Lessons for Not-for-Profit Boards

Randy Myers

Directors of not-for-profit boards are facing many of the same governance challenges as those on public-company boards. The hapless poster boy for this: Kenneth Langone, a former director of the not-for-profit New York Stock Exchange and head of its compensation committee. He's being sued by New York state attorney general Eliot Spitzer, who claims Langone misled the rest of the board about just how much Richard Grasso, the NYSE's former chairman and CEO, was being paid. Grasso is a co-defendant in the suit, which is not expected to go to trial until 2006 at the earliest. Langone, the chairman, president, and CEO of NYSE member firm Invemed Associates LLC, still serves on the boards of four public companies, but he announced in February that he would not stand for reelection to a fifth board, General Electric's, this year.

Like most other states, New York has a law requiring "reasonable" compensation for executives who run charities and other not-for-profit corporations. Spitzer argues that Grasso's take was anything but reasonable. Meanwhile, a report commissioned by the NYSE's new management team concluded not only that Grasso had a major influence on who the directors were but also that he had "the unfettered authority to select which board members served on the compensation committee and, likewise, to select the committee chair."

While Grasso and Langone have both denied the allegations against them, attorney Michael Peregrine, a partner in the Chicago office of McDermott Will & Emery, says that the case highlights the need for not-for-profit boards to consider just how much discretion they give their CEOs, especially on the hot-button issue of executive compensation. "You don't have to become adversaries," he says. "But there is something to be said for the exercise of constructive skepticism and being informed and attentive."

The Grasso affair may prove to be the most egregious case of not-for-profit directors' failing to exercise their fiduciary duty, but it's hardly the only one. In Austin, Texas, last year, a jury ordered two former officers of the Carl B. and Florence E. King Foundation to repay $7.5 million they'd taken from the charity in salary and lavish perquisites, and tacked on $14 million in punitive damages for good measure. The Texas attorney general had accused the two officers, a secretary, and a pair of the foundation's board members—Arden Grover and Jack Phipps—of violating the Texas Non-Profit Corporation Act by failing to use the foundation's assets for charity and not properly managing its holdings. Both directors resigned in the fall of 2002 and later settled with the state.

An earlier not-for-profit compensation scandal involved Adelphi University on New York's Long Island. In 1997 the state education department's board of regents removed 18 of the 19 Adelphi trustees, contending that they had grossly overpaid the school's president at the time, Peter Diamandopoulos. His annual pay and benefits were reported to exceed $800,000, even though student enrollment was declining. Both Adelphi and Dennis Vacco, then New York's attorney general, subsequently sued the former trustees, arguing that they had wasted university assets. In a 1998 settlement, the former trustees agreed to pay the school $1,025,000. Diamandopoulos has since left.

Michael Peregrine says that too many not-for-profit boards fail to follow best-practice compensation policies, a lapse that leaves their pay practices open to challenge. If they don't shape up, he warns, regulators may force them to. California has already taken a step in that direction with its 2004 Nonprofit Integrity Act, which among other things requires that compensation for the CEO and CFO of a not-for-profit operating in the state be reviewed and approved by the organization's board of directors, an authorized committee of that board, or, in the case of a charitable trust, the trustee or trustees. The law also charges those overseers with ensuring that executive salaries are "just and reasonable."

Peregrine advises directors of not-for-profit entities to adopt the same compensation protocol they should already be using on their public-company boards: create a compensation committee composed of independent directors who operate openly according to a well-defined compensation policy, advised by outside consultants with experience in serving similar organizations.

"The good news is that there's no mystery in this," says Peregrine. "The rules and best practices are awfully clear." L&G

At least they are now.

Reprinted with Permission

The article first appeared in May/June 2005 issue of *Corporate Board Member Magazine.*

Calendar

LITIGATING DISABILITY AND INSURANCE CLAIMS
September 12– 13, 2005
Vancouver, BC
For more info: www.insightinfo.com

NURSES & INFORMATICS: TRANSFORMING HEALTHCARE
September 14, 2005
Toronto, ON
For more info: http://www.cnia.ca/CFP.html

THE CAHSPR CONFERENCE
September 18, 2005
Montreal, QC
For more info: http://www.cahspr.ca/

NATIONAL HOSPICE PALLIATIVE CARE CONFERENCE
September 25– 28, 2005
Edmonton, AB
For more info: http://www.chpca.net/events/conference.htm

FROM CURE TO PREVENTION: BRINGING TOGETHER PARTNERS FOR CHANGE
September 29– October 1, 2005
Banff, AB
For more info: http://www.uleth.ca/

AMIA 2005 ANNUAL SYMPOSIUM
October 22– 26, 2005
Washington DC, U.S.
For more info: www.amia.org

CLINICAL TRIALS IN CANADA
October 24– 25, 2005
Toronto, ON
For more info: www.insightinfo.com

OHA HEALTHACHIEVE
October 31– November 2, 2005
Toronto, ON
For more info: http://www.healthachieve.com/

HEALTH BENEFITS MANAGEMENT
November 1– 2, 2005
Toronto, ON
For more info: www.insightinfo.com

THE IC 5 QUALITY CONGRESS
November 18, 2005
Toronto, ON
For more info: http://www.hospitalreport.ca/conferences.html