

WEST VIRGINIA
SECRETARY OF STATE
KEN HECHLER
ADMINISTRATIVE LAW DIVISION

Form #5

Do Not Mark In this Box

FILED
1988 DEC 30 AM 9:40

**NOTICE OF AGENCY ADOPTION OF A PROCEDURAL OR INTERPRETIVE RULE
OR A LEGISLATIVE RULE EXEMPT FROM LEGISLATIVE REVIEW**

AGENCY: Secretary of State TITLE NUMBER: 153

CITE AUTHORITY: WV Code 29-19

RULE TYPE: PROCEDURAL _____ INTERPRETIVE XXXXX

EXEMPT LEGISLATIVE RULE _____
CITE STATUTE(S) GRANTING EXEMPTION FROM LEGISLATIVE REVIEW

AMENDMENT TO AN EXISTING RULE: YES XX, NO _____

IF YES, SERIES NUMBER OF RULE BEING AMENDED: SERIES 7

TITLE OF RULE BEING AMENDED: Submission of other Documents
for approval to Solicit Contributions...

IF NO, SERIES NUMBER OF NEW RULE BEING ADOPTED: _____

TITLE OF RULE BEING ADOPTED: _____

THE ABOVE RULE IS HEREBY ADOPTED AND FILED WITH THE SECRETARY OF STATE. THE
EFFECTIVE DATE OF THIS RULE IS January 29, 1988

Ken Hechler
Ken Hechler, Secretary of State

TITLE 153
INTERPRETIVE RULE
SECRETARY OF STATE
SERIES 7

SUBMISSION OF OTHER DOCUMENTS FOR APPROVAL TO
SOLICIT CONTRIBUTIONS FOR A CHARITABLE ORGANIZATION

Handwritten marks: a checkmark, a double slash, and a signature.

§153-7-1. General.

1.1. Scope. -- This interpretive rule established the conditions for the exercise of the discretion empowered within the Secretary of State to approve or disapprove solicitation activities.

1.2. Authority. -- W. Va. Code §§29-19-3(c); 29-19-5(a); 29-19-5(c); 29-19-8; 29-19-15(d); 29-19-9 and 29A-1-2(c)

1.3. Filing Date. -- December 30, 1987

1.4. Effective Date. -- January 29, 1988

§153-7-2. Other documents prescribed by the Secretary of State.

2.1. Prior to any solicitation activity each charitable organization shall submit to the Secretary of State a copy of the printed solicitation material and a copy of any script to be used in door-to-door or person-to-person or telephone, radio or television solicitation activities.

§153-7-3. Examination of applications.

3.1. The secretary of state shall examine each application to insure conformity with the Solicitation of Charitable Funds Act. Such examination may include the following areas:

3.1.1. Governing structure as expressed in the minutes of board meetings showing that the:

- a. Board decides major expenditures for programs
- b. Board decides whether new programs / directions will become part of major purpose of charity
- c. Board gets a full report on financial condition of charity at each meeting

d. Board meets no less than three (3) times a year

e. Board receives and approves reports on budget and financial reports

f. Majority of board members are not employees of the charity.

3.3.2. Purpose of the charity as reflected in the financial and annual reports should demonstrate that the majority of the money collected is applied to the purposes expressed in the solicitation materials.

3.3.3. Information may be requested to determine the selection method used to contract for services by the board to insure board members or their families do not receive an unfair advantage from their position on the board. This may include examination of those companies contracted; with regard to ownership and relationship with board members.

3.3.4. It is the intent of the secretary of state to administer the Charitable Funds Act as a license to solicit subject to the primary purpose of protecting the public from deceptive and dishonest practices.

§153-7-4. Reapplication.

4.1. Any person whose certification is revoked may not reapply as a charitable organization for a period of one (1) year from the latter date of the denial or revocation or final disposition of appeal.

§153-7-5. Contracts to be filed.

5.1. Whenever a contract is required to be sent to the Secretary of State by either a charitable organization, professional fund-raising counsel or professional solicitor, such contract shall not be deemed complete unless it includes, either within the body of the contract or attached, the name, address and phone number of the principle contact person for each of the parties to the contract.

KEN HECHLER
Secretary of State

MARY P. RATLIFF
Deputy Secretary of State

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STATE OF WEST VIRGINIA

SECRETARY OF STATE

Charleston 25305

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Special Assistant

(Plus all the volunteer
help we can get)

Dec. 30, 1987

REPORT ON RESPONSE TO COMMENTS ON PROPOSED RULE OF SECRETARY OF STATE

RULE: AMENDMENTS TO SERIES 7
NOTICE OF COMMENT PERIOD FILED SEPT. 8, 1987
COMMENT PERIOD ENDED OCT. 13, 1987
COMMENTS RECEIVED FROM: Maupin Taylor Ellis & Adams

Jackson, Kelly, Holt & O'Farrell

COMMENTS ARE ATTACHED

Objections were to sections 3,4,5,6 & 7 based on the grounds that they exceed statutory authority or conflict with existing statutory law. We agree and have struck sections 3,4,5 & 6. They have been re-written to remove the problem elements. Section 7 has been amended although the question of statutory authority may remain. We do not feel that the requirement exceeds our authority. The administration of this program can not be hindered by applications from organizations which have been deemed as not meeting state requirements but continue to file applications and request contested case hearings on multiple applications which are so similar to the original application that they can not be reviewed with any hope of acceptance.

A handwritten signature in cursive script, appearing to read "Rich O. Hartman".

Rich O. Hartman

1987 DEC 30 PM 3 20

FBI

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October 19, 1987

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TELEPHONE (919) 544-2906

CERTIFIED MAIL - RETURN RECEIPT REQUESTED
RETURN RECEIPT NO. P.624 050 070

Secretary of State
Administrative Law Division
State Capitol
Charleston, West Virginia 25305

Attention: Rich O. Hartman

Dear Mr. Hartman:

Please accept these comments on a proposed rule filed on September 8, 1987, amending Section 153 of the West Virginia Administrative Code. The title of the rule being amended was "Submission of Other Documents for Approval to Solicit Contributions for a Charitable Organization".

The comment period for commenting on the proposed rules expired on October 13, 1987, at 5:00 p.m. This law firm had requested copies of all rules and regulations relating to solicitations of charitable contributions in the state of West Virginia on September 25, 1987. The Secretary of State's response to this request was received in our office on October 13, 1987, at 5:45 p.m. Therefore, our law firm did not have an opportunity to provide timely comments to the proposed rule.

We respectfully request your indulgence in reviewing these comments, since other organizations and their counsel may have been placed in the same position. Our comments are numbered to correspond to the numbering system used in the proposed rule.

1. Section 153-7-3. Governing Structure.

Section 3.1 states in part that "Charitable organizations must have a valid governing structure." This provision appears to be vague and overbroad. Section 29-19-8(c) requires only that the organization "substantiate" a valid governing structure. This generally would require only that organizations comply with local charitable trust or corporation laws. If West Virginia is

attempting to supersede the state nonprofit corporation laws of the other forty-nine states, the result may also be an intolerable burden upon interstate commerce. Thus, it appears that Section 3.1, which is said to be interpretive only, fails to carry out the legislature's intent and is contrary to the language of Section 29-19-8(c).

This proposed rule also states that "The governing structure shall be an independent body that meets, with a quorum present, at least three times per year." It is unclear what is meant by "independent body". There appears to be no statutory authority in West Virginia which allows the imposition of a three-meeting requirement. Also, this regulation attempts to override state nonprofit corporation laws of the other forty-nine states, which generally require only one meeting per year. This constitutes an impermissible burden upon interstate commerce. So long as a foreign nonprofit corporation remains in good standing in the state of incorporation, West Virginia should not second guess the wisdom of that state's legislators. Finally, this provision is also probably unenforceable as a practical matter.

Section 3.1 prohibits members of the governing structure of a charitable organization from engaging in business transactions in which they have conflicts of interest. This position is flatly rejected by West Virginia Code Section 31-1-25, which clearly permits directors and trustees of an organization's governing structure to engage in transactions in which they have a conflict of interest under the conditions therein stated. W. Va. Code Section 29-19-8(c). Thus, this provision is invalid and not supported by law. In any case, even if it is valid, Section 3.1 is overbroad in this respect, since the provision should be limited to self-dealing transactions with the organization itself.

In passing we note that Section 3.1 may be drawn in greater or lesser part from certain heretofore voluntary standards promulgated by an organization known as The Philanthropic Advisory Service of the Better Business Bureau. You may be aware that this is a voluntary organization that purports to set ethical standards for the conduct of charitable solicitations. The Better Business Bureau has had notably little success or impact in preventing fraudulent misrepresentations in solicitations for charitable contributions. Your apparent source for this provision is questionable at best.

2. Section 153-7-4. Related Parties.

Section 4.1 of the proposed rule purports to create an "irrefutable presumption" concerning certain transactions involving "the existence of a family relation". The federal

courts in this country are very wary of any governmental attempt to create any sort of irrebuttable presumption. At most, the courts generally allow rebuttable presumptions to be set up by statute or regulation, but to the extent that irrebuttable presumptions are created, generally these are stricken on constitutional grounds.

Section 4.1 is also impermissibly overbroad and vague. Employees of charitable organizations frequently are part-time employees who hold down two or more jobs. Many small organizations employ only part-time help, to reduce payroll tax liability. Many small organizations make liberal use of shared or leased employees, to reduce expenses and spread overhead costs. Under this Section 4.1, the use of shared employees to conserve costs could create a related party transaction through mere inadvertence. Also, since "marriage" creates a "family relation" that is an "irrefutable presumption" of a related party, it appears that in-laws may also be related parties. This would come as a great surprise to many.

This rule would also require that organizations terminate contracts for professional management with multiple management companies. Many small charities enter into agreements with multiple management companies to provide financial, management and executive services at a time in the organization's life where it cannot afford full-time employees. Such agreements allow the management company to direct the organization's affairs on a day-to-day basis. It would no doubt come as a great surprise to the leading multiple management companies in this country that the mere existence of an agreement to perform such services with a charity that solicits in the state of West Virginia places them in the position of a related party.

Finally, Section 4.1 states in part that if an individual "serves... in a fiduciary capacity or as an agent, officer or employee", a related party situation may exist. This appears to be redundant, since most state laws would treat agents, employees and officers as fiduciaries of a charity in any case, at least where the person has discretionary authority to act in an executive capacity.

Section 6.1 would limit an organization's ability to engage in related party transactions. It would require disclosure thereof in any solicitation materials. This is entirely a legislative rule, despite the label attached as interpretive, and should be subject to adoption as such under West Virginia Code Section 29A-3-13. It also is unconstitutional, vague and overbroad, as well as possibly violating the first amendment to the United States Constitution.

Proposed Section 4.2 is simply vague, overbroad and unnecessary and not justified by any statute in the West

Virginia Code. This provision should simply be deleted. In any case this Section 4.2, if valid, would be considered a legislative rule under the West Virginia Code and subject to adoption only under Section 29A-3-13 of such Code. Section 29A-1-2-(d), West Virginia Code.

3. Section 153-7-5. Control.

Section 5.1 purports to define the term "control" and states that an organization is "controlled" if a person has the "power" to control its activities, apparently whether or not such control is in fact exercised. Since an organization can act only through agents or employees, if control is not in fact exercised, it cannot in fact be controlled.

The effect of Section 5.1 would be to require that an organization, which of course would be a small organization least able to afford the expense, to hire full-time employees to manage the organization. It is not clear to us why the Secretary of State believes that professional management contracts are inherently suspect. If the Secretary of State instead intended to adopt a rule that the board of directors or trustees of an organization must retain full responsibility for the management of the organization, this rule would be unnecessary because this is an implied duty under most state laws in any case.

We believe that Section 3.1 makes Section 5.1 redundant or unnecessary. If the board of directors is required to control an organization, it is unnecessary and redundant to define "control" in terms of the authority another person or corporation may exercise in connection with the organization's activities.

4. Section 153-7-6. Conflict of Interest.

Section 6.1 also appears to be inconsistent with West Virginia Code Section 29-19-8(c). Section 6.1 states that charitable organizations may enter into transactions involving conflicts of interest only under the conditions therein stated. West Virginia law contains no limitation on self-dealing other than as set forth in Section 29-19-8(c). This statute governs the transactions of a director and does not refer to officers, agents and employees, who are free to engage in such transactions. Thus, the provision is contrary to law and unsupported by statute.

Rule 6.1 defines the term "conflict of interest" as a "clash" between the interests of the charitable organization and certain other persons. The word "clash" adds little to any effective legal analysis of a transaction. In any case, it is vague and overbroad.

Rule 6.1 also contains what lawyers refer to as "glittering generalities" that are absolutely unenforceable. Rule 6.1 states as follows:

The appearance of impropriety and conflicts of interest should be avoided. The duties of loyalty and fiduciary responsibility of the officers, agents and employees of a charitable organization are stricter than the morals of the marketplace in arms-length activities.

This rule would allow discriminatory administration. The first of the two quoted sentences is simply unsupported by the governing statutes. Section 29-19-8(c) states only that "members [of an organization's governing structure] shall comply with the provisions for conflict of interest as defined in West Virginia Code Section 31-1-25." Section 31-1-25 of the West Virginia Code specifically allows directors to engage in transactions with their organization, even if the transaction constitutes a self-dealing transaction, under the conditions therein stated. Therefore, the statement that "the appearance of conflicts of interests should be avoided" is not only vague and unenforceable, it is simply contrary to the statutory language, which specifically allows directors of nonprofit organizations to engage in transactions with their organizations in which they have a conflict of interest. The statute not only specifically allows the appearance of a conflict of interest to be created, but it also allows actual conflicts of interest to be present under the conditions set forth therein. It is unclear what is meant by the "morals of the marketplace", and in any case this would involve subjective judgments that government agencies are not permitted to render.

Again, The Philanthropic Advisory Service's publications appear to be the source of this provision. That source is poorly adapted to a governmental agency's rules and regulations which must be adjudged according to constitutional standards.

Finally, whether any alleged related party transaction or transaction involving a conflict of interest is "fair and reasonable" would certainly be open to question. The provision concerning transactions involving a conflict of interest is apparently drawn in part from Section 31-1-25(a)(3) of the West Virginia Code. If the Secretary of State's office is attempting to substitute its judgment for that of the organization's board of directors or trustees, especially in terms of reviewing fundraising agreements, the rule is probably unenforceable. Besides its vagueness and overbreadth, the "fair and reasonable" standard allows for second-guessing of an organization's

board of directors, such as where a transaction fails to produce expected results. A legal opinion on the "fair and reasonable" issue should be sufficient to establish at least a presumption that the transaction in fact was "fair and reasonable". Especially in a period of recession, such as that currently faced in the state of West Virginia, this rule would allow for dangerous subjective administrative application.

Since no West Virginia statute prohibits or restricts an organization from engaging in a related party transaction, much less defines such a transaction, the provision requiring such transactions to be "fair and reasonable", while perhaps laudable, is not justified by statute. It is also probably unnecessary under the general law of charity which would impose a higher standard of care upon directors who engage in such transactions.

5. Section 153-7-8. Contracts to be Filed.

Section 8.1 appears to be a reasonable requirement that is neither burdensome or overbroad. Therefore, we believe that Section 8.1 is a proper assertion of the Secretary of State's authority under the West Virginia statutes.

In general the proposed rule reflects misunderstanding and suspicion of the way in which charities operate. This law firm believes that your office will have great difficulty enforcing these rules, if adopted as final regulations without substantial amendment.

As a point of reference, this law firm represents about 125 charitable organizations that solicit charitable contributions in all fifty states. Many of our clients also engage in foreign transactions either as fundraising devices or as program activities. We believe that we are in as good a position as any law firm in the country to judge the legality of proposed rules and regulations purporting to govern charitable solicitations with any particular state. We generally have no objection to reasonable regulations which do not unduly interfere with the free expression of ideas. For this reason we have never objected to reasonable licensing requirements and the inclusion of clauses in fundraising agreements to protect the independence of the charity. As a whole this proposed rulemaking evidences a disdain for charitable organizations and an attitude that the "governing structure" of an organization, whatever that may be, simply cannot be trusted to act in the organization's best interest. This assumption is unjustified as well as unrealistic.

Mr. Rich O. Hartman
October 19, 1987
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If you have any questions about these comments, please
do not hesitate to contact the undersigned.

Very truly yours,


Steven D. Simpson

feh/sds82

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CLERK OF COURTS
STATE OF WEST VIRGINIA

COMMENTS TO PROPOSED RULEMAKING

TITLE 153
INTERPRETIVE RULE
SECRETARY OF STATE
SERIES 7

SUBMISSION OF OTHER DOCUMENTS FOR APPROVAL TO
SOLICIT CONTRIBUTIONS FOR A CHARITABLE ORGANIZATION

Presented by:

JAMES W. THOMAS
JACKSON, KELLY, HOLT & O'FARRELL
1600 Laidley Tower
P. O. Box 553
Charleston, West Virginia 25322

§153-7-3. Governing structure.

This proposed regulation is apparently intended to amplify and clarify the statutory language set forth at W. Va. Code §29-19-8(c). That statutory subsection provides as follows:

Charitable organizations shall substantiate a valid governing structure and members shall comply with the provisions for conflict of interest as defined in section twenty-five, article one, chapter thirty-one of this code.

The last sentence of proposed §153-7-3 would appear to absolutely prohibit members of a charitable organization's governing structure from engaging in business transactions in which they have "conflicts of interest".

W. Va. Code §29-19-8(c) specifically references the "conflicts of interest" section in the general corporation law of the State of West Virginia (W. Va. Code §31-1-25) and explicitly makes that "conflicts of interest" section applicable to charitable organizations. The clear import of this direct statutory reference is that the duties of loyalty and fiduciary responsibilities of directors of charitable organizations is identical to the duties and responsibilities of directors of other proprietary and nonprofit corporations in West Virginia. The unambiguous language of W. Va. Code §29-18-8(c) rejects the notion that such duties and responsibilities are somehow stricter when applied to charitable organizations.

Under W. Va. Code §31-1-25, a transaction between a corporation and one or more of its directors, or between a corporation and any other entity in which one or more of its directors is a director, officer, or is financially interested, shall not be void or voidable if:

1. the fact of such relationship or interest is disclosed or known to the board of directors which authorizes, approves, or ratifies the transaction by a vote or consent sufficient for the purpose without counting the vote[s] or consent[s] of the interested director[s]; or
2. the fact of such relationship or interest is disclosed or known to the shareholders entitled to vote and they authorize, approve, or ratify the transaction by vote or written consent; or
3. the transaction is fair and reasonable to the corporation.

This is the standard applicable to transactions between a charitable organization and one or more of its directors, or between a charitable organization and any other entity in which one or more of its directors is a director, officer, or is financially interested. Any attempt to absolutely prohibit transactions involving so-called "conflicts of interest" must be rejected as in direct contravention of W. Va. Code §29-19-8(c) and §31-1-25. Accordingly, the last sentence of proposed §153-7-3 should be modified to read as follows:

Members of the governing structure of a charitable organization shall comply with the conflict on interest requirements which are set forth at W. Va. Code §31-1-25.

§153-7-4 Related parties.

This proposed regulation purports to define the term "related parties", a term which does not appear anywhere in W. Va. Code §29-19-1 et seq. "Related parties" is not even a term used in the general "conflicts of interest" section of W. Va. Code §31-1-25 made applicable to charitable organizations by W. Va. Code §29-19-8(c). This proposed regulation, which has no statutory correlate, defines a whole new class of individuals and entities, and imposes a disclosure requirement applicable to both registration statements and solicitation materials. The entirety of proposed §153-7-4 is in excess of the statutory authority granted by the Legislature in W. Va. Code §29-19-1 et seq. Accordingly, it must be deleted.

In addition to being in excess of statutory authority, proposed §153-7-4 cannot be a validly promulgated as an interpretive rule under W. Va. Code §29A-1-2(c). Proposed §153-7-4 does not interpret anything in the statute, but rather creates new substantive requirements applicable to all charitable organizations. In doing so, proposed §153-7-4 violates that portion of W. Va. Code §29A-1-2(c) which reads as follows:

"interpretive rule" means every rule . . . which is intended by the agency to provide information or guidance to the public regarding the agency's interpretations, policy or opinions upon the law enforced or administered by it and which is not intended by the agency to be determinative of any issue affecting private rights, privileges or interests. An interpretive rule may not

be relied upon to impose a civil or criminal sanction nor to regulate private conduct or the exercise of private rights or privileges....

Proposed §153-7-4 cannot be intended to guide the public regarding the agency's interpretation of the law administered by it since proposed §153-7-4 has no statutory correlate. Moreover, proposed §153-7-4 is determinative of issues affecting private rights, and it regulates private conduct. All of these functions are beyond the scope of interpretive rules, and demonstrates that proposed §153-7-4 is really an invalidly promulgated legislative rule.

Especially objectionable is the disclosure requirement for "related party" transactions applicable to all solicitation materials. W. Va. Code §29-19-8 defines the disclosure requirements applicable to solicitation materials by requiring all of the following to be included in solicitations:

1. the name of the representative of the charitable organization to whom inquiries can be made;
2. the name of the charitable organization;
3. the purpose of the solicitation;
4. upon request, the estimated percentage of the money collected which will be applied to the cost of solicitation and administration or how much of the money collected will be applied directly for the charitable purpose;
5. the number of the raffle, bingo or other such state permit used for fund-raising; and
6. the following statement: "A copy of the official registration and supporting documents may be obtained from the West Virginia Secretary of

State, State Capitol, Charleston, West Virginia 25305. Registration does not imply endorsement."

None of these disclosure requirements deal with so-called "related party" transactions. The legal maxim expressio unius est exclusio alterius (the expression of one thing is the exclusion of another) must be applied and result in the conclusion that the requirements of proposed §153-7-4 are beyond those which were contemplated by the Legislature.

Finally, and most importantly, the disclosure requirements for "related party" transactions applicable to all solicitation materials is violative of the First Amendment to the United States Constitution. The United States Supreme Court has recognized that the solicitation of funds by charitable organizations is protected speech under the First Amendment. Village of Schaumburg v. Citizens for a Better Environment, 444 U.S. 826 (1980). While courts also recognize that the protection of citizens against fraud is a legitimate State interest, the means chosen to accomplish this purpose must be the least intrusive alternative while still permitting a charity to exercise its protected speech. "Related party" transactions are not per se fraudulent, and are not prohibited under proposed §153-7-4. A "related party" transaction may in fact be the lowest cost source of goods and services available to a charitable organization. Given these facts, it will be only fortuitous coincidence that the State's goal of preventing fraud might be accomplished by proposed §153-7-4. This lack of

logical congruence between the rule's design and the State's interest makes inescapable the conclusion that the rule is an unacceptable and unnecessary intrusion upon First Amendment rights. See, Maine v. Events International, Inc., 528 A.2d 458 (Me. 1987).

§153-7-6. Conflict of interest.

See comments to proposed §153-7-3. The interpretation of permissible "conflicts of interest" provided by proposed §153-7-6 is much narrower than that which is recognized by statute at W. Va. Code §29-9-8(c) and §31-1-25. Accordingly, proposed §153-7-6 must be re-written in its entirety to conform with W. Va. Code §31-1-25. As currently written, proposed §153-7-6 unduly restricts the activities of charitable organizations in violation of explicit statutory authority to the contrary.

In addition, that portion of proposed §153-7-6 prohibiting any party from receiving "advantage of their respective position" is vague. Why prohibit the charitable organization from receiving "advantage of [its] respective position"? And if the transaction is in all respects fair and reasonable, would not both parties to a transaction receive an "advantage of their respective position[s]"? Generally speaking, all parties to a transaction will obtain some benefit or advantage. The only relevant inquiry, therefore, is whether the transaction complies with or violates W. Va. Code §31-1-25. That is all that the Legislature requires, and the

agency has no discretion to expand its scope of scrutiny over the charitable organization.

§153-7-7. Reapplication.

Proposed §153-7-7 purports to establish a one year moratorium upon reapplication by any charitable organization whose certification is denied or revoked. This rule has no statutory correlate, and must be deleted in its entirety as contrary to the statutory authority granted by W. Va. Code §29-19-1 et seq. Moreover, this proposed rule more closely resembles a legislative rule than an interpretive one since it is determinative of private rights, privileges, or interests. Accordingly, it has been invalidly promulgated under W. Va. Code §29A-1-1 et seq. See comments to proposed §153-7-4.