1969

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Recommended Citation
Seth Taft, Control of Foundations and Other Non-Profit Corporations, 18 Clev.-Marshall L. Rev. 478 (1969)
Control of Foundations and Other Non-Profit Corporations

Seth Taft*

POVERTY PROGRAMS, HOUSING PROJECTS, a new school, a golf course—every new group activity seems to call for a new non-profit corporation. And hardly a day goes by without a new foundation appearing on the scene. Why? Protection against potential liabilities. Perpetuation of support for one's interests. Tax benefits. A requirement to obtain financing. An entity to receive and administer a grant. Ease of using well established procedures. For whatever reason, it's done every day. In Ohio alone, last year, 1,773 non-profit corporations were formed.

Too little attention is given to the matter of control of foundations and other non-profit corporations by those involved in forming them. A review of the subject seems justified, in advance.

Though a foundation is occasionally a charitable trust rather than a corporation (The Cleveland Foundation, for example, is a group of separate charitable trusts each of which assigns the job of making grants to the same Distribution Committee); most are non-profit corporations. Besides, the greater part of the comments in this article apply as well to charitable trusts as to non-profit corporations.

Picking the first board of trustees (or executive committee) and officers may seem a simple matter. The more difficult problem lies in "ultimate" or continuing control. The simple answer that ultimate control lies in the hands of the "members" is no longer adequate, if it ever was. For an increasing number of corporations the planners don't start with members—they start with a project sponsored by another organization or by some small group. Establishing who will be the "members" is just one of many problems to be solved.

The first question facing the planners of a non-profit corporation is the composition of the initial board of trustees. Here control is first established. The only item of substance required in the articles of incorporation of an Ohio non-profit corporation, after name and purpose, is the names of the initial trustees. So who shall they be? Is it as simple as it first appeared?

Size is a crucial element. In general, the larger a board of trustees the more concentrated will control become. The chairman of a three-man board, such as the Cuyahoga County Board of County Commissioners, is weak by comparison with the chairman of a 1,000-person group such as the central committee of a political party. Size will also affect participation. The larger a board the less will be individual participa-

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For years The Cleveland Foundation Distribution Committee of five averaged 80% or better attendance at meetings. A fifteen-man board will be lucky to hit two-thirds attendance, and a thirty-man board will almost invariably have to set its quorum at less than a majority in order to hold a valid meeting. Any size larger than about twelve to fifteen makes regular operation through an executive committee almost inevitable. C. Northcote Parkinson set the ideal number for a working group at eight, more or less.¹ My own observation supports Parkinson's "Law."

Frequently boards will gradually grow as those in command feel that more and more interests should be represented on a board, "involved" in the work of the organization. The motive may be laudable and the result may be more support, financial and otherwise, and a better sounding board for opinion—but power will almost surely thereby shift to a small group. The Greater Cleveland Growth Board grew from 25 to 36 in its six-year life; its steering committee became more and more important. The board of the Cleveland Council on World Affairs was very much enlarged a few years ago to more than fifty; the Executive Committee now does the work.

There is no perfect size for a board of trustees, but those who set or change the size should be aware of the consequences.

The overall character of a board of trustees can greatly affect the ability of a non-profit corporation to carry out its objectives. Those who have power and a common interest may join together to exercise that power collectively. The Cleveland Development Foundation was formed by Cleveland industry and run by an industry board and executive committee. Chambers of commerce are similarly organized. Unity of point of view makes for quick decisions when needed, but can also create such reactions in "outsiders" that results may be harder to achieve.

In some organizations those with power pick experts to serve on a board to carry out some objective on which those with power have agreed. Here there will never be a major decision without checking back with the bosses. In other organizations a board will represent those interested in an objective other than those who directly participate. Typical might be the Cleveland Metropolitan Housing Authority, creating and managing housing for the poor; it is broadly representative. Decisions have a greater chance of acceptance by the community because they will have been arrived at by representatives of more interests. The process can take longer, however, and may even delay action so long that the organization is powerless.

More recently, led by the national Poverty Program, those who participate are serving on boards of trustees. Students demand a vote on faculty appointments. A new dimension is added. The deciders are

now far more aware of the complications of any decision, but decision is tougher. As a control group becomes less cohesive and more representative, it has greater and greater difficulty in making decisions and mobilizing to carry them out. Participants will look more to immediate effects of action than to long-range effects. Those who plan a new organization had better recognize these differing consequences or they may be severely disappointed in reaching their basic goal.

Composition of a board of trustees may depend on the new corporation's relation to another organization. Frequently there are special reasons for an organization to form a new corporation. A housing project financed by the Federal Housing Administration may have to be put in a corporation having no other business. An activity may involve possible liabilities that the parent organization wants to avoid. And, quite regularly, a trade association or business will have a related charitable foundation. Thus, the Cleveland Bar Association has the Cleveland Bar Foundation. The Greater Cleveland Growth Association in 1968 took on such a relationship to the Cleveland Development Foundation.

Since non-profit corporations don't issue stock, other devices are necessary to form what business men would call a "subsidiary." An easy way is simply to provide that the board of the parent corporation shall ex officio constitute the membership of the subsidiary corporation. For example, the board of directors of The Cleveland Chamber of Commerce constituted the membership of the Greater Cleveland Growth Board and elected the latter's board of trustees. It is also possible to provide that one or more trustees (perhaps a majority) shall be designated by the parent organization. So it is that Case Western Reserve University may name certain of the trustees of the University Circle Development Foundation. Another practice is to form a corporation without members, or with members the same as the board of trustees, whose board therefore elects its own successors; a policy is then established to keep the membership of the board identical to the board or executive committee of the parent organization. In this way the Longwood and Garden Valley Housing Associations, owners of the Cleveland housing projects of the same name, have maintained their affiliation with the Cleveland Development Foundation.

Maintaining an identity in the bodies in working control appears to be more effective in ensuring complementary activities than the right to choose trustees. It takes a while to exercise control through the power to appoint. Firing a board (if the parent group has the power) is frequently too drastic a control mechanism. Waiting until election may involve harmful delay and still not avoid an embarrassing fight; typically an outgoing board, directly or through a nominating committee appointed by it, proposes its own successors. In Cleveland the Greater Cleveland Growth Board, with a separate budget of $250,000 per year
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raised by its Executive Committee, did not consider itself subservient to the Chamber of Commerce despite the latter's right to elect the board of trustees. The Chamber invariably elected those nominated by the Growth Board.

Term of office can be an important element of control. The longer a term the less the control. Many organizations classify their boards and elect only one-third at a time, for example, for overlapping three-year terms. Delay in effecting control is inevitable. From the opposite standpoint, however, continuity of control is made easier, for a new group seeking control can go after only one class at a time. Thus we see one business corporation after another, in the face of possible raid, classifying its board. The same incentive exists in non-profit corporations. Whether continuity is desirable, of course, depends on whether one is looking from the inside out or from the outside in.

Age limits have a visible effect upon control. There is an increasing tendency in both profit and non-profit corporations to put age limits upon trustee or director terms. Apart from the myriad arguments on both sides of this issue, age limits add to the problems of maintaining continuity of control. Frequently a key individual is dominant in maintaining continuity and an organization will fall apart on his departure at a particular time. On the other hand, compulsory retirement forces the control group to work out a transition to the next generation of managers at an earlier time. Though I concur in the principle of transfer of control to a younger group before a whole generation of thinking is skipped (often with terrible consequences to the organization), an inflexible retirement policy has significant dangers for an organization.

It is not hard to think of illustrations of the dilemma of age limits. Franklin D. Roosevelt in his fourth term as President, Conrad Adenauer leading West Germany at 88, Winston Churchill in his last years as Prime Minister of England, J. Edgar Hoover as the ageless chief of the Federal Bureau of Investigation, Frances Bolton as an 80-year-old Congressman from the Cleveland area, Chiang Kai Shek preserving a myth that the island of Taiwan is "China"—who is to say for sure whether age limits should have retired these people earlier? In each case they represented continuity and leadership, frequently in times of crisis. They also prove that age limits affect control. Continuity occurs, sometimes at the expense of later more complete shifts of control.

So much for board of trustee composition. My purpose is not to establish an ideal, but to help those who plan to plan more effectively.

Boards of trustees are chosen in a number of different ways, speaking technically. A board may be set up with ex officio members only, such as a business corporation's affiliated charitable foundation where every member of the business board is automatically a member of the charitable board. Result: the charitable corporation is the alter ego of the profit corporation. The chairman says to his staff man:
“All right, John, which hat do we have on for this action?” Control is simple, complete and quick-acting.

Then there’s the self-perpetuating board. Many educational institutions, Yale, Harvard and Vassar included, for example, have boards where a majority of the board is chosen by the board itself. This procedure is also used conveniently to maintain identity of management with a parent organization. It is appropriate where an organization is expected to have a limited life, as with the Greater Cleveland Associated Foundation, established as a ten-year undertaking by the Ford Foundation and the Leonard C. Hanna, Jr. Fund; most of the initial board is expected to be on hand for the full life of the undertaking. When used for an independent, continuing organization like a university, one has created a body subject to no controls (except compliance with legal limitations). It is a marvel that we see so few “run-away” boards under these circumstances. The technique is the result, I believe, of not knowing who should elect the board. Alumni? Students? Faculty? Some public official like a Governor, as with a state university? Each has its drawbacks. So the planner gives up and hopes for the best.

Sometimes a board is chosen by specified office-holders. For fifty years a majority of the committee distributing funds of The Cleveland Foundation, in the millions of dollars per year, were appointed, separately, by the Mayor of Cleveland, the senior Federal District Judge and the senior Probate Judge. This does not produce control in anyone when no appointing authority chooses a majority, but it does make for some influence over policy.

Membership has not figured in this discussion so far. There are many genuine membership organizations, like labor unions, political clubs, country clubs, fraternal lodges, trade and professional associations. The members are intended to be in ultimate control. Control at any one time is the result of the manner of nomination and election of officers and trustees. Most simply, the board or executive committee acts as nominating committee and proposes a slate at an annual meeting of members. Only rarely is there opposition to the management slate. Continuity is assured.

Some seek to increase the responsiveness of boards to their membership, others (by contrast) to preserve continuity. “Continuity” is assisted by mail balloting (insurgents cannot then pack an election meeting) or requiring that additional nominations be made by petition well in advance of the election (no late rushes). A secret ballot is ordinarily treated as a right, but one could probably set up an organization without it. Public voting makes dissent noticeably more difficult. And the very requirement of a nomination at least guarantees the control group against surprise. If nominations are not required, an in-

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surgent group can quietly organize, pack a meeting, vote for their candidate and elect him, before the predominant group is hardly aware an election has been held. Fairness, I believe, requires both a secret ballot and nominations.

Frequently an organization will deliberately seek diversity, or "responsiveness." The City Club of Cleveland conscientiously nominates twice the number of directors as there are places to be filled. Suddenly there is both interest and excitement—a benefit to any organization. The only drawback is the occasional inability to get on the board some important person who just can't win an election. The Yale Law School Association, for example, has some positions filled by contested election and some by appointment or single-slate election.

Choice of board of trustees is not the only factor in control of foundations and other non-profit corporations. In many organizations, such as the Cleveland Development Foundation and the Cleveland Council on World Affairs, the executive committee of the board of trustees is in fact the active management group, and the board of trustees seldom meets and even less often does anything except act on recommendation of the executive committee. The relationship of the executive committee to the board of trustees becomes much like the relationship between the members and the board in other organizations. The Cleveland Development Foundation and the Greater Cleveland Growth Association coordinate their activities by substantially identical executive committees without any particular effort being made to make the boards of trustees the same.

A further coordination of activities can be achieved through identity of executive personnel. The Cleveland Governmental Research Institute, for example, was founded in 1945 by the board of The Citizens League of Cleveland as a research organization eligible for charitable contributions. The same person has served as executive director of both organizations, and offices are shared. No other overlap or control exists between the organizations, but close cooperation and coordination does result. Joint appointment of an executive is often the first feasible step toward an ultimate combination of enterprises.

Control, or influence, through the purse strings is another often used technique. This is not control in any formal sense, but the greater the dependence on a source of funds the greater the actual control which results. The Welfare Federation of Cleveland is such an organization. It can issue no orders to Red Feather agencies, but by controlling what may be half or more of an agency's income its influence is great. So also for the Greater Cleveland Neighborhood Centers Association and its seventeen member settlement houses like Goodrich, Alta, Merrick, League Park and Phillis Wheatley.

The final, and ultimate, control mechanism of the foundation or non-profit corporation is the power to change its charter and by-laws (or
regulations), including changing the size or composition of its board of trustees and causing its dissolution. These powers, normally assigned to "members," represent the power to control the long-term destiny of an organization. Just as Franklin D. Roosevelt proposed packing the Supreme Court, power over a foundation can be shifted by enlarging its board through addition of enough trustees to change control. And as a last resort those with power over the basic form of an organization can compel dissolution.

In many respects relationships among foundations and other non-profit corporations are more complicated and varied than among business corporations. In the absence of stock ownership as the major element of control man's ingenuity has created a host of other devices. The planner of any non-profit venture can benefit from knowledge of the possibilities and some of their consequences. This article makes no effort to be comprehensive. It is little more than the observations of one who for twenty years has been heavily involved with many of Cleveland's non-profit enterprises.