May The Board Be With You – How To Address “C Suite” Relationships and Governance Issues

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Fiduciary Duties: You Know the Basics

- Officers and directors owe a fiduciary duty to the nonprofit organization
  - Duty of obedience, care and loyalty
- In performing their duties, officers and directors must act in the best interests of the Organization (e.g., work to fulfill the Organization’s tax-exempt purposes and maintain its tax-exempt status)
Fiduciary Duties: Duty of Obedience

- Officers and directors must not engage in ultra vires acts – acts that the corporation, under its charter and applicable law, cannot perform because such acts are prohibited or beyond the scope of the corporation’s powers.
Fiduciary Duties: Duty of Care

- The duty of care generally describes the level of attention required of a director in all matters related to the Corporation.
- The duty of care is perhaps more accurately described as a “duty to be informed.”
- A director has the responsibility to be informed about an issue before making a business decision relating to the issue.
  - A director will fulfill the duty of care if, prior to making a decision, he or she considers all material information reasonably available to him or her.
  - To fulfill the duty of care, the directors of a Corporation should follow deliberate procedures and consult with appropriate committees, officers, or employees of the Corporation or other outside experts in making corporate decisions.
Fiduciary Duties: Duty of Care

- **Delegating or Abdicating Authority**
  - When delegating responsibility (e.g., to a committee or individual director, or outside advisor), boards should document such a delegation, be clear as to the scope of the delegation, and clearly delineate criteria and goals
  - Board must still monitor activities to make sure the delegated authority is being exercised in a prudent and reasonable way
Fiduciary Duties: Business Judgment Rule

- In general, under the “business judgment rule,” if a Board of Directors properly exercises its duty of care, its members generally will be protected from liability for their actions on the Board
  - In effect, there is a presumption that, in making a business decision, the directors acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interest of the Corporation, even if the Board’s decisions lead to a “bad” outcome
  - This presumption can be overcome with a showing that the Board acted with gross negligence
Fiduciary Duties: Duty of Loyalty

- The duty of loyalty requires a director to act solely in the best interests of the organization rather than in his or her own interests, or those of his or her associates.
- One important aspect of the duty of loyalty is to retain the confidentiality of information that is explicitly deemed confidential by the organization, as well as information that appears to be confidential from its nature or matter.
- The duty of loyalty also encompasses a director’s obligation to avoid conflicts of interest.
  - For a director, a violation of this duty may result in personal liability for a breach of fiduciary duty.
- For the organization, such a breach may allow a court to void the corporate transaction in which a conflict was present.
Fiduciary Duties: 
Duty of Loyalty and Conflicts of Interest

- In general, a conflict of interest exists when the organization does business with:
  - a director of the organization;
  - another entity in which a director of the organization is also a trustee, director, officer, employee, consultant, or agent; or
  - another entity in which a director has a financial interest (a “financial interest” can generally be defined to include an ownership or investment interest in the entity with which the organization is contracting, or a compensation arrangement with such entity).

- To avoid even the appearance of a conflict of interest, a director may want to treat as a conflict any transaction between the organization and (i) the director’s spouse or domestic partner, or the director’s siblings, descendants, or ascendants (as well as the spouse or domestic partner of any spouse, descendant or ascendant), (ii) any entity in which such a relative is a trustee, director, officer, employee, consultant, or agent, or (iii) any entity in which such a relative has a financial interest.
Fiduciary Duties:
Duty of Loyalty and Conflicts of Interest

In addition, the organization should have its own conflict of interest policy that must be followed

– Indeed, on the federal tax return (Form 990), tax-exempt organizations are now required to disclose whether they have a written conflict of interest policy; report whether officers, directors or trustees, and key employees are required to disclose annually any interests that could give rise to conflicts; and describe how the organization monitors and enforces compliance with the conflict of interest policy

If a conflict of interest is or may be present, the director must:

• Disclose to the board of directors or relevant committee of the board the material facts as to his or her relationship or interest.
• Not participate in any board discussion or vote, unless the organization’s board determines that the director may participate in such discussion or vote.

If a director follows these disclosure and recusal procedures, a party challenging a transaction on the grounds of a conflict of interest/breach of fiduciary duty will face a heightened burden
New York Nonprofit Revitalization Act

- **Conflict of Interest**
  - Must adopt a written conflict of interest policy that applies to directors, officers and *key employees* (key employees are defined by reference to IRC 4958)
  - Include a prohibition on any attempt by a conflicted person “to influence improperly the deliberation or voting” on the matter giving rise to the conflict of interest
New York Nonprofit Revitalization Act

- Related Party Transactions
  - Requires board to make **affirmative determination** that the transaction is fair, reasonable and in the best interests of the organization
  - Board must consider alternative transactions to the extent available (and must document whether it considered alternative transactions)
  - Board must document the basis for approving related party transaction
Fiduciary Duties: General Counsel

- To whom does the General Counsel owe a fiduciary duty?
  - Is the GC an officer?
  - Attorney-client privilege?
  - Duty of confidentiality?

- Who is the client?

- How does the General Counsel manage expectations of confidentiality of discussions s/he has with the CEO/executives and the Board?
  - Especially when engaging in discussions with one about the other
While failed governance comes in many forms, the most common (in our experience) is the case on the dominant CEO

Usually, this CEO is, at least initially, very effective, but it then becomes all about him, and not about the organization

The dominant CEO frequently hand-picks board members (and executives/staff) who are friends or otherwise loyal to him
Dominant CEO

- Staffers are frequently prevented or limited in their access to the board.
- Loyalty to CEO is valued above all else and that is reflected in advancement, compensation, access, etc.
- Board members (and certainly staff) who challenge CEO or try to instill appropriate processes are also pushed out or isolated.
- Is there a sense that the Board reports to the CEO?
Dominant CEO – Mitigating Risks

- It is vital for key staffers (GCs and CFOs in particular) to have independent access to the Board (either Chair or Chair of Audit Committee or Finance Committee).
- If whistleblower policy are in place and publicized, this is one way problems come to Board’s attention, despite CEO’s control of the flow of communications from staff to Board.
- Having executive sessions without CEO at every board meeting, whether you need it or not, will give directors a chance to raise concerns and discern patterns.
Dominant CEO – Mitigating Risks (cont’d)

- Have a strong Audit Chair who oversees audit and have audit focus on areas that are high risk with CEOs like this (travel expenses, personal expense reimbursement, etc.)
- Consider the Board’s role regarding oversight when the new CEO hires former colleagues for key senior executive positions
- Make sure CEO is reviewed by Board each year, with a 360 review being done. Do not just include the usual suspects in the 360 review. Have a lower-level person from accounting, for example, those closed out of the inner circle, etc.
CEO Transitions and Searches

- Role of Search Committee and Board
  - Who conducts interviews?
  - Who has access to candidates and at what point in the process?

- Keeping the former CEO on as an advisor
  - Helps transition?
  - Sets up clash with new CEO?

- Obtaining input from staff (before and after transition)

- Board should set tone of Board-CEO relationship
Management of General Misconduct

- Ensure that appropriate controls are in place, including regular and updated harassment, diversity and other employee-related trainings
- Evaluate effectiveness of financial reimbursement mechanisms and consider whether updates are appropriate
- Consider how the organization will manage public relations related to misconduct, i.e., internal investigation, media exposure, and reputational risks
**Speaker Biographies**

**James P. Joseph (Partner)** is head of Arnold & Porter's Tax practice. He represents clients on tax planning and litigation matters. Mr. Joseph represents tax-exempt organizations (including public charities, private foundations, and international nongovernmental organizations) in structuring and implementing complex charitable programs and business ventures. He provides advice to corporations and individual donors on charitable, advocacy-related, and political giving. On tax controversy matters, he has represented corporations, partnerships, tax-exempt organizations, and individuals in IRS audits, proceedings before the IRS Appeals Office, state-level audits and administrative hearings, and litigations in the US Tax Court and in federal district and appellate courts.

**Bridget M. Weiss (Partner)** represents tax-exempt organizations, including charities, private foundations, advocacy organizations, trade associations, medical research organizations and international nongovernmental organizations. She has experience advising tax-exempt organizations in a wide variety of contexts throughout their entire lifecycle -- from initial qualification for tax-exempt status to ongoing operations, including implementation of complex programs, grantmaking, lobbying and political activities and business activities. Ms. Weiss counsels tax-exempt organizations and their governing bodies facing tax and governance controversies, including both internal investigations and audits and other examinations by the IRS and other government regulators. She also represents individuals and corporate donors on major gifts and other charitable programs.

**Andras Kosaras (Counsel)** represents domestic and international tax-exempt organizations on a broad range of regulatory, transactional and operational matters, including structuring domestic and international programs, grantmaking, and business ventures. He also represents individuals and corporate donors on charitable giving. He advises exempt organizations on executive compensation, private foundation rules, unrelated business income tax, mergers, joint ventures and the establishment of for-profit subsidiaries, as well as on managing investments and endowments, including mission- and program-related investments. He also advises exempt organizations involved in tax and governance controversies, including internal investigations, disputes over charitable gifts and gift restrictions, internal investigations, and examinations by the IRS and state charity regulators.
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