031, 1034--1036, 97 L.Ed. 1586; Joint Anti-Fascist Refugee Committee v. McGrath, 341 U.S. 123, 183--187, 71 S.Ct. 624, 654--656, 95 L.Ed. 817 (concurring opinion).

[12] If petitioner's rank-and-file members are constitutionally entitled to withhold their connection with the Association despite the production order, it is manifest that this right is properly assertable by the Association. To require that it be claimed by the members themselves would result in nullification of the right at the very moment of its assertion. Petitioner is the appropriate party to assert that rights, because it and its members are in every practical sense identical. The Association, which provides in its constitution that '(a)ny person who is in accordance with (its) principles and policies * * *' may become a member, is but the medium through which its individual members seek to make more effective the expression of their own views. The reasonable likelihood that the Association itself through diminished financial support and membership may be adversely ***460** affected if production is compelled is a further factor pointing towards our holding that petitioner has standing to complain of the production order on behalf of its members. Cf. Pierce v. Society of Sisters, 268 U.S. 510, 534--536, 45 S.Ct. 571, 573--574, 69 L.Ed. 1070.

III.

We thus reach petitioner's claim that the production order in the state litigation trespasses upon fundamental freedoms protected by the Due Process Clause of the Fourteenth Amendment. Petitioner argues that in view of the facts and circumstances shown in the record, the effect of compelled disclosure of the membership lists will be to abridge the rights of its rank-and-file members to engage in lawful association in support ****1171** of their common beliefs. It contends that governmental action which, although not directly suppressing association, nevertheless carries this consequence, can be justified only upon some overriding valid interest of the State.

[13][14][15][16] Effective advocacy of both public and private points of view, particularly controversial ones, is undeniably enhanced by group association, as this Court has more than once recognized by remarking upon the close nexus between the freedoms of speech and assembly. De Jonge v. Oregon, 299 U.S. 353, 364, 57 S.Ct. 255, 259, 81 L.Ed. 278; Thomas v. Collins, 323 U.S. 516, 530, 65 S.Ct. 315, 322, 89 L.Ed. 430. It is beyond debate that freedom to engage in association for the advancement of beliefs and ideas is an inseparable aspect of the 'liberty' assured by the Due Process Clause of the Fourteenth Amendment, which embraces freedom of speech. See Gitlow v. New York, 268 U.S. 652, 666, 45 S.Ct. 625, 629, 69 L.Ed. 1138; Palko v. Connecticut, 302 U.S. 319, 324, 58 S.Ct. 149, 151, 82 L.Ed. 288; Cantwell v. Connecticut, 310 U.S. 296, 303, 60 S.Ct. 900, 84 L.Ed. 1213; Staub v. City of Baxley, 355 U.S. 313, 321,

78 S.Ct. 277, 281, 2 L.Ed.2d 302. Of course, it is immaterial whether the beliefs sought to be advanced by association pertain to political, economic, religious or cultural matters, and state action which may have the ***461** effect of curtailing the freedom to associate is subject to the closest scrutiny.

[17][18] The fact that Alabama, so far as is relevant to the validity of the contempt judgment presently under review, has taken no direct action, cf. De Jonge v. Oregon, supra; Near v. Minnesota, 283 U.S. 697, 51 S.Ct. 625, 75 L.Ed. 1357, to restrict the right of petitioner's members to associate freely, does not end inquiry into the effect of the production order. See American Communications Ass'n v. Douds, 339 U.S. 382, 402, 70 S.Ct. 674, 685, 94 L.Ed. 925. In the domain of these indispensable liberties, whether of speech, press, or association, the decisions of this Court recognize that abridgement of such rights, even though unintended, may inevitably follow from varied forms of governmental action. Thus in Douds, the Court stressed that the legislation there challenged, which on its face sought to regulate labor unions and to secure stability in interstate commerce, would have the practical effect 'of discouraging' the exercise of constitutionally protected political rights, 339 U.S. at page 393, 70 S.Ct. at page 681, and it upheld that statute only after concluding that the reasons advanced for its enactment were constitutionally sufficient to justify its possible deterrent effect upon such freedoms. Similar recognition of possible unconstitutional intimidation of the free exercise of the right to advocate underlay this Court's narrow construction of the authority of a congressional committee investigating lobbying and of an Act regulating lobbying, although in neither case was there an effort to suppress speech. United States v. Rumely, 345 U.S. 41, 46--47, 73 S.Ct. 543, 546, 97 L.Ed. 770; United States v. Harriss, 347 U.S. 612, 625--626, 74 S.Ct. 808, 815--816, 98 L.Ed. 989. The governmental action challenged may appear to be totally unrelated to protected liberties. Statutes imposing taxes upon rather than prohibiting particular activity have been struck down when perceived to have the consequence of unduly curtailing the liberty of freedom of press assured under the Fourteenth Amendment. ***462**Grosjean v. American Press Co., 297 U.S. 233, 56 S.Ct. 444, 80 L.Ed. 660; Murdock v. Pennsylvania, 319 U.S. 105, 63 S.Ct. 891, 87 L.Ed. 1292.

[19][20][21] It is hardly a novel perception that compelled disclosure of affiliation with groups engaged in advocacy may constitute as effective a restraint on freedom of association as the forms of governmental action in the cases above were thought likely to produce upon the particular constitutional rights there involved. This Court has

recognized the **1172** vital relationship between freedom to associate and privacy in one's associations. When referring to the varied forms of governmental action which might interfere with freedom of assembly, it said in American Communications Ass'n v. Douds, supra, 339 U.S. at page 402, 70 S.Ct. at page 686: 'A requirement that adherents of particular religious faiths or political parties wear identifying arm-bands, for example, is obviously of this nature.' Compelled disclosure of membership in an organization engaged in advocacy of particular beliefs is of the same order. Inviolability of privacy in group association may in many circumstances be indispensable to preservation of freedom of association, particularly where a group espouses dissident beliefs. Cf. United States v. Rumely, supra, 345 U.S. at pages 56--58, 73 S.Ct. at pages 550--551 (concurring opinion).

[22] We think that the production order, in the respects here drawn in question, must be regarded as entailing the likelihood of a substantial restraint upon the exercise by petitioner's members of their right to freedom of association. Petitioner has made an uncontroverted showing that on past occasions revelation of the identity of its rank-and-file members has exposed these members to economic reprisal, loss of employment, threat of physical coercion, and other manifestations of public hostility. Under these circumstances, we think it apparent that compelled disclosure of petitioner's Alabama membership is likely to affect adversely the ability of petitioner and ***463** its members to pursue their collective effort to foster beliefs which they admittedly have the right to advocate, in that it may induce members to withdraw from the Association and dissuade others from joining it because of fear of exposure of their beliefs shown through their associations and of the consequences of this exposure. For the reasons stated, the judgment of the Supreme Court of Alabama must be reversed and the case remanded for proceedings not inconsistent with this opinion.

Reversed.

Kathryn R. ROBERTS, Acting Commissioner, Minnesota Department of Human Rights, et al.
v.
UNITED STATES JAYCEES.

468 U.S. 609 (1984)

***612** Justice BRENNAN delivered the opinion of the Court.

This case requires us to address a conflict between a State's efforts to eliminate gender-based discrimination against its citizens and the constitutional freedom of association asserted by members of a private organization. In the decision under review, the Court of Appeals for the Eighth Circuit concluded that, by requiring the United States Jaycees to admit women as full voting members, the Minnesota Human Rights Act violates the First and Fourteenth Amendment rights of the organization's members. We noted probable jurisdiction, ****3247**Gomez-Bethke v. United States Jaycees, 464 U.S. 1037, 104 S.Ct. 696, 79 L.Ed.2d 162 (1984), and now reverse.

I

A

The United States Jaycees (Jaycees), founded in 1920 as the Junior Chamber of Commerce, is a nonprofit membership corporation, incorporated in Missouri with national headquarters in Tulsa, Okla. The objective of the Jaycees, as set out in its bylaws, is to pursue

> "such educational and charitable purposes as will promote and foster the growth and development of young men's civic organizations in the United States, designed to inculcate in the individual membership of such organization a spirit of genuine Americanism and civic interest, ***613** and as a supplementary education institution to provide them with opportunity for personal development and achievement and an avenue for intelligent participation by young men in the affairs of their community, state and nation, and to develop true friendship and understanding among young men of all nations." Quoted in Brief for Appellee 2.

The organization's bylaws establish seven classes of membership, including individual or regular members, associate individual members, and local chapters. Regular membership is limited to young men between the ages of 18 and 35, while associate membership is available to individuals or groups ineligible for regular membership, principally women and older men. An associate member, whose dues are somewhat lower than those charged regular members, may not vote, hold local or national office, or participate in certain leadership training and awards programs. The bylaws define a local chapter as "[a]ny young men's organization of good repute existing in any community within the United States, organized for purposes similar to and consistent with those" of the national organization. App. to Juris. Statement A98. The ultimate policymaking authority of the Jaycees rests with an annual national convention, consisting of delegates from each local chapter, with a national president and board of directors. At the time of trial in August 1981, the Jaycees had approximately 295,000 members in 7,400 local chapters affiliated with 51 state organizations. There were at that time about 11,915 associate members. The national organization's executive vice president estimated at trial that women associate members make up about two percent of the Jaycees' total membership. Tr. 56.

New members are recruited to the Jaycees through the local chapters, although the state and national organizations are also actively involved in recruitment through a variety of promotional activities. A new regular member pays an initial fee followed by annual dues; in exchange, he is entitled ***614** to participate in all of the activities of the local, state, and national organizations. The national headquarters employs a staff to develop "program kits" for use by local chapters that are designed to enhance individual development, community development, and members' management skills. These materials include courses in public speaking and personal finances as well as community programs related to charity, sports, and public health. The national office also makes available to members a range of personal products, including travel accessories, casual wear, pins, awards, and other gifts. The programs, products, and other activities of the organization are all regularly featured in publications made available to the membership, including a magazine entitled "Future."

B

In 1974 and 1975, respectively, the Minneapolis and St. Paul chapters of the Jaycees began admitting women as regular members. Currently, the memberships and boards of directors of both chapters include a substantial proportion of women. As a result, the two chapters have been in violation of the national organization's bylaws for about 10 years. The national organization****3248** has imposed a number of sanctions on the Minneapolis and St. Paul chapters for violating the bylaws, including denying their members eligibility for state or national office or awards programs, and refusing to count their membership in computing votes at national conventions.

In December 1978, the president of the national organization advised both chapters that a motion to revoke their charters would be considered at a forthcoming meeting of the national board of directors in Tulsa. Shortly after receiving this notification, members of both chapters filed charges of discrimination with the Minnesota Department of Human Rights. The complaints alleged that the exclusion of women from full membership required by the national organization's bylaws violated the Minnesota Human Rights Act (Act), which provides in part:

***615** "It is an unfair discriminatory practice:

"To deny any person the full and equal enjoyment of the goods, services, facilities, privileges, advantages, and accommodations of a place of public accommodation because of race, color, creed, religion, disability, national origin or sex." Minn.Stat. § 363.03, subd. 3 (1982).

The term "place of public accommodation" is defined in the Act as "a business, accommodation, refreshment, entertainment, recreation, or transportation facility of any kind, whether licensed or not, whose goods, services, facilities, privileges, advantages or accommodations are extended, offered, sold, or otherwise made available to the public." § 363.01, subd. 18.

After an investigation, the Commissioner of the Minnesota Department of Human Rights found probable cause to believe that the sanctions imposed on the local chapters by the national organization violated the statute and ordered that an evidentiary hearing be held before a state hearing examiner. Before that hearing took place, however, the national organization brought suit against various state officials, appellants here, in the United States District Court for the District of Minnesota, seeking declaratory and injunctive relief to prevent enforcement of the Act. The complaint alleged that, by requiring the organization to accept women as regular members, application of the Act would violate the male members' constitutional rights of free speech and association. With the agreement of the parties, the District Court dismissed the suit without prejudice, stating that it could be renewed in the event the state administrative proceeding resulted in a ruling adverse to the Jaycees.

The proceeding before the Minnesota Human Rights Department hearing examiner then went forward and, upon its completion, the examiner filed findings of fact and conclusions of law. The examiner concluded that the Jaycees organization is a "place of public accommodation" within the Act and that it had engaged in an unfair discriminatory practice ***616** by excluding women from regular membership. He ordered the national organization to cease and desist from discriminating against any member or applicant for membership on the basis of sex and from imposing sanctions on any Minnesota affiliate for admitting women.

Minnesota v. United States Jaycees, No. HR-79-014-GB (Minn. Office of Hearing Examiners for the Dept. of Human Rights, Oct. 9, 1979) (hereinafter Report), App. to Juris. Statement A107-A109. The Jaycees then filed a renewed complaint in the District Court, which in turn certified to the Minnesota Supreme Court the question whether the Jaycees organization is a "place of public accommodation" within the meaning of the State's Human Rights Act. See App. 32.

With the record of the administrative hearing before it, the Minnesota Supreme Court answered that question in the affirmative. United States Jaycees v. McClure, 305 N.W.2d 764 (1981). Based on the Act's legislative history, the court determined that the statute is applicable to any "public business facility." Id., at 768. It then concluded that the Jaycees organization (a) is a "business" in that it sells goods and extends privileges in exchange for annual ****3249** membership dues; (b) is a "public" business in that it solicits and recruits dues-paying members based on unselective criteria; and (c) is a public business "facility" in that it conducts its activities at fixed and mobile sites within the State of Minnesota. Id., at 768-774.

Subsequently, the Jaycees amended its complaint in the District Court to add a claim that the Minnesota Supreme Court's interpretation of the Act rendered it unconstitutionally vague and overbroad. The federal suit then proceeded to trial, after which the District Court entered judgment in favor of the state officials. United States Jaycees v. McClure, 534 F.Supp. 766 (1982). On appeal, a divided Court of Appeals for the Eighth Circuit reversed. United States Jaycees v. McClure, 709 F.2d 1560 (1983). The Court of Appeals determined that, because "the advocacy of political ***617** and public causes, selected by the membership, is a not insubstantial part of what [the Jaycees] does," the organization's right to select its members is protected by the freedom of association guaranteed by the First Amendment. Id., at 1570. It further decided that application of the Minnesota statute to the Jaycees' membership policies would produce a "direct and substantial" interference with that freedom, id., at 1572, because it would necessarily result in "some change in the Jaycees' philosophical cast," id., at 1571, and would attach penal sanctions to those responsible for maintaining the policy, id., at 1572. The court concluded that the State's interest in eradicating discrimination is not sufficiently compelling to outweigh this interference with the Jaycees' constitutional rights, because the organization is not wholly "public," id., at 1571-1572, 1573, the state interest had been asserted selectively, id., at 1573, and the anti-discrimination policy could be served in a number of ways less intrusive of First Amendment freedoms, id., at 1573-1574.

Finally, the court held, in the alternative, that the Minnesota statute is vague as construed and applied and therefore unconstitutional under the Due Process Clause of the Fourteenth Amendment. In support of this conclusion, the court relied on a statement in the opinion of the Minnesota Supreme Court suggesting that, unlike the Jaycees, the Kiwanis Club is "private" and therefore not subject to the Act. By failing to provide any criteria that distinguish such "private" organizations from the "public accommodations" covered by the statute, the Court of Appeals reasoned, the Minnesota Supreme Court's interpretation rendered the Act unconstitutionally vague. Id., at 1576-1578.

II

Our decisions have referred to constitutionally protected "freedom of association" in two distinct senses. In one line of decisions, the Court has concluded that choices to enter into and maintain certain intimate human relationships must ***618** be secured against undue intrusion by the State because of the role of such relationships in safeguarding the individual freedom that is central to our constitutional scheme. In this respect, freedom of association receives protection as a fundamental element of personal liberty. In another set of decisions, the Court has recognized a right to associate for the purpose of engaging in those activities protected by the First Amendment--speech, assembly, petition for the redress of grievances, and the exercise of religion. The Constitution guarantees freedom of association of this kind as an indispensable means of preserving other individual liberties.

The intrinsic and instrumental features of constitutionally protected association may, of course, coincide. In particular, when the State interferes with individuals' selection of those with whom they wish to join in a common endeavor, freedom of association in both of its forms may be implicated. The Jaycees contend that this is such a case. Still, the nature and degree of constitutional protection afforded freedom of association may vary depending on the extent to which one or the other aspect of the constitutionally protected liberty is ****3250** at stake in a given case. We therefore find it useful to consider separately the effect of applying the Minnesota statute to the Jaycees on what could be called its members' freedom of intimate association and their freedom of expressive association.

A

The Court has long recognized that,

because the Bill of Rights is designed to secure individual liberty, it must afford the formation and preservation of certain kinds of highly personal relationships a substantial measure of sanctuary from unjustified interference by the State. E.g., Pierce v. Society of Sisters, 268 U.S. 510, 534-535, 45 S.Ct. 571, 573, 69 L.Ed. 1070 (1925); Meyer v. Nebraska, 262 U.S. 390, 399, 43 S.Ct. 625, 626, 67 L.Ed. 1042 (1923). Without precisely identifying every consideration that may underlie this type of constitutional protection, we have noted that certain kinds of personal bonds have played a critical role in the culture ***619** and traditions of the Nation by cultivating and transmitting shared ideals and beliefs; they thereby foster diversity and act as critical buffers between the individual and the power of the State. See, e.g., Zablocki v. Redhail, 434 U.S. 374, 383-386, 98 S.Ct. 673, 679-681, 54 L.Ed.2d 618 (1978); Moore v. East Cleveland, 431 U.S. 494, 503-504, 97 S.Ct. 1932, 1937-38, 52 L.Ed.2d 531 (1977) (plurality opinion); Wisconsin v. Yoder, 406 U.S. 205, 232, 92 S.Ct. 1526, 1541, 32 L.Ed.2d 15 (1972); Griswold v. Connecticut, 381 U.S. 479, 482-485, 85 S.Ct. 1678, 1680-1682, 14 L.Ed.2d 510 (1965); Pierce v. Society of Sisters, supra, 268 U.S., at 535, 45 S.Ct., at 573. See also Gilmore v. City of Montgomery, 417 U.S. 556, 575, 94 S.Ct. 2416, 2427, 41 L.Ed.2d 304 (1974); NAACP v. Alabama ex rel. Patterson, 357 U.S. 449, 460-462, 78 S.Ct. 1163, 1170-1171, 2 L.Ed.2d 1488 (1958); Poe v. Ullman, 367 U.S. 497, 542- 545, 81 S.Ct. 1752, 1776-78, 6 L.Ed.2d 989 (1961) (Harlan, J., dissenting). Moreover, the constitutional shelter afforded such relationships reflects the realization that individuals draw much of their emotional enrichment from close ties with others. Protecting these relationships from unwarranted state interference therefore safeguards the ability independently to define one's identity that is central to any concept of liberty. See, e.g., Quilloin v. Walcott, 434 U.S. 246, 255, 98 S.Ct. 549, 554, 54 L.Ed.2d 511 (1978); Smith v. Organization of Foster Families, 431 U.S. 816, 844, 97 S.Ct. 2094, 2109, 53 L.Ed.2d 14 (1977); Carey v. Population Services International, 431 U.S. 678, 684-686, 97 S.Ct. 2010, 2015-2016, 52 L.Ed.2d 675 (1977); Cleveland Board of Education v. LaFleur, 414 U.S. 632, 639-640, 94 S.Ct. 791, 796, 39 L.Ed.2d 52 (1974); Stanley v. Illinois, 405 U.S. 645, 651-652, 92 S.Ct. 1208, 1212- 1213, 31 L.Ed.2d 551 (1972); Stanley v. Georgia, 394 U.S. 557, 564, 89 S.Ct. 1243, 1247, 22 L.Ed.2d 542 (1969); Olmstead v. United States, 277 U.S. 438, 478, 48 S.Ct. 564, 572, 72 L.Ed. 944 (1928) (Brandeis, J., dissenting).

The personal affiliations that exemplify these considerations, and that therefore suggest some relevant limitations on the relationships that might be entitled to this sort of constitutional protection, are those that attend the creation and sustenance of a family--marriage, e.g., Zablocki v. Redhail, supra; childbirth, e.g., Carey v. Population Services International, supra; the raising and education of children, e.g., Smith v. Organization of Foster Families, supra; and cohabitation with one's relatives, e.g., Moore v. East Cleveland, supra. Family relationships, by their nature, involve ***620** deep attachments and commitments to the necessarily few other individuals with whom one shares not only a special community of thoughts, experiences, and beliefs but also distinctively personal aspects of one's life. Among other things, therefore, they are distinguished by such attributes as relative smallness, a high degree of selectivity in decisions to begin and maintain the affiliation, and seclusion from others in critical aspects of the relationship. As a general matter, only relationships with these sorts of qualities are likely to reflect the considerations that ****3251** have led to an understanding of freedom of association as an intrinsic element of personal liberty. Conversely, an association lacking these qualities--such as a large business enterprise--seems remote from the concerns giving rise to this constitutional protection. Accordingly, the Constitution undoubtedly imposes constraints on the State's power to control the selection of one's spouse that would not apply to regulations affecting the choice of one's fellow employees. Compare Loving v. Virginia, 388 U.S. 1, 12, 87 S.Ct. 1817, 1823, 18 L.Ed.2d 1010 (1967), with Railway Mail Assn. v. Corsi, 326 U.S. 88, 93-94, 65 S.Ct. 1483, 1487, 89 L.Ed. 2072 (1945).

Between these poles, of course, lies a broad range of human relationships that may make greater or lesser claims to constitutional protection from particular incursions by the State. Determining the limits of state authority over an individual's freedom to enter into a particular association therefore unavoidably entails a careful assessment of where that relationship's objective characteristics locate it on a spectrum from the most intimate to the most attenuated of personal attachments. See generally Runyon v. McCrary, 427 U.S. 160, 187-189, 96 S.Ct. 2586, 2602-2603, 49 L.Ed.2d 415 (1976) (POWELL, J., concurring). We need not mark the potentially significant points on this terrain with any precision. We note only that factors that may be relevant include size, purpose, policies, selectivity, congeniality, and other characteristics that in a particular case may be pertinent. In this case, however, several features of the Jaycees clearly place the organization outside of the category of relationships worthy of this kind of constitutional protection.

[1] ***621** The undisputed facts reveal that the local chapters of the Jaycees are large and basically unselective groups. At the time

of the state administrative hearing, the Minneapolis chapter had approximately 430 members, while the St. Paul chapter had about 400. Report, App. to Juris. Statement A-99, A-100. Apart from age and sex, neither the national organization nor the local chapters employ any criteria for judging applicants for membership, and new members are routinely recruited and admitted with no inquiry into their backgrounds. See 1 Tr. of State Administrative Hearing 124-132, 135-136, 174- 176. In fact, a local officer testified that he could recall no instance in which an applicant had been denied membership on any basis other than age or sex. Id., at 135. Cf. Tillman v. Wheaton-Haven Recreation Assn., Inc., 410 U.S. 431, 438, 93 S.Ct. 1090, 1094, 35 L.Ed.2d 403 (1973) (organization whose only selection criterion is race has "no plan or purpose of exclusiveness" that might make it a private club exempt from federal civil rights statute); Sullivan v. Little Hunting Park, Inc., 396 U.S. 229, 236, 90 S.Ct. 400, 404, 24 L.Ed.2d 386 (1969) (same); Daniel v. Paul, 395 U.S. 298, 302, 89 S.Ct. 1697, 1699, 23 L.Ed.2d 318 (1969) (same). Furthermore, despite their inability to vote, hold office, or receive certain awards, women affiliated with the Jaycees attend various meetings, participate in selected projects, and engage in many of the organization's social functions. See Tr. 58. Indeed, numerous non-members of both genders regularly participate in a substantial portion of activities central to the decision of many members to associate with one another, including many of the organization's various community programs, awards ceremonies, and recruitment meetings. See, e.g., 305 N.W.2d, at 772; Report, App. to Juris. Statement A102, A103.

In short, the local chapters of the Jaycees are neither small nor selective. Moreover, much of the activity central to the formation and maintenance of the association involves the participation of strangers to that relationship. Accordingly, we conclude that the Jaycees chapters lack the distinctive characteristics that might afford constitutional protection to the decision of its members to exclude women. We turn ***622** therefore to consider the extent to which application of the Minnesota statute to compel the Jaycees to accept women infringes ****3252** the group's freedom of expressive association.

B

An individual's freedom to speak, to worship, and to petition the government for the redress of grievances could not be vigorously protected from interference by the State unless a correlative freedom to engage in group effort toward those ends were not also guaranteed. See, e.g., Citizens Against Rent Control/Coalition for Fair

Housing v. Berkeley, 454 U.S. 290, 294, 102 S.Ct. 434, 456, 70 L.Ed.2d 492 (1981). According protection to collective effort on behalf of shared goals is especially important in preserving political and cultural diversity and in shielding dissident expression from suppression by the majority. See, e.g., Gilmore v. City of Montgomery, 417 U.S., at 575, 94 S.Ct., at 2427; Griswold v. Connecticut, 381 U.S., at 482-485, 85 S.Ct., at 1680-1682; NAACP v. Button, 371 U.S. 415, 431, 83 S.Ct. 328, 337, 9 L.Ed.2d 405 (1963); NAACP v. Alabama ex rel. Patterson, 357 U.S., at 462, 78 S.Ct., at 1171. Consequently, we have long understood as implicit in the right to engage in activities protected by the First Amendment a corresponding right to associate with others in pursuit of a wide variety of political, social, economic, educational, religious, and cultural ends. See, e.g., NAACP v. Claiborne Hardware Co., 458 U.S. 886, 907-909, 932-933, 102 S.Ct. 3409, 3422-3423, 3436, 73 L.Ed.2d 1215 (1982); Larson v. Valente, 456 U.S. 228, 244-246, 102 S.Ct. 1673, 1683, 1684, 72 L.Ed.2d 33 (1982); In re Primus, 436 U.S. 412, 426, 98 S.Ct. 1893, 1901, 56 L.Ed.2d 417 (1978); Abood v. Detroit Board of Education, 431 U.S. 209, 231, 97 S.Ct. 1782, 1797, 52 L.Ed.2d 261 (1977). In view of the various protected activities in which the Jaycees engages, see infra, at 3254, that right is plainly implicated in this case.

Government actions that may unconstitutionally infringe upon this freedom can take a number of forms. Among other things, government may seek to impose penalties or withhold benefits from individuals because of their membership in a disfavored group, e.g., Healy v. James, 408 U.S. 169, 180-184, 92 S.Ct. 2338, 2345-2347, 33 L.Ed.2d 266 (1972); it may attempt to require disclosure of ***623** the fact of membership in a group seeking anonymity, e.g., Brown v. Socialist Workers '74 Campaign Committee, supra, 459 U.S. 87, 91-92, 103 S.Ct. 416, 419-421, 74 L.Ed.2d 250 (1982); and it may try to interfere with the internal organization or affairs of the group, e.g., Cousins v. Wigoda, 419 U.S. 477, 487-488, 95 S.Ct. 541, 547, 42 L.Ed.2d 595 (1975). By requiring the Jaycees to admit women as full voting members, the Minnesota Act works an infringement of the last type. There can be no clearer example of an intrusion into the internal structure or affairs of an association than a regulation that forces the group to accept members it does not desire. Such a regulation may impair the ability of the original members to express only those views that brought them together. Freedom of association therefore plainly presupposes a freedom not to associate. See Abood v. Detroit Board of Education, supra, 431 U.S., at 234-235, 97 S.Ct., at 1799.

[2] The right to associate for expressive

purposes is not, however, absolute. Infringements on that right may be justified by regulations adopted to serve compelling state interests, unrelated to the suppression of ideas, that cannot be achieved through means significantly less restrictive of associational freedoms. E.g., Brown v. Socialist Workers '74 Campaign Committee, 459 U.S., at 91-92, 103 S.Ct., at 419-421; Democratic Party of United States v. Wisconsin, 450 U.S. 107 at 124, 101 S.Ct. 1010 at 1020, 67 L.Ed.2d 82 (1981); Buckley v. Valeo, 424 U.S. 1, 25, 96 S.Ct. 612, 637, 46 L.Ed.2d 659 (1976) (per curiam); Cousins v. Wigoda, supra, 419 U.S., at 489, 95 S.Ct., at 548; American Party of Texas v. White, 415 U.S. 767, 780-781, 94 S.Ct. 1296, 1305-1306, 39 L.Ed.2d 744 (1974); NAACP v. Button, supra, 371 U.S., at 438, 83 S.Ct., at 340; Shelton v. Tucker, 364 U.S. 479, ****3253**486, 488, 81 S.Ct. 247, 252, 5 L.Ed.2d 231 (1960). We are persuaded that Minnesota's compelling interest in eradicating discrimination against its female citizens justifies the impact that application of the statute to the Jaycees may have on the male members' associational freedoms.

On its face, the Minnesota Act does not aim at the suppression of speech, does not distinguish between prohibited and permitted activity on the basis of viewpoint, and does not license enforcement authorities to administer the statute on the basis of such constitutionally impermissible criteria. See ***624** also infra, at 3255-3257. Nor does the Jaycees contend that the Act has been applied in this case for the purpose of hampering the organization's ability to express its views. Instead, as the Minnesota Supreme Court explained, the Act reflects the State's strong historical commitment to eliminating discrimination and assuring its citizens equal access to publicly available goods and services. See 305 N.W.2d, at 766-768. That goal, which is unrelated to the suppression of expression, plainly serves compelling state interests of the highest order.

The Minnesota Human Rights Act at issue here is an example of public accommodations laws that were adopted by some States beginning a decade before enactment of their federal counterpart, the Civil Rights Act of 1875, ch. 114, 18 Stat. 335. See Discrimination in Access to Public Places: A Survey of State and Federal Accommodations Laws, 7 N.Y.U.Rev.L. & Soc. Change 215, 238 (1978) (hereinafter NYU Survey). Indeed, when this Court invalidated that federal statute in the Civil Rights Cases, 109 U.S. 3, 3 S.Ct. 18, 27 L.Ed. 835 (1883), it emphasized the fact that state laws imposed a variety of equal access obligations on public accommodations. Id., at 19, 25, 3 S.Ct., at 27, 31. In response to that decision, many more States, including Minnesota, adopted statutes prohibiting racial discrimination in public accommodations. These laws provided the primary means for protecting the civil rights of historically disadvantaged groups until the Federal Government reentered the field in 1957. See NYU Survey 239; Brief for State of New York et al. as Amici Curiae 1. Like many other States, Minnesota has progressively broadened the scope of its public accommodations law in the years since it was first enacted, both with respect to the number and type of covered facilities and with respect to the groups against whom discrimination is forbidden. See 305 N.W.2d, at 766-768. In 1973, the Minnesota Legislature added discrimination on the basis of sex to the types of conduct prohibited by the statute. Act of May 24, 1973, ch. 729, § 3, 1973 Minn.Laws 2164.

***625** By prohibiting gender discrimination in places of public accommodation, the Minnesota Act protects the State's citizenry from a number of serious social and personal harms. In the context of reviewing state actions under the Equal Protection Clause, this Court has frequently noted that discrimination based on archaic and overbroad assumptions about the relative needs and capacities of the sexes forces individuals to labor under stereotypical notions that often bear no relationship to their actual abilities. It thereby both deprives persons of their individual dignity and denies society the benefits of wide participation in political, economic, and cultural life. See, e.g., Heckler v. Mathews, 465 U.S. 728, 744-745, 104 S.Ct. 1387, 1397-1398, 79 L.Ed.2d 646 (1984); Mississippi University for Women v. Hogan, 458 U.S. 718, 723-726, 102 S.Ct. 3331, 3335-3337, 73 L.Ed.2d 1090 (1982); Frontiero v. Richardson, 411 U.S. 677, 684-687, 93 S.Ct. 1764, 1769-1770, 36 L.Ed.2d 583 (1973) (plurality opinion). These concerns are strongly implicated with respect to gender discrimination in the allocation of publicly available goods and services. Thus, in upholding Title II of the Civil Rights Act of 1964, 78 Stat. 243, 42 U.S.C. § 2000a, which forbids race discrimination in public accommodations, we emphasized that its "fundamental object ... was to vindicate 'the deprivation of personal dignity that surely accompanies ****3254** denials of equal access to public establishments.' " Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241, 250, 85 S.Ct. 348, 354, 13 L.Ed.2d 258 (1964). That stigmatizing injury, and the denial of equal opportunities that accompanies it, is surely felt as strongly by persons suffering discrimination on the basis of their sex as by those treated differently because of their race.

Nor is the state interest in assuring equal access limited to the provision of purely tangible goods and services. See Alfred L. Snapp & Son, Inc. v. Puerto Rico ex rel. Barez, 458 U.S. 592, 609, 102 S.Ct. 3260, 3270, 73 L.Ed.2d 995 (1982). A State enjoys broad authority to create rights of public access on behalf of its citizens. PruneYard Shopping Center v. Robins, 447 U.S. 74, 81-88, 100 S.Ct. 2035, 2040-2044, 64 L.Ed.2d 741 (1980). Like many States and municipalities, Minnesota has adopted a functional definition of public accommodations that reaches various forms of public, quasi-commercial conduct. ***626** See 305 N.W.2d, at 768; Brief for National League of Cities et al. as Amici Curiae 15-16. This expansive definition reflects a recognition of the changing nature of the American economy and of the importance, both to the individual and to society, of removing the barriers to economic advancement and political and social integration that have historically plagued certain disadvantaged groups, including women. See Califano v. Webster, 430 U.S. 313, 317, 97 S.Ct. 1192, 1194, 51 L.Ed.2d 360 (1977) (per curiam); Frontiero v. Richardson, supra, 411 U.S., at 684-686, 93 S.Ct., at 1769-1770. Thus, in explaining its conclusion that the Jaycees local chapters are "place[s] of public accommodations" within the meaning of the Act, the Minnesota court noted the various commercial programs and benefits offered to members and stated that "[l]eadership skills are 'goods,' [and] business contacts and employment promotions are 'privileges' and 'advantages'...." 305 N.W.2d, at 772. Assuring women equal access to such goods, privileges, and advantages clearly furthers compelling state interests.

In applying the Act to the Jaycees, the State has advanced those interests through the least restrictive means of achieving its ends. Indeed, the Jaycees has failed to demonstrate that the Act imposes any serious burdens on the male members' freedom of expressive association. See Hishon v. King & Spalding, 467 U.S. 69, 78, 104 S.Ct. 2229, 2235, 81 L.Ed.2d 59 (1984) (law firm "has not shown how its ability to fulfill [protected] function[s] would be inhibited by a requirement that it consider [a woman lawyer] for partnership on her merits"); id., at 81, 104 S.Ct., at 2237 (POWELL, J., concurring); see also Buckley v. Valeo, 424 U.S., at 71-74, 96 S.Ct., at 659-661; American Party of Texas v. White, 415 U.S., at 790, 94 S.Ct., at 1310. To be sure, as the Court of Appeals noted, a "not insubstantial part" of the Jaycees' activities constitutes protected expression on political, economic, cultural, and social affairs. 709 F.2d, at 1570. Over the years, the national and local levels of the organization have taken public positions on a number of diverse issues, see id., at 1569-1570; Brief for Appellee 4-5, and members of the Jaycees regularly engage in a variety of ***627** civic, charitable, lobbying, fundraising, and other activities worthy of constitutional protection under the First Amendment, ibid., see, e.g., Village of Schaumburg v. Citizens for a Better

Environment, 444 U.S. 620, 632, 100 S.Ct. 826, 833, 63 L.Ed.2d 73 (1980). There is, however, no basis in the record for concluding that admission of women as full voting members will impede the organization's ability to engage in these protected activities or to disseminate its preferred views. The Act requires no change in the Jaycees' creed of promoting the interests of young men, and it imposes no restrictions on the organization's ability to exclude individuals with ideologies or philosophies different from those of its existing members. Cf. Democratic Party of United States v. Wisconsin, 450 U.S., at 122, 101 S.Ct., at 1019 (recognizing the right of political parties to "protect themselves '**3255** from intrusion by those with adverse political principles' "). Moreover, the Jaycees already invites women to share the group's views and philosophy and to participate in much of its training and community activities. Accordingly, any claim that admission of women as full voting members will impair a symbolic message conveyed by the very fact that women are not permitted to vote is attenuated at best. Cf. Spence v. Washington, 418 U.S. 405, 94 S.Ct. 2727, 41 L.Ed.2d 842 (1974); Griswold v. Connecticut, 381 U.S., at 483, 85 S.Ct., at 1681.

While acknowledging that "the specific content of most of the resolutions adopted over the years by the Jaycees has nothing to do with sex," 709 F.2d, at 1571, the Court of Appeals nonetheless entertained the hypothesis that women members might have a different view or agenda with respect to these matters so that, if they are allowed to vote, "some change in the Jaycees' philosophical cast can reasonably be expected," ibid. It is similarly arguable that, insofar as the Jaycees is organized to promote the views of young men whatever those views happen to be, admission of women as voting members will change the message communicated by the group's speech because of the gender-based assumptions of the audience. Neither supposition, however, is supported by the record. In claiming that women might have a different ***628** attitude about such issues as the federal budget, school prayer, voting rights, and foreign relations, see id., at 1570, or that the organization's public positions would have a different effect if the group were not "a purely young men's association," the Jaycees relies solely on unsupported generalizations about the relative interests and perspectives of men and women. See Brief for Appellee 20-22, and n. 3. Although such generalizations may or may not have a statistical basis in fact with respect to particular positions adopted by the Jaycees, we have repeatedly condemned legal decisionmaking that relies uncritically on such assumptions. See, e.g., Palmore v. Sidoti, 466 U.S. 429, 433-434, 104 S.Ct.

1879, 80 L.Ed.2d 421 (1984); Heckler v. Mathews, 465 U.S., at 745, 104 S.Ct., at 1395. In the absence of a showing far more substantial than that attempted by the Jaycees, we decline to indulge in the sexual stereotyping that underlies appellee's contention that, by allowing women to vote, application of the Minnesota Act will change the content or impact of the organization's speech. Compare Wengler v. Druggists Mutual Insurance Co., 446 U.S. 142, 151-152, 100 S.Ct. 1540, 1545-1546, 64 L.Ed.2d 107 (1980), with Schlesinger v. Ballard, 419 U.S. 498, 508, 95 S.Ct. 572, 577, 42 L.Ed.2d 610 (1975).

In any event, even if enforcement of the Act causes some incidental abridgment of the Jaycees' protected speech, that effect is no greater than is necessary to accomplish the State's legitimate purposes. As we have explained, acts of invidious discrimination in the distribution of publicly available goods, services, and other advantages cause unique evils that government has a compelling interest to prevent--wholly apart from the point of view such conduct may transmit. Accordingly, like violence or other types of potentially expressive activities that produce special harms distinct from their communicative impact, such practices are entitled to no constitutional protection. Runyon v. McCrary, 427 U.S., at 175-176, 96 S.Ct., at 2596-2597. Compare NAACP v. Claiborne Hardware Co., 458 U.S., at 907-909, 102 S.Ct., at 3422-3424 (peaceful picketing), with id., at 916, 102 S.Ct., at 3427-3428 (violence). In prohibiting such practices, the Minnesota Act ***629** therefore "responds precisely to the substantive problem which legitimately concerns" the State and abridges no more speech or associational freedom than is necessary to accomplish that purpose. See City Council of Los Angeles v. Taxpayers for Vincent, 466 U.S. 789, 810, 104 S.Ct. 2118, 2132, 80 L.Ed.2d 772 (1984).

BOY SCOUTS OF AMERICA
v.
James DALE.

530 U.S. 640 (2000)

***643** Chief Justice REHNQUIST delivered the opinion of the Court.

Petitioners are the Boy Scouts of America and the Monmouth Council, a division of the Boy Scouts of America (collectively, ***644** Boy Scouts). The Boy Scouts is a private, not-for-profit organization engaged in instilling its system of values in young people. The Boy Scouts asserts that homosexual conduct is inconsistent with the values it seeks to instill. Respondent is James Dale, a former Eagle Scout whose adult membership in the Boy Scouts was revoked when the Boy Scouts learned that he is an avowed homosexual and gay rights activist. The New Jersey Supreme Court held that New Jersey's public accommodations law requires that the Boy Scouts readmit Dale. This case presents the question whether applying New Jersey's public accommodations law in this way violates the Boy Scouts' First Amendment right of expressive association. We hold that it does.

I

James Dale entered Scouting in 1978 at the age of eight by joining Monmouth Council's Cub Scout Pack 142. Dale became a Boy Scout in 1981 and remained a Scout until he turned 18. By all accounts, Dale was an exemplary Scout. In 1988, he achieved the rank of Eagle Scout, one of Scouting's highest honors.

Dale applied for adult membership in the Boy Scouts in 1989. The Boy Scouts approved his application for the position of assistant scoutmaster of Troop 73. Around the same time, Dale left home to attend Rutgers University. After arriving at Rutgers, Dale first acknowledged to himself and ***645** others that he is gay. He quickly became involved with, and eventually became the copresident of, the Rutgers University Lesbian/Gay Alliance. In 1990, Dale attended a seminar addressing the psychological and health needs of lesbian and gay teenagers. A newspaper covering the event interviewed Dale about his advocacy of homosexual teenagers' need for gay role models. In early July 1990, the newspaper published the interview and Dale's photograph over a caption identifying him as the copresident of the Lesbian/Gay Alliance.

Later that month, Dale received a letter from Monmouth Council Executive James Kay revoking his adult membership. Dale wrote to Kay requesting the reason for Monmouth Council's decision. Kay responded by letter that the Boy Scouts "specifically forbid membership to homosexuals." App. 137.

In 1992, Dale filed a complaint against the Boy Scouts in the New Jersey Superior Court. The complaint alleged that the Boy Scouts had violated New Jersey's public accommodations statute and its common law by revoking Dale's membership based solely on his sexual orientation. New Jersey's public accommodations statute prohibits, ****2450** among other things, discrimination on the basis of sexual orientation in places of public accommodation. N.J. Stat. Ann. §§ 10:5-4 and 10:5-5 (West Supp.2000); see Appendix, *infra,* at 2458-2459.

The New Jersey Superior Court's Chancery Division granted summary judgment in favor of the Boy Scouts. The court held that New Jersey's public accommodations law was inapplicable because the Boy Scouts was not a place of public accommodation, and that, alternatively, the Boy Scouts is a distinctly private group exempted from coverage under New Jersey's law. The court rejected Dale's common-law claim, holding that New Jersey's policy is embodied in the public accommodations law. The court also concluded that the Boy Scouts' position in respect of active homosexuality was clear ***646** and held that the First Amendment freedom of expressive association prevented the government from forcing the Boy Scouts to accept Dale as an adult leader.

The New Jersey Superior Court's Appellate Division affirmed the dismissal of Dale's common-law claim, but otherwise reversed and remanded for further proceedings. 308 N.J.Super. 516, 706 A.2d 270 (1998). It held that New Jersey's public accommodations law applied to the Boy Scouts and that the Boy Scouts violated it. The Appellate Division rejected the Boy Scouts' federal constitutional claims.

The New Jersey Supreme Court affirmed the judgment of the Appellate Division. It held that the Boy Scouts was a place of public accommodation subject to the public accommodations law, that the organization was not exempt from the law under any of its express exceptions, and that the Boy Scouts violated the law by revoking Dale's membership based on his avowed homosexuality. After considering the state-law issues, the court addressed the Boy Scouts' claims that application of the public accommodations law in this case violated its federal constitutional rights " 'to enter into and maintain ... intimate or private relationships ... [and] to associate for the purpose of engaging in protected speech.' "

160 N.J. 562, 605, 734 A.2d 1196, 1219 (1999) (quoting *Board of Directors of Rotary Int'l v. Rotary Club of Duarte,* 481 U.S. 537, 544, 107 S.Ct. 1940, 95 L.Ed.2d 474 (1987)). With respect to the right to intimate association, the court concluded that the Boy Scouts' "large size, nonselectivity, inclusive rather than exclusive purpose, and practice of inviting or allowing nonmembers to attend meetings, establish that the organization is not 'sufficiently personal or private to warrant constitutional protection' under the freedom of intimate association." 160 N.J., at 608- 609, 734 A.2d, at 1221 (quoting *Duarte, supra,* at 546, 107 S.Ct. 1940). With respect to the right of expressive association, the court "agree[d] that Boy Scouts expresses a belief in moral values and uses its activities to encourage the moral development ***647** of its members." 160 N.J., at 613, 734 A.2d, at 1223. But the court concluded that it was "not persuaded ... that a shared goal of Boy Scout members is to associate in order to preserve the view that homosexuality is immoral." *Ibid.,* 734 A.2d, at 1223-1224 (internal quotation marks omitted). Accordingly, the court held "that Dale's membership does not violate the Boy Scouts' right of expressive association because his inclusion would not 'affect in any significant way [the Boy Scouts'] existing members' ability to carry out their various purposes.' " *Id.,* at 615, 734 A.2d, at 1225 (quoting *Duarte, supra,* at 548, 107 S.Ct. 1940). The court also determined that New Jersey has a compelling interest in eliminating "the destructive consequences of discrimination from our society," and that its public accommodations law abridges no more speech than is necessary to accomplish its purpose. 160 N.J., at 619-620, 734 A.2d, at 1227-1228. Finally, the court addressed the Boy Scouts' reliance on *Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston, Inc.,* 515 U.S. 557, 115 S.Ct. 2338, 132 L.Ed.2d 487 (1995), in support of its claimed First ****2451** Amendment right to exclude Dale. The court determined that *Hurley* did not require deciding the case in favor of the Boy Scouts because "the reinstatement of Dale does not compel Boy Scouts to express any message." 160 N.J., at 624, 734 A.2d, at 1229.

We granted the Boy Scouts' petition for certiorari to determine whether the application of New Jersey's public accommodations law violated the First Amendment. 528 U.S. 1109, 120 S.Ct. 865, 145 L.Ed.2d 725 (2000).

II

In *Roberts v. United States Jaycees,* 468 U.S. 609, 622, 104 S.Ct. 3244, 82 L.Ed.2d 462 (1984), we observed that "implicit in the right to engage in activities protected by the First Amendment" is "a corresponding right to associate with others in pursuit of a wide variety of political, social, economic, educational, religious, and cultural ends." This right is crucial in preventing the majority from imposing its views on groups that would ***648** rather express other, perhaps unpopular, ideas. See *ibid.* (stating that protection of the right to expressive association is "especially important in preserving political and cultural diversity and in shielding dissident expression from suppression by the majority"). Government actions that may unconstitutionally burden this freedom may take many forms, one of which is "intrusion into the internal structure or affairs of an association" like a "regulation that forces the group to accept members it does not desire." *Id.,* at 623, 104 S.Ct. 3244. Forcing a group to accept certain members may impair the ability of the group to express those views, and only those views, that it intends to express. Thus, "[f]reedom of association ... plainly presupposes a freedom not to associate." *Ibid.*

[1] The forced inclusion of an unwanted person in a group infringes the group's freedom of expressive association if the presence of that person affects in a significant way the group's ability to advocate public or private viewpoints. *New York State Club Assn., Inc. v. City of New York,* 487 U.S. 1, 13, 108 S.Ct. 2225, 101 L.Ed.2d 1 (1988). But the freedom of expressive association, like many freedoms, is not absolute. We have held that the freedom could be overridden "by regulations adopted to serve compelling state interests, unrelated to the suppression of ideas, that cannot be achieved through means significantly less restrictive of associational freedoms." *Roberts, supra,* at 623, 104 S.Ct. 3244.

[2] To determine whether a group is protected by the First Amendment's expressive associational right, we must determine whether the group engages in "expressive association." The First Amendment's protection of expressive association is not reserved for advocacy groups. But to come within its ambit, a group must engage in some form of expression, whether it be public or private.

[3] Because this is a First Amendment case where the ultimate conclusions of law are virtually inseparable from findings of fact, we are obligated to independently review the ***649** factual record to ensure that the state court's judgment does not unlawfully intrude on free expression. See *Hurley, supra,* at 567-568, 115 S.Ct. 2338. The record reveals the following. The Boy Scouts is a private, nonprofit organization. According to its mission statement:

> "It is the mission of the Boy Scouts of America to serve others by helping to instill values in young people and, in other ways, to prepare them to make ethical choices over their lifetime in achieving

their full potential.

"The values we strive to instill are based on those found in the Scout Oath and Law:

"Scout Oath

"On my honor I will do my best
"To do my duty to God and my country
"and to obey the Scout Law;
"To help other people at all times;
"To keep myself physically strong,
****2452** "mentally awake, and morally straight.

"Scout Law

[4] "A Scout is:
"Trustworthy Obedient
"Loyal Cheerful
"Helpful Thrifty
"Friendly Brave
"Courteous Clean
"Kind Reverent." App. 184.

Thus, the general mission of the Boy Scouts is clear: "[T]o instill values in young people." *Ibid.* The Boy Scouts seeks to instill these values by having its adult leaders spend time with the youth members, instructing and engaging them in activities like camping, archery, and fishing. During the time spent with the youth members, the scoutmasters and assistant scoutmasters inculcate them with the Boy ***650** Scouts' values--both expressly and by example. It seems indisputable that an association that seeks to transmit such a system of values engages in expressive activity. See *Roberts, supra,* at 636, 104 S.Ct. 3244 (O'CONNOR, J., concurring) ("Even the training of outdoor survival skills or participation in community service might become expressive when the activity is intended to develop good morals, reverence, patriotism, and a desire for self-improvement").

Given that the Boy Scouts engages in expressive activity, we must determine whether the forced inclusion of Dale as an assistant scoutmaster would significantly affect the Boy Scouts' ability to advocate public or private viewpoints. This inquiry necessarily requires us first to explore, to a limited extent, the nature of the Boy Scouts' view of homosexuality.

The values the Boy Scouts seeks to instill are "based on" those listed in the Scout Oath and Law.App. 184. The Boy Scouts explains that the Scout Oath and Law provide "a positive moral code for living; they are a list of 'do's' rather than 'don'ts.' " Brief for Petitioners 3. The Boy Scouts asserts that homosexual conduct is inconsistent with the values embodied in the Scout Oath and Law, particularly with the values represented by the terms "morally straight" and "clean."

Obviously, the Scout Oath and Law do not expressly mention sexuality or sexual orientation. See *supra,* at 2451 and this page. And the terms "morally straight" and "clean" are by no means self-defining. Different people would attribute to those terms very different meanings. For example, some people may believe that engaging in homosexual conduct is not at odds with being "morally straight" and "clean." And others may believe that engaging in homosexual conduct is contrary to being "morally straight" and "clean." The Boy Scouts says it falls within the latter category.

The New Jersey Supreme Court analyzed the Boy Scouts' beliefs and found that the "exclusion of members solely on the basis of their sexual orientation is inconsistent with Boy ***651** Scouts' commitment to a diverse and 'representative' membership ... [and] contradicts Boy Scouts' overarching objective to reach 'all eligible youth.' " 160 N.J., at 618, 734 A.2d, at 1226. The court concluded that the exclusion of members like Dale "appears antithetical to the organization's goals and philosophy." *Ibid.* But our cases reject this sort of inquiry; it is not the role of the courts to reject a group's expressed values because they disagree with those values or find them internally inconsistent. See *Democratic Party of United States v. Wisconsin ex rel. La Follette,* 450 U.S. 107, 124, 101 S.Ct. 1010, 67 L.Ed.2d 82 (1981) ("[A]s is true of all expressions of First Amendment freedoms, the courts may not interfere on the ground that they view a particular expression as unwise or irrational"); see also *Thomas v. Review Bd. of Indiana Employment Security Div.,* 450 U.S. 707, 714, 101 S.Ct. 1425, 67 L.Ed.2d 624 (1981) ("[R]eligious beliefs need not be acceptable, logical, consistent, or comprehensible ****2453** to others in order to merit First Amendment protection").

[5] The Boy Scouts asserts that it "teach[es] that homosexual conduct is not morally straight," Brief for Petitioners 39, and that it does "not want to promote homosexual conduct as a legitimate form of behavior," Reply Brief for Petitioners 5. We accept the Boy Scouts' assertion. We need not inquire further to determine the nature of the Boy Scouts' expression with respect to homosexuality. But because the record before us contains written evidence of the Boy Scouts' viewpoint, we look to it as instructive, if only on the question of the sincerity of the professed beliefs.

A 1978 position statement to the Boy Scouts' Executive Committee, signed by Downing B. Jenks, the President of the Boy Scouts, and Harvey L. Price, the Chief Scout Executive, expresses the Boy Scouts' "official position" with regard to "homosexuality and Scouting":

"Q. May an individual who openly declares himself to be a homosexual be a volunteer

Scout leader?

***652** "A. No. The Boy Scouts of America is a private, membership organization and leadership therein is a privilege and not a right. We do not believe that homosexuality and leadership in Scouting are appropriate. We will continue to select only those who in our judgment meet our standards and qualifications for leadership." App. 453-454.

Thus, at least as of 1978--the year James Dale entered Scouting--the official position of the Boy Scouts was that avowed homosexuals were not to be Scout leaders.

A position statement promulgated by the Boy Scouts in 1991 (after Dale's membership was revoked but before this litigation was filed) also supports its current view:

"We believe that homosexual conduct is inconsistent with the requirement in the Scout Oath that a Scout be morally straight and in the Scout Law that a Scout be clean in word and deed, and that homosexuals do not provide a desirable role model for Scouts." *Id.,* at 457.

This position statement was redrafted numerous times but its core message remained consistent. For example, a 1993 position statement, the most recent in the record, reads, in part:

"The Boy Scouts of America has always reflected the expectations that Scouting families have had for the organization. We do not believe that homosexuals provide a role model consistent with these expectations. Accordingly, we do not allow for the registration of avowed homosexuals as members or as leaders of the BSA." *Id.,* at 461.

The Boy Scouts publicly expressed its views with respect to homosexual conduct by its assertions in prior litigation. For example, throughout a California case with similar facts filed in the early 1980's, the Boy Scouts consistently asserted the same position with respect to homosexuality that it asserts today. See *Curran v. Mount Diablo Council of Boy* ****653*** *Scouts of America,* No. C-365529 (Cal.Super.Ct., July 25, 1991); 29 Cal.Rptr.2d 580 (1994); 17 Cal.4th 670, 72 Cal.Rptr.2d 410, 952 P.2d 218 (1998). We cannot doubt that the Boy Scouts sincerely holds this view.

[6][7] We must then determine whether Dale's presence as an assistant scoutmaster would significantly burden the Boy Scouts' desire to not "promote homosexual conduct as a legitimate form of behavior." Reply Brief for Petitioners 5. As we give deference to an association's assertions regarding the nature of its expression, we must also give deference to an association's view of what would impair its expression. See, *e.g., La Follette, supra,* at 123-124, 101 S.Ct. 1010 (considering whether a Wisconsin law

burdened the National Party's associational rights and stating that "a State, or a court, may not constitutionally substitute its own judgment for that of the Party"). That is not to say that an expressive association can ****2454** erect a shield against antidiscrimination laws simply by asserting that mere acceptance of a member from a particular group would impair its message. But here Dale, by his own admission, is one of a group of gay Scouts who have "become leaders in their community and are open and honest about their sexual orientation." App. 11. Dale was the copresident of a gay and lesbian organization at college and remains a gay rights activist. Dale's presence in the Boy Scouts would, at the very least, force the organization to send a message, both to the youth members and the world, that the Boy Scouts accepts homosexual conduct as a legitimate form of behavior.

Hurley is illustrative on this point. There we considered whether the application of Massachusetts' public accommodations law to require the organizers of a private St. Patrick's Day parade to include among the marchers an Irish-American gay, lesbian, and bisexual group, GLIB, violated the parade organizers' First Amendment rights. We noted that the parade organizers did not wish to exclude the GLIB members because of their sexual orientations, but because they wanted to march behind a GLIB banner. We observed:

> ***654** "[A] contingent marching behind the organization's banner would at least bear witness to the fact that some Irish are gay, lesbian, or bisexual, and the presence of the organized marchers would suggest their view that people of their sexual orientations have as much claim to unqualified social acceptance as heterosexuals .... The parade's organizers may not believe these facts about Irish sexuality to be so, or they may object to unqualified social acceptance of gays and lesbians or have some other reason for wishing to keep GLIB's message out of the parade. But whatever the reason, it boils down to the choice of a speaker not to propound a particular point of view, and that choice is presumed to lie beyond the government's power to control." 515 U.S., at 574-575, 115 S.Ct. 2338.

Here, we have found that the Boy Scouts believes that homosexual conduct is inconsistent with the values it seeks to instill in its youth members; it will not "promote homosexual conduct as a legitimate form of behavior." Reply Brief for Petitioners 5. As the presence of GLIB in Boston's St. Patrick's Day parade would have interfered with the parade organizers' choice not to propound a particular point of view, the presence of Dale as an assistant scoutmaster would just as surely interfere with the Boy Scouts' choice not to propound a point of view contrary to its beliefs.

The New Jersey Supreme Court determined that the Boy Scouts' ability to disseminate its message was not significantly affected by the forced inclusion of Dale as an assistant scoutmaster because of the following findings:

> "Boy Scout members do not associate for the purpose of disseminating the belief that homosexuality is immoral; Boy Scouts discourages its leaders from disseminating *any* views on sexual issues; and Boy Scouts includes sponsors and members who subscribe to different views ***655** in respect of homosexuality." 160 N.J., at 612, 734 A.2d, at 1223.

We disagree with the New Jersey Supreme Court's conclusion drawn from these findings.

[8] First, associations do not have to associate for the "purpose" of disseminating a certain message in order to be entitled to the protections of the First Amendment. An association must merely engage in expressive activity that could be impaired in order to be entitled to protection. For example, the purpose of the St. Patrick's Day parade in *Hurley* was not to espouse any views about sexual orientation, but we held that the parade organizers had a right to exclude certain participants nonetheless.

Second, even if the Boy Scouts discourages Scout leaders from disseminating ****2455** views on sexual issues--a fact that the Boy Scouts disputes with contrary evidence--the First Amendment protects the Boy Scouts' method of expression. If the Boy Scouts wishes Scout leaders to avoid questions of sexuality and teach only by example, this fact does not negate the sincerity of its belief discussed above.

[9] Third, the First Amendment simply does not require that every member of a group agree on every issue in order for the group's policy to be "expressive association." The Boy Scouts takes an official position with respect to homosexual conduct, and that is sufficient for First Amendment purposes. In this same vein, Dale makes much of the claim that the Boy Scouts does not revoke the membership of heterosexual Scout leaders that openly disagree with the Boy Scouts' policy on sexual orientation. But if this is true, it is irrelevant. [FN1] The presence of an avowed homosexual and gay ***656** rights activist in an assistant scoutmaster's uniform sends a distinctly different message from the presence of a heterosexual assistant scoutmaster who is on record as disagreeing with Boy Scouts policy. The Boy Scouts has a First Amendment right to choose to send one message but not the other. The fact that the organization does not trumpet its views from the housetops, or that it tolerates dissent within its ranks, does not mean that its views receive no First Amendment protection.

FN1. The record evidence sheds doubt on Dale's assertion. For example, the National Director of the Boy Scouts certified that "*any* persons who advocate to Scouting youth that homosexual conduct is" consistent with Scouting values will not be registered as adult leaders. App. 746 (emphasis added). And the Monmouth Council Scout Executive testified that the advocacy of the morality of homosexuality to youth members by any adult member is grounds for revocation of the adult's membership. *Id.,* at 761.

Having determined that the Boy Scouts is an expressive association and that the forced inclusion of Dale would significantly affect its expression, we inquire whether the application of New Jersey's public accommodations law to require that the Boy Scouts accept Dale as an assistant scoutmaster runs afoul of the Scouts' freedom of expressive association. We conclude that it does.

State public accommodations laws were originally enacted to prevent discrimination in traditional places of public accommodation--like inns and trains. See, *e.g., Hurley, supra,* at 571-572, 115 S.Ct. 2338 (explaining the history of Massachusetts' public accommodations law); *Romer v. Evans,* 517 U.S. 620, 627-629, 116 S.Ct. 1620, 134 L.Ed.2d 855 (1996) (describing the evolution of public accommodations laws). Over time, the public accommodations laws have expanded to cover more places. [FN2] New Jersey's statutory ***657** definition of " '[a] place of public accommodation' " is extremely broad. The term is said to "include, but not be limited to," a list of over 50 types of places. N.J. Stat. Ann. § 10:5-5(*l*) (West Supp.2000); see Appendix, *infra,* at 2458-2459. Many on the list are what one would expect to be places where the public is invited. For example, the statute includes as places of public accommodation taverns, restaurants, retail shops, and public libraries. But the statute also includes places that often may not carry with them open invitations to the public, like summer camps and roof gardens. ****2456** In this case, the New Jersey Supreme Court went a step further and applied its public accommodations law to a private entity without even attempting to tie the term "place" to a physical location. [FN3] As the definition of "public accommodation" has expanded from clearly commercial entities, such as restaurants, bars, and hotels, to membership organizations such as the Boy Scouts, the potential for conflict between state public accommodations laws and the First Amendment rights of organizations has increased.

FN2. Public accommodations laws

have also broadened in scope to cover more groups; they have expanded beyond those groups that have been given heightened equal protection scrutiny under our cases. See *Romer,* 517 U.S., at 629, 116 S.Ct. 1620. Some municipal ordinances have even expanded to cover criteria such as prior criminal record, prior psychiatric treatment, military status, personal appearance, source of income, place of residence, and political ideology. See 1 Boston, Mass., Ordinance No. § 12-9.7 (1999) (ex-offender, prior psychiatric treatment, and military status); D.C.Code Ann. § 1-2519 (1999) (personal appearance, source of income, place of residence); Seattle, Wash., Municipal Code § 14.08.090 (1999) (political ideology).

FN3. Four State Supreme Courts and one United States Court of Appeals have ruled that the Boy Scouts is not a place of public accommodation. *Welsh v. Boy Scouts of America,* 993 F.2d 1267 (C.A.7), cert. denied, 510 U.S. 1012, 114 S.Ct. 602, 126 L.Ed.2d 567 (1993); *Curran v. Mount Diablo Council of Boy Scouts of America,* 17 Cal.4th 670, 72 Cal.Rptr.2d 410, 952 P.2d 218 (1998); *Seabourn v. Coronado Area Council, Boy Scouts of America,* 257 Kan. 178, 891 P.2d 385 (1995); *Quinnipiac Council, Boy Scouts of America, Inc. v. Comm'n on Human Rights & Opportunities,* 204 Conn. 287, 528 A.2d 352 (1987); *Schwenk v. Boy Scouts of America,* 275 Or. 327, 551 P.2d 465 (1976). No federal appellate court or state supreme court--except the New Jersey Supreme Court in this case--has reached a contrary result.

We recognized in cases such as *Roberts* and *Duarte* that States have a compelling interest in eliminating discrimination against women in public accommodations. But in each of these cases we went on to conclude that the enforcement of these statutes would not materially interfere with the ideas that the organization sought to express. In *Roberts,* we said "[i]ndeed, the Jaycees has failed to demonstrate ... ***658** any serious burdens on the male members' freedom of expressive association." 468 U.S., at 626, 104 S.Ct. 3244. In *Duarte,* we said:

> "[I]mpediments to the exercise of one's right to choose one's associates can violate the right of association protected by the First Amendment. In this case, however, the evidence fails to demonstrate that admitting women to Rotary Clubs will affect in any significant way the existing members' ability to carry out their various

purposes." 481 U.S., at 548, 107 S.Ct. 1940 (internal quotation marks and citations omitted).

We thereupon concluded in each of these cases that the organizations' First Amendment rights were not violated by the application of the States' public accommodations laws.

In *Hurley,* we said that public accommodations laws "are well within the State's usual power to enact when a legislature has reason to believe that a given group is the target of discrimination, and they do not, as a general matter, violate the First or Fourteenth Amendments." 515 U.S., at 572, 115 S.Ct. 2338. But we went on to note that in that case "the Massachusetts [public accommodations] law has been applied in a peculiar way" because "any contingent of protected individuals with a message would have the right to participate in petitioners' speech, so that the communication produced by the private organizers would be shaped by all those protected by the law who wished to join in with some expressive demonstration of their own." *Id.,* at 572- 573, 115 S.Ct. 2338. And in the associational freedom cases such as *Roberts, Duarte,* and *New York State Club Assn.,* after finding a compelling state interest, the Court went on to examine whether or not the application of the state law would impose any "serious burden" on the organization's rights of expressive association. So in these cases, the associational interest in freedom of expression has ***659** been set on one side of the scale, and the State's interest on the other.

Dale contends that we should apply the intermediate standard of review enunciated in *United States v. O'Brien,* 391 U.S. 367, 88 S.Ct. 1673, 20 L.Ed.2d 672 (1968), to evaluate the competing interests. There the Court enunciated a four-part test for review of a governmental regulation that has only an incidental effect on protected speech--in that case the symbolic ****2457** burning of a draft card. A law prohibiting the destruction of draft cards only incidentally affects the free speech rights of those who happen to use a violation of that law as a symbol of protest. But New Jersey's public accommodations law directly and immediately affects associational rights, in this case associational rights that enjoy First Amendment protection. Thus, *O'Brien* is inapplicable.

In *Hurley,* we applied traditional First Amendment analysis to hold that the application of the Massachusetts public accommodations law to a parade violated the First Amendment rights of the parade organizers. Although we did not explicitly deem the parade in *Hurley* an expressive association, the analysis we applied there is similar to the analysis we apply here. We have already concluded that a state requirement that the Boy Scouts retain Dale as an assistant scoutmaster would significantly burden the organization's right to oppose or disfavor homosexual conduct.

The state interests embodied in New Jersey's public accommodations law do not justify such a severe intrusion on the Boy Scouts' rights to freedom of expressive association. That being the case, we hold that the First Amendment prohibits the State from imposing such a requirement through the application of its public accommodations law. [FN4]

FN4. We anticipated this result in *Hurley* when we illustrated the reasons for our holding in that case by likening the parade to a private membership organization. 515 U.S., at 580, 115 S.Ct. 2338. We stated: "Assuming the parade to be large enough and a source of benefits (apart from its expression) that would generally justify a mandated access provision, GLIB could nonetheless be refused admission as an expressive contingent with its own message just as readily as a private club could exclude an applicant whose manifest views were at odds with a position taken by the club's existing members." *Id.,* at 580-581, 115 S.Ct. 2338.

[10] ***660** Justice STEVENS' dissent makes much of its observation that the public perception of homosexuality in this country has changed. See *post,* at 2477-2478. Indeed, it appears that homosexuality has gained greater societal acceptance. See *ibid.* But this is scarcely an argument for denying First Amendment protection to those who refuse to accept these views. The First Amendment protects expression, be it of the popular variety or not. See, *e.g., Texas v. Johnson,* 491 U.S. 397, 109 S.Ct. 2533, 105 L.Ed.2d 342 (1989) (holding that Johnson's conviction for burning the American flag violates the First Amendment); *Brandenburg v. Ohio,* 395 U.S. 444, 89 S.Ct. 1827, 23 L.Ed.2d 430 (1969) *(per curiam)* (holding that a Ku Klux Klan leader's conviction for advocating unlawfulness as a means of political reform violates the First Amendment). And the fact that an idea may be embraced and advocated by increasing numbers of people is all the more reason to protect the First Amendment rights of those who wish to voice a different view.

Justice STEVENS' extolling of Justice Brandeis' comments in *New State Ice Co. v. Liebmann,* 285 U.S. 262, 311, 52 S.Ct. 371, 76 L.Ed. 747 (1932) (dissenting opinion); see *post,* at 2459, 2478, confuses two entirely different principles. In *New State Ice,* the Court struck down an Oklahoma regulation prohibiting the manufacture, sale, and distribution of ice without a license.

Justice Brandeis, a champion of state experimentation in the economic realm, dissented. But Justice Brandeis was never a champion of state experimentation in the suppression of free speech. To the contrary, his First Amendment commentary provides compelling support for the Court's opinion in this case. In speaking of the Founders of this Nation, Justice Brandeis emphasized that they "believed that freedom ***661** to think as you will and to speak as you think are means indispensable to the discovery and spread of political truth." *Whitney v. California,* 274 U.S. 357, 375, 47 S.Ct. 641, 71 L.Ed. 1095 (concurring opinion). He continued:

> ****2458** "Believing in the power of reason as applied through public discussion, they eschewed silence coerced by law--the argument of force in its worst form. Recognizing the occasional tyrannies of governing majorities, they amended the Constitution so that free speech and assembly should be guaranteed." *Id.,* at 375-376, 47 S.Ct. 641.

We are not, as we must not be, guided by our views of whether the Boy Scouts' teachings with respect to homosexual conduct are right or wrong; public or judicial disapproval of a tenet of an organization's expression does not justify the State's effort to compel the organization to accept members where such acceptance would derogate from the organization's expressive message. "While the law is free to promote all sorts of conduct in place of harmful behavior, it is not free to interfere with speech for no better reason than promoting an approved message or discouraging a disfavored one, however enlightened either purpose may strike the government." *Hurley,* 515 U.S., at 579, 115 S.Ct. 2338.

The judgment of the New Jersey Supreme Court is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

Bob Jones University
v.
United States
461 U.S. 574 (1983)

***577** Chief Justice BURGER delivered the opinion of the Court.

[1] We granted certiorari to decide whether petitioners, nonprofit private schools that prescribe and enforce racially discriminatory admissions standards on the basis of religious doctrine, qualify as tax-exempt organizations under § 501(c)(3) of the Internal Revenue Code of 1954.

I

A

Until 1970, the Internal Revenue Service granted tax-exempt status to private schools, without regard to their racial admissions policies, under § 501(c)(3) of the Internal Revenue Code, 26 U.S.C. § 501(c)(3), [FN1] and granted charitable ***578** deductions for contributions to such schools under § 170 of the Code, 26 U.S.C. § 170. [FN2]

FN1. Section 501(c)(3) lists the following organizations, which, pursuant to § 501(a), are exempt from taxation unless denied tax exemptions under other specified sections of the Code:
"Corporations, and any community chest, fund, or foundation, *organized and operated exclusively for religious, charitable,* scientific, testing for public safety, literary, *or educational purposes,* or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation ..., and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." (Emphasis added).

FN2. Section 170(a) allows deductions for certain "charitable contributions." Section 170(c)(2)(B) includes within the definition of "charitable contribution" a contribution or gift to or for the use of a corporation "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes...."

On January 12, 1970, a three-judge District Court for the District of Columbia issued a preliminary injunction prohibiting the IRS from according tax-exempt status to private schools in Mississippi that discriminated as to admissions on the basis of race. *Green v. Kennedy,* 309 F.Supp. 1127 (D.D.C.), *app. dismissed sub nom. Cannon v. Green,* 398 U.S. 956, 90 S.Ct. 2169, 26 L.Ed.2d 539 (1970). Thereafter, in July 1970, the IRS concluded that it could "no longer legally justify allowing tax-exempt status [under § 501(c)(3)] to private schools which practice racial discrimination." IRS News Release (7/10/70), reprinted in App. in No. 81-3, p. A235. At the same time, the IRS announced that it could not "treat gifts to such schools as charitable deductions for income tax purposes [under § 170]." *Ibid.* By letter dated November 30, 1970, the IRS formally notified private schools, including those involved in this case, of this change in policy, "applicable to all private ****2022** schools in the United States at all levels of education." See *id.,* at A232.

On June 30, 1971, the three-judge District Court issued its opinion on the merits of the Mississippi challenge. *Green v. Connally,* 330 F.Supp. 1150 (D.D.C.), *aff'd sub nom. Coit v. Green,* 404 U.S. 997, 92 S.Ct. 564, 30 L.Ed.2d 550 (1971) (*per curiam*). That court approved the IRS' amended construction of the Tax Code. The court also held that racially discriminatory private schools were not entitled to exemption under § 501(c)(3) and that donors were not entitled to deductions for contributions to such schools under § 170. The court permanently enjoined the Commissioner of ***579** Internal Revenue from approving tax-exempt status for any school in Mississippi that did not publicly maintain a policy of nondiscrimination.

The revised policy on discrimination was formalized in Revenue Ruling 71- 447, 1971-2 Cum.Bull. 230:

> "Both the courts and the Internal Revenue Service have long recognized that the statutory requirement of being 'organized and operated exclusively for religious, charitable, ... or educational purposes' was intended to express the basic common law concept [of 'charity'].... All charitable trusts, educational or otherwise, are subject to the requirement that the purpose of the trust may not be illegal or contrary to public policy." *Id.,* at 230.

Based on the "national policy to discourage racial discrimination in education," the IRS ruled that "a private school not having a racially nondiscriminatory policy as to students is not 'charitable' within the common law concepts reflected in sections 170 and 501(c)(3) of the Code." *Id.,* at 231. [FN3]

FN3. Revenue Ruling 71-447,

1971-2 Cum.Bull. 230, defined "racially nondiscriminatory policy as to students" as meaning that:

"[T]he school admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school and that the school does not discriminate on the basis of race in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs."

The application of the IRS construction of these provisions to petitioners, two private schools with racially discriminatory admissions policies, is now before us.

B

No. 81-3, Bob Jones University v. United States

Bob Jones University is a nonprofit corporation located in Greenville, South Carolina. [FN4] Its purpose is "to conduct an institution ***580** of learning ..., giving special emphasis to the Christian religion and the ethics revealed in the Holy Scriptures." Certificate of Incorporation, Bob Jones University, Inc., of Greenville, S.C., *reprinted in* App. in No. 81-3, pp. A118-A119. The corporation operates a school with an enrollment of approximately 5,000 students, from kindergarten through college and graduate school. Bob Jones University is not affiliated with any religious denomination, but is dedicated to the teaching and propagation of its fundamentalist Christian religious beliefs. It is both a religious and educational institution. Its teachers are required to be devout Christians, and all courses at the University are taught according to the Bible. Entering students are screened as to their religious beliefs, and their public and private conduct is strictly regulated by standards promulgated by University authorities.

FN4. Bob Jones University was founded in Florida in 1927. It moved to Greenville, South Carolina, in 1940, and has been incorporated as an eleemosynary institution in South Carolina since 1952.

The sponsors of the University genuinely believe that the Bible forbids interracial dating and marriage. To effectuate these views, Negroes were completely excluded until 1971. From 1971 to May 1975, the University accepted no applications from unmarried Negroes, [FN5] but did accept applications ****2023** from Negroes married within their race.

FN5. Beginning in 1973, Bob Jones University instituted an exception to this rule, allowing applications from

> unmarried Negroes who had been members of the University staff for four years or more.

Following the decision of the United States Court of Appeals for the Fourth Circuit in *McCrary v. Runyon,* 515 F.2d 1082 (CA4 1975), *aff'd* 427 U.S. 160, 96 S.Ct. 2586, 49 L.Ed.2d 415 (1976), prohibiting racial exclusion from private schools, the University revised its policy. Since May 29, 1975, the University has permitted unmarried Negroes to enroll; but a disciplinary rule prohibits interracial dating and marriage. That rule reads:

> *There is to be no interracial dating*
>
> 1. Students who are partners in an interracial marriage will be expelled.
>
> ***581** 2. Students who are members of or affiliated with any group or organization which holds as one of its goals or advocates interracial marriage will be expelled.
>
> 3. Students who date outside their own race will be expelled.
>
> 4. Students who espouse, promote, or encourage others to violate the University's dating rules and regulations will be expelled. App. in No. 81-3, p. A197.

The University continues to deny admission to applicants engaged in an interracial marriage or known to advocate interracial marriage or dating. *Id.,* at A277.

Until 1970, the IRS extended tax-exempt status to Bob Jones University under § 501(c)(3). By the letter of November 30, 1970, that followed the injunction issued in *Green v. Kennedy, supra,* the IRS formally notified the University of the change in IRS policy, and announced its intention to challenge the tax-exempt status of private schools practicing racial discrimination in their admissions policies.

After failing to obtain an assurance of tax exemption through administrative means, the University instituted an action in 1971 seeking to enjoin the IRS from revoking the school's tax-exempt status. That suit culminated in *Bob Jones University v. Simon,* 416 U.S. 725, 94 S.Ct. 2038, 40 L.Ed.2d 496 (1974), in which this Court held that the Anti-Injunction Act of the Internal Revenue Code, 26 U.S.C. § 7421(a), prohibited the University from obtaining judicial review by way of injunctive action before the assessment or collection of any tax.

Thereafter, on April 16, 1975, the IRS notified the University of the proposed revocation of its tax-exempt status. On January 19, 1976, the IRS officially revoked the University's tax-exempt status, effective as of December 1, 1970, the day after the University was formally notified of the change in IRS policy. The University subsequently filed returns under the Federal

Unemployment Tax Act for the period from December 1, 1970, to December 31, 1975, and paid a tax ***582** totalling $21.00 on one employee for the calendar year of 1975. After its request for a refund was denied, the University instituted the present action, seeking to recover the $21.00 it had paid to the IRS. The Government counterclaimed for unpaid federal unemployment taxes for the taxable years 1971 through 1975, in the amount of $489,675.59, plus interest.

The United States District Court for the District of South Carolina held that revocation of the University's tax-exempt status exceeded the delegated powers of the IRS, was improper under the IRS rulings and procedures, and violated the University's rights under the Religion Clauses of the First Amendment. 468 F.Supp. 890, 907 (D.S.C.1978). The court accordingly ordered the IRS to pay the University the $21.00 refund it claimed and rejected the IRS counterclaim.

The Court of Appeals for the Fourth Circuit, in a divided opinion, reversed. 639 F.2d 147 (CA4 1980). Citing *Green v. Connally, supra,* with approval, the Court of Appeals concluded that § 501(c)(3) must be read against the background of charitable trust law. To be eligible for an exemption under that section, an institution must be "charitable" in the common law sense, and therefore must not be contrary to public policy. In the court's ****2024** view, Bob Jones University did not meet this requirement, since its "racial policies violated the clearly defined public policy, rooted in our Constitution, condemning racial discrimination and, more specifically, the government policy against subsidizing racial discrimination in education, public or private." *Id.,* at 151. The court held that the IRS acted within its statutory authority in revoking the University's tax-exempt status. Finally, the Court of Appeals rejected petitioner's arguments that the revocation of the tax exemption violated the Free Exercise and Establishment Clauses of the First Amendment. The case was remanded to the District Court with instructions to dismiss the University's claim for a refund and to reinstate the Government's counterclaim.

II

A

In Revenue Ruling 71-447, the IRS formalized the policy first announced in 1970, that § 170 and § 501(c)(3) embrace the common law "charity" concept. Under that view, to qualify for a tax exemption pursuant to § 501(c)(3), an institution must show, first, that it falls within one of the eight categories expressly set forth in that section, and second, that its activity is not contrary to settled public policy.

Section 501(c)(3) provides that

"[c]orporations ... organized and operated exclusively for religious, charitable ... or educational purposes" are entitled to tax exemption. Petitioners argue that the plain language of the statute guarantees them tax-exempt status. They emphasize the absence of any language in the statute expressly requiring all exempt organizations to be "charitable" in the common law sense, and they contend that the disjunctive "or" separating the categories in § 501(c)(3) precludes such a reading. Instead, they argue that if an institution falls within one or more of ***586** the specified categories it is automatically entitled to exemption, without regard to whether it also qualifies as "charitable." The Court of Appeals rejected that contention and concluded that petitioners' interpretation of the statute "tears section 501(c)(3) from its roots." *United States v. Bob Jones University, supra,* 639 F.2d, at 151.

[2] It is a well-established canon of statutory construction that a court should go beyond the literal language of a statute if reliance on that language would defeat the plain purpose of the statute:

> "The general words used in the clause ..., taken by themselves, and literally construed, without regard to the object in view, would seem to sanction the claim of the plaintiff. But this mode of expounding a statute has never been adopted by any enlightened tribunal--because it is evident that in many cases it would defeat the object which the Legislature intended to accomplish. And it is well settled that, in interpreting a statute, the court will not look merely to a particular clause in which general words may be used, *but will take in connection with it the whole statute ... and the objects and policy of the law....*" *Brown v. Duchesne,* 19 How. 183, 194, 15 L.Ed. 595 (1857) (emphasis added).

****2026** [3] Section 501(c)(3) therefore must be analyzed and construed within the framework of the Internal Revenue Code and against the background of the Congressional purposes. Such an examination reveals unmistakable evidence that, underlying all relevant parts of the Code, is the intent that entitlement to tax exemption depends on meeting certain common law standards of charity-- namely, that an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy.

[4] This "charitable" concept appears explicitly in § 170 of the Code. That section contains a list of organizations virtually identical to that contained in § 501(c)(3). It is apparent that Congress intended that list to have the same meaning in both ***587** sections. [FN10] In § 170, Congress used the list of organizations in defining the term "charitable contributions." On its face, therefore, § 170 reveals that Congress'

intention was to provide tax benefits to organizations serving charitable purposes. [FN11] The form of § 170 simply makes plain what common sense and history tell us: in enacting both § 170 and ***588** § 501(c)(3), Congress sought to provide tax benefits to charitable organizations, to encourage the development of private institutions that serve a useful public purpose or supplement or take the place of public institutions of the same kind.

FN10. The predecessor of § 170 originally was enacted in 1917, as part of the War Revenue Act of 1917, ch. 63, § 1201(2), 40 Stat. 300, 330 (1917), whereas the predecessor of § 501(c)(3) dates back to the income tax law of 1894, Act of August 27, 1894, ch. 349, 28 Stat. 509, see n. 14, *infra.* There are minor differences between the lists of organizations in the two sections, see generally Liles & Blum, Development of the Federal Tax Treatment of Charities, 39 L. & Contemp. Prob. 6, 24-25 (No. 4, 1975) (hereinafter Liles & Blum). Nevertheless, the two sections are closely related; both seek to achieve the same basic goal of encouraging the development of certain organizations through the grant of tax benefits. The language of the two sections is in most respects identical, and the Commissioner and the courts consistently have applied many of the same standards in interpreting those sections. See 5 J. Mertens, The Law of Federal Income Taxation § 31.12 (1980); 6 *id.* §§ 34.01-34.13 (1975); B. Bittker & L. Stone, Federal Income Taxation 220-222 (5th ed. 1980). To the extent that § 170 "aids in ascertaining the meaning" of § 501(c)(3), therefore, it is "entitled to great weight," *United States v. Stewart,* 311 U.S. 60, 64-65, 61 S.Ct. 102, 105-106, 85 L.Ed. 40 (1940). See *Harris v. Commissioner,* 340 U.S. 106, 107, 71 S.Ct. 181, 182, 95 L.Ed. 111 (1950).

FN11. The dissent suggests that the Court "quite adeptly avoids the statute it is construing," *post,* at 2039, and "seeks refuge ... by turning to § 170," *post,* at 2040. This assertion dissolves when one sees that § 501(c)(3) and § 170 are construed together, as they must be. The dissent acknowledges that the two sections are "mirror" provisions; surely there can be no doubt that the Court properly looks to § 170 to determine the meaning of § 501(c)(3). It is also suggested that § 170 is "at best of little usefulness in finding the meaning of § 501(c)(3)," since "§ 170(c) simply tracks the requirements set forth in § 501(c)(3)," *post,* at 2040. That reading loses sight of the fact that § 170(c) defines the term "charitable contribution." The plain language of § 170 reveals that Congress' objective was to employ tax exemptions and deductions to promote certain *charitable* purposes.

While the eight categories of institutions specified in the statute are indeed presumptively charitable in nature, the IRS properly considered principles of charitable trust law in determining whether the institutions in question may truly be considered "charitable," for purposes of entitlement to the tax benefits conferred by § 170 and § 501(c)(3).

Tax exemptions for certain institutions thought beneficial to the social order of the country as a whole, or to a particular community, are deeply rooted in our history, as in that of England. The origins of such exemptions lie in the special privileges that have long been extended to charitable trusts. [FN12]

FN12. The form and history of the charitable exemption and deduction sections of the various income tax acts reveal that Congress was guided by the common law of charitable trusts. See Simon, The Tax-Exempt Status of Racially Discriminatory Religious Schools, 36 Tax L.Rev. 477, 485-489 (1981) (hereinafter Simon). Congress acknowledged as much in 1969. The House Report on the Tax Reform Act of 1969, Pub.L. 91-172, 83 Stat. 487, stated that the § 501(c)(3) exemption was available only to institutions that served "the specified charitable purposes," H.R.Rep. No. 413 (Part 1), 91st Cong., 1st Sess. 35 (1969), U.S.Code Cong. & Admin.News 1969, p. 1645, and described "charitable" as "a term that has been used in the law of trusts for hundreds of years." *Id.,* at 43, U.S.Code Cong. & Admin.News 1969, p. 1688. We need not consider whether Congress intended to incorporate into the Internal Revenue Code any aspects of charitable trust law other than the requirements of public benefit and a valid public purpose.

****2027** More than a century ago, this Court announced the caveat that is critical in this case:

"[I]t has now become an established principle of American law, that courts of chancery will sustain and protect ... a gift ... to public charitable uses, *provided the same is consistent with local laws and* *public policy....*" *Perin v. Carey,* 24 How. 465, 501, 16 L.Ed. 701 (1861) (emphasis added).

Soon after that, in 1878, the Court commented:

"A charitable use, *where neither law nor public policy forbids,* may be applied to almost any thing *that tends to promote the well-doing and well-being of social man.*" *Ould v. Washington Hospital for Foundlings,* 95 U.S. 303, 311, 24 L.Ed. 450 (1878) (emphasis added). ***589** See also, *e.g., Jackson v. Phillips,* 96 Mass. 539, 556 (1867).

In 1891, in a restatement of the English law of charity [FN13] which has long been recognized as a leading authority in this country, Lord MacNaghten stated:

FN13. The draftsmen of the 1894 income tax law, which included the first charitable exemption provision, relied heavily on English concepts of taxation; and the list of exempt organizations appears to have been patterned upon English income tax statutes. See 26 Cong.Rec. 584-588, 6612-6615 (1894).

" 'Charity' in its legal sense comprises four principal divisions: trusts for the relief of poverty; *trusts for the advancement of education;* trusts for the advancement of religion; and trusts for *other purposes beneficial to the community,* not falling under any of the preceding heads." *Commissioners v. Pemsel,* [1891] A.C. 531, 583 (emphasis added). See, *e.g.,* 4 A. Scott, The Law of Trusts § 368, at 2853-2854 (3d ed. 1967) (hereinafter Scott).

These statements clearly reveal the legal background against which Congress enacted the first charitable exemption statute in 1894: [FN14] charities were to be given preferential treatment because they provide a benefit to society.

FN14. Act of August 27, 1894, ch. 349, § 32, 28 Stat. 509, 556-557 (1894). The income tax system contained in the 1894 Act was declared unconstitutional, *Pollock v. Farmers' Loan and Trust Co.,* 158 U.S. 601, 15 S.Ct. 912, 39 L.Ed. 1108 (1895), for reasons unrelated to the charitable exemption provision. The terms of that exemption were in substance included in the corporate income tax contained in the Payne Aldrich Tariff Act of 1909, ch. 6, § 38, 36 Stat. 11, 112 (1909). A similar exemption has been included in every income tax act since the adoption of the Sixteenth Amendment, beginning with the Revenue Act of 1913, ch. 16, § II(G), 38 Stat. 114, 172 (1913). See generally Reiling, Federal Taxation: What Is a

Charitable Organization?, 44 ABA J. 525 (1958); Liles & Blum.

What little floor debate occurred on the charitable exemption provision of the 1894 Act and similar sections of later statutes leaves no doubt that Congress deemed the specified organizations entitled to tax benefits because they served desirable public purposes. See, *e.g.,* 26 Cong.Rec. 585-586 ***590** (1894); *id.,* at 1727. In floor debate on a similar provision in 1917, for example, Senator Hollis articulated the rationale:

"For every dollar that a man contributes to these public charities, educational, scientific, or otherwise, the public gets 100 percent." 55 *id.,* at 6728 (1917). See also, *e.g.,* 44 *id.,* at 4150 (1909); 50 *id.,* at 1305-1306 (1913).

In 1924, this Court restated the common understanding of the charitable exemption provision:

"Evidently the exemption is made in recognition of the benefit which the public derives from corporate activities of the class named, and is intended to aid them when not conducted for private gain." *Trinidad v. Sagrada Orden,* 263 U.S. 578, 581, 44 S.Ct. 204, 205, 68 L.Ed. 458 (1924). [FN15]

FN15. That same year, the Bureau of Internal Revenue expressed a similar view of the charitable deduction section of the estate tax contained in the Revenue Act of 1918, ch. 18, § 403(a)(3), 40 Stat. 1057, 1098 (1919). The Solicitor of Internal Revenue looked to the common law of charitable trusts in construing that provision, and noted that "generally bequests for the benefit and advantage of the general public are valid as charities." Sol.Op. 159, III-1 C.B. 480 (1924).

****2028** In enacting the Revenue Act of 1938, ch. 289, 52 Stat. 447 (1938), Congress expressly reconfirmed this view with respect to the charitable deduction provision:

"The exemption from taxation of money and property devoted to charitable and other purposes is based on the theory that the Government is compensated for the loss of revenue by its relief from financial burdens which would otherwise have to be met by appropriations from other public funds, and by the benefits resulting from the promotion of the general welfare." H.R.Rep. No. 1860, 75th Cong., 3d Sess. 19 (1938). [FN16]

FN16. The common law requirement of public benefit is universally recognized by commentators on the law of trusts. For example, Bogert states:

"In return for the favorable treatment accorded charitable gifts which imply some disadvantage to the community, the courts must find in the trust which is to be deemed 'charitable' some real advantages to the public which more than offset the disadvantages arising out of special privileges accorded charitable trusts." G. Bogert & G. Bogert, The Law of Trusts and Trustees § 361, at 3 (rev. 2d ed. 1977) (hereinafter Bogert).

For other statements of this principle, see, *e.g.,* 4 Scott § 348, at 2770; Restatement (Second) of Trusts § 368, comment b (1959); E. Fisch, D. Freed & E. Schachter, Charities and Charitable Foundations § 256 (1974).

[5] ***591** A corollary to the public benefit principle is the requirement, long recognized in the law of trusts, that the purpose of a charitable trust may not be illegal or violate established public policy. In 1861, this Court stated that a public charitable use must be "consistent with local laws and public policy," *Perin v. Carey, supra,* 24 How., at 501. Modern commentators and courts have echoed that view. See, *e.g.,* Restatement (Second) of Trusts, § 377, comment c (1959); 4 Scott § 377, and cases cited therein; Bogert § 378, at 191-192. [FN17]

FN17. Cf. *Tank Truck Rentals, Inc. v. Commissioner,* 356 U.S. 30, 35, 78 S.Ct. 507, 510, 2 L.Ed.2d 562 (1958), in which this Court referred to "the presumption against congressional intent to encourage violation of declared public policy" in upholding the Commissioner's disallowance of deductions claimed by a trucking company for fines it paid for violations of state maximum weight laws.

[6][7][8] When the Government grants exemptions or allows deductions all taxpayers are affected; the very fact of the exemption or deduction for the donor means that other taxpayers can be said to be indirect and vicarious "donors." Charitable exemptions are justified on the basis that the exempt entity confers a public benefit--a benefit which the society or the community may not itself choose or be able to provide, or which supplements and advances the work of public institutions already supported by tax revenues. [FN18] History buttresses ***592** logic to make clear that, to warrant exemption under § 501(c)(3), an institution must fall within a category specified in that section and must demonstrably serve and be in harmony with the public ****2029** interest. [FN19] The institution's purpose must not be so at odds with the common community conscience as to undermine any public benefit that might otherwise be conferred.

FN18. The dissent acknowledges that "Congress intended ... to offer a tax benefit to organizations ... providing a public benefit," *post,* at 2040, but suggests that Congress itself fully defined what organizations provide a public benefit, through the list of eight categories of exempt organizations contained in § 170 and § 501(c)(3). Under that view, any nonprofit organization that falls within one of the specified categories is automatically entitled to the tax benefits, provided it does not engage in expressly prohibited lobbying or political activities. *Post,* at 2042. The dissent thus would have us conclude, for example, that any nonprofit organization that does not engage in prohibited lobbying activities is entitled to tax exemption as an "educational" institution if it is organized for the "instruction or training of the individual for the purpose of improving or developing his capabilities," 26 CFR § 1.501(c)(3)-1(d)(3). See *post,* at 2045. As Judge Leventhal noted in *Green v. Connally,* 330 F.Supp. 1150, 1160 (D.D.C.), *aff'd sub nom. Coit v. Green,* 404 U.S. 997, 92 S.Ct. 564, 30 L.Ed.2d 550 (1971) (*per curiam*), Fagin's school for educating English boys in the art of picking pockets would be an "educational" institution under that definition. Similarly, a band of former military personnel might well set up a school for intensive training of subversives for guerrilla warfare and terrorism in other countries; in the abstract, that "school" would qualify as an "educational" institution. Surely Congress had no thought of affording such an unthinking, wooden meaning to § 170 and § 501(c)(3) as to provide tax benefits to "educational" organizations that do not serve a public, charitable purpose.

FN19. The Court's reading of § 501(c)(3) does not render meaningless Congress' action in specifying the eight categories of presumptively exempt organizations, as petitioners suggest. See Brief of Petitioner Goldsboro Christian Schools 18-24. To be entitled to tax-exempt status under § 501(c)(3), an organization must first fall within one of the categories specified by Congress, and in addition must serve a valid charitable purpose.

B

[9][10] We are bound to approach these questions with full awareness that

determinations of public benefit and public policy are sensitive matters with serious implications for the institutions affected; a declaration that a given institution is not "charitable" should be made only where there can be no doubt that the activity involved is contrary to a fundamental public policy. But there can no longer be any doubt that racial discrimination in education violates deeply and widely accepted views of elementary justice. Prior to 1954, public education in many places still was conducted under the pall of ***593** *Plessy v. Ferguson,* 163 U.S. 537, 16 S.Ct. 1138, 41 L.Ed. 256 (1896); racial segregation in primary and secondary education prevailed in many parts of the country. See, *e.g.,* Segregation and the Fourteenth Amendment in the States (B. Reams & P. Wilson, eds. 1975). [FN20] This Court's decision in *Brown v. Board of Education,* 347 U.S. 483, 74 S.Ct. 686, 98 L.Ed. 873 (1954), signalled an end to that era. Over the past quarter of a century, every pronouncement of this Court and myriad Acts of Congress and Executive Orders attest a firm national policy to prohibit racial segregation and discrimination in public education.

FN20. In 1894, when the first charitable exemption provision was enacted, racially segregated educational institutions would not have been regarded as against public policy. Yet contemporary standards must be considered in determining whether given activities provide a public benefit and are entitled to the charitable tax exemption. In *Walz v. Tax Comm'n,* 397 U.S. 664, 672-673, 90 S.Ct. 1409, 1413, 25 L.Ed.2d 697 (1970), we observed:

"Qualification for tax exemption is not perpetual or immutable; some tax-exempt groups lose that status when their activities take them outside the classification and new entities can come into being and qualify for the exemption."

Charitable trust law also makes clear that the definition of "charity" depends upon contemporary standards. See, *e.g.,* Restatement (Second) of Trusts, § 374, comment a (1959); Bogert § 369, at 65-67; 4 Scott § 368, at 2855-2856.

[11] An unbroken line of cases following *Brown v. Board of Education* establishes beyond doubt this Court's view that racial discrimination in education violates a most fundamental national public policy, as well as rights of individuals.

"The right of a student not to be segregated on racial grounds in schools ... is indeed so fundamental and pervasive that it is embraced in the concept of due process of law." *Cooper v. Aaron,* 358 U.S. 1, 19, 78 S.Ct. 1401, 1410, 3 L.Ed.2d 19 (1958).

In *Norwood v. Harrison,* 413 U.S. 455, 468-469, 93 S.Ct. 2804, 2812, 37 L.Ed.2d 723 (1973), we dealt with a non-public institution:

> "[A] private school--even one that discriminates--fulfills an important educational function; *however, ... [that] legitimate educational function cannot be isolated from* ***594** *discriminatory practices ... [D]iscriminatory treatment exerts a pervasive influence on the entire educational process.*" (Emphasis added).
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> See also *Runyon v. McCrary,* 427 U.S. 160, 96 S.Ct. 2586, 49 L.Ed.2d 415 (1976); *Griffin v. County School Board,* 377 U.S. 218, 84 S.Ct. 1226, 12 L.Ed.2d 256 (1964).

Congress, in Titles IV and VI of the Civil Rights Act of 1964, Pub.L. 88- 352, 78 Stat. 241, 42 U.S.C. §§ 2000c et seq., 2000c-6, 2000-d et seq., clearly expressed its agreement that racial discrimination in education violates a fundamental public policy. Other sections of that Act, and numerous enactments since then, testify to the public ****2030** policy against racial discrimination. See, *e.g.,* the Voting Rights Act of 1965, Pub.L. 89-110, 79 Stat. 437, 42 U.S.C. §§ 1971 *et seq.;* Title VIII of the Civil Rights Act of 1968, Pub.L. 90-284, 82 Stat. 81, 42 U.S.C. §§ 3601 *et seq.;* the Emergency School Aid Act of 1972, Pub.L. 92-318, 86 Stat. 354 (repealed effective Sept. 30, 1979; replaced by similar provisions in the Emergency School Aid Act of 1978, Pub.L. 95-561, 92 Stat. 2252, 20 U.S.C. §§ 3191-3207 (1980 Supp.)).

The Executive Branch has consistently placed its support behind eradication of racial discrimination. Several years before this Court's decision in *Brown v. Board of Education, supra,* President Truman issued Executive Orders prohibiting racial discrimination in federal employment decisions, Exec. Order No. 9980, 3 CFR 720 (1943-1948 Comp.), and in classifications for the Selective Service, Exec. Order No. 9988, *id.* 726, 729. In 1957, President Eisenhower employed military forces to ensure compliance with federal standards in school desegregation programs. Exec. Order No. 10730, 3 CFR 389 (1954-1958 Comp.). And in 1962, President Kennedy announced:

> "[T]he granting of federal assistance for ... housing and related facilities from which Americans are excluded because of their race, color, creed, or national origin is unfair, unjust, and inconsistent with the public policy of ***595** the United States as manifested in its Constitution and laws." Exec. Order No. 11063, 3 CFR 652 (1959-1963 Comp.).

These are but a few of numerous Executive Orders over the past three decades demonstrating the commitment of the Executive Branch to the fundamental policy of eliminating racial discrimination. See, *e.g.,* Exec. Order No. 11197, 3 CFR 278 (1964-1965 Comp.); Exec. Order No. 11478, 3 CFR 803 (1966- 1970 Comp.); Exec. Order No. 11764, 3 CFR 849 (1971-1975 Comp.); Exec. Order No. 12250, 3 CFR 298 (1981).

[12] Few social or political issues in our history have been more vigorously debated and more extensively ventilated than the issue of racial discrimination, particularly in education. Given the stress and anguish of the history of efforts to escape from the shackles of the "separate but equal" doctrine of *Plessy v. Ferguson, supra,* it cannot be said that educational institutions that, for whatever reasons, practice racial discrimination, are institutions exercising "beneficial and stabilizing influences in community life," *Walz v. Tax Comm'n,* 397 U.S. 664, 673, 90 S.Ct. 1409, 1413, 25 L.Ed.2d 697 (1970), or should be encouraged by having all taxpayers share in their support by way of special tax status.

[13][14] There can thus be no question that the interpretation of § 170 and § 501(c)(3) announced by the IRS in 1970 was correct. That it may be seen as belated does not undermine its soundness. It would be wholly incompatible with the concepts underlying tax exemption to grant the benefit of tax-exempt status to racially discriminatory educational entities, which "exer [t] a pervasive influence on the entire educational process." *Norwood v. Harrison, supra,* 413 U.S., at 469, 93 S.Ct., at 2812. Whatever may be the rationale for such private schools' policies, and however sincere the rationale may be, racial discrimination in education is contrary to public policy. Racially discriminatory educational institutions cannot be viewed as conferring a public benefit within the "charitable" concept discussed earlier, ***596** or within the Congressional intent underlying § 170 and § 501(c)(3). [FN21]

FN21. In view of our conclusion that racially discriminatory private schools violate fundamental public policy and cannot be deemed to confer a benefit on the public, we need not decide whether an organization providing a public benefit and otherwise meeting the requirements of § 501(c)(3) could nevertheless be denied tax-exempt status if certain of its activities violated a law or public policy.

Under the Rainbow Child Care Center, Inc.
v.
County of Goodhue,
741 NW.2d 880 (Minn. 2007).
OPINION

ANDERSON, RUSSELL A., Chief Justice.

In this case, we review the final order of the Minnesota Tax Court exempting real property owned by respondent Under the Rainbow Child Care Center, Inc. (Rainbow), from payment of real property taxes assessed in 2004 and 2005. The tax court concluded that Rainbow's property qualified for tax exemption because Rainbow is an institution of purely public charity under Article X, Section 1 of the Minnesota Constitution and Minn.Stat. § 272.02, subd. 7 (2006), applying the six factors listed in *North Star Research Institute v. County of Hennepin,* 306 Minn. 1, 6, 236 N.W.2d 754, 757 (1975). On certiorari to this court, relator Goodhue County asserts that the evidence did not establish that Rainbow is an institution of purely public charity. We agree and reverse the tax court.

Rainbow is a state-licensed child care center in Red Wing, established as a sole proprietorship in 1994 by Michelle Finholdt, Rainbow's executive director. Rainbow was incorporated in 1995 as a nonprofit corporation under Minn.Stat. ch. 317A (2006). Rainbow's articles of incorporation state that Rainbow's mission is "to provide care [for] children away from their homes" and that Rainbow is "organized exclusively for charitable, scientific, literary, or educational purposes." Rainbow has not realized a profit during any year of its existence.

Tuition must be paid for each of the children enrolled in Rainbow. Rainbow based its child care rates on the average rates charged by other day care centers in Goodhue County. According to a comparison of rates charged by child care centers in Red Wing prepared by Goodhue County, Rainbow's 2006 weekly rates were higher than the two other child care centers in Red Wing for infants, toddlers, and preschool children. Rainbow's weekly rate was lower than that of one center but higher than the rate of the other center for school age children. The tax court found that Rainbow's tuition rates were "at or just below market rates."

Rainbow directed families who had difficulty paying tuition to Goodhue County Social Services, and Rainbow's clients included children whose families received child care assistance payments from Goodhue County, from Pierce County, Wisconsin, and from the Prairie Island Tribal Community. Families that received child care assistance from the counties or from the Prairie Island Tribal Community were charged the same tuition as families that did not receive assistance. Although Rainbow's executive director testified that Rainbow wrote off "several thousands of dollars in unclaimed childcare payments every year," Rainbow offered no scholarships and had in the past pursued collection efforts against families that did not pay.

The tax court found that all of the *North Star* factors were satisfied by Rainbow except the third factor. Based on this evaluation of the factors, the tax court concluded that Rainbow was entitled to exemption from property taxes assessed in **884** 2004 and 2005 as an institution of purely public charity under Minn.Stat. § 272.02, subd. 7.

I.

Rainbow claims it is exempt from payment of real property taxes as an institution of purely public charity. Article X, Section 1 of the Minnesota Constitution requires that "[t]axes shall be uniform upon the same class of subjects" but exempts from taxation "public burying grounds, public school houses, public hospitals, academies, colleges, universities, all seminaries of learning, all churches, church property, houses of worship, *institutions of purely public charity,* and public property used exclusively for any public purpose." (Emphasis added.) Minnesota Statutes § 272.02, subd. 7, echoes this provision, exempting from taxation "[i]nstitutions of purely public charity."

Because tax exemptions are "an exception in derogation of equal rights," all property is presumed to be taxable, and the taxpayer bears the burden of proving entitlement to an exemption. *Camping & Educ. Found. v. State,* 282 Minn. 245, 250, 164 N.W.2d 369, 372 (1969); *see also Croixdale, Inc. v. County of Washington,* 726 N.W.2d 483, 487 (Minn.2007). Furthermore, exemptions from property tax liability must be strictly construed. *E.g., Camping & Educ. Found.,* 282 Minn. at 250, 164 N.W.2d at 372. We have also observed:

> As the burdens of government should be borne by all the citizens in equal proportions, no property should be exempt from taxation in the absence of clear and explicit legislation authorizing the same, and in the construction of a law exempting property from taxation, courts will indulge no presumption that will extend the exemption beyond the plain requirements of the law itself.

St. Peter's Church, Shakopee v. Bd. of County Comm'rs, 12 Minn. 395, 397-98 (Gil. 280, 282) (1867). We must therefore construe the purely public charity exemption narrowly and take care to avoid extending the exemption under Minn.Stat. § 272.02, subd. 7, "beyond the plain requirements of the law itself."

"We may review any final order of the tax court on the ground that the tax court lacked jurisdiction or committed an error of law or that its order was not justified by the evidence or in conformity with the law." *Manpower, Inc. v. Comm'r of Revenue,* 724 N.W.2d 526, 528 (Minn.2006) (citing Minn.Stat. § 271.10, subd. 1 (2006)). We "will affirm the tax court when, after an independent review of the record, there is sufficient evidence in the record upon which the tax court could have reasonably based its conclusion." *Care Inst., Inc.-Maplewood v. County of Ramsey,* 576 N.W.2d 734, 738 (Minn.1998). As a result, we give great deference to the tax court's determination whether an organization qualifies as a purely public charity, so long as that determination is reasonably supported by the evidence. *Id.* We review the tax court's legal conclusions de novo. *Nw. Racquet Swim & Health Clubs, Inc. v. County of Dakota,* 557 N.W.2d 582, 586 (Minn.1997).

In this case, the tax court analyzed the six factors listed in our decision in *North Star:*

> (1) whether the stated purpose of the undertaking is to be helpful to others without immediate expectation of material reward; (2) whether the entity involved is supported by donations and gifts in whole or in part; (3) whether the recipients of the

> "charity" are required to pay for the assistance received in whole or in part; (4) whether the income received from gift and donations and charges to users produces a profit to the **885** charitable institution; (5) whether the beneficiaries of the "charity" are restricted or unrestricted and, if restricted, whether the class of persons to whom the charity is made available is one having a reasonable relationship to the charitable objectives; (6) whether dividends, in form or substance, or assets upon dissolution are available to private interests.

N. Star, 306 Minn. at 6, 236 N.W.2d at 757. The tax court found that Rainbow satisfied all of the factors except factor three and concluded that Rainbow qualified as an institution of purely public charity. As we will explain, we conclude that an entity cannot be an institution of purely public charity without satisfying *North Star* factor three, and therefore we reverse.

But first we add a note of caution against overly rigid reliance on the six *North Star* factors. Due in no small part to our own opinions, the *North Star* factors have come to be viewed as a multi-part test to be used in determining whether an organization is an institution of purely public charity. But we did not identify the six factors in *North Star* as the parts of a multi-faceted test. Rather, we simply explained that these were some of the factors we had assessed in previous cases when evaluating "organizations which were engaged in charitable undertakings in the traditional sense." *N. Star,* 306 Minn. at 5-6, 236 N.W.2d at 756-57. And, as pointed out recently by Justice Hanson, we did not indicate in listing the factors in *North Star* that they had all been used in combination in any of those previous cases. *Croixdale,* 726 N.W.2d at 492 (Hanson, J., concurring). Significantly, we found the six factors unhelpful in *North Star* itself, explaining that "[t]here are distinctive characteristics of North Star which make its situation so different from those of charities in the traditional sense that reference to general statements made in our previous cases are of limited value." *N. Star,* 306 Minn. at 7, 236 N.W.2d at 757. Thus, it should be apparent that *North Star* did not establish six mandatory elements that must be considered and satisfied in every charitable exemption case.

We explained the appropriate approach to the *North Star* factors in a contemporaneous case, *Mayo Foundation v. Commissioner of Revenue,* 306 Minn. 25, 236 N.W.2d 767 (1975). In *Mayo Foundation,* the Commissioner argued that our prior cases established seven prerequisites for granting tax exempt status as a charitable institution.

Id. at 35-36, 236 N.W.2d at 772-73. We rejected the Commissioner's rigid approach, explaining:

> The factors identified by the commissioner are comparable to those set forth in the North Star Research case, and we agree that they are appropriate for the consideration of charitable status. However, the significant difference between the approach advocated by the commissioner and the one which we adopt lies in our view of the weight to be given to the individual factors. *The general language of our definitional statements and the identification of factors in our prior cases are only guides for analysis.* Each case must be decided on its own particular facts and it is not essential that every factor mentioned in our decisions be present before an institution qualifies for exemption.

Id. at 36, 236 N.W.2d at 773 (emphasis added). We have reiterated in subsequent cases the methodology described in *Mayo Foundation:* that the *North Star* factors are intended to serve only as guidelines, *e.g., Cmty. Mem'l Home at Osakis, Minn., Inc. v. County of Douglas,* 573 N.W.2d 83, 86 (Minn.1997); that not all factors must be satisfied to qualify for the exemption, *e.g., Croixdale,* 726 N.W.2d at 488; and **886** that each case must be decided on its own facts, *e.g., Chateau Cmty. Hous. Ass'n v. County of Hennepin,* 452 N.W.2d 240, 242 (Minn.1990).

Nevertheless, we have referred to all six *North Star* factors in virtually every subsequent case in which the charitable exemption was at issue, and we have recently described the factors as a "six-factor test," *Croixdale,* 726 N.W.2d at 488. As a result, we may have created the impression that all six factors must be examined in every case addressing the charitable exemption issue. But as *North Star* itself illustrates, that is not true. In the circumstances of a particular case, one or more of the *North Star* factors may not be helpful in assessing whether an organization is an institution of purely public charity, and if that is true, those factors need not be analyzed. And if other analytical tools are more helpful in identifying whether an organization is an institution of purely public charity, those tools should be utilized.

The other side of this coin is that although we have often stated that not all of the *North Star* factors must be satisfied in order to qualify for the exemption, some of the factors are, indeed, essential. For example, regardless of the status of the other factors, we cannot envision an organization qualifying as an institution of purely public charity if it makes available to private interests either dividends, in form or substance, or assets upon dissolution, and thus fails to satisfy *North Star* factor six. *N. Star,* 306 Minn. at 6, 236 N.W.2d at 757. Here, the tax court found that Rainbow satisfied all the *North Star* factors except factor three, which examines the extent to which "the recipients of the 'charity' are required to pay for the assistance received in whole or in part." *Id.* at 6, 236 N.W.2d at 757. Relying on our statements that not every factor must be satisfied, the tax court concluded that even though factor three was not satisfied, Rainbow qualified as an institution of purely public charity.

Despite our statements that not all the *North Star* factors must be satisfied in order to qualify for the exemption, in applying those factors we have never found an organization that did not satisfy factor three to be an institution of purely public charity. The factor three inquiry, the extent to which the recipients of the charity are required to pay for the assistance received, tests for a value that is fundamental to the concept of charity-that is, whether the organization *gives* anything away. Because this is a core characteristic of an institution of public charity, we now clarify that the third factor must be satisfied if an organization is to be deemed an institution of purely public charity.

We must not lose sight of the fact that both the constitutional provision and the statute that we are applying authorize a tax exemption for institutions of purely public *charity.* Minn. Const. art. X, § 1; Minn.Stat. § 272.02, subd. 7. Although we have not developed a precise and all-encompassing definition of the term "charity," we have frequently relied on the following description, which, significantly, defines charity as a gift:

> The legal meaning of the word "charity" has a broader significance than in common speech and has been expanded in numerous decisions. Charity is broadly defined as a *gift,* to be applied consistently with existing laws, for the benefit of an indefinite number of persons by bringing their hearts under the influence of education or religion, by relieving their bodies from disease, suffering, or constraint, by assisting them to establish themselves for life, or by erecting or maintaining public buildings or works, or otherwise lessening the burdens of government.

887 *Junior Achievement of Greater Minneapolis, Inc. v. State,* 271 Minn. 385, 390, 135 N.W.2d 881, 885 (1965) (emphasis added) (internal quotation marks omitted). We explained further in *Junior Achievement* that not even every gift with a beneficent purpose necessarily qualifies as charity for these purposes: "it is not safe to say as a universal rule that any *gift* which tends to promote man's well-being is a charity." *Id.* at 390, 135 N.W.2d at 885 (emphasis added). We then quoted a Massachusetts decision that explained:

> It has come to be recognized that new objects must be added in order to comprehend within the class of charities a wide variety of *gifts* which represent a wholly generous and unselfish devotion of wealth to uses which benefit the public generally or whole classes of the public and from which the donor derives no personal advantage.

Id. at 391, 135 N.W.2d at 885 (emphasis added) (quoting *Boston Chamber of Commerce v. Assessors of Boston,* 315 Mass. 712, 54 N.E.2d 199, 202 (1944)). Although each of these statements addressed the breadth of purposes that a charity may serve, the common thread was another element-one that is inherent in the common understanding of charity: that charity is a gift. Absent the element of a gift, we fail to see how an endeavor can be fairly characterized as a charity.

By examining the extent to which "the recipients of the 'charity' are required to pay for the assistance received in whole or in part," factor three assesses whether the organization's operation confers a gift. *N. Star,* 306 Minn. at 6, 236 N.W.2d at 757. Therefore, if factor three is not satisfied, the organization cannot be found to be an institution of public charity. *See SHARE v. Comm'r of Revenue,* 363 N.W.2d 47, 52 (Minn.1985) (although discussing other *North Star* factors, stating that "SHARE's charitable exemption claim is defeated by application of factor three" because "SHARE provides no service without a fee").

Because the constitutional provision and the statute at issue here limit the exemption to institutions of purely public *charity,* it is not sufficient that an organization serves a worthwhile purpose, or even that it does so on a nonprofit basis. For example, in *SHARE* the organization's purpose was to "improve the availability and accessibility of quality of health care and health services," and it operated on a nonprofit basis, satisfying *North Star* factors one, four, and six. *Id.* at 51.We held that satisfaction of those three factors "does not itself qualify an institution as a 'purely public charity.' "*Id.*

This point illuminates the fundamental

difference between our analysis and that of the dissent. The dissent believes that "the essence of a charity lies in the nature of the service provided" and therefore, "the question of whether an organization is a charity depends primarily on the nature of the service it provides." In contrast, we understand the essence of charity, as defined in our cases, to be the provision of the service as a gift to the recipient. The dissent instead sees the extent to which the recipients are charged for the service simply as a matter of the mechanism for funding the service, which "has limited materiality to the question of whether the organization is a charity." This primary emphasis on purpose and the concomitant marginalization of the gift factor allow the dissent to conclude that Rainbow could be deemed a purely public charity based simply on finding that (a) Rainbow's objectives "qualify as traditionally charitable," (b) it is "organized so that no individual can profit from ownership of its assets," and (c) it does not offer its services only to "a **888** select and favored few." [FN1] This analysis would, in essence, hold that serving a worthwhile purpose and operating on a nonprofit basis is sufficient to exempt an organization from taxation as a "purely public charity." This interpretation of charity would expand the tax exemption far too broadly, for several reasons.

It is, thus, inherent in the concept of charity that there is a gift-that is, the services, goods, or whatever is conceived as the charitable benefit must be provided to the recipients of the charity without requiring them to pay full value for it. Nevertheless, the expanded legal definition of charity that has evolved in the context of tax exemptions does not require that the charitable benefit be provided to all recipients entirely free of charge. Therefore, the third *North Star* factor has been refined to require that the charity be provided "free of charge, *or at considerably reduced rates.*" *Cmty. Mem'l Home,* 573 N.W.2d at 87 (emphasis added). And the "considerably reduced rates" requirement has been described as meaning "considerably less than market value or cost." *Id.*

Utilizing this standard, we held in *Rio Vista* that a private nonprofit entity providing housing to moderate and low income people was an institution of purely public charity entitled to the exemption. 277 N.W.2d 187, 192 (Minn.1979). In *Rio Vista,* the corporation offered two rent levels, a basic level and a higher fair market level, but almost all of the tenants paid the basic rent and none was wealthy enough to pay the fair market rent. *Id.* at 188. Similarly, in *Worthington Dormitory, Inc. v. Commissioner of Revenue*, a community-based nonprofit organization provided rental housing for students at the local community college. 292 N.W.2d 276, 278 (Minn.1980). This court reversed the ruling of the tax court that the organization was not a purely public charity for tax exemption purposes. *Id.* at 277. The court concluded that the students paid less than cost for the housing they received and that it was "doubtful" that the students paid "market rents," because they **891** paid substantially less than the charges at comparable state-operated dormitory facilities. *Id.* at 281.

While granting the exemption to organizations that charged considerably less than market prices, we have consistently denied the exemption from property taxes to entities that charged recipients of their "charity" substantially market rates, even where some fees were discounted or forgiven. In *Chateau Community Housing,* the organization seeking the charitable exemption provided student and faculty housing on a nonprofit basis. 452 N.W.2d 240, 243 (Minn.1990). We found that Chateau provided no scholarships or rent assistance to needy students, that students were evicted for nonpayment of rent, and that in contrast to the discounted rental rates in *Rio Vista* and *Worthington*, Chateau charged rents comparable to private housing and considerably higher than university-owned housing. 452 N.W.2d at 243-44. As a result, we affirmed denial of the purely public charity exemption. *Id.* at 244.

Similarly, in *SHARE,* we affirmed denial of the purely public charity exemption to a health maintenance organization. 363 N.W.2d 47, 48 (Minn.1985). The HMO, SHARE, provided no services without a fee, except for a one-time short-term project, and had no policy to provide substantial discounts to those for whom cost of treatment would be an unreasonable burden. *Id.* at 52. Rather, HMO membership would be discontinued if an individual could not pay the full monthly fee. *Id.* In addition to assessing the other *North Star* factors, we declared that "SHARE's charitable exemption claim is defeated by application of factor three-whether recipients of the charity are required to pay for the assistance in whole or in part." *Id.* The fact that some of the HMO members were participants in Medicare whose fees were largely paid by that federal program did not change our assessment.

Minnesota Statutes § 501B.31 Charitable Trusts

(4) (b) If a gift, trust, or devise has been made for a charitable, benevolent, educational, religious, or other public use or trust, or upon a condition, limitation, or restriction of any kind, the property given, entrusted, or devised may be used only for that use or trust and in accordance with the condition, limitation, or restriction. The grantee, devisee, trustee, or other holder of property may petition the court under section 501B.16 for determination of the legal rights and relationship of the holder, the public, the grantor, and the grantor's heirs, representatives, or assigns in and to the property.

26 U.S. Code § 501. Exemption from tax on corporations, certain trusts, etc

(a) Exemption from taxation

1. An organization described in subsection (c) or (d) or section 401 (a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

(b) Tax on unrelated business income and certain other activities

An organization exempt from taxation under subsection (a) shall be subject to tax to the extent provided in parts II, III, and VI of this subchapter, but (notwithstanding parts II, III, and VI of this subchapter) shall be considered an organization exempt from income taxes for the purpose of any law which refers to organizations exempt from income taxes.

(c) List of exempt organizations

The following organizations are referred to in subsection (a):

(1) Any corporation organized under Act of Congress which is an instrumentality of the United States but only if such corporation—

(A) is exempt from Federal income taxes—

(i) under such Act as amended and supplemented before July 18, 1984, or

(ii) under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act, or

(B) is described in subsection (l).

(2) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section. Rules similar to the rules of subparagraph (G) of paragraph (25) shall apply for purposes of this paragraph.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no

substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

(4)

(A) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.

(B) Subparagraph (A) shall not apply to an entity unless no part of the net earnings of such entity inures to the benefit of any private shareholder or individual.

(5) Labor, agricultural, or horticultural organizations.

(6) Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(7) Clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

(8) Fraternal beneficiary societies, orders, or associations—

(A) operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and

(B) providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

(9) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

(10) Domestic fraternal societies, orders, or associations, operating under the lodge system—

(A) the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and

(B) which do not provide for the payment of life, sick, accident, or other benefits.

(11) Teachers' retirement fund associations of a purely local character, if—

(A) no part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and

(B) the income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

(12)

(A) Benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

(B) In the case of a mutual or cooperative telephone company, subparagraph (A) shall be applied without taking into account any income received or accrued—

(i) from a nonmember telephone company for the performance of communication services which involve members of the mutual or cooperative telephone company,

(ii) from qualified pole rentals,

(iii) from the sale of display listings in a directory furnished to the members of the mutual or cooperative telephone company, or

(iv) from the prepayment of a loan under section 306A, 306B, or 311 [1] of the Rural Electrification Act of 1936 (as in effect on January 1, 1987).

(C) In the case of a mutual or cooperative electric company, subparagraph (A) shall be applied without taking into account any income received or accrued—

(i) from qualified pole rentals, or

(ii) from the prepayment of a loan under section 306A, 306B, or 311 [1] of the Rural Electrification Act of 1936 (as in effect on January 1, 1987).

(D) For purposes of this paragraph, the term "qualified pole rental" means any rental of a pole (or other structure used to support wires) if such pole (or other structure)—

(i) is used by the telephone or electric company to support one or more wires which are used by such company in providing telephone or electric services to its members, and

(ii) is used pursuant to the rental to support one or more wires (in addition to the wires described in clause (i)) for use in connection with the transmission by wire of electricity or of telephone or other communications.

For purposes of the preceding sentence, the term “rental” includes any sale of the right to use the pole (or other structure).

(13) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremation which is not permitted by its charter to engage in any business not necessarily incident to that purpose and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(14)

(A) Credit unions without capital stock organized and operated for mutual purposes and without profit.

(B) Corporations or associations without capital stock organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for, and insurance of shares or deposits in—

(i) domestic building and loan associations,

(ii) cooperative banks without capital stock organized and operated for mutual purposes and without profit,

(iii) mutual savings banks not having capital stock represented by shares, or

(iv) mutual savings banks described in section 591 (b) [2]

(C) Corporations or associations organized before September 1, 1957, and operated for mutual purposes and without profit for the purpose of providing reserve funds for associations or banks described in clause (i), (ii), or (iii) of subparagraph (B); but only if 85 percent or more of the income is attributable to providing such reserve funds and to investments. This subparagraph shall not apply to any corporation or association entitled to exemption under subparagraph (B).

(15)

(A) Insurance companies or associations other than life (including interinsurers and reciprocal underwriters) if the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed $350,000.

(B) For purposes of subparagraph (A), in determining whether any company or association is described in subparagraph (A), such company or association shall be treated as receiving during the taxable year amounts described in subparagraph (A) which are received during such year by all other companies or associations which are members of the same controlled group as the insurance company or association for which the determination is being made.

(C) For purposes of subparagraph (B), the term “controlled group” has the meaning given such term by section 831 (b)(2)(B)(ii).

(16) Corporations organized by an association subject to part IV of this subchapter or members thereof, for the purpose of financing the ordinary crop operations of such members or other producers, and operated in conjunction with such association. Exemption shall not be denied any such corporation because it has capital stock, if the dividend rate of such stock is fixed at not to exceed the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, and if substantially all such stock (other than nonvoting preferred stock, the owners of which are not entitled or permitted to participate, directly or indirectly, in the profits of the corporation, on dissolution or otherwise, beyond the fixed dividends) is owned by such association, or members thereof; nor shall exemption be denied any such corporation because there is accumulated and maintained by it a reserve required by State law or a reasonable reserve for any necessary purpose.

(17)

(A) A trust or trusts forming part of a plan providing for the payment of supplemental unemployment compensation benefits, if—

(i) under the plan, it is impossible, at any time prior to the satisfaction of all liabilities, with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of supplemental unemployment compensation benefits,

(ii) such benefits are payable to employees under a classification which is set forth in the plan and which is found by the Secretary not to be discriminatory in favor of employees who are highly compensated employees (within the meaning of section 414 (q)), and

(iii) such benefits do not discriminate in favor of employees who are highly compensated employees (within the meaning of section 414 (q)). A plan shall not be considered discriminatory within the meaning of this clause merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan.

(B) In determining whether a plan meets the requirements of subparagraph (A), any benefits provided under any other plan shall not be taken into consideration, except that a plan shall not be considered discriminatory—

(i) merely because the benefits under the plan which are first determined in a nondiscriminatory manner within the meaning of subparagraph (A) are then reduced by any sick, accident, or unemployment compensation benefits received under State or Federal law (or reduced by a portion of such benefits if determined in a nondiscriminatory manner), or

(ii) merely because the plan provides only for employees who are not eligible to receive sick, accident, or unemployment compensation benefits under State or Federal law the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such laws if such employees were eligible for such benefits, or

(iii) merely because the plan provides only for employees who are not eligible under another plan (which meets the requirements of subparagraph (A)) of supplemental unemployment compensation benefits provided wholly by the employer the same benefits (or a portion of such benefits if determined in a nondiscriminatory manner) which such employees would receive under such other plan if such employees were eligible under such other plan, but only if the employees eligible under both plans would make a classification which would be nondiscriminatory within the meaning of subparagraph (A).

(C) A plan shall be considered to meet the requirements of subparagraph (A) during the whole of any year of the plan if on one day in each quarter it satisfies such requirements.

(D) The term "supplemental unemployment compensation benefits" means only—

(i) benefits which are paid to an employee because of his involuntary separation from the employment of the employer (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, and

(ii) sick and accident benefits subordinate to the benefits described in clause (i).

(E) Exemption shall not be denied under subsection (a) to any organization entitled to such exemption as an association described in paragraph (9) of this subsection merely because such organization provides for the payment of supplemental unemployment benefits (as defined in subparagraph (D)(i)).

(18) A trust or trusts created before June 25, 1959, forming part of a plan providing for the payment of benefits under a pension plan

funded only by contributions of employees, if—

(A) under the plan, it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the plan, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of benefits under the plan,

(B) such benefits are payable to employees under a classification which is set forth in the plan and which is found by the Secretary not to be discriminatory in favor of employees who are highly compensated employees (within the meaning of section 414 (q)),

(C) such benefits do not discriminate in favor of employees who are highly compensated employees (within the meaning of section 414 (q)). A plan shall not be considered discriminatory within the meaning of this subparagraph merely because the benefits received under the plan bear a uniform relationship to the total compensation, or the basic or regular rate of compensation, of the employees covered by the plan, and

(D) in the case of a plan under which an employee may designate certain contributions as deductible—

(i) such contributions do not exceed the amount with respect to which a deduction is allowable under section 219 (b)(3),

(ii) requirements similar to the requirements of section 401 (k)(3)(A)(ii) are met with respect to such elective contributions,

(iii) such contributions are treated as elective deferrals for purposes of section 402 (g), and

(iv) the requirements of section 401 (a)(30) are met.

For purposes of subparagraph (D)(ii), rules similar to the rules of section 401 (k)(8) shall apply. For purposes of section 4979, any excess contribution under clause (ii) shall be treated as an excess contribution under a cash or deferred arrangement.

(19) A post or organization of past or present members of the Armed Forces of the United States, or an auxiliary unit or society of, or a trust or foundation for, any such post or organization—

(A) organized in the United States or any of its possessions,

(B) at least 75 percent of the members of which are past or present members of the Armed Forces of the United States and substantially all of the other members of which are individuals who are cadets or are spouses, widows, or widowers of past or present members of the Armed Forces of the United States or of cadets, and

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual.

(20) an [3] organization or trust created or organized in the United States, the exclusive function of which is to form part of a qualified group legal services plan or plans, within the meaning of section 120. An organization or trust which receives contributions because of section 120 (c)(5)(C) shall not be prevented from qualifying as an organization described in this paragraph merely because it provides legal services or indemnification against the cost of legal services unassociated with a qualified group legal services plan.

(21)

(A) A trust or trusts established in writing, created or organized in the United States, and contributed to by any person (except an insurance company) if—

(i) the purpose of such trust or trusts is exclusively—

(I) to satisfy, in whole or in part, the liability of such person for, or with respect to, claims for compensation for disability or death due to pneumoconiosis under Black Lung Acts,

(II) to pay premiums for insurance exclusively covering such liability,

(III) to pay administrative and other incidental expenses of such trust in connection with the operation of the trust and the processing of claims against such person under Black Lung Acts, and

(IV) to pay accident or health benefits for retired miners and their spouses and dependents (including administrative and other incidental expenses of such trust in connection therewith) or premiums for insurance exclusively covering such benefits; and

(ii) no part of the assets of the trust may be used for, or diverted to, any purpose other than—

(I) the purposes described in clause (i),

(II) investment (but only to the extent that the trustee determines that a portion of the assets is not currently needed for the purposes described in clause (i)) in qualified investments, or

(III) payment into the Black Lung Disability Trust Fund established under section 9501, or into the general fund of the United States Treasury (other than in satisfaction of any tax or other civil or criminal liability of the person who established or contributed to the trust).

(B) No deduction shall be allowed under this chapter for any payment described in subparagraph (A)(i)(IV) from such trust.

(C) Payments described in subparagraph (A)(i)(IV) may be made from such trust during a taxable year only to the extent that the aggregate amount of such payments during such taxable year does not exceed the lesser of—

(i) the excess (if any) (as of the close of the preceding taxable year) of—

(I) the fair market value of the assets of the trust, over

(II) 110 percent of the present value of the liability described in subparagraph (A)(i)(I) of such person, or

(ii) the excess (if any) of—

(I) the sum of a similar excess determined as of the close of the last taxable year ending before the date of the enactment of this subparagraph plus earnings thereon as of the close of the taxable year preceding the taxable year involved, over

(II) the aggregate payments described in subparagraph (A)(i)(IV) made from the trust during all taxable years beginning after the date of the enactment of this subparagraph.

The determinations under the preceding sentence shall be made by an independent actuary using actuarial methods and assumptions (not inconsistent with the regulations prescribed under section 192 (c)(1)(A)) each of which is reasonable and which are reasonable in the aggregate.

(D) For purposes of this paragraph:

(i) The term “Black Lung Acts” means part C of title IV of the Federal Mine Safety and Health Act of 1977, and any State law providing compensation for disability or death due to that pneumoconiosis.

(ii) The term “qualified investments” means—

(I) public debt securities of the United States,

(II) obligations of a State or local government which are not in default as to principal or interest, and

(III) time or demand deposits in a bank (as defined in section 581) or an insured credit union (within the meaning of section 101(7) of the Federal Credit Union Act, 12 U.S.C. 1752 (7)) located in the United States.

(iii) The term “miner” has the same meaning as such term has when used in section 402(d) of the Black Lung Benefits Act (30 U.S.C. 902 (d)).

(iv) The term “incidental expenses” includes legal, accounting, actuarial, and trustee expenses.

(22) A trust created or organized in the United States and established in writing by the plan sponsors of multiemployer plans if—

(A) the purpose of such trust is exclu—sively—

(i) to pay any amount described in section 4223(c) or (h) of the Employee Retirement Income Security Act of 1974, and

(ii) to pay reasonable and necessary administrative expenses in connection with the establishment and operation of the trust and the processing of claims against the trust,

(B) no part of the assets of the trust may be used for, or diverted to, any purpose other than—

(i) the purposes described in subparagraph (A), or

(ii) the investment in securities, obligations, or time or demand deposits described in clause (ii) of paragraph (21)(B),

(C) such trust meets the requirements of paragraphs (2), (3), and (4) of section 4223 (b), 4223 (h), or, if applicable, section 4223(c) of the Employee Retirement Income Security Act of 1974, and

(D) the trust instrument provides that, on dissolution of the trust, assets of the trust may not be paid other than to plans which have participated in the plan or, in the case of a trust established under section 4223(h) of such Act, to plans with respect to which employers have participated in the fund.

(23) Any association organized before 1880 more than 75 percent of the members of which are present or past members of the Armed Forces and a principal purpose of which is to provide insurance and other benefits to veterans or their dependents.

(24) A trust described in section 4049 of the Employee Retirement Income Security Act of 1974 (as in effect on the date of the enactment of the Single-Employer Pension Plan Amendments Act of 1986).

(25)

(A) Any corporation or trust which—

(i) has no more than 35 shareholders or beneficiaries,

(ii) has only 1 class of stock or beneficial interest, and

(iii) is organized for the exclusive purposes of—

(I) acquiring real property and holding title to, and collecting income from, such property, and

(II) remitting the entire amount of income from such property (less expenses) to 1 or more organizations described in subparagraph (C) which are shareholders of such corporation or beneficiaries of such trust.

For purposes of clause (iii), the term “real property” shall not include any interest as a tenant in common (or similar interest) and shall not include any indirect interest.

(B) A corporation or trust shall be described in subparagraph (A) without regard to whether the corporation or trust is organized by 1 or more organizations described in subparagraph (C).

(C) An organization is described in this subparagraph if such organization is—

(i) a qualified pension, profit sharing, or stock bonus plan that meets the requirements of section 401 (a),

(ii) a governmental plan (within the meaning of section 414 (d)),

(iii) the United States, any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing, or

(iv) any organization described in paragraph (3).

(D) A corporation or trust shall in no event be treated as described in subparagraph (A) unless such corporation or trust permits its shareholders or beneficiaries—

(i) to dismiss the corporation's or trust's investment adviser, following reasonable notice, upon a vote of the shareholders or beneficiaries holding a majority of interest in the corporation or trust, and

(ii) to terminate their interest in the corporation or trust by either, or both, of the following alternatives, as determined by the corporation or trust:

(I) by selling or exchanging their stock in the corporation or interest in the trust (subject to any Federal or State securities law) to any organization described in subparagraph (C) so long as the sale or exchange does not increase the number of shareholders or beneficiaries in such corporation or trust above 35, or

(II) by having their stock or interest redeemed by the corporation or trust after the shareholder or beneficiary has provided 90 days notice to such corporation or trust.

(E)

(i) For purposes of this title—

(I) a corporation which is a qualified subsidiary shall not be treated as a separate corporation, and

(II) all assets, liabilities, and items of income, deduction, and credit of a qualified subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the corporation or trust described in subparagraph (A).

(ii) For purposes of this subparagraph, the term "qualified subsidiary" means any corporation if, at all times during the period such corporation was in existence, 100 percent of the stock of such corporation is held by the corporation or trust described in subparagraph (A).

(iii) For purposes of this subtitle, if any corporation which was a qualified subsidiary ceases to meet the requirements of clause (ii), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the corporation or trust described in subparagraph (A) in exchange for its stock.

(F) For purposes of subparagraph (A), the term "real property" includes any personal property which is leased under, or in connection with, a lease of real property, but only if the rent attributable to such personal property (determined under the rules of section 856 (d)(1)) for the taxable year does not exceed 15 percent of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, such lease.

(G)

(i) An organization shall not be treated as failing to be described in this paragraph merely by reason of the receipt of any otherwise disqualifying income which is incidentally derived from the holding of real property.

(ii) Clause (i) shall not apply if the amount of gross income described in such clause exceeds 10 percent of the organization's gross income for the taxable year unless the organization establishes to the satisfaction of the Secretary that the receipt of gross income described in clause (i) in excess of such limitation was inadvertent and reasonable steps are being taken to correct the circumstances giving rise to such income.

(26) Any membership organization if—

(A) such organization is established by a State exclusively to provide coverage for medical care (as defined in section 213 (d)) on a not-for-profit basis to individuals described in subparagraph (B) through—

(i) insurance issued by the organization, or

(ii) a health maintenance organization under an arrangement with the organization,

(B) the only individuals receiving such coverage through the organization are individuals—

(i) who are residents of such State, and

(ii) who, by reason of the existence or history of a medical condition—

(I) are unable to acquire medical care coverage for such condition through insurance or from a health maintenance organization, or

(II) are able to acquire such coverage only at a rate which is substantially in excess of the rate for such coverage through the membership organization,

(C) the composition of the membership in such organization is specified by such State, and

(D) no part of the net earnings of the organization inures to the benefit of any private shareholder or individual.

A spouse and any qualifying child (as defined in section 24(c)) of an individual described in subparagraph (B) (without regard to this sentence) shall be treated as described in subparagraph (B).

(27)

(A) Any membership organization if—

(i) such organization is established before June 1, 1996, by a State exclusively to reimburse its members for losses arising under workmen's compensation acts,

(ii) such State requires that the membership of such organization consist of—

(I) all persons who issue insurance covering workmen's compensation losses in such State, and

(II) all persons and governmental entities who self-insure against such losses, and

(iii) such organization operates as a non-profit organization by—

(I) returning surplus income to its members or workmen's compensation policyholders on a periodic basis, and

(II) reducing initial premiums in anticipation of investment income.

(B) Any organization (including a mutual insurance company) if—

(i) such organization is created by State law and is organized and operated under State law exclusively to—

(I) provide workmen's compensation insurance which is required by State law or with respect to which State law provides significant disincentives if such insurance is not purchased by an employer, and

(II) provide related coverage which is incidental to workmen's compensation insurance,

(ii) such organization must provide workmen's compensation insurance to any employer in the State (for employees in the State or temporarily assigned out-of-State) which seeks such insurance and meets other reasonable requirements relating thereto,

(iii)

(I) the State makes a financial commitment with respect to such organization either by extending the full faith and credit of the State to the initial debt of such organization or by providing the initial operating capital of such organization, and

(II) in the case of periods after the date of enactment of this subparagraph, the assets of such organization revert to the State upon dissolution or State law does not permit the dissolution of such organization, and

(iv) the majority of the board of directors or oversight body of such organization are appointed by the chief executive officer or other executive branch official of the State, by the State legislature, or by both.

(28) The National Railroad Retirement Investment Trust established under section 15(j) of the Railroad Retirement Act of 1974.

(d) Religious and apostolic organizations

The following organizations are referred to in subsection (a): Religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members, but only if the members thereof include (at the time of filing their returns) in their gross income their entire pro rata shares, whether distributed or not, of the taxable income of the association or corporation for such year. Any amount so included in the gross income of a member shall be treated as a dividend received.

(e) Cooperative hospital service organizations

For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing (including the purchasing of insurance on a group basis), warehousing, billing and collection (including the purchase of patron accounts receivable on a recourse basis), food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 81/2 months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170 (b)(1)(A)(iii).

(f) Cooperative service organizations of operating educational organizations

For purposes of this title, if an organization is—

(1) organized and operated solely to hold, commingle, and collectively invest and reinvest (including arranging for and supervising the performance by independent contractors of investment services related thereto) in stocks and securities, the moneys contributed thereto by each of the members of such organization, and to collect income therefrom and turn over the entire amount thereof, less expenses, to such members,

(2) organized and controlled by one or more such members, and

(3) comprised solely of members that are organizations described in clause (ii) or (iv) of section 170 (b)(1)(A)—

(A) which are exempt from taxation under subsection (a), or

(B) the income of which is excluded from taxation under section 115 (a),

then such organization shall be treated as an organization organized and operated exclusively for charitable purposes.

(g) Definition of agricultural

For purposes of subsection (c)(5), the term "agricultural" includes the art or science of cultivating land, harvesting crops or aquatic resources, or raising livestock.

(h) Expenditures by public charities to influence legislation

(1) General rule

In the case of an organization to which this subsection applies, exemption from taxation under subsection (a) shall be denied because a substantial part of the activities of such organization consists of carrying on propaganda, or otherwise attempting, to influence legislation, but only if such organization normally—

(A) makes lobbying expenditures in excess of the lobbying ceiling amount for such organization for each taxable year, or

(B) makes grass roots expenditures in excess of the grass roots ceiling amount for such organization for each taxable year.

(2) Definitions

For purposes of this subsection—

(A) Lobbying expenditures

The term "lobbying expenditures" means expenditures for the purpose of influencing legislation (as defined in section 4911 (d)).

(B) Lobbying ceiling amount

The lobbying ceiling amount for any organization for any taxable year is 150 percent of the lobbying nontaxable amount for such organization for such taxable year, determined under section 4911.

(C) Grass roots expenditures

The term "grass roots expenditures" means expenditures for the purpose of influencing legislation (as defined in section 4911 (d) without regard to paragraph (1)(B) thereof).

(D) Grass roots ceiling amount

The grass roots ceiling amount for any organization for any taxable year is 150 percent of the grass roots nontaxable amount for such organization for such taxable year, determined under section 4911.

(3) Organizations to which this subsection applies

This subsection shall apply to any organization which has elected (in such manner and at such time as the Secretary may prescribe) to have the provisions of this subsection apply to such organization and which, for the taxable year which includes the date the election is made, is described in subsection (c)(3) and—

(A) is described in paragraph (4), and

(B) is not a disqualified organization under paragraph (5).

(4) Organizations permitted to elect to have this subsection apply

An organization is described in this paragraph if it is described in—

(A) section 170 (b)(1)(A)(ii) (relating to educational institutions),

(B) section 170 (b)(1)(A)(iii) (relating to hospitals and medical research organizations),

(C) section 170 (b)(1)(A)(iv) (relating to organizations supporting government schools),

(D) section 170 (b)(1)(A)(vi) (relating to organizations publicly supported by charitable contributions),

(E) section 509 (a)(2) (relating to organizations publicly supported by admissions, sales, etc.), or

(F) section 509 (a)(3) (relating to organizations supporting certain types of public charities) except that for purposes of this subparagraph, section 509 (a)(3) shall be applied without regard to the last sentence of section 509 (a).

(5) Disqualified organizations

For purposes of paragraph (3) an organization is a disqualified organization if it is—

(A) described in section 170 (b)(1)(A)(i) (relating to churches),

(B) an integrated auxiliary of a church or of a convention or association of churches, or

(C) a member of an affiliated group of organizations (within the meaning of section 4911 (f)(2)) if one or more members of such group is described in subparagraph (A) or (B).

(6) Years for which election is effective

An election by an organization under this subsection shall be effective for all taxable years of such organization which—

(A) end after the date the election is made, and

(B) begin before the date the election is revoked by such organization (under regulations prescribed by the Secretary).

(7) No effect on certain organizations

With respect to any organization for a taxable year for which—

(A) such organization is a disqualified organization (within the meaning of paragraph (5)), or

(B) an election under this subsection is not in effect for such organization,

nothing in this subsection or in section 4911 shall be construed to affect the interpretation of the phrase, “no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation,” under subsection (c)(3).

(8) Affiliated organizations

For rules regarding affiliated organizations, see section 4911 (f).

(i) Prohibition of discrimination by certain social clubs

Notwithstanding subsection (a), an organization which is described in subsection (c)(7) shall not be exempt from taxation under subsection (a) for any taxable year if, at any time during such taxable year, the charter, bylaws, or other governing instrument, of such organization or any written policy statement of such organization contains a provision which provides for discrimination against any person on the basis of race, color, or religion. The preceding sentence to the extent it relates to discrimination on the basis of religion shall not apply to—

(1) an auxiliary of a fraternal beneficiary society if such society—

(A) is described in subsection (c)(8) and exempt from tax under subsection (a), and

(B) limits its membership to the members of a particular religion, or

(2) a club which in good faith limits its membership to the members of a particular religion in order to further the teachings or principles of that religion, and not to exclude individuals of a particular race or color.

(j) Special rules for certain amateur sports organizations

(1) In general

In the case of a qualified amateur sports organization—

(A) the requirement of subsection (c)(3) that no part of its activities involve the provision of athletic facilities or equipment shall not apply, and

(B) such organization shall not fail to meet the requirements of subsection (c)(3) merely because its membership is local or regional in nature.

(2) Qualified amateur sports organization defined

For purposes of this subsection, the term "qualified amateur sports organization" means any organization organized and operated exclusively to foster national or international amateur sports competition if such organization is also organized and operated primarily to conduct national or international competition in sports or to support and develop amateur athletes for national or international competition in sports.

(k) Treatment of certain organizations providing child care

For purposes of subsection (c)(3) of this section and sections 170 (c)(2), 2055 (a)(2), and 2522 (a)(2), the term "educational purposes" includes the providing of care of children away from their homes if—

(1) substantially all of the care provided by the organization is for purposes of enabling individuals to be gainfully employed, and

(2) the services provided by the organization are available to the general public.

(l) Government corporations exempt under subsection (c)(1)

For purposes of subsection (c)(1), the following organizations are described in this subsection:

(1) The Central Liquidity Facility established under title III of the Federal Credit Union Act (12 U.S.C. 1795 et seq.).

(2) The Resolution Trust Corporation established under section 21A of the Federal Home Loan Bank Act.

(3) The Resolution Funding Corporation established under section 21B of the Federal Home Loan Bank Act.

(m) Certain organizations providing commercial-type insurance not exempt from tax

(1) Denial of tax exemption where providing commercial-type insurance is substantial part of activities

An organization described in paragraph (3) or (4) of subsection (c) shall be exempt from tax under subsection (a) only if no substantial part of its activities consists of providing commercial-type insurance.

(2) Other organizations taxed as insurance companies on insurance business

In the case of an organization described in paragraph (3) or (4) of subsection (c) which is exempt from tax under subsection (a) after the application of paragraph (1) of this subsection—

(A) the activity of providing commercial-type insurance shall be treated as an unrelated trade or business (as defined in section 513), and

(B) in lieu of the tax imposed by section 511 with respect to such activity, such organization shall be treated as an insurance company for purposes of applying subchapter L with respect to such activity.

(3) Commercial-type insurance

For purposes of this subsection, the term "commercial-type insurance" shall not include—

(A) insurance provided at substantially below cost to a class of charitable recipients,

(B) incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations,

(C) property or casualty insurance provided (directly or through an organization described in section 414 (e)(3)(B)(ii)) by a church or convention or association of churches for such church or convention or association of churches,

(D) providing retirement or welfare benefits (or both) by a church or a convention or association of churches (directly or through an organization described in section 414 (e)(3)(A) or 414 (e)(3)(B)(ii)) for the employees (including employees described in section 414(e)(3)(B)) of such church or convention or association of churches or the beneficiaries of such employees, and

(E) charitable gift annuities.

(4) Insurance includes annuities

For purposes of this subsection, the issuance of annuity contracts shall be treated as providing insurance.

(5) Charitable gift annuity

For purposes of paragraph (3)(E), the term "charitable gift annuity" means an annuity if—

(A) a portion of the amount paid in connection with the issuance of the annuity is allowable as a deduction under section 170 or 2055, and

(B) the annuity is described in section 514 (c)(5) (determined as if any amount paid in cash in connection with such issuance were property).

(n) Charitable risk pools

(1) In general

For purposes of this title—

(A) a qualified charitable risk pool shall be treated as an organization organized and operated exclusively for charitable purposes, and

(B) subsection (m) shall not apply to a qualified charitable risk pool.

(2) Qualified charitable risk pool

For purposes of this subsection, the term "qualified charitable risk pool" means any organization—

(A) which is organized and operated solely to pool insurable risks of its members (other than risks related to medical malpractice) and to provide information to its members with respect to loss control and risk management,

(B) which is comprised solely of members that are organizations described in subsection (c)(3) and exempt from tax under subsection (a), and

(C) which meets the organizational requirements of paragraph (3).

(3) Organizational requirements

An organization (hereinafter in this subsection referred to as the "risk pool") meets the organizational requirements of this paragraph if—

(A) such risk pool is organized as a nonprofit organization under State law provisions authorizing risk pooling arrangements for charitable organizations,

(B) such risk pool is exempt from any income tax imposed by the State (or will be so exempt after such pool qualifies as an organization exempt from tax under this title),

(C) such risk pool has obtained at least $1,000,000 in startup capital from nonmember charitable organizations,

(D) such risk pool is controlled by a board of directors elected by its members, and

(E) the organizational documents of such risk pool require that—

(i) each member of such pool shall at all times be an organization described in subsection (c)(3) and exempt from tax under subsection (a),

(ii) any member which receives a final determination that it no longer qualifies as an organization described in subsection (c)(3) shall immediately notify the pool of such determination and the effective date of such determination, and

(iii) each policy of insurance issued by the risk pool shall provide that such policy will not cover the insured with respect to events occurring after the date such final determination was issued to the insured.

An organization shall not cease to qualify as a qualified charitable risk pool solely by reason of the failure of any of its members to continue to be an organization described in subsection (c)(3) if, within a reasonable period of time after such pool is notified as required under subparagraph (E)(ii), such pool takes such action as may be reasonably necessary to remove such member from such pool.

(4) Other definitions

For purposes of this subsection—

(A) Startup capital

The term “startup capital” means any capital contributed to, and any program-related investments (within the meaning of section 4944 (c)) made in, the risk pool before such pool commences operations.

(B) Nonmember charitable organization

The term “nonmember charitable organization” means any organization which is described in subsection (c)(3) and exempt from tax under subsection (a) and which is not a member of the risk pool and does not benefit (directly or indirectly) from the insurance coverage provided by the pool to its members.

(o) Treatment of hospitals participating in provider-sponsored organizations

An organization shall not fail to be treated as organized and operated exclusively for a charitable purpose for purposes of subsection (c)(3) solely because a hospital which is owned and operated by such organization participates in a provider-sponsored organization (as defined in section 1855(d) of the Social Security Act), whether or not the provider-sponsored organization is exempt from tax. For purposes of subsection (c)(3), any person with a material financial interest in such a provider-sponsored organization shall be treated as a private shareholder or individual with respect to the hospital.

(p) Cross reference

For nonexemption of Communist-controlled organizations, see section 11(b) of the Internal Security Act of 1950 (64 Stat. 997; 50 U.S.C. 790 (b)).

Treas. Reg. § 1.162-7

CODE OF FEDERAL REGULATIONS

TITLE 26--INTERNAL REVENUE

CHAPTER I--INTERNAL REVENUE SERVICE, DEPARTMENT OF THE TREASURY

SUBCHAPTER A--INCOME TAX

PART 1--INCOME TAXES

NORMAL TAXES AND SURTAXES

COMPUTATION OF TAXABLE INCOME

ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

Current through May 17, 2005; 70 FR 28407

§ 1.162-7 Compensation for personal services.

(a) There may be included among the ordinary and necessary expenses paid or incurred in carrying on any trade or business a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services.

(b) The test set forth in paragraph (a) of this section and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services and the excessive payments correspond or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing

compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is, in general, just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

(4) For disallowance of deduction in the case of certain transfers of stock pursuant to employees stock options, see section 421 and the regulations thereunder.

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Take Till It Hurts

Elroy Stock writes racist letters and gives big money to little institutions. One recipient, Augsburg College, wanted to cash in without owning up.

by Mike Mosedale

It is a little after 11:00 a.m., and Elroy Stock has just returned home from his daily trip to the post office. "Mailed six letters today. Nothing special. My usual material," he says with a shrug, cracking open the front door to his home in Woodbury. From the outside, Stock's boxy split-level fits in seamlessly with the other contemporary homes in this growing St. Paul suburb. Inside, though, the place is frozen in time. A lifelong bachelor, Stock has lived here since 1974. Most of the furnishings appear to date from that era, from the earth-tone carpeting to the black-and-white TV with rabbit ears. The upper level is cluttered, with newspaper clippings, church bulletins, and other assorted papers stacked in piles on the dining-room table, the chairs around the dining-room table, the sofa, even the floor. But the kitchen is ground zero. Stock doesn't care to cook ("I eat mostly canned food"), so the countertops function as a sorting table. Little cardboard letter boxes are lined up in a row beside the sink, filled with photocopies of Stock's letters: marginally literate screeds with titles such as "Our problem is: the Word of God versus the Word of Satan," screeds that revolve around racial purity, Stock's primary obsession. Each day, Stock mails off his missives to people involved in interracial or interfaith marriages or who have adopted children of different ethnicities. "I just believe what is respectable and decent, and nobody else does," Stock snaps sharply. "That's why they hate me, why they want me destroyed. If everybody in this world was exactly like me, we would have an almost perfect world."

The 78-year-old Stock is hardly a sympathetic character. But he looks less like a depraved hatemonger than a grumpy old man, with just a touch of country crackpot. On this day his brown button-down dress shirt is tucked neatly into his carefully creased brown polyester slacks. His hair, white at the roots, is slicked back. His posture, like his demeanor, is rigid, as if he can't get comfortable. "This is a little bit of my history that you should know about," he says, trudging unsteadily down the half-flight of stairs to his basement office. He points to a bookshelf, where, amid a selection of 50-year-old accounting books, sits a small wooden plaque. It was presented to Stock by a group of citizens from his boyhood home of Hoffman, Minnesota, after he donated a million dollars to help them build the Messiah Lutheran Church. Dated December 9, 1990, its brass face is engraved with the words *Thank You, Elroy.*

In the late Eighties and early Nineties, Stock cashed in two and a half million dollars in stock options from his former employer, West Publishing, and went on a philanthropic bender. In addition to footing the lion's share of Messiah's bill, he gave a half-million dollars to build and furnish a lakefront church near Alexandria, spent another $50,000 restoring pioneer cemeteries in central Minnesota, and, in 1987, pledged a half-million dollars to his alma mater, Augsburg College.

Stock says his gift to Augsburg, at the time the largest in the history of the liberal-arts school, was his proudest moment. On the office wall there are two framed photographs of Stock and Charles Anderson, then-president of the college. The first shot was taken in 1987, just after the college announced plans to name part of a new complex on campus the Elroy M. Stock Communications Wing. It is a classic grip-and-grin, with donor and president both smiling broadly. The second snapshot was taken on October 3, 1990, at a "recognition dinner" held for Stock at Augsburg. In that photo Anderson's smile has been replaced by an expression equal parts puzzlement and distaste, like a homeowner who has just stamped out a flaming paper bag that's been left on his front stoop.

In the years between the photographs, Stock went from being a generous, albeit obscure, alumnus to a civic embarrassment. In February 1988, WCCO-TV (Channel 4) ran a story that exposed both Stock's propensity for hate mail and Augsburg's plans to name a building in his honor. The piece prompted an intense debate both on and off campus. In the wake of the first round of publicity, Augsburg's Board of Regents moved swiftly to distance the college from its suddenly unsavory donor--deciding there would no longer be an Elroy M. Stock Communications Wing. Many students and faculty at the Lutheran school wanted even stronger action. Clergy, including Mark Hanson, now the bishop of the St. Paul Synod of the Evangelical Lutheran Church of America, publicly argued that the college should consider returning Stock's gift. Both the *Star Tribune* and the *St. Paul Pioneer Press* weighed in with editorials supporting the college's decision to keep the cash, while excoriating Stock as "pathetic" and "vile."

Shortly thereafter the story faded and Stock clung to the hope that Augsburg would one day quietly decide to put his name back on the communications wing. After all, he *did* have the college's promise in writing. And, despite the public statements, he maintained a warm relationship with his old school: attending alumni events, participating in fundraising phone-a-thons, and writing out fat checks, which the college kept cashing. There was even a plaque in a hallway of the communications wing recognizing his contribution: "Major Funding By Elroy Stock." He simply bided his time, waited for the scandal to blow over, waited to be forgiven, even though, in his view, he had done nothing wrong. In 1999, with a new president installed at Augsburg, Stock figured it was finally time to press his claim on the communications wing again. To his surprise, the college rebuffed him. So on March 9, 2000, no doubt to Augsburg's surprise, Stock took the college to Hennepin County District Court, where he's suing to have the wing named in his honor or his half-million returned. Stock's suit may be a long shot, but he is once again managing to embarrass his alma mater.

Elroy Stock grew up in a world where nearly everyone he came into contact with was white, and most were Lutheran. The eldest of four children growing up on a farm in Hoffman, Stock's lifelong preoccupation with "racial and religious preservation" began early. As Stock tells it, he first became worried about the future of "his people" after the local farm-implement dealership fell into the hands of a Catholic--the results of an interfaith marriage. After graduating high school, Stock went to work at an aircraft factory in Southern California, welding wing tips on bomber planes, then served the navy during World War II, with stints at bases in Rhode Island and California. After his discharge, he returned to Minnesota and enrolled at Augsburg, which Stock calls a "a poor man's college." In 1949, after an undistinguished academic career, Stock received his degree in business administration.

Following graduation he went to work as an accountant for West Publishing. And save for a handful of trips to neighboring states, Stock never again left Minnesota. A xenophobic farm boy in the big city, he just stayed close to home and worried about integration. "After the war, everything was getting mixed up. I saw it happening to my own people," Stock, who was initially most concerned about Lutheran girls marrying Catholic boys, reminisces. In the early 1950s, Joseph Zacchello, a Catholic priest turned Protestant, traveled to St. Paul to renounce the Catholic Church and the pope. Stock was impressed with Zacchello's address, and he quickly ordered copies of the speaker's booklets, which he decided to distribute anonymously. From the beginning Stock was secretive about his beliefs. He would scan the daily newspapers for marriage announcements. If he discovered that a Lutheran was marrying outside of the faith, he would mail them one of Zacchello's booklets. There was never a return address and Stock never told a soul what he was doing. "I knew they would run me down," he explains now, paranoid about no one in particular. "I didn't want to be categorized. I knew they'd run me down."

Stock had been mailing out the pamphlets for nearly 20 years when Zacchello died and the supply dried up. In the meantime, Stock began to develop his "belief story." In the wake of the civil-rights movement, a higher number of African Americans were making their way to Minnesota. Stock decided that this too was a threat to his heritage. "The colored men thought they had the right to date white girls. I saw that as wrong. And when I saw those girls getting pregnant, that's when my new mission started," Stock explains. The short, self-penned letters that Stock began to mail anonymously in the early Seventies were informed by a growing obsession to preserve what he still calls "family religious, family racial, and family biological heritage." They were dotted with scriptural references, civic exclamations about the Constitution, and newspaper clips.

Over the years Stock gave up the hope of having a family of his own. As a young man he fell in love once, but there was "too much competition." To this day, Stock claims with a distinctly guileless pride that he remains "a virgin bachelor": "My whole body is loaded with love for a woman. But I'm fussy: won't marry a different religion; won't marry a woman of a different heritage. I like beauty in a woman. My kind of beauty. I just can't stand hair on a woman's legs or arms or stuff like that. It just turns me off." Despite his lack of hands-on experience, the subject of sex permeates Stock's screeds. He writes that "sinful man destroyed God's Human races through sex relations with other races" and blames problems from world hunger to national debt on infidelity. He draws no distinction between homosexual and heterosexual adultery, however. And while he is pro-life, he cautions against outlawing abortion because it will only hasten the return of "the back alley butcher."

While working his way up West Publishing's corporate ladder (finally climbing to the position of head cashier), Stock dedicated his free time to his belief story, often rising in the early morning to send out a stack of mail. "I had plenty of work to do," he says. "I would fill grocery sacks with mail. I just kept working and working." He is not sure how many letters he has sent, or to how many people--hundreds of thousands at least, he guesses, maybe a half-million. He did little else. "I've lived a frugal life," he boasts. "Never taken a trip since World War II. I never married, so I never had anybody pushing me around."

In 1982 postal inspectors began receiving complaints about Stock's mailings, which were still unsigned. By 1986 there were hundreds of complaints, and the letters were finally traced back to Woodbury. According to Todd Johnson, a sergeant with the Woodbury Police Department, when investigators arrived at Stock's home, he refused to let them through the door and made no direct admissions. The entire time, though, Stock inquired anxiously whether he had broken any laws. As it turned out, he had not, even though Woodbury Police Chief Greg Orth says the department seriously examined the possibility. "We contacted the county attorney and the city attorney, and they called the attorney general, and they all said, 'No, what he's doing is not illegal. He's not threatening people. He's not trying to get money out of them. And he's not harassing them,'" Orth explains. (These days, when someone complains to the Woodbury police about Stock, they are issued a standard form letter in which Chief Orth lets it be known the department considers Stock "eccentric but harmless.")

In 1987, on Elroy Stock's 64th birthday, the postal inspectors reappeared, this time at West Publishing, to once again question Stock about his mailings. When management at the company found out about their cashier's secret hobby, he was given an ultimatum: Take early retirement or be fired. Stock resisted and was terminated on the spot. But Stock says that was nothing compared to what happened a year later. Two days after WCCO ran their story about Stock, Augsburg president Charles Anderson summoned the philanthropic alum to his office. The college's communications wing would no longer bear his name. "I broke down in tears right then," Stock remembers, "I said, 'Don't do anything. We don't know what's going on out there.' But he wouldn't listen to me." It didn't help, Stock acknowledges, that he had sent letters to Anderson's son, who had married a black woman.

In the summer of 1999, St. Paul attorney Thomas Montgomery received a phone call from Stock, who was looking for an attorney to take on Augsburg. At first Montgomery was ambivalent. A journalist-turned-lawyer, Montgomery had friends who had received Stock's mailings, and he knew what effect the bizarre missives could have on their unsuspecting recipients. "I told Elroy from day one, 'I will never defend your views. I want nothing to do with your views, and I'm gonna tell that to anyone who asks,'" Montgomery says. "Elroy wasn't real happy with that." But Stock had kept detailed records of all his communication with Augsburg, including a diary of conversations with administrators and fundraisers from the college. As Montgomery pored over the history, he came to believe he had the makings of a winnable case.

In 1986 Stock, who had been a steady contributor to Augsburg since the mid-Sixties, agreed to pledge a total of $500,000 toward the construction of a $6 million building, featuring a chapel, a theater, and a communications center. Dubbed the Foss Center, it would be the cornerstone of a decadelong effort to modernize the school's tiny, 24-acre campus, which sits in the University of Minnesota's Minneapolis shadow. In a letter to Stock dated September 10, 1986, Jeroy Carlson, then Augsburg's senior development officer, wrote that the half-million-dollar pledge "would involve the college recognizing your right to designate this pledge to name 'The Elroy M. Stock Communications Wing.'" In Montgomery's view, Carlson's letter amounts to a contract, one the college can't revoke simply because it dislikes Stock's behavior.

What's more telling, Montgomery argues, is that while the college tried to stave off bad publicity by calling Stock out, it continued to cultivate him as a donor. As evidence, Montgomery cites a recognition dinner held for Stock on the Augsburg campus in October 1989, which was publicized in neither the school newspaper nor alumni newsletter. In July of 1989, the college sent another letter to Stock promising that a plaque denoting his donation would be placed at the "entrance" of the communications wing. "Elroy, I hope you will allow Augsburg College to honor you in this way. You are one of our most generous benefactors, and your support means a great deal to us," read the note. (As it turns out, the plaque was eventually hung. But, Montgomery observes, it's stuck in a back hallway frequented only by those entering the television studio.)

"Augsburg's attitude was, 'Let's just mollify him; then he won't pursue his claim,'" Montgomery says. "So they just took his money, and continued to take his money." In fact, the college accepted just shy of $18,000 from Stock in the ten years following his disgrace. It took until 1999 for William Frame, Augsburg's current president, to decide the college would no longer accept his donations--a pronouncement, Montgomery notes, that came only after Stock made it clear he would press his naming-rights claim.

Dan Jorgensen, Augsburg's public-relations director, says the pending lawsuit prevents him and the school's administrators from commenting on their dealings with Stock. Eric Jorstad, the attorney representing Augsburg, declines to comment specifically on why the college continued accepting Stock's donations, then suddenly stopped. Jorstad says he plans to submit a motion asking for summary dismissal of

Stock's lawsuit in the next few months. Among other things, Jorstad argues that the letter from Augsburg to Stock does not constitute a contract. "This alleged contract is not a contract," Jorstad contends. "Mr. Stock did not buy the right to have a building named after him. He made a charitable contribution--a donation, an unrestricted, unconditional donation to the college, for the college's purposes. And it's charitable contribution law, not contract law, that applies." The naming of the wing, Jorstad argues, is "incidental to the donation." (Montgomery scoffs at the suggestion. "Incidental? Does that mean if you or I give $50 to Augsburg, we'll get a building named after us?")

In Jorstad's view, Stock has other major legal hurdles to clear as well, including a statute of limitations that, under typical civil procedure, dictates that Stock should have sued no later than 1996. Montgomery contends that the college's "continuing misrepresentations" void that limit. "They would send back thank-you notes from the president, handwritten, saying [Elroy's] one of the best friends Augsburg has ever had," Montgomery argues. "If Augsburg didn't want to be associated with Elroy, fine. I can see that. But should they get to keep his money and lie to him?" Stock was unsophisticated in his dealings with Augsburg, Montgomery admits. But if Hennepin County Judge Delilah Pierce decides the case should be tried, Stock's lawyer believes that will automatically bolster his case, because contract law is "designed to favor the weaker or less sophisticated party."

While there have been plenty of court cases where donors have sued to recover their gifts, those suits usually revolve around claims that the money was misspent. Jorstad allows that there is scant precedence for Stock's claim. So, should there be a trial, the Augsburg lawyer is considering a host of strategies. Under one broad legal principle, known as the doctrine of unclean hands, for instance, Jorstad says he can argue that the court should deny Stock's claim on the grounds that "it would be unfair to give a half a million dollars to someone who has harmed so many human beings." Jorstad could also make the claim that forcing the college to name a building after Stock would violate the school's Lutheran values, and thus its First Amendment right to freedom of religion. Or Jorstad could simply argue that Stock essentially waived his right to sue by accepting the honors Augsburg did confer on him. "Even if there was a contract, and even if it was breached, which the college denies, Augsburg and Stock reached a resolution: the plaque and the dinner," Jorstad insists. "He can't just call that into question 12 years later."

At Augsburg, the Elroy Stock affair no longer elicits much of a reaction from the student body. Boyd Koehler, Augsburg's former affirmative-action officer and current advisor to the school's newspaper, says he doubts more than one in ten students have even heard Stock's name. But Koehler, who is in an interracial marriage and still occasionally receives Stock's screeds in the mail, says he is disappointed that the college continued soliciting and accepting money from Stock. Koehler remembers being recruited to play piano at a 1998 campus fundraiser where he was, to his chagrin, seated next to Stock. "Given our Christian mission to diversity, I was stunned to learn that we were still accepting money from Elroy even though we knew that he was still sending out hate mail," Koehler says. "I just find it bizarre that Augsburg was that desperate." All things considered, Koehler contends, it would have been best if the college had simply severed all associations with the donor. "I can even understand, logically, why Elroy is suing," he allows. "I don't think Augsburg came through on its end of the bargain."

Vivian Jenkins Nelson, a former Augsburg faculty member and the director of Inter-Race, a nonprofit think tank set up to encourage diversity education, believes Augsburg should return "every dime" Stock donated in the years following his exposure. After starting her career as one of Augsburg's first black administrators in the late Sixties, Jenkins Nelson, who is married to a white man, also received Stock's anonymous salvos. "I would get it at home, at work. It would follow me from job to job," she says of the letters, which popped up in her mailbox in 1975 and sporadically for the next 13 years. "Even though he never threatened me directly, it was scary, because I had no idea who was sending it." In 1988, after Stock was exposed, Jenkins Nelson sued him for intentional infliction of emotional harm; the case was settled out of court that same year, with Stock agreeing to pay $5,000 to the Minnesota Council of Non-Profits. (Jenkins Nelson also testified on behalf of West Publishing when Stock unsuccessfully sued his former employer to get his job back.) Stock has remained a curiously potent force in Jenkins Nelson's profession life. While at Harvard on a Bush Fellowship, she used the Stock case as a basis for research into the question of how colleges and other nonprofit institutions should deal with donations from suspect quarters. After interviewing fundraisers and administrators across the country, Jenkins Nelson says the consensus was clear: "Everybody said, 'Walk away; don't shake hands with the devil.'"

It's rare for colleges and universities to return suspect donations, but not unheard-of. One of the best-known examples involved a $20 million endowment to Yale University in 1995 from the conservative Texas billionaire Lee Bass. In that case, Bass had put strings on his donation, requiring the endowment be used only to fund a Western-civilization curriculum that faculty and students on the campus already regarded as adequate. "Sensitive donor situations are never easy. You take the information you have at your disposal, and eventually an institution has to take a stand," says Trish Jackson, vice president of the Council for Advancement in Support of Education, a D.C.-based nonprofit that provides fundraising advice to colleges and universities. More often than not, Jackson concedes, institutions will take the black eye and keep the cash in hand. As the old saying goes: "The only problem with tainted money is 'tain't never enough."

For her part, Jenkins Nelson believes Augsburg's decision to continue accepting money from Stock was wrong for reasons that go beyond bad publicity. In her view, Stock is not competent to give away his money. "Elroy has sent his letters to kids in hospitals, kids who are ill. Is that the behavior of somebody normal?" she asks rhetorically. "I don't think so. And when somebody demonstrates that they are impaired in some way--and this kind of hatred is a real impairment--I don't think we should be taking money from them." Ironically, in the wake of Stock's exposure, then-president Charles Anderson offered Jenkins Nelson a building on campus to house Inter-Race; it has been there ever since.

Others who have spoken up against Stock have fared less well--especially those who live in his hometown. For years Hoffman resident Susan Arnquist regularly received Stock's mailings. It began in 1979, when she and her husband adopted a Korean-American infant. After the local paper printed her baptismal notice, Arnquist says Stock sent the family an anti-adoption diatribe. At the time Stock was not signing his letters, and the couple initially suspected a neighbor. In 1988, after Stock's letter-writing campaign became public, Arnquist complained to leaders of her church, Messiah Lutheran, to whom Stock had already pledged a million dollars. Arnquist's family had donated the land for the new building, and she believed the project would be tainted by Stock's involvement. When she urged her fellow parishioners to send Stock and his money packing, though, there was little sympathy: Disgusted, Arnquist left Messiah. In the years since, Arnquist has tried to keep the issue alive, mostly by writing letters to local newspapers and lobbying other institutions, including the Luther Crest Bible Camp (which received $500,000 from Stock), to stop accepting his money. In the end, Arnquist's efforts have served only to alienate her from her fellow townspeople and, she says, even her husband, from whom she was recently divorced: "The majority of people just blew me off. They took his money with open arms. And he's never been shunned from the community. Nobody asked him to be held accountable for his actions. And the fact is, they're still willing to take money from him."

Steve Olson, the current pastor at Messiah, declines to discuss the matter, saying he doesn't want to jeopardize his "ongoing conversation with Elroy." But Berdell Skogstad, the former church-council president, says "only a very, very few" church members favored shunning Stock or returning his money. "Elroy has a right to his opinions," Skogstad says. "The money that he donated was earned honestly, no cheating or anything, and he wanted to put it to a good use. He has done an awful lot of good for the community. To me, it's never been very much of a concern."

Now that he has become notorious--and since he began signing his name to his own mailings in 1988--Elroy Stock occasionally receives letters from strangers; some are critical, others are supportive. For instance, a 21-year-old college student from George Mason University, who identified himself as an aide to South Carolina Sen. Strom Thurmond, wrote to request financial help. Stock declined. A Lutheran pastor from Owatonna wrote to protest his views. Stock ignored him.

Given his limited success with the judicial system, Stock is not especially optimistic about his chances in the Augsburg matter. He figures he spent at least a quarter-million dollars fighting his dismissal from West Publishing. He lost. He then sued an attorney who represented him in the case. He lost.

And then there's the $5,000 it cost to make Jenkins Nelson go away. "I think I'm gonna be dead broke after the Augsburg College lawsuit. I'm really getting down," he says. Still, he doesn't mind the thought of spending the remainder of his fortune in a legal battle. With no children, his potential heirs would only include a brother, a sister, and a few nephews. And he is not inclined to give them the money. "I don't care for anyone inheriting my money. In fact, I would kind of hate it," he explains. Then his eyes light up behind his horn-rimmed glasses, and he wags a bony finger in the air: "You know, giving money makes people evil. There are so many evil people every place I gave. The church. The Bible camp. The college. It's terrible."

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