

TAKIS NONPROFIT LAW PLLC

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**Protecting Nonprofit Organizations
from Corporate Governance Disputes**

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DISCLAIMER

- Nothing in this presentation is intended as legal advice. The information contained herein is general information for educational purposes only. Please engage an attorney for application to your specific facts and circumstances.

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INTRODUCTION

- After over 6 years of litigation, earlier this year Dave Ross and Ben Takis won a case-ending appellate court victory for The Open eBook Forum a/k/a International Digital Publishing Forum (“IDPF”) in a case involving one member’s attempt to invalidate a merger-type transaction approved by IDPF’s Board of Directors and voting members.
 - *OverDrive, Inc. v. The Open eBook Forum*, 288 A.3d 305 (D.C. 2023) (“*OverDrive*”).
- The *OverDrive* case: (i) is a rare published appellate court opinion addressing nonprofit corporate governance dispute issues; and (ii) provides important lessons that can help other organizations mitigate the potential damage of similar disputes.

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TODAY’S AGENDA

- An overview of how nonprofit corporate governance disputes often arise and the ways Board actions can be challenged in court.
- A brief summary of *OverDrive*’s key facts and legal holdings.
- Key lessons for nonprofit organizations.

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GOVERNANCE DISPUTES

- Common ways that internal disputes arise in nonprofits:
 - Voting members objecting to the Board's leadership or specific actions.
 - Individual Board members (or factions of Board members) fighting for control and/or becoming distrustful of each other.
 - Disgruntled voting members, Board members, or officers following removal/termination.
 - Allegations that the organization is not properly following its Bylaws and/or policies or complying with applicable law (whistleblower situations).
 - Disagreements over major decisions that are not resolved through the discussion and voting process.

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GOVERNANCE DISPUTES

- Means of challenging nonprofit Board actions:
 - Any internal mechanisms created by Articles of Incorporation or Bylaws.
 - Direct suit by member with a direct injury, and thus, direct cause of action.
 - Derivative suit (*i.e.*, action that member brings "on behalf of" organization against the Board).
 - Petition for court enforcement of certain statutory member rights (e.g., right to inspect corporate records and right to member meetings).
 - Petition, pursuant to statute, for court review of contested corporate action.

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SUMMARY OF THE OVERDRIVE CASE

- *OverDrive* involved a 501(c)(6) nonprofit trade association in the digital publishing space that sought to execute a merger-type transaction with a larger nonprofit, the World Wide Web Consortium (“W3C”).
- The defendant, IDPF, was a “membership organization” under the D.C. Nonprofit Corporation Act, which means IDPF’s members had rights under D.C. law, including rights to elect Board members and officers, receive access to certain documents, and vote to approve certain corporate actions.
- The transaction in this case (an asset transfer with certain rights and privileges for IDPF’s members) was approved by IDPF’s Board of Directors and then by over 80% of IDPF’s members, voting through their “primary representatives.”

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SUMMARY OF THE OVERDRIVE CASE

- The plaintiff, *OverDrive*, sought to stop or delay the vote, organize opposition, and ultimately block the transaction, by suing in D.C. court (as well as through a separate copyright lawsuit brought in federal court).
- Prior to the lawsuit, *OverDrive* demanded that the Board provide extensive documentation and information, including but not limited to email addresses of each member’s primary representative.
- IDPF’s Bylaws included a provision by which members could petition to hold a vote to rescind a Board action, which *OverDrive* failed to use (or attempt to use).
- IDPF argued that, per D.C. law, (i) it had no obligation to provide email addresses; and (ii) so long as the Board complied IDPF’s Articles and Bylaws, the availability to members of an internal procedure to challenge Board actions prevented the court itself from intervening to invalidate the transaction.

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SUMMARY OF THE OVERDRIVE CASE

- The D.C. Court of Appeals affirmed the lower court's summary judgment ruling in favor of IPDF based on the following legal holdings:
 - The transaction did not violate IDPF's Articles of Incorporation (or Bylaws).
 - The Bylaws provision allowing members to petition to rescind a Board action constituted a **non-illusory** "means of resolving a challenge to a corporate action" under D.C. Code § 29-401.22(c).
 - Under D.C. law, this means the court was not empowered to invalidate the transaction (except if appropriate to enforce the Articles or Bylaws).
 - The Bylaws remedy was not rendered *illusory* by IDPF's refusal to provide the *email addresses* of the "primary representatives" of IDPF's members.

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SUMMARY OF THE OVERDRIVE CASE

- Other key takeaways:
 - The court affirmed the general principle that D.C. courts "ordinarily won't interfere with management and internal affairs of voluntary associations." This is a common principle in other jurisdictions as well.
 - However, the court did not say explicitly whether the "business judgment rule" applies to D.C. nonprofits. May apply in other jurisdictions.
 - D.C. Code § 29-401.22(c) probably will not apply if the action is inconsistent with the Articles of Incorporation or Bylaws, or if there are procedural irregularities, improperly managed conflicts of interest, or similar factors.
 - Voting members of D.C. nonprofits have a statutory right to obtain the "names and addresses" of other members, but this *probably* does not extend to email addresses, or even the identities of the individuals who cast votes on behalf of the members.
 - If an organization has procedures in its Bylaws for addressing dissenting views, dissenters should make efforts to use them ("exhaustion of internal remedies").

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TIPS FOR MANAGING DISPUTES

- Work towards building a culture that is open to dissenting views (easier said than done).
- Consider amending the Bylaws to add a process for hearing and addressing dissenting views (this provides special legal protections for D.C. nonprofits and may prove helpful for other organizations as well). For example:
 - Create a process for dissenters to petition for a special vote to overturn or reconsider prior actions (e.g., *OverDrive*).
 - Establish a committee outside of the Board whose role is to hear both sides of a dispute and help with resolution (either an independent advisory committee that makes *recommendations*, and/or a Board committee that makes the final decision).
 - Consider a more structured process in the Bylaws for building consensus, such as "fist to five voting."

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TIPS FOR MANAGING DISPUTES

- Know what documents and information to which dissenters are, and are not, entitled.
 - Often requested documents (prior to litigation) include financial statements, email addresses, emails and other correspondence, meeting minutes and corporate records, Board member notes, executed contracts and prior drafts, answers to lengthy lists of questions, etc.
 - Understand the line between required (and healthy) transparency and bad faith attempts to stall the decision-making process.
 - Be aware of any legal limits on a person's rights to documents and information (e.g., good faith, proper purpose, more limited rights to older documents).

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TIPS FOR MANAGING DISPUTES

- Carefully follow all governing document and statutory requirements related to meeting and voting procedures, including:
 - Meeting notice and quorum requirements.
 - Voting approval requirements (simple majority, absolute majority, super majority, etc.).
 - Voting eligibility (Board terms, or the good standing status of voting members).
 - Providing and counting ballots (for membership organizations).
 - Requirements for voting outside of a meeting (unanimous written consent resolutions for Board members).

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TIPS FOR MANAGING DISPUTES

- Be hyper-aware of potential conflicts of interest and take steps to properly manage them.
 - Have and follow a conflict of interest policy.
 - Full disclosure of potential conflicts and all relevant details.
 - Independent review and approval of conflict of interest transactions, with due diligence process.
 - Document every step of this process.

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TIPS FOR MANAGING DISPUTES

- Document all Board and member meetings through proper drafting of meeting minutes.
 - Be *intentional* about the information included in the minutes (avoid excessively detailed minutes).
 - Be *thorough* in documenting due diligence steps.
 - Be *careful, accurate, and fair* (avoid including inaccurate or false statements or opinions that may appear biased or one-sided).
 - Be *clear* about which documents are the official, Board-approved minutes (have the Secretary sign/certify meeting minutes after approval of the minutes by the Board).

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TIPS FOR MANAGING DISPUTES

- Consider the pros and cons of Board / member / volunteer confidentiality policies or agreements.
 - Pros: can dissuade dissenters from airing sensitive information to gain leverage or retaliate against the organization.
 - Cons: enforcement is difficult and can lead to negative public perception; if drafted in an overbroad way can appear that the organization is secretive or opposed to transparency.

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QUESTIONS?

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