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Conflict of interest: A statement of policy for ALA Executive Board members

Conflict of Interest: A term, the legal significance of which is confined to representation of the interest, as where a real estate broker is representing both buyer and seller, and an attorney of law attempts to act for his client and for one whose interest is adverse to or conflicting with that of his client in the same general matter.

...Ballentine's Law Dictionary, 3rd.ed. p. 246

The ethical and moral attributes and the requisites of qualification for positions as members of a board of directors are integrity, independence in judgment, courage, conscientiousness, and good faith. Such general attributes coincide with the specific criteria inherent in the nature of a fiduciary relationship. Since it is apparent that each member of the American Library Association cannot participate in the day-to-day management of the Association's affairs, the members of its Board must occupy a position of trust, acting diligently, with good faith and reasonable care to safeguard the Association's funds and to obtain the best possible results from their use in the Association's operations and activities.

Therefore, in their dealings with the business or property of the Association, members of the Board may not use their relation to the Association for their own personal gain. Full disclosure by a member of any potential conflict between his or her personal interest and the interests of the Association is required by the standard of good faith. Likewise, Board members are not privileged to use inside information for their own personal advantage or fail to disclose relevant information or misrepresent facts to the Association's members.

In order to ensure that any conflict of interest on the part of any member of the ALA Executive Board shall be made a matter of record, the following statement shall serve as a guide to Board members in reporting conflict of interest.

When any such interest becomes relevant to any subject requiring action by the Executive Board or any of its committees, the Board member having a conflict shall call it to the attention of the Board or committee, and the Board member shall not vote on the subject in which the member has a conflict of interest, shall not use personal influence, and, in those cases where the quorum of the meeting called for the purpose of voting on the subject has not yet been established, the Board member shall not be counted.

If excluded from voting because of a conflict of interest, a Board member will be required to briefly state the nature of the conflict, and may be requested to answer pertinent questions of other Board members when that Board member's knowledge of the subject will assist the Board or any of its committees. The Board may request that a Board member thus excluded from voting on a subject leave the meeting temporarily while the subject is debated and voted upon.

The minutes of the meeting shall reflect that a disclosure was made, that the Board member who stated a conflict of interest did abstain from voting, and, in those cases where the quorum was not already established, that the Board member was not counted in determining the quorum.

In addition, if any Board member, who by reason of his or her institutional affiliation or any other pertinent matter, anticipates

that in the future certain issues to be placed before the Board may place him or her in a position of conflict of interest, the Board member shall disclose such conflict in writing to the Board and make it a matter of record.

SOURCES:

George G. Bogert TRUSTS AND TRUSTEES
St. Paul, Minn.: West, 1978, # 471-510

M.S.Nicolson, DUTIES AND LIABILITIES OF CORPORATE OFFICERS AND DIRECTORS
Englewood Cliffs, N.J.: Prentice-Hall
1972, pp. 182 ff.

Submitted by Ad Hoc Committee on Legal Implications of Conflict of Interest:
Connie Dunlap, Donald Trottier, R. Kathleen Molz, chair.

Approved by the ALA Executive Board
April 30, 1980
for forwarding to Council with recommendation it be adopted as Policy
Adopted by Council, June, 1980

EBD#1.1

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June 13, 1979

Mr. Robert Wedgeworth
American Library Association
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Chicago, Illinois 60611

Dear Bob:

As you requested, here is a summary of my remarks at our dinner meeting. It sets forth the specific suggestions I made with respect to the precautions every trustee or director should observe.

The primary exposure of trustees and directors of Not-for-Profit organizations involves their fiduciary duties to the organization itself and to the public which the organization serves and for which the organization has been granted tax exemption.

The three basic duties created by the fiduciary relationship which are owned by directors to business corporations are obedience, diligence and loyalty. It is anticipated that developing case law will continue to impute these duties and standards to trustees and directors of charitable organizations.

The <u>duty of obedience</u> contemplates that directors will not permit the corporation to engage in ultra vires activities, or in other words, activities which are outside the powers granted to the corporation by statute, the corporate charter and the bylaws. A willful or negligent

breach of this duty will subject a director to liability. Good faith would be a defense only where the director is found to have committed a mere mistake or error in judgment, and not where the activity in question exceeds the limits placed upon his or the corporation's powers. As in so many legal matters, this distinction is mainly a question of fact which will depend upon the circumstances of the particular case.

The duty of diligence has been interpreted as imposing liability on directors for negligent mismanagement of the corporation. Courts once required overt or affirmative actions by a director to impose personal liability. It now appears that liability may result from mere inaction on the part of a director if such inaction is considered to be a proximate cause of loss. Directors are particularly vulnerable to personal liability for their inaction where various management responsibilities have been delegated to board committees or to officers. Such delegation is permitted only so long as all directors assume the responsibility for supervising such committees or officers by periodically scrutinizing their work. This has sometimes been characterized as the duty of diligent inquiry and active oversight.

The duty of loyalty requires that a director refrain from engaging in his own personal activities in such a manner as to injure or take advantage of the corporation. Under recent cases, it is clear this does not involve simply the possibility of pecuniary profit by the director but also failure to inform the persons approving the transaction of his interest or position and of any significant reasons why the transaction may not be in the best interests of the corporation.

Substantial conflict of interest and self-dealing problems can arise under the duty of loyalty. Given the kinds of people who normally are directors or trustees of charitable organizations and their numerous other affiliations, it is virtually impossible to avoid conflicts of interest. Such conflicts are not prohibited, but because they provide an opportunity for self-dealing, a director must immediately inform the appropriate board or committee members of the nature of the conflict and the negative

aspects of the transaction to the organization and should otherwise refrain from any discussion of or voting on the matter. While even self-dealing is not absolutely prohibited, the burden is on the interested director to establish both his good faith and the fairness of the transaction.

The recent case of Escott v. BarChris Construction Corporation, 283 F.Supp. 643 (S.D.N.Y. 1968) has been interpreted as imposing a duty of independent investigation particularly with respect to sophisticated outside directors. This duty requires directors to investigate underlying facts and not rely on the representations of management, other board members or any persons not considered experts or upon general information not specific to the decision in question. Accordingly, for sophisticated directors, the defense of reasonable reliance no longer appears viable. Many trustees or directors of charitable organizations are, of course, sophisticated business people who could be held liable under this duty while less sophisticated public directors or trustees need not have made such an investigation.

The decision in Stern v. Lucy Webb Hayes National Training School for Deaconesses and Missionaries, 381 F.Supp. 1003 (D.C.D. 1974), referred to as Sibley Memorial Hospital, is particularly instructive of the emerging principles upon which charitable organization trustees or directors will be held legally liable for their actions or inaction. The judge found that a trustee of a charitable hospital was in default of his fiduciary duties if (i) he failed to use due diligence in supervising the actions of persons responsible for day-to-day financial or investment decisions, (iii) he knowingly failed to inform the persons approving a transaction of his conflict of interest and the reasons why the transaction may be disadvantageous, (iii) he actively participated in or voted for a decision to transact business with himself or an entity in which he had a substantial interest or decision-making position, or (iv) he otherwise failed to perform his duties honestly, in good faith, and with a reasonable amount of diligence and care.

In view of the potential liabilities of directors or trustees of charitable organizations, the following specific suggestions should be used as a guide in carrying out a director's or trustee's individual responsibilities:

1. Attend most, and preferably all, of the meetings of the board and of the board committees on which you serve as a member, or resign immediately.

2. Make sure that complete minutes are kept of all board and committee meetings and that those minutes are sent to all of the board members. Carefully review the minutes which you receive as promptly as possible.

3. On any transaction of substance which is proposed in a meeting at which you are in attendance, or disclosed in the minutes of any meeting which you missed, seek any further information which seems to you to be prudent as soon as possible and make sure that your concern or objections are made a part of the minutes of the appropriate body.

4. On any matters which come up about which you have serious reservations as to legal requirements, do not hesitate to request and insist on a legal opinion from your charitable organization's legal counsel before allowing the proposed action to proceed.

5. If your board has not adopted a conflict of interest policy, urge that it do so. The policy proposed by the American Hospital Association and discussed in the Sibley Memorial Hospital opinion can serve as a guideline. Periodic written disclosure of all possible conflicts of interest should be required. A corollary policy should be adopted for the charity's administrative personnel in decision making positions.

6. Make sure that you call to the attention of the board or board committee the fact of any possible conflict of interest on any issue which arises, and abstain from further discussion of or voting on the matter. Make sure your abstention is recorded in the minutes. Disclose any information you have which other members may not as to why the proposed action may be to the disadvantage of the charity, and make sure that this is disclosed in the minutes.

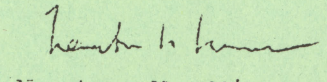
7. If the responsibility for supervising investments has been delegated to a committee of the board, make

sure that the delegation is set forth in a resolution with considerable specificity. The committee should be required to develop investment objectives which are submitted to the full governing board for approval.

Even though the above guidelines are followed and the duties of a director or trustee are carried out with diligence, care, good faith and honesty, there is no assurance that he or she will not be named as a defendant in a lawsuit. To protect its directors and officers from the expense of such legal proceedings, a charitable corporation can by statute in Illinois and many other states provide indemnification against expenses actually and necessarily incurred by them in connection with the defense or settlement of any action, suit or proceeding in which they are made parties by reason of their position -- except as to matters in which a director or officer is adjudged liable for willful misconduct in the performance of his fiduciary duties and to such matters as shall be settled by agreement predicated on the existence of such liability. Further, Illinois and other states by statute authorize the purchase of insurance on behalf of directors and officers against any liability or settlement based on asserted liability incurred by them by reason of their position. It is not clear, however, whether charitable entities not organized pursuant to such special state statutes for nonprofit corporations can provide indemnification and/or insurance. The charity's legal counsel should be consulted about the propriety of such indemnification and/or insurance. In any event, an indemnification policy adopted by the organization and the liability insurance coverage purchased should be carefully examined to be sure they cover the kinds of lawsuits which are likely in today's atmosphere and which provide sufficient limits of liability so that all of your legal expenses will be paid for the defense.

Please let me know if I may be of any further help in this matter.

Sincerely,



Newton N. Minow

NNM/vk
cc: Mary M. Hutchings