University Oversight of Public University-Affiliated Foundations: Who Watches the Watchers?

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ABSTRACT

The article addresses the potential gap in oversight of, and accountability for, the actions of some university-affiliated foundations that have been created and used by many of our state/public universities. The article provides an overview of the relationship between the state universities and their respective university-affiliated foundations, examines the nature of existing governance, accountability and oversight systems employed that may enable wrongdoing to either go undiscovered, or unpunished, and finally recommends potential mechanisms to improve those porous oversight and accountability systems. Examination of these entities, especially their "legal relationship" vis-a-viz one another, is particularly timely given their rising use and the significant value of public institution assets held by university-affiliated foundations. Their continued use and widespread impact also present unique challenges to university stakeholder constituents who seek and expect regular oversight by state universities and meaningful accountability for wrongdoing. Deficiencies in both areas have already led to a number of public financial scandals, including the previously resolved University of Louisville Foundation scandal. Reforming university governance, oversight, and accountability systems for both associated universities and their university-affiliated foundations through changes to state open records laws, to state corporate law standing rules, and through private ordering can put safeguards in place to protect university stakeholder constituencies and hold members of the respective university governing boards accountable for breach of fiduciary duties and other misconduct.

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INTRODUCTION

Most universities[1] are organized under state law, structured as nonprofit corporations, and governed by boards of trustees (similar to traditional boards of directors). As fiduciaries, the boards provide oversight and direction to their respective universities. However, recently publicized financial scandals involving university presidents at many well-known universities (both public and private) – including at Adelphi University,[2] Liberty University,[3] the University of Wisconsin,[4] and the University of Louisville[5] – lay bare oversight failures by the institutions' governing boards.[6] The harms from these fiduciary breaches, however, extend far beyond the academic halls to dramatically impact numerous stakeholder constituencies[7] and deleteriously impact the public interest.

1. This author uses "universities" to include colleges and universities.

2. In 1997, Adelphi University President Peter Diamandopoulos was ousted due to his lavish spending and numerous conflicts of interests amid plunging enrollment at Adelphi following an investigation by the New York State Attorney General, which revealed that "among other perks, Adelphi paid for his $82,314 Mercedes, his $1.3 million Manhattan condominium (in addition to a residence on the Garden City campus) and his $4,000 in holiday tips to the apartment building's staff." Sam Roberts, *Peter Diamandopoulos, Divisive Adelphi University President, Dies at 86*, N.Y. TIMES (Apr. 7, 2015), https://www.nytimes.com/2015/04/08/nyregion/peter-diamandopoulos-divisive-adelphi-university-president-dies-at-86.html. For a year and a half prior to his ouster, Adelphi's president had been criticized for his exorbitant salary and benefits package (worth $1.3 million in today's dollars), his severe cutbacks in programs and his overly close relationship with the university's trustees. *See* Bruce Lambert, *New York Regents Oust 18 Trustees from Adelphi U.*, N.Y. TIMES (Feb. 11, 1997), https://www.nytimes.com/1997/02/11/nyregion/new-york-regents-oust-18-trustees-from-adelphi-u.html. The New York State Board of Regents ousted 18 of Adelphi's 19 trustees for neglect of duty (i.e., failure of oversight) and misconduct in 1997. Roberts, *supra*; *see also* Bruce, *supra* (noting that two of the trustees from the governing board "improperly profited by doing business with the university" without disclosing the details of their conflicts).

3. Former Liberty University President Jerry Falwell Jr. was facing a $10M lawsuit in 2021 from the university for breach of fiduciary duties due to his nondisclosures while negotiating a lucrative contract for himself with the university's trustees. President Falwell resigned following revelations of an "alleged extortion by a pool boy from Miami, who claimed to have had a seven-year affair with Falwell and his wife." Richard Luscombe, *Liberty University Sues Scandal-hit Ex-president Jerry Falwell Jr for $10m*, THE GUARDIAN (Apr. 16, 2021), https://www.theguardian.com/us-news/2021/apr/16/liberty-university-jerry-falwell-jr-scandal-lawsuit.

4. *See* USA Today Network-Wisconsin, *UW-Oshkosh Foundation Scandal: What you Need to Know*, OSHKOSH NORTHWESTERN (May 15, 2018), https://www.thenorthwestern.com/story/news/investigations/2017/10/01/university-of-wisconsin-oshkosh-foundation-scandal-guide/97645146/.

5. Claire Galofaro, *University of Louisville President Gets $690,000 to Resign amid Embezzlement Scandals and a String of Other Embarrassments*, BUSINESS INSIDER (July 29, 2016), https://www.businessinsider.com/ap-university-of-louisville-accepts-presidents-resignation-2016-7. See complete discussion of this scandal at Section II.

6. *See* ASS'N. OF GOVERNING BDS. OF UNIVS. & COLLS., AGB STATEMENT ON THE FIDUCIARY DUTIES OF GOVERNING BOARD MEMBERS 1 (2015) [hereinafter AGB Statement] (stating that behind nearly every failure of governance and leadership in higher education institutions is a breach of the principles of fiduciary duty.). AGB is an organization of 1,300 boards representing 1,900 colleges, universities and institutionally-related foundations providing leadership and counsel to member boards, chief executives, organizational staff and policy makers that was founded in 1921.

7. Multiple groups may believe that they are entitled to have a voice that is both heard and respected by a public university as its beneficiaries or investors. These groups include students, alumni, donors, faculty and staff, state and federal regulators, the taxpaying public, and the community at large (collectively, "stakeholder constituents").

Therefore, university scandals call into question the governance roles and accountability responsibilities of the respective institution's governing boards.

To that end, this article explores the role of corporate governance at play in some public universities, the accountability systems designed to detect and hold wrongdoers accountable for harmful corporate governance failures, and discusses how the use of university-affiliated foundations may impact both university corporate governance and university accountability systems.[8] More specifically, this article explores the legal relationship, governance obligations, and accountability systems that exist between universities and their university-affiliated foundations, which typically control the associated universities' purse strings.[9]

By way of background, Section I begins with a general discussion of the public university system, including its organization, management, and funding structures.

Section II provides an overview of the legal and working relationship that existed between the University of Louisville[10] and its university-affiliated foundation (the University of Louisville Foundation);[11] as an illustration of the

8. *See* March 2023 University Foundation Spreadsheet (on file with Berkeley Business Law Journal) (charting relationship of each state's main public university and foundation; money and other assets held; etc.). The focus of this article is on public universities in order to narrow the examination of their recorded governance of their university-affiliated foundations. As such, the terms "university" or "universities" as used henceforth will refer only those universities and college that are publicly funded. The term "university-affiliated foundations" is used henceforth to include only those university-created foundations, which hold donations on behalf of, and for the benefit of, their associated universities—which are themselves deemed state agencies and are subject to state regulations and reporting requirement. See further discussions *infra*.

9. See Section I.C. for further discussion of the increased use of university-affiliated foundations by many public universities.

10. The University of Louisville (or "UofL") is a state-supported institution of higher learning and a member of the Kentucky state university system. It is currently governed by a 13-member board of trustees. *Board of Trustees*, UNIV. OF LOUISVILLE: OFFICE OF THE PRESIDENT, https://louisville.edu/president/boards/board-of-trustees (last visited June 18, 2023). At the time of the incident, it was governed by a 20 member voard of trustees, 17 of whom were appointed by the governor. *See* KY. AUDITOR OF PUB. ACCTS., EXAMINATION OF THE GOVERNANCE OF THE UNIVERSITY OF LOUISVILLE FOUNDATION AND ITS RELATIONSHIP TO THE UNIVERSITY OF LOUISVILLE 2–3 (Dec. 2016), https://louisville.edu/accreditation/donat-letter-files/uofl-final-state-auditors-report. That board "constitute[d] a body corporate whose powers include[d] the administration, on behalf of [UofL,] . . . of all revenues accruing from endowments, appropriations, allotments, grants or bequests, and all types of property; . . . ."; UNIVERSITY OF LOUISVILLE RESOLUTION OF THE BOARD OF TRUSTEES (Sept. 9, 2016) (attached to Chris Otts, *University of Louisville Trustees Threaten to Sue Foundation over Financial Records*, WDRB (Dec. 7, 2018), https://www.wdrb.com/news/university-of-louisville-trustees-threaten-to-sue-foundation-over-financial-records/article_8ff3aa87-1dcb-5201-b6b8-1854cbf031eb.html). *See also* KY. REV. STAT. § 164.830.

11. The University of Louisville Foundation (or "UL Foundation") is a 501(c)(3) non-profit corporation (with neither capital stock, members, nor stockholders) organized under the laws of Kentucky 1970. *See Third Amended and Restated Bylaws of The University of Louisville Foundation, Inc*. (July 29, 2021), https://louisvillefoundation.org/wp-content/uploads/2021/12/Bylaws-ULF-7.29.21-web.pdf (hereinafter By-laws); *Amended and Restated Articles of Incorporation of University of Louisville Foundation, Inc*. (Apr. 30, 2021), https://louisvillefoundation.org/wp-content/uploads/2021/12/Articles-of-Incorporation-04.2021-web.pdf. It works exclusively for the charitable and educational purpose of the UofL; as such, the UL Foundation manages the UofL endowment, and holds, invests, and designates the

potential governance and oversight failures (hereinafter collectively described as the "University of Louisville Foundation Scandal" or "UL Foundation Scandal"). This article details the activities that led to the purported fiduciary breaches, including allegations of mismanagement of university funds and abuses of authority, and the resulting narrowly-tailored litigation. Following news reports of misdeeds and the ensuing internal investigations, both entities underwent extreme "housecleaning" in the aftermath of the UL Foundation Scandal. Most notably, James R. Ramsey, who held *inter alia* dual roles as both the University President and the President of the university-affiliated foundation, was forced to resign after 14 years of service to the University of Louisville.[12] Simultaneously, the sitting Kentucky governor unilaterally disbanded and replaced the entire governing board of the University of Louisville.[13] Later, the Kentucky Auditor of Public Accounts[14] published its audit report detailing the numerous governance failures among other findings.[15]

Section III of the article explores the fiduciary obligations applicable to nonprofit corporations and charitable endowments, as well as the legal relationship that exists between public universities and their university-affiliated foundations. It analyzes both their respective governance responsibilities and accountability systems to determine their effectiveness, then specifically discusses whether the use of independent nonprofit corporations – the university-affliated foundations – as silos for many universities' non-state appropriated assets hinders those associated universities' governing bodies from appropriately meeting their fiduciary obligations to their respective institutions and their university stakeholder constituencies.

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use of UofL's assets. *See By-laws*. The UL Foundation "supports the university in its efforts to maintain its distinction as a premier, nationally recognized metropolitan research university while promoting the university's departments in their educational, scientific, and literary efforts and enterprises. *See* 2015 Federal Tax Form 990, LOUISVILLE FOUND. (2015). It is governed by a 15-member board of trustees, who (in 2016) were protected both by indemnification and insurance. *See By-laws*. Though an independent entity from UofL, the UL Foundation has been deemed a public agency, subject to the Open Records Act of the Commonwealth of Kentucky. *See* Univ. of Louisville Found., Inc. v. Cape Publ'ns, Inc., No. 2002-CA-001590-MR, 2003 Ky. App. Unpub. LEXIS 1370, at *22–23 (Ky. Ct. App. 21, 2003) (holding the Foundation is a public agency); Cape Publ'ns, Inc. v. Univ. of Louisville Found., Inc., 260 S.W.3d 818, 824 (Ky. 2008) (ordering Foundation to release records under the Open Records Act). A public agency is defined in KY. REV. STAT. § 61.870(1).

12. Claire Galofaro, *supra* note 5.

13. *Id*.

14. The Kentucky Auditor of Public Accounts is charged with acting as guardian of taxpayer dollars. Its audit was conducted due to concerns about the University of Louisville Foundation's governance practices and concerns related to the limited accountability and transparency of certain aspects of the University of Louisville Foundations' operations. Transmittal Letter from Mike Harmon, Auditor of Pub. Accounts, Commonwealth of Ky., to Dr. Neville G. Pinto, President, Univ. of Louisville, and Bruce Moore, Bd. Chair, Univ. of Louisville Found. (Dec. 14, 2016), https://louisville.edu/accreditation/donat-letter-files/uofl-final-state-auditors-report [hereinafter Transmittal Letter].

15. Mark Harmon, *Examination of the Governance of the University of Louisville Foundation and its Relationship to the University of Louisville* (Dec. 14, 2016), https://louisville.edu/accreditation/donat-letter-files/uofl-final-state-auditors-report.

While it appears that university-affiliated foundations were created to work for the benefit of the associated universities, these associated universities, without additional private ordering, may have limited oversight power over decisions made by the governing boards of their university-affiliated foundations. As structurally separate, independent nonprofit corporate entities, the prevailing view is that university-affiliated foundations' governing bodies (or their members) owe no corporate law derived fiduciary obligations to the respective associated universities or their stakeholder constituents.[16] Consequently, as will be illustrated, actions against those governing bodies for mismanagement of university-owned assets and other related abuses typically must be brought by state attorneys general, unless the injured universities are able to make a case for "special beneficiary standing" before the courts. Unfortunately, given the many priorities of state attorneys general, enforcement of fiduciary obligations owed to universities is not high on their lists – to the extent this topic makes the list.

It is worth noting that had these universities (and where appropriate their university-affiliated foundations) instead been organized either as nonprofit corporations with defined "members"[17] or as "business corporations"[18] with shareholders, the potential threat of a derivative lawsuit may have fostered adoption of stronger accountability systems to dissuade from fiduciary duty breaches based on oversight failures. Unfortunately, there currently is no significant exposure to derivative lawsuits for the governing boards of "non-member" nonprofit corporations even if their officers and directors have unquestionably breached their fiduciary duties.

Section IV sets forth recommendations for change. Notably, if members of university governing boards, as fiduciaries, are ordinarily not held accountable to their stakeholder constituents under circumstances similar to the UL Foundation Scandal due to the lack of standing or other basis to keep stakeholder constituents silent, one must reconsider the accountability methods employed at institutions of higher education. This is particularly so in those instances where universities are increasingly organizing and relying upon the existence of their

16. *See, e.g.*, Martha T. McCluskey, *Following the Money in Public Higher Education Foundations*, AM. ASS'N OF UNIV. PROFESSORS, https://www.aaup.org/article/following-money-public-higher-education-foundations#.ZBOGl-zMKDU; Jonathan W. Peters & Jackie Spinner, *How University Foundations Try to Avoid Public Scrutiny—and What Reporters Can Do*, COLUM. JOURNALISM REV.: UNITED STATES PROJECT (July 16, 2015), https://www.cjr.org/united_states_project/how_university_foundations_try_to_avoid_public_scrutiny_and_what_reporters_can_do.php.

17. A "member" means "a person in whose name a membership is registered on the records of the corporation and who has the right, not solely as a delegate, to select or vote for the election of directors or delegate or to vote on any type of fundamental transaction." MODEL NONPROFIT CORP. ACT ("MNCA") § 102 (AM. BAR ASS'N, amended 2021).

18. "Business corporations" are for-profit corporations incorporated under the laws of the state; most are subject to law adhering to the ABA Model Business Corporation Act ("MBCA"). *See* MBCA § 102 (AM. BAR ASS'N, amended 2021).

university-affiliated foundations (which are similarly organized as nonmember-nonprofit corporations) to hold, invest, and disperse university funds. Is it not past time to consider: "Who" among a university's stakeholder constituents – other than its state attorney general – should state law or public policy enable to step into the unoccupied shoes of the absent "members" of said university nonprofit corporation to enforce the governance and accountability obligations of its governing bodies? The long-requested[19] need to expand the *group having standing* (among other changes) to enforce the accountability of those who control and manage the "business and affairs" of higher education institutions is even more compelling when we consider that, in many instances, the governing bodies of "associated universities"[20] are *sharing* (if not wholly delegating) their responsibilities of university management and funding with their "university-affiliated foundations," but are seemingly hamstrung to engage in the adequate oversight.

I. BACKGROUND: THE PUBLIC UNIVERSITY

A. Its Creation and Mission

Most public universities and colleges in the United States are called "state universities" because they were either founded as state government entities or received funding and other subsidies from their respective state governments, notwithstanding that state support for such universities has been steadily declining in recent decades.[21] There is at least one public university in every state, though some states like California have more than one public institution of higher education. These state universities typically[22] resulted from the Morrill Land-Grant Acts,[23] which gave states federal lands to sell to finance public institutions

19. *See, e.g.*, Eileen L. Morrison, *Enforcing the Duties of Nonprofit Fiduciaries: Advocating for Expanded Standing for Beneficiaries*, 95 B.U. L. REV. Annex 19 (2015).

20. The term "associated university" refers to those public universities and colleges which have created and use university-affiliated foundations.

21. *See* Michael Mitchell et al., *State Higher Education Funding Cuts Have Pushed Costs to Students, Worsened Inequality*, CTR. ON BUDGET & POL'Y PRIORITIES (Oct. 24, 2019), https://www.cbpp.org/research/state-budget-and-tax/state-higher-education-funding-cuts-have-pushed-costs-to-students.

22. Some public universities received land grants under other federal or state statutes. (e.g., University of Alabama).

23. *See* Act of July 2, 1862 (Morrill Act), Pub. L. No. 37-108 (establishing land grant colleges). The Land-Grant Act of 1862, or Morrill Act, made it possible for states to establish public colleges which were funded by the development or sale of federal grants of land. The hope was to create colleges which specialized in agriculture and the mechanic arts. The Act was named for its sponsor, Vermont Congressman Justin Smith Morrill (1810–98). Specifically, the Act granted each state 30,000 acres (12,140 hectares) for each of its congressional seats. Funds from the sale of the land were used by some states to establish new schools; other states turned the money over to existing state or private colleges to create schools of agriculture and mechanic arts (known as "A&M" colleges). It was only through the second Morrill Act of 1890, which forbade racial discrimination in admissions policies for colleges receiving these federal funds, that predominantly African American and Native American public

of higher education in practical fields and liberal arts.[24] Some of these public universities began as so-called "normal schools" or teachers colleges.[25] These institutions of higher education were thought to provide benefits to society. Such benefits include the university graduates' education in areas of national need,[26] community volunteer work, leadership within the community, philanthropic contributions, and increased tax payments.[27]

Since their early days, most public universities had a stated mission to provide a good education for the common man in industry, agriculture, and engineering.[28] It was said that

> Universities are social institutions, and should perform a *social service*," otherwise, there is "no reason for the existence of any university, or for maintaining the freedom of learning and teaching which they insist upon, except in so far as they maintain and promote the humane and rational values which are essential to the preservation of democratic society, and of civilization as we understand it.[29]

It seems appropriate that today, many public universities have adopted the tri-part mission of: (i) training students for a life of service by equipping them with job-ready skills, (ii) research for the advancement of knowledge, and (iii) community service.[30] Indeed, though organized as corporations, the mission of public universities varies in that it must satisfy a wider constituency, including students, faculty, employees, alumni, donors, public officials, and society at large.

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institutions of higher education were created. *See* Act of Aug. 30, 1890 (Second Morrill Act), 7 U.S.C.§§ 322-23.

24. *See* Judith C. Areen, *Governing Board Accountability: Competition, Regulation and Accreditation*, 36 J. COLL. & U.L. 691, 696 (2010).

25. *See e.g.*, Arizona State University, UCLA, and University of Wisconsin-Milwaukee.

26. In 2015, public universities awarded 63 percent of all bachelor's degrees and 53 percent of all graduate level degrees and certificates in areas of national need as defined by the federal government, including agriculture, computer science, health, education, engineering, biology, physical sciences, math, foreign languages, social work, and protective services. *How do College Graduates Benefit Society at Large?*, ASS'N OF PUB. & LAND-GRANT UNIVS., https://www.aplu.org/our-work/5-archived-projects/college-costs-tuition-and-financial-aid/publicuvalues/societal-benefits.html (last visited June 13, 2022) (citing data compiled from the National Center for Education Statistics, U.S. Dept. of Educ. Integrated Post-Secondary Education Data System (IPEDS)).

27. *Id.*

28. *See* Act of July 2, 1862 (Morrill Act), Pub. L. No. 37-108 (establishing land grant colleges).

29. Elizabeth Garrett, *Cornell's New President: It's Time to Look at Higher Education Through a Different Lens*, WASH. POST, (Aug. 24, 2015) (emphasis added) (quoting Carl Becker, an American historian, who "linked academic freedom with a related responsibility, extending far beyond the individual professor."); Carl Becker, *The Cornell Tradition: Freedom and Responsibility*, 26 BULL. AM. ASS'N UNIV. PROFESSORS (1915-1955) 4, 509, 520 (1940) (part of speech celebrating Cornell University, which although chartered as a private school, has a public mission, given that it also receives some funding from New York state).

30. Lorenzo Compagnucci & Francesca Spigarelli, *The Third Mission of the University: A Systematic Literature Review on Potentials and Constraints*, 161 TECH. FORECASTING & SOC. CHANGE 120284 (2020).

B. University Management

1. Operations

Universities typically install a board of trustees[31] (or similarly-named governing body)[32] to run the respective institution.[33] However named, a university's board is the legal agent of the university and is solely authorized to manage the institution's business and affairs and to fulfill the institution's mission, vision, and values.[34] Though varying in size, small university boards have ten members while the larger university boards may have over fifty members. Ultimately, a university's governing documents – e.g., its charter or bylaws – will dictate the size of its governing board.[35] University board members are selected in many ways, but most are selected by the sitting state governor to serve for a specific term.[36] To that end, university trustee positions are traditionally filled by politically connected individuals and big donors to said university, causing some to argue that many of these board members lack prior corporate governance experience.[37] Today, more board members from the

31. The term "Board of Trustees" is most commonly used for naming governing boards of universities, even if it is not the most widely used across the fifty states. *See e.g.*, Ohio State, University of Connecticut, University of Florida, University of South Carolina, Indiana University, and Michigan State University, Thirty-nine states use the second most popular term "Boards of Regents" to govern their public universities. *Is a Board of Trustees the Same as a Board of Regents? What is a Board of Governors?* ASS'N. OF GOVERNING BDS. OF UNIVS. & COLLS., https://web.archive.org/web/20181101095747/https://www.agb.org/faq/is-a-board-of-trustees-the-same-as-a-board-of-regents-what-is-a-board-of-governors (last visited Nov. 1, 2018). *See, e.g.*, University of Iowa, University of Minnesota, University of Texas, University of Washington, and University of Wisconsin.

32. Some state universities instead may use any of the following designations for their governing boards: Board of Regents, Board of Visitors, or Board of Governors. *See, e.g.*, University of Iowa, University of Minnesota, University of Texas, University of Washington, and University of Wisconsin.

33. *See* Areen, *supra* note 24, at 692–95 (discussing three models of academic governance: faculty-controlled; government-controlled, and governing board-controlled). This model of governance puts control of the administration of resources and assets in the hands of a lay (nonfaculty) governing board. *Id.* at 694.

34. *E.g.*, Nick Price, *The Roles and Responsibilities of a Board of Directors for a College or University*, BOARDEFFECT (Feb. 2, 2018), https://www.boardeffect.com/blog/roles-responsibilities-board-directors-college-university/.

35. The University of Louisville, for example, has a 13-member Board of Trustees, ten of whom must be appointed by the governor, and must include at least one alumnus, one member of the teaching faculty, one member of the permanent staff and one student member who is the student body president.

36. Greg Lewis, *The Powerful Influence of Business on University Boards*, THE CENTURY FOUND. (June 11, 2013), https://tcf.org/content/commentary/the-powerful-influence-of-business-on-university-boards/; Richard Novak, *Improving Appointments to our Public College and University Governing Boards*, Richard Novak, *Improving Appointments to Our Public College and University Governing Boards*, ASS'N. OF GOVERNING BDS. OF UNIVS. & COLLS. (Sept. 17, 2021), https://agb.org/blog-post/improving-appointments-to-our-public-college-and-university-governing-boards/. *See, e.g.*, *Gov. Matt Bevin Names 10 Appointees to University of Louisville Board of Trustees*, WDRB (June 29, 2016), https://www.wdrb.com/news/education/gov-matt-bevin-names-10-appointees-to-university-of-louisville-board-of-trustees/article_6049f659-199c-5762-aafc-3b4cc68c5d3e.html.

37. Lewis, *supra* note 36; JAMES J. DUDERSTADT & FARRIS W. WOMACK, THE FUTURE OF THE PUBLIC UNIVERSITY IN AMERICA: BEYOND THE CROSSROADS 19 (2003). *See, e.g.*, Jake Lahut, *Florida Gov. Ron DeSantis Wanted $100k Donations from University of Florida Trustees or They'd Lose Their*

corporate world are being selected by universities to bring their skills and connections to the table.[38] There also has been an uptick of alumni appointed to board seats.[39]

University governing bodies generally are charged with promoting academic excellence and have significant autonomy from state government control,[40] though a university's charter or bylaws may set forth the limits of its governing body's authority.[41] Most university boards have the following minimum responsibilities: setting or reaffirming the university's mission; adopting annual budgets; university fundraising; strategic planning; selecting the university's president; management oversight; reviewing institutional performance; and setting board policies on the same.[42] The chief responsibility of any university board is to aid the university and ensure that the financial resources of the university are sufficient to provide a sound educational program.[43]

In collaboration with the university president, a university board chair usually also sets the agenda for meetings of the board. Pursuant to the same governing documents, the board also convenes and staffs the appropriate number and type of board committees required to best serve the needs of the institution.[44] Board members thereafter work collectively and through their committees to meet their responsibilities to their respective universities. As a board member, each "trustee" is also a fiduciary of the university. Their fiduciary duties[45] are purportedly upheld through regular attendance at board meetings and the oversight of the university president and other members of a university's

Appointments, Democratic Florida Commissioner Alleges, BUSINESS INSIDER (Dec. 15, 2021), https://www.businessinsider.com/ron-desantis-university-florida-board-trustees-donations-100k-nikki-fried-2021-12. *See also infra* at Section III(A)(1).

38. Lewis, *supra* note 36; Georgia Howard, *Explaining Why Few University Board of Trustees Members Have Higher Education Experience*, NPR STATEIMPACT (June 26, 2012), https://stateimpact.npr.org/florida/2012/06/26/university-boards-of-trustees-make-academic-decisions-with-no-experience-in-education/.

39. Robert Strauss, *Expectations Mount for Trustees in Higher Education*, N.Y. TIMES (Nov. 4, 2015), https://www.nytimes.com/2015/11/08/giving/expectations-mount-for-trustees-in-higher-education.html.

40. *See* Areen, *supra* note 24, at 697–98 (noting that "[b]y constitutional authority in some states, and by statute in others, most public institutions of higher education" are governed by lay boards, who serve as a buffer from excessive government control).

41. As with corporations, the board as a whole has the legal authority to act on behalf of a university, rather than individual board members acting alone.

42. Of course, a university's board will also make decisions about the number and types of degrees offered, composition of the student body, the tenure system, as well as the nature of departments, divisions, and schools through which the curriculum will be administered. *See* Teachers College, *What Do Trustees Do?*, COLUMBIA UNIV. (Mar. 10, 2009), https://www.tc.columbia.edu/articles/2009/march/what-do-trustees-do/.

43. Price, *supra* note 34.

44. Typical university board committees include: Academic Affairs, Audit, Executive, Finance, Institutional Advancement, Investment and Student Affairs. *See Key Committees*, ASS'N OF GOVERNING BDS. OF UNIVS. AND COLLS., https://agb.org/knowledge-center/key-committees/.

45. See discussion of fiduciary duties in Section II.

administration.[46] Good record-keeping and reporting by both the governing board and university administration are acceptable measures to ensure proper oversight and transparency. To that end, university governing boards must act as risk managers for their respective institutions, particularly with respect to university budgets and their institutions' investment strategies, as will be discussed in greater detail later.[47] Prudence requires having more than a passing knowledge of an institution's joint ventures and other investment holdings, including real estate investments and other property purchases.

A relationship of shared governance typically exists between a university's governing board, its administration, and the faculty members[48] to help with the management of certain areas of a university's agenda – typically teaching and research.[49] "Shared governance" recognizes that

> [A] university is a great and indispensable organ of the higher life of a civilized community, in the work of which the trustees hold an essential and highly honorable place, but in which the faculties hold an independent place, with quite equal responsibilities – and in relation to purely scientific and educational questions, the primary responsibility.[50]

A 1966 Statement on Government of Colleges and Universities, formulated by the American Association of University Professors ("AAUP") and the American Council of Education ("ACE"), both explained the need for joint efforts among key constituencies as follows: "The variety and complexity of the tasks performed by institutions of higher education produce an inescapable interdependence among governing board, administration, faculty, students, and others." [51]

Thus, while it is a university's governing board's primary responsibility to oversee the university's financial matters, faculty members had and should have a say (or at least be consulted) during the decision-making process for those

46. The "administration" consists of the university's president and their cabinet, the deans, and the department chairs. Nancy B. Rapoport, *On Shared Governance, Missed Opportunities, and Student Protest*, 17 NEV. L.J. 1, 3–4 (2016). These administrators typically "spend their days on issues of budget, facilities, due process, and regulations."

47. See Section III.B, *infra*.

48. The faculty is typically comprised of tenured and tenure-track professors, but may also include non-tenured track and researchers. Rapoport, *supra* note 46 at 3.

49. *See id*. at 4 (noting that shared governance vests the faculty with significant input into the academic side of the house on the basis that "those people with the most knowledge of an area should have the most input, subject to reasonable checks and balances.").

50. *See* Areen, *supra* note 24, at 700 (citing *Declaration of Principles on Academic Freedom and Academic Tenure*, *in* AM. ASS'N OF UNIV. PROFESSORS, GENERAL DECLARATION OF PRINCIPLES, *reprinted in* 2 AMERICAN HIGHER EDUCATION: A DOCUMENTARY HISTORY 860, 860 (Richard Hofstadter & Wilson Smith eds., 1961)).

51. *See id*. at 701 (citing AM. ASS'N OF UNIV. PROFESSORS, 1966 STATEMENT OF GOVERNMENT OF COLLEGES AND UNIVERSITIES, *reprinted in* AM. ASS'N OF UNIV. PROFESSORS POLICY DOCUMENTS & REPORTS 135–40 (10th ed. 2006)).

financial matters that will directly affect the ability of faculty to research or teach, especially regarding matters relating to the university's budgets, strategic planning, real estate acquisitions, and other construction projects.[52] The faculties' interest in being heard by university governing boards on financial matters has been growing as university revenues are becoming more and more scarce.

2. Government Funding and Endowments

Public universities rely on at least five revenue sources to fund their respective educational mission: (i) tuition and fees; (ii) state and local appropriations; (iii) private gifts, investment returns, and endowment income ("PIE"); (iv) state and local grants and contracts for research and training; and (v) federal appropriations, grants and contracts.[53] In the past, state appropriations provided a lion's share of these institutions' revenue. Unfortunately, most institutions have experienced budgetary challenges over the past few decades due to severe and sustained funding cuts by their respective state legislatures.[54]

Financial support and subsidies from both federal and state governments to public universities have sharply declined over the years – for some, a few decades.[55] The percent of state appropriations for per student schooling declined from 78% in 1974 to 43% in 2000.[56] According to a report by the Delta Cost Project,[57] state support for public universities declined by 28 percent on a per-student basis.[58] Moreover, funding per student "remains well below pre-recession levels – on average, 20 to 30 percent lower than in 2008," resulting in students of these institutions having to "pay a higher share of their educational

52. *See* Hans-Jeorg Tiede et al., *Faculty Communication with Governing Boards: Best Practices*, AM. ASS'N OF UNIV. PROFESSORS, https://www.aaup.org/report/faculty-communication-governing-boards-best-practices.

53. Donna M. Desrochers & Steven Hurlburt, *Trends in College Spending: 2003-2013*, AM. INST. FOR RSCH. 3–4 (Jan. 2016), https://www.air.org/sites/default/files/2021-08/Delta-Cost-Trends-in-College-Spending-January-2016.pdf.

54. Michael Mitchell et al., *State Higher Education Funding Cuts Have Pushed Costs to Students, Worsened Inequality*, CTR. ON BUDGET AND POL'Y PRIORITIES (Oct. 24, 2019), https://www.cbpp.org/research/state-budget-and-tax/state-higher-education-funding-cuts-have-pushed-costs-to-students.

55. *See* Brian O'Leary & Nick Perez, *State Support for Public Colleges, 2002-20*, CHRON. OF HIGHER EDUC. (Aug. 17, 2022), https://www.chronicle.com/interactives/statesupport?cid=wsinglestory.

56. Michael J. Rizzo, *State Preferences for Higher Education Spending: A Panel Data Analysis, 1977–2001*, *in* WHAT'S HAPPENING TO PUBLIC HIGHER EDUCATION? 3–35 (Ronald G. Ehlenberg ed., 2006). *See also* Michael J. Rizzo, *State Preferences for Higher Education Spending: A Panel Data Analysis*, 1977–2001 (discussing precipitous decline in state government funding of public higher education) (paper presented at Cornell Higher Education Research Institute's Annual Conference in 2005) https://archive.ilr.cornell.edu/sites/default/files/State%20Preferences%20for%20Higher%20Education%20Spending%20A%20Panel%20Data%20Analysis%201977%202001.pdf.

57. The Delta Cost Project at American Institute for Research provides policy-relevant higher education research. *See* Desrochers & Hurlburt, *supra* note 53.

58. *Id*. at 6.

costs" through tuition hikes.[59] The U.S. Government Accountability Office (GAO) reported that from fiscal year 2003 to fiscal year 2012, state funding for public colleges and universities declined by 12% from $80 billion to $71 billion, even as enrollments increased during the same period.[60] Unfortunately, students and their families are left to deal with the resulting deficit in state subsidies to higher education in the form of higher tuition and fewer scholarships and grants.

Given the ever-declining financial support from both federal and state governments to public universities, endowments[61] have become the key source of funding. This "gift of money or property to [the university is] for a specific purpose," requires "the principal [to be] kept intact indefinitely" and has enabled many universities to both thrive and grow using only the return on the investment of that gift or property.[62] More specifically, universities use these "trust-like instruments"[63] to aggregate, manage, invest, and use those assets donated to the institution to support its educational and research mission. Universities typically use endowment proceeds, unless restricted by the donors, to fund a variety of activities and programs, including student scholarships, hiring faculty, and upgrading university facilities.[64]

Increasingly, the market value of a university's endowment assets has come to reflect the financial viability of the university. As such, management of a university's endowment accounts is critical to gaining a competitive edge, requiring more than a passing glance to ensure that the university does not adopt inappropriate methods to appear solvent and more successful than it is.[65] To that end, the university board of trustees is legally charged with overseeing all university endowment accounts, whether managed in-house or professionally by a third party, to ensure achievement of the endowments' stated objectives and its

59. *See id*. Steven Hurlburt, *College Finance Report: Most Have Weathered the Recession*, AM. INSTS. FOR RSCH.: DELTA COST PROJECT (Jan. 12, 2016), https://www.air.org/resource/blog-post/college-finance-report-most-have-weathered-recession.

60. Peter Harkness, *Public Universities Have Forgotten Their Mission*, GOVERNING.COM (June 22, 2015), https://www.governing.com/archive/gov-public-universities-mission.html.

61. An endowment is "a gift of money or property to an institution (such as a university) for a specific purpose, esp. one whose principal is kept intact indefinitely and only the interest income from that principal is used." *Endowment*, BLACK'S LAW DICTIONARY (11th ed. 2019).

62. Christopher J. Ryan, Jr., *Trusting U.: Examining University Endowment Management*, 42 J.C. & U.L. 159, 165 (2016).

63. Because true endowments require the principal to be invested and preserved in perpetuity, with only interest income used for expenditures, endowments appear to be trust-like instruments. *See id*. at 166. A "trust" is "a property interest held by one person (the *trustee*) at the request of another (the *settlor*) for the benefit of a third party (the *beneficiary*). *Id*. at 168 n. 34

64. See *id*. at 165 ("[E]ndowments embody financial assets that a donor has contributed to a university. These assets are later invested by the university for the purpose of supporting the university's educational mission.").

65. *See Understanding College and University Endowments*, AM. COUNCIL ON EDUC. (2021), https://www.acenet.edu/Documents/Understanding-College-and-University-Endowments.pdf.

ability to continually generate income.[66] There are oversight rules that must be followed to ensure against inappropriate opportunistic behavior.[67]

C. The Rising Use of University-Affiliated Foundations

Public universities are increasingly creating and using university-affiliated foundations (hereinafter "university foundations") for financial support as state support for these institutions of higher education has waned.[68] However, these entities tend to be separately incorporated by the university under state corporate law as private 501(c)(3) non-stock corporations, also known as nonprofit corporations, and are organized for the exclusive purpose of advancing and furthering the aims and purposes of the associated university. Moreover, these recently created university foundations now carry out functions once exclusively managed by the "associated universities."[69] Use of university foundations has enabled public universities, which are more constrained as state agencies,[70] to act with greater flexibility in investing, fundraising, and managing the universities' assets (including those state appropriations, endowments, and real estate holdings) than otherwise would be allowed.[71]

As a result, university foundations are typically chartered to assist the university in generating private support and in managing private gifts, and other assets conveyed to the university.[72] Such responsibility requires (in some cases) the entities' management of real estate owned and used by the university.[73] There have even been instances where university foundations act as both owner and manager of assets that generate substantial income from a variety of campus functions that used to be wholly-owned and operated by the associated universities, including student housing, campus bookstores, and campus-related use of intellectual property.[74]

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66. Ryan Jr., *supra* note 62 at 166.

67. For further discussion, see Section III.B.

68. *See* McCluskey, *supra* note 16.

69. The term "associated universities" is used to identify only those public universities that have incorporated a university-affiliated foundation.

70. Public universities are generally deemed to be agencies of the state of incorporation, or a "public body," and are treated as other state governmental agencies. *See* Claudia Polsky, *Open Records, Shuttered Labs: Ending Political Harassment of Public University Researchers*, 66 UCLA L. REV. 208, 212 (2019).

71. *See College and University Foundations*, COUNCIL FOR ADVANCEMENT & SUPPORT OF EDUC., https://www.case.org/connect/college-and-university-foundations (last visited May 6, 2023). See discussion *infra*.

72. McCluskey, *supra* note 16.

73. COUNCIL FOR ADVANCEMENT & SUPPORT OF EDUC., *supra* note 71. *See also* Chris Larson, *U of L Foundation was Run with 'Lack of Accountability,' Chairwoman Says*, LOUISVILLE BUSINESS FIRST (Apr. 26, 2017), https://www.bizjournals.com/newyork/bizwomen/news/latest-news/2017/04/u-of-l-foundation-run-with-lack-of-accountability.html.

74. *See* McCluskey, *supra* note 16 (noting the various activities and campus businesses run by university foundations and the potential harm from prioritizing these revenue-generating avenues over sustaining academic goals).

It is worth noting that university foundations, like their associated universities, are nonprofit corporations; each with a separate legal existence, including the authority to own and dispose of property, among other rights; and have neither the typical board of directors nor shareholders of business corporations. Rather, each university foundation has a board of trustees that is required to manage the affairs of the university foundation through staffing. Alarmingly, the extent of allegiance and the existence of any fiduciary obligation owed by the university foundation to the associated university which caused its incorporation largely depends on the internal documents executed between the associated university and the university foundation after its creation.[75]

As to the makeup of the university foundations' governing boards, most typically consist largely of prominent business leaders, along with the universities' presidents.[76] These appointments can enable universities to use their respective university foundation board members to "extend the educational institution's sphere of influence well beyond state borders."[77] Indeed, many university foundation board members are typically required to personally contribute to the associated universities and serve as examples for other donors; help university foundation staff identify prospective donors, as well as to engage in further solicitations; and, at times, represent the universities to the media and state legislature.[78]

Use of university foundations can pose risks for the associated universities. The potential for a lack of transparency – particularly as to who is doing what for, or in the name of, the associated universities – can foster a culture of risk taking and accountability failures. As state agencies, public universities may be hampered by state requirements on procurements and appropriations when seeking to purchase property or build structures. They may need to establish a separate entity to hold funds for targeted scholarships or research fellowships that enhance diversity; and may be hampered by state restrictions against lobbying.[79] Additionally, many states mandate investment strategies for public funds, including that they are invested in low-risk, low-return vehicles to protect against the loss of real value.[80] By acting through these legally independent

75. See discussion in Section III.

76. *See, e.g.*, *Clemson Foundation Board of Directors*, CLEMSON UNIV., https://www.clemson.edu/giving/cufoundations/board/members.html; *IU Foundation Board of Directors: What We Do*, IND. UNIV., https://iufoundation.iu.edu/about/people/bod.html; *Foundation Board of Directors*, MIAMI UNIV., https://www.givetomiamioh.org/s/916/22/landing-int.aspx?gid=1&pgid=502.

77. Council for Advancement & Support of Educ., *supra* note 71.

78. Council for Advancement & Support of Educ., *supra* note 71.

79. McCluskey, *supra* note 16; Shannon Watkins, *University Foundations: A Convenient Way to Bypass Oversight*, JAMES G. MARTIN CTR. FOR ACAD. RENEWAL (Aug. 13, 2018), https://www.jamesgmartin.center/2018/08/university-foundations-a-convenient-way-to-bypass-oversight/.

80. *See, e.g.*, Scott Fitzpatrick, *Missouri Public Fund Investment Guide: Investing Public Portfolios Responsibly While Minimizing Risk*, MO. STATE TREASURER'S OFF.,

university foundations, however, associated universities can receive, invest, and spend funds directly, often bypassing university governance procedures, transparency, and restrictions that would normally apply to state appropriations and procurements.[81]

These transparency and accountability problems can be exacerbated depending on whether university foundations (as independent nonprofit corporations) are required by the respective incorporating state's open records laws to open their meetings to the public and make their records available for public inspection.[82] Such obligations typically rest on whether a particular state's definition of "public body" or "public agency" includes the university foundation, as it would the associated university; or how closely the associated university and its university foundation work together.[83] University foundations, therefore, can be misused, enabling the "private taking of significant resources from public, academic purposes to advance outside private interests."[84]

Viewed as public charities, university foundations must be held to account by the associated university, its donors, its students, its faculty and staff, and the taxpaying public. Thus, associated universities should not be able to use university foundations as private vehicles for the purpose of shielding from the public information that would otherwise be available had the actor conducting the transaction been the associated universities for whose benefit the university foundations were created. Strong governance procedures and accountability systems are required to protect against mismanagement and misuse at both associated universities and their university foundations.

II. THE UNIVERSITY OF LOUISVILLE FOUNDATION SCANDAL

The University of Louisville Foundation Scandal is a good case study demonstrating the damaging impact of failed governance and accountability at both a public university and its university- affiliated foundation. It also highlights the harms that can result when unusually close relationships are allowed to exist among top members of a university's administration and the university foundation's governing board members, who are themselves selected (or highly recommended to the post) by those university administrators. Without adequate

https://treasurer.mo.gov/pdf/Investment_Guide.pdf (last visited Apr. 1, 2023); Thomas P. DiNapoli, *Local Government Management Guide: Investing and Protecting Public Funds*, OFF. OF THE N.Y. STATE COMPTROLLER (Apr. 2016), https://www.osc.state.ny.us/files/local-government/publications/pdf/investing-and-protecting-public-funds.pdf; James McIntire, *Guide to Public Funds Investing for Local Governments*, OFF. OF THE WASH. STATE TREASURER (June 2016), https://www.tre.wa.gov/wp-content/uploads/inv_elig.pdf.

81. *See* McCluskey, *supra* note 16.

82. Alexa Capeloto, *Private Status, Public Ties: University Foundations and Freedom of Information Laws*, 33 QUINNIPIAC L. REV. 339 (2015). *See also* Spreadsheet, *supra* note 8.

83. See discussion *infra*. For example, Colorado, Georgia, Minnesota and Nevada all have state laws dictating which foundation documents are subject to disclosure.

84. McCluskey, *supra* note 16.

oversight or the fear of liability for wrongdoing, accountability systems become porous. Not only can this unmonitored relationship become obstructive to that governing board's ability to act as a fiduciary and actively engage in effective oversight of both a university's business affairs and the activities of its top administrators, but the university governing board's oversight problems become even more exacerbated where that university also works towards fulfilling its public mission using the university foundation.

A. The UL Foundation's Problematic Relationship with UL

The UL Foundation, at the time of the alleged wrongdoing, was charged to work exclusively for the charitable and educational purposes of the University of Louisville.[85] Specifically, the UL Foundation exists to support the academic, scholarly, research and community engagement activities of the University of Louisville, and to assist the university in becoming a national top tier metropolitan research university.[86] To that end, the UL Foundation was tasked with managing the University of Louisville's endowments, and also holding, investing, and designating the use of the University of Louisville's assets.[87]

Conflicts of interest were immediate. At the time in question, the 15-member board of directors which governed the UL Foundation was comprised of four members of the University of Louisville Board of Trustees, and the University of Louisville President.[88] Most notably, James R. Ramsey concurrently served as President of both the University of Louisville and the UL Foundation; a voting member of the UL Foundation board; a member of the UL Foundation Board Executive Committee; and the Chair of the UL Foundation Board Nominating Committee.[89] Finally, despite organizational documents requiring the CFO of the University of Louisville's invitation to all meetings of the UL Foundation Board Finance Committee, purportedly to foster accountability, the invitations did not appear to have occurred during the time in question.[90]

85. *See Articles of Amendment to the Articles of Incorporation of University of Louisville Foundation, Inc*., UNIV. LOUISVILLE FOUND. (July 1992), https://louisville.edu/accreditation/donat-letter-files/5f-ulf-articles-of-incorporation.

86. *See* 2020 *Federal Tax Form 990*, UNIV. LOUISVILLE FOUND. (2020), https://louisvillefoundation.org/financial-information/.

87. *See By-laws of University of Louisville Foundation, Inc*., UNIV. LOUISVILLE FOUND. (Mar. 2010), https://louisville.edu/accreditation/donat-letter-files/5b-ulf-bylaws; *Articles of Amendment to the Articles of Incorporation of University of Louisville Foundation, Inc*., *supra* note 86; KY. AUDITOR OF PUB. ACCTS., *supra* note 10 at i-ii.

88. *See By-laws of University of Louisville Foundation, Inc*., *supra* note 87 at 4–5 (relevant provisions at Article III, Section 3.4) .

89. *See* KY. AUDITOR OF PUB. ACCTS., *supra* note 10, at i.

90. *See* KY. AUDITOR OF PUB. ACCTS., *supra* note 10, at v; *Corrective Action Plan in Response to the State Auditor's Examination of the Governance of the University of Louisville Foundation and its Relationship to the University of Louisville* [hereinafter *Corrective Action Plan*], UNIV. LOUISVILLE (Feb. 13, 2017), https://louisville.edu/accreditation/donat-letter-files/5j-corrective-action-plan-021317/view (letter from Greg Postel, University of Louisville Interim President and Keith Sherman, University of Louisville Foundation Executive Director and COO to Mike Harmon, Kentucky Auditor of Public

B. Findings of the Kentucky State Auditor Investigation

The University of Louisville Foundation Scandal resulted, *inter alia*, from the inclusion of overlapping governing board members between the two entities,[91] and the dual roles played by top UofL and UL Foundation administrators[92] without requiring sufficient transparency nor the conflicts monitoring that would have prevented rubber-stamped approvals. Those roles, among other acts, blurred the lines of authority and accountability between the University of Louisville and the UL Foundation, as highlighted in the 2016 published report entitled, "Draft Examination of the Governance of the University of Louisville Foundation and its Relationship to the University of Louisville," but colloquially referred to as the "Preliminary Report" authored by the Kentucky Auditor of Public Accounts ("KAPA").[93]

The Preliminary Report detailed the significant governance weaknesses found in connection with KAPA's examination of the relationship between the University of Louisville and the UL Foundation, including the university's damaging oversight failures of its university foundation.[94] It also revealed that the UL Foundation had been operating without legally sufficient "checks and balances,"[95] which resulted in poor record keeping and $67 million in improper loans between the University of Louisville and the UL Foundation; unauthorized compensation in violation of the UL Foundation's bylaws; and missing or inconsistent UL Foundation financial records.[96] The corporate governance failures at both the University of Louisville and the UL Foundation only came to

Accounts) (outlining the university and university-affiliated foundation's responses to each of the findings from the 2016 Kentucky Auditor of Public Accounts Report).

91. *See By-Laws of University of Louisville Foundation, Inc.*, UNIV. OF LOUISVILLE FOUND. (Mar. 8, 2010), https://louisville.edu/accreditation/donat-letter-files/5b-ulf-bylaws. *Accord* KY. AUDITOR OF PUB. ACCTS., *supra* note 10, at ii.

92. *Accord* KY. AUDITOR OF PUB. ACCTS., *supra* note 10, at ii.

93. *Id.*

94. *See* KY. AUDITOR OF PUB. ACCTS., *supra* note 10 (identifying significant governance weaknesses at the university and university-affiliated foundation, including the: (i) delayed and inconsistent disclosures which validated concerns about poor recordkeeping and a lack of transparency; (ii) comingling of administrative operations between UL and ULF which led to ineffective governance; (iii) comingling of board personnel which led to excessive board conflicts at ULF; (iv) appointment of officers at ULF without UL Board approvals or knowledge and seemingly in violation of then-existing ULF Bylaws; (v) endowment funds totaling $67 million, budgeted for use by UL, were loaned to ULF and an affiliate organization without prior notification to, or approval by UL Board; (vi) excessive and unapproved compensation to James R. Ramsey, who served as both UL and ULF president; (vi) absence of UL CFO at meetings of the ULF Board Finance Committee in violation of UL Bylaws, and in direct conflict with his contract with ULF; and (viii) failure to provide ULF Board with regular orientation presentations despite the growing complexity of ULF operations.); *Transmittal Letter*, *supra* note 14. *Accord Corrective Action Plan*, *supra* note 92. *See also* Marty Finley, *State Auditor Condemns Dysfunction, Lack of Transparency at U of L Foundation*, LOUISVILLE BUSINESS FIRST (Dec. 14, 2016, 1:56 PM), https://www.bizjournals.com/louisville/news/2016/12/14/state-auditor-condemns-dysfunction-lack-of.html (summarizing key findings of the 2016 Auditor Report).

95. *Transmittal Letter*, *supra* note 14.

96. KY. AUDITOR OF PUB. ACCTS., *supra* note 10; *Transmittal Letter*, *supra* note 14. *Accord Corrective Action Plan*, *supra* note 92. *See also* Finley, *supra* note 94.

light as a result of the KAPA investigation. Indeed, the KAPA audit reportedly occurred only after public tax returns revealed that the UL Foundation had made multi-million-dollar payments in 2015 to then-UofL President James Ramsey and other insiders.[97] In other words, none of the aforementioned cited failures were uncovered using traditional corporate governance mechanisms like sufficient information reporting and monitoring systems to prevent self-dealing or over-reaching by university governing body members or administrators. There apparently were no effective corporate governance required disclosures to raise red flags, nor a general monitoring of corporate affairs to ensure the university's governing body that its administrators or those of the UL Foundation were not engaging in purportedly illegal or unlawful conduct.[98]

That Preliminary Report set the stage for a more detailed forensic audit of the UL Foundation and its affiliates and covered the more expansive period of July 2010 through June 30, 2016. The completed 135-page forensic audit report dated June 8, 2017 confirmed that both the University of Louisville and the UL Foundation's spending of "foundation funds often lacked oversight, leading to spending that exceed[ed] the authorization, or was not approved by the foundation's board of directors."[99] Moreover, the 2017 Forensic Audit detailed how a top university governing board member and some university and university foundation administrators engaged in excessive spending and purported self-dealing. The audit detailed how much of the purported wrongdoing was carried out knowingly and mostly in secret, without proper board authorizations. The audit also revealed that misleading reports about spending were issued, including those that overstated the value of certain restricted endowment funds; and that dozens of emails exchanged between top UofL administrators, UL Foundation legal counsel and others seemingly revealed an attempt to avoid public disclosure of the excessive spending, among other charges.[100] Of particular concern was a $38 million loan made at one percent interest from UofL to a newly-created campus real estate foundation for

97. Andrew Wolfson, *Report: IRS auditing U of L employment contracts*, THE COURIER-JOURNAL (Aug. 20, 2016, 12:45 p.m.), https://www.courier-journal.com/story/news/education/2016/08/20/report-irs-auditing-university-louisville-james-ramsey/89045272/.

98. *See id*. *See also* KY. AUDITOR OF PUB. ACCTS., *supra* note 10.

99. Chris Larson, *U of L Foundation Audit Shows $17.6M Fund Depleted*, LOUISVILLE BUSINESS FIRST (June 12, 2017, 2:59 pm). *See* ALVAREZ & MARSAL DISPUTES AND INVESTIGATIONS, LLC (A&M), PROCEDURES & FINDINGS REPORT (JUNE 8, 2017) 9, 44, 51 (available at this link: https://louisville.edu/accreditation/donat-letter-files/4-uofl-final-am-forensic-audit-report); Chris Larson, *U of L Foundation Audit 'Paints a Disturbing Picture,' Says Board of Trustees Chair*, LOUISVILLE BUSINESS FIRST (June 9, 2017, 10:07 A.M.), https://www.bizjournals.com/louisville/news/2017/06/08/read-the-u-of-l-foundation-audit-the-board-of.html.

100. A&M, supra note 99. *See also* Grace Schneider, *University of Louisville Foundation Audit: What You Need To Know*, COURIER JOURNAL (June 9, 2017, 9:59 AM), https://www.courier-journal.com/story/news/education/2017/06/09/university-louisville-foundation-audit-what-you-need-know/380377001/.

construction projects and property purchases,[101] purportedly also made without proper oversight or public disclosures.

C. Aftermath of the Scandal

The widespread and potentially long-lasting impact of these oversight failures and the ensuing lack of accountability at both the University of Louisville and the UL Foundation has caused undue harm to the university and its mission, as public trust has also been shattered. The more immediate harm came in the form of massive cuts to academic programs, faculty development and research, and student services.[102] The UL Foundation, now under new governance and oversight procedures, disbursed to the University of Louisville $30 million less than in the prior year for its 2017 academics and other expenses in its effort to better manage and preserve its waning $785 million endowment.[103] Unfortunately, this funding shortfall came on the heels of millions of dollars in state budget cuts[104] and a substantial decrease in the number and dollar amount of pledged gifts to the university.[105] By mid-2017, the alleged mismanagement and excessive spending reportedly cost the UL Foundation as much as $100 million, an amount that dwarfed the then-current $20 million limit for directors' and officers' insurance coverage.[106]

Concerns about integrity, the lack of transparency, and the need for sound fiscal stewardship has remained constant. Indeed, the public continues to await a conclusion to the investigations launched by the Kentucky Attorney General's Office in July 2017.[107] A criminal investigation reportedly focused on the unauthorized excessive compensation, secret loans, and bad investments in real

101. Chris Otts, *Amid Funding Cuts, University of Louisville Loans $38 Million to Real Estate Foundation*, WDRB (Dec. 7, 2018), https://www.wdrb.com/news/amid-funding-cuts-university-of-louisville-loans-38-million-to-real-estate-foundation/article_784fc1f1-9b5a-55ae-8981-bff431579fe8.html.

102. Deborah Yetter, *Foundation Slashes $30M in U of L Funding*, COURIER JOURNAL (Mar. 28, 2017, 5:48 PM), https://www.courier-journal.com/story/news/politics/2017/03/28/u-l-foundation-slashes-u-l-funding/99721234/.

103. *Id*. *See also* Dan Bauman, *One Public-College President Made $4 Million Last Year. Now His University Wants It Back*, CHRONICLE OF HIGHER EDUCATION (July 15, 2018), https://www.chronicle.com/article/one-public-college-president-made-4-million-last-year-now-his-university-wants-it-back// (noting that in the 2016 fiscal year, the UL Foundation transferred $97.5 million to the institution and in 2017, that allotment had shrunk to $53 million).

104. Yetter, *supra* note 102.

105. Grace Schneider, *Pledged Gifts to U of L Foundation Plunge $32 Million*, COURIER JOURNAL (Apr. 25, 2017, 6:48 PM), https://www.courier-journal.com/story/news/education/2017/04/25/audit-due-soon-u-l-foundation-mulls-tighter-grip-cash/306271001/.

106. Andrew Wolfson, *University of Louisville May Sue James Ramsey, Others to Recover Estimated $40M to $100M for Foundation*, COURIER JOURNAL (July 14, 2017, 12:14 PM), https://www.courier-journal.com/story/news/education/2017/07/14/losses-triple-insurance-coverage/476582001/.

107. Andrew Wolfson, *Kentucky Attorney General Investigating U of L Foundation Based on Audit's Revelations*, COURIER JOURNAL (July 13, 2017, 6:37 PM), https://www.courier-journal.com/story/news/education/2017/07/13/kentucky-attorney-general-discloses-probe-u-l-foundation-u-l-promises-cooperation/475294001/.

estate and startup companies that combined to dissipate the endowment that should have supported the university.[108] However, to date, there has not been additional reporting on any action taken thereto.

Immediately following the public disclosures of the allegations of mismanagement and misuse of the university's funds by officials at both the University of Louisville and the University of Louisville Foundation, forced resignations of many ensued, including James R. Ramsey as President of University of Louisville and the UL Foundation, and Kentucky's governor, unilaterally disbanding and replacing the entire Board of Trustees of the University of Louisville (the university's governing board).[109] Little else was done to formally hold the alleged wrongdoers to account at that time. It was not until almost two years later that any lawsuits[110] were brought against those connected to the scandal to financially account for the seemingly clear fiduciary breaches – but even then, redress was sought against only a select few, including James R. Ramsey.[111]

A full reading of the 2018 complaint against Ramsey and others, who were mostly UL Foundation officials, suggested that the former University of Louisville and UL Foundation officials structured the UL Foundation to avoid oversight and accountability by the constituent stakeholders of both entities – including the public taxpayers. The complant alleged that instead of using the UL Foundation to fund student scholarships, increase faculty hiring at market wages, enhance student services, and fund diversity initiatives (all actions that would have enhanced campus-community morale, improved academic standards, and provided more opportunities to obtain a good education at a fair value), wrongdoers caused those university's assets under the control of the UL Foundation to provide overly generous compensation packages, lavish housing,

108. *Id*.

109. Galofaro, *supra* note 5.

110. On April 25, 2018, the University of Louisville joined with the University of Louisville Foundation as plaintiffs, and filed suit against former university president James Ramsey, and other former UL Foundation employees, including two former UL Foundation finance officers and a former UL Foundation board member, in his capacity as UL Foundation officer, alleging breach of fiduciary duty, fraudulent appropriations and improper diversion of funds for personal gain, including the award of excessive compensation, as a result of conduct that occurred during the period of 2008-2016. *See* Complaint with Jury Trial Demand, Univ. of Louisville v. Ramsey (Ky. Cir. Ct. Nov. 28, 2018) (No. 18-CI-2385) (available at https://www.uoflnews.com/wp-content/uploads/2018/04/Complaint-With-Jury-Trial-Demand-File-Stamped-U-of-L-et-al.-v.-Ramsey-et-al.pdf); First Amended Complaint with Jury Trial Demand, Univ. of Louisville v. Ramsey (Ky. Cir. Ct. Nov. 28, 2018) (No. 18-CI-2385). The UL/ULF lawsuit also named as defendants the UL Foundation's outside legal cousel – a suit that was subsequently dismissed. Univ. of Louisville v. Stites & Harbison, PLLC, No. 2019-CA-000248-MR (Ky. Ct. App. 2020). The lawsuit was allowed to proceed against the other defendants after the judge denied their motions to dismiss in November 2018. Univ. of Louisville. v. Ramsey, No. 18-CI-2385 (Ky. Cir. Ct. Nov. 28, 2018).

111. Complaint with Jury Trial Demand, at 1, *Univ. of Louisville* (Ky. Cir. Ct. Nov. 28, 2018) (No. 18-CI-2385). *Univ. of Louisville*, No. 18-CI-2385, slip. op. at 1.

and travel benefits, *inter alia*, to top University of Louisville officials.[112] The tenor of the allegations was that the limited accountability for, and lack of transparency of, certain aspects of the UL Foundation business operations allowed public educational resources to be committed to private nonacademic gains at the expense of University of Louisville's stated academic mission.[113]

In sum, the University of Louisville and UL Foundation sued Ramsey and other UL Foundation officers for breach of fiduciary duty, fraudulent activity, and improper use of funds for personal gain and substantially depleting funds, thereby putting the UL Foundation at risk.[114] The parties began mediation in 2020 and settled the lawsuit in the summer of 2021.[115] Members of the University of Louisville and UL Foundation governing boards, in their capacity as directors, purportedly took part in the many oversight failures revealed in the 2017 Forensic Audit. Yet, surprisingly, no director was sued in connection with any of that wrongful conduct.[116] As a matter of fact, the University of Louisville Board of Trustees reportedly announced that it would not sue the UL Foundation's then-current governing board, as its fiduciary, so long as it established wholesale changes to avoid "past management issues;" adopted the auditor recommendations;[117] and agreed to pursue claims against certain ex-directors and officers who engaged in the wrongful acts.[118] The UL Foundation

112. *Univ. of Louisville*, No. 18-CI-2385, slip. op. 2, 4. *See also* Morgan Watkins, *Study: University of Louisville Foundation Overpaid Ramsey, Others*, COURIER-JOURNAL (May 30, 2018, 11:48 AM), https://www.courier-journal.com/story/news/2018/05/29/university-louisville-foundation-james-ramsey-excessive-pay-lawsuit-study/646304002/, Rick Seltzer, *Louisville's Foundation Mess*, INSIDE HIGHER ED (Dec. 15, 2016), https://www.insidehighered.com/news/2016/12/15/state-audit-criticizes-university-louisvilles-relationship-foundation.

113. Complaint with Jury Trial Demand, *Univ. of Louisville* (Ky. Cir. Ct. Nov. 28, 2018) (No. 18-CI-2385) (available at https://www.uoflnews.com/wp-content/uploads/2018/04/Complaint-With-Jury-Trial-Demand-File-Stamped-U-of-L-et-al.-v.-Ramsey-et-al.pdf).

114. *Id*.

115. The parties reached a settlement in August 2021. Chris Larson, *U of L, Foundation Approve Settlement in Ramsey Suit: 'We are Thrilled to Get This Behind Us'*, LOUISVILLE BUSINESS FIRST (Aug. 2, 2021, 1:27 PM), https://www.bizjournals.com/louisville/news/2021/08/02/uofl-uofl-foundation.html. In the end, the parties agreed in pertinent part that the UL Foundation would be paid $800,000 by its insurers, that monies held in escrow from Ramsey and his chief of staff ($56,000 and $18,000, respectively) would be transferred to a scholarship fund and a book fund, and Uof L and UL Foundation would not pay defendants' legal costs. *See id*. It is noteworthy that settlement talks broke down in mid 2021 among the parties as they argued over how their informal agreement reached on January 29, 2021 would be documented. Chris Larson, *U of L Lawsuit Against Ramsey May Continue as Settlement Talks Fail*, LOUISVILLE BUSINESS FIRST (Apr. 16, 2021), https://www.bizjournals.com/louisville/news/2021/04/16/uofl-ramsey-lawsuit-talks-failed-to-settlement.html.

116. *See University of Louisville Announces Settlement with Ramsey and Smith*, UOFL NEWS (Aug. 2, 2021), https://www.uoflnews.com/post/uofltoday/university-of-louisville-announces-settlement-with-ramsey-and-smith/.

117. A&M, *supra* note 99; *See* Andrew Wolfson, *University of Louisville Reins in Troubled Foundation but Decides Against Lawsuit*, COURIER JOURNAL (Dec. 14, 2017, 8:48 PM), https://www.courier-journal.com/story/news/2017/12/14/university-louisville-foundation-reform/953425001/.

118. *See also* Wolfson, *supra* note 117 (reporting that the UofL "board had considered suing the foundation and its past directors and officers since the release of the forensic audit" but seeking to ensure

Board has made meaningful changes to the governance and accountability systems[119] at both the University of Louisville and the UL Foundation since 2017, which finally seem to have righted the ship and ameliorated the problems that led to the UL Foundation Scandal. To have at least charged the members of both governing boards during the time in question with the failure of oversight would have better served accountability purposes. Though, as discussed in the next section, there is a very high standard of liability for directors.[120]

On the one hand, it would have been worthwhile to bring an action as a measure of enforcing the accountability system, given that the alleged misconduct carried on for at least six years. There arguably occurred a "sustained or systematic failure of the board to exercise oversight" and a failure to ensure "that a reasonable information and reporting system existed" at both entities. [121] Realistically speaking, however, the University of Louisville and the UL Foundation's desire to move on from the scandal is understandable, particularly in light of the fact that they reportedly had already spent both time and upwards of six million dollars on its lawsuits against Ramsey and the other former UofL and UL Foundation officials.[122] Today, the UL Foundation is wholly transformed

future donor confidence the university said [such] a lawsuit would have been 'costly, lengthy, and disruptive.'").

119. *Memorandum of Understanding Between the University of Louisville and the University of Louisville Foundation*, UNIV. LOUISVILLE FOUND. (July 1, 2017), https://louisville.edu/accreditation/uofl-sacs-monitoring-report-submitted-08-15.17/comprehensive-standard-3-10-3-footnotes/3-10-3-fn22; *Second Amended and Restated Memorandum of Understanding between the University of Louisville and the University of Louisville Foundation, Inc*., UNIV. LOUISVILLE FOUND. (Jan. 1, 2021), https://louisvillefoundation.org/wp-content/uploads/2021/12/MOU-ULF-and-UofL-01.2021-web.pdf; *Third Amended and Restated Bylaws of The University of Louisville Foundation, Inc*., UNIV. LOUISVILLE FOUND. (July 29, 2021), https://louisvillefoundation.org/wp-content/uploads/2021/12/Bylaws-ULF-7.29.21-web.pdf; *Amended and Restated Articles of Incorporation of University of Louisville Foundation, Inc*., UNIV. LOUISVILLE FOUND. (Apr. 30, 2021), https://louisvillefoundation.org/wp-content/uploads/2021/12/Articles-of-Incorporation-04.2021-web.pdf; Corrective Action Plan in Response to the State Auditor's Examination of the Governance of the University of Louisville Foundation and its Relationship to the University of Louisville, UNIV. LOUISVILLE FOUND. (Feb. 13, 2017), https://media.bizj.us/view/img/10341568/audit-response-022017.2017.pdf.

120. See discussion of the liability standard taken from *Caremark* and its progeny *infra* in Section III.

121. *In re* Caremark Int'l, 698 A.2d 959, 971 (Del. Ch. 1996) (establishing a test for directors' lack of good faith in Delaware law).

122. Chris Larson, *supra* note 115. It is worth noting that the litigation settlement agreement included a payment of $800,000 to the UL Foundation by its insurer, which is just over the amount Ramsey received upon resigning in 2016. Ramsey reportedly sees the settlement as "vindication of him, his staff, and the members of the [UofL] and UofL Foundation] board of directors that worked with him." *Id*. Remarkably, sources reportedly noted that the UL Foundation was seeking to recover $80-120 million from the defendants. Chris Larson, *Judge Forces UofL, UofL Foundation to Abide by a Settlement Agreement in Ramsey Lawsuit*, LOUISVILLE BUSINESS FIRST (July 30, 2021, 4:37 PM), https://www.bizjournals.com/louisville/news/2021/07/30/judge-enforces-settlement-in-uofl-ramsey-lawsuit.html. There also was the cost of the audits: The KY Auditor billed the UL Foundation $186,000 for its 2016 examination, and the ensuing independent forensic audit cost the University of Louisville another $1.7 million. Chris Otts, *Ky. Auditor: Under Ramsey, University of Louisville Foundation Lacked 'checks and balances'*, WDRB (Dec. 7, 2018), https://www.wdrb.com/news/ky-auditor-under-ramsey-university-of-louisville-foundation-lacked-checks-and-balances/article_a1917829-1b85-582d-8271-cad07825cd2e.html (stating that the KY audit cost $186,000); Kate Howard, *Swift Reaction to Scathing University of Louisville Audit*, 91.3 FM WKMS (June 9, 2017, 5:23 PM),

from its troublesome 2016 structure under former President Ramsey. Indeed, according to UL Foundation Board Chair Earl Reed, "[t]he foundation implemented 27 different changes in controls to better run the organization" and "the value of the foundation's assets [in 2021] totaled about $1.2 billion. That is a big increase from 2018 when the endowment assets totaled about $791 million."[123]

The Foundation has also replaced the day-to-day operators, installed a new board of directors, including a new board chair, and ended its highly scrutinized excessive compensation practice. In its effort to "set the foundation on a path of reform," the UL Foundation adopted comprehensive changes to the foundation's policies and procedures, including many that addressed the past governance and oversight failures that enabled the alleged mismanagement and fraud to flourish.[124]

III. NONPROFIT GOVERNANCE AND CHARITABLE ACCOUNTABILITY SYSTEMS

Corporate governance is a system of statutory and caselaw rules and processes by which corporations are directed, managed, operated, and controlled – with the corporation's board of directors given the legal authority to run the corporation after election by its shareholders.[125] This system is designed to foster an environment of trust, transparency, and accountability by the corporation's board to effectuate efficient and prudential management of the business and good stewardship of its assets.[126]

Corporate accountability, on the other hand, generally refers to a system by which those who manage and oversee the corporation's business and affairs are held to account for their defective stewardship.[127] While most discussions of corporate governance and corporate accountability arise in connection with business corporations, both governance and accountability systems are equally applicable to nonprofit corporations. Indeed, an increasing number of states have enacted some version of the American Bar Association's ("ABA") Model

https://www.wkms.org/education/2017-06-09/swift-reaction-to-scathing-university-of-louisville-audit (stating that the forensic audit cost $1.7 million).

123. *See* Chris Larson, *supra* note 115.

124. Morgan Watkins, *Massive Payments to Ex-Officials Trigger IRS Audit of U of L Foundation*, COURIER JOURNAL (Aug. 31, 2018, 4:39 PM), https://www.courier-journal.com/story/news/2018/08/31/irs-audit-university-louisville-foundation/1149437002/.

125. *See* COMM. ON THE FIN. ASPECTS OF CORP. GOVERNANCE, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE 14 (1992) (Section 2.5); Bus. Roundtable, *Principles of Corporate Governance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 8, 2016), https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/.

126. *Id*.

127. *See* SEC. & EXCH. COMM'N DIV. OF CORP. FIN., STAFF REPORT ON CORPORATE ACCOUNTABILITY 4–5 (1980) (printed for use of the U.S. Senate Commission on Banking, History and Urban Affairs).

Nonprofit Corporation Act (or "MNCA")[128] codifying the relevant governance and accountability rules to combat the potential for, and effect of, governance abuses.

A. Governance and Accountability of Universities (and University Foundations) as Nonprofit Corporations

1. Governance Responsibilities

Notwithstanding their names, universities, and their respective university foundations, are typically organized under state corporate law as incorporated entities and structured as nonprofit or nonstock corporations.[129] As such, these universities (and the university foundations)[130] are each independent entities, having a separate legal existence from any other entity. The existence of universities and university foundations as legal entities also enables each to legally own, control, manage, or transfer assets, including all real and other property – particularly the endowments, the management of which is discussed below in Section III, Subsection C. Additionally, as previously discussed, universities each act through their respective board of directors (even if their governing board members are designated as trustees, governors, or regents).[131] Board members, acting collectively with respect to their institution, have legal authority to manage their institution's business and affairs for the sole benefit of the respective institution. They are, for governance purposes, only bound by state nonprofit corporation law, their respective internal governing documents, and fund-specific restrictions of private donors and federal grants.[132]

It is worth noting at this juncture that nonprofit corporations differ from business corporations in that the former entities have no shareholders from whom

128. The ABA Model Nonprofit Corporation Act ("MNCA") was subject to piecemeal revisions on two previous occasions – 1987 and 2009. However, after the 2016 wholesale revision of the ABA Model Business Corporation Act ("MBCA"), the ABA taskforce undertook wholesale revision of the MNCA. A final version of the same was approved on September 23, 2021. *See* MODEL NONPROFIT CORPORATION ACT, OFFICIAL TEXT WITH OFFICIAL COMMENTS AND STATUTORY CROSS-REFERENCES (AM. BAR ASS'N, amended 2021).

129. 15A AM. JUR. 2D COLLEGES AND UNIVERSITIES § 2 (2023); McCluskey, *supra* note 16.

130. For the purposes of this Section III, the author will specifically refer to universities during the article's analysis of the relevant governance roles and accountability rules and procedures, notwithstanding that this analysis is applicable equally to both universities and university foundations since they are similarly structured. Moreover, the author will only reference university foundations henceforth in this section either to highlight the similarity or where a distinction between universities and university foundations is necessary.

131. See university management discussion in Section I. B, *supra*.

132. Indeed, much of the assets held by university foundations are restricted by donors for a particular use such that the universities and university-affiliated foundations must avoid managing, investing, and spending the funds in a manner that is inconsistent with a donor's intention. Notably, a foundation's records could be exempt from the state's open records laws to the extent that a state allows, which could throw a wrench in some accountability systems.

capital can be raised nor for whom the corporation is managed.[133] Additionally, business corporations have shareholders who serve as board oversight watchdogs, whereas non-profit corporations could elect to have "members" who would effectively serve the same function. Universities, however, typically lack "members" who could ensure the existence of good governance and decision-making by their respective governing boards. The absence of such oversight is only exacerbated when universities create, and *act* through, university foundations. Further, universities are tax-exempt nonprofit corporations, which are subject to distribution restrictions existing under both federal tax laws[134] and state charitable organization rules. These restrictions further limit the discretion of university governing boards, yet are insufficient to ensure good governance and accountability.[135]

Further distinct from business corporations, membership on university governing boards does not typically arise from an election process, but instead through an appointment process – coming either directly from the respective state's sitting governor or from the university governing board's nominating committees.[136] Some may argue that such appointment process increases the potential for harm to universities when such important university (and university foundation) positions are filled with those who are politically connected, big university donors, or local small business owners; there is also a presumed lack of skill or prior governance experience.[137]

2. Fiduciary Responsibilities

For this reason, there exists a corporate governance mechanism to help constrain impulses for mismanagement, self-dealing, and other opportunistic behavior by those in control of corporations, whether as nonprofit corporations or business corporations: it is the fiduciary relationship and its attached fiduciary duties.[138] In other words, the imposition and enforcement of fiduciary duties on those in control are believed to serve as a monitoring device to limit the potential abuse by those in positions of control. Thus, university (and university-affiliated

133. Peter Molk & D. Daniel Sokol, The Challenges of Nonprofit Governance, 62 B.C. L. REV. 1498, 1509 (2021).

134. I.R.C. § 501.

135. *See, e.g.*, Section 2, *supra*.

136. Lewis, *supra* note 36.

137. *Id.*; Duderstadt & Womack, *supra* note 36.

138. The term fiduciary duty implicitly reflects three key concepts: (1) the standard of care in which individuals perform their duties; (2) a standard of liability for holding the individual to account for their departure from a standard of performance; and (3) a framework for determining to who such individuals owe their duties. *See* LISA M. FAIRFAX, BUSINESS ORGANIZATIONS: AN INTEGRATED APPROACH, 237 (Foundation Press (2019) at p. 237; *See also* MNCA §§ 831, 842 (AM. BAR ASS'N, amended 2021). The MNCA provisions with respect to the directors' duties and liabilities "follow the provisions of the Model Business Corporation Act on the same subject." MNCA §§ 830–33 introductory cmt. (AM. BAR ASS'N, amended 2021).

foundation) governing boards, and all members of their administrations, collectively and individually, are fiduciaries, and therefore owe the same duties as other nonprofit corporation directors and officers – to the corporations for which they act and control. According to the Association of Governing Boards of Universities and Colleges, a "fiduciary" is: "someone who has special responsibilities in connection with the administration, investment, monitoring, and distribution of property—in this case, the charitable or public assets of the institution. These assets include . . . intangibles, such as the reputation of the institution and its role in the community."[139]

It is also said that the "essence of the duty of a [university] trustee" is trust; they hold "something valuable in trust—the classrooms, the libraries … the institution itself—for high purposes and benefits, not for [themselves], but for others."[140]

Most fiduciary duties, while developed from common law, have also been codified under state corporate laws for both business corporations[141] and nonprofit corporations.[142] The three main duties of nonprofit corporation fiduciaries include: (1) the duty of loyalty, (2) the duty of due care, and (3) the duty of obedience.[143] The fiduciary duties of care, loyalty and obedience collectively "require [university] board members to make careful, good-faith decisions in the best interest of their institution consistent with its public or charitable mission, [and] independent of undue influence from any party or from financial interests."[144] Exercise of such "sound business judgment" will generally protect the decision-making of fiduciaries against external second-guessing.[145]

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139. *AGB Statement*, *supra* note 6, at 2.

140. *See* Simone van Ommeren-Akelman, *Closing the Side-Door: An Argument for Imposing a Duty of Oversight on University Boards of Trustees*, 32 U.C. L.S.F.J. ON GENDER & JUST. 79, 82 (2021) (citing LOUIS HEILBRON, THE COLLEGE AND UNIVERSITY TRUSTEE: A VIEW FROM THE BOARD ROOM 3 (1973)).

141. More than half of the states have adopted corporate laws based on some version of the MBCA, which codifies certain general uniform principals of fiduciary duties imposed upon corporate officers and directors. *See, e.g.*, MBCA §§ 8.30–31, 8.42 (AM. BAR ASS'N, amended 2016).

142. More than half of the states have adopted corporate laws based on version of the MNCA, which codifies certain general uniform principals of fiduciary duties that are imposed on nonprofit corporation officers and directors. *See, e.g.*, MNCA §§ 830—31, 841–42 (AM. BAR ASS'N, amended 2021).

143. Barbara Costello, *Understanding the Unique Liabilities of serving as a Director or Officer of a Nonprofit*, 43 ABA - THE BRIEF, 46–53 (2013). *See* Rob Atkinson, *Obedience as the Foundation of Fiduciary Duty*, 34 J. CORP. L. 43, 45 (2008).

144. *AGB Statement*, *supra* note 6, at 2. *Accord* Costello, *supra* note 143 (noting that directors and officers are required to adopt the "sound business judgment" in carrying out their duties.). *See* MNCA §§ 830–31, 841–42 (AM. BAR ASS'N, amended 2021).

145. The exercise of sound business judgment triggers the application of the "business judgment rule" which is a defense to liability unless the presumption—that the governing boards' decisions are made in an informed manner, in good faith and without conflicts of interest, and in the best interest of the corporation – is rebutted by a factual showing of fraud, bad faith, or gross overreaching. *See* Costello, *supra* note 143; Lori McMillan, *The Business Judgment Rule as an Immunity Doctrine*, 4 WM. & MARY BUS. L. REV. 521, 521 (2013). State corporate law seemingly codifies the business judgment rule in defining the standard of conduct for directors. *See* MNCA § 830(a) (AM. BAR ASS'N, amended 2021) ("Each director, when discharging the duties of a director, must act: (1) in good faith, (2) with the care

While directors must act collectively as the governing board in performing their duties, each can be held individually responsible for how those duties are discharged.[146]

The fiduciary duty of care generally requires both university board members and administrative officers to dispatch their duties in the control and management of their respective university's affairs in good faith, in the best interest of the university, and using that degree of diligence, care, and skill which ordinarily prudent persons would reasonably exercise under similar circumstances in like positions.[147] The duty of care requires board members and administrators to be informed and vigilant and to exercise independent judgment.[148] Actions taken in the best interest of the university and with prudent stewardship necessarily require a balancing of competing interests, including those of university stakeholder constituencies.

Typical breach of fiduciary duty of care claims against directors and officers involve waste, negligence, or the mismanagement of their institution's corporate assets.[149] Mismanagement and negligence claims, particularly against a university's governing body or administration, arise, *inter alia*, from such conduct as leaving assets in investment vehicles that bear little or no interest, mishandling or misusing endowment funds, and failing to provide oversight of third-party professionals and executive conduct or compensation.[150] Common waste of corporate asset claims target such conduct as selling assets at below market value and investing institutional funds in underwater assets.[151]

The duty of loyalty, on the other hand, requires both university board members and administrative officers to act in good faith and in a manner that is reasonably believed to be in the interests of their respective universities, consistent with their nonprofit purpose and respective public missions, rather than in the board members and officers' own interests or in that of another person or entity.[152] Regulators increasingly expect board members to be independent, such that they have neither employment ties to, nor financial interests in, the

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that a person in a like position would reasonably exercise under similar circumstances; and (3) in a manner the director reasonably believes to be in the best interests of the nonprofit corporation.").

146. *See* MNCA § 830 off. cmt. (AM. BAR ASS'N, amended 2021).

147. *See AGB Statement*, *supra* note 6, at 4; Costello, *supra* note 143; MNCA §§ 830–31, 841–42 (AM. BAR ASS'N, amended 2021).

148. *See* Costello, *supra* note 143. Eric Pan, *Rethinking the Board's Duty to Monitor: A Critical Assessment of the Delaware Doctrine*, 38 FLA. ST. U. L. REV. 209, 212 (2011).

149. *See, e.g.*, *In re* Argo Commc'ns Corp., 134 B.R. 776 (Bankr. S.D.N.Y. 1991); Continuing Creditors' Comm. of Star Telecommc'ns, Inc. v. Edgecomb, 385 F. Supp. 2d 449 (D. Del., 2004).

150. The distinction between negligence and mismanagement claims rests on the actors' state of mind. Costello, *supra* note 143.

151. Charles Gass, *Outer Limits: Fiduciary Duties and the Doctrine of Waste*, 92 DENVER L. REV. 93 (2015).

152. *See AGB Statement*, *supra* note 6 at 9.

entities that do business with the university.[153] Governing board members should also be independent of the university's president and other administrative officers, as reflected in the UL Foundation scandal.

Breach of duty of loyalty claims often target conflicts of interest, usurpation of corporate opportunities,[154] and misuse of the institutions' confidential information for personal gain.[155] A conflict of interest claim can arise whenever a director or officer has a direct or indirect undisclosed and un-waived personal, familial, or financial interest in a transaction. Universities, like other nonprofits, are especially susceptible to conflict claims because most of their board members are recruited on the basis of either a business relationship or professional affiliation with the institution.[156]

Finally, the duty of obedience, which is an element of both care and loyalty, requires university officers and board members to ensure that their respective universities are operating in furtherance of their stated purposes as set forth in the institutions' governing documents and that they are operating in compliance with the law.[157] Under this obedience obligation, an institution's governing body must identify, understand, and create oversight systems to ensure compliance not only with the institution's internal rules but also with those external rules that might restrict an institution's actions. Examples of such external rules include accreditation and licensing regulations, labor and environmental restrictions, and athletic association membership requirements.[158]

To be effective and fulfill their fiduciary obligations, university (and university foundation) governing board members and administrators must be fully engaged with their institution. True engagement requires near-perfect attendance at board meetings, reading and evaluating all relevant materials to understand and uphold the institution's mission, monitoring and assessing the conduct and transactions of those to whom tasks are delegated, honoring confidentiality where appropriate, avoiding conflicts of interest, and ensuring both legal and ethical compliance by all university officials.[159] University board members and administrators must also ensure effective management and financial standards by establishing and maintaining diligent monitoring and

153. *Exempt Organizations Annual Reporting Requirements – Form 990, Part VI, and Schedule L: Transactions Reported on Schedule L*, INTERNAL REVENUE SERVICE (Mar. 3, 2023), https://www.irs.gov/charities-non-profits/exempt-organizations-annual-reporting-requirements-form-990-part-vi-and-schedule-l-transactions-reported-on-schedule-l; *Are Your Board Members Independent?*, MEYERS BROTHERS KALICKA (Nov. 14, 2017), https://www.mbkcpa.com/board-members-independent.

154. *See* Costello, *supra* note 143.

155. See *id*.

156. *See* Lewis, *supra* note 36. *See also* Brian Pusser et al., *Playing the Board Game: An Empirical Analysis of University Trustee and Corporate Board Interlocks*, 77 J. HIGHER EDUC. 747 (2006).

157. *See AGB Statement*, *supra* note 6, at 8; Costello, *supra* note 143 (noting that a most crucial director responsibility is to ensure that the nonprofit is adhering to the mission for which it was established).

158. *See AGB Statement*, *supra* note 6, at 8.

159. *See id*. at 9–10.

reporting systems.[160] While fiduciaries are entitled to retain outside accountants, legal advisors, and financial advisors, governing boards also must be diligent in both their oversight of these professionals and their assessment of the information these professionals present.[161] Typically, the structure of a corporation's basic governance system is outlined within its governing documents, like the articles of incorporation and bylaws, and by its internal policies and procedures, which define the appropriate standards of conduct. University governing boards and administrations may be populated with members unfamiliar with a fiduciary's role and obligations. For that reason, universities must inform and continually educate each governing board member and new officer about their fiduciary roles, obligations, and procedures to ensure continued accountability and transparency.[162] This same training approach is applicable to governing board members and corporate officers of those university foundations.

3. Liability Exposure Under Existing Accountability Systems

University governing bodies, like the boards of all nonprofit corporations, are meant to act collectively in discharging their obligations to manage the business and affairs of their respective institution. Most delegate the day-to-day management to university administrators, but nevertheless maintain oversight obligations. Such duties include the duty to monitor such delegated activities to ensure that the respective institution is well managed by those to whom the task of running the day-to-day operations was delegated. If one or more university board member or administrator acts with gross negligence, acts in bad faith, engages in self-dealing in the process of discharging their duties to the institution, or otherwise acts in violation of their fiduciary obligations, each should be held accountable.

Accordingly, good governance systems must have procedures for accountability to be effective. Unquestionably, meaningful accountability systems must provide fiduciaries the necessary insulation from frivolous litigation to encourage better focus on strategic planning, goal setting, and performance monitoring. Such systems must also allow for meaningful exposure to personal liability for their fiduciaries in the event of a proven dereliction of duties. On the issue of officer and director liability, however, the protections

160. *See* Costello, *supra* note 143.

161. *See id.*; MNCA § 830 (c), (e) (AM. BAR ASS'N, amended 2021).

162. *See* Kellie Woodhouse, *New Push for Trustee Training*, INSIDE HIGHER ED (July 7, 2015), https://www.insidehighered.com/news/2015/07/07/states-explore-required-training-university-board-members. *See, e.g.*, *Trustee Membership 101: Orientation for New Trustees*, MASS. DEPT. OF HIGHER EDUC. (Mar. 1, 2018), https://www.mass.edu/foradmin/trustees/documents/2018-03-01%20Training%20-%20Fundamentals%20of%20Trusteeship.pdf .

against second-guessing[163] afforded to those in control of corporations (whether business or nonprofit corporations) are many, varied, and in some cases, hard to overcome – making the existing accountability paradigm for fiduciary breaches by directors and officers seem toothless. Moreover, as will be discussed further below in the next subsection, the university's ability to engage in active monitoring of its university foundation's adherence to fiduciary duties can be further attenuated by these protections, given that in most cases both an associated university and its foundation are legally independent of one another.

What follows is an analysis of a few of the protections that make it difficult to hold fiduciaries of nonprofit corporations accountable for fiduciary breach violations. These management-side protections include the business judgment rule, oversight litigation pleading requirements, litigation standing requirements, and government immunity. One of the most used protections is afforded by the "business judgment rule," which is codified under state corporate law in defining the standards of conduct for directors of both business corporations and nonprofit corporations.[164] Application of the business judgment rule can be viewed both as "process-oriented," and as a rule of "judicial abstention." First, complainants charging a breach of the duty of care must overcome the presumption that the actions taken or the decisions made by the board were performed "in an informed manner, in good faith and without conflicts of interests, and in the best interest" of the corporation.[165] In most instances, the complainants will be unable to overcome this presumption and will lose their challenge when it can be shown that the board had in fact engaged in an effective decision-making process – one that was informed, done in good faith, was conflict free, and in belief that the actions taken or decisions made were in the best interest of the corporation.[166] When viewed as a rule of judicial abstention, the complainants' inability to overcome the aforementioned presumptions may result in the courts' refusal to hear the complainants' challenges, let alone decide the allegations of fiduciary breach on the merits.[167] As a result, plaintiffs' cases can be dismissed at the pleading stage. Therefore, as a protection for those in control of the corporation, the business judgment rule seems impenetrable.

163. The personal liability protections available for those in control on the corporation against allegations of fiduciary duty breaches include the application of: (i) the business judgment rule; (ii) litigation standing requirements (including demand); (iii) exculpation; (iv) indemnification; (v) directors & officer insurance; and (vi) in some cases, immunity.

164. *See e.g.*, MNCA § 830(a) (AM. BAR ASS'N, amended 2021) ("Each director, when discharging duties of a director, must act: (1) in good faith, (2) with the care that a person in like position would reasonably exercise under similar circumstances, and (3) in a manner the director reasonably believes to be in the best interests of the nonprofit corporation."). *See also* MBCA § 8.30 (AM. BAR ASS'N, amended 2016).

165. *See generally* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

166. *See id.*

167. *See id.*

A second "protection" against personal liability afforded fiduciaries is implied from how the courts apply "director oversight standard of liability."[168] The extraordinarily high standard of liability for oversight failures makes most shareholder civil actions almost unwinnable; thereby providing a similarly high hurdle to accountability and redress for oversight breaches by members of university governing bodies. Using the business corporation structure as an example, consider the circumstance where there has been a broad failure of its board to meaningfully respond to a troubling pattern of noncompliance, misconduct, or overreaching by some of its directors or managers despite the existence of red flags. In most of these cases, few directors or officers will be found liable under the very demanding director-liability standard that resulted from the *Caremark* case and its progeny.[169] Delaware judges, for example, have defined the appropriate standard of liability for cases involving governing boards' oversight failures as "bad faith," requiring complainants to establish that governing boards knew that they were not discharging their fiduciary obligations to their corporations and that they acted with conscious disregard of their duties to the corporation.[170] In other words, complainants need to overcome the herculean task of proving that such directors "consciously failed to monitor or oversee [the operations of an information and reporting systems] which disabled themselves from being informed of risks or problems requiring their attention."[171] Once again, universities and their governing boards may prevail and avoid personal liability for allegations of failed oversight if they can demonstrate the existence of good monitoring and reporting systems. Like the immunity protections, this demanding director-liability standard is not an impenetrable protection for all[172] – though few have been successful.

168. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

169. In a landmark 1996 decision, *In re* Caremark Int'l Inc. Derivative Litig., the Delaware Chancery Court held that "a director's obligation includes a duty to attempt in good faith to assure that a corporate information and reporting system, which the board concludes is adequate, exists, and that failure to do so under some circumstances, may, in theory at least, render a director liable for losses cause by non-compliance with applicable legal standards." 698 A.2d 959, 970 (Del. Ch. 1996). This director oversight principle was reinforced and broadened in 2006 in Stone v. Ritter, where the Delaware Supreme Court held that even when control systems are in place, directors who "consciously failed to monitor or oversee [the operations of a reporting or information system or controls] thus disabling themselves from being informed of risks or problems requiring their attention" may be liable. 911 A.2d 362, 370 (Del. 2006). Accord, Marchand v. Barnhill, 212 A.3d 805 (2019); *In re* Boeing Co. Derivative Litig., No 2019-0907-MTZ, 2021 WL 4059934 (Del. Ch. 2021). These recent cases have both noted that directors have the oversight duty to monitor the corporation's operational viability, legal compliance, and financial performance – including "essential and mission critical" functions. *Boeing*, 2021 WL 4059934, at 26.

170. *Id*.

171. *Stone*, 911 A.2d at 370.

172. This is also not a complete protection against liability, so caution should be taken by members of university governing boards since it is still probable that federal regulatory authorities, including the IRS, DOJ, and Dept. of Educ. may commence investigations and undertake selective prosecution discounting the "bad faith" high standard required in fiduciary duty suits. See Michael W. Peregrine, Beyond Caremark: Individual and Corporate Liability Considerations, Program on Corporate Compliance and Enforcement at New York University School of Law (Dec. 7, 2016), https://wp.nyu.edu/compliance_enforcement/2016/12/07/beyond-caremark-individual-and-corporate-

Next, this discussion turns to the narrowly-framed litigation standing requirement for the derivative action. The derivative lawsuit, an important mechanism in the enforcement of fiduciary duties, recognizes that persons other than the entity harmed (in this example, the university or the university foundation) also have standing to initiate an investigation of its management or governing board to determine the propriety of such complained about actions and to file suit in the entity's name to obtain redress when a cause of action can be found.[173] As such, the derivative action "serves as an important policing function in providing a mechanism by which those charged with management and control" of the entity "may be called to demonstrate that they are in fact discharging the obligations they have voluntarily undertaken."[174] It is also a key remedy applicable to business corporations and nonprofit corporations to enforce those fiduciary obligations under state corporate law.

When applied to a business corporation, it is the *shareholders* who are entitled to initiate the derivative litigation and persuade the courts to enforce board of directors' fiduciary obligations to the corporation and its shareholders. Essentially, it is the courts (at the behest of those shareholders) who "watch the watchers," by requiring those tasked to manage the corporation's business and affairs to defend their actions or decisions.[175] While derivative suits are indeed an available mechanism for nonprofit corporations, state statutes continue to limit *who* has standing to initiate a derivative action in the absence of shareholders. Under most states' nonprofit corporation statutes, which parallel the MNCA, standing is limited to either the entity's member(s), its director(s), or member of an entity-designated body because there are no shareholders in a nonprofit corporation.[176] In short, the fact that most universities and university foundations are organized and structured as nonmember nonprofit corporations means that the only other "person" duly authorized to have standing to initiate litigation to enforce the fiduciary obligations of the "watchers" is the

liability-considerations/. *Who Can Sue a Nonprofit Board?*, NONPROFIT RISK MGMT. CTR., https://nonprofitrisk.org/resources/articles/who-can-sue-a-nonprofit-board/ (last visited March 9, 2023). Indeed, federal regulators, in evaluating governing boards' conduct, may nonetheless pursue civil or criminal charges arguing that a university's compliance oversight is in fact flawed, inadequate, and ineffective. *See* Peregrine, *supra*. *See also* U.S.' Statement of Int. in Opposition to Defendant's Motion for Summary Judgment at 30, Students for Fair Admissions, Inc. v. President & Fellows of Harvard College, No. 1:14-cv-14176-ADB (D. Mass. Aug. 30, 2018) (stating that Harvard failed to engage in good faith consideration of race-neutral alternatives for college admissions). Likewise, state attorney generals could very well ignore the *Caremark* standard altogether and apply any number of broad theories of director liability under state charitable trust rules that attribute trustee responsibilities to nonprofit directors. Peregrine, *supra*. See discussion of attorney general investigations below.

173. *See* Thomas E. Rutledge, *Who Will Watch the Watchers?: Derivative Actions in Nonprofit Corporations*, 103 KY. L.J. ONLINE 4 (Apr. 22, 2015), http://www.kentuckylawjournal.org/index.php/2015/04/22/who-will-watch-the-watchers/ [https://perma.cc/BG7B-T9WQ].

174. *Id*.

175. *See id*. *See also* MBCA § 7.41 (AM. BAR ASS'N, amended 2016) (providing for standing of shareholders to bring a derivative suit).

176. *See* MNCA § 502 (AM. BAR ASS'N, amended 2021).

jurisdiction's state attorney general,[177] which, for reasons discussed below, may not move against these particular failing directors. This statutory obstacle, when applied in the context of the universities and university foundations, raises two related questions: (i) who watches the watchers at nonprofit corporations when there are no shareholders or members to act if the governing bodies are disabled from acting in breach of their fiduciary obligations, and (ii) for whom is the university managed – for purposes of finding a suitable stand-in for the absent shareholders or members.[178]

Finally, the existence of immunity protections – though technically outside the scope of corporate law – afforded to fiduciaries who are also state workers can negatively impact the accountability systems of public universities.[179] Sovereign immunity, a chief protection, is based on the concept that the state must consent to being sued, and as such must be overcome by the complainant to withstand a motion for summary judgment.[180] Further, this type of immunity exists since the state is acting on the public's behalf, and any damages awarded for wrongdoing would be paid from taxpayer funds.[181] Government immunity (another related immunity) extends sovereign immunity protection to shield state agencies (like universities) so long as they are performing a governmental function.[182] Lawsuits against state government officials in their official capacity are similarly deemed suits against the state itself, entitling those officials to "official immunity," which immunizes them to the same extent as the state agency they serve.[183] As such, it is applicable to officers and inside directors of public universities who are sued for harm that results from the performance of their duties when sued in their official capacity. Moreover, even where sued in an individual capacity, such state workers also have an immunity shield for their good faith judgment calls.[184] Accordingly, immunity protections can be a huge barrier – though not impossible – to overcome in trying to successfully hold such a fiduciary to account.

177. See *id*.; §§140–41 (AM. BAR ASS'N, amended 2021). *Accord* MNCA §1.70 (AM. BAR ASS'N, amended 2008).

178. Stated differently, "To Whom are the Fiduciary Duties of its Governing Body Owed?" See discussion *infra* at Section IV.

179. Yanero v. Davis, 65 S.W.3d 510 (Ky. 2001).

180. *Id*. at 517.

181. *See generally* RESTATMENT (SECOND) OF TORTS § 895B (AM. L. INST. 1979).

182. *See Yanero*, 65 S.W.3d at 519.

183. *See* Edmonson Cnty. v. French, 394 S.W.3d 410, 414 (Ky. App. 2013); Autry v. W. Ky. Univ., 219 S.W.3d 713, 717 (Ky. 2007).

184. *See Yanero*, 65 S.W.3d at 522.

4. Use of University Foundations by Associated Universities Hinders Oversight and Exacerbates Accountability Obstacles

It is inarguable that members of university governing bodies, both individually and collectively, owe fiduciary duties to their respective university, and that university foundation boards of directors similarly owe fiduciary duties to their respective university foundation. Likewise, each of the forgoing fiduciaries, as part of those fiduciary duty obligations, also have oversight responsibilities to ensure effective management of their institutions' business and affairs, particularly when such tasks are delegated to the entities' officers. These fiduciary duties are derived from common law and have been codified in state corporate law statutes to some extent.[185] However, when we consider the relationship that exists between a university and its university foundation, where each is structured as non-member, nonprofit corporations, and where one exists for the benefit of the other, questions arise regarding the true nature of this relationship. Specifically, the questions include whether a fiduciary relationship exists where there is clearly a relationship of trust and confidence, and if so, on what basis. The litigation that followed the University of Louisville Foundation Scandal brought this issue to center stage when the defendants moved to dismiss the joint civil action filed by the reconstituted governing boards of the University of Louisville and the UL Foundation against some former UL Foundation officers and a director on two key grounds, *inter alia*: (i) that the two entities were legally separate such that the university foundation officers and directors did not owe any fiduciary duties to the university, and (ii) that the university did not have standing to enforce any purported fiduciary breach, fraudulent appropriations, or other allegation of mismanagement.[186] Although the Kentucky court held that the University of Louisville has standing to enforce the fiduciary obligations of UL Foundation actors[187] thereby enabling discovery to proceed, we cannot say whether the court's decision would have withstood an appeal given the parties' subsequent settlement of all claims.

In any event, neither state legislators nor the drafters of the Model Nonprofit Corporation Act appear to have considered the likelihood that one separately-incorporated, non-member, nonprofit corporation would cause another to be separately-incorporated and similarly structured for its sole benefit to hold, manage, invest, and administer its tax-exempt charitable donations. At least, it is not apparent, given the failure to address this issue, despite the numerous

185. *See* Melanie B. Leslie, *Common Law, Common Sense: Fiduciary Standards and Trustee Identity*, 27 CARDOZO L. REV. 2713 (2006).

186. *Former U of L President Files Motion to Seek Dismissal of Lawsuit Over Foundation Spending*, WDRB (June 24, 2018), https://www.wdrb.com/news/former-u-of-l-president-files-motion-to-seek-dismissal/article_9b4cd401-cf31-5f7e-82fa-05df4feed91c.html.

187. *Univ. of Louisville*, No. 18-CI-2385, slip. op. at 2–3.

wholesale amendments[188] to modernize the Model Nonprofit Corporation Act, which has been adopted in whole or part by at least 37 states.

Nevertheless, with regularity, universities have continually created and established relationships with university-affiliated foundations to hold, manage, invest, and administer on their behalf those charitable funds donated to the universities in support of scholarships, programmatic, and capital projects, and to fund academic needs of the university. In fact, more and more university foundations are, or are becoming, the direct recipients of their respective associated university's private funds, bypassing said universities altogether.[189] Other eyebrow raising actions include, as was the case at the University of Louisville under President Ramsey, allowing some university foundations to use such funds to supplement (sometimes without adequate authority) the salaries of university officials – particularly the presidents, who are often also employed by and sit on the university foundations' executive boards.[190] Unchecked fundraising, as another example, could "turn[] a university's reputation and resources into market commodities sold off for short-term gain"[191] or could allow big donors to gain control over a university's decisions on academic content or faculty hiring[192] – a direct challenge to well established principles of academic freedom. Further still, to the extent that university foundations also engage in revenue-generating campus activities or businesses, there exists a risk that they may impermissibly prioritize these endeavors over sustaining their respective university's academic goals – the institution's purported primary mission.[193]

The potential for wrongdoing by nonprofit corporate fiduciaries, as the prior examples reflect, is why strict adherence to corporate governance, oversight, and accountability rules must be of the highest priorities at both universities and their university-affiliated foundations. Good governance rules help to ensure that fiduciaries understand their obligations to act as prudent stewards of public institutions' monies, engaging only in above-board financial dealings. Similarly,

188. *Model Nonprofit Corporation Act*, AM. BAR ASS'N, https://www.americanbar.org/groups/business_law/committees/nonprofit/mnca/ (showing redline revisions of MNCA chapters).

189. *See* Spreadsheet, *supra* note 8.

190. Alex Contarino, *How to Make University Foundations More Transparent*, JAMES G. MARTIN CENTER FOR ACADEMIC RENEWAL (Apr. 17, 2017), https://www.jamesgmartin.center/2017/04/make-university-foundations-transparent/.

191. McCluskey, *supra* note 16 (noting the 2004 news report that half the board members of the University of Georgia affiliated foundation had ties to companies doing business with the foundation or university, raking in $30 million, often without disclosures of conflict or evaluation of competing proposals, and the 2015 news reports of similar occurrences at the College of DuPage in Illinois).

192. *See id* (citing as an example, the Koch brothers' $45 million gift to George Mason University's affiliated foundation). *See also* Katherine Schaeffer, *Shaking the Foundation: Fighting for Access to University Nonprofit Foundations*, STUDENT PRESS L. CTR. (Sept. 29, 2015), https://splc.org/2015/09/shaking-the-foundation/ (discussing donations to colleges and universities by the Koch brothers and financier George Soros).

193. See discussion of the allegations against the governing board of the University of Louisville Foundations, *infra*.

robust accountability systems must exist to enforce compliance with those governance roles and fiduciary obligations. Unfortunately, given the current structures of the two entities, robust accountability rarely exists.

Had the two entities instead been restructured as business corporations, with the university holding all of the stock of the incorporated university foundation, it would follow that the existence of a fiduciary relationship would be recognized under state corporate law. However, under existing nonprofit corporate law, the question of "who owes what fiduciary obligations to whom" in a similar setting is unclear. Under nonprofit corporate law, there is a loophole that prevents naming this relationship between the university and its university foundation as a fiduciary relationship. Unquestionably, there exists a relationship of trust and confidence between these two entities, which should support recognition of the fiduciary relationship and the fiduciary obligations owed.[194]

The inability to state the nature of this relationship impacts not only who has the standing to hold university foundation officers and directors accountable for proven wrongdoings in connection with a university's assets, but also hinders both the university's oversight abilities vis-a-vis the university foundation and exacerbates the difficulties in holding those university governing bodies liable for their own fiduciary duty failures. Without a rule change, it is still the case that only the state attorneys general have legal authority to hold universities, university foundations, and their respective fiduciaries to account.[195] As discussed below, reliance on state attorneys general is an inefficient means of ensuring accountability by bad acting fiduciaries.

B. Accountability of Universities (and University Foundations) as Endowment Managers

Although typically organized and governed as nonprofit corporations under state corporate law for nonprofits, universities have investment functions which subject them to additional regulations at both the federal and the state level. State statutes modeled after the *Uniform Prudent Management of Institutional Funds Act* ("UPMIFA") constrain how universities perform these investment functions, including how they maintain and use endowments either directly or received through their university foundations.[196] The application of the UPMIFA to

194. *Cf.* U.S. v. O'Hagan, 521 U.S. 642, 652 (1997). The court found that a duty of loyalty existed between the source of the nonpublic information and its recipient, with whom the source shared a relationship of trust and confidence. Here, the analysis would follow a similar basis for finding that the misappropriation theory exists between the two entities.

195. Sarah R. Kusiak, *Case for A.U. (Accountable Universities): Enforcing University Administrator Fiduciary Duties through Student Derivative Suits*, 56 AM. U.L. REV. 129, 138–39 (2006).

196. UPMIFA aims to replace the existing Uniform Management of Institutional Funds Act (UMIFA), which the National Conference of Commissioners on Uniform State Laws (NCCUSL or Uniform Laws Commission) approved in 1972 and which 47 states have since enacted in an effort to provide uniform and fundamental rules for the investment of funds held by charitable institutions and the expenditure of funds donated as "endowments" to those institutions. Two principles underscore the

universities is significant because it imposes additional fiduciary obligations on their governing bodies as nonprofit corporation directors. The governing body members have not just the typical fiduciary duty of care and loyalty obligations discussed above, but they also have the duties of obedience, prudence, and investigation. These UPMIFA-derived fiduciary responsibilities, which attach to university and university foundation officers and directors as endowment managers, must be balanced against the pressures of producing ever-increasing endowment market values for their respective institutions. State regulations, including UPMIFA, have played a substantial role in how those ends are met.

By way of background, the historical regulatory framework limited the ways in which endowment managers could grow donors' principal donation to universities.[197] Until the early 19th century, American universities' investment choices were limited to mortgages, promissory notes, and real estate.[198] This changed in 1830 when the so-called "prudent man" rule of investing was adopted following the case of *Harvard College v. Armory*[199] to increase the investment options available to university endowment managers. In a nutshell, the prudent man rule–which allowed endowment investments in low-risk assets (like fixed income securities) as a prudent person would conduct his own financial affairsbecame the most pervasive investment standard endowment managers used for more than 100 years.[200] However, by the mid-1960s, a new endowment investment model widely replaced the prudent man rule. This new model allowed universities to invest three-fifths of endowment funds in corporate stock and the remaining two-fifths in bonds.[201] Even this so-called "60/40" model of

UMIFA rules that guided asset management until the UPMIFA supplanted them. The two principles are as follows: 1) that assets would be invested prudently in diversified investments seeking growth as well as income, and 2) that appreciation of assets could prudently be spent for the purposes of any endowment fund held by a charitable institution. Today, the UPMIFA, as an update and successor to UMIFA, establishes an even sounder and more unified basis for charitable fund management than UMIFA. *See also* UNIFORM MANAGEMENT OF INSTITUTIONAL FUNDS., https://www.uniformlaws.org/committees/community-home?attachments=&communitykey=043b9067-bc2c-46b7-8436-07c9054064a3&libraryentry=eb7409c7-2ea3-4876-9037-cc9aab6d84f9&pageindex=0&pagesize=12&search=&sort=most_recent&viewtype=row (last visited Oct. 13.)

197. For a more detailed discussion of endowment management and use, as well as the historical and modern regulatory framework for university endowments and charitable trusts, see Christopher J. Ryan, Jr., Trusting U: Examining University Endowment Management, 42 J. COLL. & U.L. 159 (2016); David Schizer, *Charitable Subsidies and Nonprofit Governance: Comparing the Charitable Deduction with the Exemption for Endowment Income*, 71 TAX L. REV. 665 (2018).

198. *See* Ryan, Jr., *supra* note 62, at 168–69.

199. Harvard College v. Amory, 9 Pick. 446, 461 (Mass. 1831) (noting that a trustee "is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested."). The court noted that a trustee should not be held liable for losses because investments naturally entail the possibility of loss unless the trustee acts in an overtly risky manner. *Id*.

200. *See* Ryan, Jr., *supra* note 62, at 169.

201. *See id*.

investment had competition, and today the industry standard is the Modern Portfolio Theory, which focuses on total return maximization.

Given the evolving investment standard for charitable trusts and directors of nonprofit corporations, it is unsurprising that the Uniform Management of Institutional Funds Act (UMIFA) was adopted in 1972 and was subsequently enacted by 47 states and the District of Columbia.[202] Universities were subject to the jurisdiction of UMIFA to the extent that they held funds exclusively for educational purposes.[203] UMIFA was less restrictive than the "law of trusts" of that era, which analyzed risk on an asset-by-asset basis, prohibited the delegation of investment authority, and had accounting rules which narrowly defined "income" to limit investment options.[204] Under UMIFA, charities organized as nonprofits could rightfully engage in total returns investing. In other words, charities could spend from an endowment fund up to the amount of appreciation above the historic dollar value (HDV), but could never spend below HDV.[205] More generally, UMIFA required an institution to exercise ordinary business care and prudence in making investment decisions.

In the years since the 1972 adoption of the UMIFA, however, trust law developed as tantamount to UMIFA through the enactment of the Uniform Prudent Investor Act (UPIA).[206] Approved in 1994 by the NCCUL and adopted in 44 states, the UPIA aimed to modernize investment management by providing guidance on the prudence standard that fiduciaries of trusts, including charitable trusts, should follow in making investment decisions.[207] Though the UPIA may equally apply to nonprofit corporations,[208] there has been confusion over which law (UMIFA or UPIA) should apply to which type of nonprofit organization, or to which of its assets. NCCUSL's attempt to clarify this issue only resulted in

202. *See* Susan Gary, *UMIFA Becomes UPMIFA*, ABA PROP. & PROB. J., https://nonprofitoregon.org/sites/default/files/uploads/file/UMIFA%20Becomes%20UPMIFA%20-%20Uniform%20Law%20Commission%20%28Article%29.pdf (last visited Oct. 13, 2023) (noting that UMIFA was approved by the National Conference of Commissioners on Uniform State Laws in 1972). *See also* Peter Conti-Brown, *Scarcity Amidst Wealth: The Law, Finance, and Culture of Elite University Endowments in Financial Crisis*, 63 STAN. L. REV. 699, 718 (2011).

203. UNIF. MGMT. OF INST. FUNDS ACT §§ 1(1), 7(a) (NAT'L CONFERENCE OF COMM'RS ON UNIFORM STATE LS., 1972).

204. *See* Gary, *supra* note 202.

205. *See id*.

206. *See* PRUDENT INV. ACT (UNIF. L. COMM'N, 1994).

207. *See id*.

208. *See* UNIF. PRUDENT INV. ACT, Prefatory Notes (UNIF. L. COMM'N, 1994) ("Although the Uniform Prudent Investor Act by its terms applies to trusts and not to charitable corporations, the standards of the Act can be expected to inform the investment responsibilities of directors and officers of charitable corporations. As the 1992 Restatement observes, 'the duties of the members of the governing board of a charitable corporation are generally similar to the duties of the trustee of a charitable trust.'") (citing RESTATEMENT OF TRUSTS 3D: PRUDENT INV. RULE § 379, cmt. b, at 190 (1992)). *See also* RESTATEMENT OF TRUSTS 3D: PRUDENT INV. RULE § 389, cmt. b, at 190–91 (noting that absent contrary statute or other provision, the prudent investor rule applies to investment of funds held for charitable corporations).

the belief that the trust guidelines and precedents were merely informative, but not binding with respect to corporate nonprofits.[209]

Not to be outdone, the Uniform Laws Commission approved a revised version of UMIFA (now called the UPMIFA) in July 2006.[210] To that end, UPMIFA both combines and incorporates the provisions of the UPIA that apply to trusts, the provisions of the MNCA that apply to nonprofit corporations, and the provisions of UMIFA.[211] In essence, UPMIFA provides that such standards for the investment and management of institutional funds (including endowment funds) held by charitable institutions should be the same whether the charitable organization is structured as a trust (i.e., where the charity is acting as the trustee), a nonprofit corporation, or some other iteration of the two. Today, UPMIFA is the law in 49 states, the District of Columbia, and the U.S. Virgin Islands; it also retroactively applies to already existing funds held in any form, but only governs decisions made or actions taken after its enactment.[212] However, UPMIFA, like UMIFA, remains inapplicable to trusts with a corporate or individual trustee.

UPMIFA, most importantly, provides updated guidance and authority for both university- and university foundation-endowment funds' management, investment strategies, expenditures, and where relevant, the delegation of such management and investments authority outside the respective institution by incorporating fiduciary obligations within the fiduciaries' prudential responsibilities. Specifically, Section 3 of UPMIFA sets forth the standard of care required of fiduciaries charged with the management and investment of institutional funds, providing that "each person responsible for managing and investing an institutional fund shall mange and invest the fund in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances."[213] UPMIFA also expands UMIFA by requiring such fiduciaries to "consider its management and investment decisions in relation to the whole economic situation of the institution and its charitable purposes."[214] Further still, UPMIFA specifically enumerates the eight factors[215] fiduciaries ought to consider in making their prudential management and investment

209. Susan N. Gary, *Is It Prudent to Be Responsible? The Legal Rules for Charities That Engage in Socially Responsible Investing and Mission Investing*, 6 NW. J.L. & SOC. POL'Y. 106, 107, 119 n.103 (2011).

210. Gary, *supra* note 202.

211. *Id*.

212. *Id*.; *Legislative Fact Sheet – Prudent Management of Institutional Funds Act*, UNIF. L. COMM'N, https://web.archive.org/web/20150330023300/http://uniformlaws.org/LegislativeFactSheet.aspx?title=Prudent%20Management%20of%20Institutional%20Funds%20Act.

213. *See* UNIF. PRUDENT MGMT. OF INST. FUNDS ACT § 3(b) (UNIF. L. COMM'N, 2006).

214. *See id*. at § 3.

215. *See id*. The eight factors are: (1) general economic conditions, (2) the possible effects of inflation or deflation, (3) the expected tax consequences, (4) the relation of each investment to the entire portfolio, (5) the expected total return, (6) other resources of the institution, (7) the need for distributions and preservation of capital, and (8) any special relationship of the assets to the institution's charitable purposes.

decisions, including any decision to invest in any type of property consistent with the Act. Finally, UPMIFA updates UMIFA to require prudence in cost management and allows only "appropriate and reasonable" costs, adds a duty to investigate the information used in making the fiduciaries' management and investment decisions, and requires diversification of assets and portfolio rebalancing after adding new assets.[216]

The NCCUSL, through its approval of UPMIFA, seemingly sought to address concerns that some nonprofit officers and directors may have failed to meet their fiduciary investment management responsibilities in making the appropriate investment management decisions, delegating their authority, or in accepting the recommendations of their investment management consultants. While UPMIFA still does not specifically grant donors the standing to challenge the charitable entity's actions, it maintains a state attorney general's traditional role in protecting both the donor's intent and the public's interest in the charitable assets. To that end, the state attorney general can bring an action to enforce the terms of a restricted gift.[217] Moreover, depending on the state corporate law governing the internal affairs of the nonprofit corporation, an officer, director, or even a voting member may be able to challenge a breach of trust.[218]

C. Government Oversight of Universities (and University Foundations) as Nonprofit Fiduciaries

1. IRS Investigations and Enforcement

The IRS grants tax-exempt status to universities and university foundations on the basis that each provides a public benefit that will both reduce the burdens on government and provide a charitable benefit to society.[219] The institution's officers and directors, as fiduciaries of the nonprofit corporation, must meet their fiduciary duty of obedience to the institution's charitable mission, their obligations to serve the public good, and must consider investment decisions to uphold those mandates in order to retain that tax-exempt status. As federally tax-exempt organizations, they also have an annual disclosure obligation to file Form 990 (an annual reporting return) with the IRS.[220] Form 990 requires reporting of university foundations' revenue, expenses, assets and debts, as well as disclosure of specific information about their: (1) governing body, management and key

216. *Id.* at §§ 3(c), (e).

217. *Id.* at § 4 cmt. subsection (a).

218. *See, e.g.*, MNCA § 502 (AM. BAR ASS'N, amended 2021) (designating who has standing to bring a derivative proceeding).

219. *Tax Exemption for Universities and Colleges: Internal Revenue Code Section 501(c)(3) and Section 115*, ASS'N OF AM. UNIV. (Mar. 2014), https://www.aau.edu/sites/default/files/AAU%20Files/Key%20Issues/Taxation%20%26%20Finance/Tax-Exempt-Status-of-Universities-FINAL.pdf.

220. I.R.C. § 6033.

employees or independent contractors, (2) program service accomplishments, (3) newly initiated activities or changes to governance structure, and (4) compensation information, including the identities of five highest paid staff members.[221] All nonprofit organizations are required to make these forms available for inspection by the public.[222] The grant of tax-exempt status requires the promise that all the institution's activities and assets will be used to benefit the public and contains the implicit promise that the institution will not engage in private or excess benefits, including the payment of excessive compensation.[223]

Failure to comply with IRS disclosure requirements, mismanagement of the nonprofit, or other violations of the federal tax laws could subject any university officer or director to investigations and enforcement actions, the consequence of which also could include loss of a university's tax-exempt status.[224] Indeed, revelations of alleged mismanagement and fraud at the UL Foundation, as well as the UL Foundation's payment of excessive compensation to its ex-officials, triggered an IRS audit in August 2018.[225] There remains the potential that the individuals who received so called excessive compensation from the UL Foundation receives a huge tax bill if the IRS imposes taxes on the individuals as a consequence of the audit[226]–a concern not lost on the defendants during settlement talks in the University of Louisville/UL Foundation lawsuit.[227]

It is worth noting that IRS audits of nonprofit corporations are not common. According to a spokesperson for the National Council of Nonprofits, the government typically does not earmark the resources needed to deploy agents around the country to engage in such investigations.[228] Moreover, it is unlikely that the UL Foundation will lose its tax-exempt status, particularly given that it has completely reformed its organizational structure, including its governance and oversight policies and procedures. Despite notification from the UL Foundation in August 2017 that "certain non-compliant activities" may have occurred and subsequently deploying an agent to pursue an audit in September

221. *About Form 990, Return of Organization Exempt from Income Tax*, INTERNAL REVENUE SERV., https://www.irs.gov/forms-pubs/about-form-990.

222. *Public Disclosure and Availability of Exempt Organization Returns and Applications: Public Disclosure Overview*, INTERNAL REVENUE SERV., https://www.irs.gov/charities-non-profits/public-disclosure-and-availability-of-exempt-organization-returns-and-applications-public-disclosure-overview.

223. *2022 Instructions for Form 990 Return of Organization Exempt from Income Tax* 61, INTERNAL REVENUE SERV., https://www.irs.gov/pub/irs-pdf/i990.pdf.

224. *How to Lose Your 501(c)(3) Tax-Exempt Status (Without Really Trying)*, IRS, https://www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf.

225. *See* Watkins, *supra* note 124 (reporting that IRS notified UL Foundation of the audit and that the foundation has been cooperating and has already reported such payments to the government).

226. *See id*.

227. Larson, *supra* note 115.

228. *See* Watkins, *supra* note 124 (reporting on the National Council of Nonprofits vice president Jennifer Chandler's view of the IRS Audit and its impact).

2018, the IRS, as of mid-2022, had neither reported its findings nor the outcome of this audit, including whether enforcement actions will be taken.[229]

2. State Attorney General Investigations and Enforcement

Both statutory and common law authority empower the state attorney general to sue nonprofit officers and directors for violations of local and state laws governing nonprofit corporations, which includes the ability to enforce nonprofit directors' fiduciary obligations.[230] This authority flows from the state attorney general's role as *parens patriae*, which requires protection of the economic welfare of the state residents, including their interests in public charities and trusts.[231] The common law belief is that only the state attorney general can stand in for state residents, who are the perceived real party in interest in suits against violators of state and federal charitable and nonprofit rules.[232] Expanding standing beyond state attorneys general would purportedly harm nonprofit and charitable entities since increased litigation would expend limited resources on costs unrelated to their missions, increase potential liability for individuals serving as trustees or directors, and reduce overall efficiency of their management.

The exclusive authority of the state attorney general is also based on the notion that there is a need to protect trustees and nonprofit directors from "unreasonable and vexatious litigation" by private, uninterested parties. Allowing the nonprofits' members or beneficiaries to sue would result in civil actions by "irresponsible parties who do not have a tangible stake in the matter and have not conducted the appropriate investigations."[233] However, it is equally true that more often than not, most state attorneys general have been inactive institutional guardians.[234]

Most state attorneys general offices are ill-equipped to enforce the numerous duties of and potential violations by nonprofit corporations. Their investigative and enforcement activities are often limited due to budgetary and staffing considerations, such as a lack of staff expertise in corporate governance. Also, many state attorneys general have no standing to police the day-to-day activities of charities or nonprofit corporations to determine whether they are adhering to

229. *See id*.

230. *See* Michael W. Peregrine & James R. Schwartz, *Revisiting the Duty of Care of the Nonprofit Director*, 36 J. HEALTH L. 183 (2003).

231. Anna Gentry, *Corporate Personhood and Nonprofit Director Duty of Obedience: Legal Implications that necessitate Expanded Standing to Sue*, 23 GEO. MASON L. REV. 165, 167 (2015).

232. Kusiak, *supra* note 195. *See, e.g.*, Lundberg v. Coleman, 115 Wash. App. 172 (2002); Oleksy v. Sisters of Mercy, 74 Mich. App. 374 (1977).

233. Gentry, *supra* note 231, at 168 (citations omitted).

234. *See id*; Mary Grace Blasko et al., *Standing to Sue in the Charitable Sector*, 28 U.S.F.L. REV. 37, 39 (1993).

their missions and bylaws.[235] More strikingly, the political nature of state attorney general positions is potentially the biggest obstacle to the investigation and enforcement of fiduciary obligation breaches by university and university foundation's governing bodies.[236] State attorney general positions are typically held by elected officers who have little incentive to wage a war on big donors (who typically hold seats on governing boards of universities and university foundations). Unfortunately, if enforcement of fiduciary duties is left solely to the state attorneys general, or only to those officers and directors of nonmember, nonprofit corporations with clean hands, many bad acts committed will go unremedied. Under these circumstances, someone else must be granted standing to both raise the alarm bells and obtain redress on behalf of the harmed entities.

IV. How to Improve Governance and Accountability at the University and University-Affiliated Foundations

A. Amend the Derivative Proceeding Standing Rules, at Least

University governance and accountability mechanisms should ensure that the governing bodies of both associated universities and university foundations fulfill their fiduciary obligationsand also protect the public and public institution funding from fraud and mismanagement. Nevertheless, we have seen with increasing frequency the problems of lack of oversight and the resulting harms from the failure of universities to enforce the fiduciary obligations of nonprofit officers and directors. Either the university governing bodies have failed, *ab initio*, to create policies and procedures to ensure proper oversight of their university foundations, or, in cases where there are overlapping members on the governing bodies of both the universities and their respective university foundations, universities have not provided secure guardrails to prevent designees from controlling or being so controlled by other board members such that they fail to meet their fiduciary obligations. Whatever the reason, there needs to be a mechanism for allowing another level of oversight to step in to enforce those fiduciary obligations when the governing board is not properly managing the business affairs of the university (nonprofit corporation) or its university foundation. Standing to enforce fiduciary obligations must be granted to another entity apart from the state attorney general, who has automatic standing but rarely acts as guardian of these entities. From an accountability and enforcement standpoint, under these circumstances, one must ask: "Who is Watching the Watchers?"

In other words, under existing state nonprofit corporation legislation, only the members of university governing bodies who do not participate in

235. Gentry, *supra* note 231, at 169.
236. *Id*.; Kusiak, *supra* note 195, at 141–42.

wrongdoing remain to enforce the fiduciary obligations that its insiders owe to universities.[237] However, corporate governance and accountability mechanisms falter at nonmember, nonprofit corporations under this existing framework when the university's governing body, in meeting its oversight obligations, attempts to sue their university foundation and its officers and directors upon finding that they have acted imprudently and mismanaged the university's assets. A similar problem arises when the university's governing body is completely prevented from bringing an action to enforce fiduciary obligations and a university stakeholder seeks to enforce the fiduciary duties of the university insiders. First, *standing* is an issue, as neither of the purported plaintiffs have standing to maintain a derivative civil proceeding in the right of the university as a nonprofit corporation.[238] Both purported plaintiffs also have a second related problem regarding recognition of *a cognizable cause of action*.

Taking the second problem first, some argue that no fiduciary duty is owed to the university in the first instance by the university foundation or its insiders, since each is a separate, legally independent entity;[239] similarly, some argue there exists no discernable group with a vested interest to whom the university owes a fiduciary obligation.[240] The issue of fiduciary duty is seemingly attenuated in the former instance, where no legally-recognized fiduciary obligation exists between the two since the university and the university foundations are legally separate and independent nonprofit corporations. However, one must look beyond the form of their relationship to its substance to see that a relationship of trust and confidence exists between them since a fiduciary is one who obligates themself to act on behalf of another (as in managing money or property). The Jefferson Circuit Court seemingly did this in the University of Louisville/UL Foundation suit.[241] Remember, university foundations exist for the benefit of their associated universities, receiving, holding, managing, and investing private monies received for that purpose.

Once the existence of a fiduciary relationship between universities and their university foundations is established, consideration of the related standing issue is necessary. Standing is a very old concept in law, which sets forth who can enforce legal duties and who cannot.[242] The Supreme Court has articulated the modern standing doctrine, providing that "in order to have standing under Article III of the Constitution, a plaintiff must have suffered 'injury in fact,' the

237. *See* MNCA § 502 (AM. BAR ASS'N, amended 2021). See also discussion in Section III, *supra*.

238. *See* MNCA §§ 501–02 (AM. BAR ASS'N, amended 2021).

239. *See* Opinion and Order, Univ. of Louisville v. Ramsey, No. 18-CI-2385 (Ky. Cir. Ct. Nov. 28, 2018).

240. *See* Trs. of Dartmouth Coll. v. Woodward, 17 U.S. 518, 641 (1819).

241. *See Univ. of Louisville*, No. 18-CI-2385, slip. op. at 6.

242. William A Fletcher, *Standing: Who Can Sue to Enforce a Legal Duty?*, 65 ALA. L. REV. 277, 278 (2013) ("[N]ot all people who would like to enforce the legal duties of others have the legal right to do so.").

plaintiff's injury must be 'fairly traceable' to the conduct complained of, and the plaintiff's injury must be redressable by the remedy sought."[243] This standing doctrine is applicable to and must be satisfied in all cases brought in Article III courts.[244] The most obvious platform is to have the state's attorney general pursue litigation against errant directors of nonprofit corporations who have breached their fiduciary duties.[245] As discussed above, state attorneys general are constrained in their instigation of an investigatory or enforcement action. Accordingly, plaintiffs must explore other avenues–including the "special interest doctrine," which is a popular alternative.

The "special interest doctrine" is the equitable platform for standing and is not based in corporate law.[246] It enables third parties (like universities) who have a special relationship with a nonprofit corporation (like university foundations) to sue a nonprofit director for breach of fiduciary duty under certain circumstances.[247] Like the derivative action, it also allows recovery in the form of a benefit to the charitable institution rather than money damages for the special plaintiff.[248] Although not preferable, the special interest doctrine has served as the basis for granting standing to a university in its attempt to hold university foundation officials liable for breach of fiduciary duties.[249]

On the other hand, universities and their constituents would more broadly benefit if standing was granted to pursue a derivative proceeding[250] against the aforementioned university and university foundation bad actors. As currently legislated, only a limited group of authorized plaintiffs may instigate such proceedings, with none applicable under either scenario provided above. Accordingly, it is past time for drafters of state nonprofit corporation legislation to recognize and address the realities that exist when universities (as nonprofit corporations) establish *de facto* fiduciary relationships with university foundations without the associated accountability mechanisms that exist with business corporations. Given that this regulatory gap risks enabling the mismanagement of millions of dollars' worth of charitable assets due to inadequate oversight, simply because two nonprofit corporations "appear to be legally separate in form" but have a relationship so intertwined as to give one

243. *Id*. at 278–79 (citing as examples, Ass'n of Data Processing Serv. Orgs. v. Camp, 397 U.S. 150, 152 (1970); Allen v. Wright, 468 U.S. 737, 751 (1984)).

244. *Id*.

245. *See* Peregrine & Schwartz, *supra* note 230 (discussing generally the director's duty of care compliance and the scrutiny of, and challenges to, the same).

246. *See* Salar Ghahramani, *Fiduciary Duty and the Ex Officio Conundrum in Corporate Governance: The Troublesome Murkiness of the Gubernatorial Trustee's Obligations*, 10 U.C. L. Bus. L.J. 1, 21–22 (2014).

247. *Id*.

248. *Id*.

249. *Id*. *See also Univ. of Louisville*, No. 18-CI-2385, slip. op. at 2–3.

250. *See* Michael W. Peregrine & and James R. Schwartz, *supra* note 230 (discussing generally the director's duty of care compliance and the scrutiny of, and challenges to, the same).

almost complete control over the assets of another. Indeed, even the charitable trust rules unquestionably establish the existence of a fiduciary relationship between the two. The ABA's Nonprofit Corporation Committee could start the process (and states will follow) both by amending the MNCA to both recognize the existence of a fiduciary relationship under these circumstances and enlarging the group of authorized plaintiffs who would have authority to bring derivative proceedings to enforce fiduciary obligations owed to nonprofit corporations.

Correspondingly, I also propose that the newly-created role be filled by the combined chairs of the following university organizations, which I believe best represent the views of respective university stakeholder constituents: the university faculty-senate, the university staff-senate, and the student government association (or similarly convened bodies). When the extraordinary circumstances contemplated by this article occur, this group can be easily convened, provided with access to all material information, experts, and legal advice, and enabled to enforce the obligations of the so-called "Watchers."[251] As noted by Professor Edward Rock more than a decade ago:[252]

> The board members and administration of a university have all the powers over the formal corporate entity that the directors and officers of a business corporation have, and are viewed by the state and the legal system as managers of the entity; but as to the very essence of the entity, they are not managers at all. They are facilitators.

Redress cannot be left to state attorneys general only, given the many constraints of their offices, nor can we rely on the "special interest doctrine" to provide standing on a case-by-case basis. The time has come to allow another "person" to bring derivative suits on behalf of universities, particularly where governing boards are disabled from acting and university foundations control the universities' purse strings without any oversight.

B. Change Open Records Rules for All University Foundations

It is becoming public knowledge that university foundations play a pivotal role in most of their associated universities' fundraising efforts, program development and planning. However, in many cases there still is little public transparency about how university foundations operate, the source of funds obtained, and how such funds are expended—including how much is set aside for administrative expenses. Though university foundations are legally required to make annual disclosures of revenues and spending,[253] they typically restrict public access to specific information about how they produce, manage, or spend

251. *See* Edward B. Rock, *The General Counsel of a Nonprofit Enterprise: Some Questions*, 46 HOUS. L. REV. 17, 31 (2009).

252. *Id*. at 22 (quoting John A Beach, *The Management and Governance of Academic Institutions*, 12 J. COLL. & U.L. 301, 326–27 (1985)).

253. See discussion *infra*.

funds on behalf of their associated universities.[254] Similarly, university foundations' meetings generally are not open to the public, including university faculty and students. As such, university governing bodies currently are the sole gatekeepers who can detect wrongdoing at university foundations (or at least notice any red flags) since the public is mostly hamstrung by the lack of transparency relating to university foundations' business affairs.[255] When a university's governing body is itself compromised, or cannot provide effective oversight, there must exist a mechanism to provide the necessary transparency so that others can take over for the "sentinel asleep at his post." [256] Supreme Court Justice Louis Brandeis stated more than a century ago, "Sunlight is said to be the best of disinfectants."[257] That remark still holds true. Transparency is the first step in the enhancing university accountability processes.

On this point, the University of Louisville Foundation Scandal is illustrative. Allegations in the parties' complaint suggest that wrongdoing took place over a period of years, suggesting there was a continued lack of oversight by the governing bodies of both the University of Louisville and the UL Foundation. The "watchers" failed to meet their fiduciary obligations, tasked under both state corporate law and state charitable rules, if the allegations are true. Only through luck and a close reading of a tax filing made by the UL Foundation did a member of the public (albeit some years into the alleged wrongdoing) manage to tip the Kentucky Auditor, who initiated the investigation that led to changes to both entities' governance and accountability systems.[258]

Better transparency about the existing relationship and business affairs between universities and university foundations would aid in ensuring better governance, oversight, and accountability of their fiduciaries. To that end, if university foundations were deemed part of their associated universities'

254. McCluskey, *supra* note 16.

255. For example, the Sonoma State University Academic Foundation revealed in 2009 that the foundation made unorthodox loans to members of its board, including a $1.25 million loan that could not be repaid. Nathan Halverson, *Losses in 6-figures; Developer was Member of Endowment's Board*, THE PRESS DEMOCRAT (July 2, 2009) https://www.pressdemocrat.com/article/news/losses-in-6-figures-developer-was-member-of-endowments-board/. The University of Central Florida Foundation had over $600,000 in questionable travel expenses in 2016. Gabrielle Russon, *State Lawmakers Question UCF Foundation Spending*, ORLANDO SENTINEL (Mar. 9, 2017), https://www.orlandosentinel.com/2017/03/09/state-lawmakers-question-ucf-foundation-spending/. The Chicago Tribune ran a series of articles (60 in all) in 2015 about the affiliated foundation and the similarly questionable conduct of College of DuPage president Robert Breuder's excessive spending in 2012 in conjunction with several requests under the state public-records law for foundation and university documents related to Breuder's spending to ensure that the public was made aware of how taxpayer funds ("public money") were being spent. Though many records were released voluntarily, the responding parties denied that the foundation is a public body subject to the required disclosure. *See* Peters & Spinner, *supra* note 16.

256. Francis v. United Jersey Bank, 87 N.J. 15, 31 (N.J. 1981).

257. Louis D. Brandeis, *What Publicity Can Do*, HARPER'S WEEKLY, Dec. 20, 1913, at 10.

258. *Kentucky Auditor Adam Edelen to Review University of Louisville Foundation*, WDRB (June 24, 2015), https://www.wdrb.com/news/kentucky-auditor-adam-edelen-to-review-university-of-louisville-foundation/article_cc1657c6-3c5b-5daf-93e4-8df21cc6daa2.html.

systems, the auditing arm of the respective state government may be entitled to audit their books and records. University foundations also would have to open all meetings to the public and virtually all records to public scrutiny under that state's "sunshine" or open records laws.[259] For example, the Virginia General Assembly, in adopting the Virginia Freedom of Information Act as part of an effort to ensure access to and transparency of public records in the custody of a public body, declared that "the affairs of government are not intended to be conducted in an atmosphere of secrecy since at all times the public is to be the beneficiary of any action taken at any level of government."[260]

It seems antithetical to the purpose of subjecting the universities to these rules if associated public universities have unrestricted ability to use university foundations in this manner. State legislatures have the power to regulate all public entities' use of state funds and should use that power to ensure that university foundations similarly act prudently, even though they are holding private monies, since such donations were made to benefit the associated universities – the public bodies. Legislatures can accomplish this either by uniformly designating such entities as public bodies, or by mandating that such entities be subject to state public meetings and open records laws as a consequence of incorporating within the state. Alternatively, legislatures can accomplish this outcome by expanding the category of *who has standing to sue* (and obtain discovery) when the universities' assets held by university foundations are misused. Courts that have considered the former issue have focused on three key factors: funding, function, and creation/control.[261]

For the last few decades, with varying degrees of success, there have been efforts to define, defend and challenge the legal status of university foundations as so-called "public bodies." These efforts have aimed to obtain access to the governing boards' private meetings and their foundations' internal documents, used to support the required annual filings of public and private charities under state "sunshine laws."[262] While often separately incorporated, some courts have concluded that the two entities "essentially act as one and the same" and "are not readily separable."[263] Indeed, courts in Florida, Michigan, Ohio, and Pennsylvania have ruled that university foundations are state agencies and can

259. Alexa Capeloto, *A Case for Placing Public-University Foundations Under the Existing Oversight Regime of Freedom of Information Laws*, 20 COMM. L. & POL'Y 311 (2015). *See, e.g.*, 19 NEV. REV. STAT. § 239 (explicitly including university foundations).

260. VA. CODE ANN. § 2.2-3700(B).

261. *See* Thomas Arden Roha, *State University-Related Foundations and the Issue of Independence. AGB Occasional Paper No. 39*, *in* OCCASIONAL PAPER SERIES, (Ass'n of Governing Bds. of Univs. and Colls.), Jan. 2000, at 3–6, 9.

262. *See e.g.*, Peters & Spinner, *supra* note 16.

263. Cape Publ'ns v. Univ. of Louisville Found., 260 S.W.3d 818, 822 (Ky. 2008); S. Ill. Univ. Found. V. Booker, 425 N.E.2d 465, 471 ((Ill. App. Ct. 1981). *See also* State *ex. rel.* Toledo Blade Co. v. Univ. of Toledo Found., 602 N.E.2d 1159 (Ohio 1992); *In re* Beachport Ent., 396 F.3d 1083 (9th Cir. 2005).

be regulated as such.[264] Not all states have been as receptive to such disclosure claims.[265]

According to a 2015 study, at least 20 states have tried to classify public-university foundations through statute or caselaw. At least 11 states have found that university foundations are alter egos of their affiliated universities and are therefore subject to public records laws, leaving nine states to exempt foundations from state sunshine laws.[266] Some courts, like those in Kentucky and South Carolina, side-step the issue of whether university foundations are public bodies or state agencies, ruling instead that although such foundations are not technically public entities, they are still subject to state open records laws because they use state employees and assets.[267] Conversely, some other states, including Indiana and West Virginia, have ruled instead that these private foundations are not subject to disclosures.[268]

If university governing bodies cannot be trusted to engage in the necessary oversight of their university foundations, open records and open meetings, like sunshine, may serve as a great disinfectant. However, even with access to corporate records of most university foundations, neither university stakeholders nor the public are guaranteed that wrongdoers are held to account for their wrongful acts once uncovered because these stakeholders typically have no standing to bring an enforcement action.[269]

C. Use Private Ordering to Establish Fiduciary Obligations and Standing Where Requested Legislation Stalls

Private Ordering is a viable means in the event the aforementioned requests for amended legislation stalls. Universities and their university foundations can and should establish the requisite basis for good corporate governance and accountability by designing an appropriate accountability mechanism by contractually acknowledging the existence of their fiduciary relationship and setting forth in detail the roles and obligations of each party. This private

264. Palm Beach Comm. Coll. Found., Inc. v. WFTV, Inc., 611 So. 2d 588 (Fla. Dist. Ct. App. 1993). *See* Cal. Univ. of Pa. v. Bradshaw, 210 A.3d 1134, 1139 (Pa. Commw. Ct. 2019). *See also* Jackson v. E. Mich. Univ. Found., 544 N.W.2d 737, 741 (Mich. Ct. App. 1996) (concluding that a university foundation is a public body for FOIA purposes); State *ex rel*. Toledo Blade Co. v. Univ. of Toledo Found., 602 N.E.2d 1159, 1163 (Ohio 1992) (concluding that a university foundation is a public office). In Nevada, the legislature has stipulated that university foundations are in fact public agencies and must allow public access to their operations. NEV. REV. STAT. § 239.005(5)(c) (2019).

265. *See, e.g.*, State Bd. of Accounts v. Ind. Univ. Found., 647 N.E.2d 342 (Ind. Ct. App. 1995).

266. *See* Alexa Capeloto, *A Case for Placing Public-University Foundations Under the Existing Oversight Regime of Freedom of Information Laws*, 20 J. COMM. L & POL'Y 311, 328 (2015).

267. Frankfort Publ'g Co. v. Ky. State Univ. Found., Inc., 834 S.W.2d 681, 683 (Ky. 1992); Weston v. Carolina Rsch. & Dev. Found., 401 S.E.2d 161, 164–65 (S.C. 1991).

268. State Bd. of Accts. v. Ind. Univ. Found., 647 N.E.2d 342, 355 (Ind. Ct. App. 1995); 4-H Rd. Cmty. Ass'n v. W. Va. Univ. Found., 182 W. Va. 434, 436 (W. Va. 1989).

269. See discussion of accountability obstacles at Section III.A.3, *supra*.

ordering is not new; it imposes internal costs on the parties where the government fails to act for all.

Professor Cheryl L. Wade's 2011 essay "Fiduciary Duty and the Public Interest"[270] raises and explores an interesting problem of "how the breach of fiduciary duties owed to shareholders has the power to dramatically impact non-shareholder groups."[271] While it is generally accepted that "[f]iduciary duties are anchored in the interests of the parties to the relationship rather than the public's interests,"[272] that statement ignores the harmful impact on stakeholder constituencies who are left without a remedy following fiduciary breaches by directors of nonprofit corporations. Stated differently, the twin breaches of fiduciary duties "owed to universities by university governing bodies" and "owed to university foundations by university foundation governing bodies" together "deleteriously impact the public interest."[273]

Professor Wade also provides a perfect example of how public interests and the interests of shareholders can converge and align in noting that fiduciaries of financial firms who fail to fulfill their obligation to monitor compliance with unfair lending laws, actually harm both groups.[274] Though they owe no legal duty to the public, university foundation insiders are still entrusted with the public welfare, like those business leaders in their quest to maximize the university foundation's assets.

Consequently, if state legislatures decide not to expand the standing rules or change state FOIA and open meeting rules to require transparency by all university foundations, university governing boards must protect the interests of their stakeholder constituents by engaging in private ordering. This means adopting a memorandum of understanding (MOU) between universities and university foundations to establish the fiduciary relationship between the two, and to formalize the beneficiary status required to obtain special circumstances of standing to enforce fiduciary obligations owed.

CONCLUSION

As fiduciaries, directors and officers of nonprofit corporations owe a high standard of care and loyalty to their corporations, a breach of which should lead to personal liability. Unfortunately, the current accountability mechanism employed by nonprofit corporations to ensure proper adherence by fiduciaries to their obligations is insufficient—especially when applied to universities and their university foundations. Despite their separate structural and legal existence and the governance structures of nonprofit corporations, these university-affiliated

270. Cheryl L. Wade, *Fiduciary Duty and the Public Interest*, 91 BOS. U. L. REV. 1191 (2011).
271. *Id*.
272. *Id*. at 1191 (quoting TAMAR FRANKEL, FIDUCIARY LAW 166 (2011)).
273. *Id*.
274. *Id*. at 1192.

foundations and their governing bodies must respond as fiduciaries to their associated universities.[275] When they do not, or where there is a failure in the associated universities' oversight of university-foundations, the members of both governing bodies need to be held to account.

The enforcement responsibility only belonging to state attorneys general, who have either common law or statutory authority to act in most states, should be shared in the case of universities and university-affiliated foundations. To that end, associated universities, as a matter of law, should have direct standing to sue their university foundations for fiduciary breaches without fear of dismissal. Similarly, where the governing bodies of associated universities are disabled from so doing by virtue of their own fiduciary lapses, standing rules should be statutorily amended to enable the associated universities' faculty/staff/student senates (or similar university shared-governance bodies), after a super-majority vote of their members, to step into the shoes of those disabled board members to act to hold such fiduciaries accountable for the harms suffered by the universities.

The public policy concerns that led to federalization[276] of state corporate governance in the wake of the 2002-03 corporate accounting scandals and the 2007-08 financial crisis exists with regard to accountability mechanisms of nonprofit corporations.[277] Like most matters, only a threat of accountability exposure will heighten compliance by nonprofit fiduciaries. Unfortunately, most state attorneys general act only in the extreme cases where there is a breach of fiduciary obligations arising under state nonprofit corporate laws or charitable trust rules. The proposed statutory changes consequently are needed to force universities and university foundations, at a minimum, to better ensure that good governance practices exist. Such changes should enable these institutions to maintain academic standards and quality facilities, and to avoid the harms that result from financial mismanagement.

275. A university's board of trustees typically contracts with its respective university foundations to carry out the fundraising duties and establishes the funding priorities of their foundations. Typically, the responsibilities are assigned through an annual memorandum of understanding which details the fundraising goals, objectives, and financial arrangements existing between the associated university and university foundation.

276. *See* Sarbanes-Oxley Act of 2002, 107 Pub. L. No. 107-204, §§ 301–03 (discussing corporate governance provisions of the Sarbanes-Oxley Act of 2002); Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 952–53.

277. *See* Peregrine & Schwartz, *supra* note 230, at 184.