

Briefing for PWSRCAC Board of Directors – May 2023

INFORMATION ITEM

Sponsor: Ashlee Hamilton, Financial Director

Project number and name or topic: Annual Code of Conduct
 Acknowledgement, Statement of Residency, and Conflict of Interest Disclosure

1. **Description of agenda item:** Each year Board members are asked to acknowledge PWSRCAC’s Code of Conduct, complete a Statement of Residency, and complete the Conflict of Interest and Transactions with Interested Parties form. This requirement is stated in PWSRCAC’s policies or bylaws. The Conflict-of-Interest form is used to identify the financial interests Board members, or their close relatives, may have in Alyeska Pipeline Service Company or any of Alyeska’s owner companies. The Transactions with Interested Parties form is used to identify financial interests Board members, or their close relatives, may have with vendors doing business with PWSRCAC and is the basis for some of the information provided on the annual Form 990 submitted to the Internal Revenue Service. [Social media guidelines](#) are included with the Code of Conduct. Other Board-approved policies and procedures referenced in these documents are available on www.pwsrcac.net.

2. **Why is this item important to PWSRCAC:** Conducting business according to standards set by the PWSRCAC Board enhances the Council’s overall credibility and effectiveness as an organization. The Statement of Residency is a requirement stated in the bylaws. The Conflict of Interest and Disclosure forms help ensure Board members do not have a financial stake in Alyeska and that business transactions are conducted in an ethical and legal fashion.

3. **Previous actions taken by the Board on this item:**

<u>Meeting</u>	<u>Date</u>	<u>Action</u>
XCOM	2/1999	Directed legal counsel to draft language for a conflict-of-interest bylaw change for the March meeting.
Board	3/1995	Amended bylaws to include a conflict-of-interest statement.
Board	2/1992	Approved policy 101, conflict of interest statement.
Board	5/2011	Approved a consolidated conflict of interest form to be signed annually by Board members.
Board	9/2013	Briefed on content of review by council lawyer for information including recommendation that requirement of form extend to all volunteers.

4. **Summary of policy, issues, support or opposition:** An explanatory memo prepared by Council attorney Joe Levesque summarizing conflict of interest issues is attached.

5. **Committee Recommendation:** Not Applicable.

Annual Board Required Documentation Completion 4-10

6. **Relationship to LRP and Budget:** Not Applicable.
7. **Action Requested of the Board of Directors:** Each Board member is asked to complete these forms. No formal Board action is required. Staff are available to answer specific questions members may have about these forms.
8. **Alternatives:** Not applicable.
9. **Attachments:**
 - A: Code of Conduct and Board Statement of Residency
 - B: Conflict of Interest and Transactions with Related Parties Disclosures
 - C: Memo from Joe Levesque dated July 9, 2013, regarding Conflicts of Interest


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MEMORANDUM

TO: Steve Rothchild, Administrative Deputy Director
Prince William Sound Regional Citizens' Advisory Council

FROM: Joseph N. Levesque 

DATE: July 9, 2013

RE: Conflicts of Interest
Our File No. 474-1

Introduction

You have requested that I provide you a legal definition of "conflict of interest," and a sampling of examples illustrating potential "conflicts of interest." In reviewing this Memorandum, you will note that there is no easy definition of "conflict of interest," especially in Alaska, where everyone seems to be related to or know everyone to some degree.¹ For example, while many people concern themselves with real potential "conflicts of interest," others imagine various types of potential "conflicts of interest." Therefore, the important points to remember are to use common sense and to self-disclose any potential "conflicts of interest."

A. General Definition

For directors of nonprofit corporations, there exists a potential conflict of interest whenever a director holds a personal stake in the outcome of a particular issue that the board must decide. Conflicts of interest arise when a board member's personal interest in the outcome of an issue is sufficiently great that affects, and is therefore in "conflict"

¹ See, *Getting ethics right – it's harder than you think*, The Foraker Group, www.forakergroup.org/index.cfm/print/Resources/President's-Letter/Focus/545, accessed 7/9/2013, Attachment A.

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with, his or her duty to make decisions on behalf of the organization solely for the purpose of furthering and serving the organization's interests.

B. The Origin and Types of Conflicts of Interest

Directors of nonprofit corporations are fiduciaries, and as such, owe fiduciary duties to the organization that they serve. One of these is the *duty of loyalty*, which requires directors to base their management decisions on the organization's best interests, as opposed to the director's personal interests, or the interests of the director's associates. It is from this duty of loyalty that a director's obligation to avoid conflicts of interest originates. A director faithfully executes this obligation by doing everything reasonably possible to avoid conflicts of interest. This obligation is set forth clearly in the Prince William Sound Regional Citizens' Advisory Council ("PWSRCAC") bylaws, which state at Section 3.20:

Council members with a financial interest shall ensure that it does not conflict with the fair and impartial conduct of his or her council duties.

A director may face numerous types of potential conflicts of interest through his or her tenure on a nonprofit corporation's board of directors. The classic situation that creates a potential conflict of interest, and the one that appears to be the primary focus of the PWSRCAC bylaws and the organization's self-disclosure requirements, occurs when a financial benefit may flow from an official board action to a director, or to the director's associates. Another situation that commonly creates potential conflicts of interest for nonprofit board members occurs when one or more possible outcomes of official board decision may have an effect upon another person or entity to which a board member also owes a duty of loyalty, such as a different nonprofit.

However, the fact that there exists a *potential* conflict of interest does not mean that a *true* conflict of interest exists at all. There are countless situations that may appear to one person as being a clear conflict of interest, but to others as presenting no conflict at all. A director's duty of loyalty to his or her organization, and the director's related obligation to avoid conflicts of interest, requires that the director to take every reasonable step to avoid conflicts.

For PWSRCAC directors, this means that directors must *disclose* to the Board the existence of any potential conflicts of interest, and to permit the Board to decide, according to the procedures set forth at 3.20(F) in its Bylaws, whether a conflict exists, and whether the best interests of the organization require that the conflicted member abstain from participating in the resolution of a particular issue.

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C. Financial Conflicts of Interest

The class of potential conflicts of interest that is most often discussed is financial in nature. Financial conflicts of interest appear to be the primary focus of the PWSRCAC Bylaws. Although the Bylaws discuss potential financial conflicts of interest in more general terms, it appears that Part 1 of the organization's self-disclosure forms focus exclusively on the identification of ties between directors and Alyeska Pipeline Service Company, or Alyeska's owners (BP, ConocoPhillips, ExxonMobil, and Koch). However, it is important to note that PWSRCAC Board members have a duty to disclose other potential financial conflicts of interest implicated by board decision-making.

For PWSRCAC, a potential for financial conflicts of interest arises whenever a director is asked to participate in a board's decision-making process, the outcome of which could result in the flowing of a financial benefit from the organization to the director, a family member, or to a close associate. Accordingly, Section 3.20(C) of the Bylaws generally prohibits Board members from holding financial interests that "conflict[] with the fair and impartial conduct of his or her duties."

PWSRCAC directors must notify the Board's presiding officer that there may exist a potential conflict of interest whenever the director realizes that an issue that has come before the Board has the potential to result in financial gain, for the director, the director's family, or for any person or other entity to which the director is closely associated. The director must notify the presiding officer as soon as the director becomes aware that the potential conflict exists.

The provision of this notice does not always mean that the director is disqualified from participating in the resolution of the issue that gives rise to the potential conflict. Section 3.20(F) does provide that members may not vote "on any question in which the member has a *direct* financial interest." However, that Section makes it clear that it is up to the presiding officer to make an initial ruling as to whether the potential conflict of interest is sufficient to require a director's exclusion from an official vote. As an added check, the presiding officer's determination may be overridden by a simple majority of other directors. It is the fact that the Board was made aware of the potential conflict, and was permitted the opportunity to meaningfully weigh the potential conflict against the best interests of the organization, that is most important.

D. Examples of Direct Financial Conflicts of Interest

1. Board member A has decided to accept a position as CEO of the organization on whose board she serves. The current bylaws do not permit an individual to be employed by the organization and to serve as a director at the same time. Board member B introduces a motion to amend the bylaws to permit employees to serve as board members. Board Member A has a direct financial interest in the outcome of the motion, and may not vote on the issue.

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2. The board of directors has issued an RFP for a company to provide it with legal services. A firm that is owned by the spouse of a board member responds to the RFP. There is the appearance that the board member has a direct financial interest in awarding the contract to the spouse's firm, and therefore, may not vote on the issue.
3. A Nonprofit Organization's purpose includes the monitoring of ACME's business practices. The organization's monitoring results in significant increased operating costs for ACME, which reduces the dividend distributions to its shareholders. One of the organization's board members inherits ACME stock from a deceased relative. The board member now has a direct financial interest in the outcome of any business decisions that may affect ACME's net profits, has a direct financial interest in the outcome of these issues, and therefore, may not vote on them.
4. A Nonprofit Organization's purpose includes the monitoring of ACME's business practices. The organization is considering a new method of monitoring ACME, which would likely result in significant increased operating costs for the company and a very significant reduction in the amount that ACME's retired employees will receive in their monthly pension checks. One board member is an ACME retiree, and receives a pension from the company. That board member has a direct financial interest in the outcome of the organization's decision regarding the new monitoring practices, and therefore may not participate in any vote on the issue.

E. Examples of Indirect Financial Conflicts of Interest

1. A Nonprofit Organization's purpose includes the monitoring of ACME's business practices. One board member has a child whose husband works for ACME. The organization's board is deciding whether to take an official action that the board member suspects may cause ACME to downsize the department in which the child's husband works. The board member has an indirect financial interest in the outcome of the issue, and must disclose that interest to the board before participating in the decision-making process.
2. A Nonprofit Organization has issued an RFP for a company to supply its office equipment and administrative materials. One company that responds is owned by one of the director's best friends. The director very likely has an indirect financial interest in the outcome of the contract's award, and must disclose this potential conflict to the board's presiding officer before participating in any board action related to it.

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F. Associational Conflicts of Interest

Although PWSRCAC Bylaws focus on potential financial conflicts of interest, the organization's directors must also take steps to avoid potential associational conflicts of interest. These would most generally arise if a PWSRCAC director sits on multiple boards, or owes a duty of loyalty to some other corporate or membership entity that stands to be affected by PWSRCAC's activities.

As with potential financial conflicts of interest, any director who suspects that a potential board outcome could have an effect on another organization to which the director owes a fiduciary duty, must disclose that potential conflict to the presiding officer as soon as possible. This ensures the Board's ability to determine whether the best interests of the organization require that the potentially conflicted member abstain from participating in the decision-making process regarding the action at issue.

G. Examples of Associational Conflicts of Interest

1. A Nonprofit Organization has for years held its annual retreat in Oceantown, because Major Airlines had a hub there, which made it the most inexpensive and convenient forum. The annual retreat was a significant source of income to Oceantown. One of the organization's directors also sits on the Oceantown Citizens' Community Development Squad. Recently, Major Airlines relocated its regional hub to Mountaintown, making Oceantown no longer the most inexpensive and convenient forum for the annual retreat, and now the board is considering whether to relocate the annual meeting to Mountaintown. The director has a potential associational conflict of interest, and must disclose it to the board's presiding officer before participating in any board action related to the relocation of the retreat from Oceantown to Mountaintown.

H. What Must Be Disclosed in PWRSCAC's Disclosure Form

Parts 1 and 2 of PWSRCAC's Standard Disclosure Form require that directors identify and list only some of the many potential sources for conflicts of interest. Part 1 relates only to a director's ties to Alyeska Pipeline Service Company and to its owners. Directors are required to disclose not only their own personal financial ties, but also the ties of their spouses, children, partners, and other organizations for which the director serves as an employee, director, trustee, or fiduciary.

This would include, but is not limited to:

- Any financial ties that the director has to Alyeska, or to its owners.
- The financial ties that the director's spouse and children have to Alyeska, or to its owners.

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- The financial ties that any organization for which the director serves as employee, officers, director, trustee, or partner has to Alyeska, or to its owners, including, for example:
 - Pension, retirement and shared income plans.
 - Income or financial benefit derived from current or former employment with Alyeska and/or its owners.
 - Income resulting from former business conducted with Alyeska and/or its owners.
 - Income resulting from a professional association doing business with Alyeska and/or its owners (for example, the fact that a director was previously employed by a union, and receives a retirement from the union that is supported by the business it conducts with Alyeska and/or Alyeska's owners).
 - Ownership of stock, stock options, bonds, or securities in Alyeska and/or Alyeska's owners.
 - Status as the beneficiary of a trust that is funded by Alyeska and/or its owners, or some other entity that has done or currently does business with Alyeska and/or its owners.

Part 2 is used for the organization's required reporting to the IRS, and requires directors to identify both past and potential future transactions between PWSRCAC and any other entity, in which the director held, or holds, some financial interest. Unlike Part 1, Part 2 does require directors to identify the amount of all covered past transactions, as well as any known balances for upcoming transactions.

Conclusion

PWSRCAC directors are required to disclose the existence of any and all potential conflicts of interest to the Board before participating in any official action related to the potential conflict. It is clear that the determination of whether a potential conflict is sufficient to warrant a director's exclusion from participation in official Board action is difficult. However, not all potential conflicts necessitate exclusion. PWSRCAC Bylaws make it clear that directors are absolutely forbidden from participating in official Board actions that may affect a director's direct financial interests. However, it is up to the presiding officer, and the Board at large, to determine whether a direct financial conflict of interest exists, or whether the best interests of the organization require that a potentially conflicted director is excluded from participating in any decision-making process related to a particular issue. The important consideration is that the Board was

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informed of the conflict or potential conflict, and was therefore capable of rendering a decision regarding an issue that in all respects represented and furthered PWSRCAC's best interests.

I remain available to discuss this matter with you. Please do not hesitate to contact me if you have any questions whatsoever or require additional information.



Getting ethics right - it's harder than you think

When Foraker introduced its first class, Board Roles and Responsibilities, questions peaked when we got to the discussion on conflicts of interest. In hindsight, I may have been too cavalier in my assessment of conflicts. I would simply say: "this is Alaska, everything is a conflict of interest - get over it." But seriously, compared to many places, we do have the opportunity to address conflicted interest more than almost anywhere else in the country. We know one another here - and Alaskans aren't afraid to speak up when they see a conflict.

All corporations have the legal duty to avoid conflicts of interest. However, because of their civic and charitable missions, nonprofit corporations, specifically 501 (c)(3), (c)(4), and (c)(6) organizations, should exceed the law's expectations to maintain the public's trust. Conflicts in our sector come in two basic forms. One occurs when an individual of influence (a board member or an executive) or an immediate family member could receive financial benefit from the nonprofit they serve. The second occurs when an individual could experience mixed loyalties while serving two or more organizations. If the interest of one organization runs counter to that of the second, it's virtually impossible to serve each fairly. Both these examples represent conflict of interest, and both are real life dilemmas for many Alaskans serving on nonprofit boards and staff.

The conflict of personal financial benefit

This type of conflict recently received attention in Washington D.C. from a Senate oversight committee. The Senate's concern focused on families that created charitable foundations and then paid themselves generous stipends to serve on the board or staff. That's considered "self-dealing" and we're not immune to it here in Alaska. Consider the case of former Fairbanks Mayor Joe Hayes and his wife. They formed a faith-based nonprofit, served on its board with close friends, then received federal funds which they used for personal benefit. The result was a perfect storm for conflicts of interest.

Other examples of conflicts from financial benefit include:

- Serving on the board and as paid staff for the same organization - it's not illegal, but it's also not considered a "best practice" because of the inherent conflicts for that individual.
- Approving service contracts to the company of a board member without transparency in reaching that decision, including full disclosure and abstention in the vote by the board member.
- Lobbying by a board member for a family member to receive a paid staff position.

We've also run across cases when individuals start a nonprofit as a way to secure personal employment. Often these folks are entrepreneurs who want little from their nonprofit experience than personal financial gain. They naively assume that getting money from the government or a foundation is easy. Eventually they either starve when they can't get the funds they expected, or too often, use inappropriate methods to get what they want. Such individuals are best advised not to start nonprofits. They should more appropriately create a for-profit corporation and then pay themselves whatever they wish. In our sector, no employee or board member should have the capacity to set their salary or any benefit without total openness and fairness. In the rare occasion where a nonprofit board provides financial reimbursement for board service, as is the practice in some rural nonprofits, those decisions should be made with full disclosure including benchmarking the compensation to like-sized organizations with similar missions.

The conflict of dual loyalty

This type of conflict is best understood by example. John Smith serves on the board of Nonprofit A, which has adopted a certain position on an issue. John then attends a meeting as a director of Nonprofit B and votes for a

position that is opposite to that of Nonprofit A. Another example - Judy Brown serves on a board debating an economic development opportunity. Judy also works for a corporation that could either benefit or be harmed by the outcome of the organization's position. Both John and Judy find themselves in a conflict of dual loyalty.

The challenge of avoiding a conflict of dual loyalty is especially difficult in our villages. From the beginning, villages had tribal organizations. With statehood, many created city governments. With the adoption of ANCSA, most created village corporations. These organizations all need board members to govern them. In a community of a few hundred people, half of whom can be under 18, there's little way to avoid dual loyalties.

When multiple organizations in one small community have conflicting interests, maybe the answer lies in collaboration among the city, the tribe and the corporation to assure board members don't get caught in the web of dual loyalty. Another solution is to operate with a great degree of transparency. For example, try to avoid executive sessions. To ensure pure motives, even when dealing with personnel issues, it may be in the best interest of boards to conduct as much of their decision-making as they can in public. That's how to demonstrate they conducted business in the interest of the organization, not any individual or family.

No organization is immune from conflict of interest

Our donors often keep us honest. But we all have seen examples when even sophisticated donors seem to stop thinking when they work with charitable nonprofits. Remember the 1992 United Way of America scandal? I do. I was teaching a class there the week the news broke and helped to organize efforts to force the resignation of CEO Bill Aramony. Bill was a tremendous leader. Had he retired when he turned 65 in 1987 - as many of his friends encouraged him to do - he would no doubt have been memorialized as the man who not only built the United Way system, but moved the nonprofit sector toward a higher level of professionalism. However, because he stayed around too long and along with his staff and board did not pay attention to obvious conflicts of interest, he was forced to retire to a federal penitentiary and a life of shame and embarrassment.

Aramony had built one of the strongest nonprofits in America by recruiting a tremendous staff. However, toward the end of his career he would not listen to some of these very bright and ethical people if they did not agree with him. He also recruited one of the most influential boards in America. He had the CEO's of UPS, American Express, IBM, USA Today, Hospital Corporation of America, United Airlines, The NFL, etc., etc. etc. He had the leaders of the Communications Workers of America and the AFL-CIO. When the scandal occurred, he even had a board member named Gates, before he was a billionaire. One could think that so much corporate power would observe and confront questionable behavior - but that wasn't the case. This lack of reaction to obvious conflicts has damaged our entire sector for 16 years. When it comes to conflicts of interest and ethics, the United Way of America scandal taught us to take nothing for granted.

What we learned from the United Way of America case

When the scandal occurred, I was asked to serve on the new Ethics Committee as United Way worked to rebuild its credibility. We recruited some of the country's leading law schools, Wharton and Harvard, to advise us on doing ethics right. We learned that every organization should develop and annually review a Code of Ethics and a Conflicts of Interest policy. In fact, under IRS regulations boards must now, through either Bylaws or formal policy, adopt a Conflicts of Interest policy. While a Code of Ethics isn't required by law, it is a "best practice" and assures donors that people associated with the organization use their contributions to fulfill the mission, not enhance themselves.

BUT MOST IMPORTANT, we learned we must work to develop an ethical environment for staff and board members. That means conducting numerous discussions on people's perception of ethical behavior and conflicts of interest - maybe adding open discussions at most meetings.

What I also learned was that while each of us may think we are ethical and without conflict, others may see us differently. The reality is that both ethics and conflicts are perceptions, not absolutes. The only way to ensure that we all act ethically or that we are handling our conflicts of interest appropriately is to consistently ask those around

us to be honest in what they see. While this sounds simple, it is very, very hard for most of us to provide such candid advice to our friends or supervisors - it's even harder for us to accept. None of us wants to be called on unethical behavior or a conflict of interest. While it is not easy, it's what we must do to maintain the trust of those who depend on us to improve their lives - and those who provide the financial and volunteer support to fulfill our mission. Good leaders surround themselves with people who speak the truth, even if it is hard for all involved.

The law is clear - conflicts of interest should be avoided. However because of our "two degrees of separation" here in Alaska, we face potential conflicts every day. Add to that the limited number of Alaskans who are available to serve on boards, and conflicts can be very difficult to avoid. In our smaller communities, many residents are related by blood or marriage. It's almost inevitable that board members will find themselves making decisions that could benefit them or an immediate family member. Literally no way exists for some organizations to conduct business without conflicts. The answer, as I emphasized above, is to make decisions after open and transparent discussion - and to fully disclose conflicts when they exist.

The Foraker Group encourages everyone in the sector to assume responsibility for maintaining the public's trust. We do that by adopting policies and practices that promote a high standard of ethical behavior and especially by avoiding conflicts of interest. Only then can we be sure we truly serve our communities, not ourselves. We have examples of Conflicts of Interest policies and Codes of Ethics. We'll share them with any organization - just call 907-743-1200.

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