

STANDARDS OF CONDUCT & COMMITMENT:

An Overview for Auxiliary Organization
Boards and Managers

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Presentation Objectives

- Identify:

Statutory Conduct Standards; to Whom they Apply; Consequences & Who has Oversight Role

- Reconcile the Standards

- Consider Standards Beyond Compliance Requirements

- Lead-in to Policy Formulations

What Laws Apply?

- *California Corporations Code* 5230-5239
- *California Education Code* 89006 & 89906, 89907, 89908 & 89909
- *California Probate Code* 16000-16015
- **NOT** *California Political Reform Act*

Are There Types of Standards?

- “Judgment” Standards (General)
- “Transaction” Standards (Specific)

"Judgment" Standards

Cal Corporations Code 5231 (for Governing Board Members):

- Duty of Care
- Duty of Inquiry
- Duty of Loyalty
- Duty to Investments
- [Comment on "Fiduciary Standard"]

“Transaction” Standards

California Corporations Code 5233 (for Board Members):

- **Self-Dealing Transactions**

California Corporations Code 5236(a)

- **Loans to Directors or Officers**

California Education Code 89906-08 (for Board Members):

- **Financial Interest Prohibitions**

California Education Code 89909 (for Board Members):

- **Use of Proprietary Information**

California Education Code 89006 (Any Person):

- **Use of Proprietary Information**

Self-Dealing Transactions

[Corporations Code §5231]

Applies to Governing Board Members

- Transaction to which Corporation is a party AND
- In which one or more directors has a *material financial interest*, *UNLESS*
- Transaction is statutorily excluded, OR
- Approved by the Attorney General (or court) OR
- Otherwise “Validated.”

Self-Dealing Transactions

[Continued]

- Board director with a *material financial interest* in a transaction is an “interested director.” The statute does not define “financial interest” or “material.”
- “Self-dealing” transactions that are specifically excluded from statutory sanctions include:
 - >Board setting director compensation;
 - >Action part of corporate purpose and approval in good faith, without unjustified favoritism, even if *interested director* or family in class of benefiting persons; or
 - >*Interested director* had no actual knowledge of transaction which did not exceed lesser of 1% corporation’s gross in preceding year, or \$100k.

Self-Dealing Transactions

[Continued]

Organization can engage in “self-dealing transaction” if it is approved or validated (before or after consummated) by any of following:

- Written, supported Request to AG
- Court Petition and Order
- Board Validation under specified pre-conditions
- Interim by other authorized persons under specified pre-conditions

Loans to Directors or Officers

[Corporations Code §5236(a)]

Applies to Board Members and Officers

- Loans to Directors and Officers are generally prohibited.
- Exceptions –
 - > Reasonable expense advances for duties
 - > Life insurance premium payments
 - > Loan to officer for principal residence purchase (conditions apply)
 - > Advances for defense against charges relating to duties or in representing corporation (with conditions)

Financial Interest Prohibitions

[Education Code §89906-08]

Applies to Governing Board Members

- Auxiliary Board Member Must Avoid transactions in which a financial interest is held, EXCEPT if
- Transaction “just and reasonable” as to auxiliary when approved AND
- Financial interest disclosed or known to Board and noted in meeting minutes, followed by favorable vote sufficient w/o including interested director – EXCEPT >>>>

Financial Interest Prohibitions

[Continued]

>>> There are several *circumstance exceptions* that revive the prohibition:

- Transaction directly between interested director and auxiliary
- Transaction between auxiliary and entity in which a director(s) holds an ownership, partnership or other proprietary interest
- Transaction between auxiliary and corporation in which interested director(s) owns or directly or indirectly holds more than 5% of outstanding common stock.
- Director fails to disclose financial interest to Board at public meeting, then influences or attempts to influence other Board members about transaction.

Financial Interest Prohibitions

[Continued]

Result – following Board transactions are specifically *impermissible*:

- Any transaction (other than an employment contract) directly between auxiliary and a Board member;
- Any transactions between auxiliary and a partnership or unincorporated association involving interested director with a partnership, owner, or holder (direct or indirect) of a proprietary interest; or
- Any transaction between auxiliary and a for-profit corporation involving interested director as owner or holder, directly or indirectly, or 5% or more of the outstanding common stock.

Use of Proprietary Information

[Education Code §89909 & 89006]

- Auxiliary Board Members are Prohibited from using *non-public information* for personal pecuniary gain (irrespective of whether or not director was board member when gain realized).
- It is also unlawful for any person to use auxiliary organization *non-public information* for personal gain.

Consequences for Noncompliance

Under Corporations Code

No personal liability upon director when reasonable diligence and care exercised, even when poor judgment results in loss or injury to corporation.

No personal liability to 3d person for monetary damages on part of volunteer director or officer if --

>Act or omission within scope of duties;

>Acted in good faith;

>No self-dealing involved; and

>Act or omission not reckless, wanton, intentional or grossly negligent.

- **“Self-dealing” interested director subject to civil damages and equitable remedies determined by court**

Consequences for Noncompliance

[Continued]

Under Education Code

- Board action involving prohibited financial interest voids transaction.
- Unlawful use of non-public information for personal pecuniary gain is a misdemeanor offense.

Reconciling Standards

- “Judgment” Standards in Corporations Code apply – no reconciliation needed
- “Transaction” Standards of Education Code are more stringent than Corporations Code, so generally control most situations.
- Where Board enters into *permissible* contract or other transaction involving interested director under Education Code standards, Board action may still be subject to *self-dealing transaction approval* or *validation* process requirements.
- *Approval* or *Validation* process under Corporations Code not recommended for *impermissible transactions* under Education Code.

Standards Oversight

- Attorney General has broad oversight authority over auxiliary organization (as nonprofit public benefit corporation) transactions. Corp Code § 5233, 5236 & Gov Code 12598
- CSU Trustees, Chancellor and campus presidents have regulatory, policy and operation authority over auxiliary organizations. Ed Code 89900 et seq. & Cal Code of Regs 42400 et seq.
- IRS (see new Form 990, Parts IV and VI)

Beyond Required Standards

- Corporate Mission & Values Statement
- Employee, Agent & Contractor Commitment Principles
- Disclosure Practices
- Procurement & Gifting Standards

Formulating Policy

- Statutes Set Standards
- Policy Statements –
 - > Summarize & Commit to Required Standards
 - > Express Standards not Required
 - > Provide Delegated Authority to implement Policy w/ Procedures
- Well Crafted Policy Statements Merit Close Attention