AVOIDING TEXAS NONPROFIT CORPORATION DISCLOSURE REQUIREMENTS: *KNAPP MEDICAL CENTER V. GRASS*[1]

Note

1. Knapp Medical Center, Inc. v. Grass, 443 S.W.3d 182 (Tex. App. 2013).

I. INTRODUCTION

The terms "private sector" and "public sector" are common and widely accepted terms to tidily and succinctly distinguish the role of government and private business in the American economy. Such a binary classification, however, ignores the "third sector:"[2] the impact of the nonprofit corporations on the ultimate distribution, production, and consumption of goods and services in the market.[3] Every area of law is necessarily intertwined with government, and the vastness of law affecting the private sector need not be explained. All the while, and possibly as a result, American Jurisprudence has often overlooked the issues that arise in laws governing charitable and nonprofit entities.[4] From a macro perspective, central to the very issue scholars have noted and policymakers have considered, how should a nonprofit be regulated? Should it be as a governmental entity, subject to similar standards of transparency and accountability, or as a private actor, accountable to itself? Texas attempted to solve this problem in Chapter 22, subchapter H of the Texas Business Organizations Code.[5] As evidenced by the difficulties presented in *Grass*, Texas has a great deal of progress to make.[6] The issue presented in *Grass* required interpretation of a key provision of Subchapter H: the requirement that nonprofit corporations keep records, books, and annual reports of the corporation's financial activity,[7] and make them available for inspection and copying to the public.[8] The court ultimately decided that the nonprofit Knapp Medical Center was not subject

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2. *See* Nancy J. Knauer, *How Charitable Organizations Influence Federal Tax Policy: "Rent-Seeking" Charities or Virtuous Politicians?*, 1996 WIS. L. REV. 971, 973 n.1 (1996).

3. *See Economics,* BLACK'S LAW DICTIONARY (10th ed. 2014).

4. Texas defines a nonprofit corporation as a corporation in which "no part of the income of which is distributable to a member, director, or officer of the corporation," which "may be formed for any lawful purpose or purposes not expressly prohibited under this chapter." TEX. BUS. ORGS. CODE ANN. §§ 22.001, .051 (West 2012). *See also id.* § 2.002 (providing a list of purposes for nonprofit entities).

5. *Id.* §§ 22.352–.355. The entirety of subchapter H applies to "Records and Reports" and contains §§ 22.351–.365. *Id.* Sections 22.352–.353 were originally passed in 1977 in the Texas Non-Profit Corporation Act and codified under 1396—2.23A in the Texas Civil Statutes. *See* discussion *infra* Section II.A. While *Grass* is the only opinion to analyze the statute as the Texas Business Organizations Code, the court was willing to extend the holding and rationale of *Tex. Appellate Practice & Educ. Res. Ctr. v. Patterson*, 902 S.W.2d 686 (Tex. App. 1995), because the purpose and language of § 22.355 was unchanged from its article 1396-2.23A(E)(2) predecessor. *Grass*, 443 S.W.3d at 189.

6. *Grass*, 443 S.W.3d at 183–84.

7. Tex. BUS. ORGS. CODE ANN. § 22.353(a) (West 2012).

8. *Id.* § 22.353(b).

to the statute, as it was exempted as a corporation that did not solicit contributions exceeding $10,000 from a source other than its own membership.[9]

Recognizing the limited amount of guidance from Texas Courts, as well as an extremely limited amount of scholarly literature concerning the topic, this note will have two aims. First, this note will examine the 13th Court of Appeals' decision in *Grass*, as well as the governing statutes and precedent guidance, arguing that the Court of Appeals faithfully applied an ineffective statute, yielding inequities and implications that will likely prove detrimental to the spirit of the statute.[10] As a secondary matter, and in reliance on the former, this note will apply the issues that persist in *Grass* to propose a remedy to Texas law.

Part II of this note begins by exploring both the history and precedent interpreting the statutes. Part III examines the 13th Court of Appeals decision and rationale in *Grass*. Part IV endorses *Grass* as a faithful application of the statute, despite an inequitable conclusion. Part V concludes by predicting the implications of *Grass* on Texas non-profits as well as proposing possible remedies.

II. BACKGROUND

Historically, as theorists and scholars have debated the role of the state in economic affairs, the policy makers have drafted legislation regulating the government and private business. Meanwhile, private individuals working toward the public good have occupied a nebulous realm between the two.[11]

Since the early 1990's, scholars and policymakers alike have begun to reevaluate the law of nonprofit corporations.[12] A key goal of state legislation in reforming nonprofit organizations is to protect donors.[13] Texas is not considered a leader in laws to

9. *Grass*, 443 S.W.3d at 190; Tex. BUS. ORGS. CODE ANN. § 22.355(2) (West 2012).

10. *See* Elizabeth Findell, *Doctors Lose in Quest for Knapp Medical Center Transparency*, THE MONITOR, (Jan. 28, 2014), http://www.themonitor.com/news/local/article_3ee0b8c4-8873-11e3-8065-001a4bcf6878.html ("The case drew statewide interest for its implications as to how nonprofits interact with the foundations that support them, and whether they can use nonprofits to skirt open records laws.").

11. *See* Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 835–36 (1980) (discussing the unique role that nonprofit corporations play in the economy, and the unique public policy challenges that they present).

12. *See* Marion R. Freemont-Smith, *The Search For Greater Accountability of Nonprofit Organizations: Recent Legal Developments and Proposals for Change*, 76 FORDHAM L. REV. 609, 609–611 (2007).

13. *Id.*

protect donors from fraudulent behavior on the part of not-for-profit entities.[14] This remains the case, although Texas first enacted legislation to increase the transparency of nonprofit corporations in 1977.[15] Even before that time, Texas courts had discussed the role of the law in charity:

> [A]lthough the relief of the poor, or a benefit to them in some way, is in its popular sense a necessary ingredient in a charity, this is not so in view of the law, by which it is defined to be "a gift to a general public use," which extends, or doubtless may do so, either to the rich or the poor.[16]

A. *Texas Law of Nonprofit Corporations*

The Texas Nonprofit Corporation Act was re-codified under Chapter 22, Subchapter H of the Texas Business Organizations Code.[17] Under Subchapter H, all nonprofit corporations are required to maintain accurate financial records "with complete entries as to each financial transaction of the corporation, including income and expenditures . . . ."[18] Under § 22.351, after a written demand stating a proper purpose, a member of a corporation is entitled to examine and copy the books and records of that corporation.[19] The right to inspect under § 22.351 is not unique to nonprofit corporations under Chapter 22.[20]

More significantly, § 22.353 requires nonprofit corporations to first "keep records, books, and annual reports of the corporation's financial activity."[21] Also, § 22.353 requires that a nonprofit corporation "*make the records, books, and reports available to the public* for inspection and copying."[22] Neither § 22.352 nor 22.354 apply if a nonprofit falls under one of the seven exemptions in § 22.355:

> (1) a corporation that solicits funds only from members of the corporation;

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14. *See id.* at 630.

15. *See* TEX. REV. CIV. STAT. ANN. art. 1396-2.23A (West 2010)(expired).

16. Paschal v. Acklin, 27 Tex. 173, 199 (Tex. 1863) (explaining the legal significance of the term "charity"). *But see* I.R.C. § 501(c)(3) (defining charities as organizations eligible to receive contributions from donors that are deductible from federal taxes).

17. *See* Acts 2003, 78th Leg., R.S., ch. 182 § 1, 2003 Tex. Sess. Law. Serv. Ch. 182 (H.B. 1156) (West).

18. Tex. BUS. ORGS. CODE ANN. § 22.352(a) (West 2012).

19. *Id.* at § 22.351.

20. *See, e.g.*, *id.* at § 21.218 (containing a similar provision for shareholders of corporations).

21. *Id.* at § 22.353(a).

22. *Id.* at § 22.353(b) (emphasis added).

> (2) a corporation that does not intend to solicit and receive and does not actually raise or receive during a fiscal year contributions in an amount exceeding $10,000 from a source other than its own membership;
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> (3) a private or independent institution of higher education described by Section 61.003, Education Code, . . . a postsecondary educational institution authorized to grant degrees under a certificate of authority issued by the Texas Higher Education Coordinating Board or a foundation chartered for the benefit of the institution or any component part of the institution, a career school or college that has received a certificate of approval from the Texas Workforce Commission, a public institution of higher education or a foundation chartered for the benefit of the institution or any component part of the institution, or an elementary or secondary school;
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> (4) a religious institution that is a church, an ecclesiastical or denominational organization, or another established physical place for worship at which religious services are the primary activity and are regularly conducted;
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> (5) a trade association or professional society the income of which is principally derived from membership dues and assessments, sales, or services;
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> (6) an insurer licensed and regulated by the Texas Department of Insurance; or
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> (7) an alumni association of a public or private institution of higher education in this state that is recognized and acknowledged as the official alumni association by the institution.[23]

The remainder of Subchapter H was not covered by the original article 1396-2.23A, and is therefore outside the scope of this article.[24]

B. *Avoiding Texas Nonprofit Corporation Disclosure Requirements:* Knapp Medical Center v. Grass

1. Historical Basis for § 22.353

State Senator Gene Jones of Houston introduced the public disclosure requirements before the 65th Term of the Texas

23. *Id.* at § 22.355.

24. The Bill has undergone several amendments since its inception in 1977. Any references made to sections 22.353 and 22.355 prior to their adoption in the Texas Business Organizations Code reference their predecessor statute.

Senate.[25] Before the 65th Legislature was in session, Jones attempted to conduct a study of a non-profit drug rehabilitation program in Houston.[26] The nonprofit rehabilitation program solicited funding from the general public to further its purported charitable ends.[27] Senator Jones saw a need to conduct the study after he heard rumors that the nonprofit commonly misappropriated donations, specifically by using them for investments in private businesses.[28] Despite his six-month investigation, Jones was unable to accurately determine how the program was utilizing the funds because the program had failed to maintain adequate records.[29] While the study was not successful in Jones' investigation, "a major recommendation from the study was that Texas law should be amended to require non-profit organizations soliciting funding from the public to keep adequate records showing how the funds were actually being used."[30] Senator Jones used the same language recommended from the study in his stated purpose for the bill: amending Texas law "to require non-profit corporations soliciting funds from the public to keep certain financial records."[31]

Jones provided additional insight into the bill's purpose during Senate hearings: "[The bill] would simply give the right of people who are considering making a contribution, the right to know that there are records kept consistent with proper accounting principles in the office of the organization soliciting those funds during business hours."[32]

Senator Jones was also eager to point out that the intent of the bill was to overcome the obstacles he faced in his investigation, stating that he "didn't try to put anybody in this bill that we haven't had reports over having problems about. It

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25. SB 857, 65th Regular Sess. (Tex. 1977), http://www.lrl.state.tx.us/legis/BillSearch/billdetails.cfm?legSession=65-0&billTypeDetail=SB&billNumberDetail=857 (relating to financial records and reports of certain nonprofit corporations; defining offenses and providing a penalty). While in office, Senator Jones served as Assistant Dean at South Texas College of Law. *See* Biographical Sketches, Texas Senate 66th Legislature, (Jan. 9, 1979), http://www.lrl.state.tx.us/scanned/members/texas_senators/Public/Texas_Senate_66.pdf; *also Senator Gene Jones*, Legislative Reference Library of Texas, *Texas Legislators Past & Present: Gene Jones*, http://www.lrl.state.tx.us/legeLeaders/members/memberdisplay. cfm?memberID=558.

26. Senate Comm. On Bus and Indus., Bill Analysis, Tex. S.B. 857, 65th Leg., R.S. (Apr. 6, 1977)

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Hearing on S.B. 857 Before the Senate Economic Dev. Comm.,* 65th Leg., R.S. 4-5 (Tex. 1977).

has been a narrowly drawn bill to direct itself to those organizations that have given rise to some problem."[33] Further, Senator Jones asserted, "[E]ven as narrowly drawn as this bill is, we didn't intend to reach anyone over whom we have no complaints. I think we have done that in this bill."[34]

2. Cases and Decisions

Texas courts have had very limited opportunities to construe sections 22.353 or 22.355 or their predecessor.[35] Specifically, there have been a mere four cases in which the 22.355(2) exemption was contested before any Texas Appellate Court.[36]

a. Texas Appellate Practice and Educational Resource Center v. Patterson

Patterson defined the meaning of "contributions," narrowly: "the term 'contributions' is not intended to include grants received through federal appropriations or from state and private foundations or to cover the donation of in-kind services".[37] In *Patterson*, State Senator Jerry Patterson requested the records, books, and annual reports of financial activity of the Texas Appellate Practice and Educational Resource Center, a non-profit corporation whose purpose was to ensure that death row inmates in Texas had adequate legal counsel.[38] Patterson was "concerned about the activities of the Resource Center in its representation of death row inmates and its public relations campaigns against the death penalty in Texas."[39] While the Resource Center received some $3.9 million from state and private foundations, the court of appeals concluded that the Resource Center was exempt from disclosure because it did not receive contributions in excess of $10,000 from the general public.[40]

The court cited the legislative history of the bill in concluding that it was a mechanism for making nonprofit corporations accountable for donations solicited from the public.[41]

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33. Tex. Appellate Practice & Educ. Res. Ctr. v. Patterson, 902 S.W.2d 686, 689 (Tex. App. 1995).

34. *Id.* at 689 (alteration in original).

35. *See* TEX. REV. CIV. STAT. ANN. art. 1396-2.23A (West 2010)(expired).

36. *See* Knapp Med. Ctr., Inc. v. Grass, 443 S.W.3d 182, 189 (Tex. App. 2013); Gaughan v. Nat'l Cutting Horse Ass'n, 351 S.W.3d 408, 411 (Tex. App 2011); *In re* Bay Area Citizens Against Lawsuit Abuse, 982 S.W.2d 371, 380 (Tex. 1998); Texas Appellate Practice & Educ. Res. Ctr. v. Patterson, 902 S.W.2d 686, 688 (Tex. App. 1995).

37. *Patterson*, 902 S.W.2d at 688.

38. *Id.* at 687.

39. *Id.*

40. *Id.* at 689.

41. *Id.* at 688.

The court explicitly held that "contributions," as defined by the statute, means "funds solicited from the general public and does not cover grant funding or in-kind services."[42] In arriving at this conclusion, however, the court only mentioned the disputed grants in that case, "i.e., from the federal government or from the ['Interest on Lawyers' Trust Accounts'] fund of the Texas Bar Association."[43] In that case, "the statute is unnecessary because the terms of the grant and the grantor's oversight provide the means of holding the corporation accountable for the use of grant funds."[44]

b. In re *Bay Area Citizens Against Lawsuit Abuse*

Some three years after *Patterson*, the Texas Supreme Court endorsed the Austin Court of Appeals' narrow reading of the statute in *In re Bay Area Citizens Against Lawsuit Abuse*.[45] A group of taxpayers from the City of Corpus Christi brought suit against the City of Corpus Christi, Bay Area Citizens Against Lawsuit Abuse ("BACALA"), and the Greater Corpus Christi Business Alliance ("the Alliance") alleging an impermissible use of public tax revenues for private interest.[46] The Alliance allowed BACALA to use office space on the Alliance's property without charging rent.[47] Despite objections on constitutional grounds, the trial court ordered BACALA to answer questions and produce documents regarding the identities of contributors, sources of funding, and relationships with private industry.[48] BACALA filed a petition for a writ of mandamus with the Texas Supreme Court complaining of the ordered disclosure of lists of donors.[49] Since the taxpayers failed to show a relationship between alleged misuse of property and BACALA's contributors, the court held that such a disclosure would violate the First Amendment's freedom of association.[50] The court then disposed of the taxpayers' argument that article 1396-2.23A required that

42. *Id.*

43. *Id. at* 689.

44. *Id.*

45. *In Re* Bay Area Citizens Against Lawsuit Abuse, 982 S.W.2d 371, 381 (Tex. 1998).

46. *Id.* at 373–74. Both BACALA and the Alliance are Texas nonprofit corporations. *Id.* at 373. In 1994, the Corpus Christi Chamber of Commerce entered into a joint venture agreement, merging its lawsuit abuse committee with BACALA. *Id.* The Alliance was subsequently formed in a merger between the Chamber of Commerce, Convention and Visitors Bureau, and Economic Development Corporation. *Id.*

47. *Id.*

48. *Id.* at 374.

49. *Id.* at 375.

50. *Id.* at 380.

BACALA disclose all of their financial information, including their list of donors.[51] BACALA conceded that the statute required the disclosure of some financial records, but was unconstitutional if it required the disclosure of contributors' identities.[52] Construing article 1396-2.23A to avoid constitutional infirmities, the court upheld the statute because the phrase "financial records" did not include the names of contributors or members.[53] The court noted that the statute's requirement that "non-profit corporations maintain 'financial records with full and correct entries made with respect to all financial transactions . . . , including all income and expenditures, suggests that more than just the amount received must be maintained;" however, the statute "does not expressly require that contributors' identities be made available to the public."[54] The court cited *Patterson's* conclusion that the statute's legislative intent was "to remedy a specific problem: the lack of accountability regarding a non-profit corporation's use of funds solicited from the public."[55] The court ultimately stated that the purpose of article 1396-2.23A was "to expose the nature of expenditures of that money once received from the public and to make non-profit organizations accountable to their contributors for those expenditures."[56] As such, "the seemingly broad scope of the statute's language is not matched by the legislative intent."[57]

c. Additional Guidance from Courts

Including *Grass, Patterson,* and *In re Bay Area Citizens Against Lawsuit Abuse,* sections 22.353 and 22.355 and their predecessors are referenced by a total of eight Texas appellate cases.[58]

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51. *Id.* at 381.
52. *Id.* at 380.
53. *Id.* at 381.
54. *Id.*
55. *Id.*
56. *Id.*
57. *Id.* The cases analyzed in this section do not endeavor into an analysis of the relevant § 22.355(2) addressed in *Grass*. While they are not helpful in the analysis of that case such are *Patterson*, the lone case analyzing that provision and *In re Bay Area Citizens Against Lawsuit Abuse*, the lone guidance from the Texas Supreme Court, they are addressed independently. *See* discussion *supra* Sections II.B.2.a–b. These cases are helpful, however in a broader analysis of the statute.
58. *See* Knapp Med. Ctr., Inc. v. Grass, 443 S.W.3d 182, 183–84 (Tex. App. 2013); Gaughan v. Nat'l Cutting Horse Ass'n, 351 S.W.3d 408 (Tex. App. 2011); *In re* Bay Area Citizens Against Lawsuit Abuse, 982 S.W.2d 371 (Tex. 1998); *Patterson*, 902 S.W.2d at 688, Children's Med. Ctr. of Dallas v. Richardson, 1995 WL 307484 (Tex. App. 1995); Citizens Ass'n for Sound Energy (CASE) v. Boltz, 886 S.W.2d 283 (Tex. App. 1994); Park Meadow Townhouse Ass'n v. Foley, 1988 WL 109817 (Tex. App. 1988); Pabst v. State, 721 S.W.2d 438 (Tex. App. 1986). The statute is only referenced in passing in *Foley*. *Foley*, 188

In *Gaughan*, the Ft. Worth Court of Appeals distinguished a member's right to inspect books and records in § 22.351 from the public's right to inspect under § 22.353 in determining whether certain records were confidential and exempt from disclosure under § 22.351.[59]In its analysis of the legislative intent behind the statute, the court relied on both *In re Bay Area Citizens Against Lawsuit Abuse* and *Patterson*'s interpretation of a narrow statute designed to hold nonprofit corporations accountable to the general public, noting that contracts with vendors, sponsors or employees were not financial documents that the general public would be able to inspect.[60]

Three months before *Patterson* was decided in 1995, the Dallas Court of Appeals in *Richardson* held that an attorney engaged in a wrongful death lawsuit against a nonprofit hospital was a member of the "public" within the meaning of § 22.353, and was therefore entitled to inspect the hospital's books and records.[61] Without the benefit of *Patterson*'s analysis of the statute, the court relied on the Texas Bar Committee's comment on the statute, indicating that its purpose was "to prevent abuse by trustees and directors of non-profit entities by requiring the maintenance of records and opening them to public inspection."[62]

In 1994, the Amarillo Court of Appeals affirmed the trial court's denial of summary judgment to Citizens Association for Sound Energy ("CASE") on the grounds that a fact question remained as to whether CASE was exempt under article 1369-2.23A(E)(7) as "an organization whose charitable activities relate to public concern in the conservation and protection of wildlife, fisheries, and allied natural resources."[63] Although the court noted that CASE's primary focus was to "monitor and protect the safety and costs of the Comanche Peak nuclear power plant."[64]

WL 109817 at *3 ("Appellant [nonprofit corporation] is charged with the duty of keeping minutes of the proceedings of its members") (internal quotation omitted). *Pabst* is worthy of note because it is a criminal case that implicates article 1396-2.23A. *Pabst*, 721 S.W.2d at 440–41. The defendant appealed his conviction of theft by deception arguing, in relevant part, that records, books, and annual reports of financial activities of a nonprofit corporation were seized in violation of the fourth amendment. *Id.* at 440. The court held that the defendant did not have a reasonable expectation of privacy to the nonprofit's records, which it was obligated to keep as a matter of law. *Id.* at 441.

59. *See Gaughan*, 351 S.W.3d at 411–12.

60. *Id.* at 415–16.

61. *See Richardson*, 1995 WL 307484 at *3.

62. *Id.* (quoting Comment of Bar Committee, TEX. REV. STAT. Art. 1396-2.23A (Vernon 1980)).

63. *Boltz*, 886 S.W.2d at 288. The relevant article 1396-2.23A(E) was amended in 2003 to remove this provision from the list of exemptions. *See* 2003 Tex. Sess. Law Serv. Ch. 238 (H.B. 1165)

64. *Boltz*, 886 S.W.2d at 286.

The court did not discuss any aspect of the statute beyond its analysis of the plain text.[65] CASE argued in its motion for summary judgment that its regulation of the power plant was motivated in part by environmental concerns.[66] In response to CASE's motion, the plaintiffs argued that CASE had only endeavored into environmental issues after the commencement of the litigation at issue.[67]

III. *KNAPP V. GRASS*

A. *Procedural History and Facts*

On February 7, 2011 Jeffery Grass sent a letter to Knapp Medical Center's ("KMC") chief financial officer requesting numerous documents pursuant to § 22.353.[68] In their reply, KMC denied Grass's request, citing their exemption from the disclosure requirements of 22.353 pursuant to § 22.355(2).[69] KMC subsequently sought declaratory judgment of their exemption under § 22.355.[70]

In his answer, Grass asserted estoppel as an affirmative defense, "based on the state's public policy that favors public disclosure of financial records of non-profit corporations.[71] Grass then moved for summary judgment, arguing that KMC was not entitled to an exemption from non-disclosure as a matter of law, because KMC had created an additional nonprofit corporation, the Knapp Medical Center Foundation (the Foundation), as a sham to circumvent § 22.353.[72] In support of his motion, KMC attached an affidavit from a former KMC consultant, stating that "[the Foundation] both solicited and received more than $10,000 yearly from sources other than its own trustees," and further

65. *Id.*

66. *Id.* at 288–89.

67. *Id.* at 289.

68. Knapp Med. Ctr., Inc. v. Grass, 443 S.W.3d 182, 183 (Tex. App. 2013). In part, Grass requested a copy of KMC's by-laws, the minutes from all Board of Directors since 2006, copies of various tax forms for each tax year since 2006, correspondence letters to auditors showing contingence and off balance sheet liabilities, and all internal control reports issued by accountants since 2006, due diligence reports as a result of KMC's proposed merger with Valley Baptist Hospital, the identities of any entities or sub-entities formed for the purpose of merging or acquiring other healthcare facilities or for the recruitment of primary care physicians, all documents related to insurance policies maintained by KMC, and a list of contractors since 2006. *Id.* at 183–84.

69. *Id.* at 184.

70. *Id.*

71. *Id.*

72. *Id.*

that the Foundation "existed only to support the work of [KMC]," and that the Foundation did not function for any other purpose.[73]

KMC also filed its own motion for summary judgment because KMC and the Foundation "are entirely separate non-profit corporations."[74] In that motion, KMC asserted that Grass's argument, that the creation of the Foundation as a "shell corporation" should not entitle KMC to an exemption, lacked evidence and citation to legal authority, as well as a basis in public policy and § 22.353.[75]

The trial court held a hearing on the parties' motions on August 17, 2011.[76] On October 11, 2011, the trial court issued its ruling granting Grass's motion for summary judgment and denying KMC's.[77] After an evidentiary hearing on what documents were subject to disclosure under § 22.353, Grass filed a "Revised Document Request."[78] The request was supported by the affidavit of an accountant asserting that all of the documents in Grass's request "fall within the definition of records, books, and annual reports [in sections 22.352 and 22.353]."[79] KMC filed a response, objecting to the opinion of Grass's affidavit as an attempt to "invade the province of the Court by interpreting the meaning of the statute",[80] and providing their own expert's affidavit.[81]

The trial court ultimately issued a ruling on what documents KMC was required to disclose,[82] but deferred its ruling pending KMC's appeal.[83] The Court of Appeals reversed the trial court's

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73. *Id.* at 185. In its response to this motion, KMC objected to the use of this affidavit because the affiant's statements were not properly qualified under Texas Rules of Civil Procedure rule 166a. *Id.* Grass remedied this in his response to KMC's motion for summary judgment. *Id.* at 184 n.2.

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 186.

78. *Id.* In this revised request, Grass requested six categories of documents. *Id.*

79. *Id.*

80. *Id.* at 186.

81. *Id.*

82. *Id.* The trial court ordered that KMC produce seven categories of documents, specifically IRS Forms 990 for 2008 and 2009; IRS Forms 990 for 2010; documents that trace how grants from the Foundation were used for 2008-2010, including documentation of any sale or disposition of any items KMC purchased with grants from the Foundation; KMC's financial statements, including all balance sheets, statement of cash flows, income statements and pre-adjusted trial balances; management letters from an external auditor; compensation documents, with redacted personal information; and deferred executive compensation including written plans, contracts with agencies, board of directors minutes authorizing such arrangements, and any contracts relating to future obligations. *Id.* at 186–87.

83. *Id.*

grant of Grass's motion for summary judgment and order that KMC disclose documents under § 22.353, and rendered KMC exempt from disclosure under § 22.353 as a matter of law.[84] The Texas Supreme Court denied review and subsequently denied a motion for rehearing of the petition for review.[85]

B. *Majority Opinion*

Writing for the court, Justice Gina M. Benavides began with a statutory analysis of sections 22.351-.356.[86] The court first read and construed § 22.353 as requiring all Texas non-profit corporations to keep "records, books, and annual reports of the non-profit corporation's financial activity on file . . . [and] to make said records, books, and annual reports . . . available to the public for inspection and copying at the corporation's registered or principal office."[87] The court then recognized § 22.355 as "a list of statutory exemptions for non-profit corporations to the record-keeping and public-disclosure requirements of § 22.353."[88] The court then turned its attention to § 22.355(2), noting that no previous case addressed, interpreted, or analyzed the § 22.355(2) exemption in its current form, but recognizing that *Patterson* was applicable because it contained similar facts and an analysis of the predecessor statute.[89] Of particular note, the court first highlighted *Patterson*'s analysis of the statute as a "'narrowly drawn law' that focused on non-profit corporations which solicited '*funds from the public.*'"[90]

In its discussion, the court first addressed Grass's argument that the Foundation was merely a "straw-man," or "shell corporation," designed to funnel money to KMC.[91] The court recognized that while the Foundation was incorporated "for the sole benefit of, and the specific purpose of supporting" KMC, the two were "separate and distinct domestic non-profit corporations."[92] Thus, although the Foundation did solicit and receive gifts from the general public, this evidence alone "[did]

84. *Id.* at 190.
85. Knapp Med. Ctr. v. Grass, 13-0561, 2014 Tex. LEXIS 462 (Tex. June 6, 2014).
86. *Grass*, 443 S.W.3d at 183, 187–88.
87. *Id.* at 188.
88. *Id.*
89. *Id.* at 189.
90. *Id.* (citing *Patterson*, 902 S.W.2d at 688–89) (emphasis in original).
91. *Id.*
92. *Id.*

not support or establish any theory of liability to pierce the corporate veil."[93]

With the distinction drawn between KMC and the Foundation as separate entities, the court concluded that the Foundation's grant funds to KMC were not contributions that would preclude exemption under § 22.355(2).[94] In arriving at this conclusion, the court noted that KMC did not solicit contributions from the public exceeding $10,000, and that the Foundation's grant funding went toward "[the] purchase [of] specific equipment and not for general operating expenses."[95] Therefore, under *Patterson*, § 22.353 was not applicable because "the terms of the grantor's oversight provide the means of holding the corporation accountable for the use of grant [funding]."[96]

C. *Dissent*

In his dissent, Chief Justice Rogelio Valdez disagreed with the majority's conclusion that KMC was exempt as a matter law under § 22.355(2) and would have affirmed the trial court's ruling, granting Grass's motion for summary judgment and denying KMC's motion for summary judgment.[97]

The dissent first provided a recitation of the background of the case and appropriate standards of review.[98] The dissent's analysis of sections 22.353 and 22.355(2) closely mirrored the majority's analysis, relying on *Patterson* and the Texas Supreme Court's analysis in *In re Bay Area Citizens Against Lawsuit Abuse* to conclude that the intent of § 22.355(2), based on its predecessor statute, "was to remedy a specific problem: the lack of accountability regarding a non-profit corporation's use of funds solicited from the public."[99]

The dissent then turned to the Austin Court of Appeals' opinion in *Patterson*.[100] The dissent's reading of *Patterson*'s interpretation of the statute, including its ultimate purpose, was not distinguishable from the majority's view.[101] However, the dissent specifically highlighted language in the *Patterson* court's

93. *Id.* (citing SSP Partners v. Gladstrong Invs. (USA) Corp., 275 S.W.3d 444, 454 (Tex. 2009)).

94. *Id.* at 190.

95. *Id.*

96. *Id.* (quoting *Patterson*, 902 S.W.2d at 689).

97. *Id.* at 190 (Valdez, C.J., dissenting).

98. *Id.* at 190–92.

99. *Id.* at 192–93 (quoting *In re* Bay Area Citizens Against Law-suit Abuse, 982 S.W.2d 371, 381 (Tex. 1998)).

100. *Id.* at 193.

101. *Id.* at 188–89, 193–94.

conclusion that when a nonprofit receives grant funding, *"i.e., from the federal government or from the IOLTA ('Interest on Lawyer's Trust Accounts') fund of the Texas Bar Association, . . .* the terms of the grant and the grantor's oversight provide the means of holding" the [nonprofit] accountable."[102]

In its analysis, the dissent distinguished the facts in *Patterson*, in particular the character and nature of the grantors, to conclude that the *Patterson* decision should not be extended to exempt KMC from disclosure under § 22.355(2).[103] The dissent first noted that there was no evidence linking the Resource Center and the grantors in *Patterson*, and that the grantors were in fact completely separate entities not created to benefit the non-profit corporation.[104] Since KMC was the sole member of the Foundation, KMC created the Foundation for the sole purpose of circumventing the legislative purpose of the § 22.353 by providing funding to KMC.[105] Because it was KMC's burden to show that it did not receive money from the public, and there was no evidence of the Foundation's oversight of the funds that it collected from the public and subsequently gave to KMC, they did not meet that burden.[106]

The dissent was careful to note that *Patterson* did not focus on whether funding came from related or unrelated entities, as it had suggested in the previous paragraph.[107] Instead, *Patterson* focused "on the issue of transparency and whether the grantors in that case had oversight of the funds given to the non-profit corporation."[108] The dissent continued that in *Patterson*, the oversight rendered public disclosure of financial records unnecessary because there was independent oversight.[109] Such oversight was not evident in the relationship between KMC and the Foundation.[110]

Following this analysis, the dissent would not have needed to proceed further in piercing the corporate veil to determine whether KMC received contributions under § 22.355(2).[111] If such an analysis was necessary, however, the dissent further argued that the corporate veil between KMC and the Foundation should

102. *Id.* at 193 (quoting *Patterson*, 902 S.W.2d at 689) (emphasis added).
103. *Id.* at 194–95.
104. *Id.* at 194
105. *Id.*
106. *Id.*
107. *Id.* at 194–95.
108. *Id.* at 195.
109. *Id.*
110. *Id.*
111. *Id.*

have been pierced, or a question of fact remained to preclude KMC from winning summary judgment.[112]

The dissent agreed with the majority that the "alter ego theory"[113] was insufficient to pierce the corporate veil.[114] However, the dissent disagreed with the majority's assertion that Grass had attempted to pierce the corporate veil utilizing the alter ego theory.[115]

Instead, the dissent construed Grass's argument that the Foundation was a "straw-man" or "shell corporation" to be one that characterized the Foundation as "a sham to perpetrate a fraud" in order to circumvent § 22.353.[116] A finding that a corporation is merely a sham to perpetrate a fraud can be made upon showing "that the separate corporation's existence would bring about an inequitable result."[117] This is so "even when two entities have observed all corporate formalities of separateness, as the majority found the entities did in this case."[118] Following this theory, the dissent would have concluded that KMC created the Foundation in order to "indirectly solicit funds from the public," circumventing the legislative intent of § 22.353.[119]

IV. *GRASS*: A FAITHFUL APPLICATION OF AN INEFFECTIVE STATUTE

In light of the statute's history, as well as precedent, the majority in *Grass* most faithfully applied sections 22.353 and 22.355 in finding KMC exempt from the public disclosure of their records.[120] Yet, the opinion remains troubling because the court was called to interpret a statute in dire need of legislative reform.

A. *The Correct Outcome, Issues Persist*

The dissent and the majority divide on two similar, but distinct issues in arriving at their respective conclusions. The

112. *Id.*

113. Under this theory of piercing the corporate veil, "the corporation is organized and operated as a mere tool or business conduit of another corporation." *Id.* (citing Castleberry v. Branscum, 721 S.W.2d 270, 272 (Tex. 1986)).

114. *Id.*

115. *Id.*

116. *Id.* (citing *Castleberry*, 721 S.W.2d at 272).

117. *Id.*

118. *Id.*

119. *Id.* The dissent added, "I am of the opinion that at the very least, the summary judgment evidence creates a fact issue regarding whether a sham to perpetrate a fraud has occurred." *Id.* at 196 n.5.

120. *Id.* at 188–90.

first, does the statute serve as a means of protecting donors, or as a means of providing transparency?[121] The second, is piercing the corporate veil an appropriate means to serve either end?[122]

1. A Requirement of Transparency, or a Means to Protect Donors?

To begin, both the majority and dissent would likely conclude that in the absence of the Foundation, KMC would be exempt from § 22.353 under § 22.355(2) as a matter of law. Similarly, both would likely conclude that the Foundation is subject to the public disclosure requirements of § 22.353 as a matter of law.

The difference is rooted in two distinct readings of *Patterson*'s conclusion:

> When a nonprofit corporation receives grant funding, i.e., from the federal government or from the IOLTA ("Interest on Lawyers' Trust Accounts") fund of the Texas Bar Association, the statute is unnecessary because the grant and the grantor's oversight provide the means of holding the corporation accountable . . . [w]e accordingly hold that the term "contributions" means funds solicited from the general public and does not cover grant funding.[123]

The majority's reading is based on the notion that grant funding presumes oversight, regardless of the source.[124] The dissent relies on the notion that the *Patterson* court reached their conclusion because the federal government and IOLTA provide independent oversight of their grants.[125] Because the dissent found that the Foundation did not provide any oversight in its grants to KMC, such contributions should count as contributions in § 22.355(2).[126]

The dissent's reading of *Patterson* is troublesome provided there is no discussion of ways or means in which either the federal government or the IOTLA provided oversight of their grant funding to the Resource Center. The dissent, however, bases its conclusion on the premise that there was no evidence that the Foundation provided oversight of the money that it solicited from the public and subsequently gave to KMC.[127]

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121. *See id.* at 195.
122. *See id.*
123. *Patterson*, 902 S.W.2d at 689.
124. *See Grass*, 443 S.W.3d at 188–90.
125. *Id.* at 193.
126. *Id.* at 194–95.
127. *Id.*

Even assuming that the dissent was correct, and that the *Patterson* court presumed some type of oversight beyond the fact that the grant came from a separate entity, such a reading is not supported by the legislative history.[128] Senator Jones stated the bill would simply give a right "to people who are considering making a contribution."[129] The Texas Supreme Court's lone comments on the statute echoed Senator Jones's concerns when it wrote that statute's purpose was to "expose the nature of the expenditure of [funds] once received from the public and to make non-profit organizations accountable *to their contributors* for those expenditures."[130] The public made contributions to the Foundation, thus making the Foundation subject to the disclosure requirements of § 22.353.[131] Therefore, the ultimate question of oversight on how contributions from the public are ultimately disbursed should be placed on the Foundation, the grantee of contributions from the public.

Senator Jones further noted that the bill was not intended to reach "anyone over whom we have no complaints."[132] Presumably, Jones was speaking in his capacity as a Senator, with his use of the term "we" in light of the investigation that gave rise to the legislation.[133] A similar situation gave rise to the dispute in *Patterson*, i.e., a state senator concerned with the activities of a non-profit corporation.[134] The *Patterson* court construed the statute as to protect the nonprofit Resource Center.[135] It would be difficult to refuse to extend the same protection to KMC in *Grass*, which involved litigation of two private parties.[136]

In the absence of piercing the corporate veil,[137] on the question of whether KMC should have been subject to the exemption, the majority's simple conclusions that KMC and the Foundation were separate entities, and that KMC never solicited nor intended to ever solicit "contributions" in excess of $10,000 precludes the implications of the dissent's insistence of a showing

128. *Id.* at 188–89, 194–95.
129. *Patterson*, 902 S.W.2d at 688.
130. *In re* Bay Area Citizens Against Lawsuit Abuse, 982 S.W.2d 371, 381 (emphasis added).
131. *See* Knapp Med. Crt. v. Grass, 443 S.W.3d 182, 188 (Tex. App. 2013).
132. *Patterson*, 902 S.W.2d at 689.
133. *Id.*
134. *Id.* at 687.
135. *Id.* at 689.
136. *See Grass*, 443 S.W.3d at 189.
137. *See* discussion *infra* Part IV.A.2.

of oversight.[138] Such an insistence leaves more questions than answers. The court's interpretation of "contributions" in *Grass* serves the statute's ultimate purpose of allowing members of the public considering contributions to know the ultimate destination of such funds.[139] Any concern that the public might have over the Foundation's ultimate use of their contributions would reveal that they are granted to KMC.[140] If a contributor found fault, or wished to inquire further, they could simply decline to contribute to the Foundation.

2. Piercing[141]

In his brief, Grass devoted very little space to piercing the corporate veil.[142] The majority concluded that there was no evidence to pierce the corporate veil under an alter ego theory merely because the Foundation was created for the sole benefit of KMC.[143]

The dissent agreed with the majority's conclusion that an alter ego theory was insufficient to pierce, but nonetheless concluded that the Foundation was a mere sham to perpetrate a fraud.[144]

B. *Statutory Holes and a Search for the Proper Remedy*

Writing for the court in *In re Bay Area Citizens Against Lawsuit Abuse*, Justice Greg Abbott[145] was directly on point when he observed "the seemingly broad scope of the statute's language is not matched by the legislative intent."[146] The ambiguities of the statute certainly are not limited to § 22.355(2).[147]

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138. *Grass*, 443 S.W.3d at 189–90, 194.

139. *Id.* at 189–90.

140. *See Grass*, 443 S.W.3d at 184 (referring to an affidavit from a former KMC consultant, stating "[the Foundation] has existed only to support the work of [KMC]") (alteration in original).

141. The piercing issue is beyond the scope of this note, but is addressed briefly here given the importance the dissent placed upon the issue in its analysis.

142. *See* Brief of Appellee at 13–14, Knapp Med. Ctr. v. Grass, 443 S.W.3d 182 (Tex. App. 2013), review denied (Jan. 17, 2014) (No. 13-12-00099-CV), 2012 WL 2395735,at *13–14.

143. *Grass*, 443 S.W.3d at 189.

144. *Id.* at 195.

145. Then-Justice Abbott later went on to become Attorney General, and most recently was elected Governor of the State of Texas. *See Office of the Governor Greg Abbott,* http://gov.texas.gov/about (last visited Sept. 13, 2015).

146. *In re* Bay Area Citizens Against Lawsuit Abuse, 982 S.W.2d 371, 381 (Tex. 1998).

147. *See* discussion *supra* Part II.A.2. (discussing the cases in which courts have adjudicated various provisions of the statute).

In 2005, State Senator Kevin Eltife of Tyler, Texas introduced sweeping changes to the record keeping and audit requirement that would have remedied the discrepancy between the statute's plain language and intent.[148] In part, the bill called for audits on an incremental level based on a nonprofit corporation's revenue.[149] The bill ultimately passed out of the Senate Committee on Business and Industry.[150]

On April 12, 2005, the House Committee on Business and Industry held a public hearing on the bill.[151] In nearly an hour of testimony, various witnesses came forward both in support and in opposition to the sweeping changes.[152] Those in favor argued for a need for reform in light of recent cases of misappropriation of nonprofit funding.[153] Those in opposition took issue with the particular income levels at which a nonprofit would be subject to audits, and more generally, argued that such measures would be ineffective in nonprofit oversight and place an undue burden on nonprofits.[154] Ultimately, the bill never passed the house committee, and reform was again overlooked.[155]

V. CONCLUSION

What is left is a statute in dire need of statutory reform. Indeed, while the legislature undertook the task of reforming the statute, they were burdened with the same recurring issues that have long burdened efforts to reform nonprofit corporations.[156] While the issue simmers on the backburner, the goals that it seeks to achieve go overlooked and Texas nonprofits are left with uncertainty for the future.

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148. *See* S.B. 1215, 79th Leg., Reg. Sess. (Tex. 2005).
149. *Id.*
150. *Id.*
151. *Hearing on H.B. 3417 Before the H. Comm. on Bus. & Indus.*, 79th Leg., Reg. Sess. (Tex. 2005).
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.*
156. *Id.*