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Norman I. Silber

Maurice A. Deane School of Law at Hofstra University

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NORMAN I. SILBER*

Anticonsultative Trends in Nonprofit Governance

I

ACCOUNTABILITY, VIABILITY, AND CONSULTATION

Prompted by economic, political, and cultural changes buffeting the nonprofit sector, public demand for greater financial accountability on the part of nonprofit organizations has intensified in recent decades.¹ Increasingly, this demand is reflected by the imposition of new legal standards on directors and managers, and also on the employees and consultants on which they rely. These newer impositions include additional federal and state disclosure rules, changes to state corporation

* Professor of Law, Hofstra University School of Law. This article was prepared originally as a discussion paper for the Annual Conference of the Association for Research on Nonprofit Organizations and Voluntary Associations (ARNOVA), November 2006, at which the other participants were David Brennen, Evelyn Brody, Susan Gary, Robert Katz, and Mark Sidel. This discussion, in turn, extended conversations that developed out of an earlier ARNOVA panel on democratic values as expressed through nonprofit governance. Those participants included Evelyn Brody, David Hammack, Dana Brakman Reiser, and Mark Sidel. I express gratitude to them and to Putnam Barber, Burnele Venable Powell, and Jack Siegel for debating several of the views I have expressed here. Thanks to Eireann Brooks, Lara Cahan, and Justin Levy for their diligent research assistance.

¹ The origin of this development can be traced to the transformation of incorporation from a privilege into an entitlement. *See* NORMAN I. SILBER, A CORPORATE FORM OF FREEDOM: THE EMERGENCE OF THE MODERN NONPROFIT SECTOR 127–59 (2001) (tracing the development of postincorporation regulatory supervision of nonprofit activity following the demise of the earlier approach to the approval of nonprofit charters).

laws and federal tax laws, and stringent court interpretations of existing common-law fiduciary duties.²

At the same time, the difficulties nonprofit organizations face in generating sufficient revenue to remain viable and address fundamental purposes have seldom been greater. Gifts and bequests continue to decline as a proportion of overall revenue received.³ Funding through federal and state grants has proven inadequate.⁴ Although income earned from the provision of services, in contrast to income from contributions or grants, has been the largest and most consistently growing category of revenue for several decades, services that previously were provided almost exclusively by nonprofit agencies are today subject to ever-greater competition from for-profit businesses.⁵

These twin “accountability” and “viability” challenges have been widely reported.⁶ To remain viable in this difficult environment, advisors encourage many nonprofit groups to change their operating and governance structures, to better build profitable lines of related and unrelated business, to attract fee-for-service contracts, and otherwise to find new opportunities for making money that fit—even if only peripherally—within their

² See generally Ellen W. McVeigh & Eve R. Borenstein, *The Changing Accountability Climate and Resulting Demands for Improved “Fiduciary Capacity” Affecting the World of Public Charities*, 31 WM. MITCHELL L. REV. 119 (2004).

³ See INDEP. SECTOR, URBAN INST., *THE NEW NONPROFIT ALMANAC & DESK REFERENCE: THE ESSENTIAL FACTS AND FIGURES FOR MANAGERS, RESEARCHERS, AND VOLUNTEERS* (2002) [hereinafter *NONPROFIT ALMANAC*]; Leslie Lenkowsky, *How Are Nonprofit Finances Changing? New Data Make It Hard to Tell*, *CHRON. PHILANTHROPY*, Nov. 9, 2006, at 34.

⁴ See generally ALAN J. ABRAMSON ET AL., *FY 2006 FEDERAL APPROPRIATIONS RECAP: IMPACT ON NONPROFIT ORGANIZATIONS* (2005), http://www.nonprofitresearch.org/usr_doc/FY_2006_Appropriations_Final.pdf (stating “[o]ur analysis reveals that Congress eventually enacted nearly two-thirds of the spending cuts in these programs that the president had proposed for FY 2006.”).

⁵ See *NONPROFIT ALMANAC*, *supra* note 3; Lenkowsky, *supra* note 3.

⁶ Peter Swords, *The Form 990 as an Accountability Tool for 501(c)(3) Nonprofits*, 51 *TAX L.* 571, 573–74 (acknowledging that pressure from media enterprises has resulted in a “negative accountability” for nonprofits, and examining various tools as a model for encouraging accountability). A third challenge, which has affected the governance structure of a significant number of nonprofits, especially those operating internationally, has only recently received some attention: that posed by imperatives of security embodied in the USA PATRIOT Act and other measures addressing concern about terrorism in the aftermath of September 11, 2001. See MARK SIDEL, *MORE SECURE, LESS FREE? ANTITERRORISM POLICY AND CIVIL LIBERTIES AFTER SEPTEMBER 11*, 87–115 (2004).

missions.⁷ It is an underappreciated consequence of the convergence of these developments that is the focus of this discussion: what I will refer to as “anticonsultative” and “anticollaborative” imperatives.⁸

Adaptation to any new legal environment often calls for outside advice and counsel, and the nonprofit environment is no exception. With increasing frequency, scholars, attorneys, and consultants are advising groups that seek to comply with nonprofit laws and enhance their financial performance to turn away from several popular cultural traditions and conventional legal norms that characterized nonprofit governance. In particular, they advise a turn from older patterns of decision making and an older advice literature, which, by and large, encouraged collaboration and consultation in the normal course of internal organization and governance.⁹

The newer advice is different. It is framed in terms of achieving very important general objectives, including “strategic positioning,”¹⁰ and providing greater transparency to outside

⁷ See Michael H. Shuman & Merrian Fuller, *Profits for Justice*, THE NATION, Jan. 24, 2005, at 13, 20–21 (challenging fellow nonprofit activists to develop other ways to generate revenue and to “try to wean ourselves from the charity habit, say by 3 percent per year. Think about just one piece of your agenda that could be framed as a revenue generator, dream about it a little, develop a business plan, and give it a try.”).

⁸ The NEW OXFORD AMERICAN DICTIONARY defines the verb “consult” as meaning “to have discussions or confer with (someone),” as in “they’ve got to consult with their board of directors.” (2d ed. 2001) (emphasis omitted). The Latin root is “consulere,” meaning “take counsel.” *Id.* (emphasis omitted). The same dictionary defines the verb “collaborate” as to “work jointly on an activity”; the root in Latin means “work together.” *Id.* (emphasis omitted).

One common understanding of nonprofit “collaboration” involves activity undertaken through joint ventures, rather than intraorganizational cooperation—but that is not the sense in which it is used throughout this discussion. For purposes of this discussion, collaborative acts involve collective assumption of responsibility for decisions; consultative acts involve actions by decision makers to seek advice or consent from others.

⁹ Peter F. Drucker, a management specialist, recognized the special place of dissent and mission orientation. He stated, “[t]oday, nonprofits understand that they need management all the more because they have no conventional bottom line. Now they need to learn how to use management so they can concentrate on their mission.” PETER F. DRUCKER & CONSTANCE ROSSUM, HOW TO ASSESS YOUR NONPROFIT ORGANIZATION, WITH PETER DRUCKER’S FIVE MOST IMPORTANT QUESTIONS: USER GUIDE FOR BOARDS, STAFF, VOLUNTEERS, AND FACILITATORS 2 (1993).

¹⁰ See, e.g., THOMAS A. McLAUGHLIN, NONPROFIT STRATEGIC POSITIONING: DECIDE WHERE TO BE, PLAN WHAT TO DO, at xviii (2006). McLaughlin states,

observers;¹¹ creating a more vibrant “culture of accountability”;¹² instituting more rigorous internal controls; and facilitating more adaptability to market conditions.¹³ With few variations, this advice often counsels the adoption of strategies for “streamlining” nonprofit governance along for-profit business principles in order to augment “corporate efficiency, and management development,” all in the name, ultimately, of service to the nonprofit mission.¹⁴

Along the way, in many cases, consultative procedures for decision making and collaborative assignments of responsibility are subtly and not so subtly being identified as impediments to accountability for strong financial performance, and as barriers to the efficient accomplishment of mission-related goals. As substitutes, hierarchical, formal, executive, and even autocratic

Strategic positioning is a streamlined approach. . . . [T]he clear distinction between the roles of the board and the executive helps prevent the confusions and misunderstandings that often accompany traditional approaches. It is a waste of time—and possibly worse—for board members to be involved in anything having to do with operations, including planning them.

Id. See also, e.g., John H. Goddeeris & Burton A. Weisbrod, *Conversion from Nonprofit to For-Profit Legal Status: Why Does It Happen and Should Anyone Care?* in *TO PROFIT OR NOT TO PROFIT: THE COMMERCIAL TRANSFORMATION OF THE NONPROFIT SECTOR* 129 (Burton A. Weisbrod ed. 1998) (explaining that conversion to for-profit structures occurs due to legal, regulatory, and constraint changes in the environment of the organization.).

¹¹ See RICHARD E. OLIVER, *WHAT IS TRANSPARENCY?* 7–8 (2004) (explaining that transparency is critical for nonprofits with regard to reputation and continued donations); see also, e.g., DAN TAPSCOTT & DAVID TICOLL, *THE NAKED CORPORATION: HOW THE AGE OF TRANSPARENCY WILL REVOLUTIONIZE BUSINESS* (2003).

¹² See George G. Brenkert, *The Need for Corporate Integrity*, in *CORPORATE INTEGRITY & ACCOUNTABILITY* 1, 9–10 (George G. Brenkert ed. 2004) (discussing the growing trend of corporate accountability and the “obvious extension” of that trend to nonprofit organizations); see also, e.g., *THE 2004 GRANT THORNTON NAT’L BOARD GOVERNANCE SURVEY FOR NOT-FOR-PROFIT ORG.* [hereinafter *GRANT THORNTON SURVEY*] (Grant Thornton, LLP, U.S. member firm of Grant Thornton Int’l), Sept. 2004, at 9, available at http://www.gt.com/staticfiles/GTCom/files/Industries/NotforProfit/Grant_Thornton_Board_Governance_Survey_2004.pdf (a survey of 700 nonprofit CEOs indicated that 24 percent had engaged their external auditor to examine their internal controls; 90 percent of those questioned indicated that their auditors had produced a management letter).

¹³ See, e.g., *GRANT THORNTON SURVEY*, *supra* note 12; Shuman & Fuller, *supra* note 7.

¹⁴ MCLAUGHLIN, *supra* note 10, at 22. McLaughlin reserves the term “collaboration” for cooperation among nonprofits, rather than within them. See *id.* at 82–88.

procedures and organizational structures largely borrowed from the for-profit business world are being identified as positive reforms and essential legal requirements in the new climate for nonprofit activity.¹⁵

Many nonprofits, of course, don't need to be counseled to change in these ways because they have never operated along especially consultative or collaborative lines.¹⁶ Nor does it seem likely that any neat pattern would emerge if nonprofits were measured by the degree to which they currently operate and govern themselves hierarchically or consultatively. Furthermore, some business models are not intrinsically anticonsultative or anticollaborative.¹⁷ But the trend I along with others observe is an across-the-board, norm-shifting change in the impetus to develop certain business-like operating practices.

If this claim is accurate, it is time to review the role of laws and legal institutions in promoting, inhibiting, or acquiescing to the anticollaborative, anticonsultative trend. Until now, the

¹⁵ At least one nonprofit relief organization has even begun holding "shareholders' meetings." Stephanie Strom, *Charity Invites Donors to 'Kick the Tires' and Squeeze the Cash Register*, N.Y. TIMES, May 26, 2006, at A14. Administrative solutions have also been advanced. See Victor B. Flatt, *Notice and Comment for Nonprofit Organizations*, 55 RUTGERS L. REV. 65, 72-79 (2002) (proposing a procedure, along the lines of the Administrative Procedure Act, to improve accountability within nonprofit organizations).

¹⁶ It is not unusual for foundations and trusts to operate on somewhat authoritarian lines, based on the founding documents of their benefactors or the advice of their agents. Within certain parts of the nonprofit sector, hierarchical structures are more common than in others. For example, among religious groups there is a wide degree of variation in the level to which voluntary organizations adopt a hierarchical or more participatory organizational structure. See, e.g., HENRY BIBB ET AL., *MAKING THE NONPROFIT SECTOR IN THE UNITED STATES* 159-203 (David C. Hammack ed. 1998) (describing the varieties of nonprofit religious groups).

¹⁷ Compare JIM COLLINS, *GOOD TO GREAT: WHY SOME COMPANIES MAKE THE LEAP . . . AND OTHERS DON'T* 13 (2001) ("When you have disciplined people, you don't need hierarchy. When you have disciplined thought, you don't need bureaucracy. When you have disciplined action, you don't need excessive controls. When you combine a culture of discipline with an ethic of entrepreneurship, you get the magical alchemy of great performance.") with Anders Porter, *Taking Care of Business in Sweden*, Nov. 17, 2006, http://www.sweden.se/templates/cs/Article___15632.aspx (discussing Swedish business practices and stating "Swedish companies tend to be less hierarchical than companies in many other countries when it comes to internal organization. This . . . eras[es] some of the chain-of-command arrangements that exist in other countries. . . . [I]t's possible for employees to take their comments, questions or concerns directly to the boss.").

ways the law accommodates and encourages such transplanted business models with new statutory proscriptions and administrative guidelines, and allows relaxed common-law interpretations of the older statutes which demote consultative values, have received little study.¹⁸ But some commentators express concern. As Paul C. Light has written, “[j]ust because the nonprofit sector needs to improve its performance does not necessarily mean it has to become more businesslike.”¹⁹

There might be no point to challenging or regretting the movement of the law as it responds to these newer imperatives. Becoming more businesslike, after all, has saved many nonprofits from the brink of financial disaster—and it builds capacity for mission accomplishment in many others.²⁰ To a considerable extent, larger social and economic conditions have forged the anticonsultative legal reformation. If becoming increasingly businesslike is a practical necessity—and if it requires relaxing the legal constraints which have imposed consultative and collaborative norms—then relaxation of these rules is the desirable response.

Equally cautionary to those who would think about restoring traditional constraints are questions about appropriate legal boundaries: perhaps matters of internal deliberative process are, and should be, irrelevant as a matter of state-ordered nonprofit law. Why should the public law care how a nonprofit accomplishes its mission through private corporate understandings, so long as the nonprofit is effective in working toward its approved goals? If only “ends” should count, then the time has come to bury the legal demand for collaboration—and to embrace the idea that consultation, collaboration, and democratic values are important only insofar as they are valuable tools in the accomplishment of a nonprofit mission.²¹

¹⁸ See *infra* Part II.

¹⁹ Paul C. Light, “Nonprofit-Like” Tongue Twister or Aspiration? 8 NONPROFIT Q., at 4, 4 (Summer 2001, issue 2), available at <http://www.nonprofitquarterly.org/section/87.html>.

²⁰ See Mike Woelflein, *Foundations of Community*, BANGORMETRO, <http://www.bangormetro.com/media/Bangor-Metro/October-2005/Foundations-of-Community/> (last visited Oct. 8, 2007) (taking an investment firm approach to organization, the Maine Community Fund weathered the recession following 9/11 and has since seen dramatic revenue increases).

²¹ States charter nonprofit organizations which establish legitimate purposes and missions under their governing laws. The Internal Revenue Service and other

On the other hand, it is possible that legal institutions should treat more seriously the claim that a great number of nonprofits, in addition to distinguishing themselves from for-profits through their formal commitment to the “nondistribution constraint,” possess distinctive associational attributes that collectively identify, enhance, and justify the special treatment they receive from courts and legislatures. It could be that these characteristics have played a crucial role in fostering deliberative discourse, creating social capital, and providing a foundation for expressive pluralism.²² Regulatory actors, legislatures, and professional groups might then establish minimal levels of consultation and collaboration through the collective assignment of fiduciary responsibilities for some or all classes of nonprofits.

If legal institutions embrace such an interventionist perspective, and this article does not conclude that they necessarily should, then reinforcement of process-oriented rules deserves further consideration, including governance reforms ranging from strengthened consultative procedures, to more rigorous legal standards to assess the process of mission performance, to compulsory constituent representation in management or board decision making. Limits could also be imposed on the wholesale adoption of for-profit management and governance models in nonprofit organizations. Functional disincentives to engaging in inconsistent for-profit activities, such as taxes on unrelated business income, or strictures against excessive compensation, could be strengthened. Restraining entrepreneurial approaches, or encouraging collaborative and consultative ones, could reinforce traditional consultative legal norms instead of jettisoning them.

The short exploration below of legal developments in nonprofit governance related to corporate advice literature, nonprofit boards, management practices, and membership rights

taxing bodies confer eligibility for tax exemption based in significant part on the extent to which the missions and purposes of the organization comply with relevant statutory provisions and enforcement agencies—particularly the office of the attorney general—and evaluate the performance of nonprofit organizations based not on collaborativeness, but rather on the relationship between their activities and their avowed purposes and missions. Few, if any, rankings or evaluations of nonprofit organizations base their findings substantially on internal processes as opposed to external results.

²² See generally SILBER, *supra* note 1.

might contribute to understanding which of these views—if either of them—might be correct.

II

THE CORPORATE ADVICE LITERATURE

It is unnecessary to dwell on whether the accountability and viability challenges mentioned above are real and significant because the literature in nonprofit studies contains ample validation.²³ Conferences devoted to these subjects are held every year.²⁴ Enforcement proceedings brought against nonprofits related to instances of financial mismanagement have become more numerous. Leaders of nonprofit organizations profess regret that they spend more and more time on the improvement of their “bottom line” than on accomplishing their missions.²⁵

It is more controversial to observe that, notwithstanding cautionary verbiage to the contrary, much of the advice that consultants provide to nonprofit boards and managers actually takes aim at collaborative and consultative traditions through its support for isolating and particularizing organizational responsibilities, creating businesslike hierarchies, and truncating collective decision making. Notwithstanding the homage that the consulting literature often pays to the need to sustain a “collaborative” culture or a “positive” working environment, true enthusiasm for consultative and collective activity is usually absent from consulting reports and guidance, because, from the point of view of addressing these accountability/viability

²³ See, e.g., Peter Swords, Conference Notes: Norman A. Sugarman Memorial Lecture, *Nonprofit Accountability: The Sector's Response to Gov't Regulation*, 25 EXEMPT ORG. TAX REV. 413 (1999), available at http://www.qual990.org/np_account.html (last visited Jan. 17, 2007) (arguing for stronger generic oversight agencies).

²⁴ See, e.g., Conference Schedule for Lyndon B. Johnson Sch. of Pub. Affairs at Univ. of Tex. (Austin), <http://www.utexas.edu/lbj/rgk/press/presentations.php> (last visited Oct. 8, 2007).

²⁵ See Lester M. Salamon & Richard O'Sullivan, *Stressed but Coping: Nonprofit Organizations and the Current Fiscal Crisis*, LISTENING POST PROJECT FINDING COMMUNIQUE NO. 2, Jan. 19, 2004, at 1, 1, available at www.jhu.edu/listeningpost/news/pdf/comm02.pdf (study finds that “American nonprofits have become, in many cases, highly entrepreneurial organizations, responding actively and creatively to new fiscal pressures. At the same time, however, the survey also makes clear that these pressures are exacting a toll.”).

challenges, consultation and collaboration are not helpful.²⁶ Considering the strong bias in our political and social culture toward open democratic discourse and the universally positive meaning ascribed to collaboration, however, it would be surprising if advisors actually went on the record to openly endorse curtailing these practices.

The newer advice literature urges directors and managerial personnel to devote greater attention to managerial accounting,²⁷ to create more “professionalized,” “financially expert” operations,²⁸ and to develop “more formal” forms of business organization. The implication is that extensive consultation intrinsically produces delay and discord. Embedded is the message that although collaboration might promote civic virtue, such virtue is not a typical nonprofit entity’s *raison d’être*; and that, on the contrary, it can in important instances diffuse and conceal responsibility (not a good thing). Effective managerial methods that emulate the best for-profit business methods for establishing accountability at the individual level, on the other hand, tend to intensify and expose inefficiencies and weak links (a very good thing).²⁹

²⁶ See, e.g., RICHARD P. CHAIT ET AL., GOVERNANCE AS LEADERSHIP: REFRAMING THE WORK OF NONPROFIT BOARDS 2 (2005) (“Historically, the stereotypical image of a nonprofit administrator was a well-intentioned ‘do-gooder,’ . . . trained as a social worker, educator, cleric, artist, or physician. . . . Yesterday’s naive nonprofit administrator or executive director has become today’s sophisticated president or CEO, titles that betray changes in the stature, perception, and professionalism of the positions.”).

²⁷ See, e.g., *Four Tips for Implementing Managerial Accounting Principles at Your Nonprofit*, NONPROFIT FISCAL FITNESS, Mar., 2005, <http://www.blackbaud.com/files/Newsletters/FiscalFitness/2005/fiscalfitnessmarch2k5.pdf>; Press Release, Open Soc’y Inst., Baltimore Nonprofits Working to Make Their Enterprises More Businesslike (Dec. 1, 2004), available at http://www.soros.org/initiatives/baltimore/news/nonprofits_20041201.

²⁸ William Foster & Gail Fine, *How Nonprofits Get Really Big*, STAN. SOC. INNOVATION. REV., Spring 2007, at 54, available at http://www.ssireview.org/images/articles/2007SP_feature_fosterfine.pdf (explaining that heightened professionalism and devotion to a culture of finance are essential elements in the quest to become big).

²⁹ See, e.g., Jeff McDonald, *Conflict over S.D. Office Puts Athletes in the Middle; Special Olympics Investigation Outrages Group’s Donors, Volunteers*, SAN DIEGO UNION-TRIB., Mar. 16, 2007, at A1 (describing an investigation of operations in which “[t]he picture emerging . . . was one of an internal struggle over the nonprofit group’s management style and business model.” Volunteers for the organization “described the investigation as a ‘turf war’ between Jackson and his superiors, especially Roxanne Thompson . . . now a chief fundraiser for Special Olympics

Empirical studies might test whether the new nonprofit culture of financial effectiveness and accountability increasingly addresses consultative activities in governance and management, however obliquely, as unaffordable, unnecessary, and even counterproductive democratic luxuries. Determining whether the number of membership organizations has in fact grown or diminished in recent years, for example, might illuminate one aspect of the phenomenon, since membership organizations are traditionally and by nature the most consultative.³⁰ Also indicative might be studies to find out whether the rights attached to membership themselves have become fewer.³¹ Tracking changes in the number of self-perpetuating organizations might also be useful, as it might reveal the unwillingness of boards to trust their members or classes of members to play a significant role in the power to determine successorship.³²

It would be interesting to discover whether the vocabulary of business missions has migrated to the nonprofit world and supplanted older and more mission-oriented vocabulary. For example, it would be useful to know whether the number of leaders who prefer to call themselves “president” or “CEO” of their nonprofit organizations, rather than, for example, “executive director,” has increased; or whether the organization’s services are routinely called “the product,” and its reputation referred to as “the franchise” or “the brand.”³³ Results of this sort might verify the trend—but the question of

Southern California. Jackson has a relaxed management style, they said, and that didn’t sit well with the more organized Thompson.”).

³⁰ See Dana Brakman Reiser, *Dismembering Civil Society: The Social Cost of Internally Undemocratic Nonprofits* 82 OR. L. REV. 829, 849–58 (2003) (noting that nonprofit organizations rely on members as being “decision-makers,” “monitors,” and “enforcers”).

³¹ Norman I. Silber, A Membership Bill of Rights (unpublished manuscript, presented in 2001 at annual conference for Ass’n for Research on Nonprofit Org. and Voluntary Action).

³² See generally ROBERT D. PUTNAM, *BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY* (2000) (creatively developing metrics to argue that a demise in “social capital” has occurred).

³³ The competencies and duties of nonprofit leaders are also often defined in terms more commonly linked to for-profit business leaders. See Shamima Ahmed, *Desired Competencies and Job Duties of Non-Profit CEOs in Relation to the Current Challenges: Through the Lens of CEOs’ Job Advertisements*, 24 J. MGMT. DEV. 913 (2005).

the real significance of the new vocabulary would even then not remain free of doubt.

The question here at hand is properly addressed not by empirical analysis of practices but through an investigation of developing legal norms. How “elastic” has the legal regime become—and how elastic should it become—in accommodating transplanted business models for governance and organization?³⁴

III

LEGAL ACCOMMODATION: THE BOARD

A nonprofit legal regime which for more than two centuries usually extolled the governance values of democratic expression, collective action, and broad principles of consultation among different constituencies might have difficulty—one would think—doing an abrupt about-face.³⁵ Nevertheless, adaptations have emerged swiftly, by way of courts, state officials, federal regulators, enforcement bodies, law revisions, and academic formulations. A few examples below illustrate that legal institutions are accommodating new attitudes toward board self-governance, management accountability, and membership involvement by relaxing several existing norms of consultation and importing different ones from for-profit guides.

A. Nondisclosure Agreements

One indicator that attitudes about consultation and sharing fiduciary responsibilities among board members are changing is the transition toward formal nondisclosure pledges and agreements. For as long as there have been boardrooms, board majorities have tried to prevent dissident directors from raising policy differences in public or bringing problems to the attention of regulatory authorities. Recently, however, the dominant majorities on some nonprofit boards have begun to ask for

³⁴ Of course, this is not the only elasticity of interest. For example, the extent to which permissible compensation includes bonuses or other incentives based on financial performance also tests the willingness of the law to relax the nondistribution constraint in the interest of models for business productivity.

³⁵ *But see supra* note 16 and accompanying text (indicating that certain nonprofit organizational traditions, especially those growing out of religious principles of organization, have involved hierarchical and nonconsultative traditions from the outset).

binding pledges not to air differences or even talk to the media about corporate affairs outside the boardroom.³⁶ In the for-profit world, particularly on large corporate boards, formal “nondisclosure” or “gag” agreements are not unusual,³⁷ and they are frequently justified as efforts to preserve proprietary information and to prevent inappropriate insider behavior.

In the nonprofit context, nondisclosure agreements or the use of “executive session” rules to curtail debates about policy and procedure depart from established norms. They shut down opportunities for public dialogue and for communication with other concerned and influential parties, including reporters. Until recent decades, and despite a longstanding emphasis by nonprofits on recruiting board members and managers who are “team players” and encouraging “closure” on contentious matters, nondisclosure agreements have been virtually unknown.³⁸ Discussions in executive sessions, where views expressed and subjects discussed are not to be divulged to

³⁶ Hewlett Packard’s boardroom soap opera received great notoriety in large part because private investigators used illegal tactics to obtain the phone records of dissident board members; less well known is the agreement Hewlett Packard directors signed which obligated them. See Douglas M. Branson, *Built to Last? Hewlett-Packard’s Problems Teach Lessons About Corporate Governance*, PITTSBURGH POST-GAZETTE, Sept. 26, 2006, at A10; see also Peter J. Howe, *Weld Lambastes T Pension Board*, BOSTON GLOBE, Feb. 28, 1992, at 72 (board votes to prevent its members from talking to reporters); *Many Knew of Tyco Bonuses, Witness Says; The Former Head of Human Resources Says Auditors Were Aware of the Disputed Payments*, L.A. TIMES, Feb. 15, 2005, at C5 (nondisclosure statements “asked” for by management from key employees who received compensation bonuses); Carolyn Said, *Corporate Directors See Risks Climbing*, S.F. CHRON., Aug. 11, 2002, at 61, 64 (practice of obtaining nondisclosure agreements in the context of mergers and acquisitions nearly universal); Julie Solomon, *Activists Fear SEC Proxy Rule*, BOSTON GLOBE, May 10, 1992, at 33 (restricted ballot initiatives on proxy statements); Dominic Jones, *Corporate Boards Should Communicate More*, IR Web Report, <http://www.irwebreport.com/daily/2006/09/11/corporate-boards-should-communicate-more/> (last visited Nov. 12, 2006).

³⁷ For example, Apple Computer Inc. is known for its closed-lips approach to market strategy. See *Daily Briefing*, ATLANTA J.-CONST., Mar. 12, 2005, at 26 (reporting on San Jose court narrowing reporters’ privilege to reveal employees who described new Apple products); Nick Wingfield, *At Apple, Secrecy Complicates Life but Maintains Buzz*, WALL ST. J., June 28, 2005, at A1.

³⁸ See, e.g., Dana Brakman Reiser, *Nonprofit Takeovers: Regulating the Market for Mission Control*, 2006 BYU L. REV. 1181, 1249 (2006) (considering insurgent friendly and incumbent friendly rules and recommending “[a]n intermediate, governance-protective standard for reviewing nonprofit takeover defenses most appropriately resolves these tensions by channeling mission change through an incremental, dialogic process.”).

anyone else, have traditionally been reserved for personnel matters and questions concerning pending or potential litigation.

In this context, the suggestion that tough nondisclosure policies would be embraced by a nonprofit membership organization devoted to the promotion of civil liberties would seem something of a bad joke. Nevertheless, the *New York Times* reported in 2006 that the board of the American Civil Liberties Union (ACLU), stung by negative publicity attendant to news interviews with some of its own board members, was proceeding to develop new policies to curb certain forms of board members' public criticism of the organization and of fellow board members. One idea that circulated among members would have discouraged criticism that would reflect negatively on the integrity of the ACLU's decision making process or the capability of its staff members.³⁹

After publication of the *New York Times* report, some donors and former board and staff members of the ACLU called for the ouster of the organization's leadership, asserting it "failed to adhere to the principles it demands of others and thus jeopardized the organization's effectiveness."⁴⁰ An attorney in the office of New York's Attorney General reportedly contacted the organization informally to ensure that nothing in any of the proposed rules discouraged the reporting of illegal activity.⁴¹

³⁹ Stephanie Strom, *A.C.L.U. May Block Criticism by Its Board*, N.Y. TIMES, May 24, 2006, at A20.

⁴⁰ Stephanie Strom, *Supporters of A.C.L.U. Call for the Ouster of Its Leaders*, N.Y. TIMES, Sept. 26, 2006, at A14; see also Wendy Kaminer, *How the ACLU Lost Its Bearings*, L.A. TIMES, July 2, 2006, at M3; Stephanie Strom, *A.C.L.U. Withdraws Proposals to Limit Public Criticism by Board Members*, N.Y. TIMES, July 12, 2006, at A16.

⁴¹ *Compare* Memorandum from Susan Herman to the NYCLU Board (2006) (on file with author) (setting forth that the NY Times report "did not mention what the committee had actually been asked to do . . . that the committee had firmly rejected the idea of imposing any sanctions on directors (like expulsion) . . . [and] that, at the end of the meeting, [the executive director] announced that the committee needed to go back to the drawing board . . .") with Memorandum from Ira Glasser to Susan Herman (2006) (on file with author) (explaining that everyone who has read those proposals—except for the nine ACLU committee members who voted for them, the Board members who defended them, and the executive committee that reviewed them five months earlier and failed to object to them—"clearly sees how they hypocritically violate fundamental ACLU free speech principles." Many argued that the reason the Board didn't vote was because a more deliberative process was required. "Then after much unfavorable publicity and donor complaints, Nadine [Strossen] called . . . and forcefully requested [the chair] to get the committee to withdraw the proposals that the Board had only a few weeks ago

Perhaps due to negative publicity about the proposals and the New York Attorney General's intervention or else because the proposals never had sufficient support to go forward, the board never voted on the proposals.⁴²

For present purposes, it is remarkable that no legal impediment would have prevented implementation of a proposed policy of board self-censorship and reprisal for information sharing had the board acted through a bylaw change to suppress dissemination of information that would reflect negatively on the decision-making process. Short of a rule preventing board members from notifying regulators that laws have been or are about to be broken, a policy preventing disclosure of internal disputes—especially policy discussions designated as confidential—does not violate any state law, or any set of applicable governance principles.⁴³ In fact, the proposed American Law Institute's Principles of Nonprofit Governance impose an affirmative obligation on the part of governing board members to maintain secrecy.⁴⁴

refused to allow a vote to reject.”). *See also* Letter from Members of the Executive Board of the ACLU to “ACLU Friends and Colleagues” (October 3, 2006) (on file with author).

⁴² *See supra* note 41.

⁴³ As a general rule, however, the duty of loyalty prevents directors and officers from profiting from transactions through secret arrangements. *See, e.g.*, N.Y. N.P.C.L. Sec. 715.

⁴⁴ *See* AM. L. INST., PRINCIPLES OF THE LAW OF NONPROFIT ORGS. § 340(b), at 311 (Tentative Draft No. 1, Nov. 1, 2007). Section 340, subsection (b) states that each member of the governing board “[m]ust preserve the confidentiality of information that the board member knows or has reason to know is confidential,” and contains an exception for a board member to disclose in good faith “to the attorney general or other regulator or to a court confidential information that he or she reasonably believes appropriate to prevent, mitigate, or remedy harm to the charity.” *Id.* The comment to subsection (b) explains that confidential information “includes details of board deliberations and opinions expressed by and votes of fellow board members.” *Id.* § 340(b) cmt. c, at 315. The confines of the duty are subject to some modification by the organizational documents, *see id.* § 305, at 47–48, and the comments to section 300 observe that while

[h]ealthy debate is good for governance[,] [a]n outvoted board member . . . should respect the confidentiality of board deliberations, and should not impede the implementation of decisions properly reached by the governing board. Once a final decision has been reached, public criticism might be permissible consistent with fiduciary duties. If disagreements are fundamental and material, a board member who is unable to support decisions of the board should consider resigning.

Id. § 300(a) cmt. f, at 32 (citations omitted). Confidential information is defined in section 340, comment c, as “nonpublic information that (or other person working or

B. Committee Charters

A second indicator that attitudes about consultation and sharing fiduciary responsibilities among board members are changing appears in the widespread enthusiasm for the formal adoption of committee charters, and the resulting impact on information flow and decision making. Governance specialists increasingly express the view that the recent “charter movement,” with its inclination to formalize and contain committee responsibilities, reflects a reasonable step toward improving the functionality of boards: an effort to increase accountability and efficiency by designating and clarifying responsibilities within governing bodies, which in the world of nonprofit corporations operate collectively.⁴⁵

The trend toward the formal adoption of committee charters has grown markedly in recent years as a result of encouragement to transplant the audit committee accountability measures legislated in the Sarbanes-Oxley Act for for-profits, and in the wake of for-profit scandals epitomized in the failures of Enron Corporation and WorldCom Corporation at the turn of the millennium.⁴⁶ Virtually all who counsel nonprofit organizations about “best practices” recommend written committee charters for audit committees, and most recommend them for most or all important committees.⁴⁷

volunteering for the organization) has been given or learned in his or her capacity as a board member.” *Id.* § 340(b) cmt. c, at 315.

⁴⁵ *But see, e.g.,* Lumen N. Mulligan, *What’s Good for the Goose is Not Good for the Gander: Sarbanes-Oxley-Style Nonprofit Reforms*, 105 MICH. L. REV. 1981 (2007).

⁴⁶ *See* Sarbanes-Oxley Act § 301 (codified at 15 U.S.C. § 78j-1 (2006)). This provision requires that the audit committee of the board of directors “shall establish procedures for—(A) the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and (B) the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.” *See also* Regina F. Burch, *Director Oversight and Monitoring: The Standard of Care and the Standard of Liability Post-Enron*, 6 WYO. L. REV. 481, 531 (2006); Richard A. Wiley, *Sarbanes-Oxley: Does It Really Apply to Non-Profit and Private Corporations?*, 50 BOSTON B. J. 10, 13 (Mar./Apr. 2006) (recommending that all sizeable nonprofits adopt “three standing Board Committees: Audit, Governance, and Compensation. Each is important and should have clear charters as to responsibilities and authority.”).

⁴⁷ *See, e.g.,* McDermott Will & Emery, *Best Practices: Nonprofit Corporate Governance*, <http://www.mwe.com/info/news/wp0604a.pdf> (last visited Sept. 16, 2007) (recommending a written audit committee charter).

Through the lens developed here, however, there are potential adverse consequences to be evaluated along with the positive gains. Have those charters which actually are being adopted served, in fact, to protect committees from interference and second-guessing? Have committee charters discouraged information from flowing from committees down to managers or sideways to other board members? Have they sanctioned a “hyperdelegation” which transcends what the laws previously allowed? Do they contribute to the tendency to concentrate legal responsibility for monitoring in fewer hands? Written charters are, in many instances, adopted by unilateral amendments to bylaws and can reduce the number of persons who are responsible for making decisions, restrict membership on committees to specialists rather than generalists, and isolate and confine responsibility. To the extent that the number of directors involved in deliberating on important issues shrinks, it is at least possible that losses from diminished deliberation could be as significant as gains in formal accountability.⁴⁸

Consider *People ex rel. v. Grasso* in which the Chairman of the New York Stock Exchange, at the time a nonprofit corporation, received in excess of \$150 million in compensation over the course of a short time period.⁴⁹ Details of the compensation package that were known to the compensation committee were unknown to members of the wider board, who testified “that they did not know about the [Supplemental Executive Retirement Plan] and if they did, they did not know what the balance was.”⁵⁰ The court characterized this as an “affirmative defense of neglect,” and declared that for “a fiduciary of any institution, profit or not-for-profit, [to] honestly admit that he was unaware of a liability of over \$100 million, or even over \$36 million, is a clear violation of the duty of care.”⁵¹ And yet for-profit corporations have adopted compensation

⁴⁸ On the other hand, the recent case of *People ex rel. Spitzer v. Grasso* suggests that courts are, at least in extreme circumstances, disinclined to accept compartmentalized responsibilities that result in violation of fiduciary duties. See *People ex rel. Spitzer v. Grasso*, No. 401620/04, Slip op., 2006 WL 3016952, at *27 (N.Y. Sup. Ct. Oct. 18, 2006), *rev'd on other grounds*, 836 N.Y.S.2d 40 (N.Y. App. Div. 2007).

⁴⁹ See *id.* at *3.

⁵⁰ *Id.* at *31.

⁵¹ *Id.*

committee charters which grant sole authority for setting compensation to members of the compensation committee, limiting the responsibility of other board members to read and depriving them of authority to review supporting materials that the compensation committee relies on.⁵² It is unclear how far nonprofit corporations will or can go to mirror such for-profit restrictions.

The debate about whether to extend Sarbanes-Oxley's requirements for identifying particular committee functions through charters and for designating financial experts has often taken place on the assumption that the disadvantage is the cost of compliance, and the advantage is better supervision and governance. But the question of whether it changes the dynamic of nonprofit collaboration in some undesirable ways needs to be considered, as well.⁵³ It is remarkable that the template for nonprofit organizations has become widespread without extended analysis of whether aspects of the movement can lead to diminished collaboration among board members, and perhaps to a reduction in the diffusion of important knowledge to larger circles.⁵⁴

⁵² See generally the McDonald's Corporation Compensation Committee Charter, available at http://www.mcdonalds.com/corp/invest/gov/board_committees/compensation_committee.html (last visited Sept. 16, 2007) (giving Compensation Committee exclusive control over executive officers' and other employees' compensation packages).

⁵³ In the for-profit context, some have resisted the application of the charters for the purposes for which they were intended. See Robert Eli Rosen, *Resistances to Reforming Corporate Governance: The Diffusion of QLCCs*, 74 *FORDHAM L. REV.* 1251, 1293 (2005) (referring to the Sherman & Stearling survey finding that "[t]he audit committees of sixty of the Top 100 companies have attempted to . . . limit the scope of the issues that audit committees will consider. They also have attempted to limit the reports that audit committees receive about compliance." The survey also states that "[f]ifteen of the Top 100 companies include in their audit committee's charter exculpatory language to the effect that it is 'not [the] audit committee's responsibility to ensure compliance with laws.'").

⁵⁴ See Dana Brakman Reiser, *Dismembering Civil Society: The Social Cost of Internally Undemocratic Nonprofits*, 82 *OR. L. REV.* 829, 830 (2003) (claiming that the state now manages and directs the market for free enterprise); Dana Brakman Reiser, *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*, 38 *U.C. DAVIS L. REV.* 205, 212-15 (2004) (identifying inadequate thought given to mission enforcement); see also Larry Cata Backer, *Surveillance and Control: Privatizing and Nationalizing Corporate Monitoring After Sarbanes-Oxley*, 2004 *MICH. ST. L. REV.* 327, 437 (2004) (suggesting principally with respect to for-profits that "the architecture of 'detect and report' so prominent in [Sarbanes-Oxley] easily fits into the sort of anti-corruption statutes that have risen to prominence in the last thirty years.").

During the drafting of the American Law Institute's Principles of Nonprofit Governance (Nonprofit Principles Project), debates about circumscribing the duties of directors exposed a divide between practitioners and academics about the virtues of extending, further than in current law, immunities resulting from the delegation and specialization of responsibilities.⁵⁵ The Nonprofit Principles Project does not address the relevance of this argument to the accelerating trend toward defining specialized board responsibilities by using committee charters.⁵⁶ The argument was pressed, however, that directors who are not assigned to particular committees or recruited onto boards for fundraising purposes should be freed from general fiduciary duties and oversight responsibilities—even if those duties involve acts as simple as reading committee reports or going to meetings.⁵⁷

C. Streamlined Governance

A third indicator that attitudes about consultation and sharing fiduciary responsibilities among board members are changing is regulatory pressure to restructure—to “downsize” or

⁵⁵ See AM. L. INST., *supra* note 44. Section 300, Fiduciary Duties, provides that “[e]ach governing-board member shall in good faith exercise the fiduciary duties of loyalty (§ 310) and care (§ 315).” The comments elaborate that “[t]he board (or committee) makes decisions as a group.” *Id.* at § 300, cmt. c(1). The draft particularly states the duty to protect information flow, but does not require consultation and collaboration. See § 320, Board Responsibilities, Functions, and Composition, which states:

(a) All powers of the charity are exercised by or under the authority of its governing board, and the activities and affairs of the charity are managed by, or under the direction and subject to the oversight of, the governing board (see § 325). The governing board must ensure that those persons who are responsible for the affairs of the charity are clearly identified. (b) Subject to any authority reserved to the charity's membership or other person, the governing board's functions normally include, but are not limited to: . . . (7) overseeing appropriate communication with the charity's constituencies and the public; and (8) establishing appropriate procedures for internal controls, including financial controls, legal compliance, and information flow to the board.

⁵⁶ *Id.* at § 320.

⁵⁷ See AM. L. INST., *supra* note 44, § 300, at 25; § 300(a) cmt. b. The Principles leave “open significant questions,” especially “what does it mean to say ‘[s]ome, but less than all, of the powers’ of the board can be assigned to a designated body?” *Id.* at xxxviii (quoting *id.* § 320 cmt. b(2)(a), at 119). Nevertheless they “endorse . . . the view that all board members should bear responsibility for governance.” *Id.* at xxxviii–xxxix.

“streamline”—advisory boards and consultation mechanisms. Advice encouraging streamlining usually emphasizes two important aspects of nonprofit governance: that most nonprofit board members are volunteers whose time and energy should be marshaled carefully; and that nonprofits must, in a market-driven economy and a crisis-oriented world, make important decisions entrepreneurially and rapidly.⁵⁸

Streamlining nonprofit governance by shortening the opportunities for discussion and for reconsideration of important questions is clearly an appropriate way for many boards to improve their operative efficiency. On the other hand, streamlining intrinsically requires the reduction or elimination of deliberative and consultative input, and sometimes amounts to a descriptive euphemism which softens the reality of changes in power relationships that are actually at the core of what the organization seeks to accomplish.⁵⁹ As environmental and consumer advocates have learned to their dismay, the streamlining of review processes is too often a vehicle for eliminating public input.⁶⁰ Likewise, in the area of nonprofit governance, streamlining may mean reducing the opportunity for board input in management decisions, or for previously involved constituencies to protect their own interests.

The Red Cross made intensive efforts to streamline its governance structure after being caught in a spotlight of intensive congressional investigation and massive publicity in the wake of its handling of relief in the 9/11 and Hurricane Katrina disasters.⁶¹ In that context, the Red Cross announced that it

⁵⁸ See CHAIT ET AL., *supra* note 26; *see also* Cornerstone Consulting Assoc., LLC, About Us: Our Clients, <http://www.cornerstoneconsultingassociates.com/clients.html> (last visited Aug. 29, 2007) (consultant helped streamline amount of time spent on planning and communication).

⁵⁹ One scholar of linguistic uses, in fact, defines “streamline” as a euphemism for “fire,” “release,” “downsize,” and “lay off.” Scott Alkire, *Introducing Euphemisms to Language Learners*, INTERNET TESL J., Vol. VIII, No. 5, May 2002, *available at* <http://iteslj.org/Lessons/Alkire-Euphemisms.html>; *see also* Dustin Solberg, *What a Difference a Citizen Can Make, ‘Proposal 121’ Rallies Bay Fishing Community*, BRISTOL BAY TIMES, Dec. 14, 2005, *available at* http://www.renewableresourcescoalition.org/news_updates3.htm (streamlining of environmental clearance process is a way to reduce or eliminate public input).

⁶⁰ Solberg, *supra* note 59.

⁶¹ *See* Robert A. Katz, *A Pig in a Python: How the Charitable Response to September 11 Overwhelmed the Law of Disaster Relief*, 36 IND. L. REV. 251, 302–19 (2003); AM. RED CROSS, REP. FOR THE BD. OF GOVERNORS (2006),

would streamline its board and create a more efficient operating structure.⁶² Its plans included cutting back sharply the “size and management role” of its fifty-member board, all under the approval of Congress, which had imposed the current board structure through amendments in 1947 to a subsequent charter.⁶³ The proposed changes were to shrink the board to between twelve and twenty members.⁶⁴ In addition, the chairman would no longer have been its “principal officer,” and instead would have been designated its CEO.⁶⁵

According to *The New York Times*, the interim president concluded that the Red Cross had “a board designed and set up by guiding principles from a time that is no longer relevant. . . . We need to take the board, its design, conventions and operating mechanisms, and bring that board up to today’s expectations.”⁶⁶ The redistribution of resources, conflicts between smaller and larger chapters, and executive-level politics were also said to play a role in the decision to undertake restructuring.⁶⁷

The Red Cross consultant on governance, Ira Milstein, assessed its problem as too much consultation with advisory “cabinet secretaries” and too much interference from parochial interests; he referred to the existing board as “meddlesome, overly influenced by the 35 members elected by local chapters and too big to move quickly and efficiently.”⁶⁸ The proposal gave the board greater authority to pick its own members by having a board committee nominate candidates, who would then be elected by delegates to the annual meeting.⁶⁹ This was not enough reform for William Josephson, the former head of the

http://www.redcross.org/static/file_cont5765_lang0_2202.pdf (noting Hurricane Katrina’s effect on the Red Cross and its impact on the organization’s decision to reorganize and streamline its governance).

⁶² Stephanie Strom, *Red Cross to Streamline Board’s Management Role*, N.Y. TIMES, Oct. 31, 2006, at A16 [hereinafter Strom, *Red Cross*].

⁶³ *Id.*; see also Am. Red Cross, Federal Charter of the Am. Red Cross, <http://www.redcross.org/museum/history/charter.asp> (last visited Aug. 29, 2007) [hereinafter Am. Red Cross Charter].

⁶⁴ Strom, *Red Cross*, *supra* note 62.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ See Jacqueline L. Salmon, *Chapter Overhaul Adds to Red Cross Turmoil*, WASH. POST, June 27, 2006, at A12.

⁶⁸ Strom, *Red Cross*, *supra* note 62.

⁶⁹ *Id.*

charities bureau in the New York Attorney General's Office, who said that the power of the chapters would be too great, and "obviously not consistent with good governance."⁷⁰

In May 2007, the final adoption of several amendments to the Red Cross Charter substantially reduced the amount of consultation required for the Board to approve major decisions.⁷¹ Whether the reorganization of the Red Cross will prove to be a significant gain for the organization will become clearer over the course of the next several years.

The Red Cross reorganization process presented unusual difficulties because it was directly in the public spotlight and because it was chartered federally, and therefore its streamlining involved more intense scrutiny than otherwise; but the membership corporation rules in most states neither prohibit curtailing consultative governance relationships contained in bylaws, nor establish minimal procedural rules, nor facilitate challenges to fundamental restructurings by private parties. Except where nonprofit organizations choose to tie their own hands by inserting restrictive language in charters and bylaws to insure constituent input into the modification of customary consultative practices, state law and administrative agency practices tolerate near-complete control by board majorities over consultative procedures, and few have voiced concern over this approach. Neither the Internal Revenue Service nor state attorneys general nor statutory rules governing the formation or modification of governing instruments meaningfully restrict the downsizing of boards or the elimination of consultative groups.

With respect to nonmembership organizations, and outside the context of nonprofit governmental bodies, perhaps the only rule that would bear on the decision of a self-perpetuating group to eliminate advisory bodies might be a decision to reduce the size of a board to not less than three persons.⁷²

⁷⁰ *Id.*

⁷¹ See Am. Red Cross Charter, *supra* note 63; Press Release, Red Cross, Red Cross Board Votes to Transform Governance, (Oct. 30, 2006), available at http://www.redcross.org/pressrelease/0,1077,0_314_5751,00.html.

⁷² Cf. Revised Model Nonprofit Corp. Act § 8.03 (1987). The Act requires that the board of directors "must consist of three or more individuals, with the number specified in or fixed in accordance with the articles or bylaws."

TABLE 1
ANTICONSULTATIVE TRENDS IN THE BOARDROOM

Indicator	Example	Authorization
Nondisclosure agreements and executive policies diminish policy debates	ACLU	Bylaw modifications, board policy handbooks, and director pledges
Formal charters are capable of compartmentalizing authority	NYSE	Compensation committee procedures and consultant reports
Streamlined governance reduces consultation with advisory bodies	Red Cross	Senatorial investigation and bylaw amendments

IV

LEGAL ACCOMMODATION: MANAGEMENT PRACTICES

The new flexibility required of nonprofits—they must be “fast acting,” “responsive to change,” and “easily adaptable”—has also fostered its own set of imperatives insofar as employment and organizational structure are concerned. In some areas of activity, for example, it is no longer advisable or even possible to keep a significant number of professional staff employed with long-term employment contracts. Preexisting bylaws, governing instruments, and standards of professional conduct sometimes stand in the way of adaptability.

A. Compensation

One indicator that management practices are changing at the expense of traditional nonprofit employment models is the changing approach toward compensating nonprofit employees. An earlier section of this article alluded to the approaches boards use to determine the compensation of executive

directors, including the emulation by nonprofit board compensation committees of for-profit procedures and compensation metrics.

Beneath the executive level, nonprofit managers are increasingly inclined to jettison older principles of compensation, which tempered relative accomplishment with egalitarian impulses and therefore deemphasized bonuses. Approximately 25 percent of nonprofit organizations “offer their key managers the opportunity to earn cash compensation awards in addition to their base salaries.”⁷³ Most of these programs are based on incentives tied to performance measures.⁷⁴

Some compensation schemes provide incentives that reward team accomplishments, but as a general matter group collaboration and collective responsibility for decision making make it more difficult for managers to assess individual merit entitlements. In step with this trend toward more targeted performance incentives, IRS rules and tax court opinions accommodate end-of-the-year performance-based bonuses and other forms of incentive pay that were previously unusual in the nonprofit sector.⁷⁵

B. Employment Security

Employment security policies provide another indicator that management practices are changing at the expense of traditional nonprofit employment models. Courts have also been deferential when nonprofit managers decide to restructure poorly performing operating units by dismissing employees, even when professional staff members lose their positions. Whereas only a few decades ago professional staff in nonprofit organizations received increasing protection under labor laws and under broad interpretations of nonprofit governing

⁷³ James E. Rocco, *Making Incentive Compensation Plans Work in Non-Profit Organizations*, THE DEV. RES. GROUP, <http://www.drgnyc.com/tips/incentive.html> (last visited June 20, 2007).

⁷⁴ *See id.*

⁷⁵ I.R.S. Priv. Ltr. Rule 200601030 (Jan. 6, 2006) (public nonprofit corporation’s long-term incentive bonus program for its senior managers was found to be consistent with Internal Revenue Code section 501(c)(3) and would not prevent the organization from operating exclusively for tax-exempt purposes or otherwise jeopardize its tax-exempt status).

instruments and policy handbooks,⁷⁶ that picture has changed. In *Major v. Memorial Hospitals Ass'n*,⁷⁷ for example, the court upheld a hospital's decision to change its anesthesiology department from its traditionally "open" staff system to a newer "closed" system that "contracted out" the work using an exclusive provider. Because the decision was deemed "administrative" and not "adjudicative," and was motivated by the overall problems associated with the operation of the department, the court determined that the plaintiffs were not entitled to due process in accordance with the medical staff bylaws prior to termination of their medical staff privileges.⁷⁸ Such judicial interpretations of bylaw restrictions which favor wider managerial discretion and greater executive power at the expense of professional autonomy reflect judicial sympathy with the contemporary emphasis on advancing the accountability and financial viability discussed earlier.

C. Mission Drift

Mission drift is another indicator that management practices are changing. Entrepreneurial activity has been on the rise, fueled by financial stress. Financially profitable activities, however, are not necessarily at the core of an organization's mission.⁷⁹ On occasion, nonprofits are reported to have chosen to devote key resources to colorably related activities in order to

⁷⁶ See Kristin Hay O'Neal, Note, *NLRB v. Health Care & Retirement Corporation of America: Possible Implications for Supervisory Status Analysis of Professionals Under the National Labor Relations Act*, 47 BAYLOR L. REV. 841, 845 n.15 (1995); David M. Rabban, *Distinguishing Excluded Managers from Covered Professionals Under the NLRA*, 89 COLUM. L. REV. 1775, 1805 n.127, 1856-58 (1989) (observing that the National Labor Relations Board reversed its position on protection for nonprofit professional employees to include them, emphasizing "the difficulty of distinguishing commercial from noncommercial activity," and "the growing congressional sentiment that employees in the nonprofit sector deserve the same protection as other workers."). NLRA amendments in 1974 extended nonprofit healthcare workers protection under the Act.

⁷⁷ *Major v. Mem'l Hosp. Ass'n*, 84 Cal. Rptr. 2d 510, 530 (Cal. Ct. App. 1999).

⁷⁸ *Id.* at 530-32.

⁷⁹ Salamon & O'Sullivan, *supra* note 25, at 4-5 (stating "dramatically, 84 percent of the organizations reported increasing their attention to commercial sources of support, including expanded marketing and increased or expanded fee-for-service activities." Eleven percent of nonprofit elderly and housing services groups studied, 7 percent of child and family services groups, and 12 percent of economic development groups had started a profit-making subsidiary in 2003 alone.)

grow or obtain financial stability, rather than to try to accomplish purposes more essentially related to the ones for which their founders created them, for which volunteers and most donors contributed their time and money, and for which the state originally chartered them. Surveys indicate, for example, that theaters and museums have “scaled back the artistic content of their programming,” and shifted to “a more ‘commercially appealing’ season;” hospitals have invested millions to develop health spas and gyms.”⁸⁰

It may appear that the problem of “mission creep” or “mission drift” is not one that implicates collaboration or consultation, that it is only an effort to find profitable opportunity somewhere within the scope of the mission of a charity. To the extent that exploiting economic opportunity costs even when the exploitation requires revision of missions and donor intentions, however, conflicts between managers and affected constituencies are about involvement in decision making. Often contemporary conflicts over “donor control” and “cy pres” amount to conflicts about the extent to which donors and grantors should be consulted by nonprofit managers.⁸¹

⁸⁰ *Id.* at 8; see also Curt Bailey & Karla Martin, *Getting to “No”: How Nonprofit Organizations Can Stretch Their Limited Resources by Focusing on Priorities and Avoiding Mission Creep*, LEADING IDEAS, Nov. 14, 2006, at 1, 2, available at <http://www.strategy-business.com/li/leadingideas/li00002> (claiming that “[f]rontline managers begin to see the head office not as a source of support, but as a bureaucracy that issues endless and often conflicting directives, which they must work around and even ignore to get something accomplished.”).

⁸¹ See *Smithers v. St. Luke’s-Roosevelt Hosp. Ctr.*, 723 N.Y.S.2d 426, 433–34 (N.Y. App. Div. 2001); *In re Milton Hershey Sch.*, 867 A.2d 674, 689–91 (Pa. Commw. Ct. 2005); see also Robert A. Katz, *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, 695–98 (2005).

TABLE 2
MANAGEMENT PRACTICE INDICATORS

INDICATOR	EXAMPLE	LEGAL AUTHORITY
Compensation	Year-end bonuses	IRS letter rulings
Employment security	Contracting out	Reinterpretation of bylaws
Mission drift	Pursuing profitable activities with marginal mission value	Common-law administrative decision doctrines

V

LEGAL ACCOMMODATION: MEMBERSHIP RIGHTS

A. Optionality

In a perceptive article titled *Dismembering Civil Society: The Social Cost of Internally Undemocratic Nonprofits*,⁸² Dana Brakman Reiser argues that a failure of nonprofit corporation laws to encourage the use of the membership form of nonprofit organization, on one hand, and an emphasis on financial accountability, on the other hand, has impoverished civil society and diminished “social capital”:

[The] focus on accountability ignores the nonprofit sector’s role in constructing and maintaining civil society. . . . Theorists who have examined civil society argue that participation in these institutions enhances our political democracy in two ways. It offers opportunities for participants to build norms of reciprocity and cooperation—also called social capital.⁸³

Professor Reiser provides several illustrations of the developing legal regime’s blindness to the value of democratic internal governance in nonprofit organizations to civil discourse in

⁸² Reiser, *supra* note 30.

⁸³ *Id.* at 830–31 (footnotes omitted).

democratic society.⁸⁴ In particular, she singles out the choice given to incorporators to decide whether to organize as membership or nonmembership corporations (“optionality,” in her vocabulary).⁸⁵ In every state and in the Revised Model Nonprofit Corporation Act, there is no need for organizations of any sort to organize as membership organizations if they don’t wish to.⁸⁶ Other political theorists, tracing back at least to Talcott Parsons and Robert Dahl, have argued that political democracy is enhanced by teaching civic skills.⁸⁷ These skills are arguably better honed in more consultative organizations.

Accepting Reiser’s fundamental point about the civic virtues inherent to the values she identifies with her version of membership, there nevertheless is not very much to recommend membership over nonmembership organizations under the legal regimes that currently apply to membership organizations. Without plunging into a debate about trends in social capital—however it is defined and measured—it seems that the values of social discourse and many other civic virtues adhere to most types of nonprofit form aside from the membership form.

The point deserves to be pressed considerably further. Most of the factors that Reiser identifies as those leading counselors to advise incorporators to choose the nonmembership rather than the membership form are not really factors that weigh against democracy as such. Nonprofit organizers and managers are trying to avoid, with increasing frequency, the collaborative and consultative aspects of nonprofit governance which are tied to membership and nonmembership corporations alike, but which historically have been harder to avoid in membership organizations.

The virtues of consultative and collaborative forms flow from the same inefficiencies that account for their costs. As Reiser observes in connection with membership groups:

[T]he costs of such a democratic internal governance structure are substantial and definite. These include, *inter alia*, the

⁸⁴ *Id.* at 831.

⁸⁵ *Id.*

⁸⁶ See Model Nonprofit Corporation Act, Ch. 7, Sub-Ch. B (Proposed 2006).

⁸⁷ See generally ROBERT A. DAHL, *DILEMMAS OF PLURALIST DEMOCRACY* (1982); ROBERT A. DAHL & CHARLES E. LINDBLOOM, *POLICIES, ECONOMICS, AND WELFARE* (Univ. Chi. Press 1976) (1953); MANCUR OLSON, JR., *THE LOGIC OF COLLECTIVE ACTION* (1965).

administrative costs of identifying members, maintaining current membership lists, holding meetings, obtaining a quorum for such meetings and the required majorities necessary to elect directors and pass other measures, and providing materials necessary to inform membership voting. Further, a voting membership structure imposes costs on transactions by forcing both a board and a membership decision on certain significant corporate actions—typically, amendments of the articles of incorporation, merger, sale of all or substantially all assets, and dissolution. These costs can be avoided entirely through use of a self-perpetuating board.⁸⁸

While the above costs can be avoided entirely through use of a self-perpetuating board and a nonmembership form, there are many other costs, risks, and benefits attached to collaboration and consultation that will adhere regardless of the membership/nonmembership distinction. From this perspective, the question is not about the membership form per se, but about the degree to which collaborative and consultative modes of operation have diminished across every organizational form.

B. Election Procedures and Membership Standing

Ironically, case law suggests that, in many states, membership corporations do not need to incur even the relatively modest costs of democracy that Reiser suggests. A principal reason is that nonprofit standing to contest antidemocratic processes has been restricted quite severely in comparison to for-profits.⁸⁹ Courts have displayed a broad deference to the actions taken by incumbent boards of membership corporations when they evaluate the permissible efforts that can be taken to insulate incumbent candidates and allow self-perpetuation of boards through restrictive bylaw provisions, unwritten campaign rules, nondisclosure, and even the expenditure of substantial organizational money.

Olson v. Automobile Club of Southern California offers a dramatic illustration.⁹⁰ In *Olson*, challengers ran for the club's

⁸⁸ Reiser, *supra* note 30, at 864 (footnotes omitted).

⁸⁹ See Russell v. Yale Univ., 737 A.2d 941, 946 (Conn. App. Ct. 1999) (Yale alumni membership denied standing); Mary Grace Blasko et al., *Standing to Sue in the Charitable Sector*, 28 U.S.F. L. REV. 37, 52–59 (1993). But see *In re Milton Hershey Sch.*, 867 A.2d 674, 689–691 (members of alumni association granted standing to contest board settlement agreement based on special interest).

⁹⁰ *Olson v. Auto. Club of S. Cal.*, 44 Cal. Rptr. 3d 1 (Cal. Ct. App. 2006) (certified for partial publication). For full opinion see *Olson v. Auto. Club of S. Cal.*, No.

board of directors, advocating, inter alia, greater regard for mass transit issues.⁹¹ After the club spent \$6 million of club funds to defeat them, the challengers sued to overturn the election and limit campaign spending to reasonable and proportionate amounts in relation to the amount spent by the petition nominees, and to require that opposition campaign statements and biographies be included in club proxy solicitations. The trial court decided that these arguments were meritless, because they were inconsistent with the statutory scheme. The court gave credence to a defense expert who testified that California's Nonprofit Mutual Benefit Corporation Code actually discouraged elections in routine situations, and it was persuaded that members do not join the club to get involved in political controversies and elections, and that artificial stimulation of elections is a distraction to management.⁹² Shortly after the opinion, the club asked its members to eliminate the election of directors entirely. Thus, as *Olson* demonstrates, common law and statutory protections, even for members of membership and mutual benefit organizations, have proven to be adjustable in light of the anticonsultative trends in favor in recent years.

B168730, *1 (Cal. Ct. App. 2006), California Courts website, www.courtinfo.ca.gov/opinions/revpub/B168730.DOC (Order of the Court, describing both Olson's original prayer for relief, as well as additional requests brought forth on appeal) [hereinafter *Olson* full opinion].

⁹¹ See *Olson* full opinion, at *2.

⁹² See *id.* at *15.

TABLE 3
MEMBERSHIP INDICATORS

INDICATOR	EXAMPLE	LEGAL AUTHORITY
Compensation	Year-end bonuses	IRS letter rulings
Employment security	Contracting out	Reinterpretation of bylaws
Mission drift	Pursuing profitable activities with marginal mission value	Common-law administrative decision doctrines

VI

MEANS AND ENDS IN NONPROFIT GOVERNANCE

Growing up, many of us developed an instinct that collaboration was usually a good thing. Perhaps because we were almost never in a position of power or authority as young people, we resisted autocratic, top-down approaches in education and family life. We wanted our opinions—however well informed by knowledge or experience—to count. We wanted our voices to be heard. At school, the word “collaboration” was often used synonymously with “teamwork,” and consultation with others was almost always highly encouraged—except, of course, when multiple-choice tests were administered.⁹³

With respect to the use of processes for deliberation in governance, we acquired the view that collaboration by different groups with common interests was a necessary but insufficient component for successful reform in democracies. Collaborative and consultative impulses usually received endorsement in the political science and historical literature we were assigned, as

⁹³ See, e.g., Colette Daiute & Bridget Dalton, *Collaboration Between Children Learning to Write: Can Novices Be Masters?* 10 COGNITION & INSTRUCTION 281–333 (1993).

well. This literature typically associated these processes with freedom, freedom with democracy, and democracy with legitimate and relatively more effective and honest government.

Collaboration today is still offered inside and outside of business as a method designed to improve creativity without regard to any democratic or legitimacy-increasing imperatives. The legendary origins tales of Silicon Valley all pay homage to the collaborative impulse as well as to the value of the open exchange of information. Intrinsically undemocratic institutions often insist on collaborative and consultative processes within the context of command and control authority structures. The Army—which is about as top-down an institution as one might imagine—praises collaboration as an important aspect of developing successful tactics and strategy, and also as a method for sustaining morale.

Among the theories offered to explain why collaborative and consultative processes are important to the accomplishment of mission-related goals and objectives are included these four: (1) that superior supervision and added intelligence result from consultative discourse because these processes demand increased attention to the desirability of the course of conduct advocated; (2) that collaboration incorporates an adversary contest in which intellectual combat and truth testing increases the probability of correct answers; (3) that providing stakeholders with a voice in the operation of an organization instills a sense of responsibility and leads parties to identify with the future success of initiatives which have been the object of an investment; and (4) that the invocation of a communal will actually improves the reception afforded to corporate activity.

But all of these virtues ought to be weighed against the drawbacks. Preserving traditions of consultation and collaboration can cost more than they are worth in time and money. As with the case of the American political deliberative process, it is difficult to agree about how much process is necessary or sufficient. Collaboration and consultation requirements can also: (1) lead to gaming the system through roadblocks and deadlocks; (2) lead to equivocation and compromise when bold and decisive action is called for; (3) make it more difficult to maintain confidentiality when multiple parties are involved in decision making; (4) undermine important interests in cohesion and in the projection of a

common corporate devotion to purpose; and (5) diffuse responsibility for poor choices. Perhaps there is a negative relationship between collective forms of governance and accountability which ought not be dismissed.

The traditional literature about the importance of collaboration to nonprofit corporate governance asserts either explicitly or implicitly that, notwithstanding their drawbacks, they would in the long run generate results preferable to those eventuating from what might be called the antithesis of collaboration—namely, authoritarian and autocratic executive decision making. The traditional claim has been that collective and collaborative approaches usually serve organizations and the collective public interest better than does control and decision making exercised by powerful individuals or small groups that make decisions in the absence of consultation with group constituencies, that choose their own successors, and that take actions without the need either to explain or listen to others.

As indicated, the more recent business consultancy literature proceeds from an opposite assumption. Whether or not it is “politically correct” or expedient to operate along democratically consultative lines, this literature insists that in the new climate, nonprofit organizations that reject business accountability and hierarchical models do so at their peril. It may be that the legal convergence of nonprofit and for-profit governance structure and style is the inevitable consequence of the economic convergence of nonprofit and for-profit activity.⁹⁴ The response of courts, legislatures, and private lawmaking projects appears thus far largely to have heeded this business consultancy counsel, with relatively little resistance from the organized nonprofit community.

At least one observer has argued that the unwillingness of the sector to rise to its own defense can be attributed, in addition to financial and accountability challenges, to the failure to identify essential valued aspects of the nonprofit culture: “[I]n an era where being businesslike is the great American ideal, the

⁹⁴ Evelyn Brody, *Agents Without Principals: The Economic Convergence of the Nonprofit and For-Profit Organizational Forms*, 40 N.Y.L. SCH. L. REV. 457, 535–36 (1996) (stating that the legal and economic differences between nonprofit and for-profit organizations are “more of a degree than of kind,” but that the two types of organizations should not necessarily be legally treated the same “based solely on the implications from economics”).

nonprofit sector has been unable or unwilling to mount a stirring call to nonprofit-ness—let alone develop a rigorous model of what being nonprofit-like might mean.”⁹⁵ Without further empirical work, it is not possible to evaluate this sort of response and determine whether the nonprofit legal regime, or particular parts of it, should fortify consultative and collaborative standards and resist recent developments.

Broader questions also deserve more attention. Is success in meeting the accountability and viability challenges at the individual level weakening long-term welfare at the collective level? At what point will the distinctions between nonprofit and for-profit operations cease to be significant enough to justify the privileges, benefits, and esteem that the legal and political system afford?

At the intersection of legal structure and political theory, even if there proves to be no genuine concern about the impact of legal trends on the collective welfare of the nonprofit sector, there may still be an unfortunate relationship between the demise of traditional governance rules and democracy and social capital. Under these circumstances, retaining and reinforcing traditional collaborative values still should have a greater priority.

The task ahead is to determine the extent to which nonprofit law should continue to encourage nonprofits to adopt for-profit governance and management practices. If the proliferation of hybrid corporate forms in recent years is any indication, it may be that *more* differentiation among the choices for incorporation (and the legal privileges and duties attached), rather than *less*, will be desirable.⁹⁶

As they evaluate the changes discussed above, courts and legislatures would do well to factor in those core values that have supported the special treatment nonprofits continue, somewhat precariously, to receive.

⁹⁵ Light, *supra* note 19.

⁹⁶ See Brody, *supra* note 94, at 535 (offering an explanation for convergence). *But see* Evelyn Brody, Book Note, *The Twilight of Organizational Form for Charity: Musings on Norman Silber*, A Corporate Form of Freedom: The Emergence of the Modern Nonprofit Sector, 30 HOFSTRA L. REV. 1261, 1267 (2002) (resisting proposals that would differentiate legal standards based on the type of charitable activity).

