NONPROFIT FORUM

Conflicts of Interest on Nonprofit Boards:
The Law and Institutional Policy

By Beverly M. Wolff

I. Introduction

A recent spate of scandals involving self-interested transactions between nonprofit institutions and their trustees has injured nonprofits in the eyes of the public and the press. Adelphi University and the Boston Children’s Heart Foundation, among others, have raised the issue of how nonprofits should be run and regulated. The impact of these scandals may reach far beyond the small number of institutions that have suffered abuse from their trustees. The charitable-giving public, Congress, the Internal Revenue Service, and state attorneys general have become more suspicious of nonprofits and their management practices.

Although such abuses might be deterred by effective enforcement, ¹ it is more appropriate for nonprofits to protect themselves from trustee abuse. Whether or not allegations of abuse are true, an investigation of trustee self-dealing may greatly damage donor confidence in the institution and further damage an abused nonprofit. The challenge is to find a method of self-regulation to prevent abuse by nonprofit fiduciaries, without subjecting innocent trustees to excessive liability or harassing law suits, or sacrificing the benefits nonprofits may gain from some transactions with their trustees.

The purpose of this paper is to look at the narrow question of whether the current legal duty of loyalty standard is adequate to prevent abuses on nonprofit boards. Would the current nonprofit loyalty standard provide the framework for fair transactions if it were uniformly

¹Copyright © 1998 Beverly M. Wolff. I would like to thank Sara Geelan, Law Clerk in the Office of General Counsel of The Museum of Modern Art, for her assistance in the preparation of this paper.
²In most instances, only the attorney general, whose resources are severely limited, and the trustees and officers of a nonprofit organization have standing to enforce trustees’ duty of loyalty in court. State attorneys general and other charity regulators have to date brought few cases to court, but they are attempting to step up their supervisory and enforcement roles in response to what appears to be increased need. The IRS also plays a role in enforcing trustees’ duty of loyalty: a self-dealing transaction from which a trustee benefits, is one way nonprofit assets may end up in the hands of a private individual, breaking the IRS rule against private inurement. Internal Revenue Code § 501(c)(3) and § 170(c)(2)(C) require that “no part of the net earnings of [the nonprofit corporation] inures to the benefit of any private shareholder or individual.” Additionally, Congress has recently enacted “intermediate sanctions,” an excise tax they can impose on a self-dealer rather than the nonprofit. 26 U.S.C. § 4958 Taxes on Excess Benefit Transactions. The IRS can impose a 25% tax on the “excess benefit” derived by a self-dealing trustee and a tax of 200% of the excess benefit derived if the harm to the nonprofit is not corrected. 26 U.S.C. § 4958(b). Some commentators question whether the IRS is the proper body to regulate nonprofit entities, organized under state laws, and if the IRS has adequate resources to do the job. See Deborah A. DeMott, Self-Dealing Transactions in Nonprofit Corporations, 59 Bklyn L.Rev. 131, 140 (1993).
followed and enforced? Alternatively, would the nonprofit community be better served if the standard were made more stringent, either legislatively or voluntarily? Part II of this paper reviews the current standard of loyalty generally. Part III addresses the specific legislative articulation of this standard and recent case law application of that standard. Part IV explores proposals for legislative reform and institutional initiatives to address real and perceived duty of loyalty concerns.

II. Current Law on a Trustee’s Duty of Loyalty

Nonprofit trustees, as fiduciaries, owe the institutions they manage a duty of care and of loyalty. Self-dealing transactions between a nonprofit and its trustees have the potential to violate this duty of loyalty. A trustee’s private profit interest may color her judgment regarding the appropriateness of a transaction for the institution. The goal of the law as applied to nonprofits is to protect the institution from insiders who might abuse their privileged status.

Trustees may abuse their power by violating the corporate opportunity doctrine as well. A trustee will breach his duty of loyalty if he uses information acquired from his “insider” status to benefit himself at the expense of the institution. This may be a more common occurrence than other fiduciary abuse since many nonprofits seek out trustees with similar interests as the institution, and the issue of abuse may not always be apparent. For instance, an art museum will often have prominent art collectors on its board, and an environmental organization may have prominent land owners on its board.

A. Application of the Corporate Standard of Loyalty to Nonprofits

The trend in nonprofit corporation laws, and case law, is to apply roughly the same fiduciary standards to trustees of nonprofits as are applied to directors of for-profit corporations. This standard allows nonprofits to transact business with their trustees or with entities in which

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2 For the purposes of this paper, the term “trustees” is used to distinguish the governing board of nonprofit institutions from “directors” of for-profit corporations. Unless noted, all trustees referred to are corporate directors of nonprofit corporations, not trustees of charitable trusts.

3 Fiduciary duties are imposed on people in a position of trust with a person or entity that cannot protect itself, including trustees of public and private trusts and directors of nonprofit and for-profit corporations. See e.g. Uniform Fiduciaries Act § 1(1).

4 See Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries, 381 F.Supp. 1003, 10013 (D.D.C. 1974) (the modern trend is to apply corporate rather than trust principles in determining the liability of the directors of charitable corporations); N.Y. NOT-FOR-PROFIT CORP. LAW §§ 715, 717, 719; and REVISED MODEL NONPROFIT CORPORATION ACT (RMNCA) §§ 8.30, 8.31.
their trustees are interested, provided conflicts of interest are disclosed and transactions are approved by a majority of disinterested trustees.\textsuperscript{5} For-profit institutions can engage in such transactions without violating corporate law if they follow the rules of procedural fairness.\textsuperscript{6} Under the business judgment rule, a court cannot inquire into actions of corporate directors “taken in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes.”\textsuperscript{7}

While the “fairness” of the transaction is the standard by which self-dealing transactions in nonprofits are judged,\textsuperscript{8} it is more difficult to determine whether a transaction is fair to a nonprofit than it is for a for-profit corporation. In addition to economic fairness, a nonprofit must consider how a transaction would impact its charitable mission, which, rather than the pursuit of profit, is its primary purpose.\textsuperscript{9} A nonprofit’s mission may be compromised by the mere appearance of impropriety in its dealings with its own trustees. Such an appearance may handicap the organization’s effectiveness in the community, and its fundraising efforts. A nonprofit must protect itself from the actual harm of such transactions as well as the reputational harm it would suffer if its public believed it were operating to benefit its trustees personally.

\textsuperscript{5}N.Y. NOT-FOR-PROFIT CORP. LAW § 717(a), RMNCA § 8.31.
\textsuperscript{6}Del. GEN. CORP. LAW § 144, N.Y. BUSINESS CORP. LAW § 713, and ALI Principles of Corporate Governance § 5.02 state that directors will not breach their duty of loyalty by transacting business with the corporations on whose boards they serve if (1) in advance of the transaction the director’s interest is disclosed to the Board of Directors and the transaction is approved by a majority of the disinterested directors; (2) in advance of the transaction the director’s interest is disclosed to the shareholders, and the transaction is approved by a majority of disinterested shareholders; or (3) the proponent of the transaction can affirmatively establish that the transaction was fair to the corporation at the time it was entered into. If these procedural rules are adhered to the corporation’s decision to enter into the transaction will be evaluated under the business judgment rule, as applied by courts and the ALI Principles of Corporate Governance § 4.01.
\textsuperscript{7}Auerbach v. Bennett, 393 N.E.2d 994, 1000 (N.Y. 1979) (corporate directors have the authority and responsibility of making business judgments and there is no objective standard by which courts can measure their correctness).
\textsuperscript{8}N.Y. NOT-FOR-PROFIT CORP. LAW § 715, RMNCA § 8.31, CAL. CORP. CODE § 5233 (California provides a test to establish the fairness of the transaction). See also Oberly v. Kirby, 392 A.2d 445 (Del. 1990), which offers an example of the application of the corporate standard of loyalty in the evaluation of an interested transaction. The Delaware Supreme Court considered and upheld the fairness of a transaction between a family foundation and a related close corporation. The corporation’s redemption of all its stock owned by the foundation represented a “virtual paradigm of an ‘interested’ transaction.” However, the court found that under Delaware law, an interested transaction could be upheld by a neutral decision making body, either (1) a committee of independent directors, (2) the courts, as a legal stand-in for stockholders of a for-profit corporation, or (3) the Attorney General representing the charitable beneficiaries. After the court determined that there were no disinterested board members, it examined the intrinsic fairness of the transaction, acting as a stand-in for stockholders of a for-profit corporation. Although this case involves an incorporated private foundation, it provides a good example of how the corporate standard would be applied to a public charity because Delaware law does not distinguish between such public and private charities.
\textsuperscript{9}The Delaware Supreme Court has said that a nonprofit is “created for a limited charitable purpose rather than a generalized business purpose, those who control it have a special duty to advance its charitable goals and protect its assets. Any action that poses a palpable and identifiable threat to those goals, or that jeopardizes its assets would be contrary to the Certificate of Incorporation and hence ultra vires.” Oberly v. Kirby, 392 A.2d at 462.
B. Application of the Charitable Trust Standard of Loyalty to Nonprofits

The historical alternative to the corporate standard is the trust standard of loyalty, which forbids any transactions between the fiduciary and the entity he serves. This standard has been applied to nonprofits under the analogy of a nonprofit to a charitable trust. The higher trust standard imposes liability on fiduciaries for negligent violations of their duties, while the corporate standard imposes liability on fiduciaries only if they have been grossly negligent in their duties. This low threshold encourages conservatism and punishes reasonable risk taking by nonprofit trustees, for fear that in retrospect a court would find the action negligent.

Courts have been reluctant to enforce either the trust or corporate standard of loyalty on nonprofits when their trustees breach their duties. The fact that trustees donate their services to nonprofits has discouraged courts from exacting penalties on wrongdoers in the absence of bad faith. It has been suggested that a court should give deference to a donor’s decision to endow a corporation rather than a trust, and therefore should not impose the higher fiduciary standard to the organization.

Query whether application of the trust standard would reduce beneficial interested transactions between a nonprofit and its trustees. Under this standard, any transaction between a trustee and the trust beneficiary would be voidable at the election of the beneficiary, regardless of its fairness. If the trust standard were applicable would a trustee be less likely to enter into favorable transactions with a nonprofit because the nonprofit’s option to void the contract would create unacceptable uncertainty for the trustee or his affiliated business.

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10See James J. Fishman, The Development of Nonprofit Corporation Law and Agenda for Reform, 34 Emory L.J. 617, 656 (1985) (noting that the law of nonprofit corporations has developed as a hybrid of trust and corporate principles and that case law indicates that courts choose which principles to apply depending upon the factual situation presented and the result which they deem socially desirable to attain); Thomas H. Boyd, A Call to Reform the Duties of Directors Under State Not-For-Profit Corporation Statutes, 72 Iowa L.Rev. 725 (1987) (advocating a trustee standard of fiduciary responsibility for public benefit corporations, and a corporate law standard for mutual benefit corporations based on the standing of members of such organizations to sue in the name of the corporation).

11See Boyd, supra note 10 at 739-40 (noting that absolute trustee status for nonprofit directors is not desirable).

12See Stern v. Lucy Webb, 381 F. Supp. at 10013 (finding breaches of the duties of care and loyalty under the more lenient corporate law standard and yet no penalty to the nonprofit directors other than court imposed procedural safeguards). There is a "widespread attitude that nonprofit directors are especially volunteers, and overly aggressive attempts to enforce their responsibilities are inappropriate and will discourage individuals from board service." James J. Fishman and Stephen Schwartz, NONPROFIT ORGANIZATIONS: CASES AND MATERIALS, 167 (Foundation Press 1995). See also, DeMott, supra note 1 at 139 (remarking that nonprofit directors are especially dilettantes who do not perform as well as directors of for-profit corporations, that they are subject to little disclosure, and there is little risk of investigation by the IRS or the attorney general).

13Oberly v. Kirby, 592 A.2d at 467.
III. Existing Legislation and Recent Case Law

A. State Nonprofit Corporate Law

1. New York Legislation

The New York Not-For-Profit Corporation Law closely parallels the New York Business Corporation Law. The statute requires trustees and officers to perform their duties in good faith, with the diligence and care of an ordinarily prudent person. The statute provides a safe harbor for interested transactions where a trustee or officer has a substantial financial interest in a transaction with the nonprofit. If the details of the interest are disclosed to the board or committee and he recuses himself from the vote, such transactions will not be void or voidable for that reason alone. If the material facts of the interested transaction are not disclosed to the board, the interested party may prevent the nonprofit from voiding the contract if he can affirmatively establish the fairness of the transaction.

2. California Legislation

The California Nonprofit Corporation Law imposes a high standard of proof in order to establish the legitimacy of an interested transaction involving a public benefit corporation. In order to uphold a transaction between a public benefit corporation and an entity with which one of its trustees is affiliated, the nonprofit must establish the following:

(a) The transaction was for the nonprofit’s own benefit;
(b) it was fair and reasonable to the nonprofit at the time;
(c) it was authorized by majority of the trustees, with knowledge of the material facts; and
(d) it was authorized after reasonable investigation that it was the most advantageous arrangement that would have been attained at the time through reasonable efforts.

The statute clearly articulates the procedure trustees must follow before committing the institution to such a contract, alleviating the social discomfort that may come from

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12A Scott on Trusts § 170.
13Compare N.Y. NOT-FOR-PROFIT CORP. LAW § 717 (the New York statute uses the term “director”, the term “trustee” is used for consistency throughout this paper) with N.Y. BUS. CORP. LAW § 717.
14Compare N.Y. NOT-FOR-PROFIT CORP. LAW § 715(a) with N.Y. BUS. CORP. LAW § 713.
15N.Y. NOT-FOR-PROFIT CORP. LAW § 715(b).
16CAL. CORP. CODE § 5233. California law, like New York law and the RMNCA, distinguishes between “public benefit corporations,” roughly analogous to § 501(c)(3) charities, and mutual benefit corporations. Again, this paper only addresses the former type of nonprofit.
17CAL. CORP. CODE § 5233 (the California statutes uses the term “director”).
questioning the reasonableness of a transaction supported by a colleague.\textsuperscript{20} The standard of “could not have obtained a more advantageous arrangement” is rigorous, requiring investigation of the market. Yet, it allows a nonprofit to accept the equivalent of the best price found, and does not require a quantifiable discount below that price.

Alternately, the attorney general may approve a self-dealing transaction by a nonprofit in California if it does not exceed the lesser of one percent of the corporation’s gross receipts or $100,000.\textsuperscript{21} Upon determining that a trustee has wrongfully benefited from an interested transaction, California courts have discretion over the amount of damages to impose on the trustee.\textsuperscript{22} A court should consider whether the corporation received any benefit from the transaction and whether the director intended to further the best-interest of the corporation. California distinguishes between situations where the director has a financial interest in a transaction and where he has no financial interest but sits on the board of a contracting corporation. The latter type of transaction will not be void if the material facts “are fully disclosed or known” and approved by the board or if shown that the transaction is “just and reasonable.”\textsuperscript{23} In “mutual director” situations, the authorizing board is not required to make reasonable investigation that it was the most advantageous deal, but need only approve the contract.

3. Legislation in Other States

Most states have enacted a not-for-profit corporation statute. These statutes range in complexity with respect to trustee duties. Where no separate legislation exists, the for-profit corporation statute applies. More than twenty states have statutes or case law on how a transaction between a nonprofit and its fiduciary can be made lawful. These statutes generally require disclosure to the board of the material facts of the transaction and of the fiduciary’s interest for the board to authorize the transaction. Without such disclosure, most jurisdictions would find the transaction voidable at the option of the nonprofit unless it could objectively be proven fair.\textsuperscript{24}

\textsuperscript{20}Felicity Barringer, \textit{Charity Board Learns to Be Skeptical}, N.Y. Times, April 19, 1992 at A10 (quoting Daniel L. Kurtz as saying probing questions by charity board members have been viewed as “simply bad manners”).
\textsuperscript{21}\textsc{Cal. Corp. Code} § 5233(b).
\textsuperscript{22}\textsc{Cal. Corp. Code} § 5233(h).
\textsuperscript{23}\textsc{Cal. Corp. Code} § 5234.
\textsuperscript{24}Fishman & Schwartz, supra note 12 at 214.
The Model Nonprofit Corporations Act, promulgated by the American Bar Association in 1964 and revised in 1987 (RMNCA), was inspired by the California statute.\textsuperscript{25} The model act defines a conflict of interest transaction as any transaction in which a trustee\textsuperscript{26} of the nonprofit has a direct or indirect interest. The board of trustees can approve such a transaction if the material facts of the transaction, and of the trustee's interest, are disclosed and they, in good faith, reasonably believe the transaction is fair to the nonprofit.\textsuperscript{27} The attorney general, or a court in an action in which the attorney general is joined, may also approve an interested transaction before or after it is consummated.\textsuperscript{28} At least one commentator has questioned the effectiveness of the RMNCA's "reasonable belief" standard, under which a self-dealing trustee only has to prove that he had a reasonable basis to believe the transaction was fair to the nonprofit.\textsuperscript{29}

B. Recent Cases

The following cases illustrate the well publicized instances of abuse in nonprofits, and their effect on public and judicial sentiment.

1. Inapplicability of the Business Judgment Rule

Nonprofit trustees will not enjoy the safe harbor of the business judgment rule when there is a conflict of interest on the board,\textsuperscript{30} although they may generally rely on it when they act in good faith to further legitimate corporate purposes.\textsuperscript{31} Recently a court reviewed an interested transaction between a nonprofit and its trustees and found that the transaction deserved close scrutiny rather than the deference of the business judgment rule. In Scheuer Family Foundation v. 61 Associates,\textsuperscript{32} the court concluded:

that the allegations that each of the individual [nonprofit trustee] defendants

\textsuperscript{25}Michael C. Hone, Aristotle and Lyndon Baines Johnson: Thirteen Ways of Looking at Blackbirds and Nonprofit Corporations -- The American Bar Association's Revised Model Nonprofit Corporations Act, 39 CASE W. RES.751, 758 (1988-89) (Michael C. Hone was reporter for both the California statute and the RMNCA).

\textsuperscript{26}The RMNCA uses the term "director."

\textsuperscript{27}RMNCA § 8.31(a) and (b)(1).

\textsuperscript{28}RMNCA § 8.31(b)(2).

\textsuperscript{29}DeMott, supra note 1 at 140-141.

\textsuperscript{30}The business judgment rule did not protect nonprofit trustees who breached their duty of care to Adelphi University, because "the rule does not shield from scrutiny irrational decisions that are based on inadequate information or consideration," Report and Recommendation to the Board of Regents (Regents' Report), dated February 5, 1997, adopted February 10, 1997 (this decision is available on the Internet at http://www.nysed.gov/.regents/adelphi.html). The Regents presumed that the business judgment rule applies to nonprofit corporations in New York. Id.

\textsuperscript{31}See supra notes 6 and 7 and accompanying text.

\textsuperscript{32}82 N.Y.S.2d 662 (App. Div. 1st Dep't 1992)(overturning the lower court's summary judgment for failure to state a cause of action due to the court's application of the business judgment rule).
participated in or had a significant interest in 61 Associates as well as the Foundation are sufficient to plead precisely the type of dual interest and potential for self-interest which would create an exception to the shield provided by the business judgment rule.\textsuperscript{33}

This case was a rare instance of a nonprofit board member suing his fellow board member on behalf of the institution.

2. Conflict with Private Business Interest

a) Jim and Tammy Faye Bakker

The trustee in bankruptcy of the Heritage Village Church and Missionary Fellowship (called PTL)\textsuperscript{34} and the IRS\textsuperscript{35} pursued Jim and Tammy Faye Bakker to recover their excess salary and profit from self-dealing transactions, on the grounds that these activities violated their duty of loyalty and amounted to private inurement of nonprofit assets. The court found that "[e]ach of the defendants breached their duty of loyalty by violating the prohibition against self-dealing, since such conduct was not in good faith."\textsuperscript{36} Without settling the question in South Carolina law as to the proper fiduciary standard required of nonprofit trustees, the court found the defendants liable, determining that:

the conduct of the defendants surpassed any standard of negligence and, in truth, was intentional, wanton, capricious and reckless. The parties have failed to perform their duties honestly, in good faith, or with any reasonable amount of diligence or care.\textsuperscript{37}

b) Adelphi University

Excessive salary and self-dealing by the president of Adelphi University, Peter Diamandopoulos, led to an investigation by the New York State Board of Regents\textsuperscript{38} and the

\textsuperscript{33}Id. at 664. The Scheuer court implied that the business judgment rule would apply to a nonprofit corporation where the disinterest of a majority of the directors was not questioned, although plaintiffs had argued that the business judgment rule should never apply to nonprofit corporations. The court declined to decide that issue definitively. Id. at 666. The Delaware Supreme Court found that the business judgment rule would not prevent a court from making an inquiry into any board action that poses a "palpable and identifiable threat" to the limited charitable purpose of the nonprofit, because any such action "would be contrary to the Certificate [of Incorporation] and hence ultra vires." Oberly v. Kirby, 592 A.2d at 462.

\textsuperscript{34}In re Heritage Village Church and Missionary Fellowship, 92 B.R. 1000 (D.S.C. 1988) aff'd 944 F.2d 901 (4th Cir. 1991).

\textsuperscript{35}Id. at 1016 (discussing the IRS’s contemporaneous investigation of the PTL). "The IRS has had agents at PTL on a full time basis for the past two and one-half to three years studying PTL’s records, receipts, disbursements, miscellaneous papers, operations, and other pertinent matters and has had as many as twelve agents at one time working on the case. The IRS report was made for the purpose of supporting the IRS position that PTL’s tax exempt status should be revoked." Id.

\textsuperscript{36}Id. (emphasis added).

\textsuperscript{37}Regents' Report, supra note 30.
New York attorney general’s office. The Regents, who have regulatory authority over all educational institutions in the state, removed eighteen of the nineteen Adelphi trustees, including Diamandopoulos, for improper self-dealing, failure to investigate Diamandopoulos, and failure to take remedial action to correct such abuse. The Regents found that trustees Ernesta Procope and George Lois breached their duty of loyalty to the University through interested transactions.

Ms. Procope’s insurance brokerage firm handled Adelphi’s insurance account for ten years, without revealing to the board that the company received a substantial fee for its services. The Regents found that Procope used her position as a trustee and chair of the subcommittee on insurance to give her company an unfair advantage in obtaining the Adelphi account. The Regents acknowledged that the deal may have been economically fair, and therefore the contract may not have been voidable under the New York Statute. However, they found that Procope had violated her fiduciary duty by acting in her own self interest, for which she should be removed as a trustee. The Regents faulted Procope for failing to investigate the insurance market, “we will never know whether or not Adelphi obtained the lowest cost coverage best suited to its needs, or whether another broker would have been a better choice.”

Mr. Lois owned an advertising agency and chaired Adelphi’s Institutional Advancement Committee, through which he proposed a new advertising campaign for the University. The board dismissed the University’s existing advertising agency, and approved Lois’ campaign, without establishing a budget, reviewing costs or discussing a fee for Lois. Although Lois had waived charges for his creative services, the Regents found that he had violated his duty to disclose to the board the commissions he received for placing the advertisements and production costs Adelphi paid him for recruitment brochures. Again the Regents found fault in Lois and his committee which “sought no proposals and considered no ideas other than

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39 New York State Attorney General Dennis Vacco is suing in New York Supreme Court to recover the amounts paid by Adelphi to indemnify its former trustees, and to stop payments to Diamandopoulos’ severance package, together totaling $6.7 million. Jack Sirica, On Comeback Trail: Leaving Anger Behind, Adelphi Aims to Rebuild, Newsday, December 21, 1997 at A7.
31 N.Y. NOT-FOR-PROFIT CORP. LAW § 715.
32 Regents’ Report, supra note 30.
those advanced by Lois." After removing the trustees, the Regents appointed new trustees who promptly fired Diamandopoulos as president.\footnote{Id.}

c) Boston University

The Massachusetts attorney general’s office agreed not to pursue legal action against Boston University President John R. Silber and its board of trustees when the board agreed to adopt internal guidelines aimed at preventing the president from dominating the board.\footnote{Lambert, supra note 40 at B2 (the new trustees were appointed February 10, 1997 and fired Diamandopoulos on February 21).} The attorney general’s investigation revealed that the trustees had granted Silber a $386,700 bonus for the sale of a University owned biotechnology company, and that the University contracted business with companies represented by various members of the board of trustees.\footnote{Alice Dsembner, BU Trustees Agree to Increase Control, Pact Sought by AG Curbs Silber Role, Boston Globe, Metro Section 33, Dec. 15, 1993.}

The attorney general apparently was most concerned with Silber’s ability to manipulate the trustees, and agreed on procedures aimed at ensuring governance by the entire board.\footnote{David Barboza, Profile: Applying the Silber Standard to Boston U., N.Y. Times, Nov. 5 1995 at A22.} In addition to new management procedures, the agreement called for a two-thirds majority of the trustees to pass any vote affecting a trustee’s financial interests, and required the trustees to disclose all business relationships with the University and all financial involvement that could be affected by board decisions.\footnote{The agreement included (1) the selection of trustees by a nominating committee, whose membership would not be entirely controlled by Silber; (2) an eight year term limit for the chair of the board of trustees; (3) a thirteen year term limit on the board of trustees, if more than 40% of the trustees have served thirteen years or more, until the membership falls below the 40% level; (4) approval of the full board, rather than the executive committee, on all votes concerning compensation of the president, provost, treasurer, and vice presidents. Dsembner, supra note 46.}

These internal guidelines offer direction in formulating guidelines for other institutions, since they were designed to make the University’s management more transparent in order to instill confidence both in University donors and in the attorney general’s office. However, they were negotiated to remedy specific abuses and do not offer a general solution to prevention of abusive practices. The guidelines’ emphasis on disclosure relies on oversight by the attorney general’s office rather than articulating general standards of an acceptable transaction. Standing alone, they would not be effective in curtailing abuse by trustees where
regulators are not already closely watching the nonprofit. A combination of internal reform and new legislation offers a more promising solution.

3. Conflicts with Other Charity Affiliations

a) Boston Children’s Heart Foundation

Boston Children’s Heart Foundation sued its president and trustee, Bernardo Nadal-Ginard, for breaching his fiduciary duty in failing to disclose to the board that he was a director of another organization performing work in the same general area as the Foundation.\(^{49}\) The court ordered him to repay the full amount of his compensation from the Foundation from the date of his breach of duty, without any showing that his salary had been excessive or that he was being paid by both institutions for the same work. In all, Dr. Nadal-Ginard was ordered to repay $6.6 million to the charity, including $4 million he improperly collected from the Foundation’s pension fund and $117,000 he embezzled.\(^{50}\)

b) Warhol Foundation

The attorney general of New York State has begun an investigation into the practices of the board of trustees of the Andy Warhol Foundation for possible self-dealing.\(^{51}\) Among the issues the attorney general will explore are conflicts between the Foundation’s board members and their other charitable boards. Foundation board members include fiduciaries of the Studio Museum of Harlem, the Walker Art Center in Minneapolis and the Museum of Modern Art, all of which have received grants or art work from the Foundation.\(^{52}\) These transactions may be fair and reasonable applications of the purposes of the Warhol Foundation. However, if a nonprofit does not have clear procedures to demonstrate the fairness of an interested transaction the attorney general will have an opportunity to malign a nonprofit and its trustees with an investigation into those transactions.

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\(^{49}\)The court found this to be a self-interested transaction, since Nadal-Ginard participated in setting his own salary and failed to disclose relevant information about his related work for, and salary from, the Howard Hughes Medical Institute to the full board of trustees. Boston Children's Heart Foundation v. Nadal-Ginard, 73 F.3d 429, 433 (1st Cir. 1996).

\(^{50}\)Dr. Nadal-Ginard's abuse of the nonprofit also led to a criminal conviction for embezzling $117,000. He began serving a one year jail sentence on March 3, 1997. His sentence also includes a three to five year suspended sentence, and two years of community service. Boston Globe, Doctor Begins One Year Jail Term, Mar. 4, 1997 at B5.


IV. Legislative Reform and Institutional Policy

A combination of legislative and policy reforms should be considered to avoid the real abuses and allegations of abuse that have been injuring the reputation of the nonprofit community. Certain general issues should be addressed through legislative reform, creating a loyalty standard maintained by board practices upon which trustees, officers and the public can rely. Certain other issues may be better addressed through a conflict of interest policy that is specific to an institution’s charitable mission. The following questions address possible changes in the law and the importance a conflict of interests policy.

A. Legislative Reform

One aspect of creating an environment in which harmful transactions will be avoided is creating a legal standard that is easily understood and internalized by nonprofit trustees.

What Constitutes a Conflict?

Most nonprofit corporation statutes are concerned with conflicts of material financial interests of a trustee.\(^{53}\) Amending nonprofit corporate laws to define conflicts more broadly may help alert trustees to their own potential conflicts, and inform the public that nonprofits are sensitive to concerns about such conflicts. Such a broader definition might include (1) conflicts with the financial interests of any member of a trustee’s household; (2) situations in which a trustee may gain personal or professional benefit from his knowledge of confidential information; and (3) the competing interests of other nonprofits for which a trustee acts as a fiduciary.

A similar concern is whether nonprofits should engage their fiduciaries for direct professional services. Do such arrangements create inherent conflicts of interest, or might they be acceptable if nonprofits received fair or superior professional services from someone close to the organization? For example, in a small community with only one local bank, a should a nonprofit have to choose between accepting the services of the bank president on its board of trustees and borrowing or taking investment advise from the bank? Should a nonprofit in a large city with many banks have to make this choice? In most circumstances, trustees become involved with a nonprofit because of their great interest in the charitable purpose of

\(^{53}\) N. Y. NOT-FOR-PROFIT CORP. LAW § 715; CAL. CORP. CODE § 5233; RNMCA § 8.31 (the model code defines an interested transaction as one in which the trustee has a direct or indirect interest).
the nonprofit, and are predisposed to benefit the corporation.\textsuperscript{54} A total ban on interested transactions would affect most nonprofits, but the harm would be most severe among new or evolving nonprofits that have not yet built a wide support base.

Legislation banning professional service transactions by trustees could produce harsh results. Instead, the right combination of disclosure and internal policy guidelines could create an atmosphere in which nonprofits would not have to choose between professional and fiduciary services from members of their community. The fairness of a transaction could be confirmed if the nonprofit were only allowed to engage in an interested transaction if it paid less than the next lowest price available, after a reasonable investigation of the market. Professional service interested transactions could be made “fair” by reforming the law as discussed below,\textsuperscript{55} or by adopting a conflict of interests policy that requires a “better-than-market” rate before the nonprofit could engage such services.\textsuperscript{56}

A nonprofit’s conflict of interests policy should address the appearance of conflicts and the possibility of misappropriation of a corporate opportunity,\textsuperscript{57} since the circumstances of such conflicts are too specific to be addressed in legislation.

\textit{What Constitutes Disinterested Approval from the Board?}

Most nonprofit corporation laws either require the board of trustees to authorize an interested transaction after full disclosure of the material facts, or allow a party to prove the transaction was fair and reasonable to the nonprofit.\textsuperscript{58} These statutes may give interested trustees too much freedom to interpret how much information must be disclosed and what is fair and reasonable to the nonprofit.\textsuperscript{59} By amending the law to specify procedures for disinterested board approval, regulators and donors to nonprofits would be reassured that the board was acting independently.

\textsuperscript{54}Other beneficial interested transactions include discount sales through which the trustee makes a partial contribution to the nonprofit. Trustees may also supply a nonprofit with products and services it is unable to procure from other sources, either for lack of credit history or public disdain. For example, a nonprofit drug treatment center may have difficulty securing a lease, despite its ability to pay fair market rent.

\textsuperscript{55}See infra p. 14 “What Is a ‘Fair’ Interested Transaction?”

\textsuperscript{56}In their decision regarding self-dealing at Adelphi University, the New York State Board of Regents implied that such procedures would have validated the contracts and actions of trustees Procope and Lois. See supra notes 42-44 and accompanying text.

\textsuperscript{57} See infra p. 17 “The Appearance of Conflicts -- What Other Interests Should Nonprofit Trustees Disclose?”

\textsuperscript{58}See e.g. N.Y. NOT-FOR-PROFIT CORP. LAW § 715; CAL. CORP. CODE § 5233(d); RMNCA § 8.31 (California and the model act require the attorney general or the approval of a court if disclosure is not made to the board).

\textsuperscript{59}See DeMott supra note 1 and text accompanying note 30 (criticizing the RMNCA’s deference to trustees’ “reasonable beliefs”).
The IRS has published a model conflict of interests policy for nonprofit health care organizations which offers a good model for legislative reform for disinterested approval. The IRS guidelines require all interested persons to disclose their financial interests and all material facts to the board whenever there is any actual or possible conflict of interest. The board then determines whether a conflict exists. If a conflict does exist, the board is to observe the following procedures to address the conflict:

a. The interested person may make a presentation to the board, but must then leave the meeting for the discussion and vote on the transaction;
b. the board shall appoint a disinterested person to investigate alternatives to the proposed transaction;
c. the board shall determine, after exercising due diligence, whether the nonprofit can obtain a more advantageous transaction with reasonable efforts that would not create a conflict of interest;
d. if a more advantageous transaction is not reasonably attainable under the circumstances, the disinterested trustees shall determine whether the transaction is in the nonprofit’s best interest and for its own benefit, and whether it is fair and reasonable to the nonprofit and shall make the decision as to whether to enter into the transaction based such on determinations.

What Is a “Fair” Interested Transaction?

The standard for a fair transaction under most nonprofit corporate statutes today is basic economic fairness and reasonableness. This may be too abstract to create the desired environment of compliance. What is fair to a corporation seeking only the greatest profit may not be fair to a nonprofit relying on charitable contributions to promote its mission. “Fairness” does not necessarily require a nonprofit to investigate the market for the goods or services it seeks and does not require it to make the best deal. In light of the potential for abuse from insiders, and the possibility of the appearance of impropriety, this is a good area for legislative reform.

The California law on interested transactions would be a good model for new legislative action. As discussed in Part II above, California requires the board of trustees of a public benefit corporation to inquire into the relevant market before authorizing an interested transaction. In reforming nonprofit corporate laws, the market inquiry requirement should

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be taken a step further. Boards of trustees should only have the power to authorize interested transactions when after reasonable investigation they are proven economically superior to the next best price the institution found in the market. This would confirm trustees’ benevolent role on a nonprofit board and exclude the possibility of improper dealing. It would also reduce the burden on trustees of trying to evaluate the fairness of a transaction in which a fellow trustee is interested. They would only need to consider those transactions in which the trustee has offered the best price available to the institution. This objective could be achieved through institutional policy as well. However, legislative action in this area would be more effective in reassuring the charitable-giving public that nonprofits were following this sound policy.

Whether by statutory or policy reform, a requirement to investigate the market before approving any interested transaction will protect trustees from the imposition of intermediate sanctions. The law imposing intermediate sanctions does not prohibit all interested transactions, if no disqualified person receives an “excess benefit.” Evidence of the trustees’ inquiry into the relevant market, therefore, would likely prove that an approved transaction was not an impermissible excess benefit transaction.

**What Is the Appropriate Remedy for a Breach of the Duty of Loyalty?**

The remedy for a breach of loyalty may include removal of the trustee, an injunction prohibiting further damage to the nonprofit, restitution of misappropriated funds, and penalties on the wrongdoers. Such penalties may be very severe, but they are rarely imposed in the absence of bad faith on behalf of the trustee. Some feel that historic lack of enforcement of nonprofit fiduciary duties is responsible for the inattentive management of many nonprofits. Others worry that imposing penalties on nonprofit fiduciaries, in the absence of bad faith, would strongly discourage people from volunteering their services on nonprofit boards of trustees.

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63 I.R.C. § 4958.
65 See _e.g._ Stern v. Lucy Webb, 381 F. Supp. 1019 (setting a very weak penalty after determining that the trustees had breached their fiduciary duties, each new member of the board was required to read the court’s decision).
A promising proposal on this topic may be to punish breaches of the duty of loyalty with fines, set at reasonable minimum and maximum amounts.\(^67\) Such fines would be levied on the self-dealing trustee and those that knowingly acquiesced to the self-dealing plan. This might help convince trustees of the seriousness of their obligation. Ideally, it would also limit liability to an amount that would not scare good people away from the board room, as might an increase in traditional enforcement actions or increased standing\(^68\) to sue on behalf of the nonprofit. Would such quantified penalties for wrong doing, combined with clear statutory directives and an explicit conflict of interests policy be enough to alert board members to the importance of their role in the nonprofit without discouraging service on boards?

**B. Institutional Policy**

Through a conflict of interests policy, each nonprofit institution can create rules to address areas of abuse to which it is most prone. In order to implement such a policy a nonprofit should draft its policy to clearly express its objectives, and distribute a copy to every member of its board.

*Should a Nonprofit Require its Trustees to Provide Complete Disclosure About Their Financial Holdings and Interests?*

Some institutions currently require written financial disclosure statements from employees and trustees in an annual review. Some accept verbal disclosure, while others merely encourage staff and trustees to disclose information of potential conflicts. There is no consensus that more disclosure is necessary. Many nonprofits fear that requiring intrusive personal disclosure from trustees will discourage participation on nonprofit boards. However, to appease nonprofit regulators who may be becoming distrustful of the efficacy of current nonprofit practices, and in the spirit of reform, nonprofits should consider asking their trustees for some financial information.

By addressing this issue in a conflict of interests policy, an institution can tailor its disclosure requirements to the type of information that would be necessary to find such conflicts.

\(^67\)Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. __ (forthcoming 1998) (proposing statutory reform specifying the worst monetary harm a fiduciary could suffer for a breach of the duty of care at a level low enough to attract directors and high enough to induce them to take their tasks seriously).

\(^68\)See Goldschmid, supra note 66 at A43 (recommending increased standing for relator, donor, member, and
Legislation on the topic would likely require the broadest disclosure, so that information relevant to every type of nonprofit would be made available. A highly intrusive standard, however, would require more information than is applicable to a particular institution's interests and could deter people from participating on nonprofit boards.

Disclosure could be effectively addressed in a nonprofit's conflict of interests policy. Some institutions may require affirmative disclosure of a trustee's assets and other fiduciary positions. Others may be able to develop a checklist of the nonprofit's financial interests against which their trustees can compare their interests and disclose any conflicts. Such a questionnaire and trustee disclosure could be updated as the nonprofit entered new contractual obligations.

If a nonprofit requires such disclosure, it must institute procedures to review the information effectively, and to safeguard trustees' privacy. The nominating committee of the board might be the best choice to review such material, first when the trustee is nominated and upon any change of circumstance.

_The Appearance of Conflicts -- What Other Interests Should Nonprofit Trustees Disclose?_

Another concern for nonprofits is the appearance of conflict, where a trustee is involved in the same activity as the nonprofit, but there is no direct business transaction. An example is the trustee of a museum who collects in the same area as the museum. Such conflicts may violate the corporate opportunity doctrine, however, they should be addressed in a conflict of interest policy rather than through legislation. Such corporate interests vary greatly from institution to institution, so that general prohibitions would not address most conflicts of this type. Institutional policy may be very effective in addressing areas of concern for a particular organization and regulating behavior. For instance, most museums encourage art collecting by their fiduciaries, but specifically require that such collecting must not compete with the museum.  

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beneficiary derivative actions in the name of a nonprofit, with "loser pays" rules to discourage spiteful litigation.  

69This would include situations in which the trustee may be competing with the nonprofit for opportunities he has learned about through his fiduciary relationship with the nonprofit. Classic violations of the corporate opportunity doctrine would be a purchase of real estate that was offered to the nonprofit through its trustee, but which the trustee chose to purchase himself.  

How Much Information on Interested Transactions Must a Nonprofit Disclose to the Public?

Considering the weak history of enforcement actions and the detrimental effect they can have on nonprofits, commentators have suggested that public disclosure of information about nonprofits and their transactions may increase trustees’ attention to their duty of loyalty. Such disclosure would presumably have the positive effect that disclosure has in the securities law context. Some nonprofit advocates support an effort to post nonprofits’ informational filings with the IRS, Form 990s, on the Internet, so that interested people can review that information anonymously and alert the attorney general to any wrong doing. Such a system could be implemented, without legislation, by the IRS or by state attorneys general who in most states already receive the Form 990 of each nonprofit in their jurisdiction. Publicly displaying so much information, however, may cause a flood of specious claims of wrong doing. Answering such claims would impose an administrative burden on nonprofits. Such claims could also overwhelm the attorneys general and actually decrease their investigative capacity.

An alternate method of disclosure, that would expose the nonprofit’s insiders to less public scrutiny, would be for nonprofit boards of trustees to submit reports to the attorney general about each self-dealing transaction it approves. The board would also have to submit a copy of the institution’s conflict of interests policy. A weak conflicts policy would alert the attorney general to the possibility that an institution has not set up procedures to adequately police itself and therefore requires greater scrutiny.

Perhaps, adequate information may already be disclosed to charity regulators. The reform most appropriate may be for attorneys general to modernize their procedures for reviewing the information on Form 990s. By storing such information in computers they could

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71Nonprofits are currently obliged to show or give a copy of their Form 990s, which detail much of the institution’s business including top salaries, trustee compensation and the top contractors doing business with the institution, to anyone who requests them. I.R.C. § 6104(e) and Prop. Treas. Reg. § 301.6104(e), 62 Fed. Reg. 187 (1997).
73Swords, supra note 72 at B11 (nearly all states that require annual financial reporting accept the Form 990).
conceivably search for suspicious transactions or perform reviews of some of the 990s on a random basis, a capacity they do not currently have.\textsuperscript{74}

V. Conclusion -- Drafting a Conflict of Interests Policy

Whether states continue to apply a corporate standard of loyalty or adopt a more protective standard, nonprofits would be wise to adopt new procedures to create a better atmosphere for self enforcement. In the view of this writer, nonprofits should adopt conflict of interests policies incorporating a high standard of loyalty, and board procedures to implement and enforce the standard. These should avoid even the appearance of impropriety by the board. The high internal standard should prevent any questionable action from arising that would warrant an investigation by the attorney general. Nonprofits must avoid such investigations to prevent negative publicity that will harm the institution even if no wrong is found.\textsuperscript{75}

A policy with a high standard of loyalty should consider addressing the following topics:

1. appointing a majority of outside trustees;\textsuperscript{76}
2. establishing the form of disclosure required, developing a questionnaire that asks board member to disclose current or potential conflicts, to be updated annually and on a change of circumstance;
3. creating an ethics committee of the board to review possible conflict of interests;
4. educating board members about doing business with, receiving benefits from, and competing with the nonprofit;
5. disallowing interested trustees from voting on the subject transaction;
6. prohibiting interested trustees from aggressively lobbying for approval of a transaction or participating in board discussion on its merit;
7. obtaining only disinterested representation in negotiating the terms of and implementing an interested transaction;

\textsuperscript{74} On the Line: Interview with New York Attorney General Dennis Vacco (WNYC A.M. radio broadcast, Jan. 18, 1998) (explaining that records on file in the attorney general's office are not currently computerized and information cannot be accessed adequately).

\textsuperscript{75} The San Diego National Sports Training Foundation, whose mission was to build an Olympic training center, fell into disrepute based on $6.2 million in contracts between the Foundation and firms run by the Foundation's board of trustees. Criticism of these transactions from the National Charities Information Bureau, and the Better Business Bureau's Philanthropic Advisory was highlighted in a disapproving article in the Los Angeles Times despite the fact that (1) procedural fairness was respected in the voting on such contracts, board members left the room and did not vote on contracts in which they had an interest; and (2) critics did not even allege that the affiliated companies took excessive profits on the contracts. Ralph Frammolino, "Foundation's Contracts Go to Firms With Ties to Officers; Charity: More than $6.2 Million Was Paid Last Year to Companies Run by Foundation Officials Working on an Olympic Training Center, But Impropriety Is Denied," Los Angeles Times, page B1, Dec. 13 1992.

\textsuperscript{76} The term "outside director" usually refers to non-employee members of a for-profit corporate board. Outside trustees are non-employee members of a nonprofit board. The IRS has suggested, in its guidelines for health care organizations, that a nonprofit hospital should have a "community board" composed of independent community members who are not employees or contractors to the organization. 1996 IRS Exempt Organizations CPE Technical Instruction Program Textbook: Part I, Chapter C: Tax-Exempt Health Care Organizations Community Board and Conflicts of Interest Policy, Article III (Released September 23, 1996) reprinted in 96 TNT 198-23.
8. establishing the fairness, or superior advantage, of every transaction involving the appearance of conflict;
9. barring trustees from obtaining a material benefit for themselves, their relatives, or friends from their association with the organization.

The attached model conflict of interests policy, drafted by Patterson, Belknap, Webb & Tyler LLP, illustrates how a nonprofit may address these issues.

A conflict of interests policy is an important complement to legislation in this area, since the application and enforcement of legislation is usually left to the organization and its board. The policy might be drafted by a new ethics committee of the board of trustees, or by an existing committee such as the executive committee. Once the policy has been drafted, either an ethics committee or perhaps the nominating committee should be appointed to enforce the policy. The nominating committee would be a logical choice, as it could initially review the disclosure materials required by the organization upon a new trustee’s nomination, and monitor periodic updates. The widespread implementation of such policies would go a long way toward reducing actual conflicts of interests. Without well publicized legislative reform, however, the public may not be satisfied.
CONFLICTS OF INTEREST POLICY

WHEREAS, the Board of Trustees of ____________, throughout its history, has conducted its affairs in accordance with the highest ethical standards, and

WHEREAS, consistent with these standards, it is important to confirm that each Trustee and Officer of ____________ has an obligation to avoid any action which may involve a direct or indirect conflict between his or her personal interests and the interests of the ____________, and

WHEREAS, counsel has recommended the adoption of an explicit conflicts of interest policy in light of the heightened public interest in the activities of the leaders of not-for-profit institutions and the new so-called "intermediate sanctions" legislation enacted in July 1996,

NOW, THEREFORE, BE IT RESOLVED that the following policies and procedures are hereby adopted as the Conflicts of Interest Policy of ____________:

Conflicts of Interest Policy

Duty of Loyalty

Each Trustee and Officer has a duty of loyalty to the ____________ which requires him or her to make decisions for the benefit of the ____________ with undivided commitment to the ____________ without regard to personal interests. Trustees and Officers should not use their positions as Trustee or Officer or access to information about the ____________ to further their own financial interests or derive personal advantage. Contracts or transactions between the ____________ and any other entity of which a ____________ Trustee or Officer is also an officer or director or is substantially financially interested, are not prohibited. However, such transactions must be approved by disinterested members of the Board of Trustees or Executive Committee following disclosure of all material facts relating to the transaction and an objective determination that the transaction is both reasonable and in the best interests of the ____________.

Disclosure

In considering candidates for election to the Board of Trustees, the Nominating Committee should ascertain whether a candidate (or a family member of the candidate) has any personal, business or organizational interests or affiliations that could be construed as being related to the affairs of the ____________ and, if so, whether such interests or affiliations should be reported to the Board of Trustees prior to the candidate being considered by the Board.

If, following election to the Board, any Trustee should acquire interests or develop affiliations that could be construed as being related to the affairs of the ____________ or whenever significant changes occur in any such prior interests or affiliations, the Trustee in
question should so advise the Secretary or the Director of the _________. The Secretary shall arrange to maintain a continuous record of all reports of such interests and affiliations.

In addition, whenever a Trustee or Officer of the _________ becomes aware that the Board of Trustees (or any committee thereof) or any Officer is considering or has considered a transaction which may involve the personal interests of such Trustee or Officer or a member of his or her family or the interests of an organization with which such Trustee or Officer is or was affiliated, such Trustee or Officer shall notify the Secretary or the Director of the _________ of the nature of his or her interest.

Withdrawal and Abstention

Whenever a transaction described above involves the personal interest of a Trustee or Officer or a member of his or her family, such Trustee or Officer shall not participate in consideration of the transaction, shall not vote on such transaction, and shall not be present for the consideration of or vote on such transaction unless the Board of Trustees requests information or interpretation from the Trustee or Officer involved. Whenever a transaction described above involves the interests of an organization with which a Trustee or Officer is or was affiliated, such Trustee or Officer shall not participate in consideration of the transaction and shall not vote on such transaction, but may be present for the consideration of or vote on such transaction.

Documentation

Whenever a Trustee or Officer withdraws from the consideration of or abstains from voting on a transaction by reason of his or her personal interest in the transaction or the interest of an organization with which he or she is or was affiliated, such withdrawal and abstention shall be recorded in the minutes of the meeting during which such consideration and vote occurred. Should the Board of Trustees (or the relevant committee) deem the transaction to be reasonable and in the best interests of the _________, despite the potential or actual conflict of interest, such determination, and the specific reasons supporting such determination, shall also be recorded in the minutes of the meeting.

Notice

To ensure that the Trustees and Officers are aware of this Conflicts of Interest Policy, a copy of this Policy shall be distributed to each Trustee and Officer upon his or her election and upon each subsequent re-election as a Trustee or Officer.
MODEL CONFLICTS OF INTEREST POLICY

1. **Purpose** - Because of their public purposes, charitable [educational, religious, etc.] organizations such as [name of organization] (the "Corporation") have a special obligation to uphold the public trust. Each trustee and officer of the Corporation, therefore, is required to conduct all the affairs of the Corporation in the best interests of the Corporation, to avoid the appearance of a conflict between his or her personal interests and the interests of the Corporation and to ensure that he or she does not benefit personally from his or her position as a trustee or officer. This obligation also requires that the Board of Trustees (the "Board") be fully informed regarding transactions and arrangements into which the Corporation enters and with respect to which trustees and officers may have an interest. To ensure fairness in the Board’s decision-making processes and to protect the Corporation’s interests when it is contemplating entering into a transaction or arrangement that might benefit the private interest of any of its trustees or officers, the Board of Trustees has adopted the following Conflicts of Interest Policy.

2. **Definitions**

2.1 **Interested Person** - Any trustee, officer or member of a committee of the Board who has a direct or indirect Interest, as defined below, is an Interested Person.

2.2 **Interest** - A person has an Interest if the person or his or her family member (including a parent, sibling, spouse or child) has, or in the near future will have, directly or indirectly:

   • a compensation arrangement or other interest in a transaction with the Corporation or with any entity or individual with which the Corporation has entered into a transaction or arrangement, or

   • an ownership or investment interest in or affiliation with any entity with which the Corporation has entered into a transaction or arrangement, or

   • an ownership or investment interest in or compensation arrangement or other affiliation with any entity or individual with which the Corporation is negotiating, or contemplating negotiating, a transaction or arrangement.

Compensation includes direct and indirect remuneration as well as gifts or favors that are substantial in nature.
3. Procedures

3.1 Duty to Disclose - Upon the first knowledge by an Interested Person that the Board or a committee thereof is considering or has considered a transaction or arrangement with an entity or individual with which the Interested Person has an Interest, the Interested Person must disclose the existence and nature of his or her Interest to the Board or the committee of the Board.

3.2 Procedures for Addressing the Conflict - After disclosure of the Interest, the Interested Person may not participate in consideration of the proposed transaction or arrangement, shall not vote on such transaction or arrangement, and shall not be present for the consideration of or vote on such transaction unless the Board or committee requests information or interpretation from the Interested Person. The Board or committee shall then determine by a majority vote of the disinterested trustees or committee members whether the transaction or arrangement is in the Corporation’s best interests and is fair and reasonable to the Corporation and shall make a decision whether to enter into the transaction or arrangement in accordance with such determination.

In determining whether the transaction or arrangement is in the Corporation’s best interests, the Corporation shall review available information regarding the cost or benefit of comparable transactions or arrangements, if any [and may investigate whether the Corporation should and is able to obtain with reasonable efforts a more advantageous transaction or arrangement that would not give rise to an Interest]. [The Board may appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.]

Interested trustees or committee members may be counted in determining the presence of a quorum at a meeting which authorizes such a transaction or arrangement.

3.3 Records of Proceedings - The minutes of the Board or the committee considering the Interest of an Interested Person shall contain:

- the names of the Interested Person(s) who disclosed or otherwise were found to have a Interest,

- the nature of the Interest,

- a record of any determination as to whether a transaction or arrangement was in the best interests of and fair and reasonable to the Corporation, notwithstanding the Interest, and the specific reasons supporting such determination, and
• the names of the persons who were present for the discussions on the transaction or arrangement and a record of any votes taken in connection therewith.

4. Violations of the Conflicts of Interest Policy - If the Board or committee thereof has reasonable cause to believe that an Interested Person has failed to disclose an actual or possible Interest, it shall inform the Interested Person of the basis for such belief and afford the Interested Person an opportunity to explain the alleged failure to disclose. If, after hearing the response of the Interested Person and making such further investigation as may be warranted in the circumstances, the Board or committee determines that the Interested Person has in fact failed to disclose an actual or possible Interest, it shall take appropriate disciplinary and corrective action which may include reconsideration of whether the transaction or arrangement was in the best interests of and was fair and reasonable to the Corporation at the time it was undertaken.

5. Compensation Committees - A voting member of any committee of the Board charged with fixing the compensation of Board members or officers of the Corporation, and who receives compensation for services as such a Board member or officer, may not be present for or participate in the discussions regarding, or vote on matters pertaining to his or her own compensation.

6. Annual Statements - Each Trustee, officer and member of a committee of the Board shall annually sign a statement which affirms that such person: (a) has received a copy of this Conflicts of Interest Policy, (b) has read and understands this Policy, and (c) has agreed to comply with this Policy.

7. Periodic Reviews - To ensure that the Corporation operates in a manner consistent with its charitable [, educational, religious, etc.] purposes and its federal tax exemption, periodic reviews will be conducted, in appropriate cases, to determine whether compensation and benefits arrangements and other transactions are reasonable and the result of arms-length negotiation.