

2006

## Any Proper Cause: The Commonwealth Court of Pennsylvania Erodes Shareholder Authority in Favor of Boards of Directors

Jeffrey V. Mansell

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### Recommended Citation

Jeffrey V. Mansell, *Any Proper Cause: The Commonwealth Court of Pennsylvania Erodes Shareholder Authority in Favor of Boards of Directors*, 44 Duq. L. Rev. 519 (2006).

Available at: <https://dsc.duq.edu/dlr/vol44/iss3/7>

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# Any Proper Cause: The Commonwealth Court of Pennsylvania Erodes Shareholder Authority in Favor of Boards of Directors

## I. INTRODUCTION

Legal scholarship in the realm of nonprofit organizations<sup>1</sup> is largely focused on the relationship between these organizations and the Internal Revenue Code.<sup>2</sup> Although achieving and maintaining tax-exempt status is an important concern, people who are closely involved in such organizations are also undoubtedly concerned with the day-to-day operations of these entities, and the rights of the individuals who occupy positions of authority.

On January 12, 2005, the Commonwealth Court of Pennsylvania issued an opinion and order that gives directors of Pennsylvania nonprofit organizations significant power to decide who will occupy those positions of authority.<sup>3</sup> By interpreting a Pennsylvania statute to that effect, the commonwealth court departed from the traditional understanding of corporate governance, and its decision could affect the powers of boards of directors in many for-profit corporations. In the world of business corporations, election and removal of directors is typically considered a function of the shareholders.<sup>4</sup> In a nonprofit organization, the members are equivalent to shareholders, and it is the members who would usually take action if the organization determined that a director should be removed.<sup>5</sup>

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1. There is a lack of uniformity as to the proper nomenclature for these groups. "Not-for-profit" seems more apt than "nonprofit," because it reflects the fact that the organization may realize an excess gain over expenditures without actually intending that result. Nonetheless, "nonprofit" is still commonly used, and it is hoped that the reader understands how much more cumbersome it would be to use "not-for-profit" repeatedly. Furthermore, "organization" leaves open the possibility that a group of people may operate in this arena without forming a corporation.

2. See, e.g., NICHOLAS P. CAFARDI & JACLYN A. CHERRY, *TAX EXEMPT ORGANIZATIONS* (2003); JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS* (1995); BRUCE R. HOPKINS, *THE LAW OF TAX-EXEMPT ORGANIZATIONS* (8th ed. 2003).

3. *Lutz v. Tanglwood Lakes Community Association, Inc.*, 866 A.2d 471 (Pa. Commw. Ct. 2005).

4. See, e.g., 18A AM. JUR. 2D *Corporations* § 1248 (2005); 43 C.J.S. *Industrial Co-operative Societies* § 28 (2005).

5. See REVISED MODEL NONPROFIT CORP. ACT § 8.08 (1987).

As nonprofits continue to flourish in communities throughout the United States, there will continue to be disagreements, sometimes heated, among the people responsible for operating them. It will become increasingly important, then, that states have clear and fair statutes governing these operations. At this point, Pennsylvania law lacks the clarity that could guide directors of these organizations through disputes, and the result of the commonwealth court's decision would not convince a dissenting voice that Pennsylvania law provides for fair treatment of directors. Furthermore, the case's holding might not be confined to nonprofit organizations, but might very well extend to for-profit business corporations. This comment analyzes the background and rationale that informs the current interpretation of Pennsylvania's statute on removal of a nonprofit's directors, and it will further discuss the effects that the commonwealth court's decision will have on the law in the area of corporate governance.

## II. THE HISTORY OF NONPROFIT ORGANIZATIONS AND THEIR DIRECTORS

### A. *Early Background*

Nonprofit organizations exist in the United States due in large part to the Statute of Charitable Uses, established in England in 1601.<sup>6</sup> The activities that are considered "charitable" are now defined, although not exclusively, by federal regulation, and the term includes "relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government."<sup>7</sup>

Homeowners associations, like charitable organizations, are now exempt from federal income taxes if certain requirements are met.<sup>8</sup> As such, these groups are part of what has been termed the

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6. Jaelyn A. Cherry, *Update: The Current State of Nonprofit Director Liability*, 37 DUQ. L. REV. 557, 558 (Summer 1999).

7. 26 C.F.R. § 1.501(c)(3)-1(d)(2).

8. 26 U.S.C. § 501(c)(4). Although that section deals explicitly with "civic leagues or organizations," that phrase has been construed to include homeowners associations. Since this comment is not primarily concerned with the issue of tax exemption, it will suffice to note that a homeowners association may be exempt from taxation even though it does not necessarily appear to provide a benefit to the community that would customarily be viewed as "charitable." See, e.g., *Rancho Santa Fe Association v. United States*, 589 F. Supp. 54 (S.D. Cal. 1954) (holding that a homeowners association "perform[ed] the functions of a governmental entity and br[ought] about civic betterments and social improvements that

nonprofit sector. Since migrating to America, this sector has become similar in many ways to the modern business corporation, including the structure and management of the organizations.<sup>9</sup>

### B. *Statutory Authority Governing Nonprofits*

In most states, nonprofits are governed by statutes and codes created specifically for the nonprofit sector and distinct from the for-profit business corporation codes.<sup>10</sup> Other states have no special legislation governing nonprofits, but follow the for-profit law and apply it by analogy to nonprofits.<sup>11</sup> In either case, the responsibilities of boards of directors (or trustees, as they are often known in the realm of nonprofits) are similar for both the for-profit and nonprofit organization.<sup>12</sup> Nonprofits can provide for the composition, election, and removal of directors in their articles of incorporation (or equivalent document) or in their bylaws. Thus, many statutory provisions govern only where those other sources of authority are silent.

### C. *Nonprofit Directors are Generally Elected and Removed by Members or Shareholders*

According to the Revised Model Nonprofit Corporation Act, directors may be removed by the members or by any sub-group of members that elected the director.<sup>13</sup> Directors may be removed by other directors only when they are elected by those directors, and even then they may only be removed for cause.<sup>14</sup> The organization's articles or bylaws, of course, can provide for different procedures and can otherwise limit the application of the Act.<sup>15</sup> If any

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would be sorely missed by the . . . community should they be lost or curtailed," and therefore was a "tax exempt organization devoted to the general welfare"). *But see Indian Lake Property Owners Association, Inc. v. Director of Revenue*, 813 S.W.2d 305, 309 (Mo. 1991) (holding that a homeowners association's activities were designed to protect wholly private interests, and therefore the organization was not exempt from taxation).

9. Cherry, *supra* note 6, at 559-60.

10. MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS* 151-52 (2004).

11. *Id.* at 152. Kansas and Delaware are the only states that do not have some kind of statutory scheme governing nonprofits exclusively. *Id.*

12. *See, e.g.*, 1 *NONPROFIT ENTERPRISES: Corps., Trusts, and Assoc.* § 3:16; *REV. MODEL NONPROFIT CORP. ACT* § 8.01 *et seq.*

13. *REV. MODEL NONPROFIT CORP. ACT* § 8.08 (2003).

14. *Id.*

15. *Id.*

of those procedures are not used, a director can be removed for cause in a judicial proceeding.<sup>16</sup>

The treatment of directors of nonprofits differs somewhat from that of for-profit directors. The Model Business Corporation Act provides for director removal only by shareholder action or through judicial proceeding.<sup>17</sup> As with nonprofits, a for-profit corporation could establish its own procedures, but evidently it is considered more normal to allow the shareholders to determine the makeup of the board. If the directors are not satisfied with that procedure because of a director's behavior, judicial intervention is still an option.

Pennsylvania provides for removal of directors in a business corporation in 15 Pa. Cons. Stat. § 1726, and provides for the removal of directors of a nonprofit in 15 Pa. Cons. Stat. § 5726. The two provisions are almost identical, both containing the following provision in subsection (b):

(b) Removal by the board.—Unless otherwise provided in a bylaw adopted by the shareholders, the board of directors may declare vacant the office of a director who has been judicially declared of unsound mind or who has been convicted of an offense punishable by imprisonment for a term of more than one year or for any other proper cause which the bylaws may specify or if, within 60 days or such other time as the bylaws may specify after notice of his selection, he does not accept the office either in writing or by attending a meeting of the board of directors and fulfill such other requirements of qualification as the bylaws may specify.<sup>18</sup>

This provision departs from the model acts for both kinds of corporations by allowing directors to remove each other under limited circumstances. As in the model acts, the Pennsylvania statutes give deference to the corporation's articles and bylaws, but if those authorities are silent, the board may remove a director for one of three reasons: (1) a judicial declaration that he or she is of unsound mind, (2) a conviction for an offense of a certain gravity, or (3) "proper cause," with the last reason apparently dependent upon the bylaws. It is against this backdrop that the common-

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16. *Id.* at § 8.10.

17. MODEL BUSINESS CORP. ACT §§ 8.08, 8.09 (2005).

18. 15 PA. CONS. STAT. ANN. §§ 1726(b), 5726(b) (1995).

wealth court decided a recent case involving a nonprofit homeowners association.

### III. THE *LUTZ* DECISION

#### A. *Background*

Keith Lutz was first elected to the board of directors (“Board”) of the Tanglwood Lakes Community Association, Inc. by its members in 1992, and he served as treasurer from 1993 until May 2003.<sup>19</sup> In April 2003, the Board undertook a financial audit to “investigate irregularities in record-keeping and in the dispensation of compensatory time.”<sup>20</sup> On July 17, 2003, the Board heard a presentation from its legal committee. The committee had concluded that Lutz had allowed employees to use their compensatory time to pay association dues, and further concluded that Lutz treated compensatory time in an “illegal manner.”<sup>21</sup>

As a result of this presentation, the Board voted to remove Lutz, as well as other employees.<sup>22</sup> Had he not been removed, Lutz’s term as director would have expired on December 31, 2003.<sup>23</sup> On August 15, 2003, Lutz petitioned the Court of Common Pleas to review the Board’s actions. The petition was dismissed as moot in an order dated January 5, 2004 because, since Lutz’s term would have expired at the end of 2003, he could not be reinstated even if the Board acted improperly.<sup>24</sup> Without any meaningful relief, there was no longer a controversy.<sup>25</sup> The court further granted the Board’s motion for summary judgment in the same order because it read 15 Pa. Cons. Stat. § 5726(b) to confer authority upon the Board to remove a director for cause, and the accusations against Lutz appeared to warrant removal.<sup>26</sup>

#### B. *The Majority Opinion*

The Commonwealth Court of Pennsylvania, in a majority opinion by Judge Leavitt, began its analysis by considering whether

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19. *Lutz v. Tanglwood Lakes Community Association, Inc.*, 866 A.2d 471, 472 (Pa. Commw. Ct. 2005).

20. *Lutz*, 866 A.2d at 472.

21. *Id.*

22. *Id.* at 472-73.

23. *Id.* at 473.

24. *Id.*

25. *Lutz*, 866 A.2d at 473.

26. *Id.*

Lutz's case was moot.<sup>27</sup> The court stated the rule that, even though an actual case or controversy might not exist, a court will hear a case when "the conduct complained of is capable of repetition yet likely to evade judicial review, when the case involves issues of great public importance or when one party will suffer a detriment in the absence of a court decision."<sup>28</sup>

The commonwealth court concluded that the issues presented in Lutz's case were of great importance to the operations of Pennsylvania nonprofits.<sup>29</sup> Furthermore, because directors' terms are generally short, the actions of the Board could easily be repeated without encountering judicial review.<sup>30</sup> As a result, the first two exceptions to the mootness doctrine applied, and the court heard the merits of Lutz's appeal.

Lutz's case, the court observed, turned on the meaning of the Pennsylvania statute governing the removal of a nonprofit's director by other directors.<sup>31</sup> It went on to conclude that, because Lutz was neither convicted of any crime nor declared to be of unsound mind, the Board's action was appropriate only if he was removed "for any other proper cause which the bylaws may specify."<sup>32</sup> Each party to the appeal offered its own interpretation of the meaning of this clause. Lutz maintained that the Board could only make use of this clause if Tanglwood's bylaws defined "proper cause."<sup>33</sup> Tanglwood countered that the Board could remove a director for any proper cause that the Board determined at the time of removal, regardless of whether the bylaws were silent on the definition of "proper cause."<sup>34</sup>

The court agreed with Tanglwood.<sup>35</sup> Its reasoning was based on the premise that "[w]ords and phrases [in statutes] shall be construed according to rules of grammar and according to their common and approved usage."<sup>36</sup> The court further relied on Strunk and White's "Elements"<sup>37</sup> to parse the phrase "any other proper

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27. *Id.*

28. *Id.* (citing *Horsehead Resource Development Co., Inc. v. Pennsylvania Department of Environmental Protection*, 780 A.2d 856 (Pa. Commw. Ct. 2001)).

29. *Lutz*, 866 A.2d at 473-74.

30. *Id.* at 474.

31. *Id.*

32. *Id.* (emphasis removed) (quoting 15 PA. CONS. STAT. § 5726(b)).

33. *Id.* at 475.

34. *Lutz*, 866 A.2d at 474-75.

35. *Id.* at 475.

36. *Id.* at 474 (quoting 1 PA. CONST. STAT. § 1903(a)).

37. WILLIAM STRUNK, JR., & E.B. WHITE, *THE ELEMENTS OF STYLE* (4th ed. 2000).

cause which the bylaws may specify.”<sup>38</sup> According to Strunk and White, the word “which” is a “nondefining, nonrestrictive pronoun.”<sup>39</sup> Therefore, the phrase “which the bylaws may specify” does not define “proper cause,” but rather modifies the term to permit the organization to define it in the bylaws.<sup>40</sup> The majority found further support for this interpretation by the use of the word “may” in the statute.<sup>41</sup> The court could have elaborated more on that point, but apparently the permissive character of that word negated any possibility that the statute *required* a definition in the bylaws.

As a result of the majority’s interpretation, the Board was authorized to remove a director “for proper cause, irrespective of whether the bylaws specify what constitutes ‘proper cause’” and the Board acted within its authority.<sup>42</sup> It therefore affirmed the trial court’s order insofar as it granted Tanglwood’s motion for summary judgment.<sup>43</sup>

### C. *The Dissenting Opinion*

Judge Smith-Ribner authored a dissenting opinion, in which he argued in favor of adopting Lutz’s interpretation of Section 5726(b).<sup>44</sup> He began by highlighting that the dispute largely turned on the statute’s use of the word “which” rather than “that.”<sup>45</sup> Indeed, if the statute had said “any other proper cause that the bylaws may specify,” most people would agree that, despite the presence of the word “may,” the only proper causes that would permit the Board to remove a director would be those set forth in the bylaws.

Instead of ending his inquiry at the Strunk & White manual, Judge Smith-Ribner cited Fowler’s grammar guide for elucidation of the which-versus-that controversy.<sup>46</sup> According to the Fowler guide, ideal English usage would dictate that “which” would be the

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38. *Lutz*, 866 A.2d at 475.

39. *Id.* (citing STRUNK & WHITE at 59).

40. *Id.*

41. *Id.*

42. *Id.*

43. *Lutz*, 866 A.2d at 475-76.

44. *Id.* at 476-79 (Smith-Ribner, J., dissenting).

45. *Id.* at 476-77.

46. *Id.* at 477 (citing THE NEW FOWLER’S MODERN ENGLISH USAGE (R.W. Burchfield ed. 1996)).



nondefining pronoun, and “that” the defining pronoun.<sup>47</sup> However, the Fowler guide includes the conclusion that “it would be idle to pretend that [this distinction] is the practice either of most or of the best writers.”<sup>48</sup> It is this simple observation of real-world practice that gives common-sense appeal to Judge Smith-Ribner’s dissent.

The dissent went on to opine that the word choice should not decide the meaning of the phrase in the statute – the punctuation should.<sup>49</sup> Judge Smith-Ribner rejected the majority’s reading of the clause as nonrestrictive for the simple fact that the clause was not introduced by a comma.<sup>50</sup> If there had been a comma, e.g. “for any other proper cause, which the bylaws may specify,” then he presumably would agree with the majority that the statute merely gave the organization the option of defining “proper cause” in its bylaws.<sup>51</sup> However, the absence of a comma communicates to the reader that the clause defines the noun preceding it: “any purpose” is limited to those purposes set forth in the bylaws.<sup>52</sup> For this point, Judge Smith-Ribner relied on Strunk & White, while observing that Fowler offers the same explanation.<sup>53</sup>

Judge Smith-Ribner further rejected the majority’s reliance on the word “may,” because that word could denote the possibility of the bylaws defining “proper cause,” rather than denoting permission to do so.<sup>54</sup> He then pointed out that the context of the nonprofit corporation statute already provided that an organization was allowed to set forth provisions for the removal of a director if it wanted, leaving no reason for this subsection to grant that permission.<sup>55</sup> Finally, the dissent argued that the context also made it clear that the members of a nonprofit have the primary authority to remove a director.<sup>56</sup> Therefore, the court should hesitate to

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47. *Id.* (citing FOWLER at 774). Fowler appears to draw the same distinction with “defining” and “nondefining” that Strunk & White draw with “restrictive” and “nonrestrictive.”

48. *Lutz*, 866 A.2d at 477 (Smith-Ribner, J., dissenting) (citing FOWLER at 774).

49. *Id.*

50. *Id.* at 477.

51. *Id.*

52. *Id.*

53. *Lutz*, 866 A.2d at 477 (Smith-Ribner, J., dissenting) (citing STRUNK & WHITE at 59; FOWLER at 672).

54. *Id.* at 477-78 (citing WEBSTER’S COLLEGIATE DICTIONARY 718-19 (10th ed. 1997); BLACK’S LAW DICTIONARY 1000 (8th ed. 2004)).

55. *Id.* at 478.

56. *Id.*

interpret the statute in such a way as to shift that power to the Board.<sup>57</sup>

For those reasons, Judge Smith-Ribner stated that he would hold that the Board did not have the authority to remove Lutz for any cause unless it was provided for in Tanglwood's bylaws.<sup>58</sup> Since there were no such provisions in the bylaws, Tanglwood's motion for summary judgment should have been denied.<sup>59</sup>

#### IV. WHY IT IS DANGEROUS TO RELY ON ONLY ONE GRAMMAR HANDBOOK

It is not every appellate court opinion that relies heavily on esoteric distinctions between restrictive and nonrestrictive clauses. Furthermore, only rarely do Strunk, White, and Fowler find their way into court opinions.<sup>60</sup> In Pennsylvania specifically, this author was only able to find one other court opinion citing the Fowler guide.<sup>61</sup>

The court in *Lutz* demonstrated why it is best to avoid relying on these sources: the majority allowed the hypertechnical to defeat the context in which the statute was operating. In the world of corporations, either for-profit or nonprofit, there are very few instances where a board of directors or trustees is allowed to usurp the role of its shareholders (or members, in a nonprofit setting) and remove one of its own. Now, in Pennsylvania, any corporation that does not provide otherwise in its bylaws is allowed, through its board, to remove a director for any reason, as long as it appears afterward to be "proper."

##### A. *A Realistic Treatment of Grammar*

Judge Smith-Ribner's dissent presents a common-sense, realistic understanding of how "which" and "that" operate in modern use of the English language. Indeed, many readers of this law review might be surprised to learn that they were supposed to be

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57. *Id.*

58. *Lutz*, 866 A.2d at 478-79 (Smith-Ribner, J., dissenting).

59. *Id.*

60. A Westlaw search of all federal cases citing STRUNK & WHITE shows forty-nine citations to the book as authority for interpreting a statute or other writing, where the interpretation might affect the outcome of a case. There are thirty-one such citations to FOWLER in the federal courts.

61. See *Girard Trust Bank v. Life Ins. Co. of North America*, 364 A.2d 495, 500 (Pa. Super. Ct. 1976) (Spaeth, J., dissenting) (finding an ambiguous use of the word "may" in an insurance policy).

using these two words with such precision. As Fowler's guide stated in the entry relied on by the dissent, through the evolution that the English language allows, "that" and "which" have become interchangeable in many instances.

The majority's first error was in ending its inquiry with White & Strunk's *The Elements of Style*. Many critics (this author included) consider that guide to be not only prescriptive, but prescriptive to an earlier era of English usage.<sup>62</sup> The Fowler guide, on the other hand, is regarded as a reflection of the actual usage of the language.<sup>63</sup> Judge Smith-Ribner's elucidation of the dispute illustrates the validity of those perspectives.

Additionally, the majority could have taken guidance from the United States Supreme Court. The High Court has provided at least one lesson in delving too deeply into grammarians' opinions when interpreting the law:

many leading grammarians, while sometimes noting that commas at the end of series can avoid ambiguity, concede that use of such commas is discretionary. See, e.g., B. EVANS & C. EVANS, A DICTIONARY OF CONTEMPORARY AMERICAN USAGE 103 (1957); M. NICHOLSON, A DICTIONARY OF AMERICAN-ENGLISH USAGE 94 (1957); R. COPPERUD, A DICTIONARY OF USAGE AND STYLE 94-95 (1964); cf. W. STRUNK & E. WHITE, THE ELEMENTS OF STYLE 1-2 (1959). ***When grammarians are divided, and surely where they are cheerfully tolerant,*** we will not attach significance to an omitted comma. It is enough to say that the statute's punctuation is fully consistent with the respondent's interpretation, and that in

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62. See, e.g., Richard H. Minear, *E. B. White takes his leave, or does he? The Elements of Style, six editions (1918-2000)*, 45 Massachusetts Review 51-71 (Spring 2004) (describing a history of the collaboration between White and Strunk, as well as praise and criticism for the book in its many editions).

63. See, e.g., L. C. Mugglestone, *The New Fowler's Modern English Usage*, 44 Notes and Queries 437 (Dec. 1997) (examining how subsequent editions of FOWLER have traced a history of the language through the twentieth century: "Arbitrary assumptions about 'correctness' are regularly rejected in favour of more complex, and pluralist, accounts of consensus norms as MEU3 [the third edition of FOWLER] comes to manifest decidedly descriptive traits."). Furthermore, Jane Rodes, my first-year legal research and writing instructor, specifically recommended FOWLER as an aide to students in their assignments, and a more reliable source of recommendation you will not find.

this case grammatical expertise will not help to clarify the statute's meaning.<sup>64</sup>

Had the commonwealth court looked to this opinion for guidance, it might have gone beyond Strunk & White to see that grammarians are indeed divided on the use of "which," and at least one grammarian is "cheerfully" tolerant of its use in place of "that." The court then could have gone on to give the statute an interpretation that comported better with ordinary usage, and perhaps also the overriding goals of the statutory scheme in question.

That interpretation might have run like this: the board of directors of a nonprofit may remove a director when one of three conditions is met: (1) a director may be removed if a court declares him or her to be of unsound mind, (2) if he or she is convicted of a crime, the conviction of which carries a possible sentence of one year or more, or (3) if the board of directors has proper cause to remove a director, provided that the organization's bylaws define "proper cause." Under the third option, the organization is free to adopt whatever definition of "proper cause" it desires.<sup>65</sup>

### B. *Conflicting Public Policies*

Before finishing its discussion of the role of grammar in the relevant statute, the majority in *Lutz* declared that "sound public policy" favored its interpretation over that of Judge Smith-Ribner's dissent.<sup>66</sup> The majority, however, did not articulate what that policy was. Instead, it stated in a conclusory manner that "the legislature's default provision is that a Board may remove a director for cause."<sup>67</sup>

There is no explanation of why public policy would favor such a default provision. The history and current state of corporate law

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64. *United States v. Bass*, 404 U.S. 336, 340 n.6 (1971) (emphasis added).

65. The majority opinion also relied, in a footnote, on the fact that 15 PA. CONS. STAT. § 5726(b) is introduced with the phrase "unless otherwise provided in a bylaw adopted by the members." *Lutz*, 866 A.2d at 475 n.9. The majority reasoned that the phrase "which the bylaws may specify" could not be reasonably read to limit the board's authority when the opening phrase allows the organization to alter any affect of the statute through its bylaws. *Id.* This explanation is unsatisfying – the opening permissive language allows the organization's bylaws to waive the affect of *all* of subsection (b), whereas the later phrase creates a limit on the default powers of the board by requiring some specificity in the bylaws before the board may remove a director for cause without submitting the issue to the organization's members.

66. *Lutz*, 866 A.2d at 475 n.9.

67. *Id.*

indicates that shareholders have that kind of authority, and the members of a nonprofit are most closely analogous to shareholders. Instead of being "sound public policy," the majority's interpretation allows a nonprofit board to remove one of its own directors between elections without allowing the primary source of control, *i.e.* the members, to take part in the decision.

The dissenting opinion does not use the term "public policy," but does indicate what was likely the true public policy behind the statute. Judge Smith-Ribner correctly observed that "the Nonprofit Corporation Law of 1988 [assigns] the primary responsibility for the selection and removal of directors to the corporation's membership."<sup>68</sup> Therefore, the court's decision leaves boards free to decide on their own what proper cause for removal will be.<sup>69</sup> That, in turn, creates the risk that a director will be removed for a cause that the average person, and actual shareholders or members, may not deem "proper," merely because the rest of the board would like to remove him or her.<sup>70</sup> A director in such a position might well be able to petition a court for reinstatement, but by then he would be relying on a judge to find some pretext on the part of the board, which a judge would very likely be anxious to avoid.

### C. *Broader Effects of the Lutz Decision*

Recall that for-profit corporations are governed by the same statutory language as nonprofits, at least with regard to removal of a director by the rest of the board. Because the language at issue in *Lutz* governs both for-profit and nonprofit corporations, the case's holding could easily be applied to disputes arising out of a for-profit board's removal of a director.

The majority in *Lutz* found (or created) a public policy in favor of allowing nonprofit directors to be removed from their positions by the very directors with whom they served. This policy arose out of the statutory language embodied in 15 Pa. Cons. Stat. § 5726 (b). The for-profit version of this language is found at 15 Pa. Cons. Stat. § 1726 (b). If the language giving rise to the policy is the same, then the commonwealth court implicitly stated that for-profit corporations are governed by the same policy. Furthermore,

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68. *Id.* at 478 (Smith-Ribner, J., dissenting) (citing 15 PA. CONS. STAT. § 5504).

69. *Id.*

70. *Id.*

the grammatical reading of the statute would have to be the same, since the word choice and punctuation is identical.<sup>71</sup>

As a result, Pennsylvania now allows directors of a for-profit corporation to be removed by fellow directors for any cause the majority deems proper, as long as the bylaws do not restrict that authority. Experienced corporate attorneys have probably already avoided this result with the corporations they represent – bylaws for large corporations probably leave little to the uncertainties of developing law. However, small businesses still often choose a corporate form, and it is by no means certain that their bylaws contain the language necessary to avoid the effects of the statutes governing director removal.

#### *D. Hope Springs Eternal*

When a court interprets a statute poorly, there are essentially two ways to undo that action: amending the statute and reversing the order of the court in question (assuming it is not the court of last resort). In this case, it is unlikely that the Pennsylvania General Assembly will make it a priority to amend this statute.<sup>72</sup> But, the Pennsylvania Supreme Court granted Lutz's Petition for Allowance of Appeal on July 19, 2005.<sup>73</sup> In that appeal, the Court will have the opportunity to take a fresh look at the extent to which 15 Pa. Cons. Stat. § 5726 limits the authority of a board of directors to remove one of its directors.

When the Pennsylvania Supreme Court undertakes its review, it will have the benefit of two strong opinions from the commonwealth court, and perhaps it will have extensive briefing by the parties concerning statutory interpretation. With those resources and the court's own ability to investigate both English usage and the relevant public policies, perhaps it can reach a reasonable conclusion and foreclose the possibility that boards of directors, of for-

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71. This comment intentionally ignores the disturbing possibility that another court could conclude that the same syntax and punctuation could give rise to a conflicting interpretation merely because a statute applies to a different kind of entity. Should a court pursue this route, it might arrive at the correct outcome for the dispute before it, but it would do nothing to aid Pennsylvania corporate jurisprudence.

72. At the time of this writing, the Pennsylvania state legislature is faced with low levels of approval as a result of controversial pay raise legislation, the repeal of which was the subject of further controversy, as well as controversial gambling and lobbying legislation. With such issues in the public eye, legislators are unlikely to effectuate a change in the treatment of corporate directors.

73. *Lutz v. Tanglwood Lakes Community Association, Inc.*, 880 A.2d 502 (Pa. 2005).

profits and nonprofits alike, will be able to usurp the authority of shareholders and members to take control of an organization.

## V. CONCLUSION

The history of for-profit and nonprofit corporations, the statutes governing corporations in Pennsylvania, and the policies underlying those statutes all support the conclusion that boards of directors should not have the authority to determine their own composition unless their organization's bylaws specifically allow for that authority. The decision of the Commonwealth Court of Pennsylvania in *Lutz v. Tanglwood Lakes Community Association, Inc.* reached a different conclusion, possibly because the court's majority simply thought that the Board made the right decision in removing Lutz. Unfortunately, notwithstanding the outcome of the case as it pertains to the parties, the court's holding might create problems of corporate governance that could affect not only nonprofits (which would be unfortunate enough) but business corporations as well.

The Supreme Court of Pennsylvania will soon hear Lutz's appeal. When it does, it should take the opportunity to fix the commonwealth court's mistake and allow Pennsylvania law to treat directors of corporations and nonprofit organizations appropriately.

*Jeffrey V. Mansell*