

**PG Briefing**

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## **The Lesson Plan is Out from Behind the Headlines – Lessons from the Resolution of the Trump Foundation Suit**

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*This Briefing is brought to you by AHLA's Business Law and Governance Practice Group.*

Good, effective governance sets the mission and direction for an organization, but may change direction in times of severe stress. It oversees operations and looks to the future, identifying opportunities and risks (including those that are organization specific, location relevant, and industry wide). It requires a board that is attentive, inquiring of management, and committed to the organization's mission.

### **Suit and Motion to Dismiss**

As health care law professionals, we look to cases brought and resolved, news articles, corporate integrity agreements, and other documents for lessons with which to educate our clients to achieve good governance and avoid going astray. This article completes a trilogy of articles<sup>i</sup> discussing governance lessons arising out of the June 2018 suit by the New York State Attorney General to, among other things, dissolve the Donald J. Trump Foundation (the "Foundation").

In addition to the dissolution of the Foundation, the suit sought to enjoin its Board Chair (President Trump) from serving as an officer, director, or trustee with any charitable organization that solicits contributions<sup>ii</sup> from New York residents for ten years, and to similarly enjoin the other directors for one year. Importantly, it also sought damages from the Board Chair equal to the amount of funds received by the Foundation at an Iowa campaign event, or approximately \$2.8 million.<sup>iii</sup> The Attorney General also sought punitive damages in an amount equal to twice the amount of general damages.

In November 2018, New York State Supreme Court Justice Saliann Scarpulla denied the Foundation's motion to dismiss the NY Attorney General's suit.<sup>iv</sup> In denying the motion to dismiss, Justice Scarpulla found that:

- The directors had (i) engaged in no governance oversight of the Foundation during the life of the Foundation, (ii) outsourced to the Board Chair's business and political campaign decisions regarding the distribution of the Foundation's

funds, and (iii) had the finance department of the Board Chair's personal business issue checks on behalf of the Foundation.

- The phrase "Related Party Transactions" under New York law with regard to board member conflicts of interest is not limited to financial deals, but may involve any arrangement, including one where the Board Chair's employees directed the charitable assets be deployed to a charity chosen to advance the Board Chair's personal interests. This deploying of charitable assets constitutes corporate waste, even if the assets are deployed to an eligible charity.
- Statutes of limitation related to a claim of a board member's breach of fiduciary duty start to run only after the board member has left the board or otherwise repudiated his fiduciary relationship to the organization. Accordingly, board members must fulfill their ongoing obligations or leave the board, for failing to do so may simply toll a statute of limitations whose expiration would otherwise reduce the board member's liability exposure.
- Retrospective corrective action of a matter of charitable waste does not serve as a basis for a dismissal of a suit alleging breach of fiduciary duty nor does it prevent the court from deciding upon the matter.

Following Justice Scarpulla's denial of the defendants' motion to dismiss the suit, on December 19, 2018 the Attorney General and the defendants' counsel entered into a stipulation to dissolve the Foundation, with the Foundation's remaining assets to be distributed in equal amounts to a list of organizations approved by the Attorney General.<sup>v</sup>

### **Decision and Stipulations Resolve the Case**

Ten months later, the Attorney General entered into a stipulation with the individual directors (other than the Board Chair) in which she agreed to dismiss the causes of action against them. This stipulation required that the directors certify that they had completed a training program covering the fiduciary responsibilities of directors and the statutes applicable to charitable organizations. In addition, the training was required to be conducted by a former Bureau Chief of the Charities Bureau of the Attorney General's office.

On November 7, 2019, Justice Scarpulla fully resolved the matter with her Decision and Order on Petition that included a So Ordered Stipulation of Final Settlement, which in turn had attached to it the Stipulation of the individual directors (other than the Board Chair) as well as the stipulation to dissolve the Foundation.<sup>vi</sup> In her decision, she directed the Board Chair to personally pay damages in the amount of \$2,000,000 to be distributed pro rata to the same Attorney General approved charities to which the funds of the dissolved Foundation were disbursed. She refused, however, to award punitive damages, because to resolve the matter the Board Chair had agreed to certain

conditions on his future conduct with respect to charitable organizations soliciting donations from New York residents.

In the So Ordered Stipulation of Final Settlement, the Foundation and the Board Chair stipulated to a number of facts that identified their failures, including among others:

- “The Foundation’s Board of Directors did not meet from 1999 through November 2018, and did not provide oversight, set policy or approve the direction, operations or acts of the Foundation.” This fundamental failure of oversight led to the other problems addressed by the lawsuit.
- “The [political] Campaign [of the Board Chair] planned, organized, and paid for [the Campaign Event], with administrative assistance from the Foundation; and the Campaign [rather than the board and officers] directed the timing, amounts, and recipients of the Foundation’s grants to charitable organizations supporting military veterans....”
- In April 2007 the Board Chair settled a lawsuit where the settlement provided that the chair “would contribute \$100,000 to charities agreed to between the parties.... In September 2007, [the Board Chair] caused the Foundation” to make the donation that was required by the Board Chair’s settlement of his personal suit out of the Foundation’s funds. The chair did not reimburse the Foundation for that donation until ten years later in March 2017.

As noted above, the New York Attorney General’s suit had sought to prevent the Board Chair from ever serving as an officer, director, or trustee of a charitable organization that solicits donations from New York residents.<sup>vii</sup> Rather than ban him from future board service, the stipulation resolved the matter by causing him to commit to certain good governance actions should he in the future serve as an officer or director of a charitable organization that solicits within New York.

As an initial matter, he was required to comply with New York laws related to conflicts of interest and related party transactions. Accordingly, any such organization on whose board he would serve is prohibited from entering into a related party transaction with the Board Chair, his family members, or any entity owned or controlled by him and his family members. The majority of board members of such entity must qualify as independent directors, having no business or familial ties with the Board Chair or any entity owned by him or his relatives. This would not prevent the Board Chair or his affiliates from donating property or services to the organization, but would trigger a requirement with respect thereto that an independent auditor certify to the Attorney General the fact of the donation and that its reported value is a fair representation of its actual costs.

In addition, such an organization is required to have an accountant that monitors the organization’s grants and expenses and performs an annual audit thereof. Moreover, the organization will have to engage counsel not just with general governance expertise, but with specific expertise in the not-for-profit laws of the state of New York so as to advise the organization and its leadership on compliance with the applicable laws and

regulations. The education and advice provided to the board is to be broader than New York law, and is to include “accepted practices.” These requirements would apply to any charitable organization on whose board he may serve.

Additional requirements were placed on “new charitable organization[s]” on whose board he may serve as a director or officer. As health care professionals, we insist our clients live by the saying that if it isn’t documented it isn’t done. The stipulation included for new organizations the basic governance requirement that a board secretary take and prepare minutes of each meeting, and that the organization maintains an ongoing archive of the minutes. Its other basic governance requirements include that the board hold an annual meeting at which officers are elected by a majority of the entire board. To ensure the most basic of adequate financial controls, the board of the new organization will be specifically empowered to enable it to require multiple signatures to sign and execute corporate checks. Also, to ensure that the board maintains its independence, a new entity will be required to set its board’s meeting quorum at one-half of the total number of directors.

In addition to the above basic good governance requirements, the Board Chair stipulated that any new charitable organization which he serves as an officer or director will, for a period of five years, provide the Attorney General with an annual report and certification of compliance with the stipulation. Under the annual report, the organization will have to:

- identify to the Attorney General its legal counsel with expertise in New York not-for-profit corporation law, as well as its auditor and the amount of time spent during the year on work for the organization;
- identify all independent members of the board, and identify any board members that are not independent due to a relationship with the Board Chair, his family, or business entities;
- identify a corporate compliance officer within the organization;
- provide copies of all of the organization’s policies and procedures intended to ensure compliance with New York law regarding audit oversight, related party transactions, whistleblower reporting, and loans to directors and officers, as well as its policies and procedures describing its internal financial controls; and
- provide any submissions received by the organization under such policy (e.g., any whistle blower complaints), and copies of board minutes and resolutions responding thereto.

The \$2 million fine placed on the Board Chair shows the significant risks faced by individual board members who disregard laws and regulations related to their organization’s legal compliance obligations. The stipulation’s requirements of legal compliance training for board members point to the importance of educating our organizations’ directors on the laws and regulations applicable to their board service, in addition to the mission and operations of their organization. The inclusion within the stipulations of basic requirements, such as minute taking, engaging counsel experienced in advising on nonprofit governance, and minimum financial controls,

shows the effectiveness of basic actions taken and documented by the board in ensuring an organization's good governance and in protecting board members from financial and reputational exposures related to their service. It comes back to the directors' attentiveness and thoughtful activity implied by their Duty of Care and their prioritizing of the organization and its mission above their own interest as required by the Duties of Loyalty and Obedience to the corporate purpose.

The case against the Trump Foundation and its directors, and its resolution, demonstrates that a board's compliance with the legal requirements governing its actions should generally not be particularly difficult. However, when the board fails in its compliance, it risks financial and reputational compromise of the organization and its board members. Accordingly, the lesson of this case is that attentive and active governance is essential for the ongoing organizational reputational and financial health of a nonprofit entity, as well as for its officers and directors.

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<sup>i</sup> The first article in the series was AHLA's Business Law and Governance (BLG) Practice Group's July 18, 2018 article, *Don't Let the Headlines Hide the Lessons for Your Board*, <https://www.americanhealthlaw.org/content-library/publications/alerts/2bed92d0-e798-4d51-8bb8-5769afaae0cf/Don-t-Let-the-Headlines-Hide-the-Lessons-for-Your>. The second was BLG's May 16, 2019 article, *Don't Let the Headlines Hide the Lessons for Your Board, Part 2*, <https://www.americanhealthlaw.org/content-library/publications/briefings/52a2c7db-5c9d-465d-898a-d57646f50a18/Don-t-Let-the-Headlines-Hide-the-Lessons-for-Your-?Token=4794fbf8-f558-4c6d-a9db-4b934ea1c2bf>.

<sup>ii</sup> It is worth highlighting that New York is among the 39 states that require charities that solicit donations from its citizens to register with the State Charities Bureau. As a result, the case sought to enjoin Mr. Trump's service as an officer, director, or trustee of any charitable organization that solicited or solicits donations from New York residents, even if such organization is located or formed in another state.

<sup>iii</sup> *Underwood v. Donald J. Trump, Donald J. Trump, Jr., Ivanka Trump, Eric F. Trump, and The Donald J. Trump Foundation*, No. 451130/2018 (NY Sup. Ct. filed June 14, 2018), [https://ag.ny.gov/sites/default/files/court\\_stamped\\_petition.pdf](https://ag.ny.gov/sites/default/files/court_stamped_petition.pdf).

<sup>iv</sup> 451130/2018 *People of the State of New York, by Barbara D. Underwood, Attorney General of the State of New York, Petitioner v. President Trump, Donald Trump, Ivanka Trump, Eric Trump, and The Donald J. Trump Foundation, Respondents*, Motion No. 002 (11-21-2018)002.

<sup>v</sup> So-Ordered Stipulation Concerning the Dissolution of the Donald J. Trump Found., *The People v. Trump*, No. 451130/2018 (N.Y. Sup. Ct. Dec. 19, 2018).

<sup>vi</sup> So Ordered Stipulation of Final Settlement, *The People v. Trump*, No. 451130/2018 (N.Y. Sup. Ct. Nov. 7, 2019).

<sup>vii</sup> This could have been especially problematic to the Board Chair, President Trump, as traditionally once presidents are no longer in office, they typically form a library for their presidential papers and to highlight their accomplishments while in office, as well as a foundation to support their ongoing public work. Whether or not the library would be located within New York state, it would undoubtedly solicit contributions from citizens of all 50 states, including New York. Accordingly, had he been banned from so serving it could have been very problematic for him and for his future foundation.

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