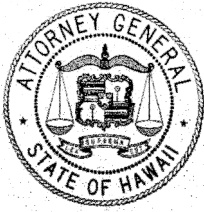


SB 2720



**TESTIMONY OF
THE DEPARTMENT OF THE ATTORNEY GENERAL
TWENTY-SIXTH LEGISLATURE, 2012**

ON THE FOLLOWING MEASURE:

S.B. NO. 2720, RELATING TO CONVERSIONS BY NONPROFIT CORPORATIONS.

BEFORE THE:

SENATE COMMITTEE ON JUDICIARY AND LABOR

DATE: Friday, February 17, 2012

TIME: 10:00 a.m.

LOCATION: State Capitol, Room 016

TESTIFIER(S): David M. Louie, Attorney General, or
Hugh R. Jones, Deputy Attorney General

Chair Hee and Members of the Committee:

The Department of the Attorney General strongly supports this bill.

The purpose of this bill is to amend the State's Nonprofit Corporation law, chapter 414D, Hawaii Revised Statutes (HRS), to repeal existing provisions that expressly allow charities that exist in corporate, rather than charitable trust form, to convert to other kinds of entities, including for-profit corporations that have shareholders.

Allowing nonprofit corporations, which do not issue stock and do not have shareholders, to convert to for-profit stock corporations is antithetical to the concept of assets being held for public, civic, religious, or educational purposes.

The existing provisions of the law are not consistent with the American Bar Association's Revised Model Nonprofit Corporations Act (1987), upon which chapter 414D, HRS, is based, and which does not allow for the conversion of the assets of charitable corporations to non-charitable purposes. Likewise, Hawaii's former nonprofit corporation law, chapter 415B, HRS, contained no similar provisions to the ones allowing conversions.

The existing conversion provisions are likewise inconsistent with the "nondistribution constraint" imposed on nonprofit corporations. For example, section 414D-19, HRS, provides, "no part of the income or profit of a corporation shall be distributed to its members, directors, or officers." Conversion to for-profit status would allow precisely that.

The existing provisions that permit conversions also allow charitable corporations to do an "end run" on existing provisions of chapter 414D, HRS, which require notice to and consent by the Attorney General for mergers, dissolutions, and the sale of substantially all of the assets

of such corporations. The conversion of charitable corporations to non-charitable entities would allow for the diversion of donor restricted gifts and endowments held by such corporations, in a manner inconsistent with section 517E-6, HRS. To the extent that a nonprofit corporation is exempt from federal tax under section 501(c)(3) of the Internal Revenue Code, such a conversion would not be permissible because such organizations must be organized and operated exclusively for charitable, religious, or educational purposes.

The existing provisions of the law would allow corporate charities to solicit funds for designated charitable purposes for which donors received tax deductible donations, and to convert those donations for use by or the benefit of the shareholders of a stock corporation or members of a limited liability company.¹ Similarly, it would allow charities holding endowments (a fund to be used for a charitable purpose the income from which is to be spent for that charitable purpose) to release the donor's restricted gift by converting to for-profit status. Section 517E-6, HRS, requires court permission to release restrictions placed by a donor on an endowment fund in excess of \$50,000.

In addition, the provisions sought to be repealed by this bill, to allow conversions of nonprofit charitable organizations are likewise inconsistent with provisions authorizing the Attorney General to review any acquisition of a nonprofit hospital in chapter 323D, HRS. A nonprofit hospital could arguably "convert" to a for-profit corporation without undergoing such review under the provisions sought to be repealed.

Finally, the duty of the Attorney General to protect assets given to charities or held for charitable purposes "is stated in the legal texts as an absolute duty and is recognized in almost all of the states either by statute or judicial decision." See Prefatory Note, Model Protection of Charitable Assets Act, National Conference of Commissioners on Uniform State Laws (2011). The existing provisions that allow conversions of charitable corporations seriously interfere with the Attorney General's ability to protect charitable assets.

¹ Such a practice would run afoul of section 467B-9(1), HRS, which contains the following prohibited practice for charities:

(1) No person, in the course of any solicitation, shall represent that funds collected will be used for a particular charitable purpose, or particular charitable purposes, if the funds solicited are not used for the represented purposes.

The Department of the Attorney General requests the Committee's favorable consideration of this bill.