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## Charities Need Lawyers in the Boardroom

By Michael W. Peregrine

The recent controversies at the Smithsonian Institution and the World Bank have drawn much attention to the relationship between boards and chief executives. But a key lesson has been missed in assessing what can be done to avoid such scandals: Nonprofit organizations need to include their lawyers in the governance process. That means that the organization's general counsel should be given the duty and the authority to be involved in board meetings and the work done by board committees.

Some chief executives have resisted this idea, often out of concern about the amount of money that needs to be spent on staffing and other costs once governance duties are added to the general counsel's role or fears about an awkward reporting relationship, in which the general counsel is reporting to both the CEO and the board.

However, similar resistance to getting lawyers involved was heavily criticized in internal investigations at the World Bank and the Smithsonian and ultimately contributed to the resignations of chief executives at those institutions. Those scandals should make organizations realize that good governance includes working with lawyers, and that efforts by executives to restrict a general counsel's access to the board will be viewed with alarm.

A progressive chief executive will make the effort now to ensure that the general counsel is routinely available to support deliberations of the organization's board.

In the corporate world, concerns about the proper role of general counsels and their access to the board emerged immediately in the aftermath of the Enron debacle. A common theme among many of the more-notorious corporate scandals in the past decade has been chief executives' efforts to "marginalize" the authority and influence of their general counsels.

A poster child for such excesses was WorldCom, where "the CEO appears to have done everything possible to undermine the stature and authority of the legal department," according to a report prepared for a federal court judge overseeing the resolution of the scandal.

In the wake of WorldCom's collapse, many public companies focused on developing ways to facilitate communications between the general counsel and the board to ensure the business was complying with the law and enhancing the stature and influence of the general counsel within the organization.

Most companies decided that it was wise to make sure that:

- The board of directors approves the selection, retention, and compensation of the general counsel.
- The general counsel meets regularly and in executive session with a committee of independent directors to discuss potential legal risks to the organization.
- The general counsel of the organization always has a direct line of communication with outside lawyers hired by the company.

The goal of those changes is to make sure that board members receive solid information and analysis about potential legal issues and violations — and that organizations would reduce their chances of getting in legal trouble by improving the information flow.

Many charities have yet to follow the lead of public companies when it comes to making such changes. That is in large part due to the reluctance of many chief executives to allow the general counsel to have direct access to the board instead of always going through the chief executive.

It is also due in part to an understandable reluctance on the part of lawyers who work at nonprofit organizations to raise the issue with the chief executive, for fear of appearing to feather their own nests. The result is that many nonprofit boards are denied regular and immediate access to the general counsel when they are called on in meetings to focus on issues with legal implications. The results can be seen in the recent scandals.

At the World Bank, a controversy arose from perceived conflicts of interest when the top executive, Paul Wolfowitz, was the key decision maker in the job assignment and compensation of a close personal acquaintance. Notably, the bank's internal review expressed specific concern with the decision made by the CEO not to consult the World Bank's general counsel regarding associated legal issues, including potential liabilities to the bank as well as compliance with internal bank policies on employment matters.

Also of concern was the chief executive's decision to prohibit the vice president for human resources (or anyone else) from contacting the general counsel on the matter. The internal review concluded that those actions "subverted" the established governance structure of the bank and deprived the institution of "any acceptable legal safeguard." They also manifested a "lack of understanding for, and a disregard of, the interests of the institution," according to the internal review.

Through those (and other) actions, the review found that Mr. Wolfowitz placed his own personal interests in opposition to the interests of the institution and undermined the legal safeguards designed to protect the institution from the exact type of legal harm and image problems it suffered after this affair. Such actions constituted a breach of provisions of his employment agreement that required him to avoid conflicts of interest.

At the Smithsonian, the controversy arose from the management style of the chief executive officer, Lawrence Small, who allegedly discouraged people who disagreed with him from influencing policy decisions and restricted the flow of information to the board, thus preventing it from exercising proper oversight.

The Smithsonian's internal review concluded that Mr. Small obstructed the general counsel's gatekeeper role by isolating him from the Board of Regents and preventing him from any meaningful oversight of the organization's leadership. Mr. Small significantly reduced the budget and staff of the Office of General Counsel, while the size and complexity of the workload increased.

Furthermore, Mr. Small allegedly said that "lawyers do not serve a useful purpose," and typically reacted negatively to advice from the general counsel that restricted his flexibility in running the organization, according to a review of his tenure commissioned by the Smithsonian. Mr. Small ultimately resigned under pressure.

The World Bank and Smithsonian cases demonstrate why attentive board members will increasingly expect to have access to an organization's general counsel.

Prudent nonprofit executives will act now to enact policies that ensure attendance by the general counsel (or a designed representative) at board and committee meetings and provide board members with immediate access to legal advice.

Those policies should call for the general counsel to make regularly scheduled reports to the board and make it a routine procedure for the general counsel to meet with trustees in executive session on matters that could involve serious legal risks.

What's more, they should guarantee that the nonprofit group's general counsel will always be kept informed by outside lawyers hired by the organization.

And to make sure that the lawyer has plenty of autonomy, the board must be involved in the hiring and firing of the general counsel, as well as in deciding how much he or she should be paid.

The nonprofit world has certainly not been immune to the controversy that has caused problems in corporate America. An attentive board of directors, exercising informed oversight with the help of a general counsel, is the best defense against scandal.

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