

# **Ethical Issues Arising in Service on a Nonprofit Board or for Attorneys Representing Nonprofit Clients**

Marquette Law School – Sensenbrenner Hall, Room 307, 3rd floor  
1103 West Wisconsin Avenue

7:30 a.m., registration and coffee

8:00 a.m., program begins

10:00 a.m., program ends

## **I. Welcome, M-LINC and Marquette Law School's Public Service Initiatives (Karin Holmberg Werner) 8:00 to 8:05**

## **II. Introduction (Teig Whaley-Smith) 8:05 to 8:10**

Many attorneys are asked at some point in their career to serve on a nonprofit board. Additionally, attorneys are frequently asked to represent nonprofit organizations as their clients. Often, such commitments give rise to ethical questions and considerations. This CLE program is intended to highlight both Wisconsin and federal law, as well as best practices, that should guide attorneys in such situations. Some key case examples will be explored in the hopes that they will help guide attorneys through such sticky situations.

## **III. Laws Concerning Nonprofit Directors (Teig Whaley-Smith) 8:10 to 8:35**

### **a. Selected Wisconsin Statutes**

#### **i. Chapter 701 of Wisconsin Statutes – Trusts**

**701.105 Private foundations. (1)** (a) In the administration of any trust which is a private foundation, as defined in section 509 of the internal revenue code, a charitable trust, as defined in section 4947 (a) (1) of the internal revenue code, or a split-interest trust as defined in section 4947 (a) (2) of the internal revenue code, all of the following acts shall be prohibited:

1. Engaging in any act of self-dealing as defined in section 4941 (d) of the internal revenue code, which would give rise to any liability for the tax imposed by section 4941 (a) of the internal revenue code.

2. Retaining any excess business holdings as defined in section 4943 (c) of the internal revenue code, which would give rise to any liability for the tax imposed by section 4943 (a) of the internal revenue code.

3. Making any investments which would jeopardize the carrying out of any of the exempt purposes of the trust, within the meaning of section 4944 of the internal revenue code, so as to give rise to any liability for the tax imposed by section 4944 (a) of the internal revenue code.

4. Making any taxable expenditures as defined in section 4945 (d) of the internal revenue code, which would give rise to any liability for the tax imposed by section 4945 (a) of the internal revenue code.

(b) This subsection shall not apply either to those split-interest trusts or to amounts thereof which are not subject to the prohibitions applicable to private foundations by reason of the provisions of section 4947 of the internal revenue code.

**(2)** In the administration of any trust which is a private foundation as defined in section 509 of the internal revenue code, or which is a charitable trust as defined in section 4947 (a) (1) of the internal revenue code, there shall be distributed, for the purposes specified in the trust instrument, for each taxable year, amounts at

least sufficient to avoid liability for the tax imposed by section 4942 (a) of the internal revenue code.

(3) Subsections (1) and (2) shall not apply to any trust to the extent that a court of competent jurisdiction shall determine that such application would be contrary to the terms of the instrument governing such trust and that the same may not properly be changed to conform to such subsections.

(4) Nothing in this section shall impair the rights and powers of the courts or the attorney general of this state with respect to any trust.

## ii. Chapter 184 of Wisconsin Statutes – Unincorporated Association

**184.01 Definitions.** In this chapter:

(1) “Member” means a person who, under the rules or practices of a nonprofit association, may participate in the selection of persons authorized to manage the affairs of the nonprofit association or in the development of policy of the nonprofit association.

(2) “Nonprofit association” means an unincorporated organization consisting of 3 or more members joined by mutual consent for a common, nonprofit purpose. However, joint tenancy, tenancy in common, or tenancy by the entireties does not, by itself, establish a nonprofit association, even if the co-owners share use of the property for a nonprofit purpose.

**184.06 Liability in tort and contract. (1)** A nonprofit association is a legal entity separate from its members for the purposes of determining and enforcing rights, duties and liabilities in contract and tort.

(2) A person is not liable for a breach of a nonprofit association’s contract merely because the person is a member, is authorized to participate in the management of the affairs of the nonprofit association, or is a person considered to be a member by the nonprofit association.

(3) A person is not liable for a tortious act or omission for which a nonprofit association is liable merely because the person is a member, is authorized to participate in the management of the affairs of the nonprofit association, or is a person considered to be a member by the nonprofit association.

(4) A tortious act or omission of a member or other person for which a nonprofit association is liable is not imputed to a person merely because the person is a member of the nonprofit association, is authorized to participate in the management of the affairs of the nonprofit association, or is a person considered to be a member by the nonprofit association.

(5) A member of, or a person considered to be a member by, a nonprofit association may assert a claim against the nonprofit association. A nonprofit association may assert a claim against a member or a person considered to be a member by the nonprofit association.

## iii. Chapter 181 of Wisconsin Statutes – Nonstock Corporations

### 1. 181.0801 Requirement for and duties of board

**181.0801 Requirement for and duties of board.**

(1) BOARD REQUIRED. A corporation shall have a board.

(2) POWERS OF BOARD. Except as provided in this chapter or sub. (3), all corporate powers shall be exercised by or under the authority of, and the affairs of the corporation managed under the

direction of, its board.

**(3) DELEGATION.** (a) The articles of incorporation or bylaws approved by the members, if any, may authorize a person to exercise some or all of the powers which would otherwise be exercised by a board. To the extent so authorized such a person shall have the duties and responsibilities of the board, and the directors shall be relieved to that extent from such duties and responsibilities.

(b) A person is not a member of the board solely because of powers delegated to that person under par. (a).

## 2. 181.0853 Consideration of interests

**181.0853 Consideration of interests in addition to members' interests.** In discharging his or her duties to the corporation and in determining what he or she believes to be in the best interests of the corporation, a director or officer may, in addition to considering the effects of any action on members, consider the following:

**(1) EMPLOYEES, SUPPLIERS AND CUSTOMERS.** The effects of the action on employees, suppliers and customers of the corporation.

**(2) COMMUNITIES.** The effects of the action on communities in which the corporation operates.

**(3) OTHER.** Any other factors that the director or officer considers pertinent.

## 3. 181.0831 Director conflict of interest

**181.0831 Director conflict of interest. (1) WHEN CONTRACT OR TRANSACTION IS NOT VOID OR VOIDABLE.** No contract or other transaction between a corporation and a director, or any entity in which a director is a director or officer or has a material financial interest, is void or voidable because of the relationship or interest or because the director is present at the meeting of the board or a committee that authorizes, approves or ratifies the contract or transaction or because the director's vote is counted for that purpose, if any of the following applies:

(a) The relationship or interest is disclosed or known to the board or committee that authorizes, approves or ratifies the contract or transaction and the contract or transaction was authorized, approved or ratified by a vote or consent sufficient for the purpose without counting the votes or consents of interested directors.

(b) The fact of such relationship or interest is disclosed or known to the members entitled to vote and they authorize, approve or ratify that contract or transaction by vote or written consent.

(c) The contract or transaction is fair and reasonable to the corporation.

**(2) QUORUM REQUIREMENTS.** Common and interested directors may be counted in determining the presence of a quorum at a meeting of the board or a committee that authorizes, approves or ratifies a contract or transaction under sub. (1).

**(3) ADDITIONAL REQUIREMENTS.** The articles of incorporation, the bylaws or a resolution of the board may impose additional requirements on conflict of interest transactions.

## 4. 181.0832 Loans to directors and officers

**181.0832 Loans to directors and officers. (1) REQUIREMENTS FOR LOAN OR GUARANTEE.** Except as provided in sub. (3), a corporation may not lend money to or guarantee the obligation of a director or officer of the corporation unless any of the following occurs:

(a) The particular loan or guarantee is approved by the members.

(b) The corporation's board determines that the loan or guarantee

benefits the corporation and either approves the specific loan or guarantee or a general plan authorizing loans and guarantees.

**(2) EFFECT OF VIOLATIONS.** A violation of this section does not affect the borrower's liability on the loan.

**(3) LIMITED APPLICABILITY.** This section does not apply to an advance to a director or officer that is permitted by s. 181.0874 or 181.0877 (3) or that is made to defray expenses incurred by the director or officer in the ordinary course of the corporation's business.

## 5. 181.0850 Reliance by directors or officers

**181.0850 Reliance by directors or officers.** Unless the director or officer has knowledge that makes reliance unwarranted, a director or officer, in discharging his or her duties to the corporation, may rely on information, opinions, reports or statements, any of which may be written or oral, formal or informal, including financial statements and other financial data, if prepared or presented by any of the following:

**(1) OFFICERS AND EMPLOYEES.** An officer or employee of the corporation whom the director or officer believes in good faith to be reliable and competent in the matters presented.

**(2) PROFESSIONALS AND EXPERTS.** Legal counsel, certified public accountants licensed or certified under ch. 442, or other persons as to matters the director or officer believes in good faith are within the person's professional or expert competence.

**(3) COMMITTEES.** In the case of reliance by a director, a committee of the board of directors of which the director is not a member if the director believes in good faith that the committee merits confidence.

## 6. 181.0855 Limited liability of directors and officers

**181.0855 Limited liability of directors and officers.**

**(1) IN GENERAL.** Except as provided in subs. (2) and (3), a director or officer is not liable to the corporation, its members or creditors, or any person asserting rights on behalf of the corporation, its members or creditors, or any other person, for damages, settlements, fees, fines, penalties or other monetary liabilities arising from a breach of, or failure to perform, any duty resulting solely from his or her status as a director or officer, unless the person asserting liability proves that the breach or failure to perform constitutes any of the following:

(a) A willful failure to deal fairly with the corporation or its members in connection with a matter in which the director or officer has a material conflict of interest.

(b) A violation of criminal law, unless the director or officer had reasonable cause to believe that his or her conduct was lawful or no reasonable cause to believe that his or her conduct was unlawful.

(c) A transaction from which the director or officer derived an improper personal profit or benefit.

(d) Willful misconduct.

**(2) EXCEPTIONS.** Except as provided in sub. (3), this section does not apply to any of the following:

(a) A civil, criminal, administrative or investigatory proceeding brought by or on behalf of any governmental unit, authority or agency.

(b) A proceeding brought by any person for a violation of state or federal law where the proceeding is brought pursuant to an express private right of action created by state or federal statute.

(c) The liability of a director under ss. 181.0832 and 181.0833.

**(3) GOVERNMENTAL ENTITY ACTING IN CAPACITY AS PRIVATE PARTY.** Subsection (2) (a) and (b) does not apply to a proceeding

brought by a governmental unit, authority or agency in its capacity as a private party or contractor.

## 7. 181.0833 Liability for unlawful distributions

**181.0833 Liability for unlawful distributions. (1) WHEN LIABLE.** Except as provided in sub. (3), a director who votes for or assents to a distribution made in violation of subch. XIII or the articles of incorporation is personally liable to the corporation for the amount of the distribution that exceeds what could have been distributed without violating subch. XIII or the articles of incorporation, if it is established that the director's vote or assent constitutes conduct described by s. 181.0855 (1) (a), (b), (c) or (d). In any proceeding brought under this section, a director has all of the defenses ordinarily available to a director.

**(2) RIGHT TO CONTRIBUTION.** A director who is liable under sub. (1) for an unlawful distribution is entitled to contribution from all of the following persons:

(a) Every other director who could be held liable under sub. (1) for the unlawful distribution.

(b) Each member, for the amount that the member accepted knowing that the distribution was made in violation of subch. XIII or the articles of incorporation.

**(3) WHEN PROCEEDING BARRED.** A proceeding under this section is barred unless it is brought within 2 years after the date on which the distribution was made.

## 8. 181.0871 to 181.0881 Indemnification

**181.0871 Definitions applicable to indemnification and insurance provisions.** In ss. 181.0871 to 181.0889:

**(1) "Corporation"** means a domestic corporation and any domestic or foreign predecessor of a domestic corporation where the predecessor corporation's existence ceased upon the consummation of a merger or other transaction.

**(2) "Director or officer"** means any of the following:

(a) An individual who is or was a director or officer of a corporation.

(b) An individual who, while a director or officer of a corporation, is or was serving at the corporation's request as a director, officer, partner, trustee, member of any governing or decision-making committee, manager, employee or agent of another corporation or foreign corporation, limited liability company, partnership, joint venture, trust or other enterprise.

(c) An individual who, while a director or officer of a corporation, is or was serving an employee benefit plan because his or her duties to the corporation also impose duties on, or otherwise involve services by, the individual to the plan or to participants in or beneficiaries of the plan.

(d) Unless the context requires otherwise, the estate or personal representative of a director or officer.

**(3) "Expenses"** include fees, costs, charges, disbursements, attorney fees and any other expenses incurred in connection with a proceeding.

**(4) "Liability"** includes the obligation to pay a judgment, settlement, forfeiture, or fine, including any excise tax assessed with respect to an employee benefit plan, plus costs, fees, and surcharges imposed under ch. 814, and reasonable expenses.

**(5) "Party"** includes an individual who was or is, or who is threatened to be made, a named defendant or respondent in a proceeding.

**(6) "Proceeding"** means any threatened, pending or completed civil, criminal, administrative or investigative action, suit, arbitration or other proceeding, whether formal or informal, which involves foreign, federal, state or local law and which is

brought by or in the right of the corporation or by any other person.

**181.0872 Mandatory indemnification. (1)** IN GENERAL. A corporation shall indemnify a director or officer, to the extent that he or she has been successful on the merits or otherwise in the defense of a proceeding, for all reasonable expenses incurred in the proceeding if the director or officer was a party because he or she is a director or officer of the corporation.

**(2) EXCEPTIONS.** (a) In cases not included under sub. (1), a corporation shall indemnify a director or officer against liability incurred by the director or officer in a proceeding to which the director or officer was a party because he or she is a director or officer of the corporation, unless liability was incurred because the director or officer breached or failed to perform a duty that he or she owes to the corporation and the breach or failure to perform constitutes any of the following:

1. A willful failure to deal fairly with the corporation or its members in connection with a matter in which the director or officer has a material conflict of interest.
2. A violation of the criminal law, unless the director or officer had reasonable cause to believe that his or her conduct was lawful or no reasonable cause to believe that his or her conduct was unlawful.
3. A transaction from which the director or officer derived an improper personal profit or benefit.
4. Willful misconduct.

(b) Determination of whether indemnification is required under this subsection shall be made under s. 181.0873.

(c) The termination of a proceeding by judgment, order, settlement or conviction, or upon a plea of no contest or an equivalent plea, does not, by itself, create a presumption that indemnification of the director or officer is not required under this subsection.

**(3) WRITTEN REQUEST REQUIRED.** A director or officer who seeks indemnification under this section shall make a written request to the corporation.

**(4) LIMITATION BY ARTICLES OF INCORPORATION.** (a) Indemnification under this section is not required to the extent limited by the articles of incorporation under s. 181.0875.

(b) Indemnification under this section is not required if the director or officer has previously received indemnification, reimbursement or allowance of expenses from any person, including the corporation, in connection with the same proceeding.

**181.0873 Determination of right to indemnification.**

Unless otherwise provided by the articles of incorporation or bylaws or by written agreement between the director or officer and the corporation, the director or officer seeking indemnification under s. 181.0872 (2) shall select one of the following means for determining his or her right to indemnification:

**(1) BOARD OF DIRECTOR VOTE.** By a majority vote of a quorum of the board of directors consisting of directors who are not at the time parties to the same or related proceedings. If a quorum of disinterested directors cannot be obtained, by a majority vote of a committee duly appointed by the board of directors and consisting solely of 2 or more directors who are not at the time parties to the same or related proceedings. Directors who are parties to the same or related proceedings may participate in the designation of members of the committee.

**(2) INDEPENDENT LEGAL COUNSEL.** By independent legal counsel selected by a quorum of the board of directors or its committee in the manner prescribed in sub. (1) or, if unable to obtain such a quorum or committee, by a majority vote of the full board of directors, including directors who are parties to the same or related proceedings.

**(3) ARBITRATORS.** By a panel of 3 arbitrators consisting of one arbitrator selected by those directors entitled under sub. (2) to

select independent legal counsel, one arbitrator selected by the director or officer seeking indemnification and one arbitrator selected by the 2 arbitrators previously selected.

**(4) MEMBERS.** By an affirmative vote of members with voting rights, if any. Membership rights owned by, or voted under the control of, persons who are at the time parties to the same or related proceedings, whether as plaintiffs or defendants or in any other capacity, may not be voted in making the determination.

**(5) COURT.** By a court under s. 181.0879.

**(6) OTHER METHODS.** By any other method provided for in any additional right to indemnification permitted under s. 181.0877.

**181.0874 Allowance of expenses as incurred.** Upon written request by a director or officer who is a party to a proceeding, a corporation may pay or reimburse his or her reasonable expenses as incurred if the director or officer provides the corporation with all of the following:

**(1) WRITTEN AFFIRMATION.** A written affirmation of his or her good faith belief that he or she has not breached or failed to perform his or her duties to the corporation.

**(2) REPAYMENT UNDERTAKING.** A written undertaking, executed personally or on his or her behalf, to repay the allowance and, if required by the corporation, to pay reasonable interest on the allowance to the extent that it is ultimately determined under s. 181.0873 that indemnification under s. 181.0872 (2) is not required and that indemnification is not ordered by a court under s. 181.0879 (2) (b). The undertaking under this subsection shall be an unlimited general obligation of the director or officer and may be accepted without reference to his or her ability to repay the allowance. The undertaking may be secured or unsecured.

**181.0875 Corporation may limit indemnification.**

**(1) METHODS OF LIMITING OBLIGATION.** A corporation's obligations to indemnify under s. 181.0872 may be limited as follows:

(a) If the corporation is incorporated on or after June 13, 1987, by the articles of incorporation, including any amendments or restatements of the articles of incorporation.

(b) If the corporation was incorporated before June 13, 1987, by an amendment to, or restatement of, the articles of incorporation which becomes effective on or after June 13, 1987.

**(2) APPLICABILITY.** A limitation under sub. (1) applies if the first alleged act of a director or officer for which indemnification is sought occurred while the limitation was in effect.

**181.0877 Additional rights to indemnification and**

**allowance of expenses. (1) ADDITIONAL RIGHTS TO INDEMNIFICATION.**

Except as provided in sub. (2), ss. 181.0872 and 181.0874 do not preclude any additional right to indemnification or allowance of expenses that a director or officer may have under any of the following:

(a) The articles of incorporation or bylaws.

(b) A written agreement between the director or officer and the corporation.

(c) A resolution of the board of directors.

(d) A resolution, after notice, adopted by a majority vote of members who are entitled to vote.

**(2) WHEN PROHIBITED.** Regardless of the existence of an additional right under sub. (1), the corporation may not indemnify a director or officer, or permit a director or officer to retain any allowance of expenses unless it is determined by or on behalf of the corporation that the director or officer did not breach or fail to perform a duty that he or she owes to the corporation which constitutes conduct under s. 181.0872 (2) (a) 1., 2., 3. or 4. A director or officer who is a party to the same or related proceeding for which indemnification or an allowance of expenses is sought may

not participate in a determination under this subsection.

**(3) APPLICABILITY.** Sections 181.0871 to 181.0883 do not affect a corporation's power to pay or reimburse expenses incurred by a director or officer in any of the following circumstances:

(a) As a witness in a proceeding to which he or she is not a party.

(b) As a plaintiff or petitioner in a proceeding because he or she is or was an employee, agent, director or officer of the corporation.

**181.0879 Court-ordered indemnification. (1) APPLICATION TO COURT.** Except as provided otherwise by written agreement between the director or officer and the corporation, a director or officer who is a party to a proceeding may apply for indemnification to the court conducting the proceeding or to another court of competent jurisdiction. Application shall be made for an initial determination by the court under s. 181.0873 (5) or for review by the court of an adverse determination under s. 181.0873 (1), (2), (3), (4) or (6). After receipt of an application, the court shall give any notice it considers necessary.

**(2) STANDARDS USED BY COURT.** The court shall order indemnification if it determines any of the following:

(a) That the director or officer is entitled to indemnification under s. 181.0872 (1) or (2). If the court also determines that the corporation unreasonably refused the director's or officer's request for indemnification, the court shall order the corporation to pay the director's or officer's reasonable expenses incurred to obtain the court-ordered indemnification.

(b) That the director or officer is fairly and reasonably entitled to indemnification in view of all the relevant circumstances, regardless of whether indemnification is required under s. 181.0872 (2).

**181.0881 Indemnification and allowance of expenses of employees and agents.** A corporation may indemnify and allow reasonable expenses of an employee or agent who is not a director or officer to the extent provided by the articles of incorporation or bylaws, by general or specific action of the board of directors or by contract.

## 9. 181.0883 Insurance

**181.0883 Insurance.** A corporation may purchase and maintain insurance on behalf of an individual who is an employee, agent, director or officer of the corporation against liability asserted against and incurred by the individual in his or her capacity as an employee, agent, director or officer, or arising from his or her status as an employee, agent, director or officer, regardless of whether the corporation is required or authorized to indemnify or allow expenses to the individual against the same liability under ss. 181.0872, 181.0874, 181.0877 and 181.0881.

## b. Selected IRS Laws

### i. Tax Code

#### 1. Private inurement (Internal Revenue Code section 501(c)(3))

**(3)** Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no

substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

## 2. Intermediate sanctions (Internal Revenue Code section 4958)

### **(a) Initial taxes**

#### **(1) On the disqualified person**

There is hereby imposed on each excess benefit transaction a tax equal to 25 percent of the excess benefit. The tax imposed by this paragraph shall be paid by any disqualified person referred to in subsection (f)(1) with respect to such transaction.

#### **(2) On the management**

In any case in which a tax is imposed by paragraph (1), there is hereby imposed on the participation of any organization manager in the excess benefit transaction, knowing that it is such a transaction, a tax equal to 10 percent of the excess benefit, unless such participation is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any organization manager who participated in the excess benefit transaction.

### **(b) Additional tax on the disqualified person**

In any case in which an initial tax is imposed by subsection (a)(1) on an excess benefit transaction and the excess benefit involved in such transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the excess benefit involved. The tax imposed by this subsection shall be paid by any disqualified person referred to in subsection (f)(1) with respect to such transaction.

### **(c) Excess benefit transaction; excess benefit**

For purposes of this section—

#### **(1) Excess benefit transaction**

##### **(A) In general**

The term “excess benefit transaction” means any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. For purposes of the preceding sentence, an economic benefit shall not be treated as consideration for the performance of services unless such organization clearly indicated its intent to so treat such benefit.

##### **(B) Excess benefit**

The term “excess benefit” means the excess referred to in subparagraph (A).

## 3. Self dealing for private foundations (Internal Revenue Code section 4941)

### **(a) Initial taxes**

#### **(1) On self-dealer**

There is hereby imposed a tax on each act of self-dealing between a disqualified person and a private foundation. The rate of tax shall be equal to 10 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing. In the case of a government official (as defined in section [4946 \(c\)](#)), a tax shall be imposed by this paragraph only if such disqualified person participates in the act of self-dealing knowing that it is such an act.

#### **(2) On foundation manager**

In any case in which a tax is imposed by paragraph (1), there is hereby imposed on the participation of any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing that it is such an act, a tax equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period, unless such participation is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any foundation manager who

participated in the act of self-dealing.

**(b) Additional taxes**

**(1) On self-dealer**

In any case in which an initial tax is imposed by subsection (a)(1) on an act of self-dealing by a disqualified person with a private foundation and the act is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the amount involved. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participated in the act of self-dealing.

**(2) On foundation manager**

In any case in which an additional tax is imposed by paragraph (1), if a foundation manager refused to agree to part or all of the correction, there is hereby imposed a tax equal to 50 percent of the amount involved. The tax imposed by this paragraph shall be paid by any foundation manager who refused to agree to part or all of the correction.

ii. Best Practices

1. IRS Form 990 – recently revamped

Section B. Policies		Yes	No
12a	Does the organization have a written conflict of interest policy? <i>If "No," go to line 13</i>		
b	Are officers, directors or trustees, and key employees required to disclose annually interests that could give rise to conflicts?		
c	Does the organization regularly and consistently monitor and enforce compliance with the policy? <i>If "Yes," describe in Schedule O how this is done</i>		
13	Does the organization have a written whistleblower policy?		
14	Does the organization have a written document retention and destruction policy?		
15	Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision:		
a	The organization's CEO, Executive Director, or top management official?		
b	Other officers or key employees of the organization? Describe the process in Schedule O. (see instructions)		
16a	Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement with a taxable entity during the year?		
b	If "Yes," has the organization adopted a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law, and taken steps to safeguard the organization's exempt status with respect to such arrangements?		

2. Governance policies

- Marquette Legal Initiative for Non Profit Corporations – [www.m-linc.org](http://www.m-linc.org)
- Boardstar – [www.boardstar.org](http://www.boardstar.org)
- Internal Revenue Service – [www.irs.gov/charities](http://www.irs.gov/charities)
- Wisconsin Department of Financial Institutions – [www.wdfi.org](http://www.wdfi.org)
- Helen Bader Institute for Nonprofit Management – [www.4.uwm.edu/milwaukeeidea/hbi/](http://www.4.uwm.edu/milwaukeeidea/hbi/)
- Nonprofit Center of Milwaukee – [www.nonprofitcentermilwaukee.org](http://www.nonprofitcentermilwaukee.org)
- Donors Forum of Wisconsin – [www.dfwonline.org](http://www.dfwonline.org)
- Marquette Funding Information Center – [www.marquette.edu/library/fic](http://www.marquette.edu/library/fic)
- Nonprofit Management Fund – [www.nonprofitmanagementfund.org](http://www.nonprofitmanagementfund.org)
- Nonprofit Portal of Greater Milwaukee – [www.cuir.uwm.edu/nonprofit/index.php](http://www.cuir.uwm.edu/nonprofit/index.php)

3. IRS publications

<a href="#">Publication 557</a>	Tax-Exempt Status for Your Organization
<a href="#">Publication 598</a>	Tax on Unrelated Business Income of Exempt Organizations
<a href="#">Publication 4220</a>	Applying for 501(c)(3) Tax-Exempt Status

<a href="#">Publication 4221-PC</a>	Compliance Guide for 501(c)(3) Public Charities
<a href="#">Publication 4221-PF</a>	Compliance Guide for 501(c)(3) Private Foundations
<a href="#">Publication 4740</a>	New Form 990 Preparation Checklist
<a href="#">Publication 4741</a>	The New Form 990: What Every Tax-Exempt Organization Needs to Know
<a href="#">Form 1023 &amp; Instructions</a>	Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code
<a href="#">Form 990 &amp; Instructions</a>	Return of Organization Exempt from Income Tax

c. Common Law

i. Duty of care

“The duty of care requires a director to ... act in ‘good faith’ using the ‘degree of diligence, care and skill’ which prudent people would use in similar positions and under similar circumstances.” Including the following:

- Be familiar with organization’s finances; periodically review financial controls
- Participate regularly in organizations governance
- Attend all board and committee meetings and actively participate.
- Carefully read material prepared for meetings prior to meetings, including minutes
- Allow time to meet without management present
- Obtain minutes for any missed meetings
- Make sure there is a clear process for approval of major commitments
- Participate in risk assessment and strategic planning
- Encourage diversity among board members
- Periodically review performance of Executive Director

See New York State Office of the Attorney General: Charities Bureau. Right from the Start: Responsibilities of Directors of Not-for-Profit Corporations, available at <http://www.charitiesnys.com/pdfs/Right%20From%20the%20Start%20Final.pdf> (“Right from the Start”) pp 3-5.

ii. Duty of loyalty

“Directors are charged with the duty to act in the best interests of the organization. The duty of loyalty requires that any conflict of interest, real or potential, always be disclosed in advance of joining a board and when they arise.” *Right from the Start*, p 5.

iii. Duty of obedience

“A board has a duty of obedience to ensure that the organization acts in furtherance of its mission,” including dedication of financial and operational resources to mission, ensuring organization carries out its mission, ensuring organization does not engage in unauthorized activities, and ensuring compliance with all applicable laws.” *Right from the Start*, pp 5-6.

#### **IV. Conflicts of Interest (Karin Holmberg Werner)**

**8:35 to 8:45**

- a. What is a conflict of interest? Examples.
  - i. Investing nonprofit funds in a company owned by a director or where a director is a key manager.
  - ii. Signing a large contract with a company (insurance, construction, etc.) owned by a director or where a director is a key manager.
  - iii. Buying land owned by a director.
  - iv. Loaning a director money.
- b. Key is not to avoid all conflicts of interest but to handle them effectively and according to a pre-arranged procedure.
- c. Get the policy in place now. It is important for nonprofit organizations to have a conflict of interest policy in place before issues arise. Otherwise there is a great risk that the debate will focus on what policy and procedure to use in dealing with the conflict rather than directly addressing the conflict itself.
- d. IRS model conflict of interest policy (Appendix A of instructions to Form 1023)
  - i. Procedure for disclosure – annual statement
  - ii. Plus mandatory disclosure as situations arise
  - iii. Recusal – i.e., leave room during vote
  - iv. Resignation – appropriate in situations where continuing, pervasive and important board function is affected by the conflict of interest. The conflict is one that cannot easily be isolated to allow for recusal.
  - v. Meeting minutes should document disclosure and recusal where appropriate
  - vi. Point: Need a general procedure for handling and documenting conflicts of interest as they arise
  - vii. Reminder: if you use the IRS model policy, remove two clauses only for hospitals.
- e. Note: Policy not required by law but now asked about on page four of Form 1023 (application for tax exempt status) and page six of Form 990 (annual filing for larger nonprofits). If no conflict of interest policy in place, new and larger nonprofits must explain themselves to the IRS.
- f. Reminder – special self dealing rules for private foundations are more restrictive and may not allow for conflicts that are acceptable (if handled appropriately) in the public charity context.

#### **V. Case Examples (Karin Holmberg Werner)**

**8:45 to 9:05**

- a. Conserve School – conflict of interest
  - i. Directors of a Wisconsin nonprofit corporation, the Conserve School Corporation., also served as trustees of an Illinois trust that was sole source of funding for the school.

- ii. Those same individuals were also directors of a Delaware for profit corporation, Central Steel and Wire Company, whose stock was the only asset held by the Illinois trust.
  - iii. When the stock fell in the fall of 2008, the directors/trustees decided not to sell the stock. Selling the stock would have meant that they could have lost control of the for profit corporation but also meant that the Wisconsin nonprofit corporation could no longer support its then activities.
  - iv. Last March, the Wisconsin Attorney General intervened in the case and argued that the directors' conflict of interest rendered them incapable of exercising independent judgment as to the affairs of the Conserve School.
  - v. Last May, a Wisconsin court ruled that the nonprofit corporation's director's decision to change the format of the school from a four year to a semester only program was within their discretion.
  - vi. Note that the Wisconsin court did not directly address the conflict of interest issue.
- b. Adelphi University – excess compensation and conflicts of interest
- i. In 1997, the New York State Board of Regents removed 18 of 19 Adelphi University trustees for failing in their oversight duties. Their failures, the Regents said, included allowing excessive compensation for the university's president, Dr. Peter Diamandopoulos, and conflicts of interest involving approving transactions with businesses related to two trustees.
  - ii. The university's outside auditor, Deloitte & Touche, had recommended the conflict of interest policy in 1992, 1993, 1994 and 1995, according to university documents, before the board began complying in 1996.
  - iii. "I can't tell you why it took as long as it did," said Thomas Calabrese Jr., who heads the board's audit committee. Mr. Calabrese, a Nynex executive, was one of the trustees initially accused of a conflict. But on Friday, the coalition dropped that charge, based on newly provided records showing that in 1989, when the board approved a Nynex contract, he stated his conflict and did not vote.
  - iv. A Chronicle of Higher Education survey in 1996 ranked Dr. Diamandopoulos as the nation's second highest paid college president.
    - 1. Key facts – board minutes never reflected board approval of the president's compensation, despite the bylaws requiring such approval. Instead, the chairman and two other trustees reviewed and set compensation each year. They simply reported to the full board that they had done so but did not reveal details of the compensation package. Testimony also stated that the trustees stopped looking at comparable compensation information from other schools because it was "of very little value."
    - 2. Was review process sufficient without full board approval?
  - v. Board chairwoman owned an insurance company that collected more than \$1.2 million in commissions from the university from 1986 to 1996.
    - 1. Was the argument that the university benefitted from this arrangement a sufficient defense?

2. Key facts – the finance committee was told that the insurance company was providing services “free of charge” in 1986-87. Evidence of whether that representation related only to consulting services or insurance commissions was disputed.
  3. Were insurance commissions concealed by deceptive statements?
  4. University president unilaterally decided on insurance company. University trustees never formally voted on hiring the insurance company.
  5. Board chairwoman admitted that there was much discussion at board meetings of the insurance coverage even if not so noted in the minutes and that she never stepped out of the room for such board discussions on insurance.
- vi. The board chairman’s wife worked for the university and received raises and a promotion while he was board chairman.
- c. J. Paul Getty Trust – excess compensation
- i. Between 2003 and 2005, both the IRS and the California Attorney General commenced inquiries into practices at the J. Paul Getty Trust.
  - ii. Accusations included excess compensation for its then chief executive, Barry Munitz, who collected salary, benefits and perks totaling nearly \$1 million annually.
  - iii. Getty Trust had an endowment at that time of more than \$5 billion.
  - iv. Conclusions included misuse of funds for lavish travel, gifts and perks.
  - v. Such expenses were approved by the trust’s board and included first-class air travel, stays at five-star hotels and a leased Porsche Cayenne.
  - vi. Also at issue was a 2002 sale of real estate owned by the trust to Eli Broad, a billionaire investor and art collector who is a close friend and traveling companion of Mr. Munitz. It was asserted that the property was sold for \$700,000 less than its appraised value.
  - vii. Misspent money was recouped when Munitz agreed to repay \$250,000 and forgo more than \$2 million in benefits when he was removed as chief executive. He resigned without a severance package.
  - viii. In 2006, the California Attorney General appointed an overseer of reforms at the trust after the 14 month investigation revealed that Mr. Munitz misspent trust money on his wife’s travel, used employees for personal errands and made improper payments to a graduate student. The California attorney general declined to take civil or criminal action against Mr. Munitz or the then board of directors as the misuse of funds did not result from fraud and the value of the settlement between the trust and Mr. Munitz exceeded the value of the losses from any improper payments.
  - ix. Getty reforms included restricting travel expenses, prohibiting the use of employees for personal ends and forbidding gifts from the trust to its trustees.
  - x. Note: all payments/expenses approved by the board and no indication of false statements or submitting false bills.
  - xi. The California Attorney General required reports every six months for two years regarding compliance with reforms.

**VI. Lawyers Serving as Director of a Client Organization (Timothy Pierce) 9:05 to 9:40**  
**Highlighted within Wisconsin Rules of Professional Responsibility**  
**Outline located in attached document**

**VII. Questions/Discussion**

**9:40 to 10:00**