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Ararat Home of Los Angeles, Inc.  
15105 Mission Hills Road  
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To the Members of the Ararat Home of Los Angeles:

Our law firm was retained by the Board of Trustees (the "Board") of the Ararat Home of Los Angeles, Inc. (the "Ararat Home") to evaluate and assist with the proposed plan of eliminating statutory membership. The Board has voted unanimously to approve the proposed amendment to the bylaws and articles of incorporation previously provided to you, and such amendments would have the effect of removing statutory membership.

In the past, we have assisted multiple other nonprofit organizations with the same transition, and each time the members have supported such elimination. In anticipation of the annual membership meeting to take place on March 29, 2020, the Board has requested that we provide our rationale to the members for recommending elimination of statutory memberships in Ararat Home. While we intend to discuss this issue in-depth at the March 29 meeting and answer any questions that you may ask, we hope this letter will provide members with helpful information to enhance discussion at the meeting.

**1. There is no intent, nor has there ever been an intent, to subject the Ararat Home to any transaction resembling a "corporate takeover," and such a transaction, if ever attempted, would be subject to stringent oversight by the California Attorney General's Office.**

As an initial point on the general issue of statutory membership, we think it is important to understand what the Board can and cannot do after the removal of statutory membership. The Board has no intent, and has never had the intent, of subjecting the Ararat Home to any liquidation, merger, sale or similar transaction (notwithstanding some members' characterization of the proposed elimination of statutory membership rights as being a "corporate takeover"). Nevertheless, any proposal by the Board to involve the Ararat Home or its assets in a merger, liquidation, sale or similar transaction would require notice to and approval from the California

Attorney General. Because the Ararat Home is considered a “health facility” under applicable law, the Attorney General's review of any proposed major transaction will be comprehensive, stringent, and include an assessment of many factors, such as the following:

- Whether the terms and conditions of the agreement or transaction are fair and reasonable to the nonprofit corporation;
- Whether the agreement or transaction will result in financial benefit to any private person or entity;
- Whether the agreement or transaction is at fair market value;
- Whether the market value has been manipulated by the actions of the parties in a manner that causes the value of the assets to decrease;
- Whether the use of the proceeds is consistent with the charitable trust on which the assets are held by the health facility, or by the affiliated nonprofit health system;
- Whether the agreement or transaction involves or constitutes any breach of trust;
- Whether the Attorney General was provided sufficient information and data by the nonprofit corporation to adequately evaluate the transaction, or the effects thereof on the public;
- Whether the agreement or transaction may create a significant effect on the availability or accessibility of health care services to the affected community;
- Whether the agreement or transaction may create a significant effect on the availability or accessibility of cultural interests provided by the health facility in the affected community; and
- Whether the agreement or transaction is in the public interest.

In addition, the Attorney General's office would publish a notice to the public of such transaction and hold one or more public meetings related to the transaction to obtain public input. The Attorney General's office would also review confidential comments from the public.

In short, any future Board that attempted to engage in such transaction would likely be prevented from doing so if the transaction conflicts with the best interests of the Ararat Home, its residents, or the public at large.

Again, the Board has no plan or intent to pursue, propose or engage in any such transaction, but the above requirements add significant safeguards to protect the Ararat Home in the event any future Board did consider such a transaction.

The Board intends to maintain a policy of transparency and make available annual reports and financial information to friends and supporters of the Home. In addition, the Board is mandated under California law to provide financial statements and information to the California Attorney General, which is available to the public at the following website: <https://oag.ca.gov/charities>.

## **2. What are Statutory Membership Rights?**

Statutory membership rights are primarily the rights of members to vote on certain important decisions with respect to the Ararat Home. Among the most significant of these rights are the rights to elect trustees of the Board and vote on amendments to the Ararat Home's bylaws and articles of incorporation.

## **3. The Argument for Keeping Statutory Membership Rights**

A commonly offered reason in support of statutory membership is that it allows members to hold the Board accountable for its actions. As the argument goes, if a Board trustee acts in a manner contrary to the best interests of the organization or otherwise in an unsatisfactory manner, then the members can elect a different trustee. This letter explains that, while statutory membership may be appropriate for some nonprofit organizations, it is not beneficial for most nonprofit organizations, including the Ararat Home, and even potentially harmful.

## **4. The Argument for Removing Statutory Membership Rights**

*Inactive members do not hold the Board accountable.*

There is a common expression that a successful democracy requires an informed and politically active citizenry. The same idea applies here. Members cannot exercise effective accountability of the Board if they do not have the necessary information to make informed decisions. As with other nonprofits we have counseled, the overwhelming majority of members do not participate in Ararat Home's affairs, yet these same inactive members are tasked with the most essential oversight decisions including, most importantly, election of the Board trustees. Despite the importance of electing the trustees, the vast majority of members do not attend the annual member meetings at which the elections are held. Because members do not take an active role with the Ararat Home, they have little or no current knowledge about Ararat Home's operations and affairs. As a result, inactive members must rely on the recommendation of the Board or other parties when deciding who they will elect to fill open trustee seats.

If relying on the recommendation of the Board, members may very well be electing the right people, but in that case the members are doing little more than "rubber stamping" the Board's slate of candidates. If relying on the recommendation of other persons, the inactive members are susceptible to manipulation and misinformation because they do not have the independent knowledge to assess the recommendation. Members may instead simply choose to vote for friends or people they know outside of the Ararat Home, which essentially turns the election into a popularity contest. In any of those scenarios, members may be making their decisions based on the wrong reasons, or based on information they are unable to independently verify. And such circumstances do not lend to effective accountability of the Board.

It should be understood that inactive members are not doing anything wrong. Rather, this problem of inactive membership is inevitable because the function and purpose of the Ararat Home simply do not necessitate consistent member involvement, unlike a church or other nonprofit organization where members gather, for example, on a weekly basis.

*With statutory membership rights, individual members can consolidate power through proxies.*

Removing statutory membership will ensure that individual members are not able to consolidate power for corrupt or otherwise wrong reasons. A member can give a voting proxy to another member, which allows the latter member to vote on behalf of the former member under the current governing documents. A member that obtains proxies from as few as twenty-five (25) members would have the power to elect an entirely new Board composed of persons of his or her personal preference. Such actions could likely have a devastating impact on the sustainability and future of the Ararat Home. To be clear, there is nothing wrong with informed members disagreeing in good faith with the actions of the Board and, based on that disagreement, electing new trustees. The danger arises when inactive members are manipulated into giving proxies to one member based on misleading or false information, and that consolidated power is used by one person to control the Board.

*Board trustees should have ultimate decision-making power because they are fiduciaries of the Ararat Home and remain involved in its oversight and affairs.*

Removing statutory membership means that the Board will have ultimate oversight responsibilities. This is beneficial for several reasons. First, all trustees must vote and by law cannot use proxies to cast additional trustee votes, nor otherwise delegate their individual duties as trustees, and a majority vote is required for the Board to take any action. This eliminates the risk that one person or one Board trustee will be able to control the Board. Moreover, because Board trustees are involved in the oversight of the Ararat Home on a consistent basis, they have independent, current knowledge upon which to base their decisions. Second, under California law, the trustees are deemed to be fiduciaries obligated to act in the best interests of the Ararat Home, placing the interests of the Ararat Home above their personal interests. Each trustee owes a duty of care and a duty of loyalty to the Ararat Home. Members do not have these duties. Trustees face civil liability and potential action by the California Attorney General for violating these fiduciary responsibilities. It makes sense that ultimate decision-making authority should be held by the persons involved in the affairs of the Ararat Home on a consistent basis and bound under California law to act in the Home's best interests.

*Statutory membership creates a cost and administrative burden for the Ararat Home.*

Every year the Ararat Home spends a significant amount of money and time on membership-related expenses. The money and time saved by eliminating statutory

membership rights could be invested in other aspects of Ararat's operations more central to Ararat's primary purpose – serving its residents.

Note that while nonprofit organizations formed in decades past may have chosen to allow statutory membership, virtually all newly formed nonprofits do not allow for statutory membership, for all of the reasons stated above. The risks associated with inactive membership, proxy voting and drastic changes in board composition are some of the primary reasons why most practitioners now favor elimination of statutory membership.

Given the legally-mandated responsibilities of trustees and the nonprofit laws applicable to the Ararat Home, membership should not fear a "money grab" or an attempt by the trustees to gain control of the Ararat Home for their personal gain, or an attempt by the trustees to subject the Ararat Home to any "corporate takeover" or similar transaction, as has been asserted and publicized in recent letter circulations and articles.

We hope to see all of you at the March 29, 2020 meeting to discuss this matter. At that time, we will do our best to answer any questions that you have.

DOWLING AARON INCORPORATED



Richard M. Aaron