Nonprofit Pluralism and the Public Trust: Constructing a Transparent Accountable, and Culturally Competent Board Governance Paradigm

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Nonprofit Pluralism and the Public Trust: Constructing a Transparent, Accountable, and Culturally Competent Board Governance Paradigm

Faith Rivers James*

In recent years, the nonprofit sector has come under scrutiny for failings of governance that present themselves in the form of policy controversies and operational scandals. Notwithstanding the altruistic nature of nonprofit organizations, too often, there is a gulf between good intentions and good governance. This article suggests that nonprofits should follow the example of the for-profit corporate sector and employ demographic diversity as a strategy to achieve better corporate governance. Demographic data indicates that the majority of nonprofit boards are significantly exclusionary in their constitution and governance. The lack of diversity can impair a nonprofit board’s efforts to be effective, inclusive, and pluralistic organizations. Nonprofits that employ diversity in governance are better positioned to maintain obedience to the organizational mission. Diverse governance enables a nonprofit board to employ better decision-making processes, and enables boards to define and achieve goals in a culturally competent, more efficient manner. In the spirit of democratic pluralism, nonprofit organizations and foundations should disclose board demographic composition as a strategy to achieve more transparent and accountable leadership. Modeling government-led efforts to disclose board demographic diversity, the sector can establish a paradigm for diverse governance that yields better nonprofit organizational performance.

I. Introduction .................................................................................................... 95
II. State of Nonprofit Diversity .......................................................................... 97
   A. Independent Sector ............................................................................ 97
   B. Accountability .................................................................................... 99
      1. Regulatory Strategies .................................................................. 99

* Professor, Elon University School of Law. J.D., Harvard Law School; A.B., Dartmouth College. The author would like to thank law faculty who attended presentations of this paper at the Southeastern Law Scholars Conference, the Southeast-Southwest and Midwest People of Color Legal Scholarship Conference, and the Lutie A. Lyrle Black Women Law Faculty Workshop for the many constructive and thoughtful comments on earlier versions of this article. For research assistance, the author extends thanks to Tiffany Dyson, Meredith Thompson, and Julie Goldfarb for their invaluable efforts. This article is dedicated to the memory of Joseph N. Shine, William A. Ruth and Claude M. Scarborough, all exemplary lawyer-leaders who embraced diversity and excellence in charitable board service.
Nonprofit Pluralism and the Public Trust

2. Fiduciary Duties and the Public Trust .............................................. 100
C. Board Diversity ................................................................................ 105
1. For-Profit Board Diversity ........................................................ 105
2. Nonprofit Sector Board Diversity ............................................... 107

III. Board Diversity and Governance ......................................................... 114
A. The Business Case for Diversity: Groupthink and Governance ..... 114
B. Nonprofit Corporation Diversity and Governance .................. 119

IV. Modeling Diverse Governance .................................................................. 126
A. Legal Services Corporation: A Cultural Competent Board
   Model ............................................................................................ 126
B. Transparent Diversity Disclosure: Learning from the SEC ............. 132
C. A Diverse Governance Paradigm for the Nonprofit Sector .......... 136

I. INTRODUCTION

Nonprofit organizations constitute a significant sector of the United States economy. Ranging from private foundations to public charities, the nonprofit sector constitutes 5.2% of gross domestic product. While hospitals and universities hold 22.4% of all nonprofit assets, the sheer number of nonprofits reflects a wide array of charitable causes, including over 900,000 traditional “relief of the poor” charitable activities in the Elizabethan sense. Despite the social significance and economic impact of the nonprofit sector, nonprofits operate in a fairly independent manner, outside of heavy government control. This huge yet “independent sector” essentially monitors itself, with governance limited to directors who typically volunteer to serve in leadership capacities.

From the Madoff Ponzi scam which led to the loss of billions swindled from poorly monitored charitable investment portfolios, to nonprofit providers publicly derided for being out of sync with the service needs of their clients, the need for a governance paradigm that is transparent and culturally competent is apparent. This paradigm would require a board makeup that includes representation from a variety of demographic, cultural, and experiential backgrounds.

The Wisconsin Board Diversity Act, the model for a culturally competent board, is a statute aimed at increasing diversity on nonprofit boards of directors. The act requires public nonprofits to report on the race, gender, age, geographic area, and legal representation of their directors. The act also requires that all boards of directors have a diversity plan, that the board consider diversity in the recruitment process, and that any director who has served for more than three years must be re-considered for re-election.

In conclusion, the Wisconsin Board Diversity Act provides a model for nonprofits to consider in their governance. By addressing the problem of board diversity, nonprofits can increase their effectiveness and accountability, and improve their ability to serve the communities they are intended to serve.
communities, poor governance has contributed to the perception that the independent sector should improve the governance model. Prof. James Fishman has argued for higher fiduciary standards for nonprofit corporations which exceed standards for for-profit corporations. Fishman argues that the “special public purposes and public trust” that nonprofit organizations serve require higher fiduciary standards because the organizations steward assets dedicated to the common benefit.

Governing a nonprofit organization requires that directors uphold this public trust in a manner that is accountable and culturally competent. Those who lead nonprofit organizations should embrace diversity and include members of various backgrounds (gender, race, ethnicity, and income) on their boards of directors. Demographically reflective leadership equips a board to avert the shortcomings of homogeneity and evolve into better decision teams that have diversity of thought and experience. With diverse governance, women and minorities will share a fair opportunity to protect, distribute, and serve charitable assets and philanthropic investments. Diverse governance provides an additional level of accountability that evades government regulators who monitor independent nonprofits from a distance. Participation by demographically diverse directors enhances a nonprofit’s ability to make sound, culturally competent decisions. As the primary consumers of nonprofit services, clients deserve a voice as board members who set the strategic direction of organizations which they rely upon for basic human services and community investments. A diverse governance parody is an essential element for a truly pluralistic nonprofit sector.

Notwithstanding the charitable or philanthropic nature of nonprofit organizations, the sector has failed to lead in the area of diverse governance. Statistical data indicates that women and minorities are under-represented on a significant portion of public nonprofit and private foundation boards. The lack of diversity has broad implications for board governance and organizational mission.

Recently, the tension between good intentions and good governance

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8. James Fishman, The Development of Nonprofit Corporation Law and an Agenda for Reform, 34 EMORY L.J. 617, 676 (1985) (noting “the special public purposes and public trust of the nonprofit corporation, the nature of the nonprofit board, and the inadequacy of internal control and enforcement.”).

9. See discussion in Section IV: Modeling Diverse Governance, infra.

Nonprofit Pluralism and the Public Trust

exploded in California during a battle between nonprofit diversity proponents and the philanthropic community over A.B. 624. While that legislative battle subsided, debates over the meaning of democratic corporate governance and pluralism in charitable work and philanthropy continue to rage in civil, yet tense, disagreements between philanthropic associations, nonprofits, and policymakers.

This Article argues that philanthropic funders and government regulators should promote more accountable self-regulation by establishing transparent board composition requirements and reporting. Public disclosure will enable funders, contributors, and the tax-paying public to assess the demographic diversity of an organization’s leadership. Moreover, to the extent that nonprofit organizations receive direct government grants or subsidies through tax credits, government should institute board composition and reporting requirements. Transparent diversity and disclosure requirements will help institute this important layer of accountability and can lead to more effective use of government resources. Modeling government grant programs, such as the Legal Services Corporation, and government subsidies offered through the New Market Tax Credits, this Article suggests that government regulators utilize board composition requirements as a strategy to ensure that taxpayer-funded support is invested in culturally competent nonprofit organizations that are effectively governed in a diversely accountable manner. Diverse governance will enable nonprofit organizations to better maintain the public trust commended to the sector.

II. STATE OF NONPROFIT DIVERSITY

A. Independent Sector

In 2009, the independent sector employed 13.5 million people, rivaling the number of people employed in the finance industry. As a matter of public policy, the United States government has endorsed the development of the nonprofit sector by providing a subsidy—foregoing tax revenues that would be


generated by these same organizations if they operated in the for-profit arena. Annually, the U.S. Treasury attributes more than $36.5 billion\textsuperscript{15} in revenues forgone (described as either tax expenditures or tax subsidies) to the nonprofit sector. Government administrative agencies utilize nonprofit organizations to deliver services through government grant funding. Annually, $25 billion\textsuperscript{16} is distributed to nonprofit organizations for activities ranging from scientific research to health services and legal assistance for the poor. To the extent that nonprofits help to relieve the burdens of government, the tax exempt subsidy brings a return on investment that can only be assessed in services and preventive measures, rather than revenues that add to the Treasury’s “bottom line.” As Prof. Henry Hansmann described, the limiting and defining characteristic of a nonprofit is the “nondistribution constraint.”\textsuperscript{17} Accordingly, boards of directors are not allowed to draw profits out of a nonprofit enterprise as a for-profit corporation would do with shareholders. Rather than shareholders, nonprofits have a variety of stakeholders that have an investment in these organizations’ performance. Donors, board members, staff, and clients are impacted by nonprofit organizational performance. These stakeholders share control of a large sector of the economy with the American public who authorize or subsidize nonprofit operations.

The public holds high expectations for the nonprofit sector as a source of trustworthy services and new solutions for societal challenges. In some respects, the tax subsidy investment empowers the sector to function as a “venture capital” industry, leading the investment in new ideas and programs that might not be undertaken by the private sector or that could be judged too risky or inappropriate for government to take on. Nonprofits are particularly sought after for services in areas where the recipients of services are not capable of monitoring performance. In such instances of “contract failure,” Hansmann opines that the public looks to nonprofits because they “trust”\textsuperscript{18} the sector to reinvest profits into the provision of quality services.\textsuperscript{19} This inability to have client-consumer feedback makes the accountability structure an essential feature for nonprofit organizations.

While most public charities and operating foundations receive funds and distribute services, some public charities and private foundations amass charitable funds (either raised or contributed) and distribute those funds to

\textsuperscript{15} Fishman & Schwarz, supra note 2, at 7.
\textsuperscript{17} Henry B. Hansmann, The Role of Nonprofit Enterprise, 89 Yale L.J. 835, 842 (1980).
\textsuperscript{18} See id. at 847.
Nonprofit Pluralism and the Public Trust

other public charities for service delivery. Congress and the Internal Revenue Service (IRS) define tax exempt activities to include activities on both ends of the spectrum, ranging from supporting elite cultural institutions—such as museums and operas—to traditional relief of the poor.20 Donors, clients served, and citizens who collectively forego tax revenues from tax exempt organizations all share an interest in the effective management and efficient delivery of services from nonprofit organizations.

B. Accountability

1. Regulatory Strategies

Nonprofit independence offers benefits in terms of autonomous governance and freedom to pursue organizational activities that serve a public benefit. Independence has its challenges, however, when it comes to organizational management and governance. From the notorious United Way of America President William Aramony scandal to the Milton Hershey School for poor children, media outlets are rife with stories of excessive spending and board breaches of fiduciary duty.21 State attorneys general have the power to oversee charitable organizations within their states.22 On the federal level, the tax exemption is awarded and monitored by the Internal Revenue Service.23 Over the past two decades, state attorneys general, Congress, and the IRS have been slow to respond to isolated incidences of egregious behavior within nonprofit organizations.

In the past, the primary federal tool to address breaches of fiduciary duty—revocation of tax exempt status—may have been an excessive penalty for a charitable organization that provided some social value, despite the incidences of poor leadership or management. In response to for-profit breaches of fiduciary duty involved in the Enron scandal, Congress took steps to improve governance and accountability through the Sarbanes-Oxley Act of 2002. Some of the measures from Sarbanes-Oxley, designed for the for-profit arena, were

20. See IRC § 1.501(c)(3)-2(d)(ii); John W. Gardner, The Independent Sector, in FISHMAN & SCHWARZ, supra note 2, at 4.


22. See Fishman, supra note 8, at 668-669.

23. See IRC § 1.501(c)(3).
subsequently applied to the nonprofit sector. Modeled after Sarbanes-Oxley legislation, the IRS took steps to enhance nonprofit governance and ward against breaches of board fiduciary duties through the intermediate sanctions regime. Rather than being limited to revocation of a nonprofit’s tax exempt status, the IRS may now impose intermediate sanctions on “bad actors” who expose nonprofits to undisclosed conflicts of interest or excess benefit transactions where an inside manager or director takes unfair advantage of a nonprofit.

A companion effort to the adoption of Intermediate Sanctions was the IRS modification Form 1023, the application for exemption. The IRS now attempts to reduce the potential for conflict of interest transactions by requiring disclosure of insider relationships, questioning relationships, and agreements that might result in excess benefit transactions, and explicitly suggesting that organizational bylaws include a comprehensive conflict of interest provision. These matters are reviewed for approval of new exemptions, but do not have any impact on existing tax exempt organizations. The typical nonprofit organization’s ongoing contact with the Service is limited to submission of the annual return (Form 990 or 990PF), which is available to the public upon request or through monitoring services such as Guidestar. In large measure, the IRS tools for monitoring organizational effectiveness are limited to the intermediate sanctions regime and the amended Form 1023 provisions for organizations seeking tax-exempt status.

2. Fiduciary Duties and the Public Trust

With its origins in the concept of trusts, nonprofit fiduciaries (be they described as directors, governors or trustees) have some level of obligation to regard the ultimate beneficiaries of the charitable endeavor. As a matter of state law, directors are required to uphold fiduciary duties to a nonprofit. First, directors must meet the duties of care—including the duties of attention, informed decision making, good faith, and fair dealing—in attending to the organization’s affairs. Second, directors have the duty of loyalty—putting the nonprofit’s interest above their own interests. Under the Revised Model

25. For example, most nonprofits now take steps to establish separate audit committees with qualified professional participation as a step toward stronger financial accountability.
28. See FISHERMAN & SCHWALBE, supra note 2, at 149.
29. Id. at 151.
30. THOMAS SILK, The Legal Framework of the Nonprofit Sector in the United States, in
Nonprofit Pluralism and the Public Trust

Nonprofit Corporation Act (RMNCA), a nonprofit director “shall discharge his or her duties as a director . . . (1) in good faith; (2) with the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner the director reasonably believes to be in the best interests of the corporation.”

While for-profit and nonprofit organizations share similar fiduciary duties and guiding principles, there are key distinctions between these organizations, particularly in the context of accountability. Shareholders monitor the judgments of for-profit corporate boards, often by reference to corporate earnings. Nonprofit corporations do not have shareholders, nor are they compelled to meet a profit bottom line in order to justify their existence. Indeed, when considering unprofitable activities, a nonprofit corporation’s mission may require the organization to continue that activity in furtherance of its mission, despite the lack of financial gain.

With regard to decision making, courts do not hold nonprofit fiduciaries to a higher “trust” standard. Rather, nonprofit directors are held to a lesser “best judgment rule,” which in many respects parallels the for-profit “business judgment rule.” Absent fraud, illegality, or a disabling conflict of interest, directors will avoid liability for corporate decisions so long as they exercise due care. Under the “best judgment rule,” courts decline to “second guess” directors, even if those decisions are revealed to have been unwise. Only if directors are guilty of gross negligence will courts find the fiduciary duty to have been breached.

In addition to the duties of care and loyalty, a third fiduciary duty accepted by some scholars and imposed by a number of state courts is the duty of obedience. The duty of obedience requires board members “to be faithful to...
the purposes and goals of the organization.” 38 Akin to trustees of a private trust, Daniel Kurtz argues that directors are “under a duty to carry out the terms of the trust—and thus ha[ve] a duty of obedience to the purpose specified by the donors.” 39 The doctrine limits directors’ activities to those which are in accord with an organization’s mission, 40 as defined or redefined by the board. 41 The doctrine also requires directors to ensure that the organization complies with all applicable laws and tax exempt status reporting requirements. 42

In the for-profit context, the duty of obedience was once the final leg in a triumvirate of fiduciary duties, but waned with the evolution of the ultra vires doctrine, which treated acts lacking business justification as excesses of power, rather than a failed duty to obey legal standards and operational norms. 43 In the for-profit context, Prof. Robert Clark observes that the duty of obedience is not a fiduciary duty per se, but rather an outgrowth of agency rules. “The rules of agency provide that an agent owes her principal a ‘duty of obedience’—in other words, the principal enjoys control over, and has the power to direct the actions of, the agent.” 44 Prof. Robert Clark distinguishes for-profit directors from agents:

Corporate directors depart radically from this model. As the ultimate decision-making body within the firm, they are not subject to direct control or supervision by anyone, including the firm’s shareholders. Moreover, this fundamental principle of directorial discretion cannot be explained away as a

39. MARION R. FREEMONT SMITH, GOVERNING NONPROFIT ORGANIZATIONS 255 (2005); see also Bjorklund, op. cit., §11-4[a], at 414, cited in Manhattan Eye, Ear & Throat Hosp. v. Spitzer, 186 Misc. 2d 126, 151, 715 N.Y.S. 2d 575, 593 (1999); see also KURTZ, supra note 37, at 84-85.
41. See Manhattan Eye, Ear and Throat Hosp., 715 N.Y.S. 2d 575 (1999) (short form); see also Shorter Coll., et. al., v. Baptist Convention of Ga., 614 S.E.2d 37 (2005) (holding that a nonprofit college transfer of assets to a foundation, without the consent of the Trustees, did not constitute a dissolution of the corporation because the result was not an extinction of the college, but the “mere transfer of the same business to another entity... for the purpose of maintaining the college as a functioning institution.”). Some scholars disagree that the duty of obedience is a separate duty and allocate these responsibilities under the duty of loyalty. See Evelyn Brody, Charity Governance: What’s Trust Law Got to Do with It? 80 CHI.-KENT L. REV. 641, 648-49 (2005); see also Summers v. Cherokee Child. & Fam. Serv. Inc., 112 S.W.3d 486 (Tenn. Ct. App. 2002) (stating that “[t]he duty of loyalty requires that a director... of [a] nonprofit... faithfully pursue the interest of the organization, and its nonprofit purpose, rather than his or her own financial or other interests, or those of another person or organization”).
42. See Brown v. Mem’l Nat’l Home, 329 P.2d 118 (Cal. 1958); see also KURTZ, supra note 37, at 86 (1989); FISHMAN & SCHWARZ, supra note 2, at 221-22.
Nonprofit Pluralism and the Public Trust

gene response to the practical difficulties associated with shareholder voting. This “directorship discretion” characterizes the nature of a for-profit corporate
directorship.

Building upon Prof. Clark’s interpretation of agency and the duty of
obedience in the for-profit context, nonprofit directors are, in a sense, both
agents, subject to the control of the principle organizational mission, as well
as fiduciaries who serve as the decision-making body for the organization. Nonprofit directors are masters of the organization, yet subject to the
organizational mission principle. In addition, there is another set of
“principals” in the nonprofit context—the public—who authorize and grant tax
subsidies to the organization to help it achieve its substantive mission. Accordingly, nonprofit directors are not empowered with complete “directorship
discretion” as for-profit directors.

The duty of obedience also requires that a nonprofit board be culturally
competent to govern and oversee effective work toward the organization’s
mission. As an example, environmental nonprofits which include
environmental justice (work to protect environmentally disadvantaged
communities from locally unwanted land uses) in their mission ought to
include diverse representation, not only in their staff, but also within their
boards, which hold the power to establish the mission and set implementation
policy. Some scholars deny the existence of a separate nonprofit duty of
obedience and argue the “duty to assure that the purposes of the trust can be and
are being carried out effectively” is subsumed in the fiduciary duty of
loyalty. Indeed, Professor Freemont Smith suggests that “[t]o the extent the
duty of obedience does not carry with it a duty to assure that the trust is
meeting contemporaneous needs, it does not set forth an appropriate
standard.”

While beneficiaries, both current and future, are important constituencies
for a board to consider, nonprofit corporations are more flexible than perpetual,
private trusts. Trusts bind trustees to adhere to the trust document, unless

45. Id. at 290-91.
46. Cf. Fishman & Schwarz, supra note 2, at 149 (noting that the elusive concept of fiduciary
obligation “unifies disparate types of legal relationships, including agency, intra-corporate, attorney-
client relationships; relations between directors, officers and an organization’s members or the public;
and between employees, managers and the organization.”).
47. Nonprofit directors are subject to the principle organizational mission that is defined in the
nonprofit’s articles of incorporation.
48. The Letter that Shook a Movement, supra note 7.
49. See Rivers, supra note 7, at 480.
51. Id. at 226 (arguing “duty to assure that the purposes of the trust can be and are being carried out
effectively”); Cf. Evelyn Brody, Charity Governance: What’s Trust Law Got to Do with It? 80
amended through a cy-près or deviation action. In addition, trustees are held to a higher standard of care and judicial review. By contrast, in the absence of a higher trust standard, the basic best judgment rule governs review of nonprofit fiduciary duties. Maintaining a specific, dedicated fiduciary duty of obedience for nonprofit organizations requires specific corporate action to achieve a change in organizational purpose and imposes an obligation on nonprofit corporations to justify how they are able to meet their mission effectively. Articulation of a separate duty of obedience for nonprofits creates an additional layer of accountability, which is sorely needed for self-monitoring boards.

Regardless of the characterization of fiduciary duty as a duty of care, loyalty, or obedience, the task of ensuring that a nonprofit effectively and efficiently serves its purpose largely is left to law enforcement. Although breaches of fiduciary duties are said to occur with “unsettling frequency,” there are very few officially reported cases of nonprofit fiduciary breach. This may be due to the pressure to resolve matters internally when breaches are publically revealed. Despite high public expectations and potentially high levels of foregone income and property tax revenues, state attorneys general (who have standing to enforce fiduciary duties) generally may be reluctant or slow to bring suits against influential political constituents. Finally, statutory charitable immunity provisions typically afford volunteers with a defense against suits brought by a third party. Accordingly, the sector is largely dependent on self-monitoring boards, grant funders, and donors to maintain or enforce good governance practices.

Board diversity is an important mechanism to improve both the governance and performance of nonprofit organizations. For decades, for-profit corporate law scholars have argued that the composition of a corporate board may have a direct impact on the quality of governance and the efficiency and effectiveness of services. The lessons from the private sector serve the nonprofit sector

54. See generally Rivers, supra note 7, at 480.
55. Fishman & Schwarz, supra note 2, at 150-51.
57. Cf. Garry W. Jenkins, Incorporation Choice, University, and the Reform of Nonprofit State Law, 41 Ga. L. Rev. 113, 1167-1169 (Discussing the impact of political lout or board member connections in conflicts with public officials a factor that influences a nonprofit organization’s incorporation jurisdictional choices.). See Fishman & Schwarz, supra note 2, at 142 (discussing how a duty of care violation is typically reported by the press, hastening the settlement of any actions brought by the attorney general).
58. Fishman & Schwarz, supra note 2, at 160-61.
59. See generally Steven A. Ramirez, Diversity and the Boardroom, 6 Stan. J. L. Bus. & Fin. 85
Nonprofit Pluralism and the Public Trust

well where board composition is as, if not more, homogenous, and where the public is even more dependent on organizational self-monitoring.

C. Board Diversity

1. For-Profit Board Diversity

Historical and current assessments reveal that for-profit boards are often exclusionary groups. The dearth of women and minorities among the ranks of corporate governing boards is significant, and contrary to the inclusive goals promoted by the Civil Rights Act of 1964 and its progeny.60 According to the Alliance for Board Diversity’s most recent survey for 2010, Fortune 500 Corporations reported that 84.4% of board seats were held by men, while women held 15.7% of seats.61 Men and women of color constituted 9.8% of directors.62 As corporation value increases, board diversity increases. Fortune 100 Corporations reported that a smaller percentage of seats held by men (82%), and a higher percentage of women directors (18%).63 Men and women of color constituted 15.5% of these larger corporation boards.64 In 2005, women held 14.6% of Fortune 500 board seats,65 but a year earlier, constituted 16.9% of Fortune 100 directors.66

In 2007, executive search firm Korn/Ferry International reported that the number of exclusively male Fortune 1000 boards decreased from 89% in 1979, to 47% in 1988, and 15% in 2007.67 Accordingly, 85% of all Fortune 1000 boards had at least one female director in 2007. Statistical progress was worse for minority directors. Korn/Ferry reported that the number of Fortune 1000

(2000).

60. See Donald J. Polden, Forty Years After Title VII: Creating an Atmosphere Conducive to Diversity in the Corporate Boardroom, 36 U. MEM. L. REV. 67, 80-81 (2005).
62. Id. Men of color held 9.9 percent of seats, while women of color held 3.0 percent of seats. Women of color serving on boards include African-Americans (1.9%), Hispanics (0.7%), and Asian Pacific Islanders (0.3%). It should be noted that men of color still outpaced women of color, holding more than three times as many seats as their minority women colleagues. Id.
63. Id.
64. Id. Men of color held 12.1 percent of seats, while women of color held 3.3 percent of seats. Men of color serving on boards include African-Americans (7.3%), Hispanics (3.1%), and Asian Pacific Islanders (0.5%). Women of color serving on boards include African-Americans (2.1%), Hispanics (0.7%), and Asian Pacific Islanders (0.5%). It should be noted that men of color still outpaced women of color, holding four times as many seats as their minority women colleagues. Id.
boards that were exclusively white decreased from 91% in 1979, to 69% in 1988, and 22% in 2007.\textsuperscript{68} Although the number of Fortune 1000 boards with minority directors increased, the halt in the rate of increase in minority directors (against the trend of changing national demographics) led Korn/Ferry to observe that “it would seem that increasing ethnic diversity would, like gender diversity, offer a strategic benefit in reflecting the makeup of customers, shareholders and employees.”\textsuperscript{69} Although the pace of diversifying has remained slow, the historical data and observations suggest a concomitant relationship between board diversity and profitability or gross revenues.

Where companies have a minimal or disproportionately low level of minority representation, tokenism remains a parallel problem for boards with few minority directors. Social scientists posit that for women and minorities to be effective board members, the board should have a critical mass of 20%-30% demographic minorities.\textsuperscript{70} Considering the 85% of Fortune 1000 boards that had at least one female director, Korn/Ferry soberingly observed that “many of the boards had just a single female director, suggesting that many companies have not yet achieved gender equality.”\textsuperscript{71} Even where women and minorities gain access to board membership, research suggests that boards will not gain the full benefits of diverse representation when the number of women and minority directors falls below a minimum critical mass.\textsuperscript{72} At a base level, organizations that engage at least proportionate demographic diversity meet the goals of the Civil Rights Act of 1964 and create a more pluralistic governance structure. Nonprofit boards fall behind their corporate counterparts and lack proximate proportional diversity for minority directors. While positions about whether and how to document this diversity deficit differ greatly, the imbalance must be considered in the context of the impact on governance of public charity and foundation boards. Organizations that attain a critical mass of corporate directors are better positioned to achieve the most effective diverse governance structure.

\textsuperscript{68} Id. at 7.
\textsuperscript{69} Id.
\textsuperscript{70} See William A. Brown, Racial Diversity and Performance of Nonprofit Boards of Directors, \textit{Journal of Applied Management and Entrepreneurship} 7(4) at 5 (2002) (suggesting that minority board membership needs to be significant, 20% or more, to effectively combat marginalization), citing Jennifer M. Rutledge, Building Board Diversity (National Center for Nonprofit Boards (1994)).
\textsuperscript{71} KORN/FERRY INSTITUTE, 34TH ANNUAL BOARD OF DIRECTORS STUDY 6, available at http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.
Nonprofit Pluralism and the Public Trust

2. Nonprofit Sector Board Diversity

The lack of diversity has broad implications for board governance and mission for nonprofit organizations which operate under the imprimatur of the public trust. According to the Urban Institute’s 2007 survey of the public charity boards, homogeneity characterizes the vast majority of public charity boards. Overall, minority directors hold 14% of public charity seats. Over one-half of nonprofit public charities (exclusive of private foundations) had no minority directors; indeed, 65% of smaller (less than $100,000 in assets) and rural nonprofit boards were exclusively white. Women have achieved a more proportionate share of nonprofit board seats, constituting 46% of nonprofit directors. This is significantly better than the disproportionate representation on Fortune corporation boards; nevertheless, challenges remain. While women hold 50% of seats in smaller public charities (with assets under $100,000), they are significantly underrepresented in major nonprofit organizations (with assets in excess of $40 million), where female representation falls to just 29%. Nonprofit boards become even more insular when private foundations are added to the calculations. Overall, private foundations have the most exclusionary boards, with whites holding 87.7% of director seats. Fortune 500 boards outpace private foundations, and are just 0.6% behind public charity boards. As noted below, Fortune 500 corporations outperform charitable foundations with regard to African American board representation by a significant portion, but public charities outperform Foundation and Fortune 500 boards by a small margin.

<table>
<thead>
<tr>
<th>Board Composition</th>
<th>Public Charity Boards</th>
<th>Foundation Boards</th>
<th>Fortune 500 Boards</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>White</td>
<td>86.0%</td>
<td>87.7%</td>
<td>84.5%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>African American</td>
<td>7.0%</td>
<td>6.7%</td>
<td>9.4%</td>
<td>+2.4%</td>
</tr>
</tbody>
</table>

74. Id.
75. Id.
76. Id. at 19.
77. Id.
80. See ALLIANCE FOR BOARD DIVERSITY CENSUS, supra note 61, Appendix 1 at 8.
The lack of nonprofit board diversity, for both public charity and private foundations, has not gone unnoticed. As with for-profits, calls for diversity were based in basic “fairness” and corporate social responsibility. These inquiries are evolving to deeper challenges about mission effectiveness and organizational governance.81

In the nonprofit sector, the calls for diversity have not come from shareholder initiatives,82 but from stakeholder constituencies: members, donors, beneficiaries, as well as philanthropic funders and contemporaries calling for increased diversity.83 Unlike shareholders, these constituencies hold little direct power over the beneficence of their respective nonprofit organizations. Where a particular group stands on board diversity may depend on where they sit on the list of constituencies.

Organizational members have the power to express their views through their election of directors. Presumably, directors who fail to reflect the membership’s norms will not be nominated or elected to a membership organization’s board. Likewise, donors are typically limited to “voting with their checkbooks.” If a nonprofit strays away from donors’ program or governance expectations and norms, donors likely will shift contributions to an organization that meets their philanthropic goals.84 Program beneficiaries,

81. See Marcelo Bonta & Charles Jordan, Diversifying the American Environmental Movement, in DIVERSITY AND THE FUTURE OF THE U.S. ENVIRONMENTAL MOVEMENT 13, 22 (Emily Enderle ed., 2007), available at http://www.environmentaldiversity.org/documents/05-Bonta-and-Jordan.pdf (suggesting that environmental nonprofits would be more productive when the organizational culture changes that these organizations begin working equitably with minority communities); see also Rivers, supra note 7, at 480.

82. See Katherine O’Regan & Sharon M. Oster, Does the Structure and Composition of the Board Matter? The Case of Nonprofit Organizations, 21 J.L. ECON. & ORG. 205-06 (2005) (arguing that a nonprofit board of directors owes responsibilities its “constituents, including donors, the state, clients, and even the staff”, rather that shareholders).

83. See discussion infra pp. 115-127.

Nonprofit Pluralism and the Public Trust

though well-positioned to evaluate the services provided by public charities, are scantily represented on nonprofit boards and rarely in a position to challenge nonprofit funders and service organizations that provide important or essential services.

The philanthropic industry is divided in its response to the diversity challenge. Many foundations embrace cultural diversity as an appropriate aspiration for their grantees, and require grant applicants to provide information on the demographic composition of their boards as a consideration factor in the application grant process. A small percentage of private foundations release information on their board demographic in an annual Council of Foundations survey. Many, however, take the position that demographic information for their board and staff should not be disclosed as public information. Others go a step further, indicating that diversity of missions and funding support of services that benefit minorities, as well as generational diversity in family giving, constitute sufficient organizational diversity. According to Council on Foundations President Steve Gunderson, “The Council on Foundations supports the diversity of philanthropy—in our members’ missions, our work, and our people. We do so because diversity of purpose and perspective defines the mission of each philanthropic organization.”


86. Cf. The Letter that Shook a Movement, supra note 7.

87. See, e.g., FORD FOUNDATION, 2005 ANNUAL REPORT 30 (2005), available at www.fordfoundation.org/pdfs/library/ar2005.pdf (“The foundation supports pluralism and equal opportunity in its grant making and in its internal policies. Opportunities that prospective grantee organizations provide for women and other disadvantaged groups are considered in evaluating proposals.”); Apply for a Grant. MARY REYNOLDS BABCOCK FOUNDATION, http://www.mrbf.org/applyForGrant.aspx (Aug. 30, 2011) (“We give preference to organizations and networks where people are working together across race, ethnic, economic and/or political lines.”).

88. Dr. Robert K. Ross, Diversity in Philanthropy Achieved Through Leadership, Not Mandates, SAN JOSE MERCURY NEWS, Mar. 12, 2008 (Ross, President of The California Endowment, noted that “community and foundations should also aspire to be more diverse and inclusive, but it is problematic to interfere with donor intent and impose diversity as a requirement” and urged legislators not to “reduce the value of diversity to a mechanistic and mandatory numbers game.”); see also COUNCIL ON FOUNDATIONS, DIVERSITY AND INCLUSION IN PHILANTHROPY: POSITION AND ACTION STEPS, RESPONSE TO CALIFORNIA ASSEMBLY BILL 624 5 (2008), available at http://www.cof.org/files/Documents/Public_Policy/AB624DiversityandPhilanthropyStatement%20Feb508.pdf (registering objection that “it would be premature to mandate the collection and publication of race and gender data on the boards and staffs of grantmaking organizations” and noting that such a requirement would be burdensome, intrusive, and a violation of privacy).


90. See id. (explaining the “diversity of mission” through an expansive list of issue areas supported by philanthropic organizations, ranging from human services, education, arts and culture, health, public affairs, society benefit, religion, and science and technology).

91. See id.
Supporters of corporate board independence often cite the seminal *Dartmouth* case, arguing that government has limited, if any, authority to direct or regulate board size, composition, or management of nonprofit institutions. In *Trustees of Dartmouth College v. Woodward*, the Supreme Court rebuffed an effort by the New Hampshire legislature to seize Dartmouth College’s assets and mandate that the educational institute become a state university. Chief Justice Marshall’s opinion is heralded for recognizing the solemnity of a contract.

The facts of the *Dartmouth* case provide an example of the obstacles that can arise when intra-family dynamics and politics threaten to overtake the mission of an organization. From a governance standpoint, the case involved a board of trustees insisting on obedience to the organization’s mission, maintaining the spirit of Dartmouth as a small liberal arts college, rather than a large, state-run university. At the heart of the controversy was an attempted intra-family dynasty which the Trustees perceived to interfere with the organization’s best interests. Founder Eleazor Wheelock passed the College presidency to his son, but the dynasty was short-lived. After a series of disagreements, the Board of Trustees removed the younger Wheelock from the Presidency. Wheelock sought refuge at the New Hampshire legislature, attempting a “hostile takeover” of sorts, amending the institution’s charter and endeavoring to convert the College into “Dartmouth University,” a state-run institution. The board of Trustees hired alum Daniel Webster to argue that the charter was an inviolate contract with the College, that Dartmouth’s assets were not public assets subject to legislative taking. Hundreds of years later, Webster is noted by alumni for his argument, not because of the successful contract theory argument, but for his articulation and obedience to the mission of maintaining Dartmouth as a small college: “It is, as I have said, a small college, sir. But there are those who love it.”

Dartmouth continues to pride itself on the “small college” atmosphere that Eleazor Wheelock established. Because the Trustees maintained allegiance to that mission, rather than the Wheelock family legacy, Dartmouth was able to

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95. *Dartmouth College, Department of Chemistry*, http://www.dartmouth.edu/~chem/ (last visited Aug. 30, 2011) (“Welcome to Dartmouth’s chemistry department, which combines the personalized instruction and mentoring of a small college with the expertise of a research university.”)
Nonprofit Pluralism and the Public Trust

rebuff the attempted legislative take-over. In addition to protecting charitable entities from contract dismantling and seizure of charitable assets for public purposes, the *Dartmouth* case exemplifies the problems that can occur when governance suffers from the challenges of nonprofit familial legacies. One important counter to insular governance is a diverse board that can perceive an organization’s mission clear of familiar and similar thinking.

The philanthropic divide over diversity exploded in California in the battle over A.B. 624, the Foundation Diversity and Transparency Act of 2007. Introduced by California State Assemblyman Joe Coto (D-San Jose), the measure sought to require California foundations with assets in excess of $250 million to annually disclose key diversity data on their websites, including foundation board and staff demographic composition, information on foundation contracts with minority-owned firms, as well as reports on foundation grants to minority board and staff led nonprofit organizations.96 The legislation was sponsored by the Greenlining Institute in response to findings that minority-led nonprofits received just 3% of total grant dollars from the nation’s 50 largest foundations. The measure was sought to institute reporting as a mechanism to prevent communities of color from being “short-changed” in foundation grant-making.97 According to Greenlining, “the public has the right to know where foundation grants are invested, especially when foundations receive $40 billion in (sic) tax benefits.”98

Although the impact of A.B. 624 would have been limited to between 10 and 30 California foundations,99 the bill prompted a firestorm of protests from state and national private foundations, as well as philanthropic associations. Progressive and conservative foundations were unified in their objection to mandatory diversity reporting, which was characterized as a “data driven solution through legislative oversight.”100 The provision was characterized as an unwelcome government regulation that would constitute an intrusion into donor choices, as well as contracting and grant affairs of private foundations and the nonprofits they fund.101 In response, the Council on Foundations

98. Id.
99. The impact of the bill would be limited due to the floor set for asset size. See id.
(COF)\textsuperscript{102} expressed a commitment to transparency and voluntary action to collect and report foundation data, but opposed the California measure’s mandate for additional data collection:

The Council invites, and will work to foster, open and frank discussion of how grant makers can improve their own diversity and serve more diverse communities. However, we believe that it would be premature to mandate the collection and publication of [data required by the act] . . . without stronger evidence that this will lead to improvements in diversity.\textsuperscript{103}

While noting the Executive Council’s initiative to develop a diverse pipeline of trustee and executive-level talent, COF cautioned that the sector’s diversity work “does not lend itself to instantaneous results and outcomes.”\textsuperscript{104}

In support of the sector’s past record of progress, the Council pointed to the wide range of “programmatic” diversity supported by foundations giving and touted the increase in the number of women board members (to 37%). Notably, COF did not identify any improvements in the representation of minorities on foundation boards.\textsuperscript{105}

The Nonprofit and Unincorporated Organizations Committee of the State Bar of California submitted a Statement of Position opposing A.B. 624, pointing out various drafting and privacy problems with the legislation (in particular, early versions that required disclosure of sexual orientation information) and challenging that the collection and publication of demographic data would be an unconstitutional invasion of privacy.\textsuperscript{106} Joining efforts to thwart off the bill, California’s three Regional Association of Grantmakers (RAGs) pledged to voluntarily assemble diversity information through a Foundation Center study that would “meet and exceed the goals and spirit of AB 624.”\textsuperscript{107}

A “California Ten” 2008 statement offered a traditional “pipeline” argument, identifying core systemic causes that inhibit minority leadership of public charities: the lack of capacity for minority-led organizations to compete for funding, a need for leadership development, and lack of access to larger

\textsuperscript{102} The Council of Foundations represents 2,100 grant making foundations and giving programs.

\textsuperscript{103} COUNCIL ON FOUNDATIONS, supra note 88.

\textsuperscript{104} Id. at 6-7.

\textsuperscript{105} Id. at 3-4 (The Council reported that women board members increased from 23% in 1992 to 37% in 2006. The report noted increasing diversity among executive and program staff. The number of women CEOs increased from 26% to 55% between 1982 and 2006. Minority CEOs increased from 1.6% to 5.8% and minority program officer ranks increased from 15.4% to 35% during this same time period. Notably, employment statistics only apply to 17% of foundations where the median staff size is two.).

\textsuperscript{106} See The State Bar of California Business Law Section, Nonprofit and Unincorporated Organizations Committee Statement of Position., on A.B. 624 (Coto), as amended Mar. 3, 2008 (Mar. 27, 2008).

\textsuperscript{107} Letter to the Honorable Dave Jones, Chair, California State Assembly Committee on Judiciary (Jan. 3, 2008) (on file with author).
Nonprofit Pluralism and the Public Trust

foundations.108 Once A.B. 624 sailed through the California Assembly,109 this pledge became the cornerstone of an agreement between the Greenlining Institute and the California Ten. In a subsequent report, the Greenlining Institute set out several recommendations110 for foundation capacity building.111 Nonprofit leaders that supported the legislation noted the irony of the foundations unwillingness to track diversity data, even though foundations often requested diversity data as a component of their grant application process.112 The Greenlining Institute’s report observed that “foundations must diversify their own institutions for sustainable change to occur” and recommended that “foundations should have boards that have the confidence of diverse communities.”113 Yet, the recommendations for specific improvement were limited to developing community advisory boards and hosting regular visits to distressed areas.

The “deal” between Greenlining and the California Ten called for boards “that have the confidence of diverse communities,” but stopped notably short of instituting any reporting, staffing requirements, or goals for foundation boards. Commenting on the grant potential of this compromise, Anna Dorfman, Executive Director of the National Committee for Responsive Philanthropy (NCRP), observed that “[d]iversifying foundations at the staff and trustee levels is important for improving effectiveness” and issued a mandate

108. Foundation Coalition, Statement by Selected California Foundation CEOs on Strengthening Nonprofit Minority Leadership and the Capacity of Minority-Led and Other Grassroots Community-Based Organizations 1 (June 23, 2008), available at http://www.packard.org/assets/files/about_the_foundation/how_we_operate/coalition_release_final_062408.pdf (This statement was endorsed by The California Endowment, as well as the Ahmanson, James Irvine, UniHealth, Ralph M. Parsons, California Wellness, Annenberg, William & Flora Hewlett, David and Lucile Packard, and Weingart Foundations.).


III. BOARD DIVERSITY AND GOVERNANCE

A. The Business Case for Diversity: Groupthink and Governance

Scholars argue that diversity serves a business corporation’s best interest because it empowers the board to understand and speak to a broader range of consumers and constituencies. The argument to promote corporate board diversity has evolved. It began as a corporate social responsibility policy\footnote{O’Connor, supra note 72, at 1307; see also Lisa M. Fairfax, The Uneasy Case for the Inside Director, 96 IOWA L. REV. 127, 184-90 (2010).} in pursuit of more pluralistic board composition. In the 1990s, the argument expanded, promoting diversity as a strategy to increase shareholder value. Advocates argue that corporations with diverse boards of directors boast better bottom-line profits than non-diverse corporations, and companies benefit from the insights and values that diverse corporate directors bring to the table.\footnote{See MICROQUEST CORP., SHATTERING THE GLASS CEILING: ISSUES AND SOLUTIONS IN PROMOTING THE ADVANCEMENT OF WOMEN AND MINORITIES TO EXECUTIVE MANAGEMENT IN CORPORATE AMERICA 4 (1996) (Paul Fireman, chairman of Reebok reports that women in the company directed Reebok’s attention to the women’s athletic shoe market, which had been overlooked by Nike: “Even though we didn’t know the word for it back then, it was diversity that was responsible for Reebok’s breakthrough, that launched our transformation from a $12 million running shoe company to a $3 billion sports and fitness company.”).} Current research indicates that while corporate directors articulated diversity as a corporate goal, on the whole, respondents to a research study were challenged when asked to provide examples or anecdotes illustrating why diversity matters to their corporations.\footnote{Lissa L. Broome et al., Dangerous Categories: Narratives of Corporate Board Diversity, 89 N.C. L. REV. 759, 760 (2010).} Beyond representative pluralism, however, board diversity has an impact on organizational decision making. Business and leadership research indicates that women and minority directors exhibit more critical assessments of organizations when serving on corporate boards.\footnote{See Donald J. Polden, Forty Years After Title VII: Creating an Atmosphere Conducive to Diversity in the Corporate Boardroom, 36 U. MEM. L. REV. 67, 85 (2005) (stating that women and minority directors seem to ask different questions and focus board attention on audits, conflict of interest guidelines, and board performance evaluations.).}

Yale psychologist Irving L. Janis developed the theory of “groupthink” to explain the compromised dynamics of group decision making in the context of policy decision failures, ranging from the Bay of Pigs disaster to the Watergate scandal. Organizational analyst William Whyte originally coined the phrase “groupthink,” and in a later work, Janis used the term to refer to “the mode of
Nonprofit Pluralism and the Public Trust

thinking that persons engage in when concurrence-seeking becomes so dominant in a cohesive in-group that it tends to override realistic appraisal of alternative courses of action.”¹¹⁹ These teams establish “group norms that bolster morale at the expense of critical thinking”; and as group cohesiveness rises, groupthink-type conformity increases.¹²⁰ Janis surmises that groupthink is “a mutual effort among the group members to maintain self-esteem and emotional equanimity by providing social support to each other, especially at times when they share responsibility for making vital decisions.”¹²¹ Seeking to preserve friendly internal relations is a hallmark of voluntary board groups, particularly when the board appointment carries community prestige or satisfies an individual’s desire to serve a charitable goal. However, in such environments, “preserving a comfortable, harmonious group environment becomes a hidden agenda that tends to suppress dissent, conflict, and critical thinking.”¹²²

From the historical failures reviewed, Janis noted several symptoms of groupthink: illusion of invulnerability (leading to unwarranted optimism and excessive risk taking), collective rationalization, unquestioned assumption of the group’s morality, stereotypes of the opposition (as evil, weak, or stupid), direct pressure on dissenting members, self-censorship (squelching deviating ideas), an illusion of unanimity, and mindguards (who protect the group from adverse information).¹²³ As a result, the challenge of groupthink is not that a member will withhold his objections to a proposal, but that he will think the proposal is a good one, without careful, critical scrutiny of an idea.¹²⁴ Janis proposes remedies for groupthink, all designed to increase the diversity of ideas considered by a group, including assigning a critical evaluator, making assignments without indicating a preference of outcome, providing for assessments by outsiders, and considering alternative scenarios.¹²⁵ Long before Enron, many corporate law scholars suggested that homogeneity detracts from a board’s ability to challenge and critically analyze an organization’s performance.¹²⁶

¹¹⁹. IRVING L. JANIS, GROUPTHINK 84 (2d ed. 1971).
¹²⁰. Id. at 84-5.
¹²¹. Id. at 88.
¹²³. JANIS, supra note 119, at 85.
¹²⁴. Id.
¹²⁵. Id.
scandal-ridden corporations have been criticized for permitting too much intermingling between directors and management, and a general lack of rigor of their analyses of corporate activities. Professor Marleen O’Connor reviewed the Enron collapse from the vantage point of social psychology work on small group decision making, and suggests that group think plagued the Enron board’s deliberations. In her view, “the Enron Board did not prevent the Enron debacle because of psychological processes that lead cohesive boards to avoid seriously scrutinizing managerial policy.” Similarly, Sharon Allen, Chairperson of Deloitte LLP, warns that groupthink “may be most dangerous in a corporate sense if it takes root in the boardroom.” She suggests that the “gravitational pull of conformity” can deter directors from questioning and challenging management. Enron only amplified the need for stronger governance measures.

Notable scholars have suggested increasing diversity as a potent tool to achieve better decision making on business corporation boards.

... [C]ultural diversity could enhance small group decision-making processes and diminish the inclination of small groups to devolve into a groupthink approach to issues. This groupthink dynamic plagues decision making within groups that share a high degree of similar experiences and characteristics. The result is mindless adherence to group norms and a failure to challenge implicit or underlying assumptions.

... As one scholar suggests, boards enjoying cultural diversity should perform better because board homogeneity leads to a boardroom culture that “avoids conflict, avoids impoliteness and as a result does not permit hard questioning.”

127. See O’Connor, supra note 72, at 1237 (observing that social psychology is the base of the behavioral law and economics movement).

128. Irving Janis describes his “groupthink” theory as “a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members’ striving for unanimity overrides their motivation to realistically appraise alternative courses of actions.” IRVING JANIS, VICTIMS OF GROUPTHINK 78 (1978), cited in O’Connor, supra note 72, at 1238-39 (observing that social psychology is the base of the behavioral law and economics movement).

129. See O’Connor, supra note 72, at 1239 n.23 (observing that social psychology is the base of the behavioral law and economics movement).

130. Id.


132. See O’Connor, supra note 72, at 1241 (proposes increasing board diversity as one mechanism to prevent groupthink and improve collective decision making on corporate boards).

133. Steven A. Ramirez, A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?, 77 ST. JOHN’S L. REV. 837, 839-40 (2003) (internal citations omitted); see also CASS SUNSTEIN, WHY SOCIETIES NEED DISSENT 2 (2005) (“The problem is that when corporate directors, even intelligent and powerful ones, are placed in groups that punish dissenters, they almost invariably begin to conform.”).

Nonprofit Pluralism and the Public Trust

In a similar vein, Prof. Michael Dorf opines that “groups need intellectual diversity to function best,” and “require contrasting ideas to park a debate that leaves them open to possibilities other than the one first considered or advanced by their leader.”135

Sharon Allen explains that “[m]y preferred method for guarding against groupthink is diversity of thought—made possible by including new voices in the boardroom along with those that are traditionally white, older, and male.”136 Allen argues that a board will be more able to “think outside the box” if directors from historically underrepresented demographic groups participate in boardroom discussions. Citing an October 2007 Catalyst report, Allen noted that Fortune 500 companies with the highest representation of female board members attained greater financial performance, ranging from 42%-66% higher returns on sales, equity, and invested capital.137

In the private sector, best-practice advocates and institutional shareholders began the drumbeat for increased board diversity as a matter of sound governance.138 For all of its benefits, high-level, pluralistic decision making that embraces an organization’s board diversity generates more difficult decision making than achieving “group think” consensus. Professor Lisa Fairfax notes research which indicates that greater diversity could “reduce collegiality in the boardroom.”139 Despite the collegiality of homogeneous boards, in the majority of corporate, sociological, and leadership research, scholars observe that diverse teams make better decisions. The lack of engaged decision making (a core characteristic of homogeneous boards) is said to be at the heart of major for-profit corporation governance problems.140

...[E]vidence suggests that companies do best if they have highly contentious boards “that regard dissent as an obligation and that treat no subject as undiscussable.” Well-functioning boards contain a range of viewpoints and

encourage tough questions, challenging the prevailing orthodoxy.\footnote{141}

While the Sarbanes-Oxley Act implemented reform measures to increase accountability of corporate officers, Professor Steven Ramirez posits that post-Enron reform fell short of the mark because the Sarbanes-Oxley Act failed to capitalize upon diversity as an internal monitoring tool to police and combat corporate corruption.\footnote{142} Particularly in the aftermath of Enron and comparable corporate debacles, advocates now recommend that diversity be embraced as a tool to enhance the level of a board’s decision-making capacity.\footnote{143} Ramirez concludes that diversity at the board level:

(1) provides additional insights that may be helpful for superior international market penetration,
(2) sparks innovation and creativity,
(3) leads to greater problem solving skills,
(4) broadens corporate perspectives, and
(5) provides for more effective relationships with global constituencies.\footnote{144}

Prof. Fairfax observes that the lack of regulation led to an overreliance on independent directors to carry the mantle of effective corporate governance.\footnote{145} She suggests increasing reliance on inside directors, including diverse inside directors, as a supplement to enhanced regulation as better structures to monitor corporate board activities.\footnote{146} To the contrary, others argue that more inclusive decision-making might eliminate the need for additional monitoring regulation.

A close observer of corporate failures concludes that the remedy lies not in stricter regulations but in working groups that encourage serious debate and that welcome direct challenges to senior managers about the issues that companies face.\footnote{147} Under either view, a for-profit corporation’s failure to employ a diverse board may be viewed as a governance failure in and of itself.

The exclusion fostered by homogenous networks often results in limited vision and perspective, as well as nepotism within organizations.\footnote{148}

\footnotetext[141]{Kent Greenfield & Gordon D. Smith, Debate: Saving the World with Corporate Law?, in BOSTON COLLEGE LAW SCHOOL FACULTY PAPERS 19 (2007).}
\footnotetext[142]{Steven A. Ramirez, A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?, 77 ST. JOHN’S L. REV. 837, 844 (2003).}
\footnotetext[143]{See generally Steven A. Ramirez, A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?, 77 ST. JOHN’S L. REV. 837, 839 (2003) (citing David A. Carter et al., Corporate Governance, Board Diversity, and Firm Value, 38 FIN. REV. 33, 36, 44, 51 (2003) (“D]iversity produces more effective problem-solving. While heterogeneity may initially produce more conflict ... the variety of perspectives that emerges causes decision makers to evaluate more alternatives and more carefully explore the consequences of these alternatives.”).}
\footnotetext[144]{Steven A. Ramirez, A Flaw in the Sarbanes-Oxley Reform: Can Diversity in the Boardroom Quell Corporate Corruption?, 77 ST. JOHN’S L. REV. 837, 844 (2003) (citing Carter, supra note 143, at 36).}
\footnotetext[145]{Lisa M. Fairfax, The Uneasy Case for the Inside Director, 96 IOWA L. REV. 127, 130 (2010).}
\footnotetext[146]{Id. at 193.}
\footnotetext[147]{CASS SUNSTEIN, WHY SOCIETIES NEED DISSERT 2 (2005).}
\footnotetext[148]{See ANCELLA B. LIVERS, KEITH A. CARVER, LEADING IN BLACK AND WHITE: WORKING
Nonprofit Pluralism and the Public Trust

Acknowledging the viewpoints of diverse people creates the opportunity for organizations to improve efficiency, foster group creativity, and become more innovative by moving beyond conventional thinking. These benefits provide a fuller view of the true value of diversity in corporate organizations.

Greenfield and Smith observe that “[a]s a matter of group and institutional dynamics, good decision making requires a diversity of viewpoints” and homogenous “corporate boards would stand to benefit from a greater openness and diversity” that would improve the quality and equity of their decision making processes. While diverse organizations may experience increased difficulties in communication and conflict in decision making, Taylor Cox argues that organizations increase their ability to problem-solve and enhance their decision making capabilities with diverse governance. Accordingly, diversely governed organizations benefit from greater creativity and innovation, as well as increased organizational flexibility. These benefits are key elements of good governance.

B. Nonprofit Corporation Diversity and Governance

While some corporate governance principles carry over between the for-profit and nonprofit sector, the quality of governance may have more impact on nonprofit organizations due to the unique characteristics of the sector. Nonprofit directors may have more direct involvement in management of institutional resources, and they are expected to perform external functions, such as “friend” and “fund” raising, and interfacing with funders, government agencies and various constituencies. With this enhanced board role, and in the absence of for-profit shareholder accountability, nonprofits depend on directors to manage their decision-making role and self-assess their own efficacy. Fishman and Schwarz report that nonprofit board decision-makers face unique challenges:

Board decision-making processes are as varied as the nonprofit sector, and they often differ from the ideal legal model of the board. Decisions often are made on the basis of incomplete information, under rushed circumstances, or on the basis of gut feelings or experiences rather than the formalized method of decision-making that the legal model suggests.

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149. See id.
150. See id.
154. See FISHMAN & SCHWARZ, supra note 2, at 142.
155. Id. at 142-43.
In addition, the historical development of nonprofit associations and charities as the province of the wealthy, well-connected, religious, and community-minded gentlemen led to establishment of a polite and refined norm for board deliberations. In her report on the United Way of America scandal, where a large board of highly capable national business leaders were surprised by the criminal actions of former President William Aramony, Felicity Barringer observed that “[i]n the genteel world of charity boards, skepticism has often seemed a bit uncouth.” In these echelons of power, probing questions have been viewed as “simply bad manners,” and an “active or investigative approach may be considered out of place.”

As with for-profits, “groupthink” can hamper a nonprofit corporate board’s ability to analyze, challenge, and govern an organization. Indeed, the Urban Institute’s first comprehensive survey of over 5,000 public charities with at least $25,000 in annual receipts suggests a link between board diversity and an organization’s implementation of sound accountability practices, including having outside audits, a separate audit committee, policies on conflict of interest, and whistleblower policies. It may appear that the consequences of poorly managed resources or services are less severe in the nonprofit sector, as these are not publically traded corporations; for the constituencies of nonprofits, however, the consequences can be direr than the loss of shareholder value. The sector is threatened by a crisis of confidence—both in ability to...
Nonprofit Pluralism and the Public Trust

govern organizations and manage charitable assets, and the willingness to embrace diversity—in program funding, operations, and sharing power in the seat of governance.

The Bernie Madoff Ponzi scheme was catastrophic for individual investors; but perhaps even more tragically, dozens of nonprofit foundations and countless charities lost valuable resources that were invested in Madoff’s operations, either directly or through financial advisors and funds.162 From sophisticated private foundations like Steven Spielberg’s Wunderkind Foundation and Elie Wiesel’s Foundation for Humanity to well-known public charities such as the Harlem Children’s Zone, Madoff stole $2.5 billion in charitable assets.163 A disturbing similarity among Madoff’s private foundation victims was the homogeneity of the board of directors. Indeed, of the 105 most affected foundations (which directly invested 30% or more of their investments with Madoff), 83% had four or fewer directors on the board of directors.164 These were primarily family foundations with median board size of 3 directors.

In addition to small size, directors playing dual governance and management roles also created the opportunity for failed foundation governance and poor investment decisions. Professor Melanie Leslie reports that Yeshiva University invested $15 million dollars with Ascot Partners, an investment firm run by Ezra Merkin, a University Trustee who chaired the finance committee. Merkin handed over University funds to Bernie Madoff, who also served as the University Treasurer.165 Mammoth foundation and charitable investment monitoring failures exemplify the failings of board homogeneity.166 These failings also illustrate the cost of poorly governed nonprofits to the public fisc, as tax revenues were foregone in exchange for the dedication of assets to public benefit purposes. These failures make the policy case for increased board diversity as a counterbalance to groupthink governance in the nonprofit arena where external accountability mechanisms are extremely limited.

162. Leslie, supra note 6, at 1181-82.
164. See JAGPAL, supra note 163, at 3.
165. Leslie, supra note 6, at 1181 (attributing this failure of effective nonprofit governance to groupthink, lax regulation of self-dealing, fuzzy fiduciary duties, and low standards for conflict of interest policies).
166. JAGPAL, supra note 163, at 1-4 (arguing that “the Madoff scandal provides additional evidence of the relevance of NCRP’s recommendation that foundations have larger, more diverse boards, that they maintain policies and practices that support ethical behavior (e.g. maintaining a written investment policy) and that they disclose information freely”).

121
Perhaps even more than for-profit organizations, where shareholders and consumers hold the keys to corporate success and accountability, nonprofit boards hold a high level of responsibility for self-governance and organizational success. Board governance expert John Carver advises that “moral ownership” by the population the board represents is a “social obligation of trusteeship” and the basis upon which a board determines its accountability. Carver suggests that board members gather evidence of the owners’ views and needs, and engage in direct contact with owners and owners’ representatives. A key component of this engagement is promoting (rather than impairing), board connections via personal similarity to the ownership; moving beyond tokenism to ongoing linkages to ownership for effective representation.

The . . . case for racial, ethnic, philosophical, and gender diversity is based not on superficial political correctness but on the diversity present in the population the board represents. Because the board is a microcosm of the ownership, the need for diversity is driven by representational integrity. Roosevelt Thomas expands the concept of diversity beyond the representational component to include the behavioral differences, similarities, and tensions that arise when people of varying backgrounds share power and responsibility. He describes the power sharing formulation as the craft of “diversity management.” Attaining representation should prompt organizations to gain experience in diversity management, resulting in better decision making and governance. Embracing both representational and power sharing concepts, diversity helps a board convert divergent views to achieve singular decisions that operate to the organization’s highest benefit. Accordingly, Carver advises that nonprofit boards should serve as a “forum for churning debate and exposure” where “disagreement is not only tolerated but is necessary to the health of the process.”

Diversity management has its roots in the concept of pluralism, the “spreading of power” across many actors. A key principle of democracy, pluralism in politics can be viewed as “the process by which conflicting interest-group desires are resolved” in a segmented power structure.

168. Id. at 205.
169. Id.
170. Id. at 276.
171. Roosevelt Thomas, Jr., Diversity Management: An Essential Craft for Leaders, Leader to Leader J., 41, 45–49 (Summer 2006).
172. Carver, supra note 167, at 276.
173. Id. at 276-77.
175. Id.
Nonprofit Pluralism and the Public Trust

Optimistic pluralists believe that segmented power structures are desirable because “a political environment with many groups actively competing will tend to produce moderate and well-considered policies.”\textsuperscript{176} In the philanthropic context, while pluralism in grant distribution to a diverse variety of organizations or organizational goals\textsuperscript{177} is a laudable and positive factor, fund distribution does not necessarily reflect pluralistic governance. Applying principles of philanthropic pluralism requires examination of the participants at the decision table. A critique of pluralism in politics reflects the challenge for pluralism in nonprofit operations and philanthropy:

A crucial assumption underlying such optimistic visions of pluralism is that all views and interests are represented. One might view the policies that emerge from interest group conflict and interaction with concern, however, if some interests are systematically unrepresented, or if some groups cannot accurately communicate to policymakers the intensity with which they support particular perspectives . . . . Elmer Schattschneider argued . . . “[t]he flaw in the pluralist heaven is that the heavenly chorus sings with a strong upper-class accent.”\textsuperscript{178}

In the absence of shared responsibility and power in the board room, nonprofits miss the opportunity to develop “well-considered” policies and objectives that are true to the organization’s mission. Exclusive hierarchical power structures may lack the incentive to moderate nonprofit corporate actions in a manner that would be culturally competent—reflective of and responsive to the range of stakeholders who maintain an interest in a nonprofit organization’s operations. In the absence of shareholder structures, client communities, along with some nonprofit service providers and advocacy associations, have expressed frustrations over the state of nonprofit organizational diversity.\textsuperscript{179} In the nonprofit arena, these stakeholders lack the power to influence and provide input to the board of directors, as shareholders have with for-profit corporations.

To the extent that a nonprofit organization endeavors to serve public benefit causes within the context of a particular community, it is essential that services be delivered in a manner that is responsive to consumer-clients. As Hansmann noted in his “contract failure” theory, recipients of nonprofit services often are not empowered to assess the quality and value of the services\textsuperscript{180} particularly in cases where service recipients are unable to verbalize an evaluation of their care or services due to infancy or age. Over the past decade, government has intentionally downsized bureaucracy and delivered more services through

\textsuperscript{176} Id.
\textsuperscript{177} Cf. Gunderson, supra note 89.
\textsuperscript{178} ESKRIDGE, supra note 174, at 50.
private entities, and a broader base of clients are being served through the nonprofit sector. The need for client feedback on program services and client insights about strategic direction is increasing. Organizations that cannot connect the client constituency with the governance and operations strategy may encounter client confidence challenges. Failure to engage with the represented community in a culturally competent manner exposes nonprofits to charges of paternalism, relevancy, and even malevolent intent or effects.

One prime example comes from the environmental arena. In the early 1990s, environmental justice advocates charged that lack of demographically diverse board representation led to incompetent policy and program strategies that counter the interests of minority and low-income communities, despite the organizations’ claims that they serve the environmental interests of these communities. Environmental justice organizations’ frustrations over the lack of diversity “boiled over” into public letters to the “Group of Ten” (major environmental organizations), demanding that these organizations stop funding environmental work in minority communities because the lack of diverse staffing was hurting, rather than helping minority communities:

Although environmental organizations calling themselves the “Group of Ten” often claim to represent our interests, in observing your activities it has become clear to us that your organizations play an equal role in the disruption of our communities. There is a clear lack of accountability by the Group of Ten environmental organizations towards Third World communities in the Southwest, in the United States as a whole, and internationally.

... Your organizations continue to support and promote policies that emphasize the cleanup and preservation of the environment on the backs of working people in general and people of color in particular . . . . We suffer from the end results of these actions, but are never full participants in the decision-making which leads to them . . . .

In the absence of a culturally competent internal governance structure to engage these issues, the environmental justice community’s public assertion that the Group of Ten nonprofits’ actions belied their mission, and harmed minority and low-income communities was a bitter but effective prescriptive measure. This example shows the internal problems and negative public

181. For example, the Bush Administration’s Faith Based Initiative, which has continued under the Obama administration.

182. See The Letter that Shook a Movement, supra note 7 (“We . . . . call upon you to cease operation in communities of color within 60 days, until you have hired leaders from those communities to the extent that they make up between 35 and 40 percent of your entire staff. We are asking that Third World leaders be hired at all levels of your operations . . . .”); see also Rivers, supra note 7, at 474-75.

183. The Letter that Shook a Movement, supra note 7. The following organizations had dubbed themselves the “Group of Ten”: Environmental Defense Fund, Environmental Policy Institute, Friends of the Earth, Izaak Walton League, National Audubon Society, National Parks Conservation Association, National Wildlife Federation, Natural Resources Defense Council, Sierra Club, and the Wilderness Society. See Rivers, supra note 7, at 474-75.
Nonprofit Pluralism and the Public Trust

perceptions that can arise when nonprofit boards lack diversity and cultural competence.

The board diversity and cultural competence challenge is not limited to the environmental segment of the nonprofit sector, and the cause has risen to the level of political advocacy. Advocates for California’s A.B. 624, which sought to require foundations to disclose diversity data, challenged California’s foundation community about the strategies employed to distribute grants to nonprofit service providers. The Greenlining Institute asserted that minority-led organizations were not receiving a proportionate share of grant funding, and suggested that foundations engage more diverse boards so that more funding might become available for diversely led organizations. In response, a contingent of foundations referred to their institutions’ operational diversity as a substitute for demographic diversity, and challenged allegations that nonprofit organizations and their directors are unfair in the management or allocation of charitable resources. However, these claims for continued unmonitored philanthropic beneficence should be considered in light of the record of self-monitoring in this arena.

In scandals ranging from United Way’s Aramony debacle to the Madoff Ponzi scheme, a number of self-monitored, homogeneous boards suffered from groupthink, failing in their efforts to self-monitor their collaborative guidance of these nonprofits. Without sufficient diversity of thought fostered by diversity of board composition, these and many other nonprofit boards overestimate their objectivity and fail to have the constitution to assess their well-intentioned efforts. Clearly, board directors of the Group of Ten underestimated the negative impact of presumably well-intended environmental conservation efforts; the community letter was a public cry for cultural competence in the quest for environmental justice. With diverse board representation and cultural competence, these calls for strategic and programmatic change within the Group of Ten could have been aired within each organization’s governance structure. Indeed, pluralistic governance can help nonprofit organizations define and achieve organizational objectives in a more effective and efficient manner.

185. COUNCIL ON FOUNDATIONS, supra note 88.
186. Leslie, supra note 6, at 1184-85.
IV. MODELING DIVERSE GOVERNANCE

A. Legal Services Corporation: A Culturally Competent Board Model

Building a culturally competent board requires leadership, and often has its genesis from some external force. Notably, many foundations require grant applicants to disclose their board composition demographics. This disclosure requirement at least prompts an organization to consider the demographic composition of their governing boards. In addition, the fact that some foundations require disclosure raises the inference that demographic diversity provides some insights about an organization’s competence and capacity to assess and deliver certain program services. As a major funder of many nonprofits, and the regulator for all tax exempt organizations, the federal government is uniquely positioned to move the diversity ball “down the field” through board composition requirements and disclosure regulations.

The quasi-governmental Legal Services Corporation (LSC) funds local legal aid programs throughout the country. LSC was an outgrowth of the legal services program under President Johnson’s White House Office of Economic Opportunity, the administrative home of the Great Society programs. LSC receives an annual federal appropriation through the Commerce, Justice, and State Subcommittee. LSC uses these federal dollars to fund its main office operations and then distributes the balance of the funding to state and local legal aid organizations, primarily in proportion to the number of low-income people in each service area.

Legal aid programs are independent nonprofit organizations run by statewide or local boards of directors. The LSC Act, subsequent reauthorizations, and regulations set out the composition requirements for grant applicant boards. The board composition provisions establish a mechanism to ensure that legal aid boards are comprised of primarily lawyers and low-income (“client eligible”) directors. In order to ensure that board seats are not filled by individuals who might have interests contrary to the legal aid mission (e.g. landlords who do not keep their properties in good repair, or their lawyers), Section 1607.3 requires that each director be “supportive of the purpose of the Act and has an interest in, and knowledge of, the delivery of quality legal services to the poor.” Sixty percent of the board seats are reserved for attorneys, the majority of whom must be appointed by bar associations. The

189. See id. § 2996c.
190. 45 C.F.R. § 1607.3(a), (b)(1) (2010).
191. Id. § 1607.3(b) (2010). Each legal aid grant organization is charged with the responsibility of ensuring this allegiance to mission under Section 1607.3(h)(1).
Nonprofit Pluralism and the Public Trust

board itself may select the balance of non-bar attorney appointments, or designate mission-oriented organizations to appoint attorney members.\textsuperscript{192} Thirty-three percent of the board must be “client eligible,” \textsuperscript{193} low-income individuals who financially qualify to receive legal aid services.\textsuperscript{194}

Client eligible directors are appointed by “appropriate groups” that may include client associations, neighborhood associations, and community-based organizations that “advocate for or deliver services or resources to the client community . . . .”\textsuperscript{195} In order to facilitate low-income client participation, the LSC regulations state that legal aid organizations may provide per diem expense payments or reimbursement for travel or other out of pocket expenses.\textsuperscript{196} This modest financial support increases the ability of low-income people to serve on boards of directors, and is an important tool in the effort to empower and enlist client populations to participate in assessment and strategic direction of services at a governance level.

The LSC regulations establish a norm that legal aid organizations should reflect a weighted balance of attorneys, who have policy and case priority responsibility for the tax-exempt law firm,\textsuperscript{197} along with a core representation of the constituent service population. Although legal aid organizations often look to bar associations to fill all of the attorney assignments, LSC regulations empower each organization to appoint up to 49% of the attorney members. The regulations designate all of the appointments of client-eligible members to client service oriented groups.\textsuperscript{198} Legal aid organizations may self-generate the remaining 7% of board seats, in addition to appointing up to 49% of the attorney positions, for a total of 56% of the governing board.

LSC’s explicit effort to share power between a range of stakeholders, including clients, is 40 years in the making; however, the inclusion of clients in legal services governance has not been seamless nor without controversy. Client advocacy representatives have expressed concerns about diversity in legal services program governance and operations.\textsuperscript{199} Legal aid staff attorney Joseph Dialing challenges that the appointment structure can be inflexible and

\textsuperscript{192} Id. § 1607.3(b)(2).
\textsuperscript{193} See 45 C.F.R. §1611.3(c)(1) (“As part of its financial eligibility policies, every recipient shall establish annual income ceilings for individuals and households, which may not exceed one hundred twenty five percent (125%) of the current official Federal Poverty Guidelines amounts.”)
\textsuperscript{194} Id. § 1607.3(a), (h)(1); § 1611.3.
\textsuperscript{195} Id.
\textsuperscript{196} Id. § 1607.3(a).
\textsuperscript{197} 45 C.F.R. § 1607.3(a) (2010).
\textsuperscript{198} Id. at 607.3(c) (“The members who are eligible clients \textit{shall} be appointed by a variety of appropriate groups designated by the recipient.”) (emphasis added).
contrarily notes that the core values of client-centered legal services can become dysfunctional in rural and modern contexts. According to Dailing, some clients have “thought that they should dictate what and how the [staff] lawyer ought to proceed, and there have been lawyers who thought that clients should listen closely and do exactly as instructed.” He suggests a number of good governance principles to improve client communications and achieve a more appropriate balance of client involvement. Other federal statutes have followed the LSC model, requiring that consumers-clients of federally supported services have at least some role in governance of grantee organizations. Power-sharing provisions have been included in federal grant programs, such as the Title V Maternal and Child Health Programs and the Technology-Related Assistance for Individuals with Disabilities Act of 1988. The New Market Tax Credit program includes provisions requiring that organizations utilizing tax subsidies include low-income residents on the governing or advisory board for the organization. Prof. Roger Graves observes that the board composition provision provides evidence of Congressional intent that the tax credit program primarily benefits low-income (rather than high-income) residents of economically depressed communities. Client-director provisions may be particularly useful in programs where clients’ ability to verbalize their assessment of services may be

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201. Id. Interestingly, Dailing suggests instituting term limits for client-directors, but does not address term limits for attorney-directors or other non-client directors. LSC regulations do not require grantee organizations to implement board term-limits. Id.


203. See generally Groves, supra note 13, at 213 (discussing governing and advisory board composition); see also Forbes, supra note 13, at 177 (giving a background summary of New Markets Tax Credit).

204. According to I.R.C. 45D(c)(1), organizations qualify as community development entities and may utilize the Work Opportunity Tax Credits if:

(A) the primary mission of the entity is serving, or providing investment capital for, low-income communities or low-income persons,

(B) the entity maintains accountability to residents of low-income communities through their representation on any governing board of the entity or on any advisory board to the entity, and

(C) the entity is certified by the Secretary for purposes of this section as being a qualified community development entity.

205. See generally Groves, supra note 13, at 220-21 (discussing governing and advisory board composition provisions).
Nonprofit Pluralism and the Public Trust

compromised. While client representation on governing boards presents challenges of its own (generally stemming from a perceived imbalance of power and lack of community between categories of board members), it is a fundamental and structural step towards establishing collaborative governance.

In the broader context of nonprofit organizations which use federal grant resources to provide direct services or benefits to low-income, minority, or gender-specific populations, diverse client participation in governance can provide further assurances that federal resources are invested in a manner that the affected community judges to be beneficial. This internal accountability structure improves organizational governance, and better protects federal investments. Client-director provisions represent one of the most progressive steps forward in institutionalizing nonprofit corporate governance diversity and pluralism.

LSC Regulations set a measurable standard for demographic diversity in board governance. In line with the requirements that are designed to ensure that the client constituency has a voice in governance, the regulations established baseline requirements for demographic composition. As a prerequisite to receiving federal funds through a grant, LSC regulations require that attorney board members “reasonably reflect the diversity of the legal community and the population of the areas served by the recipient, including race, ethnicity, gender and other similar factors.” Similarly, client-eligible board members “should be selected so that they reasonably reflect the diversity of the eligible client population served by the recipient, including race, gender, ethnicity and other similar factors.” Finally, the remaining 7% of board positions should also “reasonably reflect the diversity of the areas served by the recipient, including race, ethnicity, gender, and other similar factors.”

Together, these regulations establish a norm that legal aid organizations should attain demographic diversity as a pre-requisite to qualifying for federal funds. Moreover, the regulations set up a power-sharing model, with diversity requirements extending not only to the overall composition, but also to each category of board membership. Thus, a legal aid board that is comprised of...

206. See Henry Hansmann, supra, note 19, at 505-06 (discussing contract failure).
207. LSC/NLADA, supra note 179; LEGAL SERVS. CORP., supra note 199, at 15-16; cf. Dailing, supra note 200.
209. 45 C.F.R. § 1607.3(b)(3) (2010).
210. Id. § 1607.3(c).
211. Id. § 1607.3(d).
212. Id. § 1607.3(b)(2); see also id. §§ 1607.3(b)(3), (c), (d).
white attorneys and minority client-eligible persons would presumably violate the letter and spirit of this regulation.

To the extent that “the nature of the population, legal community or area” prevents an organization from meeting any of the board composition requirements, a legal aid grantee may request a waiver. However, the organization must “demonstrate” that it has made diligent efforts to “comply” with the board composition regulations. This demonstrative waiver requirement establishes a demographically diverse board as the default presumption for legal aid organizations.

On a national level, 60% of legal services directors are white, outpacing the percentage of clients (46.5%) by 13.5%. 24.9% of legal services clients are African American, compared to 20% of directors. Twenty percent of legal services clients are Hispanic, compared to 8% of directors. On the whole, 33% of legal services directors are minorities, while the client base is 53.5% minority. Although women make up nearly two-thirds of the client base, only 45% of legal services board directors are women.

The regulations impose the same representative goals on each of the three director categories, including attorneys, client-eligible persons, and other representatives. It is unclear, however, if the diversity record channels down within the LSC board categories for attorneys and clients. While LSC tracks information about the percentage of seats held within each director category, information is not available regarding the diversity of the directors within each category. LSC reporting on these categories would enable legislators and the public to ensure that the demographic diversity goals permeate each board category.

While many legal aid organizations function in communities that are not ethnically diverse and many bar associations are heavily dominated by white males, where gender or ethnic diversity is not a demographic possibility, a legal aid organization has a clear case for waiving the board composition

213. Id. § 1607.6(b).
214. Id. § 1607.6(c).
215. LSC Grantee Governing Body Membership by Ethnicity and Gender (Source, 2011 Grant Applications) (on file with the author).
216. Id.
217. Id.
218. The most recent statistical data for 2000 indicates that whites constitute 88.8% of lawyers, while minorities make up 11.2% of the bar. African American and Hispanic Americans comprise 4.2% and 3.4 percent respectively, with Asian Pacific Americans accounting for 2.2%, and Pacific Islanders .04%. 1.2% of lawyers report as multi-ethnic. In 2000, the bar was 73% male, 27% female, a substantial increase over the 1980 figures of 92% and 8% respectively. AM. BAR ASSOC. THE LAWYER STATISTICAL REPORT, (1985, 1994, 2004), available at http://www.americanbar.org/content/dam/aba/migrated/marketresearch/PublicDocuments/Lawyer_Demographics.authcheckdam.pdf (As of June 15, 2011, the American Bar Foundation website notes that publication of the new 2005 edition has been delayed).
Nonprofit Pluralism and the Public Trust

However, where legal aid organizations serve diverse populations, failure to fulfill the board composition mandates should be subject to a high level of scrutiny by the LSC president. In the past, LSC acknowledged that failure to maintain board diversity within each category of membership has led to a power imbalance between white attorney board members and minority client-eligible members. Acknowledging, that the average legal services board falls into a pattern of white attorneys who are most often male, and minority, female clients, LSC began a nation-wide conversation about providing services in a culturally competent manner that is sensitive to and meets the needs of a diverse client population.

Despite these challenges, the innovative establishment of a demographic diversity norm puts LSC in the forefront of the quest for diversity governance. Compared to corporate for-profit boards and other nonprofit organizations, legal services programs are more reflective of the general population. While women constitute 15.2% of Fortune 500 company boards and 17.1% of Fortune 100 boards, legal services board have 45% women directors. On the whole, minority directors make up 33% of legal services boards—twice as diverse as Fortune companies and significantly more diverse than average public charities or private foundation boards. The challenges of managing diversity goals and implementation policies also offer the positive benefits of deterring groupthink and integrity of organizational mission. A blending of attorney and client constituency participation, along with demographic and economic diversity sets up a structure that is intended to enhance a legal aid organization board’s ability to provide accountable governance for community-based legal aid services.

LSC’s administration of legal aid funding appropriations through grants to legal aid entities establishes a model that should be replicated in the government funded grant sector, and should be considered in the private philanthropic arena as well. Modeling legal services corporate board composition requirements will help nonprofit organizations to attain better governance, provide oversight capacity, and ensure that tax-forgiven charitable

219. 45 C.F.R. § 1607.6(e) (2010).
220. LEGAL SERVS. CORP., NAT’L DIALOGUE ON GENDER AND JUSTICE 5 (2001), available at http://www.lsc.gov/foia2/pdfs/opr/ndgjc.pdf (stating that “boards tend to be dominated by white males” and identifying “focusing more on how to address the composition of legal services program boards of directors, with particular attention to whether boards reflect the community (on all levels) …” as an approach to LSC’s diversity challenges).
221. LEGAL SERVS. CORP., NAT’L DIVERSITY IN THE LEGAL SERVS. CMTY. ACTION AGENDA (2002).
222. See discussion id. (for-profit board diversity).
223. Notably, LSC designed a diversity training program for legal services boards, identifying the benefits of having a diverse board, while suggesting strategies to resolve conflicts that were bound to occur in multi-cultural, diverse governing bodies. See LEGAL SERVS. CORP., supra note 199, at 30-32.
resources are managed and used in a responsible, culturally competent, and efficient manner.

As one of the largest funders of nonprofit organizations, the federal government stands in a position to advance diverse representation, power-sharing and improved governance capacity through replication of the Legal Services Corporation board composition structure for all nonprofits that receive government grant funding. In order to accomplish this goal, government grant program provisions and regulations should be amended to institute clear directions for pass-through funders (such as the Legal Services Corporation) and nonprofit grant recipients. Taxpayers deserve clear stewardship (unimpaired by groupthink) of assets dedicated to the public good through government grants. Moreover, consumer-clients who use nonprofit services should be empowered to overcome “contract failure” and gain at least a representative voice at the table in nonprofits that are being paid to serve them. Instituting diverse board composition requirements would make a considerable step towards improved governance and democratic objectives.

B. Transparent Diversity Disclosure: Learning from the SEC

Where government does not directly fund a nonprofit program, the IRS can improve accountability and confidence in the sector by requiring nonprofits to provide information on their board nomination process, as well as the organization’s statement and assessment of diversity policies, just as the Securities and Exchange Commission (SEC) has done with regard to publically traded companies. The SEC now considers the board diversity of publicly traded companies under the general umbrella of director independence. The SEC states that “it is useful for investors to understand how the board considers and addresses diversity, as well as the board’s assessment of the implementation of its diversity policy, if any.” The SEC reports that many institutional investors and advocacy groups argued that “there appears to be a meaningful relationship between diverse boards and improved corporate financial performance, and that diverse boards can help companies more

224. The Office of Management and Budget (OMB) could establish policy expectations and accounting reporting obligations through OM Circular A-133, which establishes audit reporting requirements for nonprofits that receive more than $300,000 in government grant funds. It should be noted, however, that Circular 133-A extends beyond nonprofit organizations and applies to state and local governments. This discussion is limited to tax-exempt nonprofit organizations that receive government grant funds.

225. 17 C.F.R § 229 (Item 407(c)(2)(iv) of Regulation S-K).


Nonprofit Pluralism and the Public Trust

effectively recruit talent and retain staff.”228 Citing an example where a company disclosed the number of women and minorities that held seats on the board, one SEC Commissioner observed that diversity disclosure empowers investors to make informed decisions: “This disclosure is noteworthy because instead of just talking about the diversity policy and how it is implemented, the company gives investors actual facts that show the results of the company’s efforts.”229 Nonprofit donors and clients, as well as taxpayers that subsidize nonprofit activities should have the same benefit in selecting which nonprofits they utilize, serve, invest in, and support. Despite its side-line regulatory position with respect to the independent sector, the IRS is well-positioned to set similar diversity disclosure benchmarks for nonprofit organizations.

Recently, the IRS articulated governance objectives and issued amendments to Forms 1023, 990, and 990 PF.230 The agency bases its authority to review nonprofit governance on its interest in achieving effective nonprofit operations and compliance with tax laws:

And while the tax law generally does not mandate particular management structures, operational policies, or administrative practices, it is important that each charity be thoughtful about the governance practices that are most appropriate for that charity in assuring sound operations and compliance with tax law. As a measure of our interest in this area, we ask about an organization’s governance, both when it applies for tax-exempt status and then annually as part of the information return that many charities are required to file with the Internal Revenue Service.231

In the statement on board composition, the Service expressly rejects nonprofits operating in “a climate of secrecy or neglect” which may lead to charitable assets being “diverted to benefit the private interests of insiders at the expense of public and charitable interests.”232 Diversely representative boards provide an additional opportunity for nonprofits to institute more accountable leadership. The IRS declares that “[g]overning boards should be composed of persons who are informed and active in overseeing a charity’s

228. Id.
232. Id. at 2.
operations and finances”233 and “include individuals who are not only knowledgeable and engaged, but selected with the organization’s needs in mind (e.g., accounting, finance, compensation, and ethics).”234 The Service addresses threats to board effectiveness, such as disproportionate size and lack of independence, declaring that “[s]mall boards run the risk of not representing a sufficiently broad public interest and of lacking the required skills and other resources required to effectively govern the organization,”235 and that boards “should not be dominated by employees or others who are not, by their very nature, independent individuals because of family or business relationships.”236 IRS efforts to address these authentic concerns would be bolstered by diversely accountable boards, which stand a much better chance of “representing a sufficiently broad public interest,”237 are less likely to be subject to capture, and can “operate more effectively and consistent with tax law requirements.”238

As an extension of the IRS’s board governance amendments to Forms 1023 and 990, the IRS should require nonprofits to disclose an organization’s board diversity policy on the Form 1023 Application for Exemption,239 and require annual diversity policy assessment reporting the Form 990 and 990PF returns. While Part V of IRS Form 1023 focuses on compensation and financial arrangements between board officers, staff, and independent contractors, this section could be broadened to require disclosure of board diversity policies and assessments as mechanisms that enhance independence and organizational performance.240 IRS Form 990 Part VI, Governance, Management and

233. Id.
234. Id.
235. Id.
236. Id. at 3.
237. Id. at 2.
238. Id. at 1.
239. The proposed Form 1023 Diversity Disclosure Provision could track the existing SEC disclosure provision:

Part V – Insert New Section (6) (renumber remaining provisions):

(a) Describe the organization’s process for identifying and evaluating nominees for director (trustee) and any difference in the manner in which the nominating committee or board considers demographic diversity in identifying nominees for director (trustee).

(b) If the organization has a policy with regard to the consideration of diversity in identifying director nominees,

Provide a copy of the policy and explain how the policy has been adopted, such as by resolution of the governing board.

Describe how this policy is implemented, as well as how the nominating committee or board assesses the effectiveness of its policy.

240. See I.R.C. §501(c)(3) (2010) (IRS Application for Recognition of Exemption Form 1023) at Part V. A diversity disclosure provision could be structured similar to the conflict of interest section, which under section (a) asks if an organization has adopted a conflict of interest policy and requests a copy. Rather than suggest a sample policy, as the IRS does with the conflict of interest provision), the IRS could leave definition of diversity and articulation of the policy up the nonprofit organization, as reporting and external monitor organizations may serve as an incentive for organizations to delineate relevant and sufficient diversity policy standards.
Disclosure Section B should be expanded to include reporting on board diversity, along with the existing information requested regarding conflict of interest, whistleblower, and document retention and destruction policies.\textsuperscript{241}

Learning from the SEC process and experience, the IRS should take diversity disclosure a step further and require nonprofits to disclose actual board composition information on the Form 990 or 990PF.\textsuperscript{242} Many nonprofit funders use and recommend board composition matrixes that require grant applicants to report board composition information as a method of monitoring diversity and assessing governance capacity.\textsuperscript{243} As SEC Commissioner Luis A. Aguilar\textsuperscript{244} and “watchdog” groups observed after the first round of SEC submissions from 2010, diversity disclosure information would be more effective if companies report actual board composition numbers.\textsuperscript{245} Indeed, some corporations developed internal diversity scorecards to guide their strategic planning, leadership development, and employee retention goals for company diversity.\textsuperscript{246}

\begin{itemize}
\item \textsuperscript{241} I.R.C. §501(c), 527 or 4947(a)(1)(2010) (IRS Return of Organization Exempt from Income Tax Form 990) at Part VI Section B (12)-(14). The proposed Disclosure Policy reporting Form 1023 Diversity Disclosure Provision could track the existing SEC disclosure provision:
\begin{itemize}
\item Insert New Section 13 (renumber remaining provisions):
\begin{itemize}
\item a Does the organization have written policies and procedures for identifying and evaluating nominees for director (trustee) and any difference in the manner in which the nominating committee or board considers demographic diversity in identifying nominees for director (trustee)?
\item b Provide a copy of the policy and explain how the policy has been adopted, such as by resolution of the governing board.
\item c Describe how this policy is implemented, as well as how the nominating committee or board assesses the effectiveness of its policy.
\end{itemize}
\end{itemize}
\item \textsuperscript{242} IRS, DEPT. OF TREAS., FORM 990, supra note 230; IRS, DEPT. OF TREAS., FORM 990PF, supra note 230; see also supra Section IV.B.
\item \textsuperscript{244} Aguilar, Diversity in the Boardroom, supra note 229 (assessing the challenges of the initial round of diversity disclosure submissions: “Unfortunately, while some companies provided useful information in the spirit of the SEC rule, many other companies provided only abstract disclosure — often times limiting their disclosure to a brief statement indicating diversity was something considered as part of an informal policy. Many companies did not include any discussion of any concrete steps taken to give real meaning to its efforts to create a diverse board. By leaving out the steps taken and how those efforts are evaluated, these companies fail to provide investors with useful information, and it deprives investors of information they have demanded. I have asked our staff to follow up with some of these companies and I expect this disclosure to improve….When discussing the effectiveness of the policy and how that effectiveness is assessed, the disclosure could, for example, indicate how many candidates were interviewed that were women and/or minorities.”)
\end{itemize}
In a similar vein, the IRS should require nonprofits to include a board composition matrix on the Form 1023 Application for Tax Exemption and annual Form 990 and 990PF tax returns for public nonprofits and private foundations. Limiting reports to demographic data in categories required by the U.S. Census and adopting the SEC approach of allowing an organization to define and self-report diversity alleviates the privacy concerns that contributed to the demise of California’s A.B. 624.247 Moreover, as Commissioner Aguilar has noted, reporting organizational demographic information in the aggregate would address privacy concerns.248 Given that IRS Form 990 already requires detailed disclosure of director names, titles, compensation arrangements, and familial relationships,249 inclusion of demographic data should not present further privacy challenges.

C. A Diverse Governance Paradigm for the Nonprofit Sector

Nonprofit organizations serve a number of constituents who may be impacted by an organization’s governance capacity and cultural competence, including client communities, corporate and nonprofit funders, individual donors who underwrite program operations, and the taxpaying public who support tax exemptions and subsidies for nonprofit organizations. All of these stakeholders have an interest in promoting more accountable, transparent, and culturally competent board governance. In pursuit of meeting the fiduciary duty of obedience, the responsibility of shepherding a nonprofit should be shared with diverse directors who may better understand community needs and who are willing to challenge the genteel providence of boards in order to strive for optimum organizational performance.

Philanthropic and nonprofit organizations can move the sector forward by embracing demographic diversity as a good governance strategy, and adopting a policy of demographic disclosure. Pluralistic inclusion and transparency in diversity governance will improve the accountability and performance of the

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247. One major point of contention was the legislation’s requirement for disclosure of director sexual orientation. California State Bar representatives challenged that the collection and publication of this kind of data would be an unconstitutional invasion of privacy. See Statement by California Bar Association, Business Law Section, Nonprofit & Unincorporated Organizations Committee, on A.B. 624 (Coto) (Mar. 3, 2008), available at http://dwalliance.com/sbar/NPOCom_AB624.pdf.

248. Aguilar, Diversity in the Boardroom, supra note 229; see also Aguilar, SEC Comm’r, Board Diversity: Why It Matters and How to Improve It, Speech at Agenda Luncheon Program (“Useful disclosure also could highlight the diversity of the existing board of directors, which would shed light on the effectiveness of the fund's board diversity policy even if the information was provided in the aggregate and did not specifically identify any particular directors.”)

Nonprofit Pluralism and the Public Trust

The nonprofit sector. Transparency in board demographic diversity information is an important tool in the effort to create a more inclusive nonprofit sector. Disclosure of demographic data can provide the impetus for nonprofits to become more diverse. The disclosure, in and of itself, creates an opportunity for nonprofits to conscientiously consider board composition. To the extent that an organization wants to attract funders, donors, or clients, public disclosure will allow the marketplace to be fully informed. Utilizing monitoring entities, such as Guidestar, observers can use diversity governance information to assess the potential governance capabilities of these nonprofit entities. The taxpaying public deserves to have a charitable sector that engages all sectors of America in governance decisions. Beyond pluralistic goals, diverse governance positions nonprofits for better organizational performance. Decisions about organizational mission, strategic direction, and implementation activities and assessment of client-consumer satisfaction and organizational performance are critical governance matters. The decision-making process improves as nonprofits adopt a more pluralistic composition and break the bonds of groupthink. Given the governance crises that have plagued the sector in recent years, demographically diverse nonprofits can increase the likelihood of averting poor governance structures that have come to plague the sector.

One important function of the nonprofit sector is to advance thoughts and program innovations ahead of the curve; indeed, the innovative “research and development” function is a key justification for the favored tax status that nonprofit entities enjoy.250 With regard to pluralistic inclusion, in some historical instances, government led the country to better results. Albeit slowly, under President Truman, the Armed Services set the nation on the path to desegregation.251 Likewise, President Nixon opened the doors for minority small businesses to bid on federal contracts through affirmative action.252 In both instances, the transition was far from perfect. But these efforts were borne of the recognition that all sectors of the taxpaying public deserved the opportunity to serve in the military and to engage in a share of government contracting opportunities. Likewise, women, minorities, and the client-consumer population should have an opportunity to guide and assess the performance of the nonprofits designed to serve them and tax subsidies that are invested in communities. Following the lead of successful efforts at the Legal Services Corporation and the Securities and Exchange Commission, the

nonprofit sector should lead, rather than follow, in this important evolution of American society. Equipped with diversity of thought and experience, nonprofit boards are better equipped to self-regulate. Public trust and confidence in the capacity of a nonprofit board’s capacity to effectively self-govern is enhanced by transparent disclosure of nonprofit organizations’ board demographics. Diverse governance is an important tool that will better enable nonprofit boards to meet the stewardship challenge of protecting the public trust.