GOVERNANCE: THE NUTS AND BOLTS

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AUTHOR: JACK B. SIEGEL
PRESENTERS: PATRICIA STEIGER AND JACK B. SIEGEL

Caveats

• This is not legal, tax, or accounting advice
• Legal counsel should be retained to regularly advise your organization on governance-related matters
• References to state statutes are based on a version available on the Internet and may not be current. Other provisions of state law may have bearings on the referenced provisions. The references are for discussion purposes only
• This is a general description, with a focus on spotting issues
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Jack Siegel: Biographical Information

Jack Siegel is an attorney (Illinois and Wisconsin) and CPA (Wisconsin), holding an LLM in Taxation from New York University and a Master’s of Management from Northwestern University. Jack provides consulting services through Charity Governance Consulting LLC. He focuses on training, governance, financial management, and special projects. Jack is the author of A DESKTOP GUIDE FOR NONPROFIT DIRECTORS, OFFICERS, AND ADVISORS: AVOIDING TROUBLE WHILE DOING GOOD (Wiley 2007), a 750-page book addressing the legal, financial, tax, and governance issues facing nonprofits. Jack is a member of the American Bar Association and the AICPA. He is serving a three-year term on the IRS’s Advisory Committee on Tax-Exempt and Governmental Entities (the ACT).

Jack currently is completing a book on nonprofit financial governance, focusing on the role of boards, audit committees, and auditors in governing nonprofit finances.

Jack maintains and writes the www.charitygovernance.com blog, where he posts commentary on a wide-variety of issues three times a week.

Jack also is a frequent speaker at conferences and workshops. Upcoming engagements include the BoardSource Annual Leadership Conference (conflicts of interest), the Texas State Bar Association Annual Nonprofit Law Conference (fraud prevention), the National Association of Attorneys General (regulator’s role in detecting and prosecuting fraud: lessons from Madoff), and the NAAG-NASCO Annual Conference (the role of investment committees).
Contact Information

- Jack Siegel can be contacted at:
  - Tele: 773.325.2124
  - E-Mail: jbsiegel@charitygovernance.com
  - Skype: Charitygovernance
  - Twitter: Charitygovern
- Jack is located in Chicago, Illinois
- Web site and Blog: http://www.charitygovernance.com
Conclusions

Useful Resources

THE BOARD’S ROLE

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The Differences

<table>
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<tr>
<th>Nonprofits</th>
<th>For-Profits</th>
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<tr>
<td>Tax-exempt</td>
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<td>No shareholders *</td>
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<td>Rely on volunteers directors</td>
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<tr>
<td>Disconnect between market and services *</td>
<td>Market communicates through price and volume</td>
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Board’s Role

- The board’s role addresses two of these differences
- The board fills hole left by an absence of owners (shareholders). As such, its duties involve
  - Oversight, rather than
  - Management (day-to-day operations and plan execution)
- The board connects the organization to its marketplace
  - Example: A community action agency provides needed social services to members of the community (often low-income). In many cases, the services are free or well-below cost.
    - The market (the community) takes what it gets and cannot use market power to send a message back to the organization—"We like your services," or “We don’t like your services"
The board assesses what the mission is and whether the services being provided are satisfying the mission.

It focuses on the values underlying the mission.

Common Errors

- Micromanagement
- Ceremonial
- Founder’s Syndrome
- Too Much Policy, not Enough Control
• The board micromanages the affairs of the organization
  o Board members regularly interact directly with the organization’s employees rather than working through the executive director
  o Board decisions focus on operational details
    ✗ We should start a credit counseling program—OK
    ✗ It should
      o Provide this type of advice (surveyed other programs)
      o Use this software (investigated different programs)
      o Charge this price (did market research)
      o Hire these specific individuals (reviewed resumes)
    Not OK
• Board listens to Executive Director advise how well everything is going
  o The board’s role is:
    ✗ Ceremonial
    ✗ Rubber stamp
    ✗ Potted plant (there for decoration)
  o Tripartite board helps combat that
    ✗ One-third of the board is community members
    ✗ One-third of the board is government officials
    ✗ These folks provide a view of the organization that extends beyond the executive director and the staff
  42 USC 9910
Board defers to the executive director because the executive director is the founder and chose the board members
  - This is referred to as “founder’s syndrome”
  - This often results in the board being a ceremonial body
Board sets policy, but fails to impose controls
Concepts vs. Nitty Gritty

1. Board Composition & Structure
2. Exec Selection, Compensation, and Performance
3. Financial Oversight
4. Major Risks
5. Major Decisions
6. Managing Conflicts
7. Internal Controls & Whistleblowers

Conceptual Views of the Board’s Role

Executive Director Case Study

- Did the board oversteps its bounds?
- Does the executive director understand her role?
- How might the board have better handled the proposed transition?
United Way of Central Carolinas

- The former executive director was terminated on September 30, 2008
- The initial controversy centered on the executive director’s compensation, and in particular, on the level of retirement benefits
- An internal investigation resulted in the United Way filing suit against the former executive director. Allegations have been made regarding expense reimbursements and other expenses
- The Charlotte Observer reported that there is a criminal investigation. Eric Frazier, United Way: Federal Grand Jury Investigating King (Apr. 29, 2009)

(continued)

- Questions all boards must address regarding dealings with the executive director:
  - Can a board rely on staff and internal controls that apply to everyone to curb executive director excesses?
  - Should the head of the accounting department or CFO have a direct report to the board or its chair?
  - If not, what can a board to protect the organization against the potential for executive director abuses?
Board Composition

- Finding good board members is difficult
- The board should be comprised of:
  - Professionals with specialized skills
  - People who are interested in the mission
  - People who understand the service recipients
- New board members should be as free from conflicts of interest as possible
- Staff and executive director should not be members of the board
Professionals

- CPA
- Banker/Finance Professional
- Attorney
- Employment Attorney
- Insurance Professional
- Marketing/Public Relations Professional

Board Nominating Committee

- Boards should regularly be looking for new members
  - Absolutely necessary
    - If board members are subject to term limits
    - To keep fresh ideas flowing and a high level of energy
      - But don’t be too quick to rid the board of highly productive members just because they have been on the board for several years
- A nominating committee is useful
- Potential new board members include:
  - Volunteers
  - Contributors
Exercise Caution

- The board or nominating committee should exercise caution when considering the following potential members:
  - The person who seeks a board position, but who has never attended an open meeting or volunteered his services to this nonprofit
  - The person who is already a member of several boards
  - The person who has no reputation

New Member Orientation

- New members require orientation
  - There should be a meeting with the board chair or other designated person (not the executive director) to answer questions and define expectations and responsibilities
  - New members should receive an information packet
    - Board meeting minutes for the last several years
    - The articles of incorporation and bylaws
    - The Form 990
    - Financial Statements
    - Management letter from the auditors
    - Filing with state regulators
    - Program descriptions
• Audience Questions
  o Does your board have orientations for new members?
  o What information do you provide new members?

Director Terms

• Board positions should be assigned to classes tied to terms
  o Example: If the board has fifteen members, the directors might be divided into three classes, with one-third of the board up for election each year

• Staggered terms serve two purposes:
  o Preserve institutional memory
  o Maintains a balance of power between the executive director and the board

• Staggered terms do not mean that a director cannot rerun for board membership, but state law may impose a limit
Director Removal

- Nonprofits should take advantage of short director terms to rotate off unproductive directors
- On occasion, the chairman of the board, after consulting with other board members to ascertain the degree of consensus, might suggest that a director resign
- The bylaws should permit a super majority to remove a director before the expiration of the director’s term. Obviously exercising this power creates a socially-awkward situation

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- Some boards use bylaw provisions to avoid awkward confrontations:
  - X number of absences during a specified period of time result in automatic removal
  - Failure to disclose a conflict of interest results in automatic removal
  - Mental incompetence results in automatic removal—can pose definitional issues
- Consider emeritus nonvoting classification. The honorary director
- If another organization appoints members to the board, may want to convert this to a recommendation—can make removal easier

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Ex-Officio Board Members

- In some cases, statutes or by-laws provide for ex-officio board members. In a nutshell, these are board members who serve by reason of their status rather than through election as a board member
  - For example, state law may require that the Mayor be a member of the board of a local housing development corporation
  - When Mayor Zoe leaves office, she is automatically off the board and Mayor Danny, the new Mayor, automatically assumes the board position
- Ex-officio board members pose the following issues:

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- How does the official count for purposes of determining whether there is a quorum?
- Does the official have voting rights?
- Can the official send a representative to the meeting?
  - How does the board react if the representative votes, but has no authority to vote?
  - What happens if the board adjourns to executive session to hold a confidential meeting with its lawyer about pending litigation?
- Does the official have a right to meeting notices?
(continued)

- Will the official’s presence trigger open meeting or open record requirements?
- If the official is an elected politician, does his presence pose tax-exemption issues?
  - What does a board do when the official invites everyone to a fundraiser or hands out campaign literature?
  
  These issues should all be considered before providing for an ex-officio position

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- Texas Statute 1396-2.14F provides as follows:
  The articles of incorporation or the by-laws may provide that any one or more persons may be ex-officio members of the board of directors. A person designated as an ex-officio member of the board of directors is entitled to notice of and to attend meetings of the board of directors. The ex-officio member is not entitled to vote unless otherwise provided in the articles of incorporation or the by-laws. An ex-officio member of the board of directors who is not entitled to vote does not have the duties or liabilities of a director as provided in this Act.
Is Option I or Option II the preferred option?
  - Everyone asks this question.
  - The answer, “It depends.”

- In certain organizations, there is significant overlap between the board and the officers. This usually occurs when there is no staff—the board does all the work. In these instances, Option I will probably be the model.
- Option II is more consistent with the notion of independence and oversight. I prefer it.
  - Option II is more appropriate for CAPS
  - There is both a staff and a board
The Basic Equation

Larger Boards Shift Power to the Executive Director

Smaller Boards Retain Power in the Board

BOARD SIZE

Governance: The Nuts and Bolts
June 24, 2009
The Facts

- The more people on the board,
  - The more opportunity there is to spread the work around, but
  - The sense of individual responsibility is diminished—”Look at all the other people who can cover for me”
  
  This is why the board loses power vis-à-vis the executive director

- The fewer people on the board,
  - The more vested each member feels because each senses that if he does nothing, there could be a problem

- Fortune 500 company boards function with between 10 and 15 directors

Group Think

- Group think is a scientifically observable phenomenon
  - First identified by Yale’s Irving L. Janis in Victims of Groupthink. Janis surveyed historic fiascos to find common threads. Pearl Harbor, Bay of Pigs, the Holocaust
  - The 8 elements
    - Illusion of invulnerability—results in excessive optimism
      - We were all chosen
      - People listen to us
    - Effort to discount warnings through collective rationalization
      - Very few agencies get audited
      - Somebody will give us funding
      - President Obama is on our side
Unquestioned belief in the group’s inherent morality
  • We are doing good
  • We are doing God’s work
  • If not us, who else?

Stereotypes of the “enemy”
  • Government regulators and auditors
  • Those that oppose programs
  • Other organizations

Self-censorship of deviations from the group
  • “You’re the only one”
  • “Where did you get that crazy idea from?”
  • “Have you thought about resigning?”

A shared illusion of unanimity
  • Silence must mean agreement: The Road to Abilene (Everyone drove 106 miles in 104 degree heat in a 1958 Buick to eat lousy food because everyone thought that everyone else wanted to go. Each person wanted to make the others happy despite his or her own reservations)

The emergence of self-appointed mindguards
  • Audience Question: Does your board have one or two people who criticize every new idea?
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- **WHY:**
  - Don’t want to be caste out of the group
  - Maintain self-esteem, as in the old Ramsey Lewis song, *I’m in with the In-Crowd*
  - Unanimity eliminates the cognitive dissonance that comes with making a decision: “I/we must be right if we all agree”
- **The larger the group**
  - The more likely the group will revert to the mean
  - Herd mentality prevails

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Case Study

- Susan is the longstanding executive director of Blue CAP. She has three lovely children who often visit her at the agency on their way home from school.
- Susan is happily married. Each year, she and her loving husband sponsor an annual picnic for all of Blue’s employees and clients
- Each December she throws a lovely holiday party in her home for the board.
- Susan has taken Blue from $100,000 in annual grant revenue to $25 million in just ten years time.
- Susan has won many awards and is much beloved by all
Larry Ward, an employee who has had repeated disciplinary problems, notifies the board that he has been sexually harassed by Susan. Larry, who is married, claims he was told by Susan at his last performance review that he would either engage in intimacies with her or lose his job. Larry consented, but is in deep trouble with his wife, who is threatening divorce, because she found suggestive text messages on Larry’s cell phone from Susan.

Audience Question: How is the board going to respond?
A Solution posted at Blue Avocado.org  The source is Elizabeth Vibber, a nonprofit consultant in the Philadelphia area

- Create a Devil’s Advocate card
- The person who holds the card is assigned the task of challenging the group’s consensus
- Designate someone for each board so the Devil’s Advocate role becomes routine
- Advantages
  - Removes hard feelings and animosity because the Devil’s Advocate is playing a role and everyone knows it
  - Formalizes a loyal opposition
  - May cause people who really oppose the idea, but who are afraid to speak up to do just that

A Note About Fundraising Boards

- Cultural museums (museums, theatre groups, zoos, and symphonies) often have 50 to 70 board members
- The board members are looked to for fundraising
  - There is a legal duty of
    - Care, and
    - Loyalty
  - There is no legal duty to fundraise
- The result
  - Reliance on an executive committee
  - Difficulty obtaining quorums
  - Power shifts away from the board
• The answer: Use a donor advisory committee instead of putting large donors on the board

THE BOARD’S RIGHT TO INFORMATION

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Basics

- The Model Nonprofit Corporation Act provides virtually no explicit rights to information
- A proposed revision would significantly change existing law
- In the absence of a revision:
  - Must review individual state law
  - The courts basically look to the equities
  - The courts have been more willing to mandate turning information over so a director can discharge his duties, but not always

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- Texas, at least the Nonprofit Corporation Act, grants
  - Members rights to information in Section Art. 1396-2.23B, which provides:
    A member of a corporation, on written demand stating the purpose of the demand, has the right to examine and copy, in person or by agent, accountant, or attorney, at any reasonable time, for any proper purpose, the books and records of the corporation relevant to that purpose, at the expense of the member
  - Appears to be silent on director rights
- The Maine Nonprofit Corporations Act, 13-B MRS, § 715, demonstrates the deficiencies in other state statutes
Maine Statute

“Each corporation shall keep correct and complete books and records of accounts and shall keep minutes of the proceedings of its members, board of directors and committees having any of the authority of the board of directors and shall keep at its registered office or principal office in this State a record of the names and addresses of its members entitled to vote. All books and records of a corporation may be inspected by any officer, director or voting member or the officer’s, director’s or voting member’s agent or attorney, for any proper purpose at any reasonable time . . .”

Bylaws

• When there is no controversy, consider adding a provision to the bylaws that permits directors to review information necessary to discharge their duties
  o If people are uncomfortable with this, consider requiring that a minimum of X directors must make the request before it is honored
  o Require super-majority to change this provision of the bylaws
  o Preface the provision by saying it supplements but does not supplant otherwise applicable state law
Committee charters should specify that the board can review all committee documents

Bottom Line

• Bottom Line: If a director needs information to discharge his duties and it is not forthcoming, the director should either
  o Resign, or
  o Ascertain whether there is hanky-panky that warrants legal action

• If a board finds itself denying member’s information, it has some soul searching to do
Basics

- The board chair (or president, if no chair) should conduct the meeting
- The meeting should proceed in accordance with an agenda that is distributed in advance of the meeting
  - Audience Questions:
    - How many of your board’s use an agenda?
    - Is the agenda distributed in advance?
    - Is there a procedure for people to add matters to the agenda?
- The meeting should start on time and there should be an agreed upon length
  - It certainly is OK to exceed that limit
  - But a timeframe makes people view meeting time as a valuable resource
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- The board chair or designee should lead the meeting
  - The board chair should begin the meeting by establishing that a quorum is present
  - The board chair should end the meeting by establishing the date, time, and place of the next meeting
- A board meeting belongs to the board and the organization
- A director should devote full attention to the meeting. A board meeting is not the place or time for multi-tasking
  - No cellphone conversations
  - No Blackberry e-mails
  - No balancing checkbook
  - No side conversations about the news

Procedure

- **DO NOT ADOPT ROBERTS RULES OF ORDERS**
  - The rules run over 600 pages in length
  - They are designed for parliamentary bodies
  - Someone who knows the rules has a distinct advantage over others who don’t
  - A lawyer or parliamentarian is required to navigate the rules
- ROBERTS RULES OF ORDERS publishes an abridged version, with simpler rules
- A better set of rules: THE MODERN RULES OF ORDER: A GUIDE FOR CONDUCTING BUSINESS MEETINGS, by Donald A. Tortorice. It is 59 pages and available through the American Bar Association
I  • Establish a quorum and call the meeting to order  
   • Approval of minutes

II • Review financial statements & budget variances  
   • Address business scheduled on the agenda

III • Reports from standing and special committees  
   • Other business

IV  • Address new business

V • Schedule next meeting  
   • Adjournment

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• Motions
  o Unless state law or the bylaws specifically requires otherwise, there is no requirement that:
    • Someone make a formal motion before there is a vote
    • Someone second a formal motion
    • Someone motion to begin or end discussion

• Motions are useful
  o Tell the secretary that a decision is being made that should be reflected in the minutes
  o Tell the group that a decision is called for
  o Force the group to focus on details of the vote

• In short, simplicity is best
The Beauty of the Second

- Requiring that someone second a motion to discuss new business (or business not on the agenda) protects everybody’s precious time
  - If there is not a second to open discussion of proposed new business, the group moves on
- This provides an incentive to the person wanting to bring new business before the group
  - To gauge the level of interest and support
  - To make modifications based upon suggestions
  - To go back to the drawing board and try again

Other Useful Motions

- If a more formal meeting is desirable, the following motions should prove useful
  - Motion to Postpone Consideration: This ends current discussion until a later time or date
  - Motion to Refer: This refers the matter to a committee for further study and analysis. This is a very useful motion because it recognizes that a matter may be more involved than originally thought and cuts off agenda busting efforts during the board meeting
  - Motion to End Debate: This is useful for limiting discussion, and might be combined with a motion to refer the matter to a committee. The chair, as the leader of the meeting, has
(continued)

- some discretion in entertaining this motion—The chair might offer a comment suggesting that more debate is advisable
  - Motion to Withdraw Motion: This motion can only be made by the maker of the original motion
- The foregoing motions are discussed in THE MODERN RULES OF ORDER, referred to earlier
  - These are motions made to the board, not the chair
  - These are secondary motions. They relate to the main motion before the board. There should never be two or more main motions simultaneously under consideration

(continued)

- Motions Directed to the Chair
  - Point of Personal Privilege: Request the chair to address what is termed personal matters—for example, inability to see or hear
  - Point of Procedure: Request the chair to address a procedural aspect of the meeting or a motion
Open Meeting Law

- Do state open meeting laws or the bylaws require the meeting to be open?
- If so,
  - Has the requisite noticed been provided?
  - Is an agenda required to be distributed in advance?
- If executive session is permitted,
  - What topics can be addressed in executive session?
    - Personnel?
    - Litigation?
  - Does board have a mechanism to force compliance?
In Person

- As a general rule, board members should be in the same room, seated around a table
- Everybody recognizes that there is a gestalt that comes with person-to-person communication
  - Body language
  - Subtle cues
  - No distractions
    - Balancing a checkbook
    - Putting the meeting on mute to talk with a colleague who walks in the office
  - Able to see PowerPoint presentations and flipcharts

Teleconference

- On occasion, a conference call is acceptable
  - Someone is:
    - Sick,
    - On vacation,
    - Out of town on business
- Texas law permits participation by conference call: Statute Section 1396-9.11 provides:

  Subject to the provisions required or permitted by this Act for notice of meetings, unless otherwise restricted by the articles of incorporation or bylaws, members of a corporation, members of the board of directors of a corporation, or members of any committee designated by such board may participate in and hold a meeting of such members, board, or committee by means of:

  (1) conference telephone or similar communications equipment by which all persons participating in the meeting can hear each other meeting.
Electronic Meetings

- Texas Statute Section 1396.9.11 permits electronic meetings using videoconferencing technology or the Internet, but only if:
  (a) each member entitled to participate in the meeting consents to the meeting being held by means of that system; and (b) the system provides access to the meeting in a manner or using a method by which each member participating in the meeting can communicate concurrently with each other participant.

See the introductory section of the statute for further limitations.

By E-mail

- On occasion business must be addressed in between meetings
  - Decision to settle a lawsuit
  - Emergency comes up
- Texas law permits consent resolutions: Statute Section 1396-9.10A provides:
  Any action required by this Act to be taken at a meeting of the members or directors of a corporation, or any action which may be taken at a meeting of the members or directors or of any committee, may be taken without a meeting if a consent in writing, setting forth the action to be taken, shall be signed by all the members entitled to vote with respect to the subject matter thereof, or all of the directors, or all of the members of the committee, as the case may be.
- Section 1396-9.10B permits non-unanimous consent resolutions if provided for in the articles of incorporation
- Can the board hold a meeting by e-mail?
E-mail—One Approach

Step 1
Open Meeting?

Step 2
Simultaneous?
No

Step 3
Unanimous?
Yes
No

E-Mail is Deceptive

- In the course of an afternoon, a board faced with a decision can generate hundreds of e-mails
- This will feel like a board meeting
  - Everybody is commenting
  - People anticipate the next round of e-mails
  - People do get emotional
- Suppose 9 of 10 board members participate and reach a decision. They agree to ratify the decision at the next board meeting.
  - Risk is if information changes during the gap and board members change their minds,
  - But the nonprofit changed its position
Audience Questions

- Audience Questions
  - How many of your boards conduct board business by e-mail? Make decisions?
  - Have you consulted with legal counsel whether these decisions are legally binding?
  - Have you consulted with legal counsel about open meeting considerations?

The Best Approach

- Call a special meeting
- Build flexibility into the bylaws for meeting notices
  - Bylaws require at least a 14-day notice, but
  - Create an exception for emergencies
Board members should be expected to regularly attend board meetings in person.
If a board member is a continuous no-show, he should be asked to resign.
- If have a stated policy, this should not create a socially-awkward situation.
  - The trick:
    - Everyone knows the policy in advance.
    - The policy is applied consistently.
    - There is some flexibility in the policy for unusual situations.

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Poor Attendance

Disaster
Board Member Proxies

- As a general rule, a board member may not send a proxy in his place.
  - If the bylaws permit, a board member might send a representative to observe the meeting and report back to the board member
  - Unless state law specifically permits a proxy,
    - A board member’s representative should not be counted for purposes of establishing a quorum
    - A board member’s representative should not be permitted to vote
    - A board member’s representative should not be privy to confidential information (e.g., attorney communications) or participate in executive or closed sessions

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- Lawyers, particularly partners in large law firms, are notorious for sending proxies to nonprofit board meetings. They should know better
- There can be serious consequences if a board treats a representative as a voting member if state law does not permit the use of proxies
  - Issuance of tax-exempt bond could be invalid
  - Decision to enter into a lease or purchase a building could be invalid
Basics

- Board meeting minutes are an important tool
  - Provide:
    - Evidence that the board exercised business judgment
    - Historical information about what the board decided
    - A framework for meetings
    - Clarity through the secretary’s questions
- Minimum coverage
  - Time and date of the meeting
  - Who attended
  - Whether there was a quorum
  - Describe major decisions
    - Votes—For, against, and abstain
    - Record dissent
    - Major threads of the discussion
    - Documents reviewed
(continued)

- In my view, more is better than less
- Others strenuously disagree with my position
- In no event, should minutes become a novel or a “He Said, She Said” account
- Minutes should be reviewed with an eye toward litigation
  - Employment matters
  - Pending litigation
  - Sensitive matters
(continued)

• Mechanics
  o Minutes should be based on a template
  o Minutes should be prepared as soon after the meeting as possible
  o Minutes should be retained in physical form
  o Consider compiling the minutes as an Adobe Acrobat pdf file. This will permit quick searches, which is important after ten years of monthly meetings

• The minutes for the last meeting should be distributed to the board well-in advance of the next meeting

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• After establishing that a quorum is present, the first order of business is to approve the minutes for the prior meeting
Who Takes Them

- In many organizations, the board secretary writes and maintains the minutes
  - This is custom
  - It is not required
- The minutes are an important business and legal document. This task should not be relegated to an administrative assistant
- Lawyers aren’t required to review the minutes, but when there is an issue ripe for litigation, lawyer review is advisable

(continued)

- Be careful about tape recording the meeting
  - It may make writing the minutes easier, but the tape may be evidence or subject to open record laws if the organization is subject to open record laws
  - There may be legal issues with destroying the tape (using it again) if there is litigation
  - Remember: Recording over a tape does not necessarily prevent technology from recovering information
Committee Minutes

- As a matter of best practice, committees should maintain written minutes
- Committees may be required under state law to maintain minutes if the committee has the authority of the board
- All the prior recommendations apply to committee minutes
Basics

• Committees efficiently allow for allocation of board work
• Every board should at least consider the following standing committees:
  o Audit
  o Finance
  o Compensation
  o Membership
  o Gift-acceptance; endowment; and investment
  o Quality/client relations
• An executive committee raises fundamental questions
  o Is the board too large?
  o What power/responsibility is retained by full board?

(continued)

• The board should specify whether a particular committee
  o Has independent decision-making authority, or
  o Is merely advisory
  This may depend in part on whether non-board members serve on the committee
• Board committees
  o Should operate pursuant to a charter
  o Should maintain minutes and records
  o May require
    • A budget
    • Legal counsel
Audit Committee

- Functions
  - Select auditor
  - Supervise work of internal audit staff
  - Review disagreements between management and auditors
  - Review management letter
  - Monitor internal controls
  - Serve as a repository for whistleblower complaints (financial)
- California requires an audit committee for larger organizations

Finance Committee

- Functions
  - Develop operating budget
  - Monitor operating budget
  - Work on outside financing
  - Develop long-range capital budget
- Clearly some financial expertise is warranted, but don’t exclude the non-expert
  - Serving on the finance committee is an opportunity to develop expertise
  - Consider sending non-expert to a training session
If nobody on the board has expertise
  o Think about recruiting a new board member with the expertise
  o Consider hiring an advisor for the committee

Compensation Committee

• Functions
  o Develop and negotiate key executive compensation packages
  o Monitor key executive travel and entertainment expenses
  o Evaluate key executives
  o Develop overall compensation policies
  o Focus on employee benefit plans
  o Develop the public basis for the compensation

• Overarching: Intermediate sanctions
Investment Committee

- **Function**
  - Assess risk tolerances *vis-a-vis* needs and requirements
  - Select invests or more likely investment managers
  - Evaluate investment performance
  - Possibly establishing endowment spending rate
- **Investment isn’t a hobby**
  - Internal (Harvard University)
  - Outside advisors
- **Strategy, given a defined risk tolerance and objectives**
  - Current income
  - Protect principle
  - Enough money for new facility to be built in five years

Other Committees

- Gift-acceptance committee (discuss later)
- Nominating and/or governance
- Special litigation committee
Executive Committee

- Typical for larger boards
- This is where the power is
  - Question for everyone else: Why am I on this board?
- Troubling: The self-perpetuating executive committee
- Issues for the larger board
  - What decisions are retained by the larger board?
  - Does the larger board have duties, or
  - Can it delegate everything?

Caution/Best Practices

- Before appointing someone to serve on a committee, the board should ascertain:
  - Whether the person has a hidden agenda or conflicts of interest
  - Whether the person will be tolerant of other people’s opinion
- Committee appointments should always be recorded in the minutes
- The board always should specify whether the committee has authority to make decisions or is merely advisory. Everyone involved needs to understand this
- The board should determine whether the committee is truly interested in fact finding or just a graveyard for inaction
- The board should determine whether open meeting laws or requirements apply to committee deliberations

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Committee members should recognize that they are fact finders or charged with other specific tasks. Like the board, committee members should not interfere with staff or supplant management.
Basics

- At each meeting, the board should spend time reviewing the organization’s interim financial statements, with a comparison to the budget line-items
  - The board should ask questions about significant variances from budget, demanding specific solutions for the troublesome variances
  - The board should regularly review key financial metrics
- The board should review and approve an annual budget for the nonprofit
  - The budget can be assembled by staff members

(continued)

- The board’s focus should be on the assumptions underlying the numbers rather than re-footing columns
- The board should stress test the budget
- The board should review the budget on an activity-by-activity basis
- The board should monitor the nonprofit’s system of internal and financial controls
- The board should review the annual Form 990
- The board should review the auditor’s annual management letter
A Lot of Work: Committees

Board of Directors

Finance Committee

Audit Committee

LT Capital Budget

Dev. & Monitor Operating Budget

Long-Term Finances

Involved with External and Internal Auditors

Whistle blowers

Management Letter

We have reviewed the financial statements using Generally Accepted Auditing Standards

The statements present fairly, in all material respects, the results of operations and the financial position of the nonprofit in conformity with Generally Accepted Accounting Principles

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SAS No. 99

- SAS No. 99
  - Exercise professional skepticism
  - Discuss risks of fraud
  - Identify key programs and controls to prevent fraud
  - Evaluate internal controls
  - Evaluate audit evidence
- Turn SAS No. 99 on its head
  - Board members should read it and adopt its philosophy

(continued)

- The board (it refers to the CPA) should
  - Exercise skepticism
  - Discuss the risks of fraud: Identify where is your organization vulnerable?
  - Talk to insiders
  - Consider the results of analytical procedures to identify fraud
    - Ask about the bank reconciliation
    - Ask about review of expense accounts and documentation
    - Evaluate the rationale for unusual transactions
Ask why there are so many revisions to interim financial statements
Set the right tone at the top
  • Put a conflicts-of-interest policy into practice
  • Adopt an ethics policy
  • Eliminate perceived inequalities
  • Recognize good job performance
  • Avoid nepotism
  • Promote from within
  • Establish clear responsibilities for each employee
Basics

- The board is always responsible for hiring and evaluating the executive director, CEO, or other chief executive, whatever the title
  - The board must define the position’s duties
  - The board often must decide on key criteria for hiring
    - Subject matter expert
    - Administrator
    - Fundraiser
    - Spokesperson
  - The board must identify a person who has a vision for the organization that matches the board’s own vision

Consequences of Failure

- Failure to pick the right executive director can severely damage or impede the nonprofit
  - Milwaukee Public Museum: Although not a social service agency, the Milwaukee Public Museum’s financial meltdown holds many lessons for all nonprofits, including executive recruitment. Within a five- or six-year period, the museum has a succession of three executive directors. Each brought his own vision and plans. Some have attributed the museum’s financial problems, at least in part, to expenditures on major programs that were made to implement each executive director’s vision, coupled with a failure to follow through on the last executive director’s project by the newest executive director
Then NAACP President Bruce Gordon resigned in March 2007 after just two years on the job.

- The Washington Post reported that the resignation followed long running disagreements between the board and Gordon.
- Apparently,
  - Gordon’s focus was on social service, while
  - The NAACP board’s focus was on social justice and advocacy.
- Gordon told the Associated Press, "I believe that any organization that’s going to be effective will only be effective if the board and the CEO are aligned, and I don't think we are aligned."
- Gordon was a high-powered executive from Corporate America. The NAACP past leaders had been ministers, politicians, and civil rights advocates.
Basics

• One of the board’s basic functions is setting compensation
  o For the executive director and other top tier executives, this means negotiating the entire pay package, including base salary, deferred compensation, and perquisites
  o For the staff, this means
    • Setting compensation policy and approving plans
    • Setting overall COLAs and pay-increase policies, but
      The board should not be involved in setting individual compensation
  • Going hand-in-hand with setting the executive director’s compensation is assessing performance

(continued)

• This is a critical function
  o State attorneys general and congressional officials are focused on compensation
    • American University
    • Head Start cap on salaries
  o The IRS is focused on compensation
    • Section 4958 and the intermediate sanctions
    • Report on Exempt Organizations Executive Compensation Compliance Project—Part I and II (March 2007)
      • Reviewed 2000 (c)(3)
        • Compliance checks
Audits Resulted in $21 million in assessments against 40 disqualified persons or organizations managers, which works out to about $500,000 per person. Expect much more activity in this area. The 2009 IRS Hospital Hospital Study makes clear that compliance with the rebuttable presumption is a good way to avoid tax troubles.

Form 990 is a public document, readily available at http://www.guidestar.com. The media starts with the Form 990 whenever investigating a nonprofit—WHY? Employees regularly review the Form 990—WHY? Part VII of the 2008 Core Form 990 and Schedule J.

Setting Compensation

Independent Board or Committee

Review Comparables & Market

Review Performance

Document the Compensation Package

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Independent Board or Committee

- Either the board or a compensation committee should address executive compensation
  - Using a committee is probably the most economical approach in terms of board efficiency
  - If a compensation committee is used, it should make a recommendation to the board, but the full board should approve the compensation package
- Whoever decides executive compensation, the decision must be free from conflicts of interest
  - Identify back scratching relationships

A Lot of Work: Committee

Chinese Wall

- Executive Director
- Board of Directors
- Compensation Committee
- Independent Compensation Consultant
- Develop & Negotiate Exec. Comp.
- Evaluate Executive
- Set Overall Compensation Tone
- Executive Reimbursement Review
- Intermediate Sanctions

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Performance Review

- The board should define the elements of the job
  - Mission
  - Leadership
  - Fundraising (charitable contributions and grant)
  - Human relations
  - Public relations
  - Advocacy
  - Administration
  - Relationship with board
- The board must define metrics or benchmarks so that performance can be measured
- Concrete feedback must be provided

Comparables

- Sources for comparables
  - Large consulting firms
    - Mercer Human Resources
    - Hewitt Associates
  - Large accounting firms
  - Surveys
    - Conference Board—www.conference-board.org
    - WorldAtWork
  - State Nonprofit Associations—see National Council of Nonprofit Associations Web site for a current list
  - GuideStar: Review Form 990s for comparable organizations
• The board must define the market of firms that it is competing with for executive talent
  o What types of organizations?
  o Where are the competing organizations located?
    • National, or
    • Local?
  o Which employers buy similar skills?
  o Is size of the organization (assets and revenues) a consideration?
  o Is level of organizational complexity (number of employees, subsidiaries) a factor?

Documentation

• The contract should be reduced to writing, if for no other reason than tax considerations
• All fringe benefits and perks should be contemporaneously documented
• The board should be provided with a tally sheet as part of the decision process, which summarizes in clear numbers
  o Current compensation
  o Fringe benefits
  o Deferred compensation
Specific Steps to Avoid Problems

- Board Should Eliminate Consultant Conflicts: The board should retain the compensation consultant, not the executive
  - Avoid consultants who already provide services to the nonprofits such as designing qualified plans or writing employee manuals
  - If the executive decides who receives contracts for that type of work, the consultant is conflicted
- Board Should Compare Apples to Apples: When using comparables, make sure the comparisons are to comparable organizations

(continued)

- For-Profit
  - Johnson & Johnson to Eli Lilly
- Nonprofit
  - Religious-based social service agency to a secular one
  - Art Institute of Chicago to Metropolitan Museum of Art
    - New York is an outlier
    - Art Institute runs a school, in addition to a museum
  - A CAP with two programs to a CAP with 16 programs
- Board Should Use Cash When Possible: Eliminate perquisites to the extent possible and pay cash
  - The media, government officials, and employees seem to focus more on outlandish perquisites than on aggregate cash compensation
Given that fact, don’t draw a bull’s-eye on the board’s back. Even in social service agencies, 
• Try to eliminate company cars 
• Questionable trips 
• Expense accounts

• Board Can Rely on Bonuses: Bonuses are perfectly permissible, but only if 
  o The bonus is linked to demonstrable achievements which are directly linked to personal effort rather than outside factors that the executive cannot control 
  o A bonus should never be paid just because there is some extra cash lying around

Board Should Pay Severance for Transition, Not Lifestyle: Providing an executive with severance is appropriate, just as it is for any employee. But severance payments should be designed to help the executive transition to the next phase of his life, not to support his grandchildren for the next twenty-five years

• COLA Adjustments Should be Consistent: When the board chooses to provide for a cost-of-living adjustment, the same rate should apply no matter which employee is receiving the increase
Board Should Avoid the Lake Wobegon Syndrome:
According to Garrison Keillor, in Lake Wobegon, "the women are strong, the men are good looking, and all the children are above average."

- A common practice when reviewing compensation comparables is to peg an executive’s compensation at the 70th percentile.
- A first time executive or someone who is new to the particular type of operation should not necessarily be pegged at 70%.

Board Should Receive a Tally Sheet: To repeat, when deciding on an executive’s compensation package, the board should review a “plain English” tally sheet that concisely shows the executive’s compensation, broken into the following categories:

- Cash
- Fringe benefits, with each benefit that comprises 5% or more of the total fringe benefits listed
- Prerequisites, with each detailed
- Deferred compensation and fringe benefits
  - Present and future value
Cost

- Board Should be Able to Verbalize Basis Compensation: Each board member should be able to verbalize the amount of compensation, how the package is consistent with the organization’s objectives, and why the amount is justifiable.
The Duty to “Shut Up”

- Board members who disagree with a board decision have a duty to remain silent if discussion of the issue might result in damage to the nonprofit or undermine the decision.
  - Examples include:
    - A decision by the board not to waive attorney-client privilege. Board members should not disclose these confidences unless the board authorizes disclosure. The privilege belongs to the board, not to an individual member.
    - A disagreement over an employment decision. If the board decides to dismiss an employee during an executive session, an individual director should honor the decision. Vocal disagreement could result in an employment practices lawsuit, depending on the circumstances.
A disagreement with how the board is handling a legal matter such as a lawsuit

- The focus is on confidential information
  - Assuming the board’s meetings are not open to the public, confidential information would include:
    - Views of individual board members
    - Work product
    - Information provided by experts
  - In all cases, confidential information includes discussions and decisions made during executive sessions. To the extent disclosure is required, it should be made through a designated spokesperson

Exceptions

- The duty to maintain confidential information is rooted in the duty of loyalty, but the duty to loyalty is owed to the organization, not to individuals
  - At times, that may require that a board member must make a public disclosure or a noisy withdrawal as a board member
  - Examples of these situations might include:
    - The board authorizes the destruction of documents after receiving a subpoena
    - The board or its members are violating the nonprofit’s policy on expense reimbursements
    - The board authorizes the nonprofit to enter into a contract that is illegal
    - The board authorizes the submission of false claims for reimbursements from the federal government
    - The board has abdicated its duties, resulting in a clear monetary loss to the nonprofit
Sometimes the decision to blow the whistle will be extremely difficult and unclear. For example, a board might decide to dismiss an employee. During the course of the deliberations, everyone agrees there is concrete evidence that the employee was incompetent, but two board members say, “And besides, he is old and overpaid.”

- The primary motivation for the dismissal is incompetence
- But the side comments could be the basis for an action for illegal age discrimination
  - Must the board act out of the purest of hearts?
  - Does it matter whether it is a violation of criminal or civil law?

In my view—and this is just an opinion—a board member should always err on the side of non-disclosure when there are ambiguities

- The board member should make sure that his dissent is reflected in the meeting minutes
- If the board member could face potential liability, he should consult with a lawyer
Questions of Policy

- Some organizations take public policy positions (e.g., advocacy organizations)
- In this case, it is my view that board members are permitted to publicly challenge the decision
  - Publicly taking the other side of the issue serves an educational function
  - The board member may be reflecting a minority viewpoint
  - Public discussion of the issue could result in the organization eventually changing its position
- In voicing a contrary view, the board member must be willing to accept the consequences. For example, he might not be re-nominated for a position on the board
“I Don’t Want to be Sued”

• Anytime there is a controversial decision, someone will say, “I don’t want to lose my house over this”
• Reality check:
  o Very few nonprofit directors are ever sued
  o Even fewer nonprofit directors are ever held personally liable
• It can happen, but.....
• If you:
  o Regularly attend meetings
  o Ask questions and review information provided to you
  o Avoid conflicts of interest

(continued)

• Make sure your dissent from decisions is duly recorded in the minutes
• As a board, seek expert advise when the circumstances warrant You should not have a problem
• If a director is held personally liable, liability will most likely will result from one of the following:
  o Participation in a transaction involving conflicts of interest, particularly if the conflict is undisclosed, including looking the other way if the director has some other relationship with the person or entity that benefits from the conflict
A decision that violates the law, which could include
- A failure on the part of the nonprofit to remit trust fund taxes (employee wage withholding; employee’s share of FICA, Medicare, and state unemployment taxes; and state sales and use taxes)
- A failure to maintain workers’ compensation insurance

Approval of
- A loan (usually to an insider), or
- A distribution of assets or income
  if either is prohibited under the state nonprofit corporation act
- Approval with the requisite level of intent of a transaction prohibited by one of the many excise taxes found in the Internal Revenue Code

Private foundation excise taxes (e.g., self-dealing, excess business holdings, jeopardy investments)
- Public charity intermediate sanctions
Protection

- You are protected by:
  - The Business Judgment Rule, which focuses on the process by which a decision was made rather than whether in hindsight it was a good or bad decision
  - The liability shield built into most nonprofit corporation statutes
  - The Volunteer Protection Act, assuming
    - The director is acting as a volunteer
    - The person bringing the lawsuit is not
      - The government (e.g., state attorney general)
      - The nonprofit, itself
Basics

- State statutes often provide for indemnification by the corporation of a director who is held liable while acting in his capacity as a director
- The indemnification
  - Can be mandatory in some instances, or
  - Voluntary, the corporation must adopt a provision providing for it
- The indemnification can be subject to the approval of
  - The board
  - The state attorney general
  - A court

(continued)

- The indemnification can be subject to a standard or condition
  - The director acted in good faith
  - The liability did not arise because of a criminal act or a conflict of interest
- The critical point:
  - Indemnification is only as good as the assets that stand behind it
  - If the indemnification requires approval, what good is it if everyone hates you?
Basics

- D & O (directors’ and officers’ liability insurance) provides the best protection against liability
- Nonprofit D & O insurance is relatively inexpensive
  - Most recent quotes are $1,000 premium for $1,000,000 of the coverage, or in the case of a foundation, $1,000 per $1,000,000 in assets
  - The nonprofit is purchasing liability protection for its directors, but as a practical matter, it is purchasing defense costs for its directors against what are often nuisance suits
Directors should not rely on
- Homeowner’s policy
- Umbrella policy, or
- Professional errors and omissions policies

These policies often contain exclusions for board service

- D & O insurance is written on a claims made rather than an occurrences basis
- Here are the relevant points in time for a claims-made policy

Renewal policy refers to original retroactive date

If renew policy, protected for occurrences during the prior policy periods

Claim made, event occurs after retroactive date and notice given—Sometimes coincides with incorporation date

Claim made & notice given—PURE

Retroactive Date

Expiration Date

Renewal Date

Beginning of Time

Policy Inception Date

O/S Notice Date

Extended—30 or 60 days
**Tail Coverage**

Tail Coverage—Covers claims made with respect to events that occurred while policy in effect, but not claims made with respect to events that occur after the policy is discontinued.

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
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Price as a % of annual premium

Discontinue policy because discontinue operations

---

**Sides of Coverage**

Direct coverage of the directors and officers

A-Side Coverage

C-Side Coverage

B-Side Coverage

Direct coverage of nonprofit for own “wrongdoing”

Reimburse nonprofit for indemnification payments
Key Considerations

- What claims are covered?
  - Claims arising from conflicts of interest?
  - Claims arising from intentional violations of the law?
  - Claims and expenses attributable to criminal acts?
  - Claims attributable to fines, penalties, or punitive damages?
  - Claims arising out of employment practices?
    - Is a separate policy or endorsement advisable or required?
- What happens to already reimbursed expenses if the insured ultimately is found criminally liable or to have engaged in other uncovered behavior?

(continued)

- Does the policy cover the costs of mounting a legal defense?
  - Are the expenses reimbursed at the conclusion of the lawsuit or paid directly by the insurance company as incurred?
  - Do the defense costs reduce the overall policy limits (inside the policy) or are defense costs covered outside the overall policy limits? Princeton University
  - Who puts on and controls the defense,
    - The officer or director, or
    - The insurance company?
(continued)

- When must notice be given?
  - A request for money or the filing of a lawsuit (easily identifiable events), or
  - A complaint
- Does the policy contain a severability provision?
  - Normally, if a false statement is made during the application process, the insurance company can void the policy
  - A severability provision protects the innocent insureds by providing that they still have coverage
- Is an officer or director covered once the person is no longer serving in that position?

(continued)

- Does the policy contain an insured vs. insured clause?
  - Insurance companies don’t want to pay claims arising from intra-family disputes—one board faction suing another
  - An insured vs. insured provision eliminates coverage for these sorts of disputes
  - This can be a problem if the nonprofit is suing a director. The director could lose coverage. This depends on the terms of the clause. Princeton University
Tips

- When applying for coverage, make sure financial statements and Web sites are accurate. False statements could void coverage even though not attached to the application
- Don’t wait to file a claim out of fear that a mere notice could result in higher future premiums. It might, but the failure could eliminate coverage

CONCLUSIONS

CAPLAW National Training Conference

Governance: The Nuts and Bolts
June 24, 2009
Five Critical Points

- Boards have an oversight role no matter what organizational theorists say
- Much of what constitutes good governance is nothing but common sense
- Good governance is worth the price. Lapses in governance are often direct contributors to economic loss and failures to achieve mission
- Board member liability is a possibility, but a relatively remote one
- Civility and a willingness to work together are critical (check your ego at the door)

USEFUL RESOURCES

Governance: The Nuts and Bolts
June 24, 2009
### Useful Resources

- **Jack B. Siegel**, *A Guide for Nonprofit Directors, Officers, and Advisors: Avoiding Trouble While Doing Good* (John Wiley)
- **Krista Kissman**, *Taming the Troublesome Board Member* (BoardSource)
- **John Carver**, *Boards That Make a Difference* (Jossey Bass)

### (continued)

- **Marion Fremont-Smith**, * Governing Nonprofit Organizations, State and Federal Regulation* (Belknap Press)
(continued)

- Charitygovernance Blog (at http://www.charitygovernance.com)
- CAPLAW (at http://www.caplaw.org)
- Don Kramer's Nonprofit Issues (at www.nonprofitissues.com)
GOVERNANCE: THE NUTS AND BOLTS
PATRICIA STEIGER AND JACK B SIEGEL
CAPLAW NATIONAL TRAINING CONFERENCE
JUNE 24, 2009

TAKE AWAY POINTS

The following ideas occurred to me during today’s session that might be worth implementing when I get back to the office:

1.

2.

3.

4.

5.
The Ten Spot Club is viewed by many as one of New York City’s more unique clubs, providing a steady diet of jazz, avant garde, and other challenging music over the years. What may surprise some is the fact that it is a nonprofit organization—Section 501(c)(3)—named the Institute for New and Exciting Cultural Experiences. Anyone who has attended clubs of this sort knows all too well that the audiences are often small, meaning that keeping the doors open is always a challenge. It appears from recent tax returns that the Ten Spot’s board and officers have been doing a fairly good job in terms of the finances. The last available tax return on GuideStar reports a $50,000 deficit on $2.9 million of 2007 revenue. However, the organization ran at close to a $150,000 surplus in 2006 and it had a $35,000 surplus in 2005. The Ten Spot only has a $300,000 endowment, but asking for a larger endowment may be asking a lot for this type of organization.

There is now an apparent dispute between the executive director, Evelyn Kindell, and members of the board that threatens to hinder the organization’s operations. Ms. Kindell founded the organization in 1983.

According to a February 20, 2009 article in the New York’s Daily Tattler, the board recently approved a plan to restructure the executive director position. Under the proposal, Ms. Kindell would have continued as the executive director, handling the programming and fundraising responsibilities. However, the position of business manager is to be created. The business manager would be responsible for day-to-day operations. According to the Tattler, the idea of a business manager originated with Ms. Kindell. However, she told the Tattler in a recent interview,

I proposed this idea, but on second thought it is a bad one. Nobody will take the position for the amount of money we can afford to pay. We have a choice: Hire a business manager or cut programming 20%. There is no choice under those circumstances. I’ll just have to keep doing everything.

Something happened in between the proposal and its execution. The board has now suspended Ms. Kindell without pay, apparently because, in their view, she resisted the plan as it began to evolve and as candidates were interviewed. Both sides have their side to the story. If they decide to argue it out in court, one side will prevail as a matter of course, but the Ten Spot may be the ultimate loser.

During the course of the interview, Ms. Kindell told the Tattler,

I have obtained all the funding for this organization. We have ten grants of over $100,000 each from local foundations and corporations. If I go so goes the grant money.
Several of the Ten Spots’ directors have been commenting on the dispute on the widely read Music Scene blog and in newspaper interviews.
CALL TO ORDER:
The meeting was called to order at 7:03 PM at the Agency’s headquarters in the second floor conference room. Board members present were Susan Appel, Morris Catwald, Mary Fischer, Eleanor Metcaffe, Lawrence Nickel, Felicia Roberts, Laura Smithers, Jimmy Watson, and Marcus Wiley. Wilson Owens and Jude Sheik were absent. The nine board members in attendance constituted a quorum. Also present were Susan Milano, Executive Director, and Mabel Jennings, CFO.

APPROVAL OF MINUTES:
The minutes for the January 19, 2009 board meeting were approved.

NEW BUSINESS—VERSION I

Ms. Milano requested permission from the board to terminate Larry Jenkins, the head of the Agency’s information technologies department, for cause. The board agreed to terminate Mr. Jenkins. Mr. Catwald was the sole dissenting member of the board.

Ms. Milano requested permission to purchase new wastebaskets....

NEW BUSINESS—VERSION II

Ms. Milano requested permission from the board to terminate Larry Jenkins, the head of the Agency’s information technologies department, for cause. Ms. Milano informed the board that during the second week of April, three computer hard drives failed. When this was brought to Mr. Jenkins’ attention, he first replaced the hard drives, but discovered that the server side backup system had not been backing those three computers up on a regular basis. Consequently, three months’ of Agency accounting data was lost.

Ms. Milano reminded the board that this is not the first time Mr. Jenkins has been responsible for the loss of data. Last December, all of the Agency’s Head Start records were lost when two computers failed. Once again, backup procedures were in place, but through errors on Mr. Jenkins’ part, the system was not properly functioning. In April of 2007, there was a similar incident involving all the records for the Gaylor Street Housing Project, a 210-unit low-income apartment complex operated by the Agency. In the case of the Head Start data, the Agency advised the appropriate government officials about the problem. These officials indicated that the Agency should try to reconstruct the data to
the extent possible, but that as long as this did not happen again, they would not take adverse action against the Agency.

Mr. Catwald defended Mr. Jenkins, arguing that everyone knows that computers fail on occasion. Ms. Milano pointed out that the system vendor had provided the Agency with detailed test procedures to make sure that the servers were backing up the data, but that Mr. Jenkins had ignored the procedures. When Ms. Jenkins called the vendor, they sent a technician out who was able to document that none of the procedures had been followed. She also noted that Mr. Jenkins had attended a three-day training course in Las Vegas after the system was purchased. Ms. Milano also stated that Mr. Jenkins had been warned at his last three annual performance reviews that there were indications that he was not following procedures. Those reviews and warnings were documented in writing.

Ms. Roberts agreed that Mr. Jenkins should be terminated for cause, but expressed concern that he might claim that Ms. Milano was retaliating against him for informing the board that Ms. Milano had on occasion shopped online using the Agency’s computers, which was against Agency policy. Mr. Nickel noted that the board’s investigation had determined that Ms. Roberts’ activities had been a violation of policy, but that the board decided to modify the policy to permit employees to use their computers for personal Internet use not to exceed 15 minutes per day. He also noted that this occurred two years ago.

The board recognized that there is always risk of a lawsuit when an employee is terminated, but that having an IT Department head who repeatedly fails to follow backup procedures is simply unacceptable, particularly when there have been three major failures to recover data, all three directly attributable to Mr. Jenkins’ inability to adhere to basic procedures. Following a discussion that lasted thirty minutes, the board approved the termination, with one member dissenting.

The board advised Ms. Milano to work with Evelyn Kaplan, the Agency’s outside employment law counsel, on how to handle the mechanics of the termination. Ms. Kaplan had previously told Ms. Milano that although Mr. Jenkins is an at-will employee, there is a growing trend in the state’s court system to impose constructive employment contracts, and that several facts here may provide Mr. Jenkins with a claim that he is entitled to severance pay equal to his annual salary under such a constructive contract.

NEW BUSINESS—VERSION III

Ms. Milano requested permission from the board to terminate Larry Jenkins, the head of the Agency’s information technologies department for cause. At that point, Mr. Catwald objected to the criticism being leveled against Mr. Jenkins. Screaming at Ms. Milano, Mr. Catwald said, “You’ve never liked Larry because he is a man. If you had your way, there would only be women employees in this agency.” Ms. Milano responded,
“I am not going to dignify that with a response. I know that you see Jenkins socially. You should know what a big drinker and gambler he is. I bet he didn’t attend the training sessions when he was in Las Vegas, probably at the slots all day.”

A number of board members tried to intervene, but the dispute between Mr. Catwald and Ms. Milano continued. Mr. Catwald kept yelling about giving Mr. Jenkins a second chance. Ms. Milano responded that he had three chances and had skipped out on his training in Las Vegas. In between the screaming, Ms. Metcaffe said that everyone should be primarily concerned with the security of the Agency’s data. Mr. Watson and Ms. Nickels were in agreement with Ms. Metcaffe.

Mr. Catwald said the data would be secure if the Agency had better backup equipment. Ms. Milano said the equipment came from the highest rated manufacturer, but it required a competent operator. She said Mr. Jenkins was incompetent. Ms. Milano said she had been forced by the board to take Mr. Jenkins, but never found him to be competent. In fact, she referred to him as a “drunken moron.” In response Mr. Catwald then reminded Ms. Milano about her personal use of the computer. “I bet you were looking at the latest fashion news, I know you,” he yelled. Ms. Milano noted that she had worked late the night before her online shopping excursion, so she couldn’t do her Christmas shopping. She then pointed out that she was buying a copy of the Bible for her sick mother as a Christmas present from Amazon.com. Mr. Catwald responded, “Your mother may be religious, but I know what interests you.”

These exchanges went back and forth for another twenty minutes. The board then decided to fire Mr. Jenkins.

**QUESTIONS FOR DISCUSSION**

A. Why do boards maintain minutes?

B. Which set of minutes is the preferable one?

C. Doesn’t Version I say everything that needs to be said? Why say more than noting that a decision was made and that one board member dissented?

D. Why mention the contact with Head Start in Version II? Doesn’t creating evidence of the dispute between Mr. Jenkins and Ms. Milano provide Mr. Jenkins with ammunition should he decide to sue for wrongful termination?

E. Doesn’t Version III best portray what happened at the meeting? Isn’t that the point of the minutes?

F. Should Mr. Catwald take any action after reading Versions II or III?
G. Is Mr. Jenkins precluded from suing members of the board as long as board does not “publish” the minutes?

H. Should this matter have been handled in executive session, assuming the regular board meeting was otherwise open to the public or the membership?

I. Does the reference to the advice Ms. Kaplan gave to Ms. Milano in Version II waive attorney-client privilege with respect to that advice? Even if there would be a waiver, should the secretary nevertheless describe Ms. Kaplan’s comments in the minutes?