

Fiduciary Duty and the Ex Officio Conundrum in Corporate Governance: The Troublesome Murkiness of the Gubernatorial Trustee's Obligations

Hastings Business Law Journal
(Forthcoming, Vol. 10 – 2013/2014)

*****Draft Version*****

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Abstract - Should governors serve on the boards of incorporated universities as ex officio members? This paper examines the question by considering the experience of Penn State University and analyzes the implications of governors serving on the boards of state-aided corporations through focusing on the fiduciary responsibilities of directors under corporate law. The article concludes that the current statutory framework needs reconsideration and asserts that while there is no question that the state's public interests should trump an institution's "private" interests, it is the state that has chartered the corporation for the promotion of a public good (education) and has endowed it with the governor as one of its directors to guard the institution's best interests. Accordingly, if the ex officio director is in a position where he may not be able to serve the corporation's interests, the law must mandate that the fiduciary steps aside from the board, as the constant tensions that the current paradigm condones (those between public governance political objectives and private corporate governance principles as defined by centuries of fiduciary law), cannot be sustained.

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By Salar Ghahramani

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The views expressed in this paper are solely the author's and do not necessarily represent the position of the Pennsylvania State University, its Board of Trustees, or other members of the University community.

I. INTRODUCTION

In November of 2011, the Pennsylvania State University became the subject of a nationwide scandal triggered by allegations against a retired former assistant football coach, Jerry Sandusky, accused (and later convicted) of engaging in sexual activities with underage boys.¹ The grand jury investigation against Mr. Sandusky was initiated in 2009, under the leadership of the then-attorney general, Thomas Corbett.² Accordingly, when Mr. Corbett became Pennsylvania's governor in 2011 and hence a voting ex officio³ member of Penn State's Board of Trustees,⁴ he had knowledge of potentially damaging information about the university that no other board member presumably had.⁵ Yet, despite his fiduciary responsibilities toward the university,⁶ he could not disclose the injurious information or urge his fellow trustees to take specific action to protect the institution because grand jury laws and rules of professional conduct prohibited him from disclosing anything related to the ongoing criminal investigation in which he had been instrumental when serving as attorney general.⁷

¹ See Mark Viera, *A Sex Abuse Scandal Rattles Penn State's Football Program*, N.Y. TIMES, Nov. 6, 2011, at A1 (providing the background of the charges); Tim Rohan, *Sandusky Gets 30 to 60 Years for Sexual Abuse*, N.Y. TIMES, Oct. 10, 2012, at A1 (summarizing the Sandusky trial, conviction, and sentencing).

² Mr. Corbett served as Attorney General of Pennsylvania from 2005 until 2011. In this capacity, his office was privy to the secret grand jury investigation information that had been initiated in 2009 (see Jo Becker, *Abuse Inquiry Set Tricky Path for a Governor*, N.Y. TIMES, Nov. 11, 2011, at A1) (summarizing Mr. Corbett's role as Attorney General in the Sandusky investigation).

³ Ex officio, which in Latin means "by virtue of office or position" refers to the method by which one becomes a member of a body (AMERICAN HERITAGE DICTIONARY 481 (3rd ed. 1992)). It is not a class of membership and is not about rights, despite the common misconception that ex officio members are automatically non-voting (see HENRY M. ROBERT, ROBERT'S RULES OF ORDER 466-67 (Daniel H. Honemann et al. eds., 10th ed. 2000)). The rights of ex officio members can be limited in an organization's bylaws, however. Otherwise, ex officio members enjoy the same rights and privileges as all other members. *Id.*

⁴ See 24 PA. STAT. ANN. § 2533 (West 2012) (designating the governor as an ex officio trustee). See also Penn. St. Univ. Charter [hereinafter PSU Charter] (naming the Governor of the Commonwealth, among others, as ex officio members of the Board). At Penn State, the governor had been a voting ex officio member of the Board since the inception of the University in 1855. However, in May of 2013, the Board amended the Charter, rendering the governor a non-voting member. *Id.* See also Penn. St. Univ. Bylaws [hereinafter PSU Bylaws] (denoting the roles of ex officio members).

⁵ Due to the secret nature of grand juries, none of the witnesses or others involved in the process could have legally briefed members of the Penn State Board of Trustees. There is no indication that any board member had specific knowledge of the proceedings that he or she had attained through other channels.

⁶ See PSU Bylaws art. 6(1), *supra* note 4 (noting that the board members have a fiduciary duty toward the university). See also *infra* Part III and Part VI (discussing, respectively, nonprofit board members' fiduciary responsibilities in general and Pennsylvania statutory requirements in particular).

⁷ See 42 PA. CONS. STAT. § 4549 (2012) (persons involved in the grand jury proceedings "shall be sworn to secrecy, and shall be in contempt of court if they reveal any information which they are sworn to keep secret."); 234 PA. CODE § 2.231 (2012) ("All persons who are to be present while the grand jury is in session shall be identified in the

Unrelated to the scandal, Governor Corbett's 2011 annual budget proposal to the Pennsylvania legislature had recommended severe funding cuts to the Commonwealth System of Higher Education (CSHE), of which Penn State and three other universities (Lincoln University, Temple University, and the University of Pittsburgh) are members.⁸ At all four state-related institutions,⁹ the governor retains a special role: at Lincoln, and, until May of 2013, at Penn State, the governor has been a voting ex officio member of the boards of trustees.¹⁰ At Temple and Pittsburgh, the governor is a non-voting ex officio trustee.¹¹ At all four universities, the governor also appoints several of the other trustees.¹² Yet, despite his fiduciary obligations toward these institutions as their director,¹³ the governor initiated significant budget cuts that could adversely affect the organizations' viability and their missions.

record, shall be sworn to secrecy as provided in these rules, and shall not disclose any information pertaining to the grand jury except as provided by law.”).

⁸ See Eleanor Chute & Bill Schackner, *Proposed Education Cuts Termed “Catastrophic,”* PITT. POST-GAZETTE, Mar. 29, 2011, available at <http://www.post-gazette.com/stories/local/state/proposed-education-cuts-termed-catastrophic-211559> (highlighting that the proposal included cutting the annual state support of state-owned and state-supported higher education institutions by more than fifty percent).

⁹ Pennsylvania statutes categorize the four universities as “state-related.” See 10 PA. CONS. STAT. § 374 (2012); 18 PA. CONS. STAT. § 20.302 (2012); 24 PA. CONS. STAT. § 20-2001-C (2012). State-related universities are private corporations that are aided by the state, may be considered the instrumentalities of the state, but are not owned by the state. See, e.g., 18 PA. CONS. STAT. § 20.302 (2012) (making the distinction between “state-related” and “state-owned” institutions of higher education in Pennsylvania); 24 PA. CONS. STAT. § 2510-2 (2012) (designating Temple University as a state-related university and as “an instrumentality of the Commonwealth”); 24 PA. CONS. STAT. § 2510-503 (2012) (declaring that the “Corporation for Penn State is a wholly controlled affiliate of the Board of Trustees of The Pennsylvania State University, a State-related university and an instrumentality of the Commonwealth.”).

¹⁰ See Lincoln Univ. Bylaws, art. II, § 2(A) (noting that the ex officio members “shall be voting members” of the Board); see also *supra* note 4 and accompanying text (highlighting the transformation of the governor's role on the board from voting ex officio to non-voting ex officio).

¹¹ See Temple Univ. Bylaws, art. IV, § 4.1(A) (“the Governor of the Commonwealth of Pennsylvania, the Secretary of Education of the Commonwealth of Pennsylvania, and the Mayor of the City of Philadelphia...shall be non-voting, *Ex-Officio* Trustees... . An *Ex-Officio* Trustee and an Honorary Life Trustee shall have the privilege of attending Board meetings and participating in its deliberations, but shall not have a vote in Board decisions.”); Univ. of Pitt. Governance: Bd. of Trs., available at http://www.provost.pitt.edu/handbook/ch1_gov_trustees.htm (“The Board of Trustees includes the Governor of Pennsylvania, the Secretary of Education, and the Mayor of the City of Pittsburgh, all three of whom are non-voting, ex officio members.”).

¹² At Penn State, the governor appoints six trustees to the board (see PSU Charter, *supra* note 4, at C-2). At Lincoln, the governor appoints four members to the Board, subject to a 2/3 advice and consent of the Pennsylvania Senate (see Lincoln Univ. Bylaws, *supra* note 10, at art. II, § 2(B)). At Temple, the governor appoints four of the trustees (see Temple Univ. Bd. of Trs., available at <http://www.temple.edu/secretary/trustees.htm>). At the University of Pittsburgh, the governor appoints four of the trustees (see Univ. of Pitt. Governance, *supra* note 11).

¹³ As is the norm in nonprofit corporate governance, this paper will use the terms “trustee” and “director” interchangeably.

With this background, the present article analyzes the implications of governors serving on the boards of trustees of quasi-public universities such as Penn State,¹⁴ a gubernatorial prerogative that is by no means unique to Pennsylvania.¹⁵ With a focus on the fiduciary responsibilities of directors under corporate law,¹⁶ the paper proceeds according to the following parts: Part II examines the historical roots of the corporate model of governance in American higher education.¹⁷ Part III presents an overview of fiduciary obligations in nonprofit corporations and analyzes duties of care, loyalty, and obedience as the three pillars of nonprofit corporate governance as well as the applicability of the business judgment rule in assessing nonprofit directorial performance. Part IV reviews the mechanisms available to the state attorneys general and others interested in enforcing nonprofit directorial obligations. Part V provides specific examples of enforcement of duties as applied to university fiduciaries. Part VI critiques the gubernatorial-trustee model through its examination of Penn State's experience and offers specific recommendations as potential solutions to the inherent predicaments caused by the model. Part VII concludes.

¹⁴ While chartered as private corporations, the state-related universities are essentially quasi-public institutions (*see* *Isaacs v. Bd. of Trs. of Temple Univ.*, 385 F.Supp. 473, 476 (E.D. Pa. 1974)) (noting that “. . . ‘In essence, the Temple University-Commonwealth Act establishes a working partnership between the University and the State. Temple retains its private corporate identity, but the Commonwealth shares in the control of the institution through the appointment of one-third of Temple’s Board of Trustees and through the financial accountability provisions written into the Act.’ The Act thus created an ‘organic relationship between Temple University and the Commonwealth’ that is ‘the same as that between the Commonwealth and the Pennsylvania State University. Both of these institutions, while private in corporate identity, are invested with a *quasi-public character* and charged with certain public responsibilities, obligations and commitment.” (quoting REP. OF THE HIGHER EDUC. COMM. COMMONWEALTH OF PA. H.R. (1965-1966) (emphasis added))).

¹⁵ The author is unaware of any public or quasi-public university or state university system that does *not* carve out a special role for the governor. This gubernatorial prerogative may be granted by public law and incorporated into the university charter (*see, e.g.*, PSU Charter, *supra* note 4, at C-2 & C-3) (citing statutes and court decrees that confer ex officio membership on the board and accord the Pennsylvania governor the authority to appoint other members to Penn State’s board of trustees). For a general overview of the role of public officials on university boards, *see generally*, Robert C. Lowry, *Governmental Structure, Trustee Selection, and Public University Prices and Spending: Multiple Means to Similar Ends*, 45 AM. J. POL. SCI. 845, 849 (2001) (noting that nationwide “over 80 percent of the trustees on public university governing boards are selected by elected officials or popular election, and many boards also include state government officials who serve ex officio.”).

¹⁶ Historically, the nonprofit corporation trustees’ fiduciary duties were defined by the strictest standard of care rooted in trust law. For the most part, legislatures and courts have replaced these traditional precepts with the less restrictive corporate governance principles and directorial duties found in the for-profit sector. *See* Denise Ping Lee, *The Business Judgment Rule: Should It Protect Nonprofit Directors?*, 103 COLUM. L. REV. 925, 926 (2003). Nonetheless, trust and corporate law both impose, at the very least, “nonwaivable obligations of loyalty and the good faith exercise of care.” Evelyn Brody, *The Board of Nonprofit Organizations: Puzzling Through the Gaps Between Law and Practice*, 76 FORDHAM L. REV. 521, 527 (2007).

¹⁷ The predominant legal form for a modern American university is the corporation model (*see infra* Part II). As such, the “governance” issues discussed in this paper focus on the university’s *corporate* governance, *i.e.*, the relationship between the board of trustees and the university itself, rather than the more common discussion in academia revolving around the notions of shared governance—power-sharing mechanisms among faculty, the administration, and the board.

II. THE CORPORATE UNIVERSITY

A. History

The principal legal structure for most—if not all—American universities is the corporation, a fictitious person with rights and responsibilities identical to for-profit entities, overseen by a board.¹⁸ This adoption of the corporate model of governance at colleges and universities dates back to the founding of Harvard and Yale, two of the oldest corporations within the English legal tradition.¹⁹ (Established in 1636 and chartered in 1650,²⁰ Harvard claims to be “the oldest corporation in the Western Hemisphere.”)²¹ The corporate model is not unique to private universities, as state-owned and state-related colleges and universities have also espoused the form,²² despite the absence of any legal requirement for them to do so and the availability of other governance models which they have not sought.²³

Incidentally, the cornerstone of American corporate law was laid by a lawsuit in which a college—determined to protect its pre-Republic private corporate charter from the over-reaching of the state—was the plaintiff. In *Trustees of Dartmouth College v. Woodward*,²⁴ the Supreme Court had to decide whether the New Hampshire legislature’s attempt to make Dartmouth public, thereby rendering the original charter granted by King George III void, was legal. The Court held for Dartmouth, with the Justices recognizing the original charter to have been a contract and Chief Justice Marshall famously noting that a corporation is “an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creation of law, it possesses only those properties which the charter of its creation confers upon it, either expressly,

¹⁸ See Benjamin E. Hermalin, *Higher Education Boards of Trustees*, in GOVERNING ACADEMIA 28 (Ronald G. Ehrenberg ed., 2004).

¹⁹ See *id.*

²⁰ *Historical Facts*, HARVARD UNIV. ARCHIVES, <http://www.harvard.edu/historical-facts> (last visited Nov. 16, 2012).

²¹ *President and Fellows*, HARVARD CORP., <http://www.harvard.edu/harvard-corporation> (last visited Nov. 16, 2012).

²² See, e.g., 24 PA. CONS. STAT. § 20-2002-A (1949) (the enabling legislation for the Pennsylvania State System of Higher Education establishing the 14-member state-owned university system as “a body corporate and politic constituting a public corporation and government instrumentality” having “perpetual existence as a corporation.”). See also *infra* Part VI (providing the incorporation details of the state-related Penn State University).

²³ See Hermalin, *supra* note 18, at 28-29 (“a state university could easily be overseen by civil service bureaucrats in some state agency of higher education, similar to the way many states oversee grade K through 12 education” or universities could adopt the governance systems of European institutions or service academies such as West Point). Professor Hermalin argues that the fact that American universities have not sought alternatives suggests that the corporate governance model by most universities probably works. *Id.*

²⁴ 17 U.S. 518 (1819).

or as incidental to its very existence.”²⁵ The case played “a key role in the rise of the American business corporation,”²⁶ as it reaffirmed the sanctity of contracts under the U.S. Constitution.²⁷

This utilization of the corporate model in higher education, particularly as related to the role of the board in governing the university, is unique to the United States and Canada.²⁸ Other governing structures in the world have included university control by ministries of higher education,²⁹ faculty guilds (as in Oxford and Cambridge until the mid-19th Century, when the system was reformed by Royal Commissions),³⁰ or student guilds, the original governance form of Bologna University, the oldest university in the Western world, where

[t]he students ruled through what might be called *in loco parentis* rules dominating the professors.... Faculty members had no vote. They had to swear an oath of allegiance to their student rulers. They were subject to expulsion by the students. They could not leave campus, even for one day, without permission. When they did leave, they had to deposit a sum of money to guarantee their return. Punctuality at lectures was enforced with extreme vigor. Professors were fined for what were deemed “poor” lectures.³¹

In contrast, American colleges and universities were (and continue to be) board-driven. The historical dichotomy between the American and European systems of governance is perhaps best explained by historians Richard Hofstadter and Wilson Smith who note:

The European universities had been founded by groups of mature scholars; the American colleges were founded by their communities; and since they did not soon develop the mature scholars possessed from the beginning by their European predecessors but were staffed instead for generations mainly by young and transient tutors, the community leaders were reluctant to drop their reins of control.³²

It is in this context that one can grasp the roots of the community’s oversight of universities, at times vis-à-vis the state.

²⁵ *Id.* at 636.

²⁶ R. Kent Newmyer, *John Marshall as a Transitional Jurist: Dartmouth College v. Woodward and the Limits of Omniscient Judging*, 32 CONN. L. REV. 1665, 1666 (2000).

²⁷ See U.S. CONST. art. 1, § 10, cl. 1 (Contract Clause).

²⁸ CLARK KERR & MARION GADE, *THE GUARDIANS: BOARDS OF TRUSTEES OF AMERICAN COLLEGES AND UNIVERSITIES* 12 (1989).

²⁹ *Id.* at 10.

³⁰ *Id.*

³¹ *Id.* at 11.

³² 1 AMERICAN HIGHER EDUCATION: A DOCUMENTARY HISTORY 3 (Richard Hofstadter & Wilson Smith eds., 1961).

B. State Oversight

The government's support of higher education in the United States predates the nation itself, beginning with the allocation of public resources to primarily church-chartered institutions in the form of granting public lands and authorizing lotteries to benefit the college or university.³³ The notion of governors serving as university trustees also goes back to pre-Revolutionary times. The governor of New Hampshire, for instance, held an ex officio position on Dartmouth's board by prescription of the college's original royal charter,³⁴ and the charter of Rutgers University, originally called Queen's College and created by George III in 1766, provided "for the incorporation of the Trustees in perpetuity...with appropriate corporate powers...[consisting of]...the Governor or Commander-in-Chief, the President of the Council, the Chief Justice and the Attorney-General of the colony for the time being" and others.³⁵

The creation of truly public institutions began in the latter part of the eighteenth century, with the institutions receiving direct subsidies from the state.³⁶ For decades, the state granted substantial autonomy to the institutions' boards of trustees and thus sought modest to no control over the institutions.³⁷ However, well into the nineteenth century, several legislatures sought greater control of the public institutions by inserting ex officio state-appointed trustees.³⁸

C. The Trustees

The university boards of trustees and for-profit boards of directors are derived from the same legal tradition.³⁹ University boards have been called "the guardians,"⁴⁰ and, similar to the board members of for-profit corporations, trustees of universities are understood to have

³³ Donald E. Heller, *State Oversight of Academia*, in GOVERNING ACADEMIA 49, 50 (Ronald G. Ehrenberg ed., 2004).

³⁴ James O. Freedman, *Presidents and Trustees*, in GOVERNING ACADEMIA 9, 11 (Ronald G. Ehrenberg ed., 2004).

³⁵ See *Trs. of Rutgers College v. Richman*, 41 N.J.Super. 259, 265-75, 125 A.2d 10 (Ch.Div.1956) (providing a thorough history of Rutgers).

³⁶ Heller, *supra* note 33, at 50.

³⁷ *Id.*

³⁸ *Id.*

³⁹ See Hermalin, *supra* note 18, at 28.

⁴⁰ KERR & GADE, *supra* note 28, at 12.

fiduciary duties of care and loyalty.⁴¹ On the responsibilities of university trustees, A. Lawrence Lowell, Harvard's president from 1909 to 1933, once wrote:

The trustees, or whatever the members of the governing body may be called, although vested with the legal title to the property, are not the representatives of private owners, for there are none. They are custodians, holding the property in trust to promote the objects of the institution.⁴²

Similarly, Louis Heilbron, the first chair of the Board of Trustees of the California State Colleges (now universities), noted: "The key part of the trustee's title is (or should be) the word *trust*. He holds something valuable in trust—the classrooms, the libraries...the institution itself—for high purposes and benefits, not for himself, but for others."⁴³

But how can these trustees' exact duties be assessed and evaluated, and through what criteria? Unlike the for-profit corporate boards, whose main objective is to increase shareholder value, the mission-based non-profit universities must satisfy different sets of constituencies, including students, employees, alumni, donors, public officials, and the society at large. This dichotomy in purpose may not be well-understood by some board members. In fact, as one former university president has noted, there is a "tendency to conflate the 'bottom-line' fiduciary responsibility of a for-profit corporate director with the mission-oriented responsibility of a university."⁴⁴

The complexities of university governance render the precise discernment of what a university trustee's responsibilities entail an intricate task. In general, university board members have at least the following duties toward the university:

- protecting the welfare of the individual institution and its missions;⁴⁵
- protecting the institution's autonomy from external economic and political forces;⁴⁶
- protecting the academic freedom of the institution's members;⁴⁷
- ensuring adequate resources;⁴⁸ and

⁴¹ Freedman, *supra* note 34, at 17. See also Carter G. Bishop, *The Deontological Significance of Nonprofit Corporate Governance Standards: A Fiduciary Duty of Care Without a Remedy*, 57 CATH. U. L. REV. 701, 713 (2008) ("State law nonprofit corporate board governance responsibilities are essentially the same as those that apply to the for-profit corporate director.").

⁴² JAMES BAUGHMAN, TRUSTEES, TRUSTEESHIP, AND THE PUBLIC GOOD, 16 (1987).

⁴³ LOUIS HEILBRON, THE COLLEGE AND UNIVERSITY TRUSTEE: A VIEW FROM THE BOARD ROOM, 3 (1973).

⁴⁴ Freedman, *supra* note 34, at 18.

⁴⁵ KERR & GADE, *supra* note 28, at 12.

⁴⁶ *Id.*

⁴⁷ *Id.*

- considering the public welfare.⁴⁹

Of course, any assessment of university boards' performance utilizing these criteria would have to confront the problem of defining, and pricing, the board's objectives—not a simple endeavor. For instance, should the board's performance be based on evaluating teaching effectiveness? Enrollments? Enhanced educational quality? Reputation? Revenue? Research & innovation? Accessibility? Societal impact? The fact that these criteria may at times be competing objectives can complicate the evaluation of the board's functioning. For instance, achieving higher enrollments at the expense of reducing admissions standards may diminish educational quality and university reputation, and increasing class sizes to boost income may stifle teaching effectiveness.⁵⁰

Despite the potential collision of objectives, so long as the board members act in good faith and with sound judgment, their decisions affecting the university are protected by the business judgment rule.⁵¹ For this reason, as well as the fact that there are serious challenges associated with enforcing the directorial obligations of nonprofit corporations in general,⁵² and university directors in particular,⁵³ courts have seldom been involved in addressing the responsibilities of the board toward the university. With this backdrop, the next Part examines the legal duties of nonprofit corporate directors under fiduciary law.

⁴⁸ Richard T. Ingram, *Responsibilities of the Governing Board*, in GOVERNING PUBLIC COLLEGES AND UNIVERSITIES: A HANDBOOK FOR TRUSTEES, CHIEF EXECUTIVES, AND OTHER CAMPUS LEADERS 93, 102 (Richard T. Ingram ed., 1993).

⁴⁹ KERR & GADE, *supra* note 45.

⁵⁰ These problems are not necessarily unique to a university, as for-profit corporations may also be at the mercy of contending objectives. Cost-cutting to generate short-term revenue may cause diminished product quality and long-term reputational problems for the firm. Nonetheless, it is still the "profit" by which a corporation's performance is evaluated.

⁵¹ See *infra* Part III.C (discussing the business judgment rule and its applicability to nonprofits).

⁵² See *infra* Part IV.A (noting how asserting the obligations of nonprofit directors largely falls on the state attorneys general whose charitable enforcement divisions are often understaffed to take meaningful action against alleged cases of fiduciary violations).

⁵³ See *infra* Parts IV.B and IV.C (highlighting the challenges inherent in private enforcement of directorial duties at universities given the limitations imposed by the special interest doctrine and the difficulties associated with bringing derivative action).

III. FIDUCIARY DUTY IN NONPROFIT CORPORATIONS

A. Overview

A fiduciary is one who “owes to another the duties of good faith, trust, confidence, and candor.”⁵⁴ The word itself is rooted in Latin terms *fides* (from which confidential derives),⁵⁵ or faith,⁵⁶ representing the conscience of the people⁵⁷ and their trust.⁵⁸ “*Fiducia*”⁵⁹ means a “position of trust,”⁶⁰ or “in trust.”⁶¹ Historians trace the concept to the Romans, and, in Anglo-American law, to the rise of trusts during the Middle Ages.⁶² As one scholar has observed, the “rhetoric of fiduciary obligation permeates western political theory, from Cicero’s discourses *On Moral Obligation*, to Locke’s *Two Treatises of Government*, to the seminal *Federalist Papers*.”⁶³

Throughout the centuries, Anglo-American law has extended the fiduciary concept to include a sequence of relations.⁶⁴ In a case addressing fiduciary responsibilities, Judge Cardozo noted:

Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate....⁶⁵

⁵⁴ BLACK’S LAW DICTIONARY 640 (Bryan A. Garner ed., 7th ed., West 1999) [hereinafter Black’s].

⁵⁵ See DAVID COWAN BAYNE, THE PHILOSOPHY OF CORPORATE CONTROL: A TREATISE ON THE LAW OF FIDUCIARY DUTY 36 (Loyola U. Press 1986); THE BARNHART DICTIONARY OF ETYMOLOGY 380 (Robert K. Barnhart ed., H.W. Wilson 1988) [hereinafter Barnhart].

⁵⁶ See Black’s, *supra* note 54.

⁵⁷ HANS JULIUS WOLFF, ROMAN LAW: AN HISTORICAL INTRODUCTION 65, 74-75 (U. of Okla. Press 1951).

⁵⁸ See Bayne, *supra* note 55, at 36-37.

⁵⁹ See ERNEST VINTER, A TREATISE ON THE HISTORY AND LAW OF FIDUCIARY RELATIONSHIP AND RESULTING TRUSTS 1 (3d ed., Cambridge 1955).

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² Evan J. Criddle, *Fiduciary Foundations of Administrative Law*, 54 UCLA L. REV. 117, 124 (2006).

⁶³ *Id.* at 123-24.

⁶⁴ *Id.* at 126 (providing an extensive list of such relations).

⁶⁵ *Meinhard v. Salmon*, 164 N.E. 545, 547 (N.Y. 1928).

Ultimately, fiduciary duty applies to countless relationships in almost every corner of the law, including relationships between “a trustee and beneficiary, a guardian and ward, an agent and principal, a lawyer and client, a member of the clergy and a parishioner, a director and a corporation, a partner and the other partners, an employer and an employee, and a broker and client.”⁶⁶ The legal sources of the duties are created by a wide range of federal and state statutes and the common law.⁶⁷ The myriad of cases in a given year that allege fiduciary duty violations by plaintiffs make “the law of fiduciary duty...by any measure an exceedingly complex and nuanced area of the law.”⁶⁸ As Professors Scharffs and Welch note:

While rooted in concepts such as good faith, trust, and confidence, the duties that courts have categorized under the rubric of fiduciary duty are many and varied, and are often described in very lofty terms. These duties include the duty not to commit fraud, not to engage in self-dealing, to be loyal, obedient, diligent, and exercise good faith, to disclose material information, and to exercise care and prudence, among others.⁶⁹

The fiduciary obligations of charitable corporations are rooted in both trust law and corporate law.⁷⁰ Tax law also imposes certain obligations on directors and trustees but primarily for the determination of exemption status by taxing authorities.⁷¹ As the oldest type of charitable organization in the United States, trusts have long been a guiding source in nonprofit corporation law,⁷² a phenomenon that may be attributed to the long organizational history of the trust predating the rise of the business corporation by at least half a millennium.⁷³

⁶⁶ Brett G. Scharffs & John W. Welch, *An Analytic Framework for Understanding and Evaluating the Fiduciary Duties of Educators*, 2005 BYU EDUC. & L.J. 159 at 163.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.* at 162.

⁷⁰ Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593, 597 (1999) (exploring the roots of nonprofit corporation law).

⁷¹ See Johnny Rex Buckles, *The Federalization of the Duty of Loyalty Governing Charity Fiduciaries Under United States Tax Law*, 99 KY. L.J. 645, 653-663 (2011) (discussing how federal tax laws essentially impose a duty of loyalty as a fundamental requirement for obtaining and maintaining tax exempt status as a charitable entity); Thomas Lee Hazen & Lisa Love Hazen, *Duties of Nonprofit Corporate Directors - Emphasizing Oversight Responsibilities*, 90 N.C.L. REV. 1845, 1853-54 (2012) (highlighting the 2008 amendments to IRS Form 990, which inquire what the board's role in governing the nonprofit is, and noting that because Form 990s are publicly available, the IRS requirements may affect the boards' state law obligations since “[s]tate attorneys general and others concerned with a nonprofit organization's operations now have access to details about the governance structure that may bring into question the board's role when wrongdoing occurs.”).

⁷² See GEORGE G. BOGERT & GEORGE T. BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* (2d rev. ed. 1991) (treating charitable trust law and charitable corporation law interchangeably); MARION R. FREMONT-SMITH, *GOVERNING NONPROFIT ORGANIZATIONS: FEDERAL AND STATE LAW AND REGULATION* 43-48 (Harvard Univ. Press 2004) (tracing the charitable trust form to pre-Republic colonial history); Henry Hansmann, *The Evolving Law of Nonprofit Organizations: Do Current Trends Make Good Policy?*, 39 CASE W. RES. L. REV. 807, 808 (“prior to the nineteenth century the law of nonprofit organizations had little definition as a distinct subject.... [M]any nonprofit

Accordingly, courts have historically struggled with deciding what level of fiduciary obligation they should impose on corporate charitable trustees,⁷⁴ and have at times relied upon the deeply-rooted trust law traditions to address the duties owed.⁷⁵ The charitable corporations' common usage of the term "trustee," (a phrase historically reserved for the overseers of trusts), rather than the word "director," (a term generally used for for-profit corporate board members), to refer to their oversight bodies has likely not helped the judicial uncertainty.⁷⁶ While nonprofit corporation law remains sparse relative to centuries of trust law decisions, the proliferation of state statutes, aided by model laws and guidance created by the American Bar Association and the American Law Institute, have significantly helped distinguish charitable corporation law from the law of charitable trusts.⁷⁷ It is now well-understood that while nonprofit corporate law continues to borrow from trust law, the fiduciary duties of the trustees of charitable corporations

organizations were not incorporated but rather were formed simply as charitable trusts, and the law of charitable trusts remained an important source of authority for most incorporated nonprofits as well.”).

⁷³ See Rob Atkinson, *Obedience as the Foundation of Fiduciary Duty*, 34 J. CORP. L. 43, 64 (2008) (“In Anglo-American law, the trust as a commonly used organizational form preceded the modern general-purpose business corporation by half a millennium at the very least.”).

⁷⁴ See Nina J. Crimm, *A Case Study of a Private Foundation's Governance and Self-Interested Fiduciaries Calls for Further Regulation*, 50 EMORY L.J. 1093, 1133-1140 (2001) (providing a historical overview of dual fiduciary duty standards).

⁷⁵ See, e.g., *Holt v. College of Osteopathic Physicians & Surgeons*, 394 P.2d 932 (Cal. 1964) (treating a charitable corporation as if it were a charitable trust); *Lynch v. John M. Redfield Foundation*, 9 Cal. App. 3d 293, 298 (1970) (“members of the board of directors of [a nonprofit] corporation are essentially trustees.”). See also Ping Lee, *supra* note 16, at note 71 (providing a list of cases where charitable trust principles were applied to analyze nonprofit corporate trustee actions).

⁷⁶ See generally Evelyn Brody, *Charity Governance: What's Trust Law Got to Do with It?*, 80 CHI.-KENT L. REV. 641, 642 (2005) [hereinafter Brody, *Charity Governance*].

[W]e commonly use the term “trusteeship” to describe what it is that the board of a charity does. Indeed, directors of nonprofit corporations (at least those that are charities) are frequently called “trustees”—either under their state law, their organic documents, or colloquially (including such references by courts, regulators, practitioners, and the press). The common use of the term suggests that we know what we mean by trusteeship. Granted, in the private trust context, the notion of trusteeship has an accepted content, but private trustees merely administer rather than govern.

See also Gary, *supra* note 70, at 609 (“directors of charitable corporations were often called ‘trustees,’ reflecting this intermingling of the trust form and the corporate form.”); Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance - A Comprehensive Look at Nonprofit Directors' Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 380 (2012) [hereinafter Hazen & Hazen, *Punctilios*] (“References to directors as trustees continue in current case law.”).

⁷⁷ See, e.g., MODEL NONPROFIT CORP. ACT (1952), MODEL NONPROFIT CORP. ACT (1964), MODEL NONPROFIT CORP. ACT (2008), PRINCIPLES OF THE LAW OF NONPROFIT ORGS. (2005 and 2007), and REV. MODEL NONPROFIT CORP. ACT (1987).

are “measured under standards developed in the jurisprudence of for-profit corporations,”⁷⁸ and whether actions taken by the trustees (or directors) of a charitable corporation are legal must be in accordance with “principles of corporate law rather the principles governing the fiduciary relationship between trustees of a technical trust and their trust.”⁷⁹

On the whole, the degree of the nonprofit corporate trustees’ fiduciary obligations vary and range between lax and strict, depending on the nonprofit’s type.⁸⁰ When available, the degree of the trust expected of the fiduciaries may also be shaped by the corporation and its bylaws,⁸¹ although corporate documents may not reduce the directors’ duty of loyalty⁸² or duty of care “to permit a knowing violation of law, intentional misconduct, reckless conduct, or gross negligence;”⁸³ or to “[a]bsolve a fiduciary from the obligation to act in good faith.”⁸⁴ As a general rule, nonprofit board members must promote the corporation’s best interest,⁸⁵ must disclose to the other members material information that may not be known by their fellow trustees,⁸⁶ (although such disclosure is not required if it would “violate a duty imposed by law, a legally enforceable obligation of confidentiality, or a professional ethics rule,”)⁸⁷ and have good faith duties of care, loyalty, and obedience toward the institution.⁸⁸

⁷⁸ *Oberly v. Kirby*, 592 A.2d 445, 461 (Del. 1991). *See also* *Stern v. Lucy Webb Hayes Nat’l Training Sch. for Deaconesses & Missionaries*, 381 F. Supp. 1003 (D.D.C. 1974) (“The charitable corporation is a relatively new legal entity which does not fit neatly into the established common law categories of corporation and trust....[H]owever, the modern trend is to apply corporate rather than trust principles in determining the liability of the directors of charitable corporations, because their functions are virtually indistinguishable from those of their ‘pure’ corporate counterparts.”).

⁷⁹ *Denckla v. Independence Foundation*, 41 Del. Ch. 247, 193 A.2d 538, 541 (Del. 1963).

⁸⁰ *See, e.g.*, Hansmann, *supra* note 72, at 815-17 (highlighting how the nonprofit corporation laws of California and New York created different categories of nonprofit corporations and assigned them varying degrees of fiduciary obligation).

⁸¹ *See Oberly*, 592 A.2d 445, 462 (Del. 1991).

⁸² PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 305(a) (Tentative Draft, No. 1, 2007).

⁸³ *Id.* at § 305(b).

⁸⁴ *Id.* at § 305(c).

⁸⁵ *See* REV. MODEL NONPROFIT CORP. ACT § 8.30(a) (1987).

⁸⁶ MODEL NONPROFIT CORP. ACT § 8.30(c) (2008).

⁸⁷ *Id.*

⁸⁸ While the duty of good faith has been treated as an independent duty by some scholars, this article adopts the convincing view of the Delaware Supreme Court that the duty is essentially an integrated component of duties of care and loyalty:

Although good faith may be described colloquially as part of a “triad” of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where

B. The Three Pillars

Daniel L. Kurtz has excellently summarized the three overarching duties of nonprofit directors by noting:

The duty of care concerns the director's competence in performing directorial functions and typically requires him to use the care that an ordinarily prudent person would exercise in a like position and under similar circumstances. *The duty of loyalty* requires the director's faithful pursuit of the interests of the organization he serves rather than the financial or other interests of the director or of another person or organization. And *the duty of obedience* requires that a director act with fidelity, within the bounds of the law generally, to the organization's "mission," as expressed in its charter and by-laws.⁸⁹

This section analyzes each of these duties in detail.

1. Duty of Care

The duty of care obligations of nonprofit directors are similar to those imposed on their for-profit corporate counterparts.⁹⁰ The duty mandates that directors must exercise their responsibilities in good faith and with diligence.⁹¹ They cannot fail to supervise the corporation, and, even if acting in good faith, cannot neglect to make informed decisions.⁹² The duty is both about process (did the directors act with care during the decision-making procedures?) as well as about substance: was the decision rash or reasonable?⁹³

One version of the duty of care standard, as articulated by the Revised Model Nonprofit Corporation Act, states:

violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly. The second doctrinal consequence is that the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith.

Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (footnote omitted). See also Linda Sugin, *Resisting the Corporatization of Nonprofit Governance: Transforming Obedience into Fidelity*, 76 FORDHAM L. REV. 893, 897 (2007) (providing an overview of the directorial duties of nonprofit corporations).

⁸⁹ DANIEL L. KURTZ, BOARD LIABILITY: GUIDE FOR NONPROFIT DIRECTORS 21 (1988) (emphasis added).

⁹⁰ See Bishop, *supra* note 41, at 703-4 (highlighting that the 2008 Model Nonprofit Corporation Act and the 2007 draft of the ALI Principles of the Law of Nonprofit Organizations create fiduciary duties of care comparable to those imposed on for-profit corporate directors).

⁹¹ James J. Fishman, *Improving Charitable Accountability*, 62 MD. L. REV. 218, 232 (2003).

⁹² *Id.*

⁹³ *Id.*

(a) A director shall discharge his or her duties as a director, including his or her duties as a member of a committee:

(1) in good faith;

(2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and

(3) in a manner the director reasonably believes to be in the best interests of the corporation.⁹⁴

Another articulation of the duty of care requires a director to act “in good faith...in a manner the director reasonably believes to be in the best interests of the corporation...[and] discharge [his or her] duties with the care that a person in a like position would reasonably believe” to be in the corporation’s best interest.⁹⁵ An additional source requires directors to act “with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.”⁹⁶

The duty of care obligation essentially adheres to the ordinary negligence standard,⁹⁷ but is subject to the business judgment rule, which stipulates that directors must not be held liable to the corporation if they exercise their judgment with care.⁹⁸ Accordingly, directorial liability for an alleged breach of duty of care cannot be imposed absent gross negligence.⁹⁹

2. Duty of Loyalty

The duty of loyalty requires that each board member “act in a manner that he or she reasonably believes to be in the best interests of the charity, in light of its stated purposes.”¹⁰⁰ The duty entails both negative aspects—to refrain from harmful conduct against the

⁹⁴ REV. MODEL NONPROFIT CORP. ACT § 8.30 cmt. 3 (1987).

⁹⁵ MODEL BUS. CORP. ACT § 8.30(a)-(b) (2005).

⁹⁶ PRINCIPLES OF CORP. GOVERNANCE § 4.01(a) (1992).

⁹⁷ Bishop, *supra* note 41, at 730.

⁹⁸ See *id.*; Evelyn Brody, *The Limits of Charity Fiduciary Law*, 57 MD. L. REV. 1400, 1424-1425 (1998) [hereinafter Brody, *Limits of Charity Law*] (because duty of care is subject to the business judgment rule, a director “breaches the duty of care only by committing ‘gross negligence’ rather than ordinary negligence.”). See also *infra* Part III.C (discussing the business judgment rule in the nonprofit sector).

⁹⁹ Brody, *Limits of Charity Law*, *supra* note 98, at 1425.

¹⁰⁰ PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 310(a) (Tentative Draft, No. 1, 2007).

corporation—as well as the positive obligation to affirmatively protect the corporation.¹⁰¹ As the Delaware Supreme Court notes:

[Corporate officers and directors] stand in a fiduciary relation to the corporation.... A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of [them], peremptorily and inexorably, the most scrupulous observance of his duty, *not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation*, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.¹⁰²

The director's loyalties may not be divided,¹⁰³ and the director must place the interests of the corporation above his or her own.¹⁰⁴ She must act in good faith and "maintain...unequivocal allegiance to the corporate mission."¹⁰⁵ Even when financially disinterested, the duty may be violated if the director knowingly "fails to warn other directors of material facts relevant to a transaction."¹⁰⁶ As such, duty of loyalty is largely about addressing direct or indirect conflicts of interest between the director and the corporation.¹⁰⁷ Unlike the duty of care, which may be breached by negligent conduct, disloyal acts are generally intentional,¹⁰⁸ although indifference to protect the organization, or abdication and dereliction of duties,¹⁰⁹ are sufficient to establish breach of duty of loyalty.¹¹⁰

¹⁰¹ See Bishop, *supra* note 41, at 739.

¹⁰² Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (emphasis added).

¹⁰³ See I. MAURICE WORMSER, FRANKENSTEIN INCORPORATED 125-30 (1931).

¹⁰⁴ See WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 837.50 (rev. ed. 1994).

¹⁰⁵ Michael W. Peregrine, *Legal Concerns in Specific Health Care Delivery Settings: Nonprofit Corporate Governance*, in 3 HEALTH L. PRAC. GUIDE 43, § 22 (2010).

¹⁰⁶ Hazen & Hazen, *Punctilios*, *supra* note 76, at 381.

¹⁰⁷ See *id.* at 356, 380-85.

¹⁰⁸ Bishop, *supra* note 41, at 740.

¹⁰⁹ *Id.* at 702-3 ("Unfortunately, abdication and dereliction are far more common on volunteer nonprofit charitable boards [than in for-profit corporations]....[Nonprofit] directors often view their role as advisory rather than supervisory....").

¹¹⁰ *Id.* at 740.

3. Duty of Obedience

The duty of obedience has been defined as an obligation “to carry out the purposes of the organization as expressed in the [the organization’s founding documents].”¹¹¹ The duty is largely based on the doctrine of ultra vires,¹¹² the notion that corporations are creatures of enumerated powers, as defined in their corporate charter or the powers granted to them by the state.¹¹³

While ultra vires is now largely thought of as obsolete in for-profit corporate governance,¹¹⁴ it appears to be relevant in nonprofit corporation law as a component of the duty of obedience,¹¹⁵ which itself is in danger of vanishing. Despite the long history of the recognition of the duty,¹¹⁶ the mention of the obligation has been avoided, or its importance outright rejected, by modern statutory, advisory, and scholarly authorities,¹¹⁷ to the extent that one scholar considers the future of the duty to be “very much at risk.”¹¹⁸ Nonetheless, the duty still appears in case law, although seldom.¹¹⁹ As an example, a 2007 New Jersey Supreme Court case that involved Princeton University as defendant observed that:

¹¹¹ JAMES J. FISHMAN & STEPHEN SCHWARZ, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 219 (3d ed. 2006).

¹¹² See *Gearhart Indus., Inc. v. Smith Int’l, Inc.*, 741 F.2d 707, 719-20 (5th Cir. 1984) (“The duty of obedience requires a director to avoid committing ultra vires acts, i.e., acts beyond the scope of the [authority] of the corporation as defined by its [charter] or the laws of the state of incorporation.”).

¹¹³ See *Beatty v. Lessee of Knowler*, 29 U.S. (4 Pet.) 152, 167 (1830) (“the exercise of the corporate franchise, being restrictive of individual rights, cannot be extended beyond the letter and spirit of the act of incorporation.”). See also Robert S. Stevens, *A Proposal as to the Codification and Restatement of the Ultra Vires Doctrine*, 36 YALE L.J. 297, 309 (1927) (defining the ultra vires doctrine as an act that goes beyond what is granted by either the charter or the state).

¹¹⁴ See Kent Greenfield, *Ultra Vires Lives: A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce International Law Norms)* 87 VA L. REV. 1279, 1302-13 (2002) (providing a thorough historical overview of the rise and fall of ultra vires); Alan R. Palmiter, *Duty of Obedience: The Forgotten Duty*, 55 N.Y.L. SCH. L. REV. 457, 460 (2010/2011) (noting that “as corporate law (and judicial review of corporate actions) moved from questions of corporate power to those of fiduciary duty, the ultra vires doctrine became largely vestigial—and its appendage, the duty of obedience, quietly wilted away.”).

¹¹⁵ See Sugin, *supra* note 88, at 900.

¹¹⁶ See HENRY W. BALLANTINE, *BALLANTINE ON CORPORATIONS* § 62 (rev. ed. 1946).

¹¹⁷ See, e.g., FREMONT-SMITH, *supra* note 72, at 226 (arguing that “[t]o the extent the duty of obedience does not carry with it a duty to assure that the trust is meeting contemporaneous needs, it does not set forth an appropriate standard.”); MODEL NONPROFIT CORP. ACT (2008) (lacking any mention of the duty of obedience); PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 300 cmt. g(3) (Tentative Draft No. 1, 2007) (rejecting the duty of obedience because it may conflict with “the obligation to keep the purpose of the charity current and useful.”); Sugin, *supra* note 88, at 897 (noting that no state statutes include the duty of obedience as a governance requirement).

¹¹⁸ Sugin, *supra* note 88, at 897.

¹¹⁹ See *Hazen & Hazen, Punctilios*, *supra* note 76, at notes 205, 206 (providing lists of cases in the for-profit and nonprofit sectors where courts have addressed the duty of obedience).

fiduciaries of a charitable corporation have a “special duty” to advance the charitable purposes of the charitable corporation and protect its assets by doing so. Essentially, this “special duty” is akin to the duty of obedience, a duty finding its origination in trust law, which commands “that directors of a charitable corporation have a unique fiduciary duty to be faithful to their organization’s mission.”¹²⁰

C. The Business Judgment Rule

The business judgment rule protects directors from liability if a mistake harming the corporation is made with due care and in good faith.¹²¹ The doctrine serves as a significant hurdle to plaintiffs claiming directorial breach of duty of care¹²² and in effect only permits adverse action against directors in cases of gross negligence.¹²³ Under the rule, the burden is on the plaintiff to show the breach of the duty.¹²⁴ In its articulation of the rule, the Delaware Supreme Court noted:

It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption...

...[The business judgment doctrine] has no role where directors have either abdicated their functions, or absent a conscious decision, failed to act. But it also follows that under

¹²⁰ Robertson v. Princeton University, No. C-99-02 (N.J. Super. Ct. Ch. Div. 2007) at 129 quoting Robert A. Katz, *Symposium: Who Guards the Guardians?: Monitoring and Enforcement of Charity Governance: Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion Over a Charitable Corporation's Mission and Unrestricted Assets*, 80 CHI. KENT L. REV. 689, 699 (2005).

¹²¹ See Park McGinty, *The Twilight of Fiduciary Duties: On the Need for Shareholder Self-Help in an Age of Formalistic Proceduralism*, 46 EMORY L.J. 163, 194 (1997) (providing a background on the business judgment rule); PRINCIPLES OF CORP. GOVERNANCE § 4.01(c) (1992) (“[a] director or officer who makes a business judgment in good faith fulfills the duty” if the person (i) “is not interested...in the subject of the business judgment”; (ii) is informed properly; and (iii) “rationally believes that the business judgment is in the best interests of the corporation”); Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 56 (1991) (the business judgment rule “presumes reasonable diligence and good faith.”).

¹²² See ROBERT C. CLARK, *CORPORATE LAW* 123 (1986) (noting that the doctrine dictates “that the business judgment of the directors will not be challenged or overturned by courts...and the directors will not be held liable for the consequences of their exercise of business judgment—even for judgments that appear to have been clear mistakes—unless certain exceptions apply.”).

¹²³ See Brody, *Limits of Charity Law*, *supra* note 98, at 1425.

¹²⁴ See Clark W. Furlow, *Reflections on the Revlon Doctrine*, 11 U. PA. J. BUS. L. 519, 522 (2009).

applicable principles, a conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment and enjoy the protections of the rule.¹²⁵

Essentially, the rule prevents courts from reviewing the merits of the directors' decision unless the plaintiff can demonstrate that the directors were prejudiced or failed to exercise due care.¹²⁶ Accordingly, the business judgment rule "is a standard of judicial review for director conduct, not a standard of conduct."¹²⁷ The justifications for the rule include encouraging innovation and rational risk taking by the corporation and limiting litigation and judicial intrusiveness.¹²⁸

While primarily a rule for for-profit enterprises, the doctrine's application to nonprofit corporate governance has been confirmed in a number of jurisdictions,¹²⁹ a development supported by some commentators¹³⁰ but opposed by others.¹³¹

¹²⁵ Aronson v. Lewis, 473 A.2d 805, 812-13 (Del. 1984) (citations omitted) (footnote omitted).

¹²⁶ See Furlow, *supra* note 124, at 520.

¹²⁷ DENNIS J. BLOCK et al., THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS 4 (5th ed. 1998).

¹²⁸ See Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 644 (1998).

¹²⁹ See *supra* note 94 ("Although it may seem anomalous to apply the business judgment rule to nonprofit corporations, a few courts have so applied it....While the application of the business judgment rule to directors of nonprofit corporations is not firmly established by the case law, its use is consistent with section 8.30." See also John v. John, 450 N.W.2d 795 (Wis. Ct. App. 1989) (holding that the nonprofit directors' fraudulent conduct was not protected by the business judgment rule); Yarnall Warehouse & Transfer, Inc. v. Three Ivory Bros. Moving Co., 226 So. 2d 887, 890 (Fla. Dist. Ct. App. 1969) (applying the business judgment rule to analyze the actions of a nonprofit director).

¹³⁰ See, e.g., Bishop, *supra* note 41, at 702 (arguing that a "few would seriously suggest that a nonprofit corporate director's fiduciary duty of care to oversee management should exceed that of a for-profit corporate director counterpart."); Goldschmid, *supra* note 128, at 644 (asserting that there is "wisdom in protecting nonprofit directors from hindsight reviews of their unsuccessful decisions and encouraging them to change the configuration of their nonprofit enterprises....It is sound public policy to accept the risk that informed decisions by nonprofit directors, undertaken honestly, without conflict of interest, and rationally believed to be in the best interests of the nonprofit, may not be vindicated by subsequent success.").

¹³¹ See Ping Lee, *supra* note 16, at 927 (contending that the business judgment rule should not protect nonprofit directors because "[i]t is highly questionable whether nonprofit directors warrant the extraordinary latitude bestowed upon for-profit directors when, in theory at least, the mission statements of their respective organizations lie at opposite ends of the spectrum.").

IV. ENFORCEMENT OF NONPROFIT FIDUCIARY OBLIGATIONS

While there are differences between charitable trusts and nonprofit corporations,¹³² with the former imposing a stricter duty of care on fiduciaries,¹³³ the fiduciaries' obligations in both forms are largely enforced through similar mechanisms: public enforcement by the state attorneys general,¹³⁴ or private enforcement through the special interest doctrine.¹³⁵ A third subcategory of enforcement mechanism is the non-trust based derivative suit rooted in for-profit corporate law, which, in charity law, is only available to membership-based nonprofit corporations.¹³⁶ Other potential enforcement mechanisms are either theoretical or limited in practice and thus beyond the span of this article.¹³⁷

¹³² See Brody, *Charity Governance*, *supra* note 76, at 643-44 (“a trust is not an entity—rather, a trust is viewed as a relationship between the settlor and the trustee to use specific property for a designated purpose. By contrast, the fiduciaries of a corporate charity are separate from the legal personality of the charity. Accordingly...a corporate charity could be liable for a breach of contract or a tort even if the corporate directors have not breached their fiduciary duties to the charity.”).

¹³³ See *id.* at 648 (highlighting the differences between charitable trusts and charitable corporations and discussing how trust law imposes stricter fiduciary duty standards on charitable trusts than does corporate law on nonprofit corporations); Sara R. Kusiak, *The Case for A.U. (Accountable Universities): Enforcing University Administrator Fiduciary Duties Through Student Derivative Suits*, 56 AM. U. L. REV. 129, 135 (2006) (trust law “imposes the strictest duties of loyalty, care, fair dealing, and obedience on [the charitable trust] trustees.”). See also James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 EMORY L.J. 617, 651-52 (1985) (highlighting the historical roots of the distinction between the charitable corporation and the charitable trust and tracing the supervisory evolution of the entities to the jurisdictional divide between the chancery and equity courts). In the United States, courts concluded early on that corporate trustees should fall under the jurisdiction of equity courts, which meant that “corporate directors and officers had greater managerial control over the corporation’s property” than the fiduciaries of charitable trusts. *Id.*

¹³⁴ See generally FREMONT-SMITH, *supra* note 72, at 336-38 (providing an overview of the oversight authority given to the attorney general’s office). The state attorney general’s power in this regard are quite extensive:

The range of court actions that an attorney general may request a court to take to enforce fiduciary duties is as broad as the powers of the court to devise remedies for breach of fiduciary duties. He may request accountings, removal of trustees, dissolution of corporations, forced transfer of corporate property, or a combination of these. He may ask the court to force charitable fiduciaries to restore losses caused by breach of duty and to return profits made in the course of administering the trust. He may seek to enjoin trustees from further wrongdoing or from continuing certain specific actions. Furthermore, transactions involving a breach of the duty of loyalty may be voided at the option of the attorney general unless he decides it is in the public interest to affirm them. The attorney general ... may bring actions requesting modification or deviation from the terms of a trust or cy pres application of the funds.

Id. at 471.

¹³⁵ See RESTATEMENT (SECOND) OF TRUSTS § 391 (1959) (“A suit can be maintained for the enforcement of a charitable trust by...a person who has a special interest in the enforcement of the charitable trust...” See also Mary Grace Blasko, Curt S. Crossley, & David Lloyd, *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37, 52 (1993) (noting the expansion of the special interest doctrine to charitable corporations).

¹³⁶ See Hazen & Hazen, *Punctilios*, *supra* note 76, at 405 (providing a general overview of remedies for nonprofit director abuse); MODEL NONPROFIT CORP. ACT ch. 13 (2008) (providing the framework for derivative suits in nonprofit corporations); REV. MODEL NONPROFIT CORP. ACT § 6.01(a) (1987) (“[A nonprofit corporation] may

A. Attorney General Enforcement

In every state, statute or common law permits the state attorneys general, as *parens patriae*,¹³⁸ to supervise nonprofits and enforce the fiduciary duties of charitable corporations in order to protect the public interest.¹³⁹ It is broadly understood, however, that due to the lack of funds and resources, the state attorneys general “have neither the person-power, nor sometimes the will, to monitor nonprofits effectively.”¹⁴⁰ Accordingly, although the attorney general’s power is substantial, the actual extent of charitable supervision is limited.¹⁴¹

establish criteria ... for the admission of members.”). The members are similar to shareholders as they have voting rights and may pay membership fees. They also have the right to bring derivative lawsuits on behalf of the corporation. *Id.* at 1.40(21), 6.30.

¹³⁷ See, e.g., Rob Atkinson, *Unsettled Standing: Who (Else) Should Enforce the Duties of Charitable Fiduciaries?*, 23 IOWA J. CORP. L. 655, (discussing numerous theories supporting the expansion of standing in order to more widely enforce charitable fiduciary obligations); Terri Lynn Helge, *Policing the Good Guys: Regulation of The Charitable Sector Through a Federal Charity Oversight Board*, 19 CORNELL J.L. & PUB. POL’Y 1, 47-53 (2009) (highlighting the seldom-used relator actions (attorneys general granting proxy standing to individuals to bring suit); visitorial powers (enabling the founder of a charitable organization to inquire into how the entity is being managed); and voluntary contractual relationships between private for-profit monitoring companies and the charitable organization)).

¹³⁸ *Parens patriae* literally means “parent of the country.” *West Virginia v. Chas. Pfizer & Co.*, 440 F.2d 1079, 1089 (2d Cir. 1971). *Parens patriae* powers are derived from the “ancient powers of guardianship over persons under disability and of protectorship of the public interest which were originally held by the Crown of England...and which as part of the common law devolved upon the states and federal government.” *In re Pruner’s Estate*, 390 Pa. 529; 136 A.2d 107 (1957) (citations omitted). In its early form, the authority enabled the King to act as the “general guardian of all infants, idiots, and lunatics” with “the general superintendence of all charitable uses in the kingdom.” 3 WILLIAM BLACKSTONE, COMMENTARIES 47. In practice, some scholars have argued that the authority was used when the king stood to benefit financially by assuming guardianship and that “the profit motive was clearly at the forefront of the king’s decision to offer his protection.” George B. Curtis, *The Checkered Career of Parens Patriae: The State as Parent or Tyrant?*, 25 DEPAUL L. REV. 895, 898 (1976).

¹³⁹ Gary, *supra* note 70, at 622.

¹⁴⁰ Fishman, *Improving Charitable Accountability*, *supra* note 91, at 268. See also Blasko et al., *supra* note 135, at 48 (noting the understaffing problems faced by the attorney general charitable enforcement divisions); David Villar Patton, *The Queen, the Attorney General, and the Modern Charitable Fiduciary: A Historical Perspective on Charitable Enforcement Reform*, 11 U. FLA. J.L. & PUB. POL’Y 131, 164-65 (2000) (highlighting the budgetary challenges of the state attorneys general in their charitable enforcement efforts).

¹⁴¹ See Gary, *supra* note 70, at 622-623 (highlighting the scarce resources in attorney general offices’ charitable divisions).

B. The Special Interest Doctrine

Courts may permit a private person to sue a charitable corporation by finding that the person has a “special interest” in the organization.¹⁴² The doctrine finds its roots in trust law, yet some courts have liberally applied the principle to grant standing in a number of cases involving charitable corporations.¹⁴³ However, while the usage of the doctrine by a beneficiary of a private trust could bring monetary damages to the plaintiff, the remedy sought by the special interest plaintiff suing a charitable corporation must be for a “benefit to the charity itself and not money damages for the plaintiffs.”¹⁴⁴

According to a 1993 study, special interest status is generally granted by courts considering five factors: “(a) the extraordinary nature of the acts complained of and the remedy sought by the plaintiff; (b) the presence of fraud or misconduct on the part of the charity or its directors; (c) the state attorney general’s availability or effectiveness; and (d) the nature of the benefitted class and its relationship to the charity”¹⁴⁵ and (e) “subjective and case-specific factual circumstances”¹⁴⁶ and “social desirability.”¹⁴⁷

C. Derivative Action

In most states, members of nonprofit corporations have a statutory right similar to for-profit shareholders to bring a derivative suit on behalf of the corporation in order to enforce directorial duties.¹⁴⁸ Any damages recovered by plaintiffs through derivative action symbolizes the vindication of the corporation’s rights and not those of the individual plaintiffs.¹⁴⁹ As such, the damages thus secured must be returned to the corporation.¹⁵⁰

¹⁴² *Id.* at 627.

¹⁴³ *See, e.g.,* Lopez v. Medford Cmty. Ctr., Inc., 424 N.E.2d 229, 233 (Mass. 1981) (recognizing special interest standing against a charitable corporation). *See also* Blasko et al., *supra* note 135 and accompanying text.

¹⁴⁴ Gary, *supra* note 70, at 627.

¹⁴⁵ Blasko et al., *supra* note 135, at 61.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 74.

¹⁴⁸ Kusiak, *supra* note 133, at 148. *See also* Dodge v. Woolsey, 59 U.S. 331, 335 (1855) (granting derivative rights to shareholders for the first time in American law).

¹⁴⁹ Dodge v. Woolsey, 59 U.S. at 335.

¹⁵⁰ *See* Susanna M. Kim, *Conflicting Ideologies of Group Litigation: Who May Challenge Settlements in Class Actions and Derivative Suits?*, 66 TENN. L. REV. 81, 99 (1998) (discussing that because the derivative suit is an equitable remedy where a shareholder asserts a claim that belongs to the corporation and not to the shareholder, the shareholder’s right is derivative and secondary, and thus “any judgment ultimately recovered by the shareholder belongs to the corporation.”).

The next Part examines the above-noted enforcement mechanisms in the context of university director accountability.

V. ACTIONS AGAINST UNIVERSITY TRUSTEES

The state attorney general is the only party that has automatic standing to bring suit against the trustees of an incorporated nonprofit university.¹⁵¹ But as noted above, attorneys general seldom have the resources to enforce the fiduciary obligations of charitable trustees. As a result, public directorial enforcement of duties is not common.

Under the special interest doctrine, others may also bring suit, but their standing is not guaranteed.¹⁵² One would think that students might be able to invoke the doctrine with relative ease, but they seldom gain standing against their university for breaches of fiduciary duty claims or challenging how the institution is managed.¹⁵³ In cases where students have claimed a special interest, courts have often used Justice Marshall's dictum in the Dartmouth College case, noting that "the students are fluctuating, and no individual among our youth has a vested interest in the institution, which can be asserted in a court of justice,"¹⁵⁴ to deny standing.¹⁵⁵

¹⁵¹ See *supra* note 134 and accompanying text.

¹⁵² See *supra* Part IV.B.

¹⁵³ Blasko et al., *supra* note 135, at 64 ("In most cases courts deny standing to university students primarily because of the amorphous and fluctuating nature of the class of students.").

¹⁵⁴ 17 U.S. (4 Wheat.) 518 (1819) at 647.

¹⁵⁵ See, e.g., *Miller v. Alderhold*, 184 S.E.2d 172, 175 (Ga. 1971) (holding that the students lacked standing to challenge the acts of the trustees and administrators in the college's operations because it was a private corporation and the students did not have a vested financial interest in the institution. The court noted, "It is inconceivable that one 18-year-old boy or girl the day after his or her admission to a private college could go into court or through the State's Attorneys, and seek to enjoin the trustees in the management and operation of the college, and ask for a receiver solely because he or she was a student."). *Id.* See also *Russell v. Yale Univ.*, 737 A.2d 941, 946 (Conn. App. Ct. 1999) (affirming lower court's denial of standing to students who invoked the special interest doctrine in challenging Yale's reorganization of the divinity school); *Steenek v. Univ. of Bridgeport*, No. CV 93 0133773, 1994 Conn. Super. LEXIS 2112, at 14-19 (denying standing to a student who challenged the actions of the trustees in securing a loan from a religiously-affiliated organization which, as a condition of the loan, could nominate 60 percent of the trustees, a level of control that the student believed could violate the school's non-sectarian charter.). *But cf.* *Jones v. Grant*, 344 So. 2d 1210, 1212 (Ala. 1977) ("The students of a charitable institution are beneficiaries of a charitable trust....Where the grants and loans were for the purpose of upgrading the staff and faculty, as well as the student body, members of the staff and faculty also are beneficiaries....We find that the interest of the students, staff and faculty as beneficiaries in the financing of the educational institution with which they are associated is a sufficient special interest to entitle them to bring suit."). *But see* *Cook v. Lloyd Noland Foundation*, 825 So. 2d 83, 84 (Ala. 2001) (noting that "for trusts incorporated as nonprofit corporations, the enactment of the Alabama Nonprofit Corporation Act...superseded [the] right as recognized by Jones" which only allows the state attorney general to bring action and not the beneficiaries of charitable trusts.). *Id.* at 87.

As for derivative action, since such suits are only available to corporations with members,¹⁵⁶ and since nonprofit universities are not membership-based, the action cannot be used as a method of bringing trustee accountability, although one scholar has argued that university students do have a “strong case” for derivative standing,¹⁵⁷ an assertion that, so far, has not been merited by any court.

In short, there are serious limitations to both public and private enforcement of directorial obligations at universities. The limitations arise from both resource-based concerns as well as standing-related challenges. Nonetheless, there have been some exceptions. The remainder of this Part is devoted to examining two rare cases where higher education trustee accountability was maintained successfully through judicial and quasi-judicial proceedings.

A. The Wilson College Case

In February of 1979, the Board of Trustees of Wilson College, an incorporated private women’s college chartered by the Pennsylvania legislature,¹⁵⁸ voted to close the institution by June 30th because of financial constraints.¹⁵⁹ The trustees also decided to change the college’s corporate name to Wilson College Foundation, an entity that would receive the college’s corporate assets and would invest them in order to “continue to work toward the aims of Wilson College...[the purpose for which], as stated by its founders... [was] to provide for women the opportunity for a broad and thorough education of the highest quality.”¹⁶⁰ In their declaration, the trustees noted that the Foundation would pursue its objectives through providing “educational research and development and scholarships for the undergraduate education of women.”¹⁶¹

The board’s resolution was largely based on the dwindling admissions numbers, with the reduction of the college’s entering class from the peak of 252 in 1965 to 55 in 1978.¹⁶² While the college could handle a student body of 650, its overall enrollment in February of 1979 was 214 students.¹⁶³

¹⁵⁶ See *supra* Part IV.C.

¹⁵⁷ See Kusiak, *supra* note 133, at 164 (asserting that *Stern v. Lucy Webb Hayes Nat’l Training Sch. for Deaconesses & Missionaries*, 381 F. Supp. 1003 (D.D.C. 1974), would allow nonmembers to bring a derivative suit against a nonprofit corporation).

¹⁵⁸ See *Zehner v. Alexander*, 3 FRANKLIN COUNTY LEGAL J. 27, 29 (Pa. Orphans’ Ct. 1979).

¹⁵⁹ *Id.* at 35.

¹⁶⁰ *Id.* at 71.

¹⁶¹ *Id.*

¹⁶² Fred M. Hechinger, *Wilson College, A ‘Lost Cause,’ Looks Lively*, N.Y. TIMES, Nov. 11, 1980, at C1.

¹⁶³ *Zehner* at 37.

Shortly after the trustees' vote, a dissenting trustee,¹⁶⁴ together with a group of alumnae, faculty, and enrolled as well as accepted but not yet matriculated students petitioned the court seeking injunctive relief.¹⁶⁵ Later, they asked that Wilson College also be made a co-petitioner, a motion that the judge granted.¹⁶⁶ The court found, without providing any analysis, that the dissenting trustee, faculty, alumnae, and Wilson College had standing to maintain the proceeding but that the enrolled and prospective student petitioners did not.¹⁶⁷

The petitioners sought that the trustees "show cause why they should not be removed immediately as trustees"¹⁶⁸ and also be "permanently enjoined from implementing the closing of the college."¹⁶⁹ The petitioners contended that "the very act of voting to close the College and then without Court approval proceeding to implement that decision...was totally detrimental to the charter purpose of Wilson College and grounds for judicial removal"¹⁷⁰ and that the evidence presented "established a history of mismanagement" that justified the board's dismissal.¹⁷¹

The court agreed with the petitioners that the *cy pres* doctrine,¹⁷² as codified by the legislature,¹⁷³ required court approval for any fundamental change to a nature of a nonprofit corporation, which the respondents had not sought.¹⁷⁴ The court noted:

¹⁶⁴ The dissenting trustee, Jean Colgan Zehner, disagreed with the board's decision to close the college but did not cast a vote against the resolution as she was abroad at the time the special meeting was held. *Id.* at 30.

¹⁶⁵ *Id.* at 28.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* at 84.

¹⁶⁸ *Id.* at 28

¹⁶⁹ *Id.*

¹⁷⁰ *Id.* at 83

¹⁷¹ *Id.*

¹⁷² *Cy pres* literally means "as near as" and comes from the French Norman expression "*cy pres comme possible*," which means "as near as possible." See *Kolb v. City of Storm Lake*, 736 N.W.2d 546, 553 (Iowa 2007). It is a common law doctrine that "permits a court to change the purpose or recipients of a charitable trust under certain circumstances." *Id.* (citations omitted). As defined in *Restatement, Trusts*, § 399 (1935), the doctrine of *cy pres* reads as follows:

If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but the Court will direct the application of the property to some charitable purpose which falls within the general charitable intention of the settlor.

By implementing the decision to close Wilson College the Trustees attempted to essentially deprive the Court of its power to review the recommendation of the Board and to approve or disapprove the proposed diversion of college assets from a teaching institution to some other charitable use. In addition, the implementation of the decision to close Wilson College without prior approval of the Court attempted to deprive the public, represented by the Attorney General as *parens patriae*, of an opportunity to comment upon or protest the decision.¹⁷⁵

Nonetheless, the court refused to dismiss the entire board, finding “no evidence of fraudulent conduct or dishonest acts with reference to the corporation by any trustee.”¹⁷⁶

The court did find, however, that the college president, who was also a board member, acted with “gross abuse of authority and discretion,” and thus removed her permanently from the board.¹⁷⁷ The court also removed another board member for conflict of interest, noting that the member’s presidency of the all-women Bryn Mawr College, which competed with Wilson “for women students out of the national pool of students,”¹⁷⁸ presented “proper cause” for removal.¹⁷⁹

The court declined to remove any of the remaining trustee, noting that the petitioners had failed to prove that the trustees’ conduct “constituted ‘gross abuse of authority or discretion with reference to the corporation’ or ‘any other proper cause.’”¹⁸⁰ However, in its decree, the court forbade Wilson College from paying the respondents’ court costs, finding their vote to dismantle the college “indefensible procedurally and substantively.”¹⁸¹

¹⁷³ See 15 PA. CONS. STAT. § 5547 (2012) (“Property committed to charitable purposes shall not, by any proceeding...be diverted from the objects to which it was donated, granted or devised, unless and until the board of directors or other body obtains from the court an order...specifying the disposition of the property.”).

¹⁷⁴ *Zehner* at 81.

¹⁷⁵ *Id.* at 82.

¹⁷⁶ *Id.* at 83.

¹⁷⁷ *Id.* The court also found that the president “misled the Board, student body, alumnae and the public as to the state of the College...either by design or by a total failure...to maintain any supervision of the Director of Admissions.”). *Id.* at 78.

¹⁷⁸ *Id.* at 79

¹⁷⁹ *Id.* at 83.

¹⁸⁰ *Id.* at 84.

¹⁸¹ *Id.* at 86.

The court concluded by enjoining the closing of the college on June 30th “or on any other date...without prior Court approval.”¹⁸² Without appealing the case, the entire board resigned shortly after the ruling.¹⁸³ The college remains open as of this article’s writing.¹⁸⁴

B. Adelphi University

In a 1995 survey of 477 private colleges, the president of Adelphi University in Long Island, Peter Diamandopoulos, was ranked as the second highest paid university president in the country, earning \$523,636 in 1993-1994.¹⁸⁵ The report fueled the anti-Diamandopoulos’ voices on campus, led by faculty, who had complained of the president’s and the board of trustees’ lavish spending of the university’s resources, despite grim admissions numbers and the cost-cutting efforts that had included staff layoffs.¹⁸⁶ In addition to the generous compensation, the board had provided Mr. Diamandopoulos with a \$1.2 million Manhattan apartment, bought with university funds, as well as another official residence, a Tudor-style house close to the campus.¹⁸⁷ The board had also approved reimbursement from the university of any income taxes paid on fringe benefits and compensation for sabbaticals Mr. Diamandopoulos did not take.¹⁸⁸ The board’s spending on itself included a trip to Greece for one of its meetings.¹⁸⁹

To hold the board accountable, several faculty, students, and former university officials formed a group called the Committee to Save Adelphi (CSA).¹⁹⁰ Within months after its formation, the CSA asked the New York State Board of Regents, which, under New York law,¹⁹¹

¹⁸² *Id.*

¹⁸³ Hechinger, *supra* note 162.

¹⁸⁴ See Lawrence Biemiller, *Seeking Enrollment Boost, Wilson College Will Admit Men*, CHRON. OF HIGHER EDUC., Jan. 13, 2013, <http://chronicle.com/article/Seeking-Enrollment-Boost/136657/> (announcing the board of trustees’ decision to enroll men to the college’s traditional undergraduate program).

¹⁸⁵ Douglas Lederman, *Private Colleges’ Pay: A “Chronicle” Survey*, CHRON. OF HIGHER EDUC., Sept. 29, 1995, at A23. The highest-paid president during the same period was Boston University’s. *Id.*

¹⁸⁶ Doreen Carvajal, *President’s Pay Rankles Some at Adelphi*, N.Y. TIMES, Sept. 30, 1995, at 1.

¹⁸⁷ *Id.*

¹⁸⁸ Karen W. Arenson, *Letters Illumine Adelphi Head’s Rich Deal*, N.Y. TIMES, July 27, 1996, at 29.

¹⁸⁹ Carvajal, *supra* note 186.

¹⁹⁰ *Id.*

¹⁹¹ N.Y. EDUC. LAW § 216 (2013) (giving the Regents broad authority to “incorporate any university, college, academy, library, museum, or other institution or association for the promotion of science, literature, art, history or other department of knowledge, or of education in any way, associations of teachers, students, graduates of educational institutions, and other associations whose approved purposes are, in whole or in part, of educational or cultural value deemed worthy of recognition and encouragement by the university....”); N.Y. EDUC. LAW § 216-a

“is the only state board of education having authority over all educational activity at all levels, including private and public, non-profit and for profit institutions,”¹⁹² to remove the board, contending that the board had failed to oversee the president’s expenditures and that its members had engaged in self-dealing by selling products and services such as insurance and advertisements to the university.¹⁹³

The Regents agreed. With respect to the president’s compensation, the Regents found that “the trustees failed to exercise the degree of care and skill that ordinarily prudent persons would have exercised in like circumstances,”¹⁹⁴ and that they “failed to exercise due care to ensure that Diamandopoulos’ compensation package as a whole was ‘reasonable’ and ‘commensurate with the services performed,’ as required by [New York Not-for-Profit Corporation Law].”¹⁹⁵

As for the trustees’ usage of a fellow trustee’s insurance brokerage firm for Adelphi, the Regents concluded that “[the trustee] and Diamandopoulos neglected their fiduciary duties to Adelphi,” and that “Diamandopoulos’ actions were not consistent with his duties of undivided loyalty and care to Adelphi.”¹⁹⁶ The Regents also found that Diamandopoulos and the former trustee must be removed “for neglect of their duties of due care and loyalty.”¹⁹⁷

With respect to the trustees’ utilization of a fellow trustee’s advertising firm for the university, the Regents found that the trustee “neglected both his duties of due care and undivided loyalty to Adelphi,”¹⁹⁸ and also “violated his fiduciary duty by failing to disclose to the board that [the firm] was, indeed, being paid for services rendered to Adelphi.”¹⁹⁹ The Regents concluded that the president and the trustee should be removed “for neglect of their

(2013) (subjecting the institutions chartered or incorporated by Regents to the state’s not-for-profit corporation laws).

¹⁹² *History of the Board & University of the State of New York*, NY ST. EDUC. DEP’T., available at <http://www.regents.nysed.gov/about/history-usny.html>.

¹⁹³ See *Petition, COMM. TO SAVE ADELPHI*, available at <https://folio.iupui.edu/bitstream/handle/10244/502/THE%20COMMITTEE%20TO%20SAVE%20ADELPHI.pdf?sequence=1>. See also Courtney Leatherman, *Hearings on Adelphi U. Trigger a Debate About New York’s Authority Over Private Colleges*, CHRON. OF HIGHER EDUC., Sept. 13, 1996, at A42 (providing a background on the CSA hearings).

¹⁹⁴ See *Vacco v. Diamandopoulos*, 715 N.Y.S.2d 269, 272 (Sup. Ct. N.Y. Co. 1998) (quoting the findings of the NY State Bd. of Regents).

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ *Id.*

fiduciary duties of due care and loyalty.”²⁰⁰ They also found that “the full board of trustees neglected its duty of due care to Adelphi by failing to take appropriate action once it learned of the trustees’ potential conflicts”²⁰¹ and ordered the removal of 18 of the 19 trustees, replacing them with new trustees that the Regents selected.²⁰² The dismissed trustees included Mr. Diamandopoulos, although the Regents took no action against him as president, as doing so would not have been permitted under New York law.²⁰³ Within two weeks, however, the new trustees fired Mr. Diamandopoulos.²⁰⁴

Separately, the New York Attorney General’s office began an investigation into the university’s finances,²⁰⁵ and in March of 1997, the state sued the former president and trustees for misspent money, attempting to hold the members personally liable.²⁰⁶ The suit also sought restitution of legal fees spent to defend the former officials and accused the trustees of breaching their responsibilities by permitting two of the members to do business with the university, including the payment of \$1.2 million in fees that went to the insurance firm of the former board chairwoman and \$155,000 in commissions paid to another trustee, whose advertising firm was retained by the university without any bids.²⁰⁷ The case was settled before trial, with the former president and trustees reimbursing Adelphi for certain costs but without any admission of wrongdoing.²⁰⁸

With this background, the ensuing Part explores the Penn State case, with a focus on the role of the gubernatorial ex officio trustee and the challenges associated with holding such trustee accountable with respect to his or her fiduciary obligations.

²⁰⁰ *Id.* at 273 (quoting the findings of the NY State Bd. of Regents).

²⁰¹ *Id.*

²⁰² *Id.* at 271.

²⁰³ See Bruce Lambert, *New York Regents Oust 18 Trustees from Adelphi U.*, N.Y. TIMES, Feb. 11, 1997, at A1.

²⁰⁴ Courtney Leatherman, *New Adelphi Board Fires the University’s Controversial President*, CHRON. OF HIGHER EDUC., Feb. 28, 1997, at A35.

²⁰⁵ Carvajal, *supra* note 186.

²⁰⁶ See *Diamandopoulos* at 273 (denying the defendants’ motion to dismiss the attorney general’s complaint).

²⁰⁷ See Bruce Lambert, *State Sues to Recover Funds Spent by Adelphi’s Ex-Trustees*, N.Y. TIMES, Mar. 25, 1997, at B5.

²⁰⁸ See David Halbfinger, *Lawsuits Over Ouster of Adelphi Chief Are Settled*, N.Y. TIMES, Nov. 18, 1998, at B1.

VI. PENN STATE AND THE TROUBLESOME MURKINESS OF THE GOVERNOR'S ROLE AS TRUSTEE

In 1855, the legislative creators of the Pennsylvania State University, originally named “the Farmers’ High School of Pennsylvania,” designed a corporation:

[the]...trustees, and their successors in office, are hereby elected and declared to be a body politic and corporate in law, with perpetual succession, by the name, style and title of the Farmers’ High School of Pennsylvania, by which name and title the said trustees, and their successors, shall be able and capable in law to take by gift, grant, sale or conveyance, by bequest, devise or otherwise, any estate in any lands, tenements and hereditaments, goods, chattels or effects, and at pleasure to alien or otherwise dispose of the same to and for the uses and purposes of the said institution...²⁰⁹

The Governor of the Commonwealth of Pennsylvania is an ex officio member of the board.²¹⁰ “Ex officio” refers to a specific method by which one becomes a member of a body: by the virtue of holding another office.²¹¹ Accordingly, the title “ex officio” does not, by itself, constitute a class of membership and entails no specific rights or obligations. Ex officio rights such as voting can be limited by the bylaws,²¹² but corporate documents may not reduce or absolve the general fiduciary obligations of any of the members.²¹³ While case law is scarce in addressing ex officio fiduciary duties, the cases that do acknowledge the title do not make a distinction between ex officio and non-ex officio member duties or between voting and nonvoting members.²¹⁴

At Penn State, all members of the Board of Trustees “stand in a fiduciary relationship to the University.... [They] shall act in good faith, with due regard to the interests of the University,

²⁰⁹ 24 PA. CONS. STAT. § 2533 (1855).

²¹⁰ See *supra* note 4 and accompanying text.

²¹¹ See *supra* note 3.

²¹² See *id.*

²¹³ See *supra* notes 82-84.

²¹⁴ See, e.g., *In re Spiegel*, No. 03 B 11540, 2003 Bankr. LEXIS 435, at 2-3 (Bankr. S.D.N.Y. May 7, 2003) (highlighting the existence of non-voting ex officio members on a creditor’s committee but noting that the committee as a whole had fiduciary obligations toward the class of creditors it represented); *Memphis Health Ctr., Inc. v. Grant*, 2006 Tenn. App. LEXIS 498, at 31 (Tenn. Ct. App. July 28, 2006) (holding that a non-voting ex officio member of the board of an incorporated nonprofit health center was considered a “director” and had standing to maintain a derivative action against the corporation).

and shall comply with the fiduciary principles of conduct hereinafter set forth”²¹⁵ as well as “other federal or state reporting requirements.”²¹⁶

Pennsylvania law also imposes specific fiduciary obligations on nonprofit directors:

A director of a nonprofit corporation shall stand in a fiduciary relation to the corporation and shall perform his duties as a director...in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances.²¹⁷

The law further requires that, in discharging their duties, nonprofit directors consider the best interests of the corporation by considering

the effects of any action upon any or all groups affected by such action, including members, employees, suppliers, customers and creditors of the corporation, and upon communities in which offices or other establishments of the corporation are located [and] [t]he short-term and long-term interests of the corporation, including benefits that may accrue to the corporation from its long-term plans and the possibility that these interests may be best served by the continued independence of the corporation.²¹⁸

With respect to the enforcement of obligations, the state’s common law gives the Attorney General *parens patriae* powers to supervise nonprofit corporations.²¹⁹ The state limits who has standing to enforce the nonprofit directorial obligations to the corporation itself as well as its members, so long as the members’ suit is to invoke “the right of the corporation” rather than to obtain individual relief.²²⁰

This Part presents specific instances where the governor’s public duties as an elected official have come into conflict with his duties as an ex officio corporate board member.

²¹⁵ PSU Bylaws, *supra* note 4, at art. 6(1). The specific fiduciary duties imposed by the bylaws primarily address the disclosure requirements of commercial relationships between the board members and the university, the prohibition of information misuse, and abuse of gifts and favors. *Id.*

²¹⁶ *Id.*

²¹⁷ 15 PA. CONS. STAT. § 5712 (2012).

²¹⁸ 15 PA. CONS. STAT. § 5715 (2012)

²¹⁹ See, e.g., *In re Milton Hershey School Trust*, 807 A.2d 324, 330 (Pa. Commw. Ct. 2002) (recognizing the attorney general’s *parens patriae* powers in supervising charitable organizations); *Commonwealth v. Citizens Alliance for Better Neighborhoods, Inc.*, 983 A.2d 1274, 1277 (Pa. Commw. Ct. 2009) (affirming attorney general standing to bring suit against a nonprofit corporation by noting that “it is the well-settled law of the Commonwealth that the Attorney General is responsible for the public supervision of charities through his *parens patriae* powers.”).

²²⁰ 15 PA. CONS. STAT. § 5717 (2012).

A. Ex Officio Conflicts

1. The Sandusky Scandal

Jerry Sandusky, a retired former assistant football coach at Penn State and the founder of The Second Mile, a charity he created independent of Penn State in 1977 for underprivileged youth,²²¹ was indicted by a Pennsylvania grand jury on November 4, 2011 for sex crimes against underage boys.²²² The indictment alleged that Mr. Sandusky had molested the victims, all of whom he had met through The Second Mile, during a period ranging from at least 1994 to 2009 while he was assistant coach as well as after he had retired in 1999.²²³ On at least five occasions, the indictment alleged that the abuse had taken place on Penn State premises, to which Mr. Sandusky had access after retirement.²²⁴ Mr. Sandusky's trial began on June 11, 2012.²²⁵ The jury reached its verdict on June 22, finding Mr. Sandusky guilty of 45 of the 48 charges.²²⁶ Mr. Sandusky was sentenced to 30 to 60 years in prison later in the year.²²⁷

Governor Corbett's involvement with the Sandusky investigation began prior to his gubernatorial duties, which commenced in January of 2011. Mr. Corbett had been the state's attorney general for the six years immediately preceding his inauguration as governor, and, in this capacity, convened the grand jury investigation against Mr. Sandusky in 2009.²²⁸ Due to grand jury secrecy laws, Mr. Corbett could not disclose what he knew of the investigation to his fellow Penn State trustees when he became an ex officio member of the board. As Section B of this Part explores, the clash of legal principles, i.e., grand jury confidentiality requirements versus fiduciary obligations of disclosure, render the ex officio system susceptible to reassessment.

²²¹ Mark Viera, Jo Becker, & Pete Thamel, *Sandusky's Charity Makes Plans to Fold*, N.Y. TIMES, Nov. 19, 2011, at D1.

²²² See Viera, *supra* note 1.

²²³ *Id.*

²²⁴ FREEH SPORKIN & SULLIVAN LLP, REPORT OF THE SPECIAL INVESTIGATIVE COUNSEL REGARDING THE ACTIONS OF THE PENNSYLVANIA STATE UNIVERSITY RELATED TO THE CHILD SEXUAL ABUSE COMMITTED BY GERALD A. SANDUSKY 54-55 (2012), available at http://www.thefreehreportonpsu.com/REPORT_FINAL_071212.pdf.

²²⁵ Ken Belson, *Sandusky's Trial Begins With Graphic Testimony*, N.Y. TIMES, June 12, 2012, at B9.

²²⁶ Joe Drape, *Sandusky Guilty of Sexual Abuse of 10 Young Boys*, N.Y. TIMES, June 23, 2012, at A1.

²²⁷ See Rohan, *supra* note 1.

²²⁸ See Becker, *supra* note 2.

2. The State Budget Proposal

Unrelated to the scandal, Mr. Corbett's proposed annual budget in March of 2011 had included cuts in state-supported higher education by about fifty percent,²²⁹ significantly reducing state funding granted to the fourteen universities of the state-owned Pennsylvania State System of Higher Education (PASSHE)²³⁰ and the four universities, including Penn State, that are members of the state-related Commonwealth System of Higher Education (CSHE).²³¹ The governance structures of all 18 universities include some role for the Governor of the Commonwealth of Pennsylvania. In the PASSHE system, the 20-member Board of Governors includes the Governor of Pennsylvania or a designee as a voting member.²³² At the CSHE universities, the governor is a member of the four universities' respective boards of trustees.²³³ The governor's 2011 proposed budget meant a \$182 million decrease in state aid to Penn State, approximately a 52 percent reduction from the preceding fiscal year.²³⁴ As the next section argues, the budget proposal clearly breached basic tenants of fiduciary law, providing yet another reason for the reassessment of the ex officio gubernatorial trustee model.

B. Analysis & Recommended Action

Under the duties of care and loyalty, nonprofit trustees must reveal to the other members of the board important information that may not be known to them.²³⁵ Such disclosure is not required, however, if it would "violate a duty imposed by law, a legally enforceable obligation of confidentiality, or a professional ethics rule."²³⁶ Accordingly, with respect to the Sandusky investigation, it is clear that Mr. Corbett could not have legally informed the other trustees of the investigation so that they could take appropriate action to protect the university. But here is where the problem lies: had another, non-ex officio member of the board been privy to the investigation, he or she could have simply resigned from the board in order to avoid the conflicts

²²⁹ See Chute & Schackner, *supra* note 8.

²³⁰ The Pennsylvania State System of Higher Education includes Bloomsburg University, California University of Pennsylvania, Cheyney University, Clarion University, East Stroudsburg University, Edinboro University, Indiana University of Pennsylvania, Kutztown University, Lock Haven University, Mansfield University, Millersville University, Shippensburg University, Slippery Rock University, and West Chester University.

²³¹ See *supra* Part I.

²³² *The Pennsylvania State System of Higher Education*, BD. OF GOVERNORS, available at <http://www.passhe.edu/inside/bog/Pages/BOG-Home.aspx>.

²³³ See *supra* notes 10 & 11.

²³⁴ See Chute & Schackner, *supra* note 8.

²³⁵ MODEL NONPROFIT CORP. ACT § 8.30(c) (2008).

²³⁶ *Id.*

intrinsic in being a silent fiduciary and would have been replaced with relative ease. But an ex officio member at Penn State is required to serve on the board by law.²³⁷ As such, he or she may not easily abandon the directorial obligations by resignation.

Consequently, when an ex officio board member, gubernatorial or otherwise,²³⁸ is in a position where he or she is legally obliged to conceal from the other trustees information that may adversely affect the corporation, the law must mandate that the member divulge such conflict to a court, which may in turn appoint a new trustee who would serve until the matter has come to a close, so as to not rob the institution of competent governance by being, in essence, a board member short. After all, how well can the institution be served if one of its trustees is in a position that requires the trustee to conceal detrimental information from it?

On the budget cut issue, there is very little the law can do, save for a severe but rational measure: to statutorily remove the governor as an ex officio member of the board. This proposal is based on the following assessment: there is no question that the governor of the state is entitled to proposing a budget that highlights the gubernatorial preferences, including proposals that request the reduction of the state's assistance to certain corporations. But what if the governor sits on the boards of those very corporations as their fiduciary?

Fiduciary law imposes a duty of loyalty upon all trustees, including ex officio gubernatorial directors, requiring them to pursue the best interests of the corporations at which they serve.²³⁹ The duty mandates that a trustee refrain from actions that may harm the corporation, to take affirmative steps to protect the corporation,²⁴⁰ and to do so with undivided loyalties.²⁴¹ Doing otherwise would constitute the abdication and dereliction of duties. But if so alleged against a governor-trustee, in the context of a gubernatorial proposal to cut a corporation's budget, the action would likely be summarily dismissed through the invocation of sovereign immunity as an affirmative defense.²⁴² In effect, the status quo permits a specific trustee to legally undermine an institution at which he serves, without any consequences whatsoever. This makes for bad public policy in need of transformation.

VII. CONCLUSION

²³⁷ See *supra* note 4.

²³⁸ At Penn State, for instance, Pennsylvania's Secretaries of Education, Agriculture, Environmental Resources, and the president of the university also serve as ex officio trustees. PSU Charter, *supra* note 4, at C-2.

²³⁹ See KURTZ, *supra* note 89.

²⁴⁰ See *Guth v. Loft* at 510.

²⁴¹ See WORMSER, *supra* note 103, at 125-30.

²⁴² See 42 PA. CONS. STAT. §§ 8521-8528 (Pennsylvania's sovereign immunity statute).

When Mr. Corbett was asked how he viewed his role as a Penn State trustee, he responded: “I’m the governor....I believe I have perspective on behalf of the taxpayers of Pennsylvania to share with the board.”²⁴³ This is a serious misunderstanding of a fiduciary’s role and presents a fundamental conundrum. Pennsylvania law appoints the governor as an ex officio member of the board. It does not carve out an exception regarding his fiduciary obligations toward the university, neither does it say that the governor is there to represent the state. As such, the default obligations of a fiduciary, as defined by the state’s nonprofit corporation law, prevail. It is, in fact, telling that in the minutes of the meetings of Penn State’s Board of Trustees, Mr. Corbett is referred to as “Trustee Corbett” and not “Governor.”²⁴⁴ The ex officio directors, along with the other members of the board, are there to safeguard the institution’s interests—and no other.

There is no question that the state’s public interests should trump an institution’s “private” interests. But it is the state that has chartered the corporation for the promotion of a public good (education) and has endowed it with the governor as one of its trustees to guard the institution’s best interests as its fiduciary. Accordingly, if the ex officio director is in a position where he may not be able to serve the corporation’s interests, the law must mandate that the fiduciary step aside from the board. The law should even consider abolishing the gubernatorial-trustee model altogether, since a governor’s political objectives may not be in line with what is in the interest of the corporation at which he serves as trustee. The constant tensions that the current paradigm condones, those between public governance political objectives and private corporate governance principles as defined by centuries of fiduciary law, cannot be sustained.

This is not to say that there are no benefits to the gubernatorial-trustee model; there are: “Even a governor who rarely attends board meetings...can be helpful in many ways...fending off ill-considered legislative incursions, attracting national figures to the campus, and intervening with federal officials.”²⁴⁵ But if the gubernatorial trustee believes that his service on the board means representing the will of the state’s citizens and not the best interests of the university, the university has essentially been robbed of an effective trustee. As a former university president once noted, “responsibility to a constituency is inconsistent with sound management,”²⁴⁶ an apt summary of the gubernatorial trustee conundrum.

²⁴³ Andrew McGill & John L. Micek, *Corbett not Afraid to Exercise Muscle on Penn State Board*, THE MORNING CALL, Feb. 13, 2012, http://articles.mcall.com/2012-02-13/news/mc-penn-state-corbett-trustee-20120211_1_state-president-rodney-erickson-tom-corbett-board-meeting.

²⁴⁴ See BD. OF TRS., Mins. of mtgs. at 260-10 (Jan. 20, 2012), available at <http://www.psu.edu/trustees/pdf/january2012minutesbot.pdf>.

²⁴⁵ Freedman, *supra* note 34, at 11.

²⁴⁶ *Id.* at 14.