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COURT UPHOLDS DAMAGE AWARD AGAINST UNIVERSITY OF IOWA

The Iowa Supreme Court recently upheld an unprecedented award of damages against the University of Iowa and one of its top officials in favor of the former local chapter of Phi Delta Theta.¹ The ruling brings to an end years of litigation over the use of an illegal tape-recording in a campus disciplinary proceeding and abuse of power by a University official.

The Illegal Recording and the Fraternity's Suspension

As previously reported in the March 2007 issue of *Fraternal Law*, in fall 2001, a former Phi Delta Theta pledge approached University of Iowa Vice President Phillip Jones and alleged that the chapter was hazing and violating alcohol policies. His evidence consisted of a voice-activated recording device he had secretly planted in the basement of the fraternity house. The fraternity admitted the alcohol violation, but denied that any hazing had occurred and denied that the recording was authentic. Vice President Jones offered a one-year suspension of the fraternity's right to recognition, conditioned on the fraternity giving up its right to a formal hearing. When the fraternity refused to waive the hearing, Vice President Jones revoked the fraternity's recognition indefinitely.

Settlement discussions between the University and Phi Delta Theta alumni failed because Vice President Jones insisted that Phi Delta Theta admit to the hazing charge as part of any resolution. A campus administrative hearing was finally held in August 2003. The illicit recording was the sole evidence against the fraternity, and despite no proof of authenticity, it was admitted over the fraternity's objections. Based solely on the recording, the hearing officer found Phi Delta Theta guilty of hazing and continued the indefinite suspension of the fraternity's recognition.

The fraternity appealed the decision through the University's administrative system. Early in that process, the fraternity's attorneys pointed out that Iowa law prohibits use of intercepted communications in any legal or administrative proceeding. Iowa Code §808B makes use of such a recording a Class D felony, and authorizes liquidated damages of \$100 per day, as well as punitive damages and attorneys' fees, against anyone who uses such a recording. In November 2003, on the advice of the University's counsel, Vice President Jones dismissed the hazing charge because the recording had been used illegally. However, Jones con-

tinued the indefinite suspension of recognition, now based solely on the admitted alcohol violation. The suspension continued until July 29, 2004 when University President David Skorton ended it.

The Suspension Leads to Litigation

Phi Delta Theta's recognition was suspended for 983 days. During that time the fraternity's membership had declined by more than 50% and the chapter and its alumni house corporation had lost tens of thousands of dollars in dues and rental income. The chapter and its alumni also incurred substantial attorneys' fees while trying to regain recognized status.

On February 4, 2005, the chapter filed suit against the University and Vice President Jones in Iowa District Court. After hearing testimony, on January 24, 2007 the trial court ruled in favor of the fraternity. The trial court's 17-page ruling found that the University and Jones "used" the illegal recording against the chapter, in violation of Iowa law, by improperly suspending its recognition. The court also found that even after the University dismissed the hazing charge on the advice of its attorneys, Jones continued to use the recording against the fraternity by imposing disproportionately harsh sanctions under the "pretext" of the admitted alcohol violation.

The trial court ordered the University and Vice President Jones to pay damages of \$98,300 to the chapter (983 days at \$100 per day). The court also ordered the University and Jones to pay the chapter \$24,444.18 for attor-

IN MEMORIAM

Barbara Schwartz Bromberg, the leading national expert on taxation issues for Greek organizations, died on January 30, 2009, while attending the NIC Foundation Institute for Greek Advancement in Cabo San Lucas, Mexico, where she was a scheduled presenter. Barbara, a close friend of the late Robert Manley, *Fraternal Law's* founder, responded to Bob's invitation to contribute to *Fraternal Law*. Over the years, she authored 67 articles in *Fraternal Law*, presented at all 12 *Fraternal Law* Conferences, and advised numerous fraternities and sororities on taxation issues. Barbara will be missed by the entire Greek community.

neys' fees it incurred in the administrative proceedings and \$37,216.25 for fees it incurred in the court litigation. The court also ordered Jones, personally, to pay \$5,000 in punitive damages to the chapter based on his conduct. The total judgment against the University and Jones was more than \$164,000 (plus pre-judgment interest).

The University and Jones appealed the trial court's ruling.

The Supreme Court's Decision

On February 20, 2009, the Iowa Supreme Court announced its decision. The Court agreed with the trial court that the clandestine recording was a type of oral communication protected by Iowa Code §808B, and that the University and Jones had willfully used the recording against the fraternity in suspending its recognition. However, the Court reduced the damages: it found that the University stopped using the recording on November 21, 2003 when the hazing charge was dismissed, so the period of wrongful use was reduced to 732 days, for a total of \$73,200 in liquidated damages. The Court also reversed the award of attorneys' fees arising from the administrative proceeding because Iowa law does not allow for such an award.

The Court held that Vice President Jones could be held personally liable for his actions under Iowa law as it existed at the time of the violation. However, it reversed the award of \$5,000 in punitive damages against him because he stopped using the recording after he learned that its use was illegal.

A couple of aspects of the Supreme Court's ruling were puzzling. First, the Court held that the University stopped "using" the recording against the fraternity on November 21, 2003 when it dropped the hazing charge, and reduced the daily damages on that basis. But the trial court had found that the University and Jones actually continued using the recording after that time by using the "pretext" of the alcohol violation to simply impose the same penalty as

before. The trial court did not believe the University and Jones's denial on this issue, calling it "ludicrous". The Supreme Court did not mention these factual findings by the trial court.

Second, the Supreme Court's exoneration of Vice President Jones from the punitive damages award also seemed to ignore the trial court's factual findings. The trial court had called portions of his trial testimony "not credible" and "disingenuous at best," and described his early dealings with the chapter as "strong-arm tactics." The court found that Jones's "stubborn, obstinate, and willful conduct" in continuing to use the recording against the chapter, even after he learned that such use was illegal, justified an award of punitive damages against him personally.

In any event, even after the significant reductions ordered by the Supreme Court, the University and Jones still owe the fraternity more than \$110,000 (plus interest).

Moving Forward

Just before the lawsuit came to trial, Phi Delta Theta's General Headquarters suspended its Iowa chapter's charter because of continued membership decline. (The trial court found that the actions of the University and Vice President Jones were a significant cause of the failure of the chapter.) Recently Phi Delta Theta has re-established a colony at the University of Iowa. The money the University will pay in damages is expected to assist the chapter in starting over.

- James C. Harvey

¹ *Phi Delta Theta House Ass'n and Iowa Beta Chapter of Phi Delta Theta v. State of Iowa, et al.*, Iowa Supreme Court Case No. 07-0330, Released 2-20-09.

Mr. Harvey is an attorney in Orange County, California. He is a member of Phi Delta Theta and the NIC Legal Advocacy Committee.

HOW TO HANDLE AN INTERNAL REVENUE SERVICE AUDIT

No one likes to be audited by the Internal Revenue Service. However, as a recent audit of the Alpha Chapter House Corporation of the Kappa Alpha Order shows, preparation before an audit can make all the difference in the world. Mark Shuford, the President and Treasurer of the Alpha Chapter House Corporation testifies to that. "Two things I took away from this experience that are worth passing along: one, having Swisher Davis handle all of our payroll, bookkeeping and tax filings made life so much easier as they had great records and all the right answers. Two, this should probably serve as a wakeup call to all house corporations that they need to make sure their records are in order and that ... they should think about employing an out-

side accounting firm to help them do their job." Mark goes on to say that having an experienced advisor assisting with the audit was a calming influence in an otherwise stressful situation.

The audit ended favorably for the Alpha Chapter House Corporation, perhaps in part because the officers of the corporation were well prepared for, and well advised during, the audit. This article describes in some detail the audit process and how preparation like that undertaken by Alpha Chapter House Corporation can help other organizations prepare for an IRS audit.

The audit of the Alpha Chapter House Corporation was not an unusual occurrence. Based upon normal IRS pro-

cedures, it is highly likely that all national fraternities will be audited at least once every five years. While the audit of fraternity foundations, local chapters, alumni groups and house corporations are, generally, less frequent, we have noticed an increase in audit activity of house corporations over the last 24 months.

An IRS audit may be signaled by the receipt of a telephone call from a local Internal Revenue Service agent informing you that your organization will be audited. However, you are entitled to receive — and you should ask for — a written request detailing the year or years under audit and exactly what information the agent wants you to provide. The agent will often request organizing instruments (articles of incorporation), by-laws, minutes of meetings, all books and records pertaining to the assets and liabilities of your organization, receipts and disbursements, check register, canceled checks and bank statements, copies of any other federal tax returns filed, correspondence files, pamphlets, magazines and membership information.

The time and place of the audit should be stated in the letter you receive from the IRS. If the time scheduled for you is inconvenient or if you need more time to assemble the materials requested by the agent, do not hesitate to call the agent and explain the situation. However, do not delay merely for the sake of delay. The audit will not go away, and you will only succeed in alienating the agent. Any early contact with the agent will most likely set the tone for the audit; therefore, be polite and businesslike in your dealings with him. IRS agents are often treated poorly by those they are assigned to audit, and in our experience, setting a polite and business-like tone may develop goodwill with the agent that could be helpful during the audit.

As soon as you have been notified of the audit, contact the person who prepared the tax returns that are being audited and/or your other tax advisor, and follow the instructions he or she may give you for handling the audit. Next, gather the materials requested by the agent and have them arranged in a logical and orderly fashion. This is where ongoing recordkeeping and good advisors are key. Solid recordkeeping procedures will make gathering and organizing the requested information far easier than if procedures are not in place. Further, your advisors will help you give only what is asked for and not offer anything extra. Offering more than what is asked for is a good way to open the door for an inquiry that goes beyond the agent's original scope. If you cannot provide everything requested by the agent, be sure that you have a good explanation as to why it is unavailable. Finally, be prepared for the auditor's visit. In this case, the old trial lawyer's adage that "preparation, preparation, preparation" is the key to success is certainly appropriate. Meeting with your tax advisor to review the requested materials and to discuss possible issues that might be raised is an important aspect of the organization's preparation. Your advisor will

assist you with formulating a response if the agent raises such an issue.

With regard to the actual handling of the audit, remember that IRS agents are people, and treat the agent in the same manner that you would like to be treated if you were doing the agent's job. Give the agent a separate room, if possible, and offer him or her coffee or tea. Make sure the agent is out of the normal traffic patterns of your employees and staff. IRS agents often pick up issues and problems by hearing the everyday conversation in an office. By the same token, instruct your employees not to engage in conversation with the agent, but to refer the agent to you or a designated contact person. Before you leave the room, make sure that the agent knows how to reach you or the contact person when the agent has questions or needs help. Do not hover over the agent. Leave him or her alone and let the agent do his or her work. If the agent raises a question which you cannot answer, do not panic. Tell the agent that you need to check further for the information and that you will let him or her know. Then make sure you follow through on this item.

Finally, find out the time parameters of the audit. You should know when the agent will arrive, when he or she will leave, and if the audit has been concluded or if another visit is necessary. Otherwise, an agent may continue to appear unexpectedly at your office or house, and this is not desirable.

Some of the issues that may be raised by an agent auditing a national fraternity or a local group include:

- 1) Late filing or non-filing of Forms 990 and/or 990-T.
- 2) Failure to file other required forms such as Form 1099.
- 3) Improper use or allocation of set aside funds or failure to follow correct procedures in setting funds aside.
- 4) Lack of documentation for transactions.
- 5) Compensation, reimbursement policies or fringe benefits as they relate to officers, staff and volunteers such as chapter visitors.
- 6) The handling of local housing loans.
- 7) Receipts from fund raising projects.
- 8) Nonmember income and whether the 15 and 35 percent gross receipts tests have been violated.
- 9) Commingling of chapter and house corporation receipts and expenses.

Most of these issues relate to whether the organization will be required to pay taxes plus interest on unrelated business income, but a few of the issues can affect the organization's tax exempt status. It is very unlikely that an agent will suggest revocation of exemption, but if this is mentioned, you should seek competent professional advice immediately. This is a far more serious matter than a proposed imposition of tax. Sometimes an agent will request that you sign an agreement with the IRS on behalf of your organization. *Never* sign anything with the IRS without seeking professional advice about the effect this document will have on your organization.

If the agent raises issues or proposes adjustments to your tax returns and if you cannot fully satisfy the agent's concerns or convince the agent that they are unfounded, you should refer the agent to your tax advisor. You will be required to give your accountant or counsel a power of attorney, Form 2848, authorizing your representative to act for you in discussions with the IRS. From then on, the agent is supposed to speak only with your representative and not directly with you. If the agent contacts you after you have furnished him or her with a signed power of attorney, you should remind him or her politely to call your representative.

Your representative will do any necessary research on the issues raised by the agent and present the agent with factual materials and legal arguments. Usually, your representative will have at least one meeting with the agent and generally will attempt to settle the matter at the lowest possible level of the IRS — with the agent or his or her supervisor.

Your representative should be someone who has had experience in handling Internal Revenue Service audits of exempt organizations so that he or she is aware of IRS policies and procedures on this particular subject. For example, sometimes in an exempt organization audit it is possible to agree that a questioned item will be handled differently in the future in order to avoid having to pay tax or having an exemption revoked. This is not usually possible in other types of audits, but the announced mission of the IRS in dealing with exempt organizations is not to collect the most tax possible, but to make sure that the requirements which the law imposes for maintenance of exemption are being followed. A word of caution: In most cases, it is a mistake to try to use outside influence to settle an audit. For example, do not try to exert political influence or go over the agent's head through non-authorized channels except in very rare circumstances and on the specific advice of your representative.

If your representative cannot settle the matter at the agent level, he or she will consider appealing the matter to the Appellate Division of the Internal Revenue Service, at which time a written protest must be filed setting forth legal arguments and the facts upon which the organization relies. If the problem is not resolved before it reaches the IRS Ap-

pellate Division, it is best at this stage to involve a lawyer if you have not already done so, since a court proceeding is the next available step.

If a legal issue involved in the case is a novel one, your advisor may suggest requesting technical advice from the National Office of the Internal Revenue Service; in some cases, the IRS itself may initiate such a request. This can be a lengthy process, and it may be that at some stage of the proceedings the organization will be asked to sign a waiver of expiration of the statute of limitations. The matter can then proceed without the statute of limitations expiring against the government. In most cases it is in the organization's best interests to sign such a waiver. Otherwise, the IRS will usually issue an immediate deficiency notice so that its interests are protected. Nevertheless, the waiver should not be open-ended. If possible, waivers should be signed for six-month intervals only so that the matter can be reviewed periodically to determine whether it is still wise to extend the statute of limitations. If one or more issues in the case have been settled, your advisor should attempt to secure a partial waiver, so that the statute is extended only as to unagreed issues.

Never sign anything with the IRS without seeking professional advice about the effect this document will have on your organization.

As a last resort in resolving the issues, the organization may file suit to the Tax Court without first paying the tax; or, it may file suit to other federal courts if it wishes to pay the tax first. An organization should not necessarily be fearful of litigation, but it is not a matter to be taken lightly. It is expensive, time consuming and there is always a chance that the matter will be decided entirely against you. Therefore, before authorizing litigation, you should be sure that the matter cannot be settled in any other way and that you have at least a 50-50 or better chance, based upon your advisor's judgment, of being successful in court. Your representative will advise you whether a particular court will be a better forum in which to raise the issue involved in your case and what the procedure is for taking the matter to that court.

Most controversies of fraternities with the IRS are generally resolved short of the litigation stage. If you follow the above approaches and your tax advisor's recommendations, it is less likely that your organization will be involved in one of the relatively few cases reaching the courts.

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HAZING LEADS TO LAWSUIT, CRIMINAL CHARGES

“I don’t regret joining this Fraternity,” Brent Whiteside was quoted in the January 6, 2009 *Richmond Register* saying about Kappa Alpha Psi Fraternity. “What they stand for is what I want to be. There were just a couple of bad seeds out there.” The bad seeds he was referring to were three members of the Eastern Kentucky University Kappa Alpha Psi Chapter who had just pleaded guilty to 4th Degree Assault after beating Whiteside so severely as a part of a hazing ritual that he suffered renal failure and had to be hospitalized.

The three members who each pleaded guilty got off relatively lightly, each being sentenced to home incarceration ranging from 30 days to 100 days. They will be eligible to have their charges diverted this fall and can ultimately eliminate their criminal record by having the charges expunged.

On January 22, 2009, Whiteside filed suit in the Fayette County Circuit Court of Kentucky against the Kappa Alpha Psi Fraternity, Inc.¹ The Complaint claimed that Whiteside, a student at Eastern Kentucky University, and a pledge of the Eta Alpha Chapter of Kappa Alpha Psi, was beaten on two occasions – once in January of 2008 and again in March. The suit claims that members of the Fraternity “repeatedly struck and violently beat Whiteside with hands, fists, feet, paddles and canes on and upon his stomach, chest, back and buttocks, inflicting life threatening and disabling injuries.” Members of the Kappa Alpha Psi Chapter at the University of Kentucky joined in the second beating and “repeatedly punched and slapped Whiteside on and about his stomach, chest and back, inflicting additional life threatening and disabling injuries.”

The lawsuit claims in its first count that the Fraternity failed in its duty to supervise its members. That failure, it is claimed, led directly to Whiteside’s injuries which made it impossible for Whiteside to complete this spring semester. Whiteside alleges he suffered lost wages and an impairment of his future earning capacity and “serious and permanent physical injuries, as well as mental impairment, anguish, embarrassment and humiliation.”

Count Two of the Complaint claims that by granting charters to chapters at Eastern Kentucky University and the University of Kentucky, the fraternity was “liable for the acts of its members conducted in furtherance of fraternity matters.” The suit claims that the “initiation rituals” were conducted in furtherance of the local charters granted by the Fraternity. Count Three claims that the Fraternity acted with “reckless disregard for the health, safety and welfare of its member pledges, including Whiteside.”

A complaint is a statement of claims (facts) which have not yet been proven. The legal arguments are just that, arguments. For example, it is certainly not clear that simply

because a fraternity grants a charter, it is responsible for the misconduct of a chapter or its members. The Plaintiff may have a difficult time proving that the beatings were part of “initiation rituals” in furtherance of the charters.

The Fraternity, which as of this writing has not answered the lawsuit, makes clear on the home page to its web site its anti-hazing policy. Kappa Alpha Psi has joined with the eight other historically African American fraternities and sororities in adopting the National Pan-Hellenic Council, Inc. (NPHC) Resolution which absolutely prohibits hazing.

That policy notes that “NPHC organizations are ... committed to promoting the self-respect and dignity of all persons seeking membership in the respective organizations; and ... hazing is antithetical to this commitment and is strictly prohibited by the Constitution, Policies and Procedures of each NPHC organization.” The policy notes that each NPHC organization has instituted rules against hazing and taken steps to reinforce and strengthen its stand against such conduct. The policy warns that individuals who engage in such conduct will be held liable and required “to respond in monetary damages, civil and criminal penalties and severe disciplinary action by the organization.”

This lawsuit is in its very early stages. But it is worth noting that the plaintiff failed to name the individuals who engaged in the criminal conduct in spite of the fact that they were obviously well known to him and instead sued only the national fraternity. Eastern Kentucky University was also not named as a defendant despite the fact that the college may have been in a better position to recognize the conduct that was going on than was the national fraternity located hundreds of miles away.

Obviously, the conduct engaged in and the damage inflicted on Brent Whiteside has no place in the fraternity world. It is, as the NPHC Policy says, “inimical to the principles for which each organization stands and fails to foster respect for fellow members or preserve human dignity.”

While those who beat Whiteside violated his rights and deserve to be held accountable, it is unclear that Kappa Alpha Psi is the responsible party. Clearly, those who beat Whiteside are responsible parties. To the extent chapter officers knew or encouraged the conduct, they may be responsible parties. But if Kappa Alpha Psi can document that it has a solid record of enforcing the terms of the NPHC Resolution and its own policies and rules against hazing, the fraternity itself may be in a strong position to defend this case.

• Timothy M. Burke

¹ *Whiteside v. Kappa Alpha Psi Fraternity, Inc.*, Fayette Circuit Court, Civil Branch, 4th Division, Case No. 09-CI-352.