



American Red Cross
Governance for the 21st Century

A report of the Board of Governors

October 2006



National Headquarters
430 17th Street NW
Washington, DC 20006

Bonnie McElveen-Hunter
Chairman

November 1, 2006

A Letter from the Chairman of the Board of the American Red Cross

In 1900, Clara Barton, the founder of the American Red Cross, said, “To you – the people of America – this sacred trust is committed: in your hands the charge is laid.” The more than 1,000,000 volunteers and 35,000 employees who represent today’s American Red Cross understand that you have entrusted the Red Cross with a great responsibility and charge to meet the critical needs of your neighbors around the corner and across the globe in their most critical hour of need. You count on us to be there when *you* need us the most. And, you have entrusted the American Red Cross to be effective stewards of the time, talent and treasure that you have so generously given to our organization.

When an organization is given such an important and sacred trust by the American people, it must do everything in its power not only to ensure that it is worthy of this trust but to deliver in all areas of its responsibility – and there is no more critical responsibility than in the area of governance, oversight and transparency. Accordingly, in February of this year, the American Red Cross Board of Governors took decisive action to modernize and strengthen our governance structure and practice, which had not been substantially addressed since 1947.

The Board of Governors charged its Governance Committee to conduct a comprehensive review and analysis of the Board’s role, composition, size, relationship with management, governance relationship with Red Cross chartered units, and whistleblower and audit function. Embracing the best practices of governance in both the non-profit and for-profit sectors, this effort was designed to determine how the Red Cross’s governance structure and practices could be enhanced.

To achieve the transformational changes the Board envisioned, the Governance Committee requested that an Independent Governance Advisory Panel be created, with the assistance of independent counsel, to provide the Board of Governors its substantial expertise and knowledge of best practices in governance. Working collaboratively with the Independent Governance Advisory Panel, the Governance Committee advised the Board of improvements and enhancements that it could consider. These recommendations, accompanied by the historical governance practices of the Red Cross and an analysis of best practices in non-profit and for-profit governance, formed the basis of a draft report that was reviewed and deliberated upon on October 27, 2006, by the Board of Governors.

The Board of Governors unanimously approved all recommendations as proposed by the Governance Committee with the advice of the Independent Governance Advisory Panel. Several

of these recommendations – such as focusing the Board’s role on governance and strategic oversight, reducing its size by more than half and creating a single category of Governors, will require Congressional approval. Other actions – such as streamlining the Board’s committee structure, creating a National Leadership Council and creating a Governance and Board Development Committee to actively recruit and nominate prospective Governors based on criteria established by the Committee can be addressed by the Board itself. The Board of Governors is eager to begin making these changes as quickly as possible.

The enclosed report, “American Red Cross Governance for the 21st Century” was made possible by the extraordinary leadership and commitment of many individuals. On behalf of the Board of Governors, we are deeply grateful to the members of our Independent Governance Advisory Panel who generously donated their time to this effort. Members of the Panel, led by its Chair, Karen Hastie Williams include: Peter Clapman, Professor Charles Elson, Margaret Foran, Professor Jay W. Lorsch, Patricia McGuire and Professor Paul Neuhauser. The Board also greatly benefited from the assistance of other governance experts, such as Ira Millstein. The Red Cross is also very appreciative of the advice and assistance we received from our independent counsel, Gibson, Dunn & Crutcher LLP, under the able leadership of John Olson, Stephanie Tsacoumis and Amy Goodman.

The Board of Governors is also very grateful to Senator Charles Grassley, Chairman of the Senate Finance Committee, and Chairman Grassley’s Tax and Senior Counsel, Dean Zerbe, for providing their guidance and recommendations throughout this collaborative process. And finally, without the unwavering commitment and leadership of the Chair of our Governance Committee, Joyce Hoffman, and First Vice Chair Ross Ogden, as well as the dedication of the volunteer members of the American Red Cross Board of Governors, these significant changes would not have been possible.

George Washington said, “Perseverance and spirit have done wonders in all ages.” Throughout our history, the American Red Cross has persevered through devastating natural disasters, world wars, health pandemics and unimaginable man-made disasters while at the same time we have providing lifesaving blood and teaching lifesaving skills. However, it has been the enduring and compassionate spirit of the American people that has remained steadfast in times of triumph and tragedy. On behalf of the American Red Cross, I want you to know that we will do our very best to continue to be worthy of representing this unique and inspiring American spirit in times of need... and to be worthy of your sacred trust.

Sincerely,

A handwritten signature in black ink that reads "Bonnie McElveen-Hunter". The signature is written in a cursive, flowing style.

Bonnie McElveen-Hunter

FOREWORD

"I was privileged to be one of those urging the American Red Cross Board to seriously examine itself. And with some background in not for profit governance I knew how challenging it would be for a major and prominent institutional board to honestly and with diligence -- actually do it.

The American Red Cross Board more than accepted the challenge. With the assistance of superb volunteer experts and outstanding counsel, the Board carefully noted its needs and the statutory inhibitions placed on it, and then proceeded to outline the necessary changes, some of which might have been resisted by a less publicly spirited board. For example, seriously downsizing itself, and suggesting, as well, that the status of certain Presidential appointees, provided for in its Federal Charter, be changed. The menu of changes is surely daunting, as this Report demonstrates, but with the help of Congress and the President, it will get done in the public interest.

The Report is very significant in still another important respect. It is a scholarly review of 'corporate governance' best practices as they should be applied to not for profits, generally. This is a major accomplishment, and the best richly detailed analysis I know of. It is made more relevant because it is based on the reality of an actual case study - the American Red Cross. It is certain to become must reading for all in the field."

Ira Millstein

Senior Partner, Weil, Gotshal & Manges, LLP
Senior Associate Dean for Corporate Governance,
Yale School of Management

"The governance audit commissioned by the American Red Cross Board of Governors, under the auspices of its Governance Committee, and this resulting Report provide an important guide for other nonprofit organizations embarking on a similar effort. While the Red Cross is, of course, unique in the size and complexity of its operations and responsibilities, the cooperative and deliberative process followed in its governance audit is easily transferable. Central to this process were the period of empirical research at the outset followed by close cooperation between a panel of independent governance experts and members of the Red Cross Board of Governors to produce workable solutions. The end result was a set of recommendations that will enhance the effectiveness and efficiency of Red Cross governance to the benefit of the American people.

With heightened concern about the accountability of all important institutions today, including the leading participants in our nation's nonprofit sector, there is a tendency to look for 'one size fits all' governance approaches. With the enactment of the Sarbanes-Oxley Act of 2002 and the securities market corporate governance listing standards, an agreed upon set of minimum 'best

practices’ for publicly traded companies has evolved. While no such detailed set of practices has emerged for the nonprofit sector due to the variety of organizations in this sector, many leading nonprofit organizations have benchmarked their governance practices against the evolving corporate model, with appropriate modifications for their particular circumstances. This Report reviews all of the literature with respect to nonprofit governance considered in connection with the Red Cross governance audit and should be a resource to other nonprofit organization examining their governance practices.

In commissioning its governance audit, the Red Cross Board recognized the need for outside governance expertise. It established an Independent Governance Advisory Panel whose members served without compensation and each of whom had extensive experience with entities other than the Red Cross in both the nonprofit and corporate arenas. But, to be effective, the Panel also needed knowledge about the Red Cross—its mission, culture and current governance practices. This was provided by the more than 130 interviews with current and former Red Cross Board members, current and former Red Cross employees and volunteers, Congressional staff members and others that were undertaken by special counsel and shared with the Panel. In addition, the Panel met with senior managers of the Red Cross responsible for all its significant operational and functional areas in order to better understand the organization’s governance needs.

Effective changes in governance require a thorough understanding of the organization and genuine ‘buy in’ to the recommended changes by an organization’s leaders. Thus, it was particularly important that, after the initial phase of interviews and other fact finding, the Panel and a small group of members of the Board of Governors and its Governance Committee under the leadership of Board Chairman Bonnie McElveen-Hunter and Governance Committee Chair Joyce Hoffman worked together. Through several intense and candid roundtable sessions, Panel members and the Board representatives developed a set of governance recommendations that drew upon corporate governance ‘best practices’ and the nonprofit literature yet reflect the mission, history and culture of the Red Cross. These recommendations were then considered and unanimously approved by the Board of Governors.

We are proud to have had a role in this important undertaking and are very gratified with the acceptance of this Report and its recommendations both within the Red Cross and externally. We hope that this Report, the research it summarizes and the recommendations it contains will be a valuable resource for other nonprofit organizations embarking on governance audits of their own.”

Karen Hastie Williams
Chair, Independent Governance Advisory Panel

John Olson
Senior Partner, Gibson, Dunn & Crutcher LLP
Counsel for the Governance Audit

“American Red Cross Governance for the 21st Century”

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SECTION 1. INTRODUCTION

The Red Cross—A National Treasure

The American National Red Cross (the “Red Cross”) is a national treasure that occupies a unique place among nonprofit organizations. Founded in 1881 by Clara Barton and chartered by Congress in 1900, the Red Cross celebrated the 125th anniversary of its founding on May 21, 2006.¹

Under its mission statement, the Red Cross is “a humanitarian organization led by volunteers and guided by its Congressional Charter and the Fundamental Principles of the International Red Cross Movement, [that] will provide relief to victims of disasters and help people prevent, prepare for and respond to emergencies.”² Through its Congressional Charter (the “Charter”), the Red Cross “is designated as the organization which is authorized to act in matters of relief” and hence fulfill U.S. treaty obligations under the Geneva Conventions, to provide communications services with the national Red Cross or Red Crescent societies of other countries and the International Committee of the Red Cross, and to act as an intermediary in communications between families and their relatives who are members of the armed forces of the United States.³ In addition, the Charter requires that the Red Cross provide national and international peace-time disaster preparedness, prevention and relief services.⁴ The Red Cross has been designated, along with a host of U.S. government departments and agencies, as a key participant in the federal government’s national disaster response plan.⁵

The operations of the Red Cross also include a more than \$2 billion-a-year blood-related business.⁶ Started as a war relief effort to provide life-saving blood for soldiers during World War II, today, the Red Cross’ blood-related business collects and distributes almost half the

¹ Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006); American Red Cross, *The Governance Structure of the American Red Cross* 1 (Jan. 2006).

² Red Cross Mission Statement, available at http://www.redcross.org/services/volunteer/0,1082,0_421_,00.html (last visited Sept. 20, 2006).

³ See Charter, codified at 36 U.S.C. §§ 300101 *et seq.*, § 2.

⁴ Charter, §§ 2 & 5(b).

⁵ U.S. Department of Homeland Security, *National Response Plan* 3, 11 & Emergency Support Function (“ESF”) Annex #6 – Mass Care, Housing, and Human Services (Dec. 2004), available at http://www.dhs.gov/interweb/assetlibrary/NRP_FullText.pdf (last visited Sept. 20, 2006); as updated by Notice of Change to the National Response Plan (May 25, 2006), available at http://www.dhs.gov/interweb/assetlibrary/NRP_Notice_of_Change_5-22-06.pdf (last visited Sept. 20, 2006) (hereinafter, the National Response Plan and the May 2006 update are collectively referred to as the “National Response Plan”); see also U.S. Department of Homeland Security, *Quick Reference Guide for the National Response Plan* 1 (May 22, 2006), available at http://www.dhs.gov/interweb/assetlibrary/NRP_Quick_Reference_Guide_5-22-06.pdf (last visited Sept. 20, 2006).

⁶ Red Cross Consolidated Statement of Activities for the year ended June 30, 2006.

nation's supply of blood and blood components.⁷ In addition, the Red Cross delivers a range of other services, both domestically and abroad, by:

- responding to more than 70,000 natural and man-made disasters annually, and providing education and training on disaster preparedness;⁸
- offering education and training programs in health and safety (such as first aid and CPR), to help people prevent, prepare for and respond to emergencies;⁹
- supporting members of the military, veterans and their families through emergency communications services, access to financial assistance, counseling and other services at U.S. military installations worldwide;¹⁰
- providing community-based services such as meal delivery to housebound residents, food pantries, rides to medical appointments and transitional housing, with the particular services determined by local Red Cross chapters based on community needs;¹¹ and
- working with other members of the International Red Cross and Red Crescent Movement to provide humanitarian aid around the world, such as assistance in preventing, preparing for, and responding to disasters, serious diseases (such as measles and malaria), health and sanitation conditions, and humanitarian emergencies.¹²

The Red Cross could not carry out this work without the tremendous support of the nearly one million Americans who serve as Red Cross volunteers in their local communities and around the world.

Over the course of its 125-year existence, the Red Cross has played a unique and critical role in filling a broad spectrum of societal needs. In recent years, the Red Cross has considered how best to enhance the effectiveness of its governance structure.¹³ In light of the increased numbers of catastrophic domestic and international events in 2004 and 2005, and with a view toward continuing the legacy of the Red Cross and strengthening its position to meet the

⁷ Biomedical Services, *available at* http://www.redcross.org/services/biomed/0,1082,0_491_,00.html (last visited Sept. 20, 2006); American Red Cross, *The Governance Structure of the American Red Cross* 1 (Jan. 2006).

⁸ Disaster Services, *available at* http://www.redcross.org/services/disaster/0,1082,0_319_,00.html (last visited Sept. 20, 2006); Get Prepared, *available at* http://www.redcross.org/services/prepare/0,1082,0_239_,00.html (last visited Sept. 20, 2006).

⁹ Health and Safety Services, *available at* <http://www.redcross.org/services/hss> (last visited Sept. 20, 2006).

¹⁰ Military Members and Families, *available at* http://www.redcross.org/services/afes/0,1082,0_321_,00.html (last visited Sept. 20, 2006).

¹¹ Community Services, *available at* <http://www.redcross.org/more/commserv> (last visited Sept. 20, 2006).

¹² International Services, *available at* http://www.redcross.org/services/intl/0,1082,0_323_,00.html (last visited Sept. 20, 2006).

¹³ See discussion under “Red Cross Governance Task Force” and “The Sarbanes-Oxley Act of 2002 and Beyond” below.

unprecedented challenges of the 21st century (including terrorism, natural and man-made disasters, and the need for a safe blood supply), in February 2006, the Red Cross Board of Governors (the “Board”) authorized and commissioned an audit of Red Cross governance. The goal of the audit was to identify appropriate governance changes that are in the best interest of the Red Cross and the American public. Moving forward, the Red Cross must have an appropriate governance structure to support its ongoing, vital mission. A governance structure that is consistent with and supports the critical elements of the Red Cross mission will preserve and enhance the ability of the Red Cross to meet the needs of future generations.

Role of the Red Cross Chapters and Blood Services Regions

The Red Cross relies heavily on a network of local units, known as “chapters,”¹⁴ to deliver many of the services it offers. Currently, the Red Cross has just under 800 chapters. The chapters provide services to their communities on a day-to-day basis and respond to local disasters, such as single-family home fires, that can be handled most effectively at the local level. The chapters also act as the organization’s front-line responders to large-scale disasters. Since September 2003, the chapters have been organized in eight geographic regions, called “Service Areas,” which, among other things, provide tools and resources to assist the chapters in service delivery as well as to evaluate chapter performance in light of chapter strategic, financial and service delivery plans in support of the Red Cross’ overall strategic plan.¹⁵

The Red Cross operates its biomedical services business through 35 blood services regions located throughout the country. The biomedical services business is responsible for providing blood products collected through voluntary donations. The blood services regions are managed centrally from the biomedical services headquarters.¹⁶

“One Red Cross”

Although the Red Cross currently has just under 800 local chapters, it is a single, Congressionally-chartered nonprofit organization.¹⁷ The chapters are not separate legal

¹⁴ Charter, § 3(b)(1) (“The chapters of the corporation are the local units of the corporation.”); American Red Cross Chapters, *available at* <http://www.redcross.org/museum/history/chapters.asp> (last visited Sept. 20, 2006) (discussing the function of the chapters throughout the history of the Red Cross).

¹⁵ Board of Governors Policy Manual, Pt. 2, §§ 3.2.1 & 3.2.2 (May 2006) (hereinafter, the “Policy Manual”).

¹⁶ *See, e.g., id.*, Pt. 2, § 2.2.1 (“Biomedical Services . . . operates its blood services program under a single establishment license issued by the US Food and Drug Administration (FDA). The [Board] and FDA require Biomedical Services to provide positive management control of its decentralized local community operations. To ensure this control, Biomedical Services will operate using standardized policies and procedures. Through such standardization, the local community operations function as an integral part of Biomedical Services in their local communities.”).

¹⁷ *See* Charter, § 1; *id.* § 3(b)(1) (“The chapters of the corporation are the local units of the corporation.”); Ronald C. Moe, U.S. Library of Congress, Congressional Research Service, *Congressionally Chartered Nonprofit Organizations (“Title 36 Corporations”): What They Are and How Congress Treats Them* CRS-4 – CRS-5 (Apr. 8, 2004).

entities.¹⁸ The Internal Revenue Service has classified the Red Cross as a single, tax-exempt charitable organization, covering its constituent chapters, units and regions, for purposes of Section 501(c)(3) of the Internal Revenue Code of 1986 and as a “public charity” under Section 509(a) of the Internal Revenue Code.¹⁹ As a single legal entity, the Red Cross is distinct from many other large, national nonprofit organizations with local organizations throughout the United States, the vast majority of which have local affiliates or chapters formed as separate legal entities.²⁰

Unique Status and Responsibilities of the Red Cross

The federal government has assigned the Red Cross several responsibilities that distinguish it from other nonprofit organizations, including the approximately 100 nonprofit organizations that, like the Red Cross, have been chartered by Congress for patriotic, national, historical and similar purposes.²¹ Of these Congressionally-chartered organizations, only one—the Red Cross—has been designated as a “treaty obligation organization” due to the Red Cross’ responsibilities (discussed below) with respect to U.S. treaty obligations under the Geneva Conventions.²² The Red Cross is also the only nonprofit organization with a Congressional mandate to provide disaster relief domestically and internationally.²³ In addition, unlike any other nonprofit organization, the Red Cross provides communications and other health and welfare services to the armed forces that are not provided by the U.S. military.²⁴ The

¹⁸ Bylaws of the American National Red Cross, § 9.1 (May 2006) (hereinafter, the “Bylaws”) (“Chartered Units shall not be constituted as legal entities separate from the [Red Cross].”) This is also true of the blood services regions, which, together with the chapters, are considered “chartered units” of the Red Cross. *Id.* § 1.3 (defining “chartered units” to include chapters and blood services regions).

¹⁹ American Red Cross, *The Governance Structure of the American Red Cross* 4 (Jan. 2006).

²⁰ See *Report of the Governance Advisory Panel to the Executive Committee and the Board of Governors of The Nature Conservancy* 12 (March 19, 2004), available at http://www.nature.org/pressroom/files/gap_final.pdf (last visited Sept. 20, 2006) (hereinafter, “The Nature Conservancy Report”). Research conducted in connection with this Governance Audit on the legal structures of large, national nonprofit organizations with local affiliates or chapters was consistent with the findings of the Nature Conservancy’s Governance Advisory Panel that affiliate-based organizations formed as a single legal entity are uncommon.

²¹ See Ronald C. Moe, U.S. Library of Congress, Congressional Research Service, *Congressionally Chartered Nonprofit Organizations (“Title 36 Corporations”): What They Are and How Congress Treats Them* CRS-4 – CRS-5 (Apr. 8, 2004).

²² *Id.* at CRS-4 – CRS-5 (stating that the Red Cross has “long been unusual” among the patriotic and national organizations chartered by Congress because of the organization’s treaty-related responsibilities).

²³ Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-6 (March 15, 2006).

²⁴ Wesley A. Sturges, *The Legal Status of the Red Cross*, 56 MICH. L. REV. 1, 17 (1957) (“The health and welfare services to be rendered by [the] Red Cross to the armed forces in the time of war are unique functions; they are not duplicated by the military establishment; they are not shared by any other government corporation. They put the Red Cross in the position of an auxiliary of the military establishment.”); see also discussion under “Services for America’s Military and Their Families” below.

responsibilities of the Red Cross under its Charter have remained essentially the same since the organization first received its Charter.²⁵

Treaty Obligations

The Red Cross was chartered by Congress in 1900 primarily for the purpose of fulfilling the obligations of the United States under the Geneva Conventions. The first Geneva Convention, of August 22, 1864, provided for neutrality in the care of sick and wounded soldiers on the battlefield and is also known as the “Red Cross Treaty” because it grew out of resolutions adopted a year earlier by the newly formed International Committee of the Red Cross (originally known as the International Committee for Relief to the Wounded). These resolutions provided for the establishment of national societies to provide relief to wounded soldiers—the future Red Cross and Red Crescent societies.²⁶

While the initial Geneva Convention dealt exclusively with wounded soldiers, the Convention expanded over the years and by 1949 included provisions designed to cover wounded, sick and shipwrecked members of the armed forces at sea, prisoners of war, and civilians under enemy control, among others. The United States assumed the obligations of the Geneva Conventions upon ratification in 1882.

The Charter states that one of the purposes of the Red Cross is to “provide volunteer aid in time of war to the sick and wounded of the armed forces, in accordance with the spirit and conditions” of the Geneva Conventions and “any other treaty, convention, or protocol similar in purpose to which the [United States] has given or may give its adherence.”²⁷ The Charter also designates the Red Cross as the national Red Cross society of the United States for purposes of carrying out the duties of the United States as a signatory to the Geneva Conventions and performing the duties required of a national Red Cross society in the International Red Cross and Red Crescent Movement.²⁸ National Red Cross and Red Crescent societies must be chartered by their respective governments, and each country is allowed to charter only one Red Cross or Red

²⁵ See An Act to Incorporate the American National Red Cross, and for other purposes, ch. 784, § 3, 31 Stat. 277, 279 (1900) (repealed 1905); An Act to Amend the Act of January 5, 1905, to incorporate the American National Red Cross, ch. 23, § 3, 33 Stat. 599, 600 (1905), *amended by* Pub. L. 42, ch. 50, § 4, 61 Stat. 80, 81 (1947); Charter, § 2; *see also* Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-14 – CRS-26 (March 15, 2006) (side-by-side comparison of successive Congressional charters). The Red Cross’ biomedical business is not addressed in the Charter.

²⁶ International Committee of the Red Cross, *From the battle of Solferino to the eve of the First World War* (Dec. 28, 2004), *available at* <http://www.icrc.org/Web/Eng/siteeng0.nsf/iwpList288/FAFDE5C21CBC5ACDC1256B66005B0E39> (last visited Sept. 20, 2006).

²⁷ Charter, § 2(1).

²⁸ See Charter, §§ 2(2) & 5(b). The Red Cross is one of approximately 185 national Red Cross and Red Crescent societies that, collectively, make up the International Federation of Red Cross and Red Crescent Societies. The Federation, together with the national societies and the International Committee of the Red Cross, make up the International Red Cross and Red Crescent Movement, one of the largest humanitarian networks in the world, which is guided by seven fundamental principles: humanity, impartiality, neutrality, independence, voluntary service, unity and universality.

Crescent society.²⁹ As the national Red Cross society of the United States, the Red Cross has the exclusive right to use the Red Cross emblem,³⁰ a right which is protected under federal criminal law.³¹

Disaster Preparedness and Relief

The Red Cross also has governmental obligations relating to peace-time disaster preparedness and relief. Under its Charter, the Red Cross has responsibility “to carry out a system of national and international relief in time of peace, and apply that system in mitigating the suffering caused by pestilence, famine, fire, floods, and other great national calamities, and to devise and carry out measures for preventing those calamities.”³² This provision implements the “American Amendment” to the Geneva Convention of 1864 (proposed by the Red Cross in 1884 at the Third International Red Cross Conference) and is the basis for the non-military peacetime activities of the Red Cross and other countries’ Red Cross and Red Crescent societies.³³

As part of its disaster relief responsibilities, the Red Cross is the only nongovernmental organization designated as a “primary agency” under the National Response Plan, which establishes a single, comprehensive approach to domestic incident management to prevent, prepare for, respond to, and recover from terrorist attacks, major disasters and other emergencies.³⁴ Other participants in the National Response Plan primarily include federal government departments and agencies, as well as the Corporation for National and Community Service (which, like the Red Cross, is Congressionally-chartered),³⁵ and National Voluntary Organizations Active in Disaster (“NVOAD”), a consortium of volunteer organizations (including the Red Cross)³⁶ that coordinates and plans efforts for disaster response.³⁷

²⁹ Conditions for recognition of national societies, Article IV, Statutes of the International Red Cross and Red Crescent Movement (1986, as amended 1995), available at <http://www.icrc.org/Web/eng/siteeng0.nsf/iwplList126/4471D4F85B856434C125704D00500FB7> (last visited Sept. 20, 2006).

³⁰ See Charter, § 6.

³¹ 18 U.S.C. § 706 (2006).

³² Charter, § 2(4).

³³ See, e.g., A Brief History of the American Red Cross, available at <http://www.redcross.org/museum/history/brief.asp> (last visited Sept. 20, 2006); Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006); Clara Barton: Founder of the American Red Cross, available at <http://www.redcross.org/museum/history/claraBarton.asp> (last visited Sept. 20, 2006); Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-5 (March 15, 2006).

³⁴ See National Response Plan.

³⁵ See 42 U.S.C. § 12651 (2006).

³⁶ See National Members, at <http://www.nvoad.org/membersdb.php?members=National> (last visited Sept. 20, 2006).

³⁷ For a list of signatories to the National Response Plan, see National Response Plan, at v – viii.

Like the Federal Emergency Management Agency (“FEMA”), the Red Cross is a “primary agency” charged with responsibility for providing leadership in coordinating and integrating overall federal efforts associated with emergency support functions related to “mass care,” housing and human services during incidents requiring a coordinated federal response.³⁸ In this role, the Red Cross’ function is to coordinate federal mass care resources to support overwhelmed state and local governmental entities providing mass care relief services. Mass care relief services at the local level include shelter, feeding, basic first aid, disaster welfare information and bulk distribution of emergency relief items.³⁹

The Red Cross is also designated as a “support agency” and a “cooperating agency” under various provisions of the National Response Plan.⁴⁰ As a “support agency” to the Department of Health and Human Services for emergency support functions related to public health and medical services, the Red Cross’ functions include the provision of emergency first aid, other disaster health services, and supportive counseling during incidents requiring a coordinated federal response.⁴¹ The Red Cross also coordinates with an industry task force to provide blood products and services as needed.⁴²

³⁸ National Response Plan, Emergency Support Function (“ESF”) Annex # 6 – Mass Care, Housing, and Human Services. In addition to being a primary agency for “mass care,” housing and human services under ESF # 6, FEMA is also designated as the “ESF Coordinator” for these functions. *See id.* ESFs with multiple primary agencies designate an “ESF coordinator” for the purposes of pre-incident planning and coordination. National Response Plan, ESF Annexes: Introduction, ESF-i. The ESF coordinator has ongoing responsibilities throughout the prevention, preparedness, response, recovery and mitigation phases of incident management. *Id.* at ESF-iii (describing responsibilities of ESF coordinators).

³⁹ National Response Plan, ESF Annex # 6, ESF # 6-2 – ESF # 6-3.

⁴⁰ “Support agencies” are responsible, among other things, for “[c]onducting operations, when requested by [the Department of Homeland Security (“DHS”)] or the designated ESF primary agency, using their own authorities, subject-matter experts, capabilities, or resources” and furnishing available personnel, equipment or other resources as requested by DHS or the ESF primary agency. *See* National Response Plan, ESF Annexes: Introduction, ESF-iv (describing responsibilities of a support agency). “Cooperating agencies” are responsible, under the leadership of other designated agencies, for performing a range of support functions (such as those related to financial management, and worker health and safety), that are common to most incidents and for assisting in responding to specific types of hazards that require specialized application of the National Response Plan (such as nuclear/radiological and biological terrorism incidents). *See* National Response Plan, Support Annexes: Introduction, SUP-I & SUP-ii & Incident Annexes: Introduction, INC-i & INC-iii. For provisions of the National Response Plan designating the Red Cross as a “support agency,” *see* ESF Annex # 3 – Public Works and Engineering; ESF Annex # 5 – Emergency Management; ESF Annex # 8 – Public Health and Medical Services; ESF Annex # 11 – Agriculture and Natural Resources; and ESF Annex # 14 – Long-Term Community Recovery and Mitigation, *in* National Response Plan. For provisions of the National Response Plan designating the Red Cross as a “cooperating agency,” *see* Financial Management Support Annex; International Coordination Support Annex; Private-Sector Coordination Support Annex; Public Affairs Support Annex; Tribal Relations Support Annex; Biological Incident Annex; Catastrophic Incident Annex; and Nuclear/Radiological Incident Annex, *in* National Response Plan; *see also* Press Release, *American Red Cross Key Part of National Response Plan*, available at http://www.redcross.org/pressrelease/0,1077,0_489_3922,00.html (Jan. 6, 2006) (last visited Sept. 20, 2006).

⁴¹ National Response Plan, ESF Annex # 8, ESF # 8-13.

⁴² *See id.*

Services for America's Military and their Families

The Red Cross has a long history of providing services to members of the U.S. military and their families during times of war and peace. Under its Charter, the Red Cross is charged with “act[ing] in matters of voluntary relief and in accordance with the military authorities as a medium of communication between the people of the United States and the armed forces of the United States.”⁴³ The origins of this provision are not entirely clear,⁴⁴ although its roots may be found in the work of Clara Barton, founder of the Red Cross, who established and operated the Office of Correspondence with Friends of the Missing Men of the United States Army to help reunite missing soldiers with their families at the end of the Civil War.⁴⁵ Today, the Red Cross continues this work through its Armed Forces Emergency Services (known as “AFES”), which keeps military personnel in touch with their families following important events such as the death of a loved one. In addition, AFES staff are deployed to support armed forces units in the field, providing counseling and other support services to members of the armed forces.⁴⁶

The role of the Red Cross in supporting the U.S. military is so important that it is codified as part of federal law, which authorizes the President of the United States to accept and employ the cooperation and assistance of the Red Cross whenever the President finds it necessary.⁴⁷ Federal law also authorizes the United States to provide transportation, meals, housing and other supplies to Red Cross personnel providing cooperation and assistance to the U.S. military.⁴⁸

Financial Background and Funding

The Red Cross is a large, complex organization involved in several business activities that, collectively, generated close to \$6 billion in revenues during the Red Cross' most recent fiscal year (ended June 30, 2006).⁴⁹ By far, the largest area of the Red Cross' operations is its biomedical services business, which collects, tests and distributes blood and blood components and operates 35 regional blood centers throughout the United States. In the Red Cross' most recent fiscal year, the biomedical services business accounted for about \$2.2 billion of the Red

⁴³ Charter, § 2(3). The Charter further provides that the Red Cross will “act in those matters [of voluntary relief] between similar national societies of governments of other countries through the International Committee of the Red Cross and the Government, the people, and the armed forces of the United States.” *Id.*

⁴⁴ Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-5 (March 15, 2006).

⁴⁵ Clara Barton: Founder of the American Red Cross, available at <http://www.redcross.org/museum/history/claraBarton.asp> (last visited Sept. 20, 2006).

⁴⁶ See, e.g., Katie Lawson, *Red Cross Continues the Century-Long Tradition of Serving Those Who Serve* (Apr. 28, 2006), available at http://www.redcross.org/article/0,1072,0_312_5341,00.html (last visited Sept. 20, 2006).

⁴⁷ An Act to provide for the use of the American National Red Cross in aid of the Armed Forces, and for other purposes, ch. 222, 67 Stat. 178 (1953) (*codified as amended at* 10 U.S.C. § 2602 (2006)).

⁴⁸ 10 U.S.C. §§ 2602(b) – (d) (2006).

⁴⁹ Red Cross Consolidated Statement of Activities for the year ended June 30, 2006.

Cross' almost \$6 billion in revenues, or approximately 37% of total revenues.⁵⁰ The biomedical services business also accounted for about \$2 billion, or approximately 36%, of the Red Cross' \$5.6 billion operating expenses in fiscal year 2006.⁵¹

The Red Cross receives significant financial support in the form of donor contributions, which accounted for about 42% of its consolidated operating revenues in fiscal year 2006.⁵² This support takes the form of both unrestricted donations and donations that are directed for specific purposes, such as particular disasters. Historically, most of the Red Cross' fundraising has been episodic, meaning that the Red Cross has raised money primarily in response to specific disasters rather than on an ongoing basis. Because of the stature and reputation of the Red Cross, when large-scale disasters occur, the organization typically receives a proportionately large share of the collective funds donated to charities in response to the disaster.⁵³

In addition to donations received in response to a large-scale disaster, a significant portion of the funds donated to the Red Cross is raised at the chapter level and spent locally in responding to local incidents, such as single-family home fires. At the national level, the Red Cross maintains a general Disaster Relief Fund that is used primarily to provide and support relief services for victims of disasters, like major fires, floods, or hurricanes and other catastrophic disasters that are beyond local resources and response capabilities.⁵⁴ When a catastrophic disaster strikes, the Red Cross also receives donations at the national level that donors designate specifically for a particular disaster. In the wake of the September 11, 2001 terrorist attacks, the Red Cross received contributions in unprecedented amounts totaling over \$1 billion.⁵⁵ Following the Southeast Asian tsunami that struck in December 2004, the Red Cross received donations for relief and recovery efforts totaling approximately \$570 million.⁵⁶ A

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ See, e.g., *Re-examining the Red Cross*, The New York Times (Dec. 4, 2005) (noting that, of the \$2.7 billion donated for hurricane relief through November 21, 2005, the Red Cross had received \$1.52 billion, compared to \$270 million received by the Salvation Army, the next largest recipient); Jacqueline L. Salmon & Elizabeth Williamson, *Red Cross Borrowing Funds for Storm Aid; Loan of \$340 Million Comes as Nonprofit Draws New Scrutiny*, The Washington Post (Oct. 28, 2005) (stating that the Red Cross "holds near-mythic status as the premier U.S. disaster relief agency"); *Charity, Inc.*, St. Louis Post-Dispatch (Dec. 15, 2005) (noting that because of its "reputation and high-profile, the Red Cross soaked up charitable donations" following Hurricane Katrina, while "[s]maller, less well-known charities and those dedicated to purposes other than short-term relief complained about being shoved aside."); U.S. House Committee on Homeland Security Democratic Staff, *Trouble Exposed: Katrina, Rita, and the Red Cross: A Familiar History* 5, 9 (Dec. 2005) (footnotes omitted).

⁵⁴ See Red Cross 2005 Annual Report, at 20.

⁵⁵ The Red Cross' policy of donor directed funding was developed in the wake of concerns expressed post-September 11. See American Red Cross, *September 11, 2001: Unprecedented Events, Unprecedented Response; A Review of the American Red Cross' Response in the Past Year* 7, 19 (Sept. 2002), available at http://www.redcross.org/press/disaster/ds_pr/pdfs/arcwhitepaper.pdf (last visited Sept. 19, 2006). Subsequently, the Red Cross has distributed funds donated in response to the September 11 attacks through the Liberty Disaster Relief Fund. See *id.* at 9; see also Red Cross 2005 Annual Report, at 20.

⁵⁶ As of December 31, 2005. See Tsunami Recovery Program, Your Compassion Meeting Global Needs, available at <http://www.redcross.org/news/in/tsunamis/financial.html> (last visited Sept. 20, 2006).

portion of these funds was used for emergency response work, while the remainder will fund a five-year plan to help areas affected by the tsunami to recover and rebuild.⁵⁷ The Red Cross raised over \$2.2 billion in donations and pledges in response to Hurricanes Katrina, Rita and Wilma, the largest outpouring of donor assistance in its 125-year history. This amount included \$2.067 billion in funds designated specifically for the three hurricanes and an additional \$141 million designated for the Disaster Relief Fund.⁵⁸

History of Red Cross Governance

The Early Years (1881-1900)

The Red Cross began as a small, Washington, D.C.-based nonprofit association in 1881, when Clara Barton, the organization's first president, together with 50 other individuals, adopted a constitution forming the "American Association of the Red Cross."⁵⁹ The constitution specified five objectives for the association, including securing U.S. adoption of the Geneva Conventions and obtaining recognition for the association from the U.S. government.⁶⁰ The constitution and the articles of incorporation of the American Association of the Red Cross established an executive board, a "board for consultation" consisting of the President of the United States and other government officials, and several officer positions (president, vice-presidents, secretary and treasurer).⁶¹

In 1882, shortly after the United States became a signatory to the Geneva Conventions,⁶² the Red Cross drew up a new constitution that established a different governance structure. The constitution created an 11-member advisory board and a three-member central committee consisting of the Red Cross president, secretary and treasurer to replace the executive board as the "working force" of the organization.⁶³

⁵⁷ American Red Cross Tsunami Recovery Plan of Action (Aug. 2005), available at <http://www.redcross.org/news/in/tsunamis/TsunamiPlanOfAction.pdf> (last visited Sept. 20, 2006).

⁵⁸ Hurricane Season 2005, Facts & Figures, available at <http://www.redcross.org/news/ds/hurricanes/2005/facts.html> (last visited Sept. 20, 2006). In February 2006, the Red Cross announced that it had raised sufficient funds to cover the estimated costs of its response to the hurricanes and encouraged donor assistance to be directed to organizations addressing long-term recovery needs. Press Release, *Generous Donors Meet American Red Cross Hurricane Relief Costs* (Feb. 3, 2006), available at http://www.redcross.org/pressrelease/0,1077,0_314_5090,00.html (last visited Sept. 20, 2006).

⁵⁹ Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006); American Red Cross, *The Governance Structure of the American Red Cross* 1 (Jan. 2006).

⁶⁰ Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006).

⁶¹ *Id.*; American Red Cross, *The Governance Structure of the American Red Cross* 1 (Jan. 2006).

⁶² See discussion under "Treaty Obligations" above.

⁶³ Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006); American Red Cross, *The Governance Structure of the American Red Cross* 1 (Jan. 2006).

Over the next decade, the Red Cross continued efforts to obtain a Congressional charter.⁶⁴ In 1893, the organization amended its articles of incorporation to change the corporate name to the “American National Red Cross” to emphasize the national scope of the organization’s work and to distinguish it from a growing number of local Red Cross societies with various (if any) ties to the national organization.⁶⁵

The First Charter (1900)

In recognition of “the importance of [its] work,”⁶⁶ and in an attempt to implement “more systematic governance and greater fiscal responsibility,”⁶⁷ the Red Cross received its first charter in 1900 (the “1900 Charter”),⁶⁸ establishing it as the national organization designated to carry out the purposes of the Geneva Conventions and to perform the duties required of a national Red Cross society.⁶⁹

The 1900 Charter did not address the organization or composition of the governing body of the Red Cross. The 1900 Charter identified 56 Red Cross supporters, including Clara Barton, as “incorporators.”⁷⁰ These individuals evolved into a group known as the “Board of Incorporators,” which played a role in the governance of the Red Cross until the group was abolished as part of the 1947 amendments to the Charter.⁷¹ The initial function of the individuals on the Board of Incorporators was to bring the Red Cross organization into being when it was incorporated under the 1900 Charter (and subsequently reincorporated in 1905).⁷²

⁶⁴ Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006).

⁶⁵ *Id.*; American Red Cross, *The Governance Structure of the American Red Cross* 1 (Jan. 2006).

⁶⁶ See An Act to Incorporate the American National Red Cross, and for other purposes, ch. 784, 31 Stat. 277, 278 (1900) (repealed 1905).

⁶⁷ Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006). Another reason that prompted Congress to grant a charter in 1900 was concern over the way the Red Cross conducted its business. Although Clara Barton remained a highly popular public figure, some individuals closely associated with the Red Cross viewed her personal management style with concern and, in particular, questioned the accuracy and completeness of the organization’s financial recordkeeping under her leadership. *See id.*

⁶⁸ Ch. 784, 31 Stat. 277, 278 (1900) (repealed 1905).

⁶⁹ *Id.* at 279.

⁷⁰ *Id.* at 278.

⁷¹ Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006); American Red Cross, *The Governance Structure of the American Red Cross* 2 (Jan. 2006); Advisory Committee on Organization, *The American National Red Cross Report of the Advisory Committee on Organization* 28 (June 11, 1946) (hereinafter, the “Harriman Report”).

⁷² Harriman Report, at 28.

The 1905 Charter

In 1905, Congress adopted a new charter for the Red Cross (the “1905 Charter”) that established a governance structure for the organization.⁷³ The 1905 Charter made specific reference to the need to place the Red Cross “under Government supervision” due to the importance of its work.⁷⁴

The 1905 Charter named a 65-member Board of Incorporators, including five individuals to be appointed by the President of the United States, one from each of the Departments of State, War, Navy, Treasury and Justice.⁷⁵ The 1905 Charter established as the governing body of the Red Cross an 18-member central committee that would initially be composed of six members appointed by the Board of Incorporators and 12 members appointed by the President of the United States, including one whom the President would designate as Chairman of the Red Cross.⁷⁶ The 1905 Charter also directed the central committee to organize, “with as little delay as possible,” state and territorial societies of the Red Cross and provided that, once six societies had been formed, the 18-member central committee would thereafter consist of:

- six members elected by the Board of Incorporators;
- six members elected by representatives of the state and territorial societies; and
- six members appointed by the President of the United States, one of whom would be designated as Chairman, and the remaining five who would be chosen from the Departments of State, War, Navy, Treasury and Justice.⁷⁷

The 1905 Charter also gave the central committee power to create a seven-member executive committee to exercise the powers of the central committee when it was not in session.⁷⁸

The 1905 Charter did not include any provisions related to the management of the Red Cross. The Bylaws designated the President of the United States as *ex officio* President of the

⁷³ An Act to Amend the Act of January 5, 1905, to incorporate the American National Red Cross, ch. 23, 33 Stat. 599 – 602 (1905).

⁷⁴ *Id.* at 599. It was thought that increased governmental supervision would enhance public confidence in the Red Cross, and that increased supervision of the organization, as the national Red Cross society of the United States, would be more consistent with the degree of oversight that foreign governments had with respect to their national societies. See Wesley A. Sturges, *The Legal Status of the Red Cross*, 56 MICH. L. REV. 1, 11 (1957) (citations omitted).

⁷⁵ Ch. 23, § 1, 33 Stat. 599, 599 – 600 (1905). The Board of Incorporators also included a number of then-current and former members of Congress and “eminent citizens of the day.” Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-9 & n.41 (March 15, 2006).

⁷⁶ Ch. 23, § 5, 33 Stat. 599, 601 (1905).

⁷⁷ *Id.*

⁷⁸ *Id.*

organization and the Chairman of the central committee (one of the six Presidential appointees to the committee) as “the executive head of the [Red Cross] under the advice and direction of the Central Committee.”⁷⁹

The “Harriman Report” and the 1947 Amendments to the Charter

In 1946, the then-Chairman of the Red Cross appointed an Advisory Committee on Organization (the “Harriman Committee”) “to study the structure of the organization of the [Red Cross] in the light of its tremendous growth and expansion in the last 40 years.”⁸⁰ The Harriman Committee issued a report, known as the “Harriman Report,”⁸¹ recommending significant changes that were intended to make the governance structure of the Red Cross more democratic.⁸² As an initial matter, the Harriman Committee recommended increasing the size of the Board, stating that the existing, 18-member governing body was “inadequate to the needs of the organization,” which, by 1946, had grown to have 3,745 chapters.⁸³ The Harriman Committee sought to provide the Red Cross chapters with proportionally greater representation on the Red Cross governing body and to provide for more equitable distribution of representation among the chapters on the basis of geographic location, chapter size and the size of the populations served, among other factors.⁸⁴

The Harriman Committee also sought to recognize the national scope of the Red Cross’ work by increasing the proportion of at-large members on the governing body and having the full governing body, rather than the Board of Incorporators (who tended to be “leading lights in society who resided in a few locales”)⁸⁵ elect the at-large members.⁸⁶ To facilitate this increased representation, the Harriman Committee concluded that a governing body substantially larger

⁷⁹ Harriman Report, at 7.

⁸⁰ *Id.* at 1.

⁸¹ The Harriman Report takes its name from E. Roland Harriman, Chairman of the Harriman Committee (the Advisory Committee on Organization).

⁸² *See id.* at 15 – 16, 19 – 20, 21 – 22; American Red Cross, *The Governance Structure of the American Red Cross* 3 & n.2 (Jan. 2006) (quotations omitted).

⁸³ Harriman Report, at 19.

⁸⁴ *See id.* at 15 – 16, 19 – 20, 21 – 22; American Red Cross, *The Governance Structure of the American Red Cross* 3 & n.2 (Jan. 2006) (quotations omitted); Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-10 (March 15, 2006) (stating that the 1947 amendments resulting from the Harriman Report were “prompted by complaints that the management of the [Red Cross] was insufficiently attentive to the preferences of the . . . local Red Cross chapters, which collected from donors a considerable portion of [the Red Cross’] funds and whose members were on the front line in disaster and war relief duties.”); *see also* Brien R. Williams (Historian, American Red Cross Museum), *The Federal Charter of the American Red Cross* (Apr. 2005), available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 20, 2006); American Red Cross, *The Governance Structure of the American Red Cross* 1 (Jan. 2006).

⁸⁵ Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-11 n.48 (March 15, 2006).

⁸⁶ Harriman Report, at 15 – 16, 21 – 22.

than the 18-member central committee was necessary. Accordingly, the Harriman Report recommended eliminating both the Board of Incorporators⁸⁷ and the central committee and centralizing policy-making authority in a single 50-member governing body known as the “Board of Governors.”⁸⁸

Following the issuance of the Harriman Report, the Red Cross prepared a proposal for amending the 1905 Charter.⁸⁹ The charter was amended by Congress in 1947⁹⁰ and, with minor changes, remains in place today. The Charter, as supplemented by the Bylaws, establishes a 50-member Board that consists of:

- 30 members to be elected by the chapters and blood services regions (collectively “chartered units”) under nomination and election procedures that seek to “ensure equitable representation of all [chartered units], with regard to geographical considerations, the size of the [chartered units], and the size of the populations served”;⁹¹
- 12 “members-at-large” who are “representative of the national interests that the [Red Cross] serves, and with which it is desirable that the [Red Cross] have close association”;⁹² and
- Eight members appointed by the President of the United States, including the Chairman of the Board. The remaining seven Presidential appointees must be “officials of departments and agencies of the United States Government, whose positions and interests qualify them to contribute to carrying out the programs and purposes” of the Red Cross, including at least one, and not more than three, who are selected from the armed forces.⁹³

Under the Charter, members of the Board serve staggered three-year terms, with one-third of the members elected each year.⁹⁴ The Charter authorizes the appointment of an executive committee

⁸⁷ According to the Harriman Report, due to “the passage of time and changed conditions,” the functions of the Board of Incorporators had diminished over time, so that by 1946, it performed only three functions: selecting six members of the central committee, selecting trustees of the endowment fund, and electing their own successors on the Board of Incorporators. *Id.* at 28.

⁸⁸ *Id.* at 19 – 20. This change was intended to eliminate what the Harriman Report characterized as “divided authority” between the central committee and the Board of Incorporators resulting from “the slight residual authority in the Incorporators under the original Charter.” *Id.* at 19.

⁸⁹ Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-10 (March 15, 2006) (footnotes omitted).

⁹⁰ See Pub. L. 42, ch. 50, 61 Stat. 80 – 83 (1947).

⁹¹ Charter, § 4(a)(1)(B).

⁹² *Id.* § 4(a)(1)(C).

⁹³ *Id.* § 4(a)(1)(A).

⁹⁴ *Id.* §§ 4(a)(2) & 4(b)(1).

consisting of at least 11 Board members “to exercise the powers of the board when the board is not in session.”⁹⁵

The Charter also gives the executive committee authority to appoint and remove officers and employees of the Red Cross, with the exception of the Chairman of the Board, whom the President of the United States appoints and the Charter designates as the “principal officer” of the Red Cross.⁹⁶ Although the Harriman Committee spent significant time debating possible methods for selecting the chief executive of the Red Cross, and considered this “one of the most important matters assigned to” the Committee, the Committee did not reach agreement on this subject.⁹⁷ Pending issuance of a supplemental report addressing the matter,⁹⁸ the Harriman Committee concluded that the President of the United States should continue to appoint the Chairman.⁹⁹

Red Cross Governance Task Force

In October 2001, the Board formed a Governance Task Force consisting of Board members and management to review the Red Cross’ governance practices with expert advice from Professor Jay Lorsch of the Harvard Business School. The review sought to address several aspects of Red Cross governance, including the large size of the Board, variation in the knowledge and experience of Board members, the large number of Board committees, and the need for more constructive discussion and engagement at Board meetings and greater involvement in strategic planning at the full Board level.¹⁰⁰

The Governance Task Force issued a report in early 2002 recommending a series of reforms and the report was approved by the Board in May 2002.¹⁰¹ These reforms were developed with the understanding that the Red Cross would not be seeking Charter amendments

⁹⁵ *Id.* § 4(c)(1).

⁹⁶ *Id.* § 4(c)(2).

⁹⁷ Harriman Report, at 1.

⁹⁸ The Harriman Report states that the Harriman Committee intended to issue a supplemental report addressing this subject. *See id.* at 2. Recent efforts by the Red Cross to locate that report in connection with this Governance Audit were unsuccessful, and whether this report was in fact prepared is unclear.

⁹⁹ *Id.* at 2, 28 – 29.

¹⁰⁰ *See* Course Materials for Remarks of Professor Jay W. Lorsch, American Red Cross Corporate Governance Summit on Enhancing Board Effectiveness (March 21, 2006); Remarks of Professor Jay W. Lorsch, American Red Cross Corporate Governance Summit on Enhancing Board Effectiveness (March 21, 2006).

¹⁰¹ *See* American Red Cross Final Report of the Governance Task Force (May 2002).

from Congress to change its governance structure.¹⁰² Among the report’s recommendations were:

- strengthening the full Board’s focus on strategy, policy, resources and general oversight of the affairs of the Red Cross and placing responsibility for more detailed and ongoing oversight of Red Cross operations with the Executive Committee;¹⁰³
- placing greater emphasis on skills and experience in selecting new Board members;¹⁰⁴ and
- establishing a Governance Committee and consolidating the committee structure.¹⁰⁵

As a result of the recommendations relating to Board committees, the Board created a new Governance Committee to oversee executive compensation and Board leadership matters, which previously had been overseen by two separate subcommittees.¹⁰⁶ The then-Strategic Planning Committee was disbanded and the Executive Committee assumed primary responsibility for oversight of strategic planning.¹⁰⁷ Responsibility for overseeing the Red Cross’ biomedical services business was consolidated into the Biomedical Services Committee.¹⁰⁸ In addition to the recommendations related to committees, most of the other recommendations in the report of the Governance Task Force (including those outlined above) were implemented. However, as noted above, no changes were made in the size or composition of the Board.

The Sarbanes-Oxley Act of 2002 and Beyond

Since the Governance Task Force report in 2002, the Red Cross has implemented a number of governance “best practices.” Following the adoption of the Sarbanes-Oxley Act of 2002, the Red Cross conducted a review of its governance practices in light of the requirements of this statute. Although nearly all provisions of the Sarbanes-Oxley Act apply only to publicly-traded companies, many of these provisions, as well as the corporate governance listing standards applicable to companies trading on the New York Stock Exchange (the “NYSE”) and the NASDAQ Stock Market, Inc. (“NASDAQ”), have increasingly emerged as best practices in the nonprofit sector.¹⁰⁹ Accordingly, many organizations—including the Red Cross—that are

¹⁰² Remarks of Professor Jay W. Lorsch, American Red Cross Corporate Governance Summit on Enhancing Board Effectiveness (March 21, 2006).

¹⁰³ American Red Cross Final Report of the Governance Task Force, recommendations I.2 & I.3 (May 2002).

¹⁰⁴ *Id.*, recommendation I.6.

¹⁰⁵ *Id.*, recommendations I.4 & I.5.

¹⁰⁶ *Id.*, recommendation I.5.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ For example, audit committees at many nonprofit organizations are now responsible for overseeing the relationship with the outside auditor, and many nonprofit boards (including the Board) now conduct regular board and committee self-assessments. *See, e.g.*, ABA Coordinating Committee on Nonprofit Governance,

not subject to these requirements are nevertheless considering, to varying degrees, adoption of many of the processes and practices mandated for publicly listed corporations as “best practices” in the nonprofit sector.¹¹⁰

The Red Cross itself has already taken a number of steps in this regard. For example, consistent with the Sarbanes-Oxley requirements applicable to public company audit committees, the Red Cross Audit Committee now is directly responsible for appointing, determining compensation for, and overseeing the work of, the Red Cross’ outside auditor, and the Audit Committee pre-approves all audit and non-audit services to be provided by the auditor.¹¹¹ Similarly, consistent with the NYSE and NASDAQ requirements that boards hold regular executive sessions outside the presence of management,¹¹² the Board and each Board committee meet regularly in executive session without management. The Board also conducts an annual evaluation of the Board and its committees, which is required under the NYSE listing standards for boards and the three key committees (audit, compensation and governance).¹¹³ In addition, each of the eight standing committees of the Board operates under a written function statement outlining its duties and responsibilities.

Other Red Cross governance practices include a requirement that Board members annually certify that they have read and comply with the Red Cross Code of Conduct, which requires disclosure of conflicts of interest and outlines recusal procedures for Board members in the event of conflicts.¹¹⁴ In addition, Board members are required to complete a questionnaire addressing their independence upon joining the Board and on an annual basis. New Board member orientation is provided at which the responsibilities, duties and obligations of Board members are outlined and an overview of the key strategic, risk, legal and financial issues of the organization is provided.

Additionally, the Red Cross has a comprehensive whistleblower program for employees and volunteers to report, confidentially and anonymously, allegations of waste, fraud, abuse, criminal actions and other improper actions. The whistleblower program includes two hotlines. Claims are investigated, and necessary remedial actions are taken, by management. Major investigations, cases and trends are reported to the Audit Committee on a regular basis.

[Footnote continued from previous page]

Guide to Nonprofit Corporate Governance in the Wake of Sarbanes-Oxley (2005); BoardSource and Independent Sector, *The Sarbanes-Oxley Act and Implications for Nonprofit Organizations* (2006), available at <http://www.boardsource.org/clientfiles/Sarbanes-Oxley.pdf> (last visited Sept. 20, 2006).

¹¹⁰ *See id.*

¹¹¹ Amended and Restated Audit Committee Function Statement, paras. 2(b) & (c); Securities Exchange Act of 1934 (the “Exchange Act”), § 10A(m)(2), 15 U.S.C. § 78j-1(m)(2) (2006) and Exchange Act Rule 10A-3(b)(2), 17 C.F.R. § 240.10A-3(b)(2) (2006); Exchange Act § 10A(i), 15 U.S.C. § 78j-1(i) (2006) and Securities and Exchange Commission Regulation S-X § 2-01(c)(7), 17 C.F.R. § 210.2-01(c)(7) (2006).

¹¹² NYSE Listed Company Manual, § 303A.03 (2004); NASDAQ Marketplace Rules, Rule 4350(c)(2) (2006).

¹¹³ NYSE Listed Company Manual, §§ 303A.04(b)(ii), 303A.05(b)(ii), 303A.07(c)(ii) & 303A.09 (2004).

¹¹⁴ Policy Manual, Pt. 1, §§ 1.5.2 – 1.5.5.

Currently, the governance framework and practices of the Red Cross are addressed in the Charter, Bylaws, committee function statements, and a two-part Board of Governors Policy Manual (the “Policy Manual”) that sets forth general corporate and financial policies, procedures for nominating and electing Board members, and details about the organizational structures of, and services delivered by the chapters, Service Areas and blood services regions. Specific aspects of the Red Cross’ governance practices are addressed elsewhere in this report.

SECTION 2. GOVERNANCE AUDIT PROCESS

Following the adoption of various recommendations proposed by the Red Cross Governance Task Force in 2002 and increased emphasis on governance following the Sarbanes-Oxley Act, Red Cross governance continues to receive attention. As a result, on February 17, 2006, the Board of Governors authorized and commissioned “a comprehensive assessment of its governance model with the goal of identifying concrete reforms that will streamline the organization’s ability to meet the growing demands of its mission”¹¹⁵ (the “Governance Audit”).

The Corporate Governance Summit

As a first step in its comprehensive governance assessment, the Red Cross organized a Corporate Governance Summit with the National Association of Corporate Directors (the “NACD”), on March 21, 2006. The summit brought together for-profit and nonprofit governance experts to provide Board members the most up-to-date information on current governance best practices.

Presenters at the summit included Professor Jay W. Lorsch of the Harvard Business School (also a member of the group of experts, discussed below under “The Independent Governance Advisory Panel,” established to advise in connection with the Governance Audit); Charles W. Gould, President and CEO of Volunteers of America; Deborah S. Hechinger, President and CEO of BoardSource; John R. Seffrin, President and CEO of the American Cancer Society; Karen Hastie Williams, a retired partner of the law firm Crowell & Moring LLP and a member of several audit committees (also the chair of the group of experts advising in connection with the Governance Audit); Mark Terrell, former chair of KPMG’s Audit Committee Institute; and Ira M. Millstein, Director of the Yale Center for Corporate Governance and Performance.

Presenters addressed a variety of topics, including recommended governance practices, board size and structure, board and committee meetings, and the importance of independence. Audit committee and internal control-related matters also were discussed.

The Independent Governance Advisory Panel

Soon after the summit, on April 4, 2006, the Board announced that a seven-member group of experts (the “Panel”), under the auspices of the Governance Committee, would undertake a comprehensive, independent audit of Red Cross governance, with the goal of identifying “governance changes that are in the best interest of the Red Cross and the American public.”¹¹⁶ In addition, the Governance Committee retained a team of lawyers and governance

¹¹⁵ Press Release, *American Red Cross Announces Comprehensive Governance Review Process*, available at http://www.redcross.org/pressrelease/0,1077,0_314_5173,00.html (Feb. 24, 2006) (last visited Sept. 19, 2006).

¹¹⁶ Press Release, *American Red Cross Board of Governors Announces Independent Governance Advisory Panel*, available at http://www.redcross.org/pressrelease/0,1077,0_314_5254,00.html (Apr. 4, 2006) (last visited Sept. 19, 2006).

experts at Gibson, Dunn & Crutcher LLP, including John F. Olson, Amy L. Goodman and Stephanie Tsacoumis, to serve as independent counsel and to assist in the Governance Audit.

The seven governance experts on the Panel are:

Karen Hastie Williams, Panel Chair, a retired partner in the Washington, D.C. law firm of Crowell & Moring LLP and member of the boards of the NAACP Legal Defense and Education Fund, Amherst College, the Federal National Mortgage Association Foundation, The Chubb Corporation, Continental Airlines, Inc., Gannett Company, Inc., SunTrust Bank and Washington Gas Holdings Company.

Peter Clapman, the CEO of Governance for Owners USA, Inc., the former Senior Vice President and Chief Counsel for Corporate Governance at TIAA-CREF and the Executive Director of the Pace Law School Directors Institute.

Charles Elson, the Edgar S. Woolard, Jr., Chair in Corporate Governance and Director of the John L. Weinberg Center for Corporate Governance at the University of Delaware.

Margaret M. Foran, the Senior Vice President-Corporate Governance, Associate General Counsel and Corporate Secretary of Pfizer Inc.

Jay W. Lorsch, the Louis E. Kirstein Professor of Human Relations at the Harvard Business School and Faculty Chairman of the Harvard Business School's Global Corporate Governance Initiative.

Patricia McGuire, the President of Trinity University in Washington, D.C.

Paul Neuhauser, Professor Emeritus at The University of Iowa College of Law, where he teaches in the area of corporate law.

Detailed biographies of the Panel members are set forth at Exhibit A. The Panel appointed Karen Hastie Williams to serve as its chair.

The seven Panel members are volunteering their time. No member of the Panel has served on the Board or any Red Cross chapter board of directors. All Panel members have extensive governance experience, including service on the boards of numerous nonprofit organizations and public corporations.

Focus Areas for the Governance Audit

On April 4, 2006, the Board also announced the five focus areas for the Governance Audit:

1. the size and composition of the Board, participation by and independence of Governors and the process for selecting candidates for the Board;

2. the organization and functioning of the Board, including the composition, structure and roles of the Board's committees;
3. the roles and relationships of the Board and management;
4. the Board's oversight of the governance practices of the Red Cross chapters; and
5. the relationships and lines of reporting between the Audit Committee, the outside auditor, and the internal audit function, including the whistleblower process as it applies to Red Cross employees and volunteers as well as constituencies served by the Red Cross.¹¹⁷

Consistent with the charter for the Governance Audit and guidance from the Governance Committee, the audit has focused on these five areas.¹¹⁸

Conducting the Governance Audit

This report presents the work conducted in connection with the Governance Audit. In light of best practices in governance and the unique position of the Red Cross in the United States, the report includes a series of recommendations, which were formulated by the Governance Committee based on the advice of the Panel and independent counsel, and approved, adopted and authorized by the Board, acting by unanimous vote of all members of the Board present at its meeting on October 27, 2006. As discussed in the report, it is anticipated that these and other recommendations can be implemented through a combination of voluntary action on the part of the Red Cross and changes to the Charter.

The Governance Audit proceeded pursuant to a work plan that was presented to the Governance Committee of the Red Cross in March 2006. During the course of the audit, the Red Cross granted unfettered access to members of the Board, senior management and volunteers. The Red Cross also facilitated access to former Board members, employees and volunteers. Senior Red Cross executives were cooperative and encouraging of the endeavor, and were forthcoming with information. The General Counsel and the Red Cross legal staff were available and responsive to multiple information and document requests.

The Governance Audit—which has included research and extensive information-gathering, study and analysis of best practices, as well as extensive deliberations—provides the basis for the recommendations set forth in this report.

¹¹⁷ The whistleblower process applicable to the Red Cross' biomedical operations was not within the scope of the Governance Audit.

¹¹⁸ Press Release, *American Red Cross Board of Governors Announces Independent Governance Advisory Panel*, available at http://www.redcross.org/pressrelease/0,1077,0_314_5254,00.html (Apr. 4, 2006) (last visited Sept. 19, 2006).

Research and Information-Gathering

Information was obtained from a variety of sources. The Red Cross made available numerous documents and background materials (including Board minutes, meeting materials and attendance records), and provided access to materials posted on a Red Cross internal website. The Governance Audit also included a review of historical and current legislative materials relating to the Red Cross and applicable statutory provisions.

In addition to Red Cross documents and materials, the audit included a review of legal and academic sources, materials obtained from leading governance-related organizations, studies relating to nonprofit organizations, governance-related materials from other nonprofit organizations, Congressional Research Service reports on federally-chartered nonprofits and other federally-chartered entities, and media coverage and other third-party statements about Red Cross governance practices.

A bibliography of these sources is attached as Exhibit B.¹¹⁹

Interviews of Red Cross Stakeholders and Governance Experts

In addition to a review of documents and other information about the Red Cross, the Governance Audit included interviews of individuals who were likely to have significant experience, perspective or insights relevant to the Red Cross' governance practices. In total, the Governance Audit included interviews of 137 persons.

By design, the interviews covered a broad cross-section of Red Cross stakeholders as well as outside experts. Interviews included current and former Board members, representatives of Presidentially-appointed Board members, current and former Red Cross senior management and employees, current and former chapter board members and executives, Congressional staff members who have responsibilities relevant to the Red Cross, partners with the Red Cross' outside auditor, and outside governance experts who are neither employed by the Red Cross nor serve on the Board.

To facilitate structured, yet candid, discussions, the interviews followed written interview outlines, which included general questions applicable to most interviewees, as well as questions tailored to particular interviewees' experience and backgrounds. At the beginning of each interview, interviewees were provided with an overview of the nature and purpose of the Governance Audit. Interviewees also were advised that specific comments would not be ascribed in this report to any named individuals.

Most interviews were conducted individually; a small number of Board member interviews were conducted in a "focus group" setting. All requests for individual interviews or follow-up interviews by focus group members were honored.

¹¹⁹ Confidential and nonpublic documents are not included in the bibliography or referenced in this report.

Deliberations

During the course of the Governance Audit, regular meetings were held to discuss the progress of the audit as well as emerging themes. Meetings included Panel members, counsel, members of the Governance Committee and other Board members, and senior Red Cross executives.

The Panel had nine meetings from April through October 2006. At an early Panel meeting, Red Cross management briefed the Panel on the Red Cross' organizational structure, its operations and functions and related matters, such as finance, chapter supervision, disaster operations and blood services.

The Governance Committee met with members of the Panel during the course of the Governance Audit. In addition, members of the Panel and counsel regularly briefed the Governance Committee on the status of the audit. The Board also formed a small group of members to work with the Governance Committee and the Panel, and this small group held several meetings with the Panel, counsel and senior Red Cross staff.

At the end of an iterative and deliberative process, the Governance Committee and the Panel agreed upon the recommendations presented to the Board. Although all members of the Panel concurred that the Red Cross should have a smaller Board,¹²⁰ some Panel members believe that the recommended size range of 12 to 20 members is higher than optimal and that a Board considerably smaller than 20 would be more effective for the Red Cross.

On October 27, 2006, at a day-long meeting, portions of which were facilitated by Roger W. Raber, the President and Chief Executive Officer of NACD, the full Board considered the recommendations presented by the Governance Committee. With the potential benefits to the organization in mind, the members of the Board present at the meeting unanimously approved, adopted and authorized the recommendations contained in this report by formal resolution, a copy of which is set forth at Exhibit C. These recommendations are intended to enhance the effectiveness and efficiency of Red Cross governance in the best interest of the organization and the American public.

Ongoing Red Cross Initiatives

Some Red Cross activities during the time period of the Governance Audit had governance implications. The search process for a new Red Cross Chief Executive Officer (the "CEO") continued during the course of the audit. The Red Cross also announced the Community Presence Initiative, a new chapter service delivery model that will reorganize the chapter structure. In tandem with the Community Presence Initiative, the Red Cross continued to implement its Shared Administrative Services Initiative, under which administrative, accounting and other functions for chapters will be more centralized. Further, during the Governance Audit, the Red Cross announced plans to enhance its disaster response capabilities, including standardized financial management, strategic fundraising, implementation of more vigorous

¹²⁰ See discussion under Section 4B, "Size and Composition of the Board" below.

internal controls, partnering with other nonprofit and faith-based organizations, continued recruitment of diverse volunteers and employees, and a renewed focus on addressing the needs of under-served communities.¹²¹

Scope of the Governance Audit

The Governance Audit focused on the areas identified in “Focus Areas for the Governance Audit” above, and did not encompass other matters. Attention was devoted to governance rather than operational subjects, and an effort was made to refrain from addressing matters more appropriately handled by management. For instance, while inquiries were made about structural and reporting relationships among finance, treasury and internal audit personnel and the outside auditor, no effort was made to conduct a substantive review of financial reporting, or accounting or internal audit procedures. While inquiries were made about hotline procedures, no substantive evaluation of specific hotline or whistleblower complaints was made. Allegations of theft, mismanagement or fraud (whether in connection with various disasters or otherwise) likewise were not within the scope of the audit.

¹²¹ See American Red Cross, *From Challenge to Action: American Red Cross Actions To Improve and Enhance Its Disaster Response and Related Capabilities For the 2006 Hurricane Season and Beyond* (June 2006). See also discussion under Section 4F, “Ongoing Initiatives” below.

SECTION 3. NEED FOR CHANGES RELATED TO GOVERNANCE

A Changed World

Historically, the Red Cross has been able to address disasters by drawing on its network of chapters, employees and volunteers. However, the past decade has witnessed disasters of unprecedented scope. The terrorist attacks of September 11, 2001 demonstrated that the disaster environment now includes terrorism on a scale never before seen. The four hurricanes of September 2004, followed by the December 2004 Southeast Asian tsunami, strained the domestic and international disaster response capabilities of the Red Cross and other national societies throughout the world. These disasters were, however, eclipsed by the destruction caused by the 2005 hurricanes. The rapid succession and the enormity of Hurricanes Katrina, Rita and Wilma created the need for unprecedented levels of assistance in areas that suffered catastrophic devastation and again seriously challenged the Red Cross' existing response systems for disaster relief.¹²²

In light of the current environment, the Red Cross has been taking steps to enhance its disaster relief program,¹²³ centralize its operations and reorganize its chapter structure. All of these initiatives reflect recognition on the part of the Red Cross that it is critically important for the organization to have a robust, state-of-the-art infrastructure capable of delivering services and responding to the disasters of the 21st century. The Red Cross' governance structure must support the ongoing, vital mission of the Red Cross.

A Changed Red Cross

Since the 1900 Charter and the 1947 amendments, the scope of the Red Cross' operations and the attendant public expectations have expanded. Today, the operations of the Red Cross include an extensive governmentally regulated blood-related business¹²⁴ and responsibilities as a key participant in the federal government's coordinated response to terrorist attacks, major disasters and other emergencies.

The diversity of services offered by the Red Cross, the resulting complexity of its operations, the degree of regulation and the importance of the Red Cross' blood-related business—both to the Red Cross' ongoing financial viability and to the nation's blood supply—and the Red Cross' elevated status in the country's emergency response efforts, all require that the Red Cross have a modern, flexible governance structure that will support the ongoing, vital mission of the Red Cross.

¹²² *Id.* at 7, 5 – 13 (summarizing “key systemic challenges that impaired Red Cross effectiveness during the 2005 hurricane response”); U.S. House Committee on Homeland Security Democratic Staff, *Trouble Exposed: Katrina, Rita, and the Red Cross: A Familiar History* (Dec. 2005).

¹²³ See generally American Red Cross, *From Challenge to Action: American Red Cross Actions To Improve and Enhance Its Disaster Response and Related Capabilities For the 2006 Hurricane Season and Beyond* (June 2006).

¹²⁴ The blood-related business is subject to regulation by the Food and Drug Administration (the “FDA”).

A Changed Governance Landscape

The governance landscape has also changed dramatically since the current Red Cross governance structure was put in place in 1947. Most recently, scandals in both the corporate and nonprofit sectors have seriously eroded public confidence and prompted a heightened focus on the importance of effective governance. Today, corporations and nonprofit organizations alike are devoting greater attention to governance practices. This increased emphasis on governance has resulted in large part from the enhanced public expectations regarding the accountability and transparency of all organizations—nonprofits as well as for-profit and public corporations—and their governing boards.

In July 2002, Congress passed the Sarbanes-Oxley Act,¹²⁵ which, among other things, impacted the financial reporting processes and the audit committees of publicly-traded companies. As a result of the Sarbanes-Oxley Act, senior management of public corporations now must certify the accuracy of financial statements,¹²⁶ and assess and document the effectiveness of their corporations' internal controls over financial reporting.¹²⁷ The Sarbanes-Oxley Act mandated independence standards for audit committee members¹²⁸ and made the audit committee directly responsible for hiring and firing the outside auditor and overseeing a company's relationship with its outside auditor.¹²⁹ Following the passage of the Sarbanes-Oxley Act, the NYSE and NASDAQ adopted new corporate governance standards applicable to companies listed on these markets, including requirements to: (1) have boards of directors with a majority of independent directors, who meet in executive session outside the presence of management on a regular basis;¹³⁰ (2) provide for independent director oversight of executive compensation and director nominations;¹³¹ (3) adopt codes of conduct applicable to all directors, officers and employees;¹³² and (4) adopt a set of corporate governance principles.¹³³

While the Sarbanes-Oxley Act and the related corporate governance listing standards of the major securities markets primarily affect publicly-traded companies, they have increasingly

¹²⁵ Pub. L. No. 107-204, 116 Stat. 745 (July 30, 2002).

¹²⁶ See Sarbanes-Oxley Act of 2002, § 302, *codified at* 15 U.S.C. § 7241 (2006).

¹²⁷ See *id.* § 404, *codified at* 15 U.S.C. § 7262 (2006).

¹²⁸ See *id.* § 301, *codified at* 15 U.S.C. §§ 78j-1(m)(1) & (3) (2006) (Exchange Act §§ 10A(m)(1) & (3) (2006)).

¹²⁹ See *id.* § 301, *codified at* 15 U.S.C. §§ 78j-1(m)(1) & (2) (2006) (Exchange Act, §§ 10A(m)(1) & (2) (2006)).

¹³⁰ NYSE Listed Company Manual, §§ 303A.01 & 303A.03 (2004); NASDAQ Marketplace Rules, Rules 4350(c)(1) & (2) (2006).

¹³¹ NYSE Listed Company Manual, §§ 303A.04 & 303A.05 (2004); NASDAQ Marketplace Rules, Rules 4350(c)(3) & (4) (2006).

¹³² NYSE Listed Company Manual, § 303A.10 (2004); NASDAQ Marketplace Rules, Rule 4350(n) (2006).

¹³³ NYSE Listed Company Manual, § 303A.09 (2004). NASDAQ listing standards do not require that companies adopt governance principles.

become best practices.¹³⁴ As a result, the nonprofit community has looked to public company requirements to assess whether, and to what extent, to comply with them voluntarily.¹³⁵

In addition, the nonprofit sector has been subject to increased scrutiny over the past several years in the wake of publicity about conflicts of interest and other irregularities at a handful of well-known organizations. Both houses of Congress have been examining the need for increased regulation and accountability of the nonprofit sector, and the Senate Committee on Finance and the House Ways and Means Committee held a series of hearings on this subject over the past several years.¹³⁶ In June 2004, the staff of the Senate Committee on Finance issued a discussion draft outlining proposed reforms in a number of areas related to the regulation and practices of nonprofit organizations, including financial reporting, disclosure and governance.¹³⁷ The proposals, which were also the subject of a hearing,¹³⁸ were intended to foster continued discussion and suggestions as the Committee on Finance proceeded to consider possible legislation.¹³⁹ Reacting to the same concerns, many state legislatures have considered “mini-Sarbanes-Oxley” statutes to enhance the accountability and transparency of nonprofit organizations.¹⁴⁰

¹³⁴ See discussion under Section 1, “The Sarbanes-Oxley Act of 2002 and Beyond” above.

¹³⁵ See, e.g., ABA Coordinating Committee on Nonprofit Governance, *Guide to Nonprofit Corporate Governance in the Wake of Sarbanes-Oxley* (2005); BoardSource and Independent Sector, *The Sarbanes-Oxley Act and Implications for Nonprofit Organizations* (2006), available at <http://www.boardsource.org/clientfiles/Sarbanes-Oxley.pdf> (last visited Sept. 20, 2006). Because the governance structures of nonprofit corporations resemble those of their profit-seeking counterparts, the precedent in the for-profit area is an instructive touchstone and reference. See, e.g., James J. Fishman & Stephen Schwarz, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 140 – 141 (3d ed. 2006).

¹³⁶ See, e.g., Transcript, *Overview of the Tax-Exempt Sector, Hearing Before the House Comm. on Ways and Means*, Serial 109-6, 109th Cong. 1st Sess. (Apr. 20, 2005), available at <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=3039> (last visited Sept. 20, 2006); *Charities and Charitable Giving: Proposals for Reform, Hearing Before the Sen. Comm. on Finance* (Apr. 5, 2005), available at <http://finance.senate.gov/sitepages/hearing030505.htm> (last visited Sept. 20, 2006).

¹³⁷ U.S. Senate Committee on Finance, Staff Discussion Draft, *Tax-Exempt Governance Proposals* (June 2004), available at <http://finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf> (last visited Sept. 20, 2006).

¹³⁸ See Transcript, *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities*, S. Hrg. 108-603, *Hearing Before the Sen. Comm. on Finance*, 108th Cong. 2d Sess. (June 22, 2004), available at <http://finance.senate.gov/hearings/95482.pdf> (last visited Sept. 20, 2006).

¹³⁹ See Transcript, *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities*, S. Hrg. 108-603, *Hearing Before the Sen. Comm. on Finance*, 108th Cong. 2d Sess. 2 (June 22, 2004), available at <http://finance.senate.gov/hearings/95482.pdf> (last visited Sept. 20, 2006); U.S. Senate Committee on Finance, Staff Discussion Draft, *Tax-Exempt Governance Proposals* 1 (June 2004), available at <http://finance.senate.gov/hearings/testimony/2004test/062204stfdis.pdf> (last visited Sept. 20, 2006).

¹⁴⁰ See National Council of Nonprofit Associations, *Nonprofit Oversight and Accountability Proposals and Bills Introduced at the State Level 2005* (Dec. 2005), available at http://www.ncna.org/_uploads/documents/live/2005_State_Governance-Updated_6-20-2005.doc (last visited Sept. 20, 2006). In September 2004, California became the first state to pass this type of legislation. See Nonprofit Integrity Act of 2004, 2004 Cal. Stat. 919, codified at CAL. BUS. & PROF. CODE § 17510.5 and CAL. GOV'T CODE §§ 12581 *et seq.* (West 2006).

In October 2004, at the request of leaders of the Senate Committee on Finance, the Independent Sector, a coalition of leading nonprofit organizations, convened a national panel to make recommendations on improvements to the oversight and governance of nonprofit organizations.¹⁴¹ The panel, known as the Panel on the Nonprofit Sector, issued a final report in June 2005 containing an integrated package of recommendations for action by nonprofit organizations, Congress and the Internal Revenue Service that collectively were intended to strengthen the transparency, governance and accountability of nonprofit organizations.¹⁴² The Panel on the Nonprofit Sector has encouraged nonprofit organizations to endorse the report as a sign of their commitment to furthering these goals, and the Red Cross has done so.¹⁴³

In April 2006, the Panel on the Nonprofit Sector issued a supplemental report containing recommendations in nine additional areas, including international grantmaking and the solicitation of charitable donations.¹⁴⁴ The supplemental report announced that the organization intended to continue working with government officials and nonprofit organizations to encourage implementation of its recommendations.¹⁴⁵ The supplemental report also indicated that the Panel on the Nonprofit Sector would be examining and developing recommendations on financial reporting standards, improvements to Internal Revenue Service Form 990 (the annual information return filed annually by most tax-exempt organizations) and self-regulation by nonprofit organizations, and that the Panel would be preparing sample governance policies in areas such as conflicts of interest and board and executive compensation.¹⁴⁶

Going forward, the operations and governance practices of nonprofit organizations are likely to face continued examination from regulators, donors and the public. To maintain public trust, the Board recognizes that large, high-visibility organizations should focus on maintaining effective governance practices that meet evolving best practices.

In considering the governance structure and practices that are appropriate for the Red Cross, it is important to emphasize that “one size does not fit all” for nonprofit organizations.¹⁴⁷

¹⁴¹ Press Release, *Independent Sector Convenes National Panel on Nonprofit Sector* (Oct. 12, 2004), available at http://www.nonprofitpanel.org/press/Independent_Sector_Convenes.html (last visited Sept. 20, 2006); Panel on the Nonprofit Sector, *Strengthening Transparency, Governance and Accountability of Charitable Organizations – A Final Report to Congress and the Nonprofit Sector* 15 (June 2005), available at http://www.nonprofitpanel.org/final/Panel_Final_Report.pdf (last visited Sept. 20, 2006) (hereinafter, the “Panel on the Nonprofit Sector Final Report”).

¹⁴² See Panel on the Nonprofit Sector Final Report.

¹⁴³ See Panel on the Nonprofit Sector Final Report; List of Those Who Have Signed On to the Panel’s Final Report, available at <http://www.nonprofitpanel.org/signers/> (last visited Sept. 20, 2006).

¹⁴⁴ See Panel on the Nonprofit Sector, *Strengthening Transparency, Governance and Accountability of Charitable Organizations – A Supplement to the Final Report to Congress and the Nonprofit Sector* (Apr. 2006), available at http://www.nonprofitpanel.org/supplement/Panel_Supplement_Final.pdf (last visited Sept. 20, 2006).

¹⁴⁵ *Id.* at 3.

¹⁴⁶ *Id.*

¹⁴⁷ See, e.g., ABA Coordinating Committee on Nonprofit Governance, *Guide to Nonprofit Corporate Governance in the Wake of Sarbanes-Oxley* 2 (2005) (recognizing that some practices “may be neither useful nor appropriate” depending on “size, mission, or other factors”); Judith L. Miller-Millesen, *Understanding the*

The governance structure and practices that are appropriate for one organization may not work well for others. A nonprofit organization's governance must be considered in light of a variety of factors, such as the nature of the organization's mission, and its size, operations and culture. For the Red Cross, these factors include its international, national and local role in disaster preparedness and relief, its role with respect to the nation's blood supply, and the size and diversity of the populations the Red Cross serves. Ultimately, the governance structure of the Red Cross must support its operations and empower the organization to carry out its vital and increasingly complex mission in the next century. The recommendations that follow are intended to facilitate this objective.

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Behavior of Nonprofit Boards of Directors: A Theory-Based Approach, NONPROFIT AND VOLUNTARY SECTOR QUARTERLY, Vol. 32, No. 4, 521, 523 (Dec. 2003) (“a consistent theme in the literature is that there is no one-size-fits-all model of board governance”).

SECTION 4. GOVERNANCE ISSUES

A. ROLE OF THE BOARD

Introduction

A central focus of the Governance Audit was defining the appropriate role of the Board. Other key issues (such as Board size and composition) follow from clarification and definition of the Board's role.

Background

The governing documents of the Red Cross establish a role for the Board that involves governance and oversight of the organization, including “management” of the Red Cross. The “Harriman Report,” issued following a 1946 review of the Red Cross’ governance, reflected an intention that the Board function as a “supervisory and policy-making group.”¹⁴⁸ The Charter states that the Board “is the governing body of [the Red Cross] with all the powers of governing and *managing* the [Red Cross],”¹⁴⁹ and the Bylaws of the Red Cross state that “all powers of government, direction, and *management*” are vested in the Board.¹⁵⁰

The references to “management” in the Red Cross governing documents are consistent with the language of the Delaware corporations statute in effect in 1947 (when the Charter was last amended), which provided that the business of a corporation “shall be managed by a Board of Directors.”¹⁵¹ While the term “management” may suggest an operational role, under modern corporate law, as reflected in both the Revised Model Nonprofit Corporation Act and current Delaware law (among other state corporations statutes), “management” as applied to boards of directors is generally understood to refer to supervision and direction of the individuals who manage day-to-day operations, rather than direct operational responsibilities.¹⁵² The Revised

¹⁴⁸ Harriman Report, at 19.

¹⁴⁹ Charter, § 4(a)(1) (emphasis added).

¹⁵⁰ Bylaws, § 2.1 (emphasis added).

¹⁵¹ DEL. CORP. LAW ANN. § 9 (1943).

¹⁵² Revised Model Nonprofit Corp. Act, Official Comment to Section 8.01 (1987) (“In [some] nonprofit corporations the board . . . validates or approves policy and other decisions made by the corporation’s officers and employees. In such instances the corporate powers are exercised under the authority of the board and the affairs are managed under the direction of the board.”); Section of Business Law, American Bar Association, GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS 24 (George W. Overton, ed.) (1993) (hereinafter, the “ABA GUIDEBOOK”) (stating that:

The board of directors is not expected to operate the corporation on a day-to-day basis. Even under statutes providing that the business and affairs of a corporation shall be “managed” by the board of directors, it is recognized that actual operation is a function of “management,” that is, the officers and agents of the corporation. In conventional corporate theory, the responsibility of the board is limited to overseeing such operations.);

R. Franklin Ballotti & Jesse A. Finklestein, 1 THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS §§ 4.17 & 4.18, & § 4.17, at 4-37 (3d ed. & Supp. 2006) (“Management’ is deemed to

[Footnote continued on next page]

Model Nonprofit Corporation Act states that “all corporate powers shall be exercised by or under the authority of, and the affairs of the corporation *managed under the direction of*, its board.”¹⁵³ Similarly, the Delaware General Corporation Law now provides that the business and affairs of a corporation are “*managed by or under the direction of*” its board of directors.¹⁵⁴

The Harriman Report and the Charter also reflect the dual (and potentially conflicting) ideas that members of the Board should act on behalf of the organization as a whole and that the Board should be representational. The Harriman Report emphasized that “[e]very member of the [Board], once chosen, must regard himself as a Governor of the Red Cross, and not as the special representative of any particular element.”¹⁵⁵ However, the Harriman Report also noted—and this was reflected in changes to the Charter that remain in the Charter today—that the Board should provide appropriate representation of the Red Cross chapters and the “national interests” served by the Red Cross.¹⁵⁶

The information-gathering done in connection with the Governance Audit suggests that structural, cultural and historical factors have blurred the distinction between governance and management functions at the Red Cross. Although the distinction between governance and management is not always a bright line,¹⁵⁷ the melding of these functions at the Red Cross has both contributed to, and resulted from, a lack of clarity about the role of the Board. Factors that have led to this situation include:

- *The language of the Charter.* The Charter establishes a structure that designates the Chairman of the Board as the “principal officer” of the Red Cross.¹⁵⁸
- *The strong volunteer component of the Red Cross.* The strong commitment of Board members (who serve without compensation) and the longstanding involvement by many

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encompass ‘supervision, direction and control. [T]he details of the business [may be] delegated to . . . officers, agents and employees.’”) (citations omitted).

¹⁵³ Revised Model Nonprofit Corp. Act § 8.01(b) (1987) (emphasis added). The Revised Model Nonprofit Corporation Act was adopted in 1987 by the Subcommittee on the Model Nonprofit Corporation Law of the Business Law Section of the American Bar Association. *But see* N.Y. NOT-FOR-PROFIT CORP. LAW § 701(a) (2006) (stating that “a corporation shall be managed by its board of directors”) and Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 639 (1998) (noting the danger that “the word ‘managed’ [may be taken] literally” under both the “managed under the direction of” and “managed by” formulations used in the Revised Model Nonprofit Corporation Act and the New York statute, respectively); *see also* D.C. CODE § 29-301.18 (2006) (stating that “[t]he affairs of a corporation shall be managed by a board of directors”).

¹⁵⁴ 8 DEL. CODE § 141(a) (2006) (emphasis added).

¹⁵⁵ Harriman Report, at 22.

¹⁵⁶ *Id.* at 21. *See* discussion under Section 1, “The ‘Harriman Report’ and the 1947 Amendments to the Charter” above.

¹⁵⁷ *See* discussion under “Analysis” below.

¹⁵⁸ Charter, § 4(a)(1)(A).

of them with the Red Cross have prompted them to become very involved in the organization's work. In addition, Board members often have skills and expertise in specific substantive areas that are useful to the Red Cross, and that the Board and management draw upon. As a result, Board members may participate in operational decisions and matters while on the Board. For example, Board members serve alongside members of management on task forces that are formed, by management in many cases, to address operational issues in depth.

- *The experience of Board members at the chapter level.* Many Board members with chapter backgrounds are accustomed to “rolling up their sleeves” alongside management and getting involved in addressing local disasters and other needs. As a result, these Board members may be accustomed to being more “hands on” with respect to operational matters; and
- *The impact of the chapters' perspective on the Board.* The prevailing view among those interviewed in connection with the Governance Audit was that chartered unit-elected Board members understand that their duties as Board members run to the national organization and they act accordingly. However, a few interviewees did express the view that some Board members historically had, and in a few cases continue to have, a tendency to view their roles from the perspective of chapter representation.

Analysis

Well-established principles of governance—both nonprofit and corporate—indicate that a board's role is oversight, such that the board governs an organization and oversees management, while management runs the organization's operations.¹⁵⁹ In connection with its governance role,

¹⁵⁹ See, e.g., ABA Coordinating Committee on Nonprofit Governance, *Guide to Nonprofit Corporate Governance in the Wake of Sarbanes-Oxley* 19 (2005) (The board should be in the “position of being an effective overseer of corporate operations—not to micro-manage such operations but to exercise a more in-depth, informed, and objective oversight role.”); BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 1 (2005) (“Nonprofit boards have primary legal responsibility for governance—the exercise and assignment of power and authority—of their organizations. Boards reserve to themselves organizational oversight and policy setting, and delegate to the chief executive responsibility for managing operations and resources.”); Bruce R. Hopkins, BoardSource, *LEGAL RESPONSIBILITIES OF NONPROFIT BOARDS* 8, 21 (2003) (stating that:

Directors generally oversee administration of the organization. The word generally is used because day-to-day management is supposed to be the province of employees. The directors are the policy makers of the organization—they develop plans for the organization and oversee its affairs. The board of directors may delegate certain duties to officers. . . . The members of the board serve as overseers, not day-to-day managers. . . . The board should oversee the activities of the organization's staff—not meddle in tasks that it has delegated to the chief executive.);

ABA GUIDEBOOK, at 24 (“The board of directors, as such, does not operate the day to day business of the corporation. In delegating that function to others, it must set policies and oversee the corporate agents.”); see also Colin B. Carter & Jay W. Lorsch, *BACK TO THE DRAWING BOARD: DESIGNING CORPORATE BOARDS FOR A COMPLEX WORLD* 79 (2004) (hereinafter, “BACK TO THE DRAWING BOARD”) (“[D]elegation to management will always be substantial because whatever role the board adopts, non-executive directors cannot be management. Directors, even on the most active boards, can only be involved in significant decisions and

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the board of a nonprofit organization provides objective oversight of operations, sets policy, monitors plans for the organization, and delegates to management responsibility for running operations and executing policies and plans.¹⁶⁰ Ultimately, the role of a nonprofit organization's governing board is to "oversee the operations of the organization in such manner as will assure effective and ethical management."¹⁶¹ The relationship between the board and management of a nonprofit organization also has been characterized as a "constructive partnership" in which the

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oversight of the company's performance."); Robert A.G. Monks & Nell Minow, *CORPORATE GOVERNANCE* 201 (3d ed. 2004) ("The board is not sufficiently involved in the day-to-day decisions of the company to determine how the company should be managed—that is the job of the executives. . . . Directors are responsible for the overall picture, not the daily business decisions, the forest, not the trees."); John F. Olson & Michael T. Adams, *Composing a Balanced and Effective Board to Meet New Governance Mandates*, 59 *BUS. LAW.* 421, 425 & 424–26 ("Management makes decisions regarding corporate operations, including strategic planning, risk management, and financial reporting. . . . [T]he board oversees management performance on behalf of shareholders. The board both monitors management performance and intervenes to remedy deficient management operations.") (citations omitted); Ira M. Millstein, *The Role and Independence of Boards and Their Advisors—and the Role of Compensation*, *THE CORPORATE GOVERNANCE ADVISOR*, Vol. 10, No. 3, 5, 7 (2002) (stating that:

The board is the focal point of our corporate governance system. [It] is charged generally with directing the affairs of the corporation. The board fulfills its role by delegating managerial authority to the managers, which it hires, monitors, incentiv[iz]es (compensates), and replaces when necessary. . . . The board is not positioned to (and hence does not) manage, audit, [or] practice law . . . Rather, it delegates to management, and then monitors the management and performance of the company, all on behalf of shareholders and the company.) (citations omitted).

But see Michael Klausner & Jonathan Small, *Failing to Govern?: The Disconnect Between Theory and Reality in Nonprofit Boards, and How to Fix It*, *THE INT'L JOURNAL OF NOT-FOR-PROFIT LAW*, Vol. 7, No. 3 (June 2005), available at http://www.icnl.org/knowledge/ijnl/vol7iss3/art_5.htm (stating that, unlike directors of for-profit entities, members of nonprofit boards perform a range of functions in addition to governing, including giving and/or raising funds, providing special expertise, maintaining ties to important communities, and bringing stature to the work of the organization through their service on the board, and suggesting a "bifurcated" board structure under which some directors would have governance responsibilities and others would perform other functions). *See also* discussion under Section 4B, "Recommendations" below.

¹⁶⁰ *See, e.g.*, ABA Coordinating Committee on Nonprofit Governance, *Guide to Nonprofit Corporate Governance in the Wake of Sarbanes-Oxley* 19 (2005) (The board should be in the "position of being an effective overseer of corporate operations."); BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 1 (2005) ("Nonprofit boards have primary legal responsibility for governance—the exercise and assignment of power and authority—of their organizations. Boards reserve to themselves organizational oversight and policy setting, and delegate to the chief executive responsibility for managing operations and resources."); Bruce R. Hopkins, BoardSource, *LEGAL RESPONSIBILITIES OF NONPROFIT BOARDS* 8, 21 (2003) ("*Directors* generally oversee administration of the organization. The word *generally* is used because day-to-day management is supposed to be the province of employees. The directors are the policy makers of the organization—they develop plans for the organization and oversee its affairs. The board of directors may delegate certain duties to officers.").

¹⁶¹ American Bar Association, ABA Coordinating Committee on Nonprofit Governance, *Guide to Corporate Governance in the Wake of Sarbanes-Oxley* 17, 19 (2005). *See also* Bruce R. Hopkins, BoardSource, *LEGAL RESPONSIBILITIES OF NONPROFIT BOARDS* 1–2 (2003) ("Board members . . . must exercise due diligence to see that the organization is well managed . . . As the ultimate authority, [the board] must ensure that the organization is operating in compliance with the law and its own policies.").

board establishes strategic plans, provides guidance and delegates operations to the chief executive.¹⁶²

At the same time, authorities on governance have acknowledged that the distinction between “governing” and “managing” is not necessarily a precise one.¹⁶³ Moreover, some activities (such as hiring a member of senior management or approving a major transaction or purchase) may involve elements of both what are traditionally viewed as “governance” (that is, policy-level issues) and “management” (that is, operational issues).

Efforts to articulate the oversight role of a board of directors with greater specificity have led to the identification of a series of functions that are commonly accepted as part of the core responsibilities of the board of a nonprofit organization. These core responsibilities include:

- determining the organization’s mission;
- reviewing and monitoring implementation of strategic plans;
- selecting, compensating and evaluating the organization’s chief executive;
- evaluating the performance and establishing the compensation of the senior leadership team;
- planning for management development and succession;

¹⁶² BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 1 (2005); Cyril O. Houle, *GOVERNING BOARDS: THEIR NATURE AND NURTURE* 86 – 87 (1989) (describing the board-management relationship as a “responsible partnership” in which the two parties complement each other in a variety of ways).

¹⁶³ *See, e.g.*, Bruce R. Hopkins, BoardSource, *LEGAL RESPONSIBILITIES OF NONPROFIT BOARDS* 8 (2003) (“[I]t is difficult to set a precise line of demarcation as to where the scope of authority of the board of directors ends and the authority of the officers begins.”); Brian O’Connell, *THE BOARD MEMBER’S BOOK* 48 (3d ed. 2003) (“The worst illusion ever perpetrated in the nonprofit field is that the board of directors makes policy and the staff carries it out. This is just not so. The board, with the help of staff, make[s] policy, and the board, with the help of staff, carries it out.”); Cyril O. Houle, *GOVERNING BOARDS: THEIR NATURE AND NURTURE* 88 (1989) (stating that:

The board’s activities are sometimes called “governance” and the executive’s, for sake of contrast, “administration” or “management.” But this distinction ultimately proves unsatisfactory, both theoretically and practically. It can imply that the board and the executive are wholly separate entities—sometimes opponents vying for power—rather than partners in a common enterprise.);

see also *BACK TO THE DRAWING BOARD*, at 80 (2004) (stating that:

[T]he dividing line between the board’s role and that of management is assumed to be fixed. Many writers on governance assert that all directors have the same job and that their work is fundamentally different from that of an executive. *Governing* and *managing* are held to be quite distinct from one another. If we accept this, the task of deciding how involved a board should be becomes constrained by definition—directors are barred from any task that management undertakes. . . . The distinction between governance and management is not cut-and-dried.).

- overseeing the integrity and reliability of the organization’s finances;
- overseeing management in its operation of the organization and its programs;
- overseeing legal and ethical compliance; and
- identifying, cultivating and soliciting donor support for the organization.¹⁶⁴

In addition, the role of the board of a nonprofit organization necessarily will vary depending on factors such as the size, structure and mission.¹⁶⁵

To promote effective oversight, groups such as the Panel on the Nonprofit Sector have recommended that the board of a nonprofit organization establish “strong and effective mechanisms to ensure that the board carries out its oversight functions and that board members are aware of their legal and ethical responsibilities in ensuring that the organization is governed properly.”¹⁶⁶ An initial step is to establish clarity in the governing documents. For example, in response to a finding that the Corporation for Public Broadcasting had not adequately defined the respective roles and responsibilities of its board and management,¹⁶⁷ the organization’s bylaws were amended to clarify that the board is responsible for providing “clear direction on the course it wishes management to pursue” and management is responsible for deciding how to implement the board’s directives.¹⁶⁸

Another step that some large, national nonprofit organizations, such as The Nature Conservancy and Volunteers of America, have taken in this respect is to develop a “position description” outlining the core responsibilities of their governing boards.¹⁶⁹ A position

¹⁶⁴ See, e.g., BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* (2005); Brian O’Connell, *THE BOARD MEMBER’S BOOK* 55 – 56 (3d ed. 2003); Fisher Howe, *Nonprofit Accountability: The Board’s Fiduciary Responsibility* 29, 32 – 33, in *Section of Business Law, American Bar Association et al., NONPROFIT GOVERNANCE AND MANAGEMENT* (Victor Futter et al., eds. 2002); see also Business Roundtable, *Principles of Corporate Governance 2005* 8 – 10 (Nov. 2005), available at <http://www.businessroundtable.org/pdf/CorporateGovPrinciples.pdf> (last visited Sept. 26, 2006) (hereinafter, “Business Roundtable 2005 Principles of Corporate Governance”); *BACK TO THE DRAWING BOARD*, at 17 – 18 (2004) (outlining activities that best practices suggest boards should perform); Robert A.G. Monks & Nell Minow, *CORPORATE GOVERNANCE* 169 (3d ed. 2004) (outlining descriptions of the specific responsibilities of boards developed by organizations such as Business Roundtable and the American Law Institute).

¹⁶⁵ See, e.g., Revised Model Nonprofit Corp. Act, Official Comment to Section 8.01 (1987) (“The role played by the boards of nonprofit corporations varies widely due to the nature, size, characteristics and needs of the organizations.”).

¹⁶⁶ Panel on the Nonprofit Sector Final Report, at 75.

¹⁶⁷ Corporation for Public Broadcasting, Office of Inspector General, Report of Review (Nov. 15, 2005), available at http://www.cpb.org/oig/reports/602_cpb_ig_reportofreview.pdf (last visited Oct. 3, 2006).

¹⁶⁸ Corporation for Public Broadcasting, Office of Inspector General, Evaluation of CPB Response to the OIG Report of Review (June 9, 2006), available at http://www.cpb.org/oig/reports/606_EvaluationCPBResponse.pdf (last visited Oct. 3, 2006).

¹⁶⁹ See, e.g., The Nature Conservancy, *Board of Directors Charter of Governance Responsibilities*, available at <http://www.nature.org/aboutus/leadership/art15471.html> (last visited Sept. 20, 2006); Volunteers of America,

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description may also include specific responsibilities that are appropriate in light of the mission and structure of an organization. For example, the “Board of Directors Charter of Governance Responsibilities” adopted by the Board of Directors of The Nature Conservancy includes among the board’s responsibilities the responsibility to “[e]stablish sound mechanisms for the engagement of volunteers in the activities of the chapters and the mission of the organization as a whole.”¹⁷⁰

Some of the core responsibilities of the Red Cross Board (including responsibility for strategic planning, evaluation of the President and CEO, executive compensation, and donor support) are currently described in a Corporate Governance Directory that is distributed annually to the Board¹⁷¹ and whose purpose is to “serve[] as a guide on the roles and responsibilities of the [Board].”¹⁷² These responsibilities are not included in a more formal governance document.

Reflecting current governance best practices, the appropriate role for the Board is one in which the Board functions as a true oversight board working in partnership with senior management (recognizing that in crisis or extraordinary situations—such as the FDA consent decree applicable to the Red Cross biomedical services business¹⁷³— temporary Board involvement in operational matters may be necessary). Like board members at many nonprofit organizations, members of the Board also would remain involved in fundraising. In performing its oversight role, the Board must appropriately integrate the perspectives of the Red Cross chapters¹⁷⁴ and volunteers.¹⁷⁵ A board that effectively oversees the management of the Red Cross as a whole is critical to support the significant national responsibilities of the Red Cross

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Statement of Values and Code of Ethics for Volunteers of America, *available at* <http://www.voa.org/AboutUs/Statement+of+Values+and+Code+of+Ethics+for+Volunteers+of+America.htm> (last visited Sept. 20, 2006).

¹⁷⁰ The Nature Conservancy, *Board of Directors Charter of Governance Responsibilities*, *available at* <http://www.nature.org/aboutus/leadership/art15471.html> (last visited July 25, 2006).

¹⁷¹ See American Red Cross Board of Governors Corporate Governance Directory 3 – 6 (2005 – 2006).

¹⁷² *Id.* at 1.

¹⁷³ The FDA consent decree applicable to the Red Cross’ biomedical services business requires Board oversight of quality assurance and compliance matters related to the biomedical business, to be effectuated through the Biomedical Services Committee and the Audit Committee. The consent decree provides that the Biomedical Services Committee must consist of the Chairman of the Board and not less than ten or more than 14 individuals, with at least a majority of the members to be Board members. See Amended Consent Decree of Permanent Injunction, *United States of America v. American National Red Cross*, Civ. No. 93-0949 para. III.B.7 (D.D.C. Apr. 15, 2003), *available at* http://www.fda.gov/ora/frequent/letters/ARCAmendedDecree_1.pdf (last visited Oct. 3, 2006) (hereinafter, the “FDA Consent Decree”). Any change in this oversight structure would require notification to the FDA. See *id.* para. XVIII.A (requiring advance notification to the FDA of “any . . . change of the corporate structure or function of the [Red Cross] that may affect compliance obligations arising out of [the Consent Decree.]”). As a result, absent notification to the FDA, the Biomedical Services Committee and the Audit Committee are required to oversee the biomedical services business.

¹⁷⁴ See discussion of a National Leadership Council under Section 4B, “Advisory Functions” below.

¹⁷⁵ As reflected in the Red Cross’ mission statement, the Red Cross is “led by volunteers.” See Section 1, “The Red Cross—A National Treasure” above for the mission statement of the Red Cross.

and the interests of the American people.¹⁷⁶ It also is critical to support the notion of “one Red Cross” that is increasingly reflected in Red Cross initiatives.¹⁷⁷ These initiatives, in turn, are critical to supporting the ongoing, vital mission of the Red Cross.

Recommendations

For reasons described earlier in this report, the Board has determined that it should be a board that focuses solely on governance and strategic oversight of the organization.

Changes in Governance Practices

A number of steps should be taken to clarify the Board’s role:

1. The Bylaws¹⁷⁸ should be amended to include a statement clarifying the Board’s role as a governance and strategic oversight board and to outline areas of Board responsibility, including, but not limited to:
 - reviewing and approving the mission statement for the Red Cross;
 - approving and overseeing the Red Cross strategic plan and maintaining strategic oversight of operational matters;
 - selecting, evaluating and determining the level of compensation of the Red Cross CEO;
 - evaluating the performance and establishing the compensation of the senior leadership team, and providing for management succession;
 - overseeing the financial reporting and audit processes, internal controls and legal compliance;
 - holding management accountable for performance;
 - providing oversight of the financial stability of the organization;
 - ensuring the inclusiveness and diversity of the Red Cross;
 - providing oversight of the protection of the Red Cross brand; and

¹⁷⁶ See Section 1, “Unique Status and Responsibilities of the Red Cross” above.

¹⁷⁷ See discussion under Section 2, “Ongoing Red Cross Initiatives” above and Section 4H, “Background – Red Cross Chapters” below.

¹⁷⁸ As noted earlier, *see* Section 1, “The Sarbanes-Oxley Act of 2002 and Beyond,” some of the governance practices of the Red Cross are set forth in the Policy Manual. In light of the changes being recommended in this report, including those relating to the role of the Board, the continued need for, and contents of, the Policy Manual should be considered.

- assisting with fundraising on behalf of the Red Cross.
2. The Bylaws should be amended to:
 - clarify that the “management” responsibilities of the Board under both the Charter and the Bylaws consist of “overseeing management”; and
 - explicitly delegate to management responsibility for operations and day-to-day management of the Red Cross.
 3. In addition to amending the Bylaws, the Board should adopt a detailed statement of its core governance responsibilities. This statement should be incorporated into a set of governance principles that would be approved by the Board.
 4. The Board should focus its meetings on in-depth discussions and may include outside experts at Board meetings.

Changes to the Charter

In addition to amending the Bylaws to clarify the Board’s role, the Charter should be amended to replace references to Board “management” with references to directing and overseeing management. As noted above, responsibility for “management” as applied to an organization’s governing board generally has been understood to include the supervision and oversight of individuals to whom the board has delegated authority and responsibility for managing day-to-day operations. However, given the structural, cultural and historical factors that have blurred the distinction between governance and management functions at that Red Cross, the language of the Charter should be clarified, so it states that the Board is “overseeing the management of the business and affairs” of the Red Cross rather than that the Board has “all powers” of “managing” the Red Cross.

B. SIZE AND COMPOSITION OF THE BOARD

Introduction

In light of changes in the Red Cross and governance best practices since the Charter was last amended in 1947, it is appropriate to consider the appropriate size and composition of the Board for the 21st century.

Background

The Charter,¹⁷⁹ as clarified by the Bylaws,¹⁸⁰ provides for a Board of 50 members, composed of eight Presidentially-appointed members including the Chairman,¹⁸¹ 30 members elected by the chartered units,¹⁸² and 12 at-large Governors.¹⁸³ The 50-member Board, which replaced the prior 18-person governing body, was implemented in the 1947 Charter amendments in light of the need to reflect input from the large number of chapters at the time. The Harriman Committee recommended increasing the size of the Board, stating that the 18-member governing body was “inadequate to the needs of the organization,” which, by 1946, had grown to 3,745 chapters.¹⁸⁴ The expanded Board was intended to allow “proper geographical [and] other types of representation” while “avoid[ing] the difficulties of unwieldy size.”¹⁸⁵ Specific reference was made to the use of “executive and subcommittees to assist in the efficient handling of the affairs of the organization.”¹⁸⁶

In recent years, the size of the Board has been criticized as too large and unwieldy by those who believe that a smaller Board would facilitate discussion and prioritization, permit more flexible scheduling and agenda setting, and provide for more effective and efficient oversight.¹⁸⁷ Based on information gathered in connection with the Governance Audit, others

¹⁷⁹ Charter, § 4(a).

¹⁸⁰ Bylaws, § 2.2.

¹⁸¹ Charter, § 4(a)(1)(A). Currently, the seven Presidentially-appointed Board members in addition to the Chairman are the Secretaries of Health and Human Services, Homeland Security, Veterans Affairs, State, Commerce and Education and the Chairman of the Joint Chiefs of Staff. *See* Corporate Governance Directory: American Red Cross Board of Governors 2005 – 2006.

¹⁸² The Charter provides for election of 30 Board members by “chapters.” Charter, § 4(a)(1)(B). Under the Bylaws, the 30 Board members are to be elected by “chartered units,” defined as chapters and blood services regions chartered by the Board. Bylaws, § 1.3.

¹⁸³ Charter, § 4(a)(1)(C).

¹⁸⁴ Harriman Report, at 19. *See* discussion under Section 1, “History of Red Cross Governance” above.

¹⁸⁵ Harriman Report, at 19. *See* discussion under Section 1, “History of Red Cross Governance” above.

¹⁸⁶ Harriman Report, at 19 & 25 – 26.

¹⁸⁷ Advocates of a smaller board for the Red Cross include governance experts, such as Peter Dobkin Hall and Paul Light. *See* Nicole Gaouette, *Red Cross Chief Quits, Internal Politics Blamed: Officials in the Relief Organization say Marsha J. Evans’ Resignation has Nothing to do with Her Performance after Hurricane Katrina*, L.A. Times, Dec. 14, 2005, at A20; *see also* Peter D. Hall, *Red Cross Crisis*, Nonprofit Quarterly, Dec. 2005; Interview by Margaret Weaver with Paul Light, Paulette Goddard Professor Service, New York

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believe that a relatively large Board is justified by the complexity of the Red Cross and its operations, resulting in a substantial workload for Board members. Moreover, a larger Board provides an opportunity for greater diversity and can facilitate fundraising.¹⁸⁸ Like many entities with large boards, the Board relies heavily on active committees.¹⁸⁹

The Charter provided for Presidential appointees on the Board because the Red Cross performs certain treaty obligations and has “responsibilities in the field of disaster relief, health and welfare,” which were thought to require a close affiliation with the federal government.¹⁹⁰ In addition to being the only volunteer organization with a role under the Geneva Conventions,¹⁹¹ the Red Cross is the only nongovernmental organization with primary agency responsibilities under the National Response Plan.¹⁹²

Among Board members, Presidential appointees other than the Chairman rarely attend Board meetings.¹⁹³ Many Presidential appointees send representatives to Board and committee meetings; such representatives participate in discussions, but do not vote.¹⁹⁴ While

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University, on PBS (Dec. 14, 2005). See also Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-11 (March 15, 2006) (noting that a 50-member board is without precedent among federally-chartered entities, that a board of this size may suffer from “too many cooks in the kitchen,” and may not comport with the board’s role of oversight rather than involvement in day-to-day operations).

¹⁸⁸ See William G. Bowen, *Inside the Boardroom: A Reprise* 3, 5, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* (Victor Futter et al., eds. 2002); Sandra R. Hughes et al., BoardSource, *THE BOARD BUILDING CYCLE: NINE STEPS TO FINDING, RECRUITING, AND ENGAGING NONPROFIT BOARD MEMBERS* 8 (2000).

¹⁸⁹ See AMERICAN BAR ASSOCIATION, *CORPORATE DIRECTORS GUIDEBOOK* 29 (4th ed. 2004) (“Large boards often resolve . . . participation problem[s] through delegation of many significant activities to board committees.”). See discussion under Section 4E, “Background” below.

¹⁹⁰ Harriman Report, at 20. See also Sturges, Wesley A., *The Legal Status of the Red Cross*, 56 Mich. L. Rev. 1, 9 (1957) (“importance of the work to be done by the corporation required that it be put under government supervision.”).

¹⁹¹ See *The Federal Charter of the American Red Cross*, available at <http://www.redcross.org/museum/history/charter.asp> (last visited Sept. 18, 2006); Harriman Report, at 13 – 14.

¹⁹² National Response Plan, Emergency Support Function (“ESF”) Annex # 6 – Mass Care, Housing, and Human Services. Additionally, the Red Cross serves as a “support agency” for other National Response Plan “emergency support functions.” Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional charter of the American National Red Cross: Overview, History, and Analysis* CRS-4 – CRS-5 (March 15, 2006).

¹⁹³ A Presidential appointee was in attendance at only four of the 23 Board meetings held between October 2000 and May 2005. During that period, no Presidential appointee attended more than a single meeting. See Letter from Bonnie McElveen-Hunter, Chairman, American Red Cross, to Senator Charles Grassley, Chairman, Committee on Finance, U.S. Senate (Jan. 31, 2006) (Attachment B –Board Attendance Information), available at <http://www.senate.gov/~finance/sitepages/grassley.htm> (last visited Sept. 25, 2006).

¹⁹⁴ See Harvey Lipman, *Top White House Officials on the Red Cross Board Rarely Attend Meetings*, *THE CHRONICLE OF PHILANTHROPY* (March 13, 2006), available at <http://philanthropy.com/free/update/2006/03/2006031301.htm> (last visited Sept. 18, 2006).

representation of Presidential appointees at meetings is not uniform, those representatives who consistently attend are said to be constructive participants, based on information gathered in connection with the Governance Audit. This information also indicates that representatives of Presidential appointees who attend meetings generally believe that they serve an important liaison and communication role between the Red Cross and their respective Departments.

Commentators have suggested that the President should not appoint Cabinet members because the attendance records demonstrate that most Presidential appointees do not participate directly in Board deliberations.¹⁹⁵ Potential conflicts of interest also have been raised as a concern with respect to some Presidential Board appointees.¹⁹⁶ For example, it has been suggested that matters involving the Red Cross' compliance with FDA blood program-related requirements may pose a conflict for the Secretary of the Department of Health and Human Services, and that matters involving FEMA's and the Red Cross' respective responsibilities under the National Response Plan may pose a conflict for the Secretary of Homeland Security.¹⁹⁷

Under the Charter, Board members elected by the chartered units now comprise 60% of the total Board. The 1947 amendments to the Charter changed the composition of the Board to add members elected from the "field" in order to give local chapters greater influence and make the governing body of the Red Cross more "democratic."¹⁹⁸ In contrast to the 3,745 chapters at the time that a 50-member Board was deemed appropriate, the Red Cross now has just under 800 chapters and 35 blood services regions. Additionally, chapters now operate pursuant to uniform operational and governance standards and requirements, and formal reporting relationships to the national organization through Service Areas.¹⁹⁹

Board members—whether elected by the chartered units or the Board—participate in an orientation and mentoring program following election to the Board.²⁰⁰ At Board orientation, Board members are educated as to their role, duties and responsibilities and are reminded of their obligation to act with the best interests of the Red Cross in mind, rather than as representatives of any constituency.²⁰¹ Information gathered in connection with the Governance Audit indicates that current Board members elected from the field generally viewed their role from the

¹⁹⁵ See *id.* (noting that six of the Presidential appointees did not attend any Board meetings between October 2000 and May 2005).

¹⁹⁶ See *id.*

¹⁹⁷ See *id.* (noting the concern of Donna Shalala, Secretary of the Department of Health and Human Services, about "the conflict-of-interest situation" of the Secretary, and quoting Secretary Shalala as stating that legal counsel advised her "that serving on the board was indeed a problem").

¹⁹⁸ Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-10 (March 15, 2006). See discussion under Section 1, "History of Red Cross Governance" above.

¹⁹⁹ See discussion under Section 4H, "Background" below.

²⁰⁰ See American Red Cross Corporate Governance Manual 2005 – 2006, at 6.

²⁰¹ See American Red Cross Board of Governors Reference Guide, 2006; see also American Red Cross Corporate Governance Directory 7 (2005-2006) (Board members are assessed on their objectivity and independence, among other things).

perspective of the organization as a whole, not from the viewpoint of a particular chapter or blood services region. As expressed in the Harriman Report, “[e]very member of the [Board], once chosen, must regard himself as a Governor of the Red Cross, and not as the special representative of any particular element of the national life.”²⁰²

Under the Charter, Board members serve staggered three-year terms,²⁰³ and the Bylaws further provide that chartered unit-elected and at-large Board members are ineligible for re-election for at least two years after serving two consecutive three-year terms.²⁰⁴

While the Red Cross has not adopted formal standards for addressing the independence of Board members, independence-related inquiries are made of Board members. No current Board member has a “material personal or professional relationship” with the Red Cross or with management. Consequently, each Board member has been determined to be independent.²⁰⁵ Each Board member also is subject to prohibitions on: (1) accepting personal remuneration for work performed as an employee or under contract for any Red Cross unit during the member’s Board term; and (2) holding any other appointed, elected or voting governance position or volunteer management position with the Red Cross (unless appointed by the Chairman, the Board or a Board committee).²⁰⁶ A Code of Conduct applicable to Board members addresses conflicts of interest, among other topics, and complements these independence-related proscriptions, as do Policy Manual provisions detailing a Board member’s duty of loyalty to the organization.²⁰⁷

Analysis

Size of the Board

Determining the right size and composition for a nonprofit board is difficult, and may be “[t]he single biggest obstacle faced by nonprofit boards in achieving effective governance.”²⁰⁸ There is general agreement that a “one size fits all” approach to creating a nonprofit board is not appropriate.²⁰⁹ Among nonprofit organizations, major differences in “mission, size, numbers of employees, endowments, membership, relationships with affiliates” and other factors all affect

²⁰² Harriman Report, at 23.

²⁰³ Charter, §§ 4(a)(2) & 4(b)(1).

²⁰⁴ Bylaws, § 2.3.

²⁰⁵ American Red Cross, *The Governance Structure of the American Red Cross* 9 (Jan. 2006).

²⁰⁶ Policy Manual, Pt. 1, §§ 1.5.5 – 1.5.6.

²⁰⁷ *Id.*, Pt. 1, § 1.5.2.

²⁰⁸ Daniel L. Kurtz, *The Sarbanes-Oxley Act of 2002: Lessons for Nonprofits*, Practising Law Institute, Tax Law and Estate Planning Course Handbook Series, PLI Order Number J0-009A (2003) 81, 119 – 121.

²⁰⁹ See Panel on the Nonprofit Sector Final Report, at 7; Daniel L. Kurtz, *The Sarbanes-Oxley Act of 2002: Lessons for Nonprofits*, Practising Law Institute, Tax Law and Estate Planning Course Handbook Series, PLI Order Number J0-009A (2003) 81, 98; Candace Widmer & Susan Houchin, *Governance of National Federated Organizations*, The Aspen Institute, at 33 (1999) (hereinafter, the “Aspen Institute Study”).

optimal board size and make it difficult to recommend one board size for all organizations.²¹⁰ Nevertheless, a nonprofit organization “should review its board size periodically to determine the most appropriate size to ensure effective governance and to meet the organization’s goals and objectives.”²¹¹

Despite the difficulty in prescribing a uniform size, as noted by Ira Millstein, “[g]enerally, the non-profit sector, like the commercial sector, has come to recognize that smaller boards—which meet more frequently and have standing committees focused on particular issues relevant to the organization—are more effective than overly large boards.”²¹² While some experts note that a larger board may be necessary to ensure the range of perspectives and expertise required for some organizations or to share fundraising responsibilities,²¹³ others “argue that effective governance is best achieved by a smaller board, which . . . demands more active participation from each member.”²¹⁴

²¹⁰ See Daniel L. Kurtz, *The Sarbanes-Oxley Act of 2002: Lessons for Nonprofits*, Practising Law Institute, Tax Law and Estate Planning Course Handbook Series, PLI Order Number J0-009A (2003) 81, 119 – 121.

²¹¹ Panel on the Nonprofit Sector Final Report, at 75.

²¹² Ira M. Millstein, *Progress Report on The Nature Conservancy* 6 (Apr. 19, 2005) available at <http://www.nature.org/aboutus/leadership/art15519.html> (last visited Sept. 18, 2006) (hereinafter, the “Millstein Report”); see also *id.* (both commercial and nonprofit boards should have nine to 15 members); William G. Bowen, *Inside the Boardroom: A Reprise* 3, 5, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* (Victor Futter et al., eds. 2002) (“Overly large boards are an especially serious problem in much of the nonprofit sector.”); Ronald C. Moe & Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *Federal Government Corporations: An Overview* CRS-12 (March 23, 2006) (“Large boards (comprising more than 12 members) . . . may experience difficulty in making decisions.”); Donors Forum of Chicago, “Illinois Nonprofit Principles and Best Practices” (2005), available at <http://www.donorsforum.org/publictrust/howto2c.html> (last visited Sept. 18, 2006) (“Although there are currently no laws limiting the number of members of nonprofit governing bodies, the median size is 17 and some experts recommend 13-15 members to operate effectively.”); Panel on the Nonprofit Sector Final Report, at 75 (“Other problems emerge when a board disperses responsibility among many people, thereby lessening the obligations of each.”).

²¹³ Panel on the Nonprofit Sector Final Report, at 77.

²¹⁴ *Id.* See also American Bar Association, ABA Coordinating Committee on Nonprofit Governance, *Guide to Corporate Governance in the Wake of Sarbanes-Oxley* 21 (2005); Discussion Draft, U.S. Senate Finance Committee, at 13 (2004) (suggesting that the size of nonprofit boards be set at “no less than three members and no more than fifteen”); Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-11 (March 15, 2006) (larger board “may suffer from the problem of ‘too many cooks in the kitchen.’”). Note that some authorities have cautioned against boards that are too small to allow for sufficient deliberation and diversity of perspectives. See, e.g., Minnesota Council of Nonprofits, “Principles & Practices for Nonprofit Excellence” 7 (2005) (recommending that nonprofit boards consist of at least seven individuals); Panel on the Nonprofit Sector Final Report, at 7 (suggesting a minimum of three members); BBB Wide Giving Alliance Standards for Charity Accountability, available at <http://www.give.org/standards/newcbbbstds.asp> (last visited Sept. 18, 2006) (suggesting a minimum of five voting members).

Empirical studies also support the conclusion that small boards are more effective and more efficient.²¹⁵ Although the considerations for nonprofit organizations are somewhat different, studies support this conclusion in the nonprofit context as well.²¹⁶ For example, median board size among nonprofits participating in BoardSource surveys declined from 17 members in 1994 to 15 members in 2004.²¹⁷

Two large nonprofit organizations that recently studied their governance practices, the United Way and The Nature Conservancy, concluded that smaller governing boards were desirable. The Nature Conservancy reduced its board from 40 to 21 members²¹⁸ after determining that “a 40-member Board could not govern effectively, no matter how qualified the members were; there were simply too many of them to operate as a modern, hands-on board.”²¹⁹ After study, the organization concluded that a smaller board would “improve [its] effectiveness without compromising the necessary oversight for what is a very large and complex

²¹⁵ See, e.g., David Yermack, *Higher Valuation of Companies with a Small Board of Directors*, 40 JOURNAL OF FINANCIAL ECONOMICS, 185 – 212 (1996); Katherine O’Regan & Sharon M. Oster, *Does the Structure and Composition of the Board Matter? The Case of Nonprofit Organizations*, 21 JOURNAL OF LAW, ECONOMICS, AND ORGANIZATION 208 (2005) (citing study supporting conclusion that as board sizes increase, free-rider problems increase and board effectiveness declines); Lawrence Brown & Marcus Caylor, *Corporate Governance and Firm Performance*, Dec. 7, 2004 at 6, available at <http://www.issproxy.com/pdf/Corporate%20Governance%20Study%201.04.pdf> (last visited Sept. 25, 2006) (larger boards have poorer communication and decision-making (citing Martin Lipton & J. W. Lorsch, *A Modest Proposal for Improved Corporate Governance*, 48 BUS. LAW. 1 (1992), and Michael Jensen, *The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems*, 48 JOURNAL OF FINANCE (1993)); board sizes between six and 15 have higher returns on equity and higher net profit margins); Michael Jensen, *The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems*, 48 JOURNAL OF FINANCE (1993) (“when boards get beyond seven or eight people they are less likely to function effectively”). See also Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921, 941 (1995) (noting belief that “a board’s effectiveness may decline as board size increases beyond a moderate number (typical suggestions are for a board of seven to nine members)” and citing studies reporting evidence that “some boards may be too large”).

²¹⁶ See Katherine O’Regan & Sharon M. Oster, *Does the Structure and Composition of the Board Matter? The Case of Nonprofit Organizations*, 21 JOURNAL OF LAW, ECONOMICS, AND ORGANIZATION 206 (2005) (large board size, “common among nonprofits,” is associated with lower levels of monitoring the organization).

²¹⁷ BoardSource, *Nonprofit Governance Index 2004: Executive Summary* 4 (2005) available at http://www.boardsource.org/dl.asp?document_id=424#search=%22boardsource%20nonprofit%20governance%20index%22 (last visited Oct. 8, 2006). Average (mean) board size decreased, from 19 members in 1994 to 17 members in 2004. According to BoardSource, the average is slightly higher as a few respondents reported “extraordinarily” large boards. *Id.*

²¹⁸ See The Nature Conservancy, *Summary of Actions Taken to Strengthen Governance, Policies and Procedures June 2003 – May 13, 2005*, available at <http://www.nature.org/aboutus/leadership/art15473.html> (last visited Sept. 18, 2006).

²¹⁹ The Nature Conservancy, *Summary of Actions Taken to Strengthen Governance, Policies and Procedures June 2003 – May 13, 2005*, available at <http://www.nature.org/aboutus/leadership/art15473.html> (last visited Sept. 18, 2006).

organization.”²²⁰ Similarly, the United Way reduced the size of its board from 50 to a range of 20 to 40 after its governance study, and currently has 26 board members.

The trend toward smaller boards also is manifest among for-profit entities.²²¹ Best governance practices in the for-profit context favor smaller boards.²²² “Directors serving on a smaller board will have more opportunity to participate actively in board deliberations, whereas larger boards may inhibit effective participation by individual members.”²²³ Some experts suggest that corporate boards should have no more than ten members, with 12 being the absolute maximum.²²⁴ A 2005 survey of the 500 largest public companies indicated that the average corporate board of directors had 10.7 members, with two-thirds having nine to 12 directors.²²⁵

Some experts caution, however, that for-profit best practices may require adjustment in the nonprofit context: “a larger board may be necessary [for some nonprofits] in order to ensure the range of perspectives required or to share fundraising responsibilities.”²²⁶ Several surveys support the conclusion that nonprofit boards tend to be somewhat larger than for-profit boards.²²⁷ For example, a 2004 survey by BoardSource found that the median nonprofit governing body in 2004 was 17 members.²²⁸ While nonprofit boards may be somewhat larger than for-profit boards, large size nevertheless may impair effectiveness.²²⁹

²²⁰ Hank Paulson, Former Chairman of The Nature Conservancy’s Board of Directors, *in* Press Release, *Nature Conservancy Further Restructures Board to Strengthen Organization’s Governance* (May 16, 2005), available at <http://www.nature.org/pressroom/press/press1927.html> (last visited Sept. 18, 2006).

²²¹ Robert A.G. Monks & Nell Minow, *CORPORATE GOVERNANCE* 198 (3d ed. 2004) (Boards of directors “have made great strides in paring back to a more workable size” (quoting Spencer Stuart’s annual survey of board practices)).

²²² Business Roundtable 2005 Principles of Corporate Governance, at 13; *see* BACK TO THE DRAWING BOARD, at 17 (“Boards should be as small as feasible.”); The Millstein Report, at 6.

²²³ AMERICAN BAR ASSOCIATION, *CORPORATE DIRECTOR’S GUIDEBOOK* 29 (4th ed. 2004).

²²⁴ *See* BACK TO THE DRAWING BOARD, at 89.

²²⁵ *See* Spencer Stuart Board Index 7 (2005), available at <http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI-2005.pdf> (last visited Sept. 18, 2006).

²²⁶ Panel on the Nonprofit Sector Final Report, at 75. *See also* William G. Bowen, *Inside the Boardroom: A Reprise* 3, 5, *in* Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* (Victor Futter et al., eds. 2002) (“[F]or-profit boards should normally have no more than ten to fifteen members. Many nonprofit boards need to be larger, primarily because of the twin needs to represent more diverse constituencies and to raise money.”); Minnesota Council of Nonprofits, “Principles & Practices for Nonprofit Excellence” 7 (2005) (“To allow for sufficient deliberation and diversity of perspectives, nonprofit boards should consist of no fewer than seven individuals.”).

²²⁷ *See* Francie Ostrower & Melissa M. Stone, *Governance: Research, Trends, Gaps, and Future Prospects* 7 (2005), available at <http://www.hhh.umn.edu/img/assets/9684/OstrowerStone.pdf> (last visited Oct. 8, 2006) (citing several studies finding that nonprofit boards are larger than corporate boards); Donors Forum of Chicago, “Illinois Nonprofit Principles and Best Practices” (2005), available at <http://www.donorsforum.org/publictrust/howto2c.html> (last visited Sept. 18, 2005).

²²⁸ BoardSource, *Nonprofit Governance Index 2004: Executive Summary* 4 (2005), available at [http://www.boardsource.org/dl.asp?document_id=424#search=%22boardsource%20nonprofit%20governance%](http://www.boardsource.org/dl.asp?document_id=424#search=%22boardsource%20nonprofit%20governance%20)

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In addressing the appropriate size and composition of the Board, consideration of the functions currently performed by the Board is important.²³⁰ As discussed above under “Role of the Board,”²³¹ members of the Board perform multiple functions. In addition to their governing role, many Board members, particularly those elected by the chartered units, have relevant and valued experience and knowledge with respect to Red Cross matters. As a result, Board members often serve with management on task forces that are formed to address operational and other issues. Similarly, the representatives of the Presidential appointees provide input to, and assist management with respect to, issues within their areas of expertise and also serve as a conduit to government functions that relate to the Red Cross’ mission. Many of these functions are important—and, in some cases, critical to Red Cross operations—but do not necessarily relate to governance and oversight and are not appropriate Board functions.²³²

Another aspect of board functioning consists of committee responsibilities. The Board presently has a number of committees, which are addressed below in this report.²³³ Because all of the Board’s committees other than the Executive Committee were established pursuant to the Bylaws, the Board has considerable flexibility in changing its committee structure. As a legal matter, however, the FDA Consent Decree currently restricts the Board’s ability to change or eliminate the Biomedical Services Committee without notification to the FDA.²³⁴ To the extent that the committee structure is streamlined with fewer and smaller committees focused on oversight and governance, the Board structure likewise can be streamlined.

Red Cross-Specific Factors

Thus, in addition to taking best governance practices into account, a number of Red Cross-specific factors should be considered in developing the most effectively structured Board for the Red Cross. These include: (1) maintaining the significant and essential role of volunteers in the Red Cross; (2) facilitating efficient Board oversight and strategic decision-making (but not management) in the context of the Red Cross’ business; (3) preserving vital input from chapters and blood services regions; and (4) sustaining a close nexus to applicable government departments and agencies. These multiple goals could be achieved by separating the current

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20index%22 (last visited Oct. 8, 2006). A survey of Illinois nonprofits likewise found a median nonprofit board size of 17. Donors Forum of Chicago, “Illinois Nonprofit Principles and Best Practices” (2005), *available at* <http://www.donorsforum.org/publictrust/howto2c.html> (last visited Sept. 18, 2005) (noting that “some experts recommend 13-15 members to operate effectively”).

²²⁹ See, e.g., Millstein Report, at 4 (“[A] 40-member Board could not govern effectively, no matter how qualified the members were; there were simply too many of them to operate as a modern, hands-on board.”)

²³⁰ BACK TO THE DRAWING BOARD, at 8 – 9 (board structure, composition and processes must be “aligned to the role [the board] intends to play and to the complexity of the company”).

²³¹ See discussion under Section 4A, “Analysis” above.

²³² *Id.*

²³³ See discussion under Section 4E, “Background” below.

²³⁴ See footnote 173 above.

Board into several bodies, based on function.²³⁵ Specifically, the governance structure of the Red Cross could be tailored to its functions by creating: (1) a governing body to focus on oversight and strategic decision-making; (2) a chartered unit body to obtain input from the chapters and blood services regions for the governing body and management and to communicate back to the chapters and blood services regions; and (3) a body that includes federal government representatives to foster the requisite government nexus and secure applicable government input and advice.²³⁶

Governing Function

A smaller governing board could perform the oversight responsibilities discussed above in this report under “Role of the Board.” A smaller oversight board would address concerns about the efficiency and effectiveness of a larger governing body while preserving the Red Cross’ ability to achieve diversity, attract Board members with specialized skills and expertise, secure fundraising assistance and include a member or two who would liaise with the chartered unit body. Recommendations regarding selection of nominees to the governing Board are discussed below under Section 4C, “Board Selection.”

Advisory Functions

Two advisory groups, a National Leadership Council and a Cabinet Council, could perform some of the nongovernance roles performed by current Board members, among other things.

National Leadership Council. The National Leadership Council could communicate input from chapters, blood services regions, volunteers and donors. Input could encompass operational as well as policy and strategic matters. As a body that will address primarily operational matters, the National Leadership Council should report directly to the CEO. Specifics regarding membership selection and terms, frequency of meetings, and relationship with management and the Board should be determined with significant input from chapter and blood services region employees and volunteers in the field. The relationship between, and coordination of functions of, the National Leadership Council and the Presidential Advisory Council²³⁷ also should be considered and defined.

²³⁵ See James J. Fishman, *The Development of Nonprofit Corporation Law and an Agenda for Reform*, 34 EMORY L. J. 617, 679 – 83 (1985) (suggesting bifurcating nonprofit boards into oversight and advisory components to improve oversight and encourage “directorial responsibility”).

²³⁶ See Michael Klausner & Jonathan Small, *Failing to Govern?: The Disconnect between Theory and Reality in Nonprofit Boards, and How to Fix It*, THE INT’L JOURNAL OF NOT-FOR-PROFIT LAW, Vol. 7, No. 3 (June 2005), available at http://www.icnl.org/knowledge/ijnl/vol7iss3/art_5.htm#_ednref13 (last visited Sept. 18, 2006) (advocating bifurcated nonprofit boards).

²³⁷ The Presidential Advisory Council is composed of chapter executives who provide “input and feedback to the President and CEO on opportunities, challenges, and/or concerns affecting the organization. The council considers strategic priorities, joint (national-chapter) fundraising strategies, parameters for chapter assessment, leadership development, revenue generation opportunities, and emerging issues facing the organization.” The Council is currently composed of 15 chapter executives and one *ex officio* blood services region chief executive.

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Cabinet Council. The Cabinet Council would have a nongovernance function, and it would report to the Board. The members should be Cabinet members and other senior government officials appointed by the President of the United States and should meet with the Board at least once a year. This Council would preserve the formal ties that the Red Cross has with various government agencies and facilitate the ongoing close working relationships that are necessary in view of Red Cross responsibilities. Government departments and agencies important to the Red Cross mission include the Departments of Defense, Health and Human Services, Homeland Security, State, Education, Commerce, Veterans Affairs and the Joint Chiefs of Staff. Relieving government representatives of oversight and governance responsibilities would eliminate potential conflicts of interest and concerns about attendance at Board meetings.

Experts agree that advisory bodies are a “way to expand resources available to the board.”²³⁸ They are a useful way to enable “a board to enlist the interest and activity of individuals who would be too numerous to serve on the board directly.”²³⁹ Advisory bodies serve the additional role of linking the organization to “key stakeholders” in the organization.²⁴⁰ Such bodies “add [capacity] without, in most cases, undermining the strengths of the current board of directors.”²⁴¹ Moreover, they link organizations to many different constituencies, including “government agencies; business, corporate, banking, legal and other professional groups; foundations; the press; arts audiences; and individual donors.”²⁴² The Red Cross currently makes use of a number of advisory councils and groups, including: the Presidential Advisory Council, composed of chapter executives; and the Liberty Oversight Commission; Museum Advisory Council; National Diversity Advisory Council; National Nursing Committee; and National Youth Council, all composed of volunteers.

Several other nonprofit organizations make effective use of advisory boards or auxiliary groups to provide additional field or other perspectives. The Nature Conservancy has a trustee council made up of one representative from each of its 55 chapters, which provides input from the local level to the national organization. The co-chairs of the trustee council are selected from the governing board and have a chapter background, which helps to create synergy between the council and the board. Similarly, the U.S. Salvation Army has a National Advisory Board of 50 to 70 members that advises the Commissioners’ Conference (its governing body) on issues of

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In order to be selected for the Presidential Advisory Council, a member must be a full-time chapter executive with at least two years as a full-time executive and have extensive additional volunteer leadership experience. Each member serves a three-year term, with one-third of the Presidential Advisory Council rotating off each year. *See* American Red Cross Presidential Advisory Council Charter.

²³⁸ Sandra R. Hughes et al., BoardSource, *THE BOARD BUILDING CYCLE: NINE STEPS TO FINDING, RECRUITING, AND ENGAGING NONPROFIT BOARD MEMBERS* 9 (2000); *see also* Aspen Institute Study, at 3; ABA GUIDEBOOK, at 94.

²³⁹ ABA GUIDEBOOK, at 94.

²⁴⁰ *See* Judith R. Saidel & Alissandra M. D’Aquanni, *Expanding the Governance Construct: Functions and Contributions of Nonprofit Advisory Groups*, The Aspen Institute, at 1 (1999).

²⁴¹ *Id.*

²⁴² *Id.*

national significance and provides guidance for programs and services throughout the United States. The National Advisory Board is made up of community, corporate and civic leaders from across the United States, with members often drawn from the Salvation Army's local advisory organizations. The Smithsonian Institution also has an advisory board, the 47-member Smithsonian National Board, that is made up of national business, legal and community leaders and advises the Secretary (who is the chief executive) on issues of institutional advancement, fosters communication between the Smithsonian and its various constituencies, and works to promote public-private partnerships. In addition, the American Cancer Society and other medical societies use "reference forums," which are non-board councils that conduct town hall-type meetings²⁴³ on particular issues and present their findings to the board.

An advisory council also can be an effective mechanism to develop future board members. Particularly dedicated members of an advisory council who possess skills that the board seeks might be targeted as potential future board members. Some organizations require that prospective board members serve in a volunteer capacity before joining the governing board.²⁴⁴ Conversely, if a board member has particularly useful skills that the organization would like to employ after expiration of the board term, that person might be targeted for advisory board service at that time.²⁴⁵

Composition of the Board

While the Red Cross is a Congressionally-chartered organization,²⁴⁶ it is in a class of its own.²⁴⁷ Although Congress has chartered approximately 100 nonprofit organizations,²⁴⁸ only the Red Cross is classified as a "treaty obligation organization."²⁴⁹ Likewise, only the Red Cross has nationwide responsibilities under the National Response Plan as a nongovernmental entity, and only the Red Cross has a significant role in nationwide healthcare by providing a substantial

²⁴³ See Aspen Institute Study, at 3.

²⁴⁴ Sandra R. Hughes et al., BoardSource, *THE BOARD BUILDING CYCLE: NINE STEPS TO FINDING, RECRUITING, AND ENGAGING NONPROFIT BOARD MEMBERS* 14 (2000).

²⁴⁵ See Judith R. Sidel & Alissandra M. D'Aquanni, *Expanding the Governance Construct: Functions and Contributions of Nonprofit Advisory Groups*, The Aspen Institute, at 13 – 14 (1999).

²⁴⁶ Ronald C. Moe & Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *Federal Government Corporations: An Overview* CRS-10 (March 23, 2006). The governance of Congressionally-created corporations varies greatly; such entities do not all have boards of directors and not all existing boards of such entities include Presidentially-appointed board members.

²⁴⁷ Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *The Congressional Charter of the American National Red Cross: Overview, History, and Analysis* CRS-3 (March 15, 2006) ("The [Red Cross] is a somewhat unusual case. Although its charter may be found in Title 36 of the U.S. Code, the organization bears little resemblance to the other congressionally chartered charitable entities found there.").

²⁴⁸ *Id.* (citing Ronald C. Moe, U.S. Library of Congress, Congressional Research Service, *Congressionally Chartered Nonprofit Organizations ("Title 36 Corporations"): What They Are and How Congress Treats Them* (Apr. 8, 2004)).

²⁴⁹ *Id.* See also discussion under Section 1, "Unique Status and Responsibilities of the Red Cross" above.

portion of the nation's blood supply. The composition of the Board must be evaluated in this context.²⁵⁰

Presidential Appointees

Given the Red Cross' disaster relief mission and its responsibilities under the Geneva Conventions and the National Response Plan, a close relationship between the Red Cross and certain government agencies is important.²⁵¹ In particular, access to senior officials at the Department of Defense, the Joint Chiefs of Staff, the Department of Homeland Security and the Department of Health and Human Services is viewed as critical during major disasters. Having Presidentially-appointed Board members may be seen as important to, and as properly reflecting the significance of, the Red Cross' responsibilities.

The sporadic attendance of Presidentially-appointed Board members, however, necessarily limits the involvement of Presidential appointees in Board matters. Understandably, the full workload and schedules of Cabinet secretaries may preclude their more active participation. Indeed, the Red Cross' experience with Presidential appointees is consistent with the attendance records of Cabinet secretaries on other federally-chartered corporation boards.²⁵² Based on information gathered in connection with the Governance Audit, even when Presidential appointees or their representatives do participate in Board matters, their participation often is limited to matters involving their respective departments or agencies.

The participation of Cabinet-level officials on boards—even boards of federally-chartered entities—can create confusion as to their roles, as well as inherent conflicts.²⁵³ For example, should a Presidential appointee acting as a Red Cross Governor evaluate decisions in light of policies adopted by that appointee's department or agency, or is the appointee obligated to act from a neutral perspective?²⁵⁴ Should a Presidential appointee be recused when the Board is discussing matters involving regulatory supervision of the Red Cross by a department or agency for which the appointee is responsible?

One alternative to full Board membership for Presidential appointees would be to have the Presidential appointees serve as *ex officio* members of the Board with no voting rights,

²⁵⁰ See BACK TO THE DRAWING BOARD, at 8 – 9 (board structure, composition and processes should be aligned to the organization's role and complexity).

²⁵¹ See Harriman Report, at 20.

²⁵² Ronald C. Moe & Kevin R. Kosar, U.S. Library of Congress, Congressional Research Service, *Federal Government Corporations: An Overview*, CRS-10 n.37 (March 23, 2006) (“Cabinet secretaries placed on corporate boards . . . rarely attend such meetings, sending subordinates instead to protect departmental interests.”).

²⁵³ See *id.* at CRS-10 – CRS-11 & n.37 (discussing evidence of the problems that some analysts contend are associated with boards of directors that include cabinet officials).

²⁵⁴ *Id.*

similar to the approach adopted by some other federally-chartered entities.²⁵⁵ A non-voting *ex officio* position would parallel actual practice, where Presidential appointees rarely attend meetings and their representatives in attendance do not vote. *Ex officio* status, however, often presents problems.²⁵⁶ While the title suggests an official office or position, paradoxically the title also suggests a position that is not regarded as fully participating.²⁵⁷ The vague status of *ex officio* board members also may create other issues, such as whether the presence of an *ex officio* board member destroys attorney-client privilege in sensitive situations.²⁵⁸

The desire to preserve and foster a close relationship between the Red Cross, on the one hand, and relevant governmental bodies and their senior officials, on the other hand, coupled with the impracticality of obtaining meaningful Board participation by Cabinet-level officials and the issues raised by *ex officio* status, suggest that a preferred approach would be for government officials to participate in Red Cross matters through a Cabinet Council, as discussed above.

Chartered Unit-Elected Governors

Because many service delivery and fundraising activities are conducted at the Red Cross chartered unit level, the “field” perspective is very important in governing the Red Cross. At the same time, as was recognized even in 1946, every member of the Board is a Governor of the Red Cross and not the “special representative of any particular element.”²⁵⁹ Good governance practices suggest that Board members should be selected based on knowledge, experience, expertise and competency in various, applicable areas.²⁶⁰

During the 60 years since the Board last was restructured, the number of chapters has decreased significantly (from 3,745 to just under 800) and a number of measures (such as the Service Area structure, the more recent Community Presence Initiative and the Chapter Performance Standards) have been adopted to organize and streamline chapter functions and monitor chapter performance.²⁶¹ Not only do these developments reflect the increasing need for

²⁵⁵ See, e.g., Corporation for National & Community Service, Export-Import Bank of the United States and The United States Institute for Peace.

²⁵⁶ See ABA GUIDEBOOK, at 9.

²⁵⁷ See *id.* at 10.

²⁵⁸ See *id.* at 9.

²⁵⁹ Harriman Report, at 22.

²⁶⁰ See The Nature Conservancy Report, at 9; see also William G. Bowen, *Inside the Boardroom: A Reprise* 3, 6, in Section of Business Law, American Bar Association et al., NONPROFIT GOVERNANCE AND MANAGEMENT (Victor Futter et al., eds. 2002) (“We should reject categorically any notion that individual board members are meant to represent particular constituencies.”).

²⁶¹ See discussion under Section 4H, “Background” below.

coordinated regional—and sometimes nationwide—Red Cross efforts, they reflect a heightened recognition of the Red Cross as a single entity that must be governed and managed as such.²⁶²

These developments in Red Cross organizational structure also suggest that, while input from the field continues to be important, reserving 60% of the Board seats for field-elected nominees is no longer necessary or appropriate. Indeed, current governance best practices would suggest that no Board seats be reserved for any constituency.²⁶³ Rather, Board members should be selected based on desired skills and attributes, as opposed to a representational or constituency-oriented basis.²⁶⁴ Insofar as chapter, local disaster and blood services experience continues to be critical, however, nomination of candidates with such “field” credentials, in addition to other skills and experience, should be actively encouraged.²⁶⁵

Eliminating designated “chartered unit seats” on the Board would not only reflect organizational and operational developments as well as current governance best practices, but will enhance the organization’s flexibility in the future. The Red Cross should have the ability to shift the composition of its Board over time based on then-applicable needs and priorities—without any need for a Charter change.

In addition to encouraging the nomination of Board members with chapter, blood services region or other relevant Red Cross experience, such input to the Board and management could be formalized in a National Leadership Council, as discussed above. The National Leadership Council would institutionalize a channel of communication between the chapters and blood services regions, and both the Board and management.

Independence

One trend that has characterized boards of directors over the past 20 years has been the rise of the “independent” outside director. Independent directors in the nonprofit sector generally are considered to be those “individuals who have received no compensation or material benefits directly or indirectly from the organization in the previous 12 months, whose compensation is not determined by other board or staff members, and who [are] not related to someone who received such compensation from the organization.”²⁶⁶ Some nonprofit organizations have established detailed definitions of independence similar to those adopted by public companies.²⁶⁷ The now well-established consensus for public company boards (and

²⁶² See discussion under Section 3, “A Changed Governance Landscape” above.

²⁶³ See William G. Bowen, *Inside the Boardroom: A Reprise* 3, 6, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* (Victor Futter et al., eds. 2002).

²⁶⁴ See *id.*

²⁶⁵ See discussion under Section 4C, “Nominations Process” below.

²⁶⁶ Panel on the Nonprofit Sector Final Report, at 7. A few states have enacted somewhat similar definitions with respect to those persons who may serve on nonprofit boards. See CAL. CORP. CODE § 5227 (West 2006); ME. REV. STAT. ANN. tit. 13-B, § 713-A (West 2005); N.H. REV. STAT. ANN. § 292:6-a (2006).

²⁶⁷ See, e.g., The Ford Foundation, NACD, United States Olympic Committee.

required by the NYSE and NASDAQ for listed companies)²⁶⁸ is that a majority of the board should consist of members who qualify as independent.²⁶⁹ In the nonprofit sector, there also has been a focus on board independence and a consensus has emerged that a significant portion of a board should consist of independent members.²⁷⁰

While the Red Cross has not adopted specific “independence standards” for its Board members, the Policy Manual specifically prohibits any Board member from “accept[ing] personal remuneration for work performed as an employee or under contract for any Red Cross unit.”²⁷¹ Additionally, the Policy Manual provides that no Board member “may hold any other appointed, elected or voting governance position or volunteer management position in the Red Cross” while serving on the Board unless specifically appointed to that position by the Chairman of the Board, the Board or a Board Committee.²⁷² Thus, chartered unit-elected Board members may not have any continuing governance positions with any chartered unit.

The Policy Manual does not prohibit Board members from volunteering for Red Cross activities in the chartered units or in connection with national or international disasters. With respect to indirect relationships that Board members may have with the Red Cross (for example, through affiliations with organizations that, in turn, have relationships with the Red Cross), the Policy Manual contains general conflict-of-interest procedures that govern these relationships. Under these procedures, if any Red Cross unit enters into a contractual arrangement with a company with which a Board member is affiliated, the relationship must be disclosed to the Red Cross, the work cannot be performed by the Board member, any benefit obtained by the member must be indirect, and the member must recuse himself or herself from any discussions or decisions regarding the matter.²⁷³

Commentators have pointed out that defining and encouraging Board independence enhances good governance. “More important is independent-mindedness, the ability to put the

²⁶⁸ See NYSE Listed Company Manual, § 303A.01 (2004); NASDAQ Marketplace Rules, Rule 4350(c) (2006).

²⁶⁹ See Business Roundtable 2005 Principles of Corporate Governance, at 14; see also BACK TO THE DRAWING BOARD, at 16; NACD Blue Ribbon Commission on Director Professionalism 11 (2005) (calling for a “substantial majority” of directors to be independent); Calpers Corporate Governance Core Principles & Guidelines (updated March 13, 2006), available at <http://www.calpers-governance.org> (last visited Sept. 25, 2006) (because “independence is the cornerstone of accountability,” a “substantial majority” of the board should consist of directors who are independent).

²⁷⁰ See Panel on Nonprofit Sector Final Report, at 7 (“one-third of the members of the organization’s governing board should be independent.”) See also BoardSource, *The Source: Twelve Principles of Governance that Power Exceptional Boards* principle 5 (2005) (describing board independence as a preeminent goal); American Bar Association, ABA Coordinating Committee on Nonprofit Governance, *Guide to Corporate Governance in the Wake of Sarbanes-Oxley* 23 – 28 (2005); Discussion Draft, U.S. Senate Finance Committee, at 13 (2004); BBB Wise Giving Alliance Standards for Charity Accountability, Standard 4, available at <http://www.give.org/standards/newcbbbstds.asp> (last visited Sept. 18, 2006) (no more than the greater of one or 10% directly or indirectly compensated persons shall serve as voting members of the board).

²⁷¹ Policy Manual, Pt. 1, § 1.5.5.

²⁷² *Id.*, Pt. 1, § 1.5.6.

²⁷³ *Id.*, Pt. 1, § 1.5.5.

organization's interests first; to establish a point of view separate from that of the chief executive, staff and board members; and to set aside personal agendas."²⁷⁴ Experts encourage boards "to establish strong and effective mechanisms to ensure that the board carries out its oversight functions and that board members are aware of their legal and ethical responsibilities in ensuring that the organization is governed properly."²⁷⁵ In this regard, through its orientation and ongoing director education, the Board emphasizes to its members their obligations to the organization as a whole.

Term Limits

Like many nonprofit organizations, the Red Cross has adopted term limits for Board members. Under the Bylaws, chartered unit-elected and at-large Board members who have served two full consecutive terms of three years are ineligible for re-election for at least two years.²⁷⁶ A six-year term limit is consistent with the term limits adopted by other nonprofit organizations²⁷⁷ and no information gathered in connection with the Governance Audit suggests the need for a change in the existing term limits.

Non-Governor Board Members

Currently non-Governor Board members serve on the Biomedical Services Committee as provided in the Bylaws,²⁷⁸ and as a matter of practice on the Public Support and Governance Committees. Additionally, the National Chair of Volunteers serves as a non-voting, *ex officio* member of the Board, the Executive Committee and the Disaster and Chapter Services Committee.²⁷⁹ In keeping with the Board's governance and oversight role, these non-Board member participants would be more appropriately placed on the various councils or as advisors to management. There should no longer be non-Governor members or *ex officio* members involved in Board or Board committee meetings.

²⁷⁴ BoardSource, *The Source: Twelve Principles of Governance that Power Exceptional Boards* principle 5 (2005).

²⁷⁵ Panel on the Nonprofit Sector Final Report, at 7.

²⁷⁶ Bylaws, § 2.3.

²⁷⁷ The American Cancer Society, for instance, limits board members to a maximum of three two-year terms. *See also* BoardSource, "Term Limits," available at <http://www.boardsource.org/Knowledge.asp?ID=1.254> (last visited Oct. 3, 2006) (three quarters of the nonprofit organizations surveyed had three-year board terms with those who used term limits having, on average, term limits of a maximum of two terms); BoardSource, *Nonprofit Governance Index 2004: Executive Summary* 6 (2005), available at http://www.boardsource.org/dl.asp?document_id=424#search=%22boardsource%20nonprofit%20governance%20index%22 (last visited Oct. 8, 2006) (64% of the nonprofits participating in survey had three-year board terms; 41% limited directors to two terms, while 16% limited directors to three terms).

²⁷⁸ *See* Bylaws, § 3.2.2.

²⁷⁹ The National Chair of Volunteers is the most senior volunteer in the Red Cross and a member of "Corporate Management," and is responsible for providing leadership on all matters affecting volunteers. *See* Policy Manual, Pt. 1, § 6.7.1.

Recommendations

While a number of steps can be taken to address issues related to the size and composition of the Board pending a Charter change, because Board size and composition are so central to governance and because good governance is so critical to the Red Cross' functioning, an immediate and rapid Charter change should be sought.

Changes in Governance Practices

1. Pending a Charter change, the Board should downsize by March 31, 2009 to a maximum of 25 members through Bylaw amendments, Board action and otherwise, and should consider corresponding changes to quorum requirements. Among the actions that the Board should consider to reduce Board size are the following:
 - the Board should refrain from filling Board vacancies;
 - the Board should refrain from re-nominating current members at the end of their terms; and
 - the Board should request that the President of the United States seek resignations of the individuals (other than the Chairman of the Board) serving as Presidentially-appointed members of the Board.²⁸⁰
2. The Board should adopt specific standards of independence applicable to Board members, which should include standards governing Board members' affiliations with organizations that have relationships with the Red Cross. Independent Board members should be individuals who do not serve in any capacity with a Red Cross chartered unit, who have received no compensation or material benefits directly or indirectly (including through organizations with which Board members are affiliated) from the Red Cross in the previous 12 months, whose compensation is not determined by other Board or Red Cross staff members, and who have no immediate family members who received such compensation from the Red Cross. All Board members (with the exception of the CEO, if a member of the Board) should be required to be independent. In addition, the Red Cross should consider revising its conflict-of-interest procedures to add greater specificity.
3. The Bylaws should be amended to establish, as appropriate, advisory councils to advise the Board and management. In particular, a National Leadership Council should be created to facilitate communication between the chapters and blood services regions, and the Board and management. In addition, pending a Charter change to provide for a Presidentially-appointed Cabinet Council (as described below), the Bylaws should be amended to provide for the Cabinet Council, which would report to the Board and meet periodically during the year.

²⁸⁰ The President should be asked to appoint the resigning Board members to the newly-created Cabinet Council.

4. Non-Governor Board members should be eliminated from Board committees and *ex officio* members should be eliminated from the Board and Board committees.

Changes to the Charter

For the reasons described above, the size of the Board should be smaller in light of the Board's oversight responsibilities and functions, including committee structure. Charter revisions should include the following:

1. Amending the Charter to authorize the Board to set, by resolution, the number of Board members, provided that: (a) as of March 31, 2009, there shall be no fewer than 12 Board members and no more than 25 Board members; and (b) as of March 31, 2012, there shall be no fewer than 12 Board members and no more than 20 Board members. As set forth above, reductions in Board size can be effected in a variety of ways.
2. Amending the Charter to reflect a single "category" of elected Board members, all of whom, except for the Chairman of the Board, would be nominated and elected through the same process (discussed below) to serve staggered, three-year terms.
3. Amending the Charter to provide for a Presidentially-appointed Cabinet Council that would consist of no fewer than eight and no more than ten officials of U.S. government departments and agencies, including the Secretary of Commerce, the Secretary of Defense, the Secretary of Education, the Secretary of Health and Human Services, the Secretary of Homeland Security, the Secretary of State, the Secretary of Veterans Affairs and the Chairman of the Joint Chiefs of Staff. At least one, but not more than three, of the members of the Cabinet Council shall be selected from the Armed Forces.

C. BOARD SELECTION

Introduction

The selection of Board members is a critical component of effective governance for the Red Cross. Presently, the chartered unit-elected Board members are selected by a 14-member nominating committee. At-large Board members are evaluated by the Governance Committee and then elected by the Board. Both chartered unit-elected and at-large Board members serve staggered three-year terms. Board selection, including the composition of the nominating committee and the selection process, were considered as part of the Governance Audit.

Background

The Charter currently provides that 30 of the 50 members of the Board are to be elected by the chapters using procedures that “ensure equitable representation of all chapters, with regard to geographical considerations, the size of the chapters, and the size of the populations served by the chapters.”²⁸¹ The Charter further provides that 12 “members-at-large” are to be elected by the Board and eight members are to be appointed by the President of the United States.²⁸²

The Bylaws and the Policy Manual establish a Committee on Nominations,²⁸³ which is responsible for nominating nationally-elected volunteer leadership, including Board members.²⁸⁴ The Committee on Nominations consists of two Board members who are ineligible for re-election to the Board (due to term limits) and 12 other individuals elected by the chartered units at the annual meeting.²⁸⁵ Committee members are limited to a two-year term.²⁸⁶

Under the Bylaws, the Governance Committee of the Board is responsible for determining the skills and experience to be sought in Board nominees.²⁸⁷ The Committee performs an annual assessment of the Board and identifies the desired qualifications based on a review of the skills and attributes of the current Board members and the needs of the Board.²⁸⁸ The Governance Committee and the Committee on Nominations, working with the Chairman of the Board, finalize the specific skills and characteristics desired of nominees to the Board. The

²⁸¹ Charter, § 4(a)(1)(B). Pursuant to the Bylaws, both the chapters and the blood services regions elect these 30 Board members. Thus, references to chapters throughout this section will also refer to the blood services regions. See Bylaws, §§ 1.3 & 2.2.

²⁸² Charter, §§ 4(a)(1)(A) & (C).

²⁸³ See Bylaws, § 7.2; Policy Manual, Pt. 1, § 5.4.

²⁸⁴ See Bylaws, §§ 7.2 – 7.3; Policy Manual, Pt. 1, §§ 5.4 (Committee on Nominations) & 5.6 (Nomination and Election of Governors).

²⁸⁵ See Bylaws, § 7.2.

²⁸⁶ See *id.*

²⁸⁷ *Id.* § 3.8.1(c); Governance Committee Function Statement.

²⁸⁸ *Id.* § 3.8.1(a). Annually, typically at its July meeting, the Governance Committee assesses the skills and qualifications of current Board members, prepares a matrix of all current Board members’ skills and experience, and determines the skills and qualifications needed on the Board.

Governance Committee is responsible for communicating these criteria and assisting in recruiting new members to the Board.²⁸⁹ The Governance Committee also is charged with working with the Committee on Nominations in assessing potential chartered unit-elected and at-large candidates.²⁹⁰

Chartered Unit-Elected Board Members

The Board nomination process commences with a letter soliciting Board nominees, sent by the Chairman of the Board to chapters and blood services regions.²⁹¹ The solicitation letter, generally sent in August, provides background information on Board service and outlines the skills and qualifications identified by the Governance Committee to be sought in Board nominees.²⁹² Applications, which are submitted by the nominating chapter executive, generally are due in November.²⁹³ Following telephone interviews of potential candidates, typically conducted through January and February, the Committee on Nominations meets to select the candidates to be presented for election at the annual meeting.²⁹⁴ Beginning in 2006, an effort was made to have the ten final candidates interviewed by the Chair and Vice Chair of the Committee, key members of management and other Board members.²⁹⁵

The work of the Committee on Nominations is supported by the National Chair of Volunteers, who plays a key role in the nominations process. In recent years, the National Chair of Volunteers has actively targeted and pursued Board candidates and has led recruitment and outreach efforts.

The Governance Committee and the National Chair of Volunteers recently have taken steps to improve the nominations process. In 2006, the size of the Committee on Nominations was reduced from 19 to 14 members to improve the efficiency of the Committee. To increase Board involvement, the Chair and Vice Chair of the Committee on Nominations now must be

²⁸⁹ *Id.* § 3.8.1(c).

²⁹⁰ Governance Committee Function Statement.

²⁹¹ *See* Call for Nominations (known internally at the Red Cross as “the Blue Letter”); *see also generally* Policy Manual, Pt. 1, §§ 5.4.3 & 5.6.1.

²⁹² *See* Bylaws, § 3.8.1(c); Governance Committee Function Statement; *see also* Call for Nominations (known internally as “the Blue Letter”).

²⁹³ Most chapters do not submit any candidates; in 2005, 96% of the chapters did not submit applications for any candidates. Historically, mid-sized chapters submit the largest number of potential Board candidates. In 2006, for example, the Committee on Nominations received submissions for 40 candidates to the Board, of which five were from the largest 100 chapters.

²⁹⁴ *See* Policy Manual, Pt. 1, §§ 5.4.4 & 5.6.1 – 5.6.2.

²⁹⁵ Different procedures apply where vacancies are being filled. Vacancies are filled by vote of the Executive Committee, following an assessment by the Governance Committee. The new member serves until the next annual meeting. *See* Bylaws, § 2.8.

members of the Board who are not eligible for re-election due to term limits.²⁹⁶ Additionally, the nomination application has been shortened and simplified.

At-Large Board Members

The Charter specifies that the Board elect 12 at-large members “who are representative of the national interests that the [Red Cross] serves, and with which it is desirable that the [Red Cross] have close association.”²⁹⁷ Potential at-large members are identified by the Board Chairman, Red Cross management and others and referred to the Governance Committee for consideration. The Governance Committee considers the candidates and recommends the approved candidates to the Board for consideration and election.²⁹⁸

Analysis

Nominations Committee

Although board members of nonprofit organizations are nominated in a variety of ways,²⁹⁹ nonprofit organizations overwhelmingly assign responsibility for nominations to the governance committee or a separate nominating committee.³⁰⁰ The nominating and governance responsibilities often are assigned to the same committee because the nomination function relates

²⁹⁶ Currently, the Chair of the Committee on Nominations is a former member of the Board (having just completed the last year of Board service), and the Vice Chair is a Board member in the last year of Board service.

²⁹⁷ Charter, § 4(a)(1)(C). The eight remaining Board members, including the Board Chairman, are appointed by the President of the United States. *See id.* § 4(a)(1)(A). Those members “appointed by the President shall be officials of departments and agencies of the United States Government, whose positions and interests qualify them to contribute to carrying out the programs and purposes of the [Red Cross]. At least one, but not more than 3, of those officials shall be selected from the armed forces.” *Id.*

²⁹⁸ At-large vacancies are filled by election of the Executive Committee of the Board, following an assessment of the Governance Committee. The new member serves until the next annual meeting. *See* Bylaws, § 2.9.

²⁹⁹ Aspen Institute Study, at 13; Bruce R. Hopkins, BoardSource, LEGAL RESPONSIBILITIES OF NONPROFIT BOARDS 9 (2003) (noting that board members often arrive by one of several routes and that boards use various processes in defining their composition). A BoardSource survey of over 400 nonprofits found that “[t]he majority of boards (68 percent) are self-perpetuating,” meaning that new board members are nominated and elected by the current board. BoardSource, *Nonprofit Governance Index 2004: Executive Summary* 5 (2005), available at http://www.boardsource.org/dl.asp?document_id=424#search=%22boardsource%20nonprofit%20governance%20index%22 (last visited Oct. 8, 2006).

³⁰⁰ Of the over 400 nonprofits responding to a BoardSource survey, 78% designated a “special board committee” to identify and nominate new board members. BoardSource, *Nonprofit Governance Index 2004: Executive Summary* 6 (2005), available at http://www.boardsource.org/dl.asp?document_id=424#search=%22boardsource%20nonprofit%20governance%20index%22 (last visited Oct. 8, 2006). According to BoardSource, “[t]raditionally called a nominating committee, this committee is increasingly referred to as the governance or board development committee.” *Id.* *See also* Spencer Stuart’s 2005 survey of the 500 largest public companies, which found that 98.5% of these companies had nominating committees or governance committees that performed nominating functions. *Spencer Stuart Board Index* 16 (2005), available at <http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI-2005.pdf> (last visited Sept. 18, 2006); Aspen Institute Study, at 13 (board members are “commonly nominated by nominating committees”).

to, and overlaps to a large extent with, governance matters.³⁰¹ In considering the structure and operation of an organization's governing bodies, a governance committee will, as part of its ongoing activities, consider the appropriate composition of those bodies. As a result, organizations such as The Nature Conservancy have tasked their governance committees with nomination responsibilities.

Commonly, persons serving on the body with nominating functions are appointed by the board,³⁰² although in some organizations the membership body elects nominating committee members or they are chosen by others.³⁰³ Some organizations do not use governance or nominating committees at all; in these organizations, the membership nominates board candidates.³⁰⁴ Some organizations—like the Red Cross—use a combination of methods.³⁰⁵

Organizations that have committees serving a nominating function (whether the governance committee or a separate nominating committee) rely on them to identify and recruit board members with diverse viewpoints and skill sets that align with the needs of the organization.³⁰⁶ In addition to the capabilities and expertise of committee members, several factors impact the composition of an effective nominating committee. A threshold consideration is whether the nominating committee should consist of all board members, all non-board members, or some combination.

³⁰¹ Thomas Silk, *Ten Emerging Principles of Governance of Nonprofit Corporations and Guides to a Safe Harbor*, THE INT'L JOURNAL OF NOT-FOR-PROFIT LAW, Vol. 7, No. 1, 76, 80 (Nov. 2004), available at http://www.icnl.org/knowledge/ijnl/vol7iss1/ijnl_vol7iss1.pdf (last visited Oct. 3, 2006) (“Every nonprofit corporation should have a nominating/governance committee. . . . The notion that every board of directors should have a nomination/governance committee is widespread in recommended practice codes.”); Linda Lysakowski, *Get Rid of Your Nominating Committee!* CharityChannel (Aug. 7, 2003) available at <http://charitychannel.com/publish/templates/?a=275&z=0> (last visited Oct. 3, 2006) (advocating assignment of nominating functions to governance committee).

³⁰² Aspen Institute Study, at 13 (nominating committees are appointed by the national board in 38% of a sample of nonprofits).

³⁰³ See *id.* (nominating committees are elected by the membership in 28% of a sample of nonprofits).

³⁰⁴ See *id.* (national board members nominated by the membership body itself in 12% of a sample of nonprofits).

³⁰⁵ As reflected in this report, the Red Cross has three categories of Board members, each nominated and selected in a different manner. See discussion under “Background” above, and under Section 4B, “Background” above. Other organizations also nominate and select board members using a combination of methods. A portion of the national board members of Girls Incorporated, for example, is selected by a membership-elected nominating committee; some are selected by regional nominating committees. At the Planned Parenthood Federation of America, some board members are elected at-large, some regionally, and some hold seats that are designated for individuals holding specified offices in other organizations. See Aspen Institute Study, at 13 – 14.

³⁰⁶ See Judith A. Cion, *Development of an Effective Board*, in NONPROFIT GOVERNANCE AND MANAGEMENT 61, 63 (Victor Futter et al., eds. 2002); see also BACK TO THE DRAWING BOARD, at 114 – 115, 118 (noting that boards should think strategically about the board's skill mix in light of any issues facing the organization); Business Roundtable, *The Nominating Process and Corporate Governance Committees: Principles and Commentary* 9 (Apr. 2004), available at <http://www.businessroundtable.org/pdf/20040421002CorpGovComm.pdf> (last visited Sept. 25, 2006) (stating that boards “should consider whether candidates have the requisite knowledge, skills and experience to understand the business of the corporation”).

Many nonprofit organizations—including Boy Scouts of America, Goodwill Industries International, Catholic Charities USA and United Way—employ nominating committees composed solely of board members.³⁰⁷ Board members can bring institutional knowledge and understanding to a nominating committee, as well as informed input on board needs and intangible factors, such as personal characteristics and working relationships. In addition, board members are more likely than non-board members to understand fully the mission of the organization and the board’s oversight role.³⁰⁸ Using the governance committee for nominations has the benefit of calling upon board members who already are well-versed in governance-related needs of the organization and who are likely to have an educated perspective on appropriate candidates for nomination. Including board members in the nominations process also may enhance communication relating to board and organizational needs and the nominating process. This benefit can be maximized by using governance committee board members for nominations as nomination-related communications will dovetail with regular governance committee communications to the full board.

Other prominent nonprofit entities—such as Volunteers of America, American Heart Association, YMCA and American Cancer Society—have nominating committees that are composed either entirely or partially of non-board members. Including non-board members on a nominating committee can provide an additional, outside perspective to the committee. Bringing “outsiders” on to the nominating committee also extends the organization’s recruitment network, enhancing the organization’s potential ability to solicit candidates from a larger and broader pool.

Independence also is a consideration.³⁰⁹ Whether the members of the committee with nominating responsibilities are board members or “outside” third parties, they should in any event be independent.³¹⁰ Specifically, they should not be employees of the Red Cross or any unit or chapter of the Red Cross and they should not have received any compensation or material benefits from the Red Cross or any related entity in the prior year.³¹¹

Because nominating committees benefit from continuity, committee members should have a tenure that is long enough to allow the committee members to establish a knowledge base,

³⁰⁷ Similarly, some federally-chartered organizations use a board nominating committee to select their board of directors, such as Federal National Mortgage Association (“Fannie Mae”) and Federal Home Loan Mortgage Corporation (“Freddie Mac”).

³⁰⁸ See Judith A. Cion, *Development of an Effective Board*, in NONPROFIT GOVERNANCE AND MANAGEMENT 61, 62 (Victor Futter et al., eds. 2002).

³⁰⁹ According to the 2005 Spencer Stuart survey of the 500 largest public companies, nearly all (99.8%) of the members of the nominating committees (or governance committees who performed nominating committee functions) were independent. See *Spencer Stuart Board Index* 16 (2005), available at <http://content.spencerstuart.com/sswebsite/pdf/lib/SSBI-2005.pdf> (last visited Sept. 18, 2006).

³¹⁰ See Judith A. Cion, *The Role of the Nominating or Governance Committee of a Nonprofit*, in NONPROFIT GOVERNANCE AND MANAGEMENT 179, 180 (Victor Futter et al., eds. 2002) (“The nonprofit nominating committee . . . should consist entirely of outside directors.”); ABA Coordinating Committee on Nonprofit Governance, *Guide to Corporate Governance in the Wake of Sarbanes-Oxley* 26 – 28 (2005).

³¹¹ See Panel on the Nonprofit Sector Final Report, at 53.

to build on prior initiatives and to preserve momentum.³¹² Understanding organizations and their board needs often takes time and recruiting high quality candidates may require prolonged efforts.

Nominations Process

The nominations process should begin with an evaluation of the current board, assessing both current and anticipated needs relating to board composition and the board's future work.³¹³ When determining board composition, nonprofit boards should seek diversity in professional and personal backgrounds and should strive to include members with leadership skills, senior executive experience (such as tenure as a chief executive, chief financial officer or chief operating officer), business and financial expertise, legal expertise, regulated-industry expertise (if applicable), mission-related expertise (such as medical), fundraising capabilities, community involvement, political connections, and a commitment to the mission of the organization.³¹⁴

Once the desirable qualifications for board members have been determined, a rigorous and focused recruiting process should be pursued. The nominating committee should have "a well-defined process for recruitment that assesses future organizational needs and current board member competencies."³¹⁵ The committee should maintain an "inventory" of potential board candidates and should reach out to cultivate additional potential candidates with necessary skills and expertise.³¹⁶ Candidates should be sought through institutional, community, professional and personal connections.

³¹² See Sandra R. Hughes et al., BoardSource, *THE BOARD BUILDING CYCLE: NINE STEPS TO FINDING, RECRUITING, AND ENGAGING NONPROFIT BOARD MEMBERS* 1 (2000) (noting that the most effective boards evolve over time through careful planning).

³¹³ See *id.* at 5 (2000); Julie H. Daum, *The New Rigor in Director Recruiting*, *DIRECTORS & BOARDS* 64, 64 (2004).

³¹⁴ See Sandra R. Hughes et al., BoardSource, *THE BOARD BUILDING CYCLE: NINE STEPS TO FINDING, RECRUITING, AND ENGAGING NONPROFIT BOARD MEMBERS* 7 (2000); see also BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 12 (2005) (noting that members should "possess knowledge of the nonprofit sector, superior financial acumen, ability to secure funding, and personal characteristics and experiences that positively enrich group interaction").

³¹⁵ See BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 12 (2005); see also William G. Bowen, *Inside the Boardroom: A Reprise*, in *NONPROFIT GOVERNANCE AND MANAGEMENT* 3, 5 (Victor Futter et al., eds. 2002) ("The selection of outstanding individuals is obviously of paramount importance to the composition of a board. The right people can make any structure work.").

³¹⁶ See Fisher Howe, *Nonprofit Accountability: The Board's Fiduciary Responsibility*, in *NONPROFIT GOVERNANCE AND MANAGEMENT* 29, 34 (Victor Futter et al., eds. 2002) (noting that board member selection and recruitment processes must be effective); see also Judith A. Cion, *The Role of the Nominating or Governance Committee of a Nonprofit*, in *NONPROFIT GOVERNANCE AND MANAGEMENT* 179, 181 (Victor Futter et al., eds. 2002); Julie H. Daum, *The New Rigor in Director Recruiting*, *DIRECTORS & BOARDS* 64, 65 (2004) (nominating committee members should seek suggestions from management, board members and other knowledgeable parties, noting that boards now often are considering a broader group of candidates).

Organizations like the Red Cross with nationwide affiliate or chapter bases benefit from regional and local input and advice.³¹⁷ A National Leadership Council³¹⁸ could provide a means for chapters and blood services regions to serve as a source of nominees for the Board committee handling nominations. Red Cross field units also should be encouraged to submit Board candidates directly to the Board committee as should the Service Area executives.³¹⁹

While a board nominating committee is formally charged with selecting board candidates,³²⁰ the availability and assistance of board members and senior management can be important.³²¹ Potential board members may have questions and concerns that members of the board or senior management may be able to address.³²² Likewise, board and senior management involvement may be necessary to persuade highly sought-after candidates that the organization is worthy of their time and energy.³²³ The role of non-nominating committee members, however, is a supporting rather than a substantive one (as in assessing or selecting candidates).

Recruitment efforts should be accompanied by equally vigorous evaluation and diligence efforts, including reference and background checks.³²⁴ Diligence should include assessment of a candidate's "independence" and substantive qualifications. Potential Board members who are likely Audit Committee members, for instance, should be evaluated for the requisite "financial literacy" or financial expertise.

³¹⁷ See Sandra R. Hughes et al., *THE BOARD BUILDING CYCLE: NINE STEPS TO FINDING, RECRUITING, AND ENGAGING NONPROFIT BOARD MEMBERS* 13 (2000).

³¹⁸ See discussion under Section 4B, "Advisory Functions" above.

³¹⁹ Business Roundtable, *The Nominating Process and Corporate Governance Committees: Principles and Commentary* 8 – 10 (Apr. 2004), available at www.businessroundtable.org/publications/index.aspx (last visited Sept. 25, 2006) (noting that as a matter of good corporate governance, the committee should consider candidates submitted by other constituencies).

³²⁰ See Sandra R. Hughes et al., *THE BOARD BUILDING CYCLE: NINE STEPS TO FINDING, RECRUITING, AND ENGAGING NONPROFIT BOARD MEMBERS* 20 (2000).

³²¹ Julie H. Daum, *The New Rigor in Director Recruiting*, *DIRECTORS & BOARDS* 64, 66 (2004) ("Candidates today typically meet with the CEO and several directors, including the board chair and nominating committee chair, and may want to spend time at corporate headquarters to get a feel for the organization.").

³²² See ABA Coordinating Committee on Nonprofit Governance, *Guide to Corporate Governance in the Wake of Sarbanes-Oxley* 35 (2005); Sandra R. Hughes et al., *THE BOARD BUILDING CYCLE: NINE STEPS TO FINDING, RECRUITING, AND ENGAGING NONPROFIT BOARD MEMBERS* 3 (2000) (noting the importance of explaining expectations and responsibilities of board members and inviting questions from potential board members throughout the recruiting process).

³²³ ABA Coordinating Committee on Nonprofit Governance, *Guide to Corporate Governance in the Wake of Sarbanes-Oxley* 35 (2005). See also Julie H. Daum, *The New Rigor in Director Recruiting*, *DIRECTORS & BOARDS* 64, 66 (2004) ("Because outstanding director candidates are in high demand, they have the luxury to be particular about which board to join.").

³²⁴ See Julie H. Daum, *The New Rigor in Director Recruiting*, *DIRECTORS & BOARDS* 64, 65 – 66 (2004) (nominating committee should perform due diligence on each candidate, thoroughly checking references).

Some nonprofit organizations allow their members to nominate board candidates by employing a petition process.³²⁵ Such an approach can be employed to present for election board candidates who are supported by a material portion of the membership but who may not have been identified in the nominating process. The threshold percentage of the membership to be required for presentation of a candidate by petition should be set high enough so that the petition represents a substantial common view of the membership (and does not represent “outlier” perspectives), but low enough as not to be preclusive. A notice requirement also may be necessary to facilitate orderly and informed discussion of candidates presented by petition. The Red Cross currently has a petition process whereby the chapters and blood services regions can nominate candidates for election.³²⁶ Modifications to the petition process should be considered, including the appropriateness of changes to the proportion of chapters and blood services regions required to nominate a candidate for election.

Recommendations

For the reasons outlined earlier in this report, the selection process for new Board members should be revised.

Changes in Governance Practices

Given the recommendation that the Board have a single category of directors,³²⁷ all Governors, except for the Chairman of the Board, should be nominated using the same procedure. Additionally, because the matters considered by the Red Cross Governance Committee overlap with those addressed by the Committee on Nominations in the nominations process, and because the Governance Committee already has involvement in nominations, the Bylaws and Policy Manual should be amended to eliminate the existing Committee on Nominations and to provide for the assumption of nominating functions by a newly constituted Governance and Board Development Committee. The following actions should also be initiated:

1. The Bylaws and Policy Manual³²⁸ should be amended to modify the current Nominations Committee process. The Board members would be nominated by the Governance and Board Development Committee for approval by the full Board, and, except for the Chairman, would then be submitted at the organization’s annual meeting to delegates for election.

³²⁵ See generally Aspen Institute Study, at 14 – 15 (members in some organizations may present from the floor matters to be brought to a vote).

³²⁶ See Bylaws, § 7.3(a) (permitting nominations by petition from such proportion of the chartered units as may be specified by the Board); Policy Manual, Pt. 1, § 5.6.3 (allowing governing boards of any group of 20 chartered units to submit nominations by petition to the Committee on Nominations).

³²⁷ See discussion under Section 4B, “Composition of the Board,” above.

³²⁸ As noted earlier, see Section 1, “The Sarbanes-Oxley Act of 2002 and Beyond,” the continued need for the Policy Manual should be examined.

2. The Governance and Board Development Committee should continue to:
 - conduct an annual formal Board assessment; and
 - formulate and approve and provide to those submitting candidates the skills and attributes desired for Board members each year, based on the formal assessment.
3. The Governance and Board Development Committee, in consultation with the Chairman and the CEO, should be responsible for identifying, recruiting, evaluating and selecting an inclusive and diverse pool of Board candidates.
4. Among the skills and attributes to be sought in prospective Board members by the Governance and Board Development Committee, the following should be considered:
 - proven leadership ability;
 - previous experience serving on boards (either for-profit or nonprofit);
 - diversity, including, but not limited to, gender, ethnicity, race, age, disabilities and geography;
 - experience with large and complex organizations;
 - current or prior chief executive officer, chief operating officer, or chief financial officer level experience (either for-profit or nonprofit);
 - knowledge and experience regarding nonprofit and volunteer organizations (not limited to Red Cross experience);
 - specific skills such as finance, audit, legal, international, information technology, diversity awareness, governmental affairs, public relations, marketing, leadership development, disaster relief, medical, biomedical, regulated industries and pharmaceutical; and
 - community experience and knowledge in local Red Cross services.
5. The Governance and Board Development Committee, current Board members, senior management and all field units should participate in active outreach and recruiting efforts. Suggestions for candidates from the chapters and blood services regions through the National Leadership Council and Service Area executives should be encouraged.
6. The members of the Board may continue to serve in a volunteer capacity with the Red Cross, but not in a governance capacity in a chapter or blood services region.
7. In addition to the formal nominations process, the current process in the Bylaws and Policy Manual permitting nomination of candidates by petition for presentation at the annual meeting should be reviewed for any appropriate modifications, such as changes to

the proportion of chapters and blood services regions required to nominate a candidate for election.

Changes to the Charter

As mentioned above, the Charter should be amended to eliminate the existing three categories of Board members, thus creating a single category of elected Board members.

D. RESPONSIBILITIES AND SELECTION OF THE CHAIRMAN OF THE BOARD AND THE CHIEF EXECUTIVE OFFICER

Introduction

The Red Cross has a Chairman of the Board, who is appointed by the President of the United States, and a President and CEO, who is nominated by the Chairman and selected by the Board. The Red Cross governance documents designate the Chairman as the organization’s “principal officer” and outline in general terms the responsibilities of the Chairman and the President and CEO. However, the Red Cross currently has no formal written descriptions for these positions.

Background

The Charter provides for eight Presidentially-appointed members of the Board, “one of whom the President shall designate to act as the principal officer of the [Red Cross] with the title and functions provided in the bylaws.”³²⁹ The Bylaws state that the principal officer appointed by the President of the United States is the Chairman of the Board.³³⁰ Under the Bylaws, the Chairman’s duties are as follows:

- serving as the representative of the Red Cross in its relations with both public and private agencies and the public at large;³³¹
- communicating to the President and CEO the policies and programs adopted or approved by the Board;³³²
- reporting to the Board the conduct and management of the affairs of the Red Cross;³³³
- chairing the Board and presiding over the Executive Committee;³³⁴ and
- serving as an *ex officio* member of all Board committees (except the Audit Committee).³³⁵

The term of office of the Chairman is three years³³⁶ and is “coterminous” with the Chairman’s term of office as a Presidentially-appointed Board member.³³⁷

³²⁹ Charter, § 4(a)(1)(A).

³³⁰ See Bylaws, §§ 2.2(a) & 6.1(a).

³³¹ See *id.* § 6.1(c).

³³² See *id.*

³³³ See *id.*

³³⁴ See *id.*

³³⁵ See *id.*

The Charter does not provide for any other officers of the Red Cross. The officer positions are set forth in the Bylaws, which state that “the President and CEO shall be nominated by the Chairman and shall be elected by the [Board].”³³⁸ The Bylaws also provide for additional officers, including a Chief Financial Officer, a General Counsel, a Secretary and Assistant Secretaries, and “Administrative Officers.”³³⁹ Officers (including the President and CEO) generally hold office for one-year terms, subject to re-election.³⁴⁰ The Policy Manual states that the President and CEO, and other members of management, are “accountable to the [Board].”³⁴¹

The Bylaws designate the President and CEO as the “chief executive officer” of the Red Cross with responsibility for “carrying into effect the policies and programs adopted or approved” by the Board.³⁴² The Policy Manual contains a broad delegation of authority from the Board to the President and CEO, pursuant to which the President and CEO has “all such authority as is necessary and appropriate to manage and protect the interests of the [Red Cross], consistent with the Bylaws and [Board] policies and resolutions.”³⁴³ The Policy Manual also details a handful of specific responsibilities of the President and CEO, including communicating throughout the organization statements of purpose adopted by the Board (such as the mission and strategic plan),³⁴⁴ developing and presenting to the Board annual national budgets for certain areas of Red Cross operations, such as the biomedical services business,³⁴⁵ and “provid[ing] support to the [Board] and its committees.”³⁴⁶ The President and CEO does not serve on the Board; however, by practice, the President and CEO attends full Board and committee meetings.

Analysis

Roles of the Chairman and the CEO

Just as defining the respective roles of the board and management of a nonprofit organization is important,³⁴⁷ it is equally critical to define the roles of the organization’s

[Footnote continued from previous page]

³³⁶ See Charter, § 4(b)(1); Bylaws, § 6.1(c).

³³⁷ Bylaws, § 6.1(c).

³³⁸ *Id.* § 6.3.

³³⁹ See *id.* §§ 6.4 – 6.8.

³⁴⁰ See *id.* § 6.9. The Bylaw provision on one-year terms does not apply to “Administrative Officers.”

³⁴¹ Policy Manual, Pt. 1, § 6.3.

³⁴² Bylaws, § 6.3.

³⁴³ Policy Manual, Pt. 1, § 6.1.1.

³⁴⁴ See *id.*, Pt. 1, § 6.4.

³⁴⁵ See *id.*, Pt. 1, § 6.6.1.

³⁴⁶ *Id.*, Pt. 1, § 6.2. Specific examples of the “support” required from the President and CEO, as set forth in the Policy Manual, include providing “background papers, policy proposals, analyses, financial information, and any other such information responsive to the requests of the Board of Governors and its committees.” *Id.*

³⁴⁷ See Section 4A, “Role of the Board” above.

chairman and its chief executive (or those persons, whatever their titles, who perform equivalent functions).³⁴⁸ Established principles of governance—both nonprofit and corporate—suggest that the roles of the chairman and the chief executive should be clear and that the responsibilities associated with the respective positions should be specifically delineated.³⁴⁹ For a nonprofit organization to operate effectively, “it must be clear who has authority to act on behalf of the organization and the scope of such authority.”³⁵⁰ Established principles of governance also indicate that the role of the chairman of the board is to lead the board in performing its oversight role, while the role of the chief executive is to act as the “principal officer” and lead the management team.³⁵¹ In this regard, the chairman is to “guide, develop, and coordinate the work of the board,” while the chief executive “is the central authority in operating the institution and therefore must have the central responsibility for doing so.”³⁵² In addition, the chief executive may serve as the spokesperson for the organization.³⁵³

³⁴⁸ See, e.g., Revised Model Nonprofit Corp. Act, Official Comment to Section 8.40 (1987) (noting that, in some nonprofit organizations, the “president” is a volunteer who has been “given the title of president in recognition of the significant contributions he or she has made or is making to the organization. The president is not involved in the day-to-day activities of the organization, and may or may not be the most significant member of its board of directors.”) See also Brian O’Connell, THE BOARD MEMBER’S BOOK 58-59, 191 – 192 (3d ed. 2003) (attributing what the author views as common confusion about the roles of the chairman and chief executive in nonprofit organizations to the titles themselves and noting that because “[v]oluntary organizations are very different from both business organizations and government agencies,” these roles are “unique to nonprofit organizations” and “not synonymous” with their counterparts in a business corporation).

³⁴⁹ See, e.g., Brian O’Connell, THE BOARD MEMBER’S BOOK 192 (3d ed. 2003) (“A great deal of time and effort needs to be invested in being sure that this unique team of [chairman] and [chief executive] understands and respects each other’s roles and is working effectively together.”); BACK TO THE DRAWING BOARD, at 189 (2004) (“Both [the chairman and the chief executive] need to be clear about . . . individual duties and responsibilities. . . . It is essential that the [chairman and the chief executive] have a clear understanding about who is going to do what.”).

³⁵⁰ Victor Futter, *Delegations of Authority in the Nonprofit Organization*, in Section of Business Law, American Bar Association et al., NONPROFIT GOVERNANCE AND MANAGEMENT 215, 215 (Victor Futter et al., eds. 2002).

³⁵¹ See, e.g., Brian O’Connell, THE BOARD MEMBER’S BOOK 38 – 39 (3d ed. 2003) (“The absolute primary role” of the chairman “is to build the board’s sense of mutual responsibility and trust . . . to be the *builder* of the board”); see also *id.* at 59 (as the “chief volunteer officer,” the chairman “is head of the board in the fulfillment of its accountability functions,” while the chief executive “is hired to assist the board in its efforts to fulfill its accountability”); Cyril O. Houle, GOVERNING BOARDS: THEIR NATURE AND NURTURE 12 (1989) (The chairman’s “primary task is to create and maintain a spirit of unity among the diverse people on the board and to ensure that it works appropriately with the executive and staff in exercising power effectively and ethically”); see also *id.* at 10 – 11 (describing the functions of the chief executive, who “directs the actual operation of the organization or association under the control of the board to which he or she is responsible”); BACK TO THE DRAWING BOARD, at 189 (2004) (In discussing the corporate model, Carter and Lorsch write that “[T]he CEO is the leader of the company and its management, and the chairman is the leader of the board.”).

³⁵² Cyril O. Houle, GOVERNING BOARDS: THEIR NATURE AND NURTURE 11, 13 (1989).

³⁵³ See *id.* at 11 (1989) (“if somebody needs to speak out publicly, that task belongs to” the chief executive); but see Brian O’Connell, THE BOARD MEMBER’S BOOK 56 – 57 (3d ed. 2003) (stating that “[a]n area of frequent difficulty in board and [chief executive] relations involves the degree to which the [chief executive] serves as the spokesperson for the agency” and concluding that the chairman, as the volunteer leader, “should generally be the spokesperson”).

In practice, however, the roles of an organization's chairman and chief executive are not always clear.³⁵⁴ This lack of clarity may be more pronounced in the nonprofit sector, where the practice of combining the roles of chairman and chief executive officer is less common than in for-profit corporations,³⁵⁵ where the U.S. model historically has been for a single individual to serve as chairman of the board and chief executive officer.³⁵⁶

For the Red Cross, the designation of the Chairman as the "principal officer" has complicated the delineation of the respective roles and responsibilities of the Chairman and the CEO. According to the Red Cross, "[t]he President and CEO's role and that of the Presidentially-appointed 'principal officer of the corporation' has varied and been the subject of some debate over the course of the past 60 years."³⁵⁷ The Charter and Bylaws do not define the term "principal officer," which may have contributed to this variation in roles. For example, although the Bylaws designate the Chairman as the representative of the Red Cross to the public at large,³⁵⁸ information-gathering conducted in connection with the Governance Audit indicates that, at various times throughout the Red Cross' history, the CEO has taken a more active role in this area. Although the current Chairman does not act as "principal officer," in the past the designation of the Chairman as the "principal officer" has caused some uncertainty about the respective roles of the Chairman and the CEO. This has included uncertainty about whether management is accountable to the Chairman or the CEO, and who is in charge of, and speaks for,

³⁵⁴ See, e.g., Brian O'Connell, *THE BOARD MEMBER'S BOOK* 57 – 58 (3d ed. 2003) (stating that "[t]he greatest source of friction and breakdown in voluntary organizations of all types, sizes, ages, and relative degrees of sophistication and excellence relates to misunderstandings and differing perceptions between the [chairman] and [the chief executive]" and noting that "the individuals, and sometimes the boards" of nonprofit organizations "don't agree on the roles of these two leaders"); see also *id.* at 191 – 193 (citing "confusion" between the roles of chairman and chief executive, and about the role of the chairman, as being among the chief risks facing nonprofit organizations); BACK TO THE DRAWING BOARD, at 189 (2004) ("Both [the chairman and the chief executive officer] need to be clear about . . . individual duties and responsibilities. . . . It sounds simple, but [there are] too many instances where there is confused overlap or conflict.").

³⁵⁵ See, e.g., William G. Bowen, *Inside the Boardroom: A Reprise*, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* 3, 9 (Victor Futter et al., eds. 2002) (stating that "the separate chairman model, which is so unusual in the for-profit world, has been dominant in the nonprofit sector for years"); see also NACD, *2005 NACD Not-for-Profit Governance Survey* 9 (2005) (finding that 91.2% of 52 "leading not-for-profits" surveyed, including the Red Cross, separate the positions of chairman and chief executive). Organizations such as the Panel on the Nonprofit Sector have advocated separating the roles of the chairman and chief executive. See Panel on the Nonprofit Sector, *Strengthening Transparency, Governance and Accountability of Charitable Organizations—A Final Report to Congress and the Nonprofit Sector* 75 – 76 (June 2005), available at http://www.nonprofitpanel.org/final/Panel_Final_Report.pdf (last visited Aug. 15, 2006).

³⁵⁶ See Business Roundtable 2005 Principles of Corporate Governance, at 15 ("Most American corporations have been well served by a structure in which the CEO also serves as chairman of the board."). Recently there has been a movement toward separating the chairman and chief executive officer positions. See Jay Lorsch & Andy Zelleke, *Should the CEO Be the Chairman?*, MIT SLOAN MANAGEMENT REVIEW 71 (2005) (noting that "[a]s a result of recent corporate scandals, reformers and investors have increasingly called for U.S. companies to separate the chairman and CEO jobs.").

³⁵⁷ American Red Cross, *The Governance Structure of the American Red Cross* 8 (Jan. 2006).

³⁵⁸ See Bylaws, § 6.1(c).

the Red Cross. In conducting the current CEO search, the Chairman and Board are addressing this concern.

Some flexibility in roles and responsibilities is desirable so that an organization can take advantage of the particular skill sets of its chairman and chief executive officer.³⁵⁹ However, governance best practices suggest that job descriptions for an organization’s chairman and chief executive officer, and specific delegations of authority from the organization’s board to the chief executive, are essential.³⁶⁰ Job descriptions and delegations of authority clarify the expectations of the chairman and chief executive and can promote clarity throughout the organization as a whole.³⁶¹

Appointment of the Chairman

As discussed above,³⁶² the President of the United States designates one of his eight appointees to the Board as the “principal officer” of the Red Cross³⁶³ and, pursuant to the Bylaws, this individual serves as Chairman of the Board.³⁶⁴ The Bylaws also establish a process

³⁵⁹ See, e.g., Brian O’Connell, *THE BOARD MEMBER’S BOOK* 60 (3d ed. 2003) (emphasizing the need for reflection on the chairman and chief executive “as individuals” in defining their respective roles and responsibilities).

³⁶⁰ See, e.g., Revised Model Nonprofit Corp. Act, Official Comment to Section 8.40 (1987) (stating that where:

[S]ubstantial authority rests in . . . a full-time officer who runs the day-to-day activities of the corporation and makes basic decisions relating to corporate activities . . . the bylaws or a resolution of the board should specify the power and authority of the [chief executive] consistent with the requirement that the affairs of the corporation be managed under the direction of the board);

BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 1 (2005) (stating that a board should “[d]evelop a job description with and for the chief executive”); Brian O’Connell, *THE BOARD MEMBER’S BOOK* 60 (3d ed. 2003) (emphasizing “how important it is that [the chairman and chief executive] work very hard at understanding one another’s roles”); see also *id.* (stating that, as specific functions are delegated to the chief executive, “the delegation should be explicit and should be reflected in the job description” because “[t]he board and the staff need to know whether such functions will be tightly controlled by the board or whether they will be largely delegated”); Victor Futter, *Delegations of Authority in the Nonprofit Organization*, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* 215, 215 – 16 (Victor Futter et al., eds. 2002) (stating that, although how a board delegates authority will vary with business needs and management style, “[w]hat should not vary . . . is the ability to point to something in writing that clearly establishes who has the authority to take each kind of organizational action”); ABA *GUIDEBOOK*, at 25 (recommending “that [nonprofit] corporations give consideration to making more formal delegations of authority to the chief executive officer”).

³⁶¹ See, e.g., Brian O’Connell, *THE BOARD MEMBER’S BOOK* 59 (3d ed. 2003) (“A great many of the [] differences” in perceptions and understandings about the roles and responsibilities of the chairman and chief executive “can be anticipated and to some extent reduced if the job descriptions and expectations of both board and staff are clear”); Victor Futter, *Delegations of Authority in the Nonprofit Organization*, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* 215, 216 (Victor Futter et al. eds., 2002) (“Written delegations of authority help both management and board to understand management’s parameter of authority.”).

³⁶² See discussion under “Background” above.

³⁶³ Charter, § 4(a)(1)(A).

³⁶⁴ See Bylaws, §§ 2.2(a) & 6.1(a).

for the Executive Committee of the Board to consider and submit recommended candidates for the position of Chairman to the President of the United States.³⁶⁵ Under this process, a subcommittee of the Executive Committee, chaired by the incumbent Chairman (or the most senior vice chairman, in the absence or at the request of the Chairman), considers candidates for the position and makes a recommendation to the Executive Committee, which, in turn, submits the recommendation to the President of the United States.³⁶⁶

Customarily, the governing bodies of organizations select their own chairmen, and many nonprofit organizations follow this model.³⁶⁷ Among federally-chartered organizations like the Red Cross, methods for selecting the chairman of an organization's governing body vary.³⁶⁸ There are persuasive reasons for the President of the United States to continue to appoint the Chairman of the Board.³⁶⁹ As noted above, the federal government has assigned the Red Cross responsibility for fulfilling the obligations of the United States under the Geneva Conventions, for carrying out peace-time disaster relief functions (including under the National Response Plan), and for providing services to members of the U.S. military and their families.³⁷⁰ In 1946, the Harriman Committee concluded that the unique responsibilities of the Red Cross "require a close affiliation with the Federal Government which can be best brought about by the continuation in the Charter of provisions requiring the naming of a portion of the governing body

³⁶⁵ See Bylaws, § 6.1(b).

³⁶⁶ See *id.*

³⁶⁷ See, e.g., Bylaws of The Ford Foundation, available at <http://www.fordfound.org/about/docs/bylaws.pdf> (last visited Oct. 5, 2006); Bylaws of The Nature Conservancy, available at <http://www.nature.org/aboutus/leadership/art15494.html> (last visited Aug. 14, 2006); Press Release, *Goodwill International's New Board Chair Brings Business Expertise and Unique Insight to Serving People* (Aug. 28, 2006), available at <http://www.goodwill.org/page/guest/about/newsroom/newsreleases/archivednewsreleases/nr083006002> (last visited Oct. 5, 2006) (announcing that the Board of Directors of Goodwill International Industries, Inc. had elected a new Board Chair).

³⁶⁸ For example, the President of the United States appoints the chairman of the governing body of the United States Holocaust Memorial Museum. See 36 U.S.C. § 2302(d) (2006). The statute creating the Corporation for National and Community Service provides for the President of the United States to appoint the initial chairman of the organization's governing body and for that body to elect successive chairmen from among its members. See 42 U.S.C. § 12651a(b)(1) (2006). The charters of Big Brothers-Big Sisters of America, Boy Scouts of America and Boys and Girls Clubs of America provide that the board determines how the chairman is selected in its bylaws. Other federally-chartered entities have *ex officio* chairmen; for example, the charter of the National Park Foundation provides that the Secretary of the Interior serves as chairman. See 16 U.S.C. § 19f (2006). Still other federally-chartered entities follow the corporate model for selecting board chairmen. For example, the Bylaws of two publicly-traded and federally-chartered government-sponsored entities, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), provide for board-selected chairmen. See § 4.08 of Fannie Mae's Bylaws, available at <http://www.fanniemae.com/governance/bylaws/> (last visited Aug. 14, 2006), and § 3.05 of Freddie Mac's Bylaws, available at http://www.freddiemac.com/corporate/about/pdf/bylaws_071505.pdf (last visited Aug. 14, 2006).

³⁶⁹ The process for selecting the CEO, a position separate from the Chairman, is discussed in "Selection of the CEO" below.

³⁷⁰ See discussion under Section 1, "Unique Status and Responsibilities of the Red Cross" above.

by the President of the United States.”³⁷¹ The Harriman Committee further concluded that the President of the United States should continue to designate one of these appointees as the chief executive (the Chairman) of the Red Cross.³⁷² The rationale for the Harriman Committee’s recommendation with respect to the appointment of the Chairman is just as relevant today as it was 60 years ago—the responsibilities of the Red Cross necessitate a strong connection with the federal government. Presidential appointment of the Chairman confers influence and stature on the position of Chairman and helps further a collaborative relationship between the Red Cross and the federal government that has existed since the early years of the organization. Given the nature of the Red Cross’ responsibilities, the organization must have a positive and collaborative relationship with the federal government.

On the other hand, there are arguments for vesting in the Board additional authority with respect to selecting the Chairman. As an initial matter, Board selection of the Chairman would be consistent with widespread governance practice, although, as noted above, the process for appointing a chairman varies among federally-chartered organizations.³⁷³ In addition, the members of a board generally are best positioned to identify the desired qualities for the leader of the board, to assess the performance of the board’s leader, and to determine when a change in leadership may be appropriate.³⁷⁴ Currently, the Executive Committee of the Red Cross plays a role in selecting the Chairman through a subcommittee that considers possible candidates and recommends a candidate to the Executive Committee for submission to the President of the United States.³⁷⁵ However, the President need not accept the recommendation of the Executive Committee.

Another option would be for the Board to elect the Chairman without Presidential review, thus giving the full Board a greater role in and authority over the selection of its leader. This would permit the Red Cross to engage in succession planning for the position of Chairman, which is a critical function³⁷⁶ and one that is not practical under the present structure in which the President of the United States has the ultimate authority to select the Chairman.

Given the fact that the Executive Committee recommendation and Presidential appointment of the Chairman of the Board has worked very well over its 60-year history, the

³⁷¹ Harriman Report, at 20.

³⁷² See Harriman Report, at 2, 27 – 28. As discussed above, this subject was discussed at length and was “[t]he only major question” on which the Committee did not reach agreement. *Id.* at 1. See discussion under Section 1, “The ‘Harriman Report’ and the 1947 Amendments to the Charter” above.

³⁷³ See discussion under “Appointment of the Chairman” above.

³⁷⁴ See Business Roundtable 2005 Principles of Corporate Governance, at 29 (“Directors should serve only so long as they add value to the board.”).

³⁷⁵ See Bylaws, § 6.1(b).

³⁷⁶ See, e.g., Cyril O. Houle, GOVERNING BOARDS: THEIR NATURE AND NURTURE 76 – 77 (1989) (“The chairmanship is the key element in the life of the board. Each new holder of that office should be chosen with great care, and the board must be constantly aware of the need to develop leaders who can eventually serve in the top post.”).

recommended approach is a combination of two methods: the Governance and Board Development Committee would recommend a candidate to the full Board, which in turn would recommend the candidate to the President.³⁷⁷ This process would provide the full Board a role in selecting its leader, while preserving the Presidential appointment of the Chairman, which could be significant in maintaining the desired relationship with the federal government so essential for the national mission of the Red Cross.

Selection of the CEO

The selection of the chief executive is one of the most important responsibilities of a board.³⁷⁸ One governance expert has noted that “[w]hatever the differences between types of nonprofit organizations, the most important job a board has is to hire the [chief executive].”³⁷⁹ In addition, long-term planning for the chief executive and senior management development and succession is an important function of the board.³⁸⁰

Currently, under the Bylaws of the Red Cross, the President and CEO is nominated by the Chairman and elected by the full Board.³⁸¹ Information-gathering conducted in connection with the Governance Audit suggests that, in practice, the Chairman historically has worked cooperatively with the Board to evaluate and identify candidates for the position of President and

³⁷⁷ Given the new respective roles of the Executive Committee and the Governance and Board Development Committee (see discussion under Section 4.E, “Executive Committee” and “Recommendations” below), it would be more appropriate for the Governance and Board Development Committee to perform this role.

³⁷⁸ See, e.g., Cyril O. Houle, *GOVERNING BOARDS: THEIR NATURE AND NURTURE* 104 (1989) (“As all authorities agree, the selection of a new executive is a crucial function of the board” of a nonprofit organization); see also Brian O’Connell, *THE BOARD MEMBER’S BOOK* 75 – 86 (3d ed. 2003) (discussing the recruitment, encouragement and evaluation of the chief executive of a nonprofit organization); Fisher Howe, *Nonprofit Accountability: The Board’s Fiduciary Responsibility*, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* 29, 32 (Victor Futter et al., eds. 2002) (listing the selection, compensation, evaluation and dismissal of a chief executive as one of the five “fundamental” responsibilities of the board); see also American Red Cross and the NACD, *Report of the American Red Cross Corporate Governance Summit on Enhancing Board Effectiveness* 4 (March 21, 2006) (“One of the most important tasks of any board is to select and work with a CEO.”); Robert A.G. Monks & Nell Minow, *CORPORATE GOVERNANCE* 200 (3d ed. 2004) (listing the selection of the chief executive as one of the board’s primary functions); Business Roundtable 2005 Principles of Corporate Governance, at 2 (“[T]he paramount duty of the board of directors of a public corporation is to select a chief executive officer and to oversee the CEO and senior management in the competent and ethical operation of the corporation on a day-to-day basis.”).

³⁷⁹ See, e.g., Brian O’Connell, *THE BOARD MEMBER’S BOOK* 55 (3d ed. 2003). See also *id.* at 76 (noting “general acknowledgement that recruitment of the staff head is the most important decision the board will make”).

³⁸⁰ See, e.g., BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 1 (2005) (“[e]xceptional boards . . . continually evaluate the organization’s leadership needs as part of succession planning”); Cyril O. Houle, *GOVERNING BOARDS: THEIR NATURE AND NURTURE* 104 (1989) (calling it “sound practice” to “think far ahead” on succession planning); see also Business Roundtable 2005 Principles of Corporate Governance, at 8 & 28 – 29 (describing succession planning as “one of the board’s most important functions”).

³⁸¹ See Bylaws, § 6.3.

CEO. This information-gathering also indicated that, historically, management development and succession have not been a consistent focus of the Board.³⁸²

Board Membership of the CEO

Currently, the President and CEO of the Red Cross is not a member of the Board. Governance practices in this area differ somewhat between the corporate and nonprofit sectors.³⁸³ Although the chief executive of a for-profit corporation almost always serves on the board,³⁸⁴ this is not the case in nonprofit organizations.³⁸⁵ In nonprofit organizations, the chief executive officer often sits on the board, but as an *ex officio*, non-voting member.³⁸⁶ There are arguments both for and against having the chief executive serve on the board of a nonprofit organization, and, in cases where the chief executive does serve on the board, for giving the chief executive full voting rights.³⁸⁷ Advocates of making the chief executive a voting member of the board argue that this:

- facilitates the chief executive's understanding of the organization, allowing the chief executive to make more informed decisions;³⁸⁸
- adds credibility and authority to the chief executive's position, elevating the chief executive's stature among other board members and among outside constituencies such as community leaders;³⁸⁹

³⁸² See discussion of committees and recommendation to establish a compensation and management development committee under Section 4E, "Compensation and Management Development Committee" below.

³⁸³ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board 1* (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006) ("The model for CEOs serving on the board started in the corporate world.").

³⁸⁴ See, e.g., Robert A.G. Monks & Nell Minow, *CORPORATE GOVERNANCE* 203 (3d ed. 2004) ("[T]he CEO . . . also acts as chairman of the board in the overwhelming majority of American companies.").

³⁸⁵ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board 2* (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006) ("There are many models of governance, ranging from a complete separation of management and governance all the way to working boards that are responsible for everything. Many boards function somewhere between the two.").

³⁸⁶ See Peter Dobkin Hall, quoted in *Should an Executive Director be a Member of the Board?* The Nonprofit FAQ, Internet Nonprofit Center, available at <http://www.idealists.org/if/idealists/en/FAQ/QuestionViewer/default?category-id=3&item=17§ion=3&sid=72551253-40-DZkxz> (last visited Aug. 28, 2006).

³⁸⁷ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board 6* (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006) (summarizing limitations and advantages of various models).

³⁸⁸ See *id.* at 4.

³⁸⁹ See *id.*; see also BoardSource, *Should the Chief Executive Vote?* (2006), available at <http://www.boardsource.org/Knowledge.asp?ID=1.234> (last visited Sept. 15, 2006) (stating that making a chief executive a voting member of the board "enhances his or her position of authority inside and outside of the

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- gives the chief executive “an equal voice at the board table,” which is essential to forming a true partnership between the board and the chief executive;³⁹⁰ and
- assists in recruiting more seasoned candidates by demonstrating faith in the chief executive and support for a governance model that includes a strong chief executive.³⁹¹

Those who support not having the chief executive serve on the board of a nonprofit organization argue that this:

- helps preserve the distinction between governance and management;³⁹²
- strengthens the board’s independent decision-making by eliminating the possibility that the board will defer to, and vote in accordance with, the judgment of the chief executive;³⁹³

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organization”); William G. Bowen, *Inside the Boardroom: A Reprise*, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* 3, 9 (Victor Futter et al., eds. 2002).

³⁹⁰ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board* 1, 5 (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006). See also William G. Bowen, *Inside the Boardroom: A Reprise*, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* 3, 8 – 9 (Victor Futter et al., eds. 2002). In describing the difference between for-profit and nonprofit governance practices with regard to the membership of the chief executive on the board, Bowen writes:

I am amazed by the fact that people debate actively the question of whether the [chief executive] should even be a member of the board, or whether the [chief executive] should have a vote. My answer to both of these questions is: Absolutely! The [chief executive] needs to feel that he or she is much more than a hired hand, and that board members are peers, not superior beings. That is essential if a real partnership is to be formed and is to work.

BACK TO THE DRAWING BOARD, at 120 (“[T]he relationship between the CEO and the board will be strongest if the CEO and the board see each other as partners.”); BoardSource, *Should the Chief Executive Vote?* (2006), available at <http://www.boardsource.org/Knowledge.asp?ID=1.234> (last visited Sept. 15, 2006) (stating that by making a chief executive a voting member of the board, the chief executive can “strengthen the working partnership with the board.”).

³⁹¹ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board* 5 (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006).

³⁹² See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board* 2 – 3 (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006); BoardSource, *Should the Chief Executive Vote?* (2006), available at <http://www.boardsource.org/Knowledge.asp?ID=1.234> (last visited Sept. 15, 2006) (stating that board membership for the chief executive may lead to a “[b]lurring of the distinction between the board’s responsibilities and the chief executive’s responsibilities.”); Betsy Rosenblatt, *Should the CEO Have a Vote on the Board?* (Apr. 2000), available at http://www.boardnetusa.org/infocenter/vz/rc_content.asp?contentid=69 (last visited Sept. 15, 2006) (“For [the chief executive] to be voting on the board and influencing decisions about his or her role creates a conflict of interest.”).

- eliminates the inherent conflicts of interest that arise because the board supervises, and sets the compensation of, the chief executive;³⁹⁴
- enhances effective board oversight of the chief executive's performance;³⁹⁵ and
- eliminates tensions that may arise between the chief executive and other board members.³⁹⁶

Organizations and governance experts that have considered the issue have reached different conclusions about the advisability of having the chief executive serve on the board, but predominantly have concluded that the chief executive should serve on the board, either as a voting or non-voting member.³⁹⁷

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³⁹³ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board 3* (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006); Betsy Rosenblatt, *Should the CEO Have a Vote on the Board?* (Apr. 2000), available at http://www.boardnetusa.org/infocenter/vz/rc_content.asp?contentid=69 (last visited Sept. 15, 2006) (“If the chief executive were able to sway board decisions by voting, the board’s independent role in keeping the chief executive on his or her toes is at risk.”).

³⁹⁴ For example, a chief executive might not want to vote against the majority of his board, or might be concerned if his or her voice is not strong enough to persuade the board to the chief executive’s point of view. See Alan Bergstedt, quoted in The Nonprofit FAQ, Internet Nonprofit Center, *Should an Executive Director be a Member of the Board?*, available at <http://www.idealists.org/if/idealists/en/FAQ/QuestionViewer/default?category-id=3&item=17§ion=3&sid=72551253-40-GptkV> (last visited Sept. 21, 2006). See also, e.g., Council on Foundations, *Board Briefing: CEOs on the Board 3* (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006); Betsy Rosenblatt, *Should the CEO Have a Vote on the Board?* (Apr. 2000), available at http://www.boardnetusa.org/infocenter/vz/rc_content.asp?contentid=69 (last visited Sept. 15, 2006) (“The board . . . sets the chief executive’s salary, so it clearly doesn’t make sense for the CEO to vote on that decision. Yes, the chief executive could recuse himself or herself from that discussion, but for how many other decisions would recusing be appropriate?”).

³⁹⁵ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board 3* (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006); see also BoardSource, *Should the Chief Executive Vote?* (2006), available at <http://www.boardsource.org/Knowledge.asp?ID=1.234> (last visited Sept. 15, 2006) (“Board assessment of the chief executive’s performance and determination of compensation” may be compromised if the chief executive is a board member.).

³⁹⁶ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board 4* (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006); see also BoardSource, *Should the Chief Executive Vote?* (2006), available at <http://www.boardsource.org/Knowledge.asp?ID=1.234> (last visited Sept. 15, 2006) (There is a potential for some relationships between the chief executive and certain board members to “become strained if the chief executive votes against a particular initiative or ideas.”).

³⁹⁷ See, e.g., Council on Foundations, *Board Briefing: CEOs on the Board 5* (Dec. 2004), available at http://www.cof.org/files/Documents/Governing_Boards/Board%20Briefs/CEOs_ON_BOARD_FINAL.doc (last visited Aug. 22, 2006) (“There is no good reason why a CEO could not or should not serve on the board.”); BACK TO THE DRAWING BOARD, at 119 – 120 (2004) (“The CEO *must* be on the board unless laws preclude it.

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Reasons for making the CEO of the Red Cross a member of the Board with full voting rights include furthering an effective Board-management partnership, enhancing the credibility and stature of the CEO, and empowering the CEO in managing the operations of the Red Cross. Empowering the CEO is especially important at the Red Cross, where concerns have been raised about confusion in the roles of the Chairman of the Board and the CEO as a result of the “principal officer” language in the Charter. Concerns about having a chief executive serve on the board, such as the possible blurring of the distinction between governance and management and the potential for conflicts of interest, could be handled through mechanisms such as clarifying the role of the Board,³⁹⁸ introducing position descriptions for the Chairman and the CEO, and following conflict-of-interest policies, which the Red Cross already has in place.

At the same time, many of the reasons supporting Board membership for the chief executive are not as compelling in the case of the Red Cross. Because the President and CEO currently attends all Board and Board committee meetings, the President and CEO is present at these meetings (except executive sessions) as the leader of management and, as a practical matter, is fully informed about Board matters. Concerns about empowering the CEO can be addressed by removing the “principal officer” language from the Charter, developing a position description for the CEO that clearly delineates the CEO’s authority and responsibility for managing the operations of the Red Cross, and focusing on enhancing the effectiveness of the partnership between the CEO and the Board. Such a partnership would be characterized by mutual trust, forthrightness and a common commitment to the mission of the Red Cross, and by the Board’s full support of the CEO in the leadership of the Red Cross.³⁹⁹ The Governance Committee, as well as the Panel, were split on the best practice for the Board. Thus, the Committee concluded that the *status quo* should remain unless and until circumstances justify a change.

Recommendations

For the reasons outlined above, a number of changes relating to the positions of the Chairman and the CEO should be made. At this point, there is no compelling reason for the Red

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Even if she is not a board chairman, she should be on the board because she is the driver of the board’s agenda and the key informant to the board about the company.”) (emphasis added).

³⁹⁸ See discussion under Section 4A, “Role of the Board” above.

³⁹⁹ See, e.g., BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 1 (2005) (stating that:

Exceptional boards recognize that they cannot govern well without the chief executive’s collaboration and that the chief executive cannot lead the organization to its full potential without the board’s unflinching support. Exceptional boards forge a partnership with the chief executive characterized by mutual trust, forthrightness, and a common commitment to the mission. They encourage a strong, honest chief executive to pose questions and offer answers, and to share bad news early and openly. In turn, chief executives provide boards with tools and information to govern exceptionally. They welcome differing points of view and strategic thinking at the board table. Members of exceptional boards communicate regularly with the chief executive, informally discussing concerns in and between board meetings.).

Cross to change its current practice under which the CEO is not a member of the Board. Going forward, the Board has the flexibility to make a determination regarding whether the CEO should serve on the Board based on the individual circumstances. The Board also has flexibility to make a determination regarding whether the CEO should also serve as President (as is currently the case) or whether these roles should be filled by two different individuals.

Changes in Governance Practices

Pending a Charter change, recommendations for which are discussed below, there are a number of steps that should be taken now:

Roles of the Chairman and the CEO

1. The Bylaws should be amended to: (a) reflect that the Chairman, when present, will preside at meetings of the Board and will have such other duties and responsibilities as may be set forth in the Bylaws or by resolution of the Board; and (b) delete references to the Chairman serving as the “principal officer” of the Red Cross. The current language in the Bylaws describing the CEO as the “chief executive officer” of the Red Cross would remain unchanged.
2. The Board should consider the specific responsibilities to be performed by the Chairman and the CEO, and these responsibilities should be clearly delineated in written position descriptions approved by the Board. These position descriptions may, of course, be changed from time to time depending upon the skills and experience of the individuals in the positions and organizational needs.
3. The Board should adopt a more specific, written delegation of authority from the Board to the CEO. The delegation would expand upon the broad delegations currently in place and serve as a basis for the written job description to be developed pursuant to the previous recommendation. Both the position description and the delegation of authority should clearly establish the authority and responsibility of the CEO for managing the operations of the Red Cross.

Appointment of the Chairman

4. The Bylaws should be amended to provide that the Board considers candidates for the position of Chairman and recommends a Chairman candidate to the President of the United States. In addition, the Bylaws should state that the Chairman cannot also serve as the CEO.

Selection of the CEO

5. Given the importance of a board’s responsibility for hiring the chief executive, the Bylaws should be amended to remove the requirement that the Chairman nominate the CEO and provide that the Board appoints the CEO. In addition, the Bylaws should be amended to provide that the positions of President and CEO do not need to be held by the same individual.

Changes to the Charter

Roles of the Chairman and the CEO

1. The Charter should be amended to reflect that: (a) the Chairman, when present, will preside at meetings of the Board and will have such other duties and responsibilities as may be set forth in the Bylaws or by resolution of the Board; (b) to remove references to the “principal officer” of the Red Cross; and (c) to provide for a chief executive officer.

Appointment of the Chairman

2. The Charter should provide that the Board will recommend a Chairman candidate for appointment by the President of the United States.

E. BOARD COMMITTEES

Introduction

The Board currently does much of its work through eight active committees. While many nonprofit and corporate boards also rely on committees, the large size of the Board and the fact that the full Board meets only four times per year⁴⁰⁰ necessitate a greater reliance on Board committees by the Red Cross.

Background

The Charter establishes the Board as the governing body of the Red Cross and provides for an Executive Committee of at least 11 Board members.⁴⁰¹ Under the Charter and the Bylaws, the Executive Committee possesses and may exercise all the powers of the Board when not in session and any other powers and authority delegated to it by the Board.⁴⁰² Pursuant to the Bylaws, the Board has established an additional seven Board committees: Biomedical Services; Finance; Disaster and Chapter Services; Audit; Public Support; International Services; and Governance.⁴⁰³ The purpose, authority, composition, election and meetings of each of the committees are set forth in the Bylaws and additional information with respect to each of the committees is set forth in their respective “function statements.”⁴⁰⁴ For the most part, the Board has not delegated decision-making authority to the committees.⁴⁰⁵ Rather, the committees generally make recommendations to the full Board, which then takes action. The Board has, however, delegated authority and responsibility for governance and oversight of the blood services regions to the Biomedical Services Committee,⁴⁰⁶ the authority to set and approve compensation and benefit programs for senior executives who report to the President and CEO and others pursuant to Section 4958 of the Internal Revenue Code to the Governance Committee,⁴⁰⁷ and responsibility for the Red Cross’ relationship with its outside auditor to the Audit Committee.⁴⁰⁸

⁴⁰⁰ Sections 1.7 and 2.12 of the Bylaws provide that the Board shall meet annually at the annual meeting of the Red Cross. Section 2.13 of the Bylaws provides that the Board shall meet two times per year in addition to this annual meeting. In practice, the Board also meets one additional time for a strategic retreat.

⁴⁰¹ See Charter, §§ 4(a) – 4(c).

⁴⁰² See *id.* § 4(c); Bylaws, § 3.1.1.

⁴⁰³ See Bylaws, § 3.

⁴⁰⁴ The Board may establish other standing committees. See Bylaws, § 3.9.

⁴⁰⁵ Each committee has and may exercise all authority as is delegated to it by the Board. See Bylaws, § 3.1.1 (Executive Committee); *id.* § 3.2.1 (Biomedical Services Committee); *id.* § 3.3.1 (Finance Committee); *id.* § 3.4.1 (Disaster and Chapter Services Committee); *id.* § 3.5.1 (Audit Committee); *id.* § 3.6.1 (Public Support Committee); *id.* § 3.8.1 (Governance Committee).

⁴⁰⁶ See Policy Manual, Pt. 1, § 1.9.2.

⁴⁰⁷ See Bylaws, § 3.8.1(i).

⁴⁰⁸ See Amended and Restated Audit Committee Function Statement.

The committees range in size from seven to 19 members. In consultation with the Chairman of the Board, the Governance Committee annually considers membership on the committees and conveys recommendations to the Executive Committee and, in turn, to the full Board for approval. The committees are active, meeting from three to nine times per year (in 2005), both in conjunction with regular Board meetings and separately. When committee meetings are held in conjunction with Board meetings, committee meetings are scheduled sequentially. As a result, all members may attend all committee meetings, and many of them do. In addition, members of Red Cross management and other employees often attend committee meetings. It is therefore not unusual for 30 or more people to attend a committee meeting. However, all committees are authorized to use executive sessions, from which management is excluded, and many do, particularly the Executive, Audit and Governance Committees. The Committees regularly report on their activities at Board meetings.

The current Board committee structure is based, in part, on the recommendations of the 2001 Governance Task Force. In light of the large size of the Board, the 2001 Governance Task Force recommended keeping in place a committee structure that included not only the traditional board committees—Executive, Audit, Finance and Governance Committees, but also Biomedical Services, Disaster and Chapter Services, and International and Public Support Committees that oversee particular aspects of Red Cross operations.⁴⁰⁹

The Biomedical Services Committee serves an important role under the FDA Consent Decree. Specifically, the Committee is responsible for oversight of quality assurance and compliance matters related to the Red Cross' biomedical services business under the FDA Consent Decree,⁴¹⁰ which also establishes parameters governing the size and composition of the Committee.⁴¹¹

Analysis

Committees Generally

The directors of corporations and nonprofit organizations frequently do business through board committees.⁴¹² Reliance on committees permits the board to address key areas in more depth than may be possible in a full board meeting.⁴¹³ The authority and function of each

⁴⁰⁹ See American Red Cross Final Report of the Governance Task Force, recommendation I.5 (May 2002).

⁴¹⁰ See, e.g., FDA Consent Decree, para. IV.A.18.

⁴¹¹ See *id.* para. III.B.7 (providing that the Biomedical Services Committee must consist of the Chairman of the Board and not less than ten or more than 14 individuals, with at least a majority of the members to be Board members).

⁴¹² See Section of Business Law, American Bar Association, *GUIDEBOOK FOR DIRECTORS OF NONPROFIT CORPORATIONS* 48 (George W. Overton, ed. 1993). See also *ABA GUIDEBOOK*, at 41 (“Much of the work of the typical board of directors of a public company is performed in committee.”); Business Roundtable 2005 Principles of Corporate Governance, at 16 (“Virtually all boards of directors of large, publicly owned corporations operate using committees to assist them.”).

⁴¹³ See Business Roundtable 2005 Principles of Corporate Governance, at 16.

committee should be clearly defined,⁴¹⁴ and the full board should be kept regularly informed of committee activities.⁴¹⁵ For publicly traded companies, this information generally is contained in committee charters which are approved by the board and disclosed to shareholders.⁴¹⁶ The board or the committee in charge of governance should periodically review the functions assigned to each of the committees.⁴¹⁷

With respect to committee size, commentators generally suggest that “smaller groups are more efficient—three to seven in size is an optimal size—and large committees are unwieldy.”⁴¹⁸ As discussed above, the Board committees generally are larger and members of management and other employees commonly attend meetings.

Operational Committees

“A sound and effective committee structure is vital to the successful operation of any board and the operation of the organization as a whole.”⁴¹⁹ There is no consensus as to the optimal number of committees for a nonprofit board or their responsibilities.⁴²⁰ An “organization must determine which committees are needed for its particular mission.”⁴²¹ However, given that the role of a board is overseeing management and not operating the organization on a day-to-day basis, a nonprofit board should be hesitant to create committees

⁴¹⁴ See ABA GUIDEBOOK, at 42. See also Business Roundtable 2005 Principles of Corporate Governance, at 17.

⁴¹⁵ See ABA GUIDEBOOK, at 42. See also Business Roundtable 2005 Principles of Corporate Governance, at 16.

⁴¹⁶ See NYSE Listed Company Manual § 303A.04 (2004) (nominating/corporate governance committee), § 303A.05 (2004) (compensation committee), & § 303A.06 (2004) (audit committee); NASDAQ Marketplace Rules, Rule 4350(d) (2006) (audit committee).

⁴¹⁷ See ABA GUIDEBOOK, at 43.

⁴¹⁸ *Id.* at 51. However, the committee must contain enough people to carry out its mission. *Id.*

⁴¹⁹ David M. Bardsley, *Committees*, in Section of Business Law, American Bar Association et al., NONPROFIT GOVERNANCE AND MANAGEMENT 125, 125 (Victor Futter et al., eds. 2002). See also ABA GUIDEBOOK, at 41 (“Much of the work of the typical board of directors of a public company is performed in committee.”); Business Roundtable 2005 Principles of Corporate Governance, at 16 (“Virtually all boards of directors of large, publicly owned corporations operate using committees to assist them.”).

⁴²⁰ See David M. Bardsley, *Committees*, in Section of Business Law, American Bar Association et al., NONPROFIT GOVERNANCE AND MANAGEMENT 125, 128 (Victor Futter et al., eds. 2002) (“[Some] committees are not appropriate for every organization.”). See also ABA GUIDEBOOK, at 41 (“Diversity in board structure and size does not allow for a particular committee structure.”); Jeffrey Callen, April Klein & Daniel Tinkelman, *Board Composition, Committees, and Organizational Efficiency: The Case of Nonprofits*, in NONPROFIT AND VOLUNTARY SECTOR QUARTERLY 503 (Dec. 2003), available at <http://nvs.sagepub.com/content/vol32/issue4/> (last visited Sept. 18, 2006) (“nonprofit organizations vary widely as to board committee types and composition”); Compass Point Nonprofit Services, *Board Committee Job Descriptions* (Feb. 1999), available at <http://www.compasspoint.org/boardcafe/details.php?id=67> (last visited Sept. 19, 2006) (“It goes without saying that there is no one-size-fits-all committee list for boards, or what the responsibilities or activities should be for each committee.”).

⁴²¹ David M. Bardsley, *Committees*, in Section of Business Law, American Bar Association et al., NONPROFIT GOVERNANCE AND MANAGEMENT 125, 128 (Victor Futter et al., eds. 2002).

whose responsibilities are to oversee particular operational units within the organization.⁴²² It is the role of the entire board to oversee *all* of the organization's operations. As one nonprofit expert has noted, "Directors generally oversee administration of the organization. . . . [D]ay-to-day management is supposed to be the province of employees."⁴²³

The Red Cross' current "operational" committees—Biomedical Services, Disaster and Chapter Services, Public Support and International Services—reflect the operational structure of the organization. They line up directly with operating units and management, a structure which invites overstepping the role of the Board.⁴²⁴ Consideration should be given to the continued need for certain of these operational committees.⁴²⁵ The Board as a whole, rather than discrete committees, could focus on oversight of those significant operational issues raised by management. This approach would permit the entire Board to focus on oversight of significant operational risks as well as strategic and other "high level" issues.

In some highly regulated industries, a separate board committee may be necessary to oversee management's regulatory compliance functions.⁴²⁶ This is particularly the case where specialized knowledge is required of board members to exercise effective oversight. The Red Cross biomedical services business operates under the heightened scrutiny of the FDA. Continuation of a committee that oversees management's regulatory compliance activities in this area is therefore prudent. To reflect this Committee's function of oversight of regulatory compliance (rather than involvement in business operations), the Committee might be better named the Quality and Regulatory Compliance Committee. It also would be appropriate for this committee to report on a periodic basis to the Audit Committee, which also is responsible for certain compliance matters.

Philanthropy Committee

Fundraising is of vital importance to nonprofit organizations, including the Red Cross. Many nonprofits establish a fundraising or philanthropy committee to lead the development and implementation of a fundraising plan and to approach potential donors.⁴²⁷ In fact, it has been

⁴²² See, e.g., Robert A.G. Monks & Nell Minow, *CORPORATE GOVERNANCE* 195 (3d ed. 2004) ("The board's primary role is to monitor management.").

⁴²³ Bruce Hopkins, BoardSource, *LEGAL RESPONSIBILITIES OF NONPROFIT BOARDS* 8 (2003).

⁴²⁴ See discussion concerning the role of the Board under Section 4A, "Analysis" above.

⁴²⁵ See, e.g., Robert A.G. Monks & Nell Minow, *CORPORATE GOVERNANCE* 201 (3d ed. 2004) ("The board is not sufficiently involved in the day-to-day decisions of the company to determine how the company should be managed—that is the job of the executives.").

⁴²⁶ See, e.g., Basel Committee on Banking Supervision, Risk Management Group, *Enhancing Corporate Governance for Banking Organisations* 6-7 (Sept. 1999), available at <http://www.bis.org/publ/bcbs56.pdf> (last visited Oct. 27, 2006) (noting benefit of risk management committee to oversee management's activities in managing legal and other risks).

⁴²⁷ Carter McNamara, *Overview of Nonprofit Fundraising Sources and Approaches*, available at http://www.managementhelp.org/fndrsng/np_raise/fndraise.htm (last visited Sept. 19, 2006). See also Grant Thornton, 2005 GRANT THORNTON LLP NATIONAL BOARD GOVERNANCE SURVEY FOR NOT-FOR-PROFIT ORGANIZATIONS 8 (2005) (noting that 65% of survey respondents had a fundraising committee); The Society of

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suggested that “the absence . . . of a fundraising committee might compromise the effectiveness of board and organizational fundraising.”⁴²⁸ The function of a fundraising committee is not, however, primarily to raise money but rather to oversee the organization’s overall fundraising.⁴²⁹ The appropriate responsibilities of a fundraising committee are:

- “To work with staff to establish a fundraising plan that incorporates a series of appropriate vehicles, such as special events, direct mail, product sales, etc.;
- To work with fundraising staff in their efforts to raise money;
- To take the lead in certain types of outreach efforts, such as chairing a dinner/dance committee or hosting fundraising parties, etc.;
- To be responsible for involvement of all board members in fundraising, such as having board members make telephone calls to ask for support; and
- To monitor fundraising efforts to be sure that ethical practices are in place, that donors are acknowledged appropriately, and that fundraising efforts are cost-effective.”⁴³⁰

The Red Cross currently has a Public Support Committee whose purpose is “to consider policy matters relating to public relations and public support of [the organization], including questions related to fundraising and relationships with federated fund-raising groups, unions, businesses, foundations, government, and other organizations that affect the financial and volunteer support of [the Red Cross].”⁴³¹ Some of these responsibilities extend well beyond oversight of fundraising activities and relate to operational matters, such as communications and government relations, which are within the purview of management. On the other hand, some of these responsibilities relate to overseeing fundraising activities that are necessary to secure and grow the Red Cross’ financial health. Given the role of fundraising within the Red Cross, consideration should be given to reconstituting the Public Support Committee as a Philanthropy

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Corporate Secretaries and Governance Professionals & The National Center for Nonprofit Boards, *Governance for Nonprofits: From Little Leagues to Universities: A Summary of Organizational Governance Principles and Resources for Directors of Nonprofit Organizations*, available at <http://www.governanceprofessionals.org/governnfp/board.shtml> (last visited Sept. 19, 2006) (listing a “Development/Fund-Raising Committee” as a common board committee for nonprofit organizations).

⁴²⁸ Governance Matters, *Nonprofit Governance Indicator Guide* (2006), available at <http://governance1.web132.discountasp.net/web/NGIG/5.aspx> (last visited Sept. 19, 2006).

⁴²⁹ *But see* Gayle Gifford, *Is It Time To Abolish the Board Fundraising Committee?* (June 6, 2002), available at <http://www.charitychannel.com/publish/templates/?a=616&z=0> (last visited Sept. 19, 2006) (“The [fundraising] committees of too many nonprofit boards are often ineffective because they are neither here (a policy group of the board) nor there (an action group of the staff). They aren’t effective at creating policy, and they aren’t any good at raising money either.”).

⁴³⁰ Compass Point Nonprofit Services, *Board Committee Job Descriptions* (Feb. 1999), available at <http://www.compasspoint.org/boardcafe/details.php?id=67> (last visited Sept. 19, 2006).

⁴³¹ *See* Public Support Committee Function Statement.

Committee, which would consider strategic and oversight matters involving Red Cross fundraising.

Compensation and Management Development Committee

An organization should have a committee comprising independent directors that determines the compensation of the chief executive officer and other executive officers.⁴³² This function currently is performed by the Board's Governance Committee (for senior management's compensation and benefits) and in conjunction with the Executive Committee (for the President and CEO's compensation and benefits). Another important responsibility of the board is management development and succession.⁴³³ In this regard, "[b]oards are expected to carry out certain activities . . . [that include] [o]versight of the company's management development and succession planning, especially for the chief executive officer and other senior management positions."⁴³⁴ Responsibility for this function is often assumed by a board compensation committee, although at some companies the governance committee assumes this responsibility.⁴³⁵

Management development and succession is an area where the Board could devote more attention. The Red Cross has had three chief executives and three interim chief executives since 1999, and all of the President and CEOs (excluding the interim President and CEOs) within that time period have been recruited from outside the Red Cross. A committee that would be responsible for management development, as well as compensation issues, could assist the Board in seeing that management develops talent and promotes gifted management and staff. This committee, the Compensation and Management Development Committee, would have the responsibility to "periodically monitor and review the development and progression of potential internal candidates" for management positions and would oversee compensation matters.⁴³⁶ This committee also could see that the organization "has in place emergency procedures for management succession in the event of the unexpected death, disability or departure of the chief

⁴³² See Business Roundtable 2005 Principles of Corporate Governance, at 23. See also ABA GUIDEBOOK, at 53 ("A compensation committee should . . . be considered . . . [s]ince such a task involves the receipt and evaluation of confidential and sensitive data.").

⁴³³ See Business Roundtable, 2005 Principles of Corporate Governance, at 27 ("[l]ong-term planning for CEO and senior management development and succession is one of the board's most important functions"); see also Robert A.G. Monks & Nell Minow, CORPORATE GOVERNANCE 212 (3d ed. 2004) ("Boards of directors must understand that CEO succession planning is their responsibility, not the CEO's, and that it is a perpetual responsibility that begins right after the party celebrating a new hire for the top position. . . . [The board] should be familiar enough with the senior staff to get a perspective on the CEO's performance and a sense of who should be cultivated as a candidate for the CEO position.").

⁴³⁴ BACK TO THE DRAWING BOARD, at 17 – 18.

⁴³⁵ See ABA GUIDEBOOK, at 69, 70 ("[T]he committee should—to the extent not done by another board committee—review the performance of chief executive officer and members of senior management on a formal basis at least annually, and should periodically update succession planning and related procedures.").

⁴³⁶ Business Roundtable 2005 Principles of Corporate Governance, at 28.

executive officer and should review with the chief executive officer management's plans for the replacement of other members of the senior management team."⁴³⁷

Audit Committee

The Red Cross has long had standing, separate Audit and Finance Committees. In recent years, however, the functions of these committees have increasingly overlapped. For example, the Finance Committee is authorized to consider, among other things, matters related to the financial affairs of the Red Cross,⁴³⁸ while the Audit Committee is authorized to consider, among other things, matters related to the Red Cross' financial statements and internal controls. Board members have indicated that similar agenda items appear on both committee calendars. In the past year, for example, both committees have called upon management for updates on internal controls and financial audits.

Although many organizations have a single committee that performs the functions now performed by these separate Red Cross committees,⁴³⁹ some audit and finance committee responsibilities overlap in a manner that could be perceived as inappropriate. For instance, a finance committee often acts on operational budgets and proposed expenditures; an audit committee oversees the financial reporting for and audit of operations and expenditures. A solution would be for the Audit Committee to perform those functions that do not raise conflict issues with its audit functions, and the full Board to consider the remaining responsibilities currently performed by the Finance Committee, such as budget approval.

Executive Committee

"The use and effectiveness of [an] executive committee depends upon the particular organization's structure, operation, and style. An executive committee may be used more frequently if a board is large and/or meets relatively infrequently,"⁴⁴⁰ as has been the case with the Red Cross historically.

⁴³⁷ ABA GUIDEBOOK, at 70.

⁴³⁸ See Finance Committee Function Statement.

⁴³⁹ David M. Bardsley, *Committees*, in Section of Business Law, American Bar Association et al., NONPROFIT GOVERNANCE AND MANAGEMENT 125, 132 (Victor Futter et al., eds. 2002) ("The function of the [finance] committee may be combined within the audit . . . committee."). See also Kay Sohl, *Congress and IRS Demand More Nonprofit Accountability* (2005), available at <http://www.tacs.org/tacsnews/dirtemplate.asp?pID=153> (last visited Sept. 19, 2006) ("For many nonprofits, the finance committee will serve as the audit committee."); NACD, NACD NOT-FOR-PROFIT GOVERNANCE SURVEY 19 (noting that 66.1% of survey respondents had a finance committee and 86.6% of respondents had an audit committee, and if combined, the audit and finance committees most often combined functions with one another); Grant Thornton, 2005 GRANT THORNTON LLP NATIONAL BOARD GOVERNANCE SURVEY FOR NOT-FOR-PROFIT ORGANIZATIONS 8 (2005) (noting that 83% of survey respondents had a finance committee and 60% of respondents had an audit committee).

⁴⁴⁰ David M. Bardsley, *Committees*, in Section of Business Law, American Bar Association et al., NONPROFIT GOVERNANCE AND MANAGEMENT 125, 129 (Victor Futter et al., eds. 2002).

Greater use of an executive committee was one of the recommendations of a panel of governance experts to The Nature Conservancy in 2004.⁴⁴¹ This recommendation was designed to address the “problem [of a 40-person board] by proposing the creation of an 11-member Executive Committee, which would function as a ‘board within a board Thus, a larger board would remain, but the ‘work’ would be accomplished by an Executive Committee and active functioning committees.”⁴⁴² It should be noted that The Nature Conservancy Board ultimately determined to reduce the size of its board instead.⁴⁴³ Consistent with The Nature Conservancy recommendation, a ‘board within a board’ role for the Red Cross Executive Committee was considered, but was rejected in view of concerns about, among other things, the legal responsibilities of Board members and the preference for a smaller Board.

Given the revised role and size of the Red Cross Board, a broad delegation of authority to the Executive Committee may no longer be necessary. Instead, Board authority should be delegated to the Executive Committee to address only those specific matters that arise between Board meetings and to perform duties delegated to it by the Board.

Recommendations

1. The Bylaws should be amended as necessary to provide for the following standing committees: Executive, Audit, Governance and Board Development, Compensation and Management Development, Quality and Regulatory Compliance, and Philanthropy.
 - The Executive Committee will include the Committee chairs and the Chairman of the Board and may perform tasks such as establishing the Board agenda. The Committee will meet between Board meetings and perform the duties delegated to it by the Board.
 - The Audit Committee will continue to be responsible for oversight of financial reporting, internal controls, internal and external audits, and compliance with Red Cross policies and legal requirements. The Audit Committee should receive compliance reports from management and periodic reports from the Quality and Regulatory Compliance Committee. The functions of the current Finance Committee, such as budget approval, generally should be the responsibility of the full Board.
 - The Governance and Board Development Committee, in consultation with the Chairman, will recommend committee membership to the full Board for approval.
2. Committee charters and annual agendas should be adopted for each of the standing committees.

⁴⁴¹ The Nature Conservancy Report, at 7.

⁴⁴² Millstein Report, at 5.

⁴⁴³ *Id.*

F. WHISTLEBLOWER PROCESSES AND INTERNAL AUDIT FUNCTION

Introduction

Effective whistleblower processes are essential compliance and governance tools, because they enable organizations to identify compliance issues and other significant risks that would not otherwise be identified through traditional reporting channels.⁴⁴⁴ Internal audit functions also are critical to risk management. The Red Cross' whistleblower procedures (other than those related to its biomedical services business) and the structure of its internal audit function were examined as part of the Governance Audit. In addition, related matters concerning consolidated financial reporting and internal controls were considered.⁴⁴⁵

Background

The Red Cross' Whistleblower Hotlines

The Red Cross operates two whistleblower hotlines, the Concern Connection Line (the "CCL") and the Biomedical Response Line (the "BRL"). The CCL, which was established by the Red Cross in 2003, is a 24-hour telephone service hotline, operated by an outside company, through which Red Cross employees and volunteers may report concerns regarding fraud, waste, abuse and potentially illegal, unsafe or unethical conduct. Although callers may choose to identify themselves, in general the CCL is confidential, anonymous and toll-free. The BRL, which Red Cross biomedical personnel may use to report biomedical issues, was established in August 2000 as part of the Red Cross' quality assurance program under the FDA Consent Decree.⁴⁴⁶ The BRL was not examined as part of the Governance Audit.

Both the CCL and the BRL are operated by trained third-party professionals from Global Compliance Services, a company that also operates hotlines for other large organizations. The Red Cross promotes awareness of the CCL and the BRL through its intranet, CrossNet, as well as brochures and wallet cards that are provided to employees and volunteers. CrossNet also includes the email addresses for Audit Committee members, who sometimes receive complaints directly via email.

When a call is received on one of the hotlines, an employee of Global Compliance Services asks a series of questions, based on a script approved by the Red Cross, to understand the concern being expressed. The Global Compliance Services employee then prepares a report and forwards the report to the Red Cross. For all hotline calls not involving biomedical issues, the reports are forwarded to the Red Cross' Office of Investigations, Compliance and Ethics (the "IC&E"), within the Enterprise Risk Department at the Red Cross' national headquarters. Reports relating to biomedical issues are forwarded to the Biomedical Quality Assurance group,

⁴⁴⁴ See, e.g., Panel on the Nonprofit Sector Final Report, at 80; Association of Certified Fraud Examiners ("ACFE"), *2006 ACFE Report to the Nation on Occupational Fraud & Abuse* 29-31 (2006) ("ACFE Report").

⁴⁴⁵ See also discussion under Section 4H, "Governance Oversight of the Chartered Units" below.

⁴⁴⁶ See Consent Decree Notification (Apr. 14, 2004), available at http://www.fda.gov/ora/frequent/letters/1000123507_ARC/consent_decree_100023507_01.html (last visited Sept. 20, 2006).

which oversees compliance with the FDA Consent Decree. After an investigation of a complaint has been completed, the whistleblower may use the confidential complaint number to inquire about the results of the Red Cross' investigation into the complaint.

Investigations and Responses to CCL Whistleblower Complaints

The IC&E group includes two full-time paid investigators, a paralegal and approximately 22 investigative analysts. The group is headed by the Vice President for IC&E, who has worked in a Washington, D.C. government security group and is a former manager of security and safety for Exxon Mobil Corporation. She reports to the Senior Vice President for the Enterprise Risk Department and coordinates with the General Counsel in responding to complaints presenting significant legal issues.

In calendar year 2005, the IC&E group handled 621 CCL cases, representing a 22% increase from 2004. The 2005 CCL cases raised a broad range of issues:

- about one-third involved allegations of fraud;
- about one-sixth were categorized as general concerns;
- less than one-sixth involved concerns about workplace conduct; and
- the remaining calls involved complaints about employment issues, safety concerns and other issues.

Although final CCL statistics are not yet available for calendar year 2006, preliminary information from IC&E indicates that call volume for 2006 likely will be higher than call volume for calendar year 2005.

Following receipt of complaints, IC&E performs a three-level triage analysis based on the immediacy of risks posed by the complaint. Priority A calls are those that require immediate response, because they involve "incidents of imminent harm or danger to life or property." Priority B calls are those that report "incidents of harm or danger to life or property that have already occurred." Most complaints involving allegations of fraud, waste or abuse are Priority B complaints, because they often are reported after the fact. All complaints of both priority levels are investigated. Priority C calls are those that report general workplace misconduct and human resource issues of a non-legal nature. Priority C complaints are either investigated or referred to management and human resources for appropriate handling.

For "serious complaints"—such as those involving allegations of criminal acts, fraud or significant misuse of Red Cross resources—the Vice President for IC&E, in coordination with the Office of the General Counsel (the "OGC") and the Senior Vice President for the Enterprise Risk Department, decides whether the investigations should be performed by IC&E investigators or outside counsel.

Claims involving "significant compliance and legal risks"—such as those involving unusual or egregious violations of law, regulations or Red Cross policies that could expose the Red Cross to significant civil or criminal penalties or undermine the effectiveness of Red Cross

services or its reputation—are reviewed by the General Counsel and presented to the Audit Committee Chair and the Chairman of the Board (and, if necessary, the entire Audit Committee) for their determination of: (1) whether the Audit Committee needs to retain outside advisors, including independent legal counsel; or (2) whether the matter may be investigated by the General Counsel, either with in-house or external counsel. In the event of a General Counsel investigation, the General Counsel is required to keep the Chairman of the Board and the Chair of the Audit Committee, as well as the Red Cross’ outside auditor, informed of the progress and results of the investigation, along with any recommended remedial actions.⁴⁴⁷

For complaints not involving allegations of significant compliance and legal risks or serious misconduct, IC&E assigns one of its investigators, and then forwards the complaint to the appropriate Red Cross management—which varies depending on the department or group that is the subject of the complaint—for an initial investigation. If the complaint involves chapter personnel, but does not involve a chapter executive, then the complaint is forwarded to the chapter executive for the initial investigation. If the complaint involves a chapter executive, then the complaint is forwarded to the Service Area for an investigation by a Service Area employee. If the complaint involves headquarters personnel, then the complaint is forwarded to an impartial headquarters manager for review. During the initial investigation, the assigned IC&E investigator provides assistance to the person conducting the investigation. After the initial investigation has been completed, the assigned IC&E investigator reviews the report prepared by the person who conducted the initial investigation for adequacy and completeness. In some cases, additional investigation, either by the person preparing the report or IC&E, is conducted.

After an investigation has been completed, IC&E prepares a summary that is made available for any follow-up inquiries by the whistleblower. The IC&E group also refers matters to, and cooperates with, the Department of Justice and other law enforcement entities on any criminal investigations involving Red Cross funds, employees or volunteers.

Disciplinary Practices

In cases where whistleblower complaints concerning violations of the Red Cross’ policies or Code of Conduct are substantiated, the Red Cross must decide whether to take disciplinary action against the violator or violators. Violators may include either employees or volunteers.

Decisions regarding possible disciplinary actions are made by a team of Red Cross personnel, which include a “business owner” from the violator’s group or organization (often the violator’s supervisor or a higher-level manager), an employment attorney from OGC, an investigator from IC&E who is familiar with the facts and circumstances, and a representative from human resources (from national headquarters or the relevant Service Area). In addition, for potentially severe violations involving high-level personnel—such as a chapter executive or an executive at the national headquarters—possible disciplinary actions are discussed with the General Counsel, the Audit Committee, and senior management.

⁴⁴⁷ The Audit Committee and Executive Committee approved the *General Counsel Protocol for Notification of Significant Compliance and Legal Risks* in July 2006.

Although disciplinary actions may vary—depending on the nature and severity of the violation, the particular person’s involvement, and that person’s level in the organization and history at the Red Cross—the Red Cross undertakes to maintain consistency across all parts of the organization with respect to similar types of violations. In particular, OGC and human resources personnel (in the national headquarters and the Service Areas) attempt to ensure that similar violations are treated consistently across the organization. For violations of certain policies, such as the policy prohibiting retaliation against whistleblowers, the disciplinary action may be termination, regardless of whether the violator is an employee or volunteer in the national headquarters, a blood services region or a chapter.

Audit Services—The Red Cross’ Internal Audit Function

The Red Cross’ internal audit department is referred to as “Audit Services.” The Policy Manual provides that “Audit Services at National Headquarters is an independent, objective assurance and consulting activity designed to add value and improve the organization’s operations. It helps the organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”⁴⁴⁸ The Policy Manual further states that Audit Services must have “complete access” to “audit and examine any Unit, department, operation, program, or related entity of the Corporation.”⁴⁴⁹ In addition, the “[i]nternal auditors shall be independent of the activities they audit . . . [and] shall have direct access to the Chair of the [Red Cross], Audit Committee, and the President and CEO.”⁴⁵⁰

Audit Services includes approximately 18 paid audit professionals, as well as some trained volunteers, headed by the position of Chief Audit Executive (formerly referred to as the General Auditor). The former General Auditor departed in 2005 and during most of 2006, the Red Cross internal audit function was headed by an interim head of internal audit; the Red Cross currently is recruiting a permanent replacement, with a contract Chief Audit Executive now in place.

Role of the Audit Committee

Oversight of Whistleblower Processes

The Audit Committee’s function statement provides that the Committee has responsibility for reviewing “legal and regulatory matters that may have a material impact on the [Red Cross’] financial statements, related corporate compliance policies, and programs and reports received from regulators.”⁴⁵¹ The function statement also provides that the Audit Committee shall “[c]ause to be made an investigation into any matter brought to its attention within the scope of its duties, with the power to retain outside counsel for this purpose if, in its

⁴⁴⁸ Policy Manual, Pt. 2, § 3.6.1.

⁴⁴⁹ *Id.* at § 3.6.2.

⁴⁵⁰ *Id.* at § 3.6.3.

⁴⁵¹ Amended and Restated Audit Committee Function Statement, para. 16.

judgment, that is appropriate.”⁴⁵² In this regard, the Audit Committee oversees the Red Cross’ whistleblower processes.

The Audit Committee regularly receives oral reports at its meetings from the Vice President for IC&E, regarding complaints received, investigated, and resolved by IC&E. These reports sometimes are accompanied by confidential, written summaries regarding significant complaints. In response to a recent request for details from IC&E regarding specific complaints and responses, the Vice President for IC&E has been providing additional information about specific complaints and related responses at Audit Committee meetings. The Vice President for IC&E also provides an annual report, delivered at the beginning of each year and accompanied by a written summary of statistics and trends, regarding CCL complaints received and investigated over the course of the prior year.

The General Counsel also reports to the Audit Committee on complaints presenting significant compliance and legal risks and concerns, including complaints requiring investigation by outside counsel. The General Counsel provides an annual report to the Audit Committee and other Board members outlining the major litigation, contracts and transactions, ethics matters and other legal practice areas that OGC has worked on over the course of the year.

Oversight of Audit Services and Internal Controls

The Audit Committee is responsible for overseeing the audit process and financial statements, as well as the Red Cross’ systems of internal controls.⁴⁵³ Specifically, the Audit Committee’s function statement states that the Audit Committee shall “[c]onsider and review, with Corporate Management and the Auditors, the adequacy of the [Red Cross’] risk management methodology and internal controls, including computerized information system controls and security.”⁴⁵⁴ The Bylaws provide that management of the Red Cross is responsible for maintaining internal controls and for preparing accurate financial statements in accordance with Generally Accepted Accounting Principles.⁴⁵⁵

The function statement also provides that the Audit Committee shall “[c]onsider and review with Corporate Management and the general auditor” various matters concerning Audit Services and the annual audit plan.⁴⁵⁶ Historically, the Audit Committee has received regular reports on the status of audits performed by Audit Services, as well as an annual review of the internal audit plan, from the head of internal audit. Before a reorganization in 2005, the head of internal audit reported functionally to the Audit Committee and reported administratively to the President and CEO. Since 2005, the head of internal audit continues to report functionally to the Audit Committee, but reports administratively to the Senior Vice President for the Enterprise Risk Department, who reports to the President and CEO.

⁴⁵² *Id.* para. 21.

⁴⁵³ Bylaws, §§ 3.5.1(a) – (b).

⁴⁵⁴ Amended and Restated Audit Committee Function Statement, para. 9.

⁴⁵⁵ Policy Manual, Pt. 1, § 6.6.4.

⁴⁵⁶ Amended and Restated Audit Committee Function Statement, para. 12.

Ongoing Initiatives

The Red Cross has several ongoing initiatives intended to improve its whistleblower processes, financial reporting and internal controls.⁴⁵⁷ First, the Red Cross has created a Disaster Response Unit within the IC&E function, composed of volunteers with investigative experience, who will be deployed by IC&E to all “Level 3” and above national disaster relief sites to oversee and coordinate awareness of whistleblower processes and responses to complaints and to investigate allegations of fraud, waste and abuse. Second, the Red Cross plans to supplement its telephone hotlines with email addresses through which complainants may submit complaints or ethics questions to IC&E.⁴⁵⁸ Third, the Red Cross is in the process of hiring an Ethics Officer, who will oversee development of organization-wide ethics training. Fourth, there has been a special focus on providing training and access to information on the CCL and the whistleblower process to volunteers deployed in disasters.

The Red Cross also has a number of initiatives under way to improve its financial reporting and internal controls. First, through the Shared Administrative Services Initiative, the Red Cross plans to centralize responsibility for financial reporting and accounting functions for its chapters.⁴⁵⁹ Second, the Red Cross (with the assistance of Deloitte & Touche USA LLP) has undertaken a review of financial management processes.⁴⁶⁰ Third, the Red Cross is in the process of enhancing its controls in the disaster relief context, including the following:

- expansion of recruiting and training for disaster relief employees and volunteers, including a background check process and training for all chapters on the appropriate use of Client Assistance Cards;
- creation of a group of 50 to 75 well-trained individuals who may be deployed by the Red Cross during disasters as community relations leaders;
- development of a single client assistance system and related controls regarding appropriate use of that system in providing disaster relief; and
- improvement of operational capabilities, including systems relating to logistics and the supply chain for relief supplies.⁴⁶¹

⁴⁵⁷ See American Red Cross, *Enhancing the American Red Cross Ethics Awareness Program* (Sept. 2006).

⁴⁵⁸ The email addresses are: ethics@redcross.org and fraudalert@redcross.org.

⁴⁵⁹ See discussion under Section 2, “Ongoing Red Cross Initiatives” above and discussion under Section 4H, “Governance Oversight of the Chartered Units” below.

⁴⁶⁰ See American Red Cross, *From Challenge to Action: American Red Cross Actions To Improve and Enhance Its Disaster Response and Related Capabilities For the 2006 Hurricane Season and Beyond* 18 (June 2006).

⁴⁶¹ *Id.* at 17 – 19.

Analysis

Nonprofits,⁴⁶² public companies⁴⁶³ and governmental agencies⁴⁶⁴ alike have adopted whistleblower processes because they are effective tools for identifying potential fraud as well as controls and compliance issues within an organization.⁴⁶⁵ Vigorous internal controls coupled with an effective internal audit function also help stem fraud and abuse and are critical to accurate financial reporting.⁴⁶⁶ Financial accountability enhances donor confidence in nonprofit organizations just as it enhances investor confidence in public companies and other for-profit firms.⁴⁶⁷

In recent years, public companies have been required to adopt whistleblower processes under the Sarbanes-Oxley Act,⁴⁶⁸ and all types of organizations have been encouraged to adopt whistleblower processes and other compliance measures under the Federal Sentencing Guidelines⁴⁶⁹ and as a matter of good practice.⁴⁷⁰ Similarly, internal audit departments are

⁴⁶² See The Nature Conservancy, *Nature Conservancy Whistleblower Policy*, available at <http://www.nature.org/aboutus/leadership/art15485.html> (last visited Sept. 21, 2006).

⁴⁶³ See NYSE Listed Company Manual § 303A.07 – 08 (2004).

⁴⁶⁴ See *Department of Homeland Security Whistleblower Policies*, available at <http://www.dhs.gov/xoig/index.shtm> (last visited Oct. 31, 2006).

⁴⁶⁵ According to a 2006 study performed by the ACFE, tips from employees and other stakeholders were the most common means by which not-for-profit organizations and public companies detected occupational fraud. See *ACFE Report*, at 29-31. For not-for-profit organizations participating in the study, 22.4% of the tips were provided anonymously through a hotline or similar mechanism. *Id.* at 41. In addition, the median loss attributable to frauds for organizations with anonymous fraud hotlines (\$100,000) was approximately half of the median loss for organizations without a hotline (\$200,000). See *id.* at 35.

⁴⁶⁶ Robert K. Herdman, Chief Accountant, U.S. Securities and Exchange Commission, *Making Audit Committees More Effective* (March 7, 2002) (Speech to Tulane Corporate Law Institute, New Orleans).

⁴⁶⁷ BoardSource and Independent Sector, *The Sarbanes-Oxley Act and Implications for Nonprofit Organizations 6* (2006), available at <http://www.boardsource.org/clientfiles/Sarbanes-Oxley.pdf> (last visited Sept. 20, 2006). See also New York Charities Bureau, Attorney General Eliot Spitzer, *Internal Controls and Financial Accountability for Not-for-Profit Boards*, available at www.oag.state.ny.us/charities.html (last visited October 10, 2006).

⁴⁶⁸ See Exchange Act § 10A(m)(4), 15 U.S.C. § 78j-1(m)(4) (2006) and Exchange Act Rule 10A-3(b)(3), 17 C.F.R. § 240.10A-3(b)(3) (2006).

⁴⁶⁹ See United States Sentencing Commission Guidelines § 8B.2.1(b)(5) (2005) (providing that an organization may mitigate criminal liability if it has “a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization’s employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.”).

⁴⁷⁰ Panel on the Nonprofit Sector Final Report, at 80.

required by certain stock exchange listing standards,⁴⁷¹ and they are increasingly common at nonprofit organizations.⁴⁷²

By and large, the Red Cross' whistleblower processes that were examined in the Governance Audit are comparable to those used by other large organizations, including public companies that are subject to the requirements of the Sarbanes-Oxley Act. For example, the CCL is operated by the same company, Global Compliance Services, that operates whistleblower hotlines for numerous other large organizations (*e.g.*, Ahold's foreign and U.S. operations).⁴⁷³ In addition, the Red Cross' organizational structure—whereby the Audit Committee oversees the whistleblower process, which is managed by a compliance group that reports directly to the Audit Committee—generally is consistent with the structure adopted by many large organizations, including public companies that are subject to the Sarbanes-Oxley Act. There are, however, several areas in which the Red Cross could improve its processes, as set forth below.

Awareness of the Red Cross' Whistleblower Processes

Even though the Red Cross publicizes its whistleblower processes in various ways, as set forth above, some Red Cross stakeholders—in particular, “spontaneous” volunteers who assist with disaster relief—likely were not as aware of the CCL or other whistleblower processes as they should have been. Historically, spontaneous volunteers have not been formally trained, and many of them do not have access to CrossNet. For regular disaster volunteers, the Red Cross requires training that includes information about accessing the CCL.

Training of volunteers is significant, since volunteers comprise such a large part of the Red Cross' operations.⁴⁷⁴ For example, out of the estimated 245,000 relief workers for the 2005 hurricanes, approximately 235,000 were volunteers.⁴⁷⁵ Other organizations have noted that non-employee stakeholders are a potentially valuable source for tips. According to the 2006 ACFE study, a significant number of tips for occupational fraud—18.1% in the study—came from non-employee stakeholders, such as customers and vendors.⁴⁷⁶

⁴⁷¹ NYSE Listed Company Manual § 303A.07 (2004).

⁴⁷² See The IIA Research Foundation, *Internal Audit Reporting Relationships: Serving Two Masters* (2003), available at http://www.theiia.org/iiia/abouttheiia/research/projects/Internal_Auditing_Reporting_Relationships.pdf#search=%22Serving%20Two%20Masters%20IIA%22 (last visited Oct. 10, 2006).

⁴⁷³ See *Ahold's Whistleblower Procedure*, available at <http://www.ahold.com/page/503.aspx> (last visited Sept. 14, 2006).

⁴⁷⁴ See United States Sentencing Commission Guidelines § 8B2.1(b)(4) (2005) (providing that organizations may mitigate criminal liability through required compliance and ethics training, including periodic updates, for all employees and agents of the organization).

⁴⁷⁵ American Red Cross, *From Challenge to Action: American Red Cross Actions To Improve and Enhance Its Disaster Response and Related Capabilities For the 2006 Hurricane Season and Beyond* 8 (June 2006).

⁴⁷⁶ See 2006 ACFE Report, at 29. See also Grant Thornton, Grant Thornton CorporateGovernor Series, *Hear that whistle blowing! Establishing an effective complaint-handling process*, Vol. 2, No. 2, at 7 (Aug. 2006), available at http://www.grantthornton.com/staticfiles/GTCom/files/AboutUs/Corporate%20Governance/CorporateGovernor_white_paper_series/Grant%20Thornton%20CG%20WP3%20Whistle%20Blower.pdf (last

[Footnote continued on next page]

Protections for Whistleblowers

Policies that prohibit retaliation against whistleblowers and encourage communication regarding compliance and ethics issues are an essential part of any whistleblower program.⁴⁷⁷ According to the Red Cross' intranet, CrossNet, the Red Cross "does not tolerate retaliation and will take remedial action should retaliation occur. . . . Failing to report misconduct is an act contrary to the best interests of the [Red Cross] and is, therefore, a violation of the Code of Conduct." These policies are available on the Red Cross' intranet, but they are not included in the Red Cross' Code of Conduct or the Red Cross' external website.

Above and beyond policies prohibiting retaliation, some organizations also encourage whistleblowers to report misconduct by hiring an ombudsman—an employee who is independent of management and who often reports directly to the audit committee—to provide another avenue for employees and other stakeholders to report complaints without fear of retaliation.⁴⁷⁸

Oversight by the Audit Committee

Whistleblower Processes

For audit committees to provide appropriate oversight of whistleblower processes, there must be regular and in-depth reporting—directly to the audit committee or the full board—on trends and significant complaints that arise through those processes.⁴⁷⁹ Consistent with this

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visited Oct. 30, 2006) (recommending that audit committees should have established policies for receiving complaints from external sources, in addition to employees).

⁴⁷⁷Section 1107 of the Sarbanes-Oxley Act, which prohibits retaliation against a person who provides truthful information to a law enforcement officer regarding a federal offense, applies to all persons, including nonprofit organizations. See Sarbanes-Oxley Act of 2002, § 1107, *codified at* 18 U.S.C. § 1513(e) (2006). In addition, Section 806 prohibits public companies from retaliating against an employee who lawfully provides information or assists in an investigation of fraud investigations or violations of the securities laws. See Sarbanes-Oxley Act of 2002, § 806, *codified at* 18 U.S.C. § 1514A (2006). See also Daniel Kurtz, et al., *Representing & Managing Tax-Exempt Organizations*, GEORGETOWN UNIVERSITY LAW CENTER CONTINUING LEGAL EDUCATION, 2004 WL 2800532 (Apr. 29-30, 2004) (discussing various state whistleblower protections); Bruce D. Collins, *Representing & Managing Tax-Exempt Organizations: Part II Whistleblower and Conflict of Interest Policies*, GEORGETOWN UNIVERSITY LAW CENTER CONTINUING LEGAL EDUCATION, 2004 WL 2800532, *7 (Apr. 29-30, 2004) (describing sample employee handbook language regarding protection of whistleblowers); Laurie A. Webb, *Prepare for When the Whistle Blows: Top Ten Practical Tips on How To Effectively Create and Maintain a Whistleblower Policy*, PRACTISING LAW INSTITUTE CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, at *125 (2004) (sample financial integrity and non-retaliation policy).

⁴⁷⁸ See General Electric's Governance Principles, *available at* <http://www.ge.com/en/citizenship/govcomp/governance.htm> (last visited Sept. 21, 2006) (stating that whistleblower complaints are investigated by GE's ombudsman).

⁴⁷⁹ See AICPA, *Management Override of Internal Controls: The Achilles' Heel of Fraud Prevention*, at 7-8 (2005); Carol Pergola, et al., *Investigation Tips from the Hotline: An Examination of the Unique Oversight Done by Corporate Directors*, NACD – Directors Monthly, at 11-12 (Feb. 2006); See also Grant Thornton, Grant Thornton CorporateGovernor Series, *Hear that whistle blowing! Establishing an effective complaint-handling process*, Vol. 2, No. 2, at 16 – 17 (Aug. 2006), *available at* <http://www.grantthornton.com/staticfiles/GTCom>

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practice, the Vice President for IC&E regularly reports to the Audit Committee regarding trends and significant complaints.

In addition, there should be specific criteria for the types of complaints that should be reported immediately to the board, the audit committee, and senior management.⁴⁸⁰ At the Red Cross, the *General Counsel Protocol for Notification of Significant Compliance and Legal Risks* applies to IC&E investigators and OGC attorneys, who must report significant compliance and legal risks to senior management, the Chairman of the Board, and the Audit Committee. The protocols were approved by the Audit Committee and the Executive Committee in July 2006.

Internal Audit and Internal Controls

Accurate and transparent financial reporting requires effective internal controls⁴⁸¹ and an effective internal audit team that tests and reinforces internal controls.⁴⁸² Internal control structure and internal audit function also are crucial to preventing fraud and abuse.⁴⁸³ These principles are equally important in nonprofit organizations.

As defined by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), internal control is a process effected by the board and management designed to provide reasonable assurance regarding: (1) effectiveness and efficiency of operations; (2) reliability of financial reporting; and (3) compliance with applicable laws and regulations. Internal control can be judged as effective in each of the categories if the board and management have reasonable assurance that: (1) they understand the extent to which operational objectives are achieved; (2) published financial statements are prepared reliably; and (3) applicable laws and regulations are being complied with.

Senior management is responsible for the integrity of the financial reporting system and financial statements, and for establishing, maintaining and periodically evaluating internal

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/files/AboutUs/Corporate%20Governance/CorporateGovernor_white_paper_series/Grant%20Thornton%20CG%20WP3%20Whistle%20Blower.pdf (last visited Oct. 30, 2006).

⁴⁸⁰ See *AICPA Toolkit for Not-for-Profit Organizations: AICPA’s Model Issues Report From Management*, available at http://www.aicpa.org/audcommctr/toolkitsnpo/Issues_Report_from_Management.htm (last visited Sept. 19, 2006) (sample criteria for significant complaints that should be reported to the Audit Committee).

⁴⁸¹ See Business Roundtable 2005 Principles of Corporate Governance, at 11.

⁴⁸² See Robert K. Herdman, Chief Accountant, U.S. Securities and Exchange Commission, *Making Audit Committees More Effective* (March 7, 2002) (Speech to Tulane Corporate Law Institute, New Orleans).

⁴⁸³ *Id.*

controls.⁴⁸⁴ The board of directors, primarily through the audit committee, is responsible for reviewing adoption and implementation of internal financial controls.⁴⁸⁵

Under the internal control framework established by COSO, an organization's audit committee has a number of internal control-related functions. These functions include: approving the internal audit annual audit plan; hiring, evaluating and replacing when necessary the head of internal audit; assuring sufficient staffing in the accounting and internal audit functions; considering and assessing a variety of risks, including external risks (economic conditions, creditor demands), internal risks (retention and succession planning, financing, information systems reliability and security), and risks of financial statement misstatements; establishing a process for informing audit committee members about significant issues on a timely basis and in a manner conducive to conveying a full understanding of the issues and implications; monitoring financial reporting milestones to ensure timing deadlines are met; and establishing an appropriate reporting structure.⁴⁸⁶

Because the internal audit function has become increasingly important in the post-Sarbanes-Oxley era, the independence and objectivity of internal auditors has assumed heightened significance. To protect the independence of the internal audit function, the Institute of Independent Auditors recommends that the head of internal audit should report functionally to the audit committee and administratively to the chief executive.⁴⁸⁷ The head of internal audit also should report periodically to the audit committee.⁴⁸⁸

The functional reporting line of the Red Cross' internal audit group, Audit Services, to the Audit Committee, is consistent with the recommendation of the Institute of Independent Auditors and the internal audit departments of other organizations.⁴⁸⁹ Rather than reporting to the President and CEO through an intermediary, however, the Red Cross head of internal audit

⁴⁸⁴ See Business Roundtable 2005 Principles of Corporate Governance, at 11.

⁴⁸⁵ Panel on the Nonprofit Sector Final Report, at 80. See also AICPA, *Internal Control: A Tool for the Audit Committee* (2005), available at http://www.aicpa.org/audcommctr/toolkitsnpo/Internal_Control.htm (last visited Oct. 11, 2006).

⁴⁸⁶ AICPA, *Internal Control: A Tool for the Audit Committee* (2005), available at http://www.aicpa.org/audcommctr/toolkitsnpo/Internal_Control.htm (last visited Oct. 11, 2006).

⁴⁸⁷ Institute of Internal Auditors, *Internal Audit Standards: Why They Matter* (2005), available at www.theiia.org/download.cfm?file=83632 (last visited Oct. 11, 2006). See also AICPA, *Internal Control: A Tool for the Audit Committee* (2005) available at http://www.aicpa.org/audcommctr/toolkitsnpo/Internal_Control.htm (last visited Oct. 11, 2006); The IIA Research Foundation, *Internal Audit Reporting Relationships: Serving Two Masters* (2003), available at http://www.theiia.org/ia/abouttheiia/research/projects/Internal_Auditing_Reporting_Relationships.pdf#search=%22Serving%20Two%20Masters%20IIA%22 (last visited Oct. 10, 2006).

⁴⁸⁸ *Id.*

⁴⁸⁹ Under the Institute for Internal Auditors' Practice Standards (Attribute Standard 1110), "[t]he chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities." According to a 2005 survey of 142 organizations, 75% of internal auditors reported functionally to the Audit Committee or the Board. See David I. Currie, *Establishing the Authority of the Internal Audit Activity*, available at www.theiia.org/download.cfm?file=85317 (last visited Oct. 10, 2006).

function preferably should have direct access and a direct administrative reporting relationship to the President and CEO.

At the Red Cross, filling the Chief Audit Executive position should be a high priority, and the Audit Committee should continue its involvement in the recruiting and hiring process with vigor. While qualified talent is in short supply,⁴⁹⁰ the Audit Committee should see that adequate internal audit staffing is in place.

Responsibility For Compliance And Ethics

Under the Federal Sentencing Guidelines, “specific individual(s) within high-level personnel,” such as the general counsel, must have oversight responsibility for an organization’s compliance program.⁴⁹¹ Further, other individuals who have day-to-day responsibility for the compliance program must report periodically to high-level personnel and to the Board or an appropriate subgroup of the Board.⁴⁹²

At the Red Cross, there is no single person with responsibility for the overall compliance program. Since Spring of 2005, IC&E—which has some day-to-day compliance responsibility—has been part of the Enterprise Risk Department. Various groups within the organization have responsibility for different aspects of the Red Cross’ compliance program.

Recommendations

Awareness of Whistleblower Processes

1. The Red Cross should expand awareness among employees, volunteers and others of its whistleblower processes, including the CCL. Specifically, the Red Cross should:
 - include a link on its external website, redcross.org, that is devoted to the CCL, the Code of Conduct, and other ethics issues, in order to facilitate awareness for all volunteers and other stakeholders;⁴⁹³
 - post signs with information regarding the CCL (*e.g.*, instructions for use, phone number) at all facilities, including chapters and disaster relief locations; and
 - expand the Ethics Awareness Program, which should include awareness of the CCL and other ethics issues, through sign-posting, training and regular ethics awareness activities.⁴⁹⁴

⁴⁹⁰ PricewaterhouseCoopers, *2006 State of the Internal Audit Profession Study: Continuous Auditing Gains Momentum* 19 (2006) (internal audit faces a continuing shortage of qualified talent).

⁴⁹¹ See United States Sentencing Commission Guidelines § 8B.2.1(b)(2)(B) (2005).

⁴⁹² See *id.* § 8B2.1(b)(2)(C).

⁴⁹³ Posting the Code of Conduct on the Red Cross’ website also would be consistent with listing standards governing codes of conduct for public companies. See NYSE Listed Company Manual, § 303A.10 (2004); NASDAQ Marketplace Rules, Rule 4350(n) (2006).

Chapter-Level Ethics and Compliance Training

2. The Red Cross IC&E group should oversee and coordinate ethics and compliance training for all chapter personnel, including both employees and volunteers. Ethics training for chapter personnel currently is conducted by the chapters themselves, rather than IC&E. The Red Cross should also explore the use of on-line ethics and compliance training.

Code of Conduct Revisions

3. The Red Cross should revise its Code of Conduct to include the following:
 - information regarding the CCL;
 - the Red Cross' policy of encouraging open communication and reporting of potential misconduct to appropriate persons;⁴⁹⁵ and
 - the Red Cross' no-retaliation policy.

The Code of Conduct and these policies should be posted on, among other places, the Red Cross' internal and external websites.

Ombudsman

4. The Red Cross should consider establishing an ombudsman position, which would provide an additional avenue for independent review of significant issues within the organization.

Periodic Audit of Whistleblower Processes

5. On a periodic basis, to be overseen by the Audit Committee, the Red Cross internal auditors or an outside firm with experience in whistleblower processes should audit the Red Cross whistleblower processes, including the CCL.⁴⁹⁶ In 2004, for example, the Red Cross head of internal audit conducted an audit of the CCL, and provided a written report with recommendations to the General Counsel, who at that time had oversight

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⁴⁹⁴ See Bruce D. Collins, *Representing & Managing Tax-Exempt Organizations: Whistleblower and Conflict of Interest Policies (Part II)*, GEORGETOWN UNIVERSITY LAW CENTER CONTINUING LEGAL EDUCATION, 2004 WL 2800532, *3-4 (Apr. 29-30, 2004) (describing various methods to expand awareness of a whistleblower hotline).

⁴⁹⁵ See AICPA *Toolkit for Not-for-Profit Organizations: Sample Whistleblower Policy*, available at http://www.aicpa.org/audcommctr/toolkitsnpo/Whistleblower_Tracking.htm (last visited Sept. 19, 2006).

⁴⁹⁶ See AICPA, *Management Override of Internal Controls: The Achilles' Heel of Fraud Prevention*, at 7 (2005) (recommending that internal auditors, as overseen by the audit committee, should periodically evaluate the design and operating effectiveness of the hotline).

responsibility for the CCL. This year, the Red Cross hired an outside firm to review both the CCL and the BRL.

Compliance Officer

6. The Red Cross should designate the General Counsel as the organization's Compliance Officer responsible for oversight of the Red Cross compliance function. The IC&E group will be responsible for the day-to-day compliance function and should report to the Compliance Officer.

Internal Audit, Controls and Financial Reporting

7. The Red Cross should expedite the hiring of a new Chief Audit Executive. After the new Chief Audit Executive has been hired, the Audit Committee should review with the Chief Audit Executive the adequacy and appropriateness of resources (including skill level and budget) for Audit Services. In addition, the Chief Audit Executive should report administratively to the CEO, rather than an intermediary, and should continue reporting functionally to the Audit Committee.
8. The Board should oversee management in continuing to improve financial systems, controls and reporting for the consolidated organization and, in particular, for all chapters (including through the Shared Administrative Services Initiative).⁴⁹⁷

⁴⁹⁷ See also discussion under Section 4H, "Governance Oversight of the Chartered Units" below.

G. RESOLUTIONS PROCESS

Introduction

The Policy Manual provides for a resolutions process that allows chapters and blood services regions to recommend proposals relating to significant Red Cross policy matters. These proposals are advisory in nature and submitted to the Board for action that the Board deems appropriate. In recent years, use of the resolutions process has declined significantly and questions have been raised about the effectiveness and efficiency of continuing the current process.

Background

The resolutions process was established in the late 1940s to provide a means for Red Cross chapters and blood services regions to address important corporate policy issues. The Policy Manual establishes a Committee on Resolutions responsible for reviewing proposed resolutions from the chapters and blood services regions and submitting appropriate resolutions for consideration by voting delegates at the annual meeting.⁴⁹⁸ The Policy Manual also governs the specifics of the resolutions process.⁴⁹⁹ The resolutions process previously was conducted at the annual meeting, but was modified to occur independently from the convention with voting by delegates to be done electronically.⁵⁰⁰

The Committee on Resolutions is composed of 21 members from the chapters and blood services regions who are elected at the annual meeting and serve staggered two-year terms (with the exception of the Chairman, who serves a third year on the Committee on Resolutions in this role).⁵⁰¹ The Governance Committee designates one Board member to serve as a liaison to the Committee.⁵⁰² This liaison may not participate in the Committee's deliberations, but is responsible for conducting an annual evaluation with the Committee Chairman and Vice Chairman and for tracking all resolutions adopted by the voting delegates to assure that appropriate consideration and actions are taken on the resolutions and communicated to the entire Red Cross organization.⁵⁰³

Generally by September 30th of each year, the Chairman of the Board solicits proposed resolutions from the chapters and blood services regions.⁵⁰⁴ Proposals must be submitted to the

⁴⁹⁸ See Policy Manual, Pt. 1, § 5.5. Voting delegates at the annual meeting consist of representatives from both the chapters and the blood services regions. Bylaws, §§ 1.3 & 7.1.

⁴⁹⁹ See generally Policy Manual, Pt. 1, § 5.5.

⁵⁰⁰ See *id.*

⁵⁰¹ See *id.*, Pt. 1, §§ 5.5.1 & 5.5.2.

⁵⁰² See *id.*, Pt. 1, § 5.5.4.

⁵⁰³ See *id.*

⁵⁰⁴ See *Call for Proposed Resolutions*, Memorandum from Bonnie McElveen-Hunter, Board Chairman, to Chapter Chairs/Chief Executive Officers and Blood Services Region Chairs/Chief Executive Officers (Oct. 14, 2005); see also Policy Manual, Pt. 1, § 5.5.5.

Committee on Resolutions in accordance with the schedule for the resolutions process identified by the Committee.⁵⁰⁵

The Committee reviews and considers all proposals for resolutions, accepting, pursuant to the Policy Manual, only those resolutions “addressing significant corporate policy issues” submitted by the governing boards of chartered units.⁵⁰⁶ Management and the submitting and other chartered units are given the opportunity to meet with the Committee in person or telephonically to discuss proposed resolutions. Following a Committee meeting to debate and evaluate proposed resolutions, the Committee makes available to all chartered units the preliminary report of its tentative resolutions.⁵⁰⁷ The Committee next conducts an Open Hearing open to the entire Red Cross community to participate electronically after which the Committee completes its consideration and revisions of the resolutions.⁵⁰⁸ The Committee issues a final report outlining the tentative resolutions to voting delegates who again participate electronically.⁵⁰⁹ Only those tentative resolutions, with any amendments, may be voted upon by the voting delegates.⁵¹⁰

Resolutions adopted by the voting delegates are referred to the Board for consideration.⁵¹¹ The Board issues its report on the outcome of the resolutions, including any responses or actions to be taken, to the Red Cross community generally by mid-September each year.⁵¹² The Board generally assigns each resolution to the appropriate Board committee under whose purview the issue falls and asks management to work with that committee to develop a response. A status report of outstanding convention resolutions is posted on the Red Cross’ internal website.

In recent years, there has been a significant decline in the number of resolutions submitted for consideration by the chapters and blood services regions.⁵¹³ For example, the number of substantive resolutions proposed by the chapters and blood services regions has declined from nine in 2002 to one in 2006.⁵¹⁴ Of the 27 resolutions proposed between 2001 and 2005, the Committee on Resolutions determined that 11 were not appropriate for presentation at

⁵⁰⁵ See Policy Manual, Pt. 1, § 5.5.5.

⁵⁰⁶ See *id.*, Pt. 1, § 5.5.7.

⁵⁰⁷ See *id.*, Pt. 1, §§ 5.5.8 – 5.5.9.

⁵⁰⁸ See *id.*, Pt. 1, §§ 5.5.10 – 5.5.11.

⁵⁰⁹ See *id.*, Pt. 1, § 5.5.11.

⁵¹⁰ See *id.*, Pt. 1, § 5.5.12.

⁵¹¹ See *id.*, Pt. 1, § 5.5.13.

⁵¹² See *id.*

⁵¹³ In fact, the lack of resolutions submitted for the 2006 annual meeting prompted the Chair of the Committee on Resolutions to send a reminder message in early January 2006 to all of the chapters and blood services regions to submit proposed resolutions.

⁵¹⁴ Typically, between one and three commendatory resolutions are proposed by the Committee each year, which are not included in the numbers presented above as they are not substantive resolutions proposed by the field.

the annual meeting. In some cases, the Committee determined that the proposed resolutions were operational or did not involve a policy change, and as such, the proposals were referred to management or to a task force for further study.⁵¹⁵ In other cases, the Committee referred proposals to the Board for review or continued action if the proposal involved a policy matter already under consideration by the management or Board.⁵¹⁶ Of the 27 resolutions proposed between 2001 and 2005, 14 ultimately were approved by the convention delegates.⁵¹⁷

As reflected in the Policy Manual, the resolutions process is lengthy, occurring over a good portion of the year. The process also requires a significant amount of chapter, management, Committee on Resolutions and Board time and effort. Not only must the chapters or blood services regions consider the basis for and formulate proposed resolutions, they must compile and present supporting materials and arguments to the Committee. Management also must consider proposed resolutions, develop background papers and appear before the Committee during deliberations. Another hearing regarding tentative resolutions is held, followed by additional Committee deliberation. The Board and Board committees must follow up on resolutions recommended to the Board. Frequently, the resolutions relate to management or operational programs, rather than policy, or to policy matters already under consideration by the Board and management.

As reflected in the declining number of resolutions presented, chapters and blood services regions increasingly have refrained from using the resolutions process. Following the 2006 annual meeting, the Chairman of the Committee on Resolutions asked the Board to consider changes to the resolutions process to create a more effective mechanism for raising issues from the chapters and blood services regions to the Board. The Board asked that the resolutions process be addressed as part of this Governance Audit.

Analysis

Effective communication between the board of directors and the stakeholders or membership of a nonprofit organization is critical.⁵¹⁸ Particularly in nonprofit organizations with a large chapter or affiliate base, communication between the board, management and local

⁵¹⁵ For example, a 2002 proposal regarding whether chapters should be given more discretion to select investment components and investment managers was determined to be an administrative matter and, as such, was referred to the interim President and CEO for action.

⁵¹⁶ For example, two 2004 proposals—one requesting an examination of the costs of service delivery within selected areas and another requesting a review of certain chapter assessment calculations—were determined to be policy matters under active consideration.

⁵¹⁷ These numbers do not include resolutions of commendation presented to the voting delegates at the annual meetings between 2001 and 2005.

⁵¹⁸ See BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 6 (2005) (“Exceptional boards understand that it is in the organization’s best interests to develop open relationships with . . . stakeholders and the larger community.”); see also Aspen Institute Study, at 29 (noting that several nonprofit organizations “indicated that communication was a key concern for their organization, [and] that relationships among the varying levels of governance work better or worse depending on how well these entities communicate”).

affiliates is crucial to developing trust in the national organization and ensuring that the voice of the membership is heard.⁵¹⁹

Nonprofit organizations have structured communications between the national organization and the field in a variety of ways. Some organizations, for instance, use advisory councils or non-board committees to secure input from the chapters on policy decisions and strategic initiatives.⁵²⁰ Other nonprofit organizations, including a number of medical societies, use “reference forums” (similar to town hall meetings) to debate policies or controversial issues, with an ensuing summary or assessment presented to the board.⁵²¹ Nonprofit organizations also appoint task forces, involving members of the board and representatives from the field, to deal with specific issues.⁵²²

Among national nonprofit organizations with a large chapter or affiliate base, a highly structured formal process for communication between national and the field, such as the current resolutions process at the Red Cross, is unusual. Although some other nonprofit organizations have formal processes through which members may propose resolutions on policy issues, the applicable procedures generally do not involve the type of substantive information submission, hearings and deliberations required at the Red Cross. Many organizations, for example, accept for presentation to the full membership any resolution that has been approved by a minimum percentage of members.⁵²³ Other nonprofits require that those wishing to sponsor resolutions simply consult first with their respective regional representative.⁵²⁴

As a practical matter, nonprofit organizations generally rely on informal avenues of communication to secure local affiliate input and views. These informal means of communication often are useful because they can be relied upon more frequently and throughout

⁵¹⁹ See generally Aspen Institute Study, at 29, 34. Effective communication between boards of directors and stakeholders in public companies is similarly important. For example, New York Stock Exchange-listed companies are required to have a method by which shareholders can communicate directly with non-management directors to voice concerns. NYSE Listed Company Manual, § 303A.03 (2004).

⁵²⁰ See Aspen Institute Study, at 29; see, e.g. Overview of Reforms at The Nature Conservancy, dated May 11, 2005, available at <http://www.nature.org> (last visited Sept. 22, 2006) (discussing the Trustee Advisory Council that provides input from the chapters to the board of directors “on major policy decisions and organizational initiatives”). See discussion under Section 4B, “Advisory Functions” above.

⁵²¹ See Aspen Institute Study, at 29 (including, for example, the American Cancer Society).

⁵²² See *id.* (noting, for example, that the Grey Panthers consider task forces “another tier of governance” to examine policy and other issues of importance to the membership).

⁵²³ See, e.g., Constitution of the Girl Scouts of the United States of America, Article IV.1b (proposals submitted by 15% of the local councils must be deemed appropriate for the meeting); NOW National Conference: 2006, Resolutions 411, available at <http://www.now.org/organization/conference/2006/resolutions411.html> (last visited Aug. 12, 2006) (proposal can be introduced at a full meeting if a certain number of signatures have been obtained).

⁵²⁴ See e.g., AIUSA 2006 – 2007 Resolutions Guidelines & Submission Form, available at <http://www.amnestyusa.org/resolutions> (last visited Aug. 14, 2006) (members of Amnesty International USA who intend to sponsor a resolution must first consult their regional representative member of the national resolutions committee).

the year, rather than just once a year, and these communications need not be limited to policy matters or restricted issues. Informal avenues of communication also do not require formal information submissions or presentations nor do they require the resources or preparation necessitated by committee hearings or meetings. Additionally, organizational structures and mechanisms can be implemented to facilitate—and even encourage—informal communications.

At the Red Cross, several informal methods of communication between the field and the Board and management exist. First, the Presidential Advisory Council (composed of not more than 15 chapter executives and one *ex officio* blood services region executive) provides feedback from the chapters to management on “concerns affecting the organization.”⁵²⁵ Second, the Red Cross often appoints task forces, composed of Board members, management and chapter and blood services region executives, to study and assess emerging issues facing the organization. Third, the Service Area structure was designed in part to enhance communication between the chapters and the national organization through the Service Area executives.⁵²⁶ Fourth, the Board and management hold town hall meetings to receive input from the field, which occurred in the implementation of the Service Areas in 2003 and most recently in response to the establishment of the new Community Presence Initiative.⁵²⁷ The proposed National Leadership Council also could channel enhanced communications from the chapters and blood services regions to the national organization and the Board.⁵²⁸

A formal procedure for communicating policy-related matters to the national organization can usefully supplement these less structured means of conveying input from the field. The Red Cross resolutions process could continue to augment and complement informal communications, particularly if streamlined and made more effective.

Recommendations

As evidenced by the decreasing number of resolutions submitted each year and the small percentage of resolutions ultimately adopted, the resolutions process does not appear in recent years to have effectively provided input and feedback from the chapters to the national organization. Communication from the field is important, however, and preserving a resolutions process with improvements could be beneficial to the organization.

The Red Cross should maintain the existing resolutions process and re-examine it after the next annual meeting with the goal of strengthening its effectiveness in light of the changes in governance practices recommended in this report. For instance, the Red Cross could adopt a more streamlined approach whereby a proposed resolution would be accepted for submission if

⁵²⁵ American Red Cross Presidential Advisory Council Charter.

⁵²⁶ See generally Policy Manual, Pt. 2, § 3.2.1; see also discussion under Section 4H, “Governance Oversight of the Chartered Units” below.

⁵²⁷ See discussion under Section 2, “Ongoing Red Cross Initiatives” above.

⁵²⁸ See discussion under Section 4B, “Advisory Functions” above; see also Aspen Institute Study, at 4 (noting that these types of delegate assemblies often act “as a timing mechanism to indicate when issues are directly affecting the membership”).

the proposal: (1) satisfies some advance notice requirement; (2) has the support of some threshold number of chapters and blood services regions; and (3) meets some minimal standard of propriety (*e.g.*, the proposal must concern a matter of organizational policy) without requiring committee hearings, “discovery” on the proposals or submissions to the Committee.

Because informal and more frequent communications from the field can be important, the Red Cross should encourage use of broad-based avenues of communication, including the following:

- communications through existing structural mechanisms, such as the Service Area executives and the Presidential Advisory Council; and
- using the National Leadership Council to enhance communications between national and the field regarding matters of significant corporate policy as well as matters involving management and operations.⁵²⁹

⁵²⁹ The structure and details of the National Leadership Council should be determined with significant input from chapter and blood services region employees and volunteers in the field. The relationship between, and coordination of functions of, the National Leadership Council and the Presidential Advisory Council also should be considered and defined. *See* discussion under Section 4B, “Advisory Functions” above.

H. GOVERNANCE OVERSIGHT OF THE CHARTERED UNITS

Introduction

The Red Cross is organized as a single nonprofit 501(c)(3) entity with just under 800 chapters and 35 blood services regions nationwide. The chapters and blood services regions are the “chartered units” of the organization. The chapters function as the local units of the Red Cross, providing services to local communities on a day-to-day basis and responding to smaller disasters. Although each chapter has a board of directors with delegated authority to perform some governance functions, the Board has ultimate governance and oversight responsibility for each of the chapters. The blood services regions, unlike the chapters, are governed and managed by the national organization, but have advisory boards of directors.

Background

Red Cross Chapters

Red Cross chapters serve as the primary link between local communities and the national organization.⁵³⁰ Clara Barton, the founder of the Red Cross, formed the first local “society” of the Red Cross, now known as Clara Barton Chapter No. 1, in 1881.⁵³¹ Slowly other societies were created over time, first as a response to natural disasters, and later as a response to the 1905 Charter, which called for the creation of state and local societies “with as little delay as possible.”⁵³² The number of chapters grew significantly with World War I and World War II, peaking at 3,757 chapters in 1943 and 1944.⁵³³ During peacetime, the number of chapters started to decline, often as a result of chapter consolidations (or “mergers”).⁵³⁴ Today, there are just under 800 Red Cross chapters in the United States.⁵³⁵

The relationship between chapters and the national organization has changed substantially over time, fluctuating between minimal control by the national organization to a centralized high level of control by the national organization.⁵³⁶ These changes arose from developments within the organization as well as in response to local, national and international

⁵³⁰ See American Red Cross Chapters, available at <http://www.redcross.org/museum/history/chapters.asp> (last visited Sept. 19, 2006).

⁵³¹ See *id.*

⁵³² *Id.*; see Wesley A. Sturges, *The Legal Status of the Red Cross*, 56 MICH. L. REV. 1, 11 (1957); Harriman Report, at 8.

⁵³³ See American Red Cross Chapters, available at <http://www.redcross.org/museum/history/chapters.asp> (last visited Sept. 19, 2006).

⁵³⁴ See *id.*

⁵³⁵ See *id.*

⁵³⁶ See *id.*; Harriman Report, at 8 – 10. See generally Wesley A. Sturges, *The Legal Status of the Red Cross*, 56 MICH. L. REV. 1, 11 (1957).

events.⁵³⁷ For example, in 1909 (following the new 1905 Charter), the functions of the chapters (then called state boards) were fundraising, service delivery and providing other services to the local community.⁵³⁸ As a result of the expansion of Red Cross services during World War II, the significant growth in the number of chapters and other factors, the 1947 (and current) Charter gave chapters a larger and more significant role in the governance of the national organization, with representatives from the chapters electing 30 of the 50 seats on the Board.⁵³⁹ Chapters also played a major role in the blood program until governance and management control for biomedical services was centralized in the national organization in 1993.⁵⁴⁰

Operationally, Red Cross chapters historically have been organized in a number of local and regional reporting structures.⁵⁴¹ Since September 2003, the chapters report to one of eight Service Areas, a structure approved by the Board to formalize the lines of accountability and responsibility from chapter executives to the President and CEO, through the Service Area executives.⁵⁴²

The governing documents of the Red Cross establish a framework whereby the Board has ultimate governance authority over chapters, but has delegated to chapters and local chapter boards some local governance and management responsibilities. The Charter establishes chapters as the local units of the national organization.⁵⁴³ The Charter requires the Board to prescribe regulations relating to:

- requirements for granting and revoking chapter charters;⁵⁴⁴
- chapter geographic boundaries;
- the relationship of chapters to the national organization;

⁵³⁷ See American Red Cross Chapters, available at <http://www.redcross.org/museum/history/chapters.asp> (last visited Sept. 19, 2006).

⁵³⁸ See *id.*

⁵³⁹ See *id.*; see also Charter, § 4(a)(1)(B); Wesley A. Sturges, *The Legal Status of the Red Cross*, 56 MICH. L. REV. 1, 13 (1957).

⁵⁴⁰ See Policy Manual, Pt. 2, § 2.2.1 (“The Board of Governors and FDA require Biomedical Services to provide positive management control of its decentralized local community operations.”); see also *United States of America v. American National Red Cross*, Civ. No. 93-0949, 1993 WL 186094 (D.D.C. May 12, 1993) (issuing the original consent decree on behalf of the FDA calling for centralized management of Red Cross blood services).

⁵⁴¹ See generally American Red Cross Chapters, available at <http://www.redcross.org/museum/history/chapters.asp> (last visited Sept. 19, 2006).

⁵⁴² See Policy Manual, Pt. 2, §§ 3.2.1 – 3.2.2; see also discussion under Section 2, “Ongoing Red Cross Initiatives” above.

⁵⁴³ See Charter, § 3(b)(1); see also Wesley A. Sturges, *The Legal Status of the Red Cross*, 56 MICH. L. REV. 1, 16 (1957).

⁵⁴⁴ See Bylaws, § 9.2 (defining the charter as a certificate of recognition of the chapter together with a statement of the chapter’s territorial jurisdiction).

- chapter compliance with Red Cross policies; and
- procedures for electing chapters' governing bodies.⁵⁴⁵

The Red Cross Bylaws confirm that the chapters are not constituted as separate legal entities.⁵⁴⁶ Assets held by chapters are assets of the consolidated corporate entity,⁵⁴⁷ and title to all property held by chapters must be “vested” in the Red Cross.⁵⁴⁸

The Board has exclusive authority over chapter chartering⁵⁴⁹ and the territorial jurisdiction of the chapters.⁵⁵⁰ In addition, activities of the chapters are governed by nationally-established regulations of the corporation.⁵⁵¹

Chapters that do not comply with Red Cross requirements may be sanctioned by the President and CEO or by the full Board.⁵⁵² Sanctions may include revoking the chapter's charter, removing the chairman or chapter board members, requiring amendments to a chapter's governing documents, suspending a chapter's ability to provide Red Cross services and restricting a chapter's ability to vote at the annual meeting.⁵⁵³

The President and CEO of the national organization has specific authority with respect to chapter affairs.⁵⁵⁴ For example, the President and CEO, or his or her designee, must approve the selection of any chapter executive.⁵⁵⁵ The President and CEO (or his or her designee) also must

⁵⁴⁵ See generally Charter, § 3(b).

⁵⁴⁶ See Bylaws, § 9.1.

⁵⁴⁷ See Policy Manual, Pt. 1, § 3.3.1.

⁵⁴⁸ See *id.*, Pt. 1, § 3.2.1. For example, all funds are held or invested in the name of the chapter as a “division” of the Red Cross. See *id.*, Pt. 1, § 3.1.9.

⁵⁴⁹ See *id.*, Pt. 1, § 2.3; Bylaws, § 9.2.

⁵⁵⁰ See Policy Manual, Pt. 1, § 2.12.2; see also Bylaws, § 9.8.

⁵⁵¹ See Charter, § 3(b)(1)(D) (noting that the Board shall prescribe regulations relating to chapter compliance “with the policies and regulations of the corporation”); see also Bylaws, § 1.5 (defining the term “corporate regulations” as the “Congressional Charter, the Bylaws, the Board of Governors Policy Manual, all resolutions of the Board of Governors, all Chairman’s Letters, and all other regulations, directives, rules, and policies of the President and CEO, or his or her designees”); Policy Manual, § 2.4.1 (“Each Chapter and the officers, directors, employees, volunteers, agents, and representatives thereof shall comply fully with all applicable provisions of the Corporate Regulations.”).

⁵⁵² See generally Bylaws, §§ 9.6 – 9.7. These Red Cross requirements include the Chapter Performance Standards, which were established by the Board in 2004 for the annual evaluation of chapters. See Policy Manual, Pt. 1, § 2.2.1; see also *infra* text accompanying footnotes 570 – 576 (discussing the Chapter Performance Standards).

⁵⁵³ Bylaws, § 9.6.

⁵⁵⁴ See *id.* § 9.7.

⁵⁵⁵ See *id.* § 9.7(c); Policy Manual, Pt. 1, § 2.17.2.

approve the evaluation, compensation and retention of the chapter executive⁵⁵⁶ and may terminate the chapter executive.⁵⁵⁷

Chapter executives are accountable both to their chapter boards and their respective Service Area executives.⁵⁵⁸ The chapter boards and the applicable Service Area coordinate the evaluation of the chapter executive—the chapter board chairman prepares the chapter executive’s annual performance evaluation, the Service Area executive must approve it.⁵⁵⁹

While the Board is ultimately responsible for all chapter activities,⁵⁶⁰ some responsibilities have been delegated to chapter boards and management.⁵⁶¹ For example, the Board has delegated to chapter boards the authority to:

- govern the chapter (consistent with standard chapter bylaws);⁵⁶²
- develop and approve local strategic plans, in conjunction with the chapter executive, that align with the national organization’s strategic plan;
- oversee delivery of services;
- raise funds as specified in the chapter budget and by other financial goals;
- approve the hiring, retention, compensation and performance evaluation of the chapter executive, subject to the approval of the President and CEO (or his or her designee); and
- exercise fiduciary responsibilities, including budget and annual audit oversight.⁵⁶³

In addition, the President and CEO has delegated certain local management responsibilities, such as responsibility for the collection and administration of the chapter’s funds,⁵⁶⁴ to chapter management.⁵⁶⁵

⁵⁵⁶ See Bylaws, § 9.7(c); Policy Manual, Pt. 1, § 2.17.2. This responsibility is designated to the Service Area executive in Part 2 of the Policy Manual. See *id.*, Pt. 2, § 3.2.2(b)(iii).

⁵⁵⁷ See Bylaws, § 9.7(c); Policy Manual, Pt. 1, § 2.17.4.

⁵⁵⁸ See *id.*, Pt. 1, §§ 1.9.3 & 2.17.1; *id.*, Pt. 2, § 4.3.

⁵⁵⁹ See *id.*, Pt. 1, § 2.17.3.

⁵⁶⁰ See *id.*, Pt. 1, § 3.1.1.

⁵⁶¹ See generally *id.*, Pt. 1, §§ 1.9.1 & 3.1.

⁵⁶² See generally *id.*, Pt. 1, §§ 1.91(a) & 2.10; *id.*, Pt. 2, § 5.1 (providing a form of standard chapter bylaws).

⁵⁶³ See *id.*, Pt. 1, § 1.9.1; see also *id.*, Pt. 2, § 4.3.

⁵⁶⁴ See *id.*, Pt. 1, § 3.1.6 (noting that chapter management and chapter boards have joint responsibility “for the proper collection, administration, and expenditure of Chapter funds”).

⁵⁶⁵ See *id.*, Pt. 1, § 3.1.4.

Chapter boards and management have an obligation to “carry out their responsibilities in good faith, with diligence and loyalty . . . in the best interests of the [Red Cross].”⁵⁶⁶ The chapters are responsible for “the proper collection, administration and expenditure of Chapter funds.”⁵⁶⁷ Chapter boards have “overall fiduciary responsibility for finances,”⁵⁶⁸ though, as noted above, the funds belong to the national organization and are only entrusted to the chapters for use as authorized in the chapters’ charters.⁵⁶⁹

In July 2004, the Board established a set of Chapter Performance Standards to be used in the annual evaluation of chapters.⁵⁷⁰ These Chapter Performance Standards were built upon a similar set of standards that was used by the national organization beginning in 1993.⁵⁷¹ Those earlier performance standards were used primarily to evaluate chapters on their ability to deliver high-priority services.⁵⁷² However, the current Chapter Performance Standards are more formal and more comprehensive, and include certain “core” Standards, such as the chapter board’s adoption of standard chapter bylaws, review and approval of an annual chapter budget and review of financial statements.⁵⁷³ Failure to meet the requirements will result in sanctions.⁵⁷⁴ Depending on the compliance issue, sanctions can—and have—ranged from revocation of a chapter’s charter to a required merger with a healthy chapter to replacement of a chapter’s board to replacement of a chapter’s executive director.

The current 36 Chapter Performance Standards include seven standards specifically relating to chapter governance, including requirements to:

- adopt standard chapter bylaws as established by the Board;
- conduct the annual performance appraisal of the chapter executive and submit it to the Service Area for approval;
- review and approve the annual chapter budget and submit it to the Service Area for approval; and

⁵⁶⁶ *Id.*, Pt. 1, § 3.1.5.

⁵⁶⁷ *Id.*, Pt. 1, § 3.1.6.

⁵⁶⁸ *Id.*, Pt. 1, § 3.1.6. *See generally id.*, Pt. 2, § 5.1 (standard chapter bylaws, §§ 3.2 & 5.2(i)).

⁵⁶⁹ *See id.*, Pt. 1, § 3.3.1.

⁵⁷⁰ *See id.*, Pt. 1, §§ 2.2.1 – 2.2.2; *id.*, Pt. 2, §§ 4.2 – 4.3.

⁵⁷¹ *See American Red Cross Chapters*, available at <http://www.redcross.org/museum/history/chapters.asp> (last visited Sept. 19, 2006).

⁵⁷² *See id.*

⁵⁷³ *See* 2007 Field Evaluation System – Chapter Performance Standards Scorecard.

⁵⁷⁴ *See* Policy Manual, Pt. 1, § 2.2.1; *see also supra* text accompanying footnotes 552 & 553 (discussing various sanctions available to the Board).

- conduct a self-evaluation at least once every 24 months.⁵⁷⁵

The standard chapter bylaws outline requirements for, among other things, the size of the chapter board and the establishment of standing board committees, such as audit and governance committees.⁵⁷⁶

In a further effort to improve chapter performance, effectiveness and efficiency, the Red Cross recently announced its “Community Presence Initiative.” In early 2006, a Community Presence Task Force was established by the Red Cross Chairman (and managed by the Disaster and Chapter Services Committee of the Board) to promote improved planning and more centralized decision-making and to improve local service delivery.⁵⁷⁷ The Community Presence Task Force, composed of 16 members, was headed by the Vice Chair of the Disaster and Chapter Services Committee, and included additional Board members, national management staff and a chapter executive. The Task Force recommended to the Board adoption of the Community Presence Initiative; the Board approved the initiative on May 10, 2006.⁵⁷⁸

The new structure under the Community Presence Initiative will result in two categories of chapters: large Regional Chapters (of which there are expected to be approximately 200) and smaller Community Chapters (of which there are expected to be approximately 600).⁵⁷⁹ In supervising Community Chapters after implementation of the new structure, Regional Chapters ultimately would have oversight responsibility for Red Cross services in their regions. The Regional Chapters also would coordinate their efforts with the blood services regions.⁵⁸⁰ Community Chapters under the new structure would focus on service delivery, fundraising and community relations within their respective communities.⁵⁸¹ This new flexible structure is

⁵⁷⁵ See 2007 Field Evaluation System – Chapter Performance Standards Scorecard.

⁵⁷⁶ See generally Policy Manual, Pt. 2, § 5.1 (standard chapter bylaws, §§ 5.1, 5.15, 5.17).

⁵⁷⁷ See *New Business Model Reinvigorates Chapter Service Delivery*, Message from Bonnie McElveen-Hunter, Board Chairman, and Jack McGuire, Interim President and CEO, to Chapter Executives and Chairs, all Service Area Staff, Blood Services Regions CEOs, AFES Station Managers, and all NHQ/BHQ Staff (May 2006). See generally American Red Cross, *From Challenge to Action: American Red Cross Actions to Improve and Enhance Its Disaster Response and Related Capabilities for the 2006 Hurricane Season and Beyond* 14 (June 2006) (noting that following the major hurricanes of 2005, one of the goals of the Red Cross was to promote accountability throughout all levels of the organization).

⁵⁷⁸ See *New Business Model Reinvigorates Chapter Service Delivery*, Message from Bonnie McElveen-Hunter, Board Chairman, and Jack McGuire, Interim President and CEO, to Chapter Executives and Chairs, all Service Area Staff, Blood Services Regions CEOs, AFES Station Managers, and all NHQ/BHQ Staff (May 2006). Since the Board’s approval in May 2006, the Community Presence Initiative has been the subject of a series of nationwide “town hall meetings” with the chapters.

⁵⁷⁹ See *New Business Model Reinvigorates Chapter Service Delivery*, Message from Bonnie McElveen-Hunter, Board Chairman, and Jack McGuire, Interim President and CEO, to Chapter Executives and Chairs, all Service Area Staff, Blood Services Regions CEOs, AFES Station Managers, and all NHQ/BHQ Staff (May 2006).

⁵⁸⁰ See *id.*

⁵⁸¹ See *id.*

intended to better meet the changing service needs of local communities and ultimately increase the number of Community Chapters.⁵⁸²

The Community Presence Initiative will be implemented in phases over a two-year period.⁵⁸³ Although the general terms of the Initiative were approved by the Board, many implementation details, including the responsibilities of the Regional and Community Chapters' boards, are still being determined. A related initiative, the Shared Administrative Services Initiative, under which administrative, accounting and other functions for the chapters will be more centralized, is being implemented in conjunction with the new structure.⁵⁸⁴

Blood Services Regions

Beginning with a request from the U.S. Armed Forces to create a national blood donor program during World War II, the Red Cross biomedical services business has expanded significantly and now collects and distributes nearly half of the nation's blood supply through regional units known as "blood services regions."⁵⁸⁵ Although the Charter does not address the Red Cross' biomedical services or reference blood services regions, in the mid-1980s the Red Cross established blood services regions as chartered units. Thus, the Bylaws define the term "chartered unit" to include both chapters and blood services regions chartered by the Board.⁵⁸⁶ As "chartered units" under the Bylaws, blood services regions and chapters are treated similarly in certain respects.⁵⁸⁷ For instance, like chapters, blood services regions may send delegates to the annual meeting to vote in the election of Board members⁵⁸⁸ and may submit proposed resolutions to the Committee on Resolutions on matters of significant corporate policy for consideration.⁵⁸⁹

Before 1993, the blood services regions operated in a manner similar to chapters, with a formal charter, boards with local governance authority and regional chief executive officers having management authority. Following a consent decree issued at the behest of the FDA in 1993,⁵⁹⁰ governance and management control for biomedical services was centralized in the

⁵⁸² *See id.*

⁵⁸³ *See id.*

⁵⁸⁴ *See* discussion under Section 2, "Ongoing Red Cross Initiatives" above.

⁵⁸⁵ *See* Blood Services Milestones of the American Red Cross, *available at* <http://www.redcross.org/museum/history/bldmilestones.asp> (last visited Sept. 19, 2006).

⁵⁸⁶ Bylaws, § 1.3. The Board established the blood services regions as "chartered units" equivalent to the chapters beginning in the mid-1980s.

⁵⁸⁷ *See id.*; *see also* Policy Manual, Pt. 1, § 1.1.

⁵⁸⁸ *See generally* Bylaws, § 7.

⁵⁸⁹ *See generally* Policy Manual, Pt. 1, § 5.5.

⁵⁹⁰ *United States of America v. American National Red Cross*, Civ. No. 93-0949, 1993 WL 186094 (D.D.C. May 12, 1993).

national organization.⁵⁹¹ Between 1991 and 1998, the Red Cross completed a \$287 million reorganization of the biomedical services business, which included centralizing the blood services regions as well as donor databases and inventory management systems.⁵⁹²

The biomedical services business currently is divided into 35 blood services regions nationwide. Eleven division vice presidents, who are employees of the national organization, have management authority for their respective blood services regions, and each vice president is accountable to the President and CEO or his or her designee, currently the Executive Vice President for Biomedical Services.⁵⁹³ The chief executives of each of the 35 blood services regions are also employees of the national organization⁵⁹⁴ and report to their respective division vice presidents.⁵⁹⁵ They are hired or terminated by the division vice presidents, and their performance is evaluated by the division vice president as well (“with consideration given to comments” from the blood services region chairman).⁵⁹⁶

Although the blood services regions are not separate entities, but rather function similarly to divisions of the national organization, each blood services region is required to adopt standard bylaws.⁵⁹⁷ In addition, each blood services region is required to establish a volunteer advisory body, called a board of directors.⁵⁹⁸ The standard blood services region bylaws states that this advisory body shall:

- encourage volunteerism, recruitment of qualified donors and the promotion of Red Cross blood services;
- enhance community relationships by assisting with strategy development for donor recruitment and marketing;
- bring community issues to the attention of regional management;
- provide input to the division vice president as needed in the evaluation of the blood services region chief executive; and

⁵⁹¹ Policy Manual, Pt. 2, § 2.2.1 (“The Board of Governors and FDA require Biomedical Services to provide positive management control of its decentralized local community operations.”).

⁵⁹² See Blood Services Milestones of the American Red Cross, available at <http://www.redcross.org/museum/history/bldmilestones.asp> (last visited Sept. 19, 2006).

⁵⁹³ See Policy Manual, Pt. 1, § 1.9.4.

⁵⁹⁴ *Id.*, Pt. 1, § 2.18.1.

⁵⁹⁵ See *id.*, Pt. 1, §§ 1.9.4 & 2.18.3.

⁵⁹⁶ *Id.*, Pt. 1, §§ 2.18.2 – 2.18.3.

⁵⁹⁷ *Id.*, Pt. 2, § 5.2 (providing a form of standard blood services region bylaws).

⁵⁹⁸ *Id.*, Pt. 1, § 1.9.2. See generally *id.*, Pt. 2, § 5.2 (standard blood services region bylaws, §§ 5.1 – 5.11).

- promote cooperative relationships with participating chapters.⁵⁹⁹

Blood services regions' chief executives are not accountable to the advisory body, but, as noted above, report directly to their respective division vice presidents.⁶⁰⁰ The Board has delegated authority and responsibility for governance and oversight of the blood services regions to the Biomedical Services Committee of the Board.⁶⁰¹

Members of the Red Cross

The Red Cross became a membership organization with adoption of the current Charter, which requires that the organization be open to members, defined as “all the people of the United States and its territories and possessions, on payment of an amount specified in the bylaws.”⁶⁰² From 1947 until the mid-1990s, the amount “specified in the bylaws” for qualification as a member was \$1.00. Under the current Bylaws, members are those who make monetary contributions toward, perform volunteer services on behalf of, or donate blood to the Red Cross.⁶⁰³ Membership is determined on an annual basis. The Policy Manual states that the purpose of membership “is to promote community understanding, commitment, and support for the Mission, Strategic Plan, and services of the [Red Cross] and its” chapters and blood services regions.⁶⁰⁴

Red Cross members are entitled to notice of local membership meetings and are eligible to vote on local board members and delegates to the annual meeting.⁶⁰⁵ Each member is entitled to a single vote.⁶⁰⁶ Any 25 members may petition the Board to review local procedures regarding membership, selection of local board members or annual meeting delegates, and any 30 members can petition to form a new chapter.⁶⁰⁷ Decisions regarding chapter voluntary dissolution are the right of the membership.⁶⁰⁸ Termination of a person’s membership results in appeal rights to the Board.⁶⁰⁹

⁵⁹⁹ See *id.*, Pt. 2, § 5.2 (standard blood services region bylaws, §§ 5.1(a) – (g)).

⁶⁰⁰ See *id.*, Pt. 1, § 1.9.4.

⁶⁰¹ See *id.*, Pt. 1, § 1.9.2.

⁶⁰² Charter, § 3(a).

⁶⁰³ See Bylaws, § 8.1.

⁶⁰⁴ Policy Manual, Pt. 1, § 2.9.1.

⁶⁰⁵ See Bylaws, §§ 9.3(b) & (d); Policy Manual, Pt. 1, § 2.11.1.

⁶⁰⁶ Bylaws, § 9.3(c). See also Policy Manual, Pt. 2, § 5.1 (standard chapter bylaws, § 4.6); *id.*, Pt. 2, § 5.2 (standard blood services region bylaws, § 4.6).

⁶⁰⁷ Bylaws, §§ 9.2 & 9.5(b); Policy Manual, Pt. 1, § 2.1.2.

⁶⁰⁸ Policy Manual, Pt. 2, § 5.1 (standard chapter bylaws, § 12.1).

⁶⁰⁹ Bylaws, § 8.2.

The introduction of membership into the Red Cross structure was intended to make the organization more democratic.⁶¹⁰ To this end, the Charter specifies that chapters must “adhere to the democratic principles of election specified in the bylaws in electing the governing body of the chapter and selecting delegates to the [annual meeting].”⁶¹¹ The Bylaws direct chapters and blood services regions to take adequate steps to ensure that all eligible members are given the opportunity to participate in the election of members of the local governing board and its delegates to the annual meeting.⁶¹² It is not clear that “adequate steps” are taken in all instances to ensure that eligible members are given an opportunity to participate in voting. At a minimum, chapters and blood services regions do not follow uniform practices in providing members an opportunity to elect local board members or participate in the local annual meeting.

Analysis

Red Cross Chapters

A major challenge facing national nonprofit organizations with large chapter or affiliate bases is striking the appropriate balance between providing strong, centralized national leadership and providing the necessary support to local chapters.⁶¹³ This is particularly true of the Red Cross with its strong chapters and their important role in the delivery of services, recruitment of volunteers and fundraising.

The ways in which national nonprofit organizations structure their relationships with affiliates fall along a continuum, including, at opposite ends, relationships that involve almost complete local autonomy and those that involve centralized control.⁶¹⁴ A myriad of factors,

⁶¹⁰ See Harriman Report, at 3, 15, 29 – 30. The recommendations in the Harriman Report led to the first inclusion in the Charter of a requirement that the Red Cross be open to members. One of the two core objectives of the Harriman Committee was to “make certain that all the American people who constitute [the Red Cross] have adequate representation in shaping the policies of the National organization” so that the Red Cross would “truly represent the Nation that it serves.” *Id.* at 3. In view of this objective, and the fact that the Red Cross had “become truly national in character and in each community,” the Harriman Committee found it “desirable that included among the Charter amendments . . . the principle should be laid down that membership in the Red Cross should be open to all men and women of the United States, its territories and dependencies, without discrimination of any kind.” *Id.* at 29 – 30. See Charter, § 3(a) (“Membership in the [Red Cross] is open to all the people of the United States and its territories and possessions, on payment of an amount specified in the bylaws.”).

⁶¹¹ Charter, § 3(b)(1).

⁶¹² See Bylaws, § 9.3(e); see also Policy Manual, Pt. 1, § 2.11.

⁶¹³ *How the Red Cross Should Move Forward: Advice From Experts*, 18 CHRON. PHILANTHROPY 34 (Jan. 12, 2006) (providing comments from various nonprofit experts, including Brian A. Gallagher, President, United Way of America, Alexandria, Virginia).

⁶¹⁴ See Aspen Institute Study, at 11 (noting that a sample of nonprofit organizations with affiliate or chapter bases “ranged from loose associations of autonomous local (and/or regional) members to affiliations in which the national organization exercised almost total control”); Dennis R. Young et al., *Strategy and Structure in Managing Global Organizations*, 10 VOLUNTAS: INT’L J. VOLUNTARY & NONPROFIT ORG., 323, 326 – 328 (1999); La Piana Associates, Inc., *What is Strategic Restructuring? Structuring of Relationships among*

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historical, economic and demographic, can influence the organizational and structural strategy.⁶¹⁵ There is no consensus on the optimal governance for national nonprofit organizations with local affiliate relationships and, in fact, different structures have proven successful for different organizations.⁶¹⁶ When making determinations with respect to organizational structure, a nonprofit board should tailor structure to address the needs and unique circumstances of the organization.⁶¹⁷

Unlike many organizations with many, independently-incorporated chapters or affiliates, the Red Cross is a single legal entity.⁶¹⁸ While chapters and blood services regions are considered “chartered units” under the Bylaws, neither chapters nor blood services regions are separately incorporated. As a single corporate entity, ultimate governance and oversight responsibility, and ultimate liability for all actions of the chapters (as well as blood services regions), lie with the national organization’s Board and management.

While large scale disasters require regional and even national coordination⁶¹⁹ and the international aspects of the Red Cross’ work are handled at a national level, the Red Cross also has an important local focus. Service delivery occurs at a chapter level. The organization relies heavily on local volunteers in responding to local disasters, promoting volunteer involvement, identifying and serving community needs and fundraising.⁶²⁰ Blood donations are locally-based.

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Affiliates of National Nonprofits, available at <http://www.lapiana.org/defined/structuring.html> (last visited Sept. 19, 2006).

⁶¹⁵ Dennis R. Young et al., *Strategy and Structure in Managing Global Organizations*, 10 VOLUNTAS: INT’L J. VOLUNTARY & NONPROFIT ORG., 323, 326 (1999).

⁶¹⁶ See Aspen Institute Study, at 33; Dennis R. Young et al., *Strategy and Structure in Managing Global Organizations*, 10 VOLUNTAS: INT’L J. VOLUNTARY & NONPROFIT ORG., 323, 341 (1999) (stating that there is “substantial choice among structural alternatives but that also there may be no one best structural type”); The Nature Conservancy Report, at 12 (concluding that there was no evidence to support the idea that adopting a federation approach, instead of being set up as a single corporate organization, “significantly improves overall governance of the entity”).

⁶¹⁷ See BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 10 (2005); Dennis R. Young, Neil Bania and Darlyne Bailey, *Structure and Accountability: A Study of National Nonprofit Associations*, 6 NONPROFIT MGMT. & LEADERSHIP, 347, 362 (Summer 1996).

⁶¹⁸ Other examples of nonprofit organizations that are organized as single corporate entities include: American Diabetes Association; American Heart Association; Catholic Relief Services; Juvenile Diabetes Research Foundation International; Leukemia & Lymphoma Society; MADD (Mothers Against Drunk Driving); March of Dimes Birth Defects Foundation; Muscular Dystrophy Association; The Nature Conservancy; and U.S. Fund for UNICEF. However, the Governance Advisory Panel to The Nature Conservancy concluded that the majority of the nonprofit organizations with local affiliates have chapters or affiliates that are separately incorporated. See The Nature Conservancy Report, at 12. Research conducted in connection with this Governance Audit was consistent with this conclusion.

⁶¹⁹ See discussion under Section 3, “A Changed World” above.

⁶²⁰ Sharon M. Oster, *Nonprofit Organizations and Their Local Affiliates: A Study in Organizational Forms*, 30 J. ECON. BEHAV. & ORG., 83 (1996) (stating that at many nonprofit organizations “activity occurs through operations coordinated and run at the local level”); see also *id.* at 89 (noting that particularly with respect to

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Nonetheless, given the Red Cross' broad responsibilities, and its national—indeed international—reach, coupled with the need for centralized management and control of the biomedical business, the current Red Cross structure as a single legal entity appears appropriate. Under these circumstances, a federated structure with separately-incorporated affiliates would not offer advantages, and might impair organizational efficiency and effectiveness.⁶²¹ A single-entity organizational structure also will facilitate ongoing efforts to promote accountability at all levels and to implement organization-wide performance standards, internal controls and financial reporting systems.⁶²² Additionally, a single-entity organizational structure can facilitate increased sharing of services, improving operational efficiency.⁶²³

The implementation and enforcement of Chapter Performance Standards has increased chapter accountability. Chapter accountability also will be improved as a result of the Red Cross' ongoing financial management review (undertaken with the assistance of Deloitte & Touche USA LLP). In addition to these efforts, continued improvements in internal controls and financial reporting functions in the chapters should be pursued as a high priority. The ability of the Red Cross to prepare accurate, complete and timely consolidated financial information is critical. Not only is the generation of consolidated financial information promptly after the close of a period important, but the ability to access organization-wide financial information on a reasonably current basis (such as liquidity information that includes chapter resources) can be critical in managing consolidated operations. Similarly, an organization-wide system of internal controls is essential, and consideration might be given to assessing internal controls against a defined standard (such as the Public Company Accounting Oversight Board's Auditing Standard No. 2 or the COSO framework for internal controls).

Finally, thought should be given to the feasibility of obtaining from all chapters financial information audited by specified independent auditors. Currently, in KPMG LLP's ("KPMG") audit of the Red Cross' consolidated financial statements, KPMG relies on financial statements

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fundraising, local chapters or affiliates "are better able to tap local resources to fund their operations because their localness makes them easier to observe").

⁶²¹ See The Nature Conservancy Report, at 12 (concluding that there was no evidence to support the idea of adopting a federation approach; instead being set up as a single corporate organization, "significantly improves overall governance of the entity").

⁶²² See American Red Cross, *From Challenge to Action: American Red Cross Actions To Improve and Enhance Its Disaster Response and Related Capabilities For the 2006 Hurricane Season and Beyond* 14 (June 2006) (noting that following the major hurricanes of 2005, one of the goals of the Red Cross was to promote accountability throughout all levels of the organization); The Nature Conservancy Report, at 11 (noting the importance for nonprofit organizations to "blend strong local presence with centralized leadership"). See also Maisie O'Flanagan & Lynn K. Taliento, *Nonprofits: Ensuring that bigger is better*, THE MCKINSEY QUARTERLY, 2004 No. 2, 113, 117 – 119 (discussing benefits of performance standards for local chapters or affiliates).

⁶²³ See also Maisie O'Flanagan & Lynn K. Taliento, *Nonprofits: Ensuring that bigger is better*, THE MCKINSEY QUARTERLY, 2004 No. 2, 113, 119 – 120 (recommending that federated nonprofits take advantage of the economies of scale attainable by sharing back-office functions such as finance, benefits, information technology and purchasing).

provided by the chapters.⁶²⁴ These chapter financial statements generally are required to be audited at the chapter level, by an auditor retained (sometimes on a volunteer basis) and overseen by a chapter audit committee.⁶²⁵ For fiscal year 2005, chapter financial statements not audited by KPMG constituted 24% of the total assets and 16% of the total revenues and gains, respectively, of the consolidated totals.⁶²⁶ In this regard, risk management considerations should be considered along with strict accounting requirements and requirements under Generally Accepted Accounting Principles.

From a governance perspective, the Red Cross should define with more clarity the role and responsibilities of chapter boards of directors. In a single-entity structure, these boards do not have any legal status nor do they have defined rights and responsibilities. Their functions and obligations are created under, and governed by, the governance documents of the Red Cross. The need to define the legal status and governance role of the chapter boards will be heightened as the Community Presence Initiative is implemented. The Community Presence Initiative contemplates different roles for Regional Chapters and Community Chapters, suggesting that the roles of the respective boards of Regional Chapters and Community Chapters also will differ. These roles are in the process of being defined.

Successful implementation of the governance aspect of the Community Presence Initiative will require that the governance structures of the Regional and Community Chapters and the responsibilities of their respective boards of directors be defined with care. The governance and operational lines of authority and accountability relating to Regional and Community Chapters likewise should be delineated. Again, the resulting structure should reflect the Red Cross' status as a single legal entity and the need for organization-wide accountability and controls, while supporting the critical role of chapters in the organization's mission and delivery of services.

Blood Services Regions

The Bylaws designate blood services regions as "chartered units" like chapters.⁶²⁷ Each blood services region is required to adopt bylaws and has a "board of directors" that is advisory. Yet, in practice, the blood services regions have been integrated into the national organization, and are managed very much like integrated divisions.

⁶²⁴ See KPMG's FY 2005 Report, dated September 30, 2005, attached to Red Cross Consolidated Financial Statements (June 30, 2005).

⁶²⁵ Chapters with less than \$100,000 in annual operating expenses (representing approximately 3% of the Red Cross' total chapter revenues for fiscal year 2005) report financial information on a cash basis and are not required to obtain audits. See American Red Cross, *Overview of Governance and Accountability Practices*, available at <http://www.redcross.org/arcgovernanceoverview/> (last visited Oct. 11, 2006). With respect to chapters that either do not secure audits or do not report timely or complete financial information, estimates are used in preparing consolidated Red Cross financial statements. These estimates generally are deemed immaterial for accounting purposes, but may impact operational or risk management matters.

⁶²⁶ KPMG's FY 2005 Report, dated September 30, 2005, attached to Red Cross Consolidated Financial Statements (June 30, 2005).

⁶²⁷ See Bylaws, § 1.3.

There is, however, still a role for blood services region advisory boards. These boards now are charged with assisting in enhancing Red Cross relationships with their communities through retention and recognition of donors, donor recruitment and marketing, and cooperation with participating chapters.⁶²⁸ These advisory boards also bring community issues and perspectives to the attention of blood services management.⁶²⁹ Advisory boards can serve useful functions⁶³⁰ and are useful in the blood services region context. As with other advisory boards, the role and responsibilities of the blood services region advisory boards should be clarified.

Members of the Red Cross

National nonprofit organizations with large affiliate or chapter bases define membership in a variety of ways.⁶³¹ Some nonprofits have only organizational members, others have only individual members, while still others have some combination of both.⁶³² Many nonprofits do not have members at all.⁶³³ (Indeed, the Red Cross did not have members until 1947.)

A wide continuum exists as to the governance role of members in various nonprofit organizations.⁶³⁴ The range includes, at opposite ends of the spectrum, governance structures in which the board of directors has complete power and the membership none⁶³⁵ to organizations in which the membership has the power to make policy on its own and even overrule the board.⁶³⁶

The rights and duties of nonprofit organizations' members generally are provided by statute or in the organization's governing documents.⁶³⁷ These membership rights often include:

- internal governance rights, such as the election of directors of the board, the right to call special meetings of the membership, and the right to adopt, amend or repeal bylaws or restrict the rights of the board to do so;

⁶²⁸ See Policy Manual, Pt. 2, § 5.2 (standard blood services region bylaws § 5.1(b)).

⁶²⁹ See *id.*, Pt. 2, § 5.2 (standard blood services region bylaws § 5.1(c)).

⁶³⁰ See discussion of advisory bodies under Section 4B, "Advisory Functions" above.

⁶³¹ See Aspen Institute Study, at 9.

⁶³² See *id.*

⁶³³ James J. Fishman & Stephen Schwarz, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 76 (3rd ed. 2006).

⁶³⁴ See Aspen Institute Study, at 15.

⁶³⁵ Members of The Nature Conservancy, for example, do not vote. See also *id.* at 16 (finding that in 22% of a sample of nonprofit organizations, membership had no vote).

⁶³⁶ See *id.* at 17 (finding that in 16% of a sample of nonprofit organizations, membership elected the board and could amend bylaws, vote on policies and overrule the board).

⁶³⁷ Nina J. Crimm, *A Case Study of a Private Foundation's Governance and Self-Interested Fiduciaries Calls for Further Regulation*, 50 EMORY L.J. 1093, at n. 420 (Fall 2001); Jack B. Siegel, *A DESKTOP GUIDE FOR NONPROFIT DIRECTORS, OFFICERS, AND ADVISORS—AVOIDING TROUBLE WHILE DOING GOOD* 43 – 45 (2006). See also James J. Fishman & Stephen Schwarz, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 74 – 77 (3d ed. 2006).

- monitoring rights, such as the inspection of corporate books and records and the right to receive an annual financial report; and
- the right to bring actions against directors or officers on behalf of corporation.⁶³⁸

Members of the Red Cross have the right to vote in elections for chapter boards and delegates to the annual meeting.⁶³⁹ As a practical matter, however, it is not clear whether Red Cross members nationwide understand their voting rights, whether they receive effective notice of chapter meetings and elections or whether they participate by actually voting. Information gathered in connection with the Governance Audit suggests that chapter practices with respect to members may not be uniform, and that the rights of members to elect local chapter boards, for instance, may not be recognized or facilitated effectively in many instances. Likewise, it is not clear that chapters take “adequate steps to ensure that all eligible members are given the opportunity to participate in the election of members of the local governing board and its delegates” to the annual meeting as required by the Bylaws.⁶⁴⁰ If the Red Cross continues under the Charter as a membership organization, then the governance role of members should be assessed, and steps taken to fulfill the rights accorded to members.

Recommendations

No change in the existing relationship of the Red Cross Board and the boards of its chartered units is recommended. However, some clarifications as set forth below are appropriate.

Red Cross Chapters

1. The Red Cross should continue efforts to implement organization-wide internal controls and to promote accountability throughout the organization.
2. In light of the anticipated reorganization of chapters under the Community Presence Initiative, the Board should consider the appropriate role and responsibilities of Regional Chapter boards and Community Chapter boards. Once determined, the relevant corporate governance documents, including chapter bylaws, should be revised to define those roles and responsibilities with clarity.

Blood Services Regions

3. The role of the advisory boards for the blood services regions should be clearly defined.

⁶³⁸ See *id.*; see also David V. Patton, *The Queen, The Attorney General, and the Modern Charitable Fiduciary: A Historical Perspective on Charitable Enforcement Reform*, 11 U. FLA. J.L. & PUB. POL’Y 131, 172 (Spring 2000) (noting that courts in many jurisdictions have recognized the right of members of nonprofit corporations to bring derivative suits on behalf of the nonprofit corporation).

⁶³⁹ See Bylaws, § 9.3(b).

⁶⁴⁰ *Id.*

Members of the Red Cross

4. The rights of “members” of the Red Cross should be reviewed and clarified so that actual practice and the Bylaws are consistent.

I. ENHANCED TRANSPARENCY OF GOVERNANCE PRACTICES

Background

While the Red Cross has posted some governance-related documents on its website, such as the Charter, the bylaws, and a listing of Board members and senior management, this information is limited and difficult to find.⁶⁴¹ For example, no information with respect to the membership or functions of the Board committees is publicly available. The Red Cross does not have a conspicuous “governance” section on its website. The Red Cross also has its Annual Report and Form 990 posted on its website, but this information too is difficult to locate.⁶⁴²

Analysis

“Exceptional boards promote an ethos of transparency by ensuring that donors, stakeholders, and interested members of the public have access to appropriate and accurate information regarding finances, operations, and results.”⁶⁴³ In the current environment, there is a great deal of interest in the governance practices of nonprofit organizations.⁶⁴⁴ Accordingly, the Red Cross should inform donors, the government, other constituents and the public of its governance practices. Additional transparency with respect to governance practices will allow groups such as “[g]overnment regulators, watchdog agencies, and the media [who] play an active role in shaping public perception,”⁶⁴⁵ to have better access to important information. The Red Cross already follows “best practices” with respect to many of the documents available to the public, such as its annual report and Form 990.⁶⁴⁶ An enhanced website with these and other governance documents, including changes made as a result of this report, would greatly benefit the Red Cross.

Websites of other nonprofits, such as The Ford Foundation, The Nature Conservancy and the American Cancer Society, provide useful examples. The Ford Foundation’s website⁶⁴⁷ has links to “Governance” and “Financials” near the top of its homepage, which is a recommended practice.⁶⁴⁸ On the Governance page, users can view the charter, bylaws, committee charters and

⁶⁴¹ See <http://www.redcross.org> (last visited Sept. 18, 2006).

⁶⁴² See *id.*

⁶⁴³ BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 6 (2005).

⁶⁴⁴ See discussion under Section 3, “A Changed Governance Landscape” above.

⁶⁴⁵ BoardSource, *The Source: Twelve Principles of Governance That Power Exceptional Boards* principle 6 (2005).

⁶⁴⁶ See Fisher Howe, *Nonprofit Accountability: The Board’s Fiduciary Responsibility* 29, 35 – 36, in Section of Business Law, American Bar Association et al., *NONPROFIT GOVERNANCE AND MANAGEMENT* (Victor Futter et al., eds. 2002); BBB Wise Giving Alliance Standards for Charity Accountability, *available at* <http://www.give.org/standards/newcbbbstds.asp> (last visited Sept. 18, 2006).

⁶⁴⁷ See <http://www.fordfound.org/> (last visited Sept. 18, 2006).

⁶⁴⁸ See David Matheson & Adriana Maestas, *Keep Me Posted! Web Site Posting of SEC and Corporate Governance Material*, *THE CORPORATE GOVERNANCE ADVISOR*, Vol. 14, No. 4, 25, 29 (2006).

memberships, standards of independence, trustee code of ethics, staff code of conduct and ethics, and procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls and auditing matters in one place.

The Nature Conservancy's website has a readily available page entitled "Governance Accountability,"⁶⁴⁹ which not only includes links to its governance documents, but also contains a link to a separate page called "Strengthened Governance."⁶⁵⁰ The Strengthened Governance page highlights the "numerous changes that affect nearly every aspect of the Conservancy's day-to-day operations to ensure it is acting in accordance with the highest standards."⁶⁵¹ Users can access The Nature Conservancy Governance Advisory Panel's report, an overview of governance reforms and a summary of actions taken to strengthen governance. Users can also read a statement from the Board about the importance of the governance reforms.

The American Cancer Society has a page called "ACS Governance Practices,"⁶⁵² where users can locate information about its National Assembly, National Board of Directors, officers, ethics and financial practices, and committee charters. The American Cancer Society website also has a "Financial Information" page,⁶⁵³ where users can obtain the Form 990 and the Annual Report.

Websites of public corporations can also provide useful examples. For example, the Marriott website includes information about its Board of Directors and Board committees, charters for all Board committees, Governance Principles, Bylaws, Certificate of Incorporation, Business Conduct Guide, and Code of Ethics.⁶⁵⁴ Similarly, the General Electric Governance page provides a "Governance Overview," and includes links to the company's Governance Principles, details about the composition and independence of the Board of Directors, committee charters and related information about the membership and functioning of the committees, Certificate of Incorporation, By-Laws, copies of the annual report and proxy statement, and information about how to contact the Board.⁶⁵⁵ Other companies that have taken similarly comprehensive approaches to providing disclosure about their governance practices include Medtronic and Pitney Bowes.⁶⁵⁶

⁶⁴⁹ See <http://www.nature.org/aboutus/leadership/> (last visited Sept. 18, 2006).

⁶⁵⁰ See <http://www.nature.org/aboutus/leadership/art15473.html> (last visited Sept. 18, 2006).

⁶⁵¹ See *id.*

⁶⁵² See http://www.cancer.org/docroot/AA/content/AA_1_5_ACS_Governance_Practices.asp (last visited Sept. 18, 2006).

⁶⁵³ See http://www.cancer.org/docroot/AA/content/AA_1_6_Financial_Information.asp (last visited Sept. 18, 2006).

⁶⁵⁴ See <http://ir.shareholder.com/mar/corporategovernance.cfm> (last visited Sept. 18, 2006).

⁶⁵⁵ See <http://www.ge.com/en/citizenship/governance/index.htm> (last visited Oct. 9, 2006).

⁶⁵⁶ See http://www.medtronic.com/corporate_governance/ (last visited Oct. 9, 2006); <http://www.pb.com/cgi-bin/pb.dll/jsp/GenericEditorial.do?catOID=-18256&lang=en&country=US> (last visited Oct. 9, 2006).

Recommendations

To increase the transparency of the Red Cross' governance practices and financial reporting, the Red Cross should revise its internal and external websites and create an easily accessible governance page where extensive information related to governance practices can be found. This page should include, among other things, the following documents:

- Charter;
- Bylaws;
- governance guidelines;
- committee charters;
- identification of Board and committee members;
- statement of Board core governance responsibilities;
- Code of Conduct;
- whistleblower procedures, including CCL and BRL information; and
- ways for interested parties to communicate with the Board.

In addition, the Red Cross website should include this report and information about implementation of the recommendations contained in the report. The website might also include a statement from the Board highlighting the importance of governance generally and the changes at the Red Cross. The page should be updated on a regular basis to keep the Red Cross' stakeholders and the public aware of changes to the Red Cross' governance practices.

SECTION 5. EXHIBITS

- A. Biographies of Panel Members
- B. Bibliography
- C. Resolution of the Board of Governors

Exhibit A

Biographies of Panel Members

Karen Hastie Williams, the Panel Chair, is a retired partner in the Washington, D.C. law firm of Crowell & Moring LLP and was a speaker at the March 21 Governance Summit convened by the Red Cross Board of Governors. She is a member of the boards of the NAACP Legal Defense and Education Fund, Amherst College, the Federal National Mortgage Association Foundation, and formerly of the National Cathedral School. She is also a member of the boards of The Chubb Corporation, Continental Airlines, Inc., Gannett Company, Inc., SunTrust Bank and Washington Gas Holdings Company. She also serves as Chair of the Black Student Fund, the BOLD (Business Opportunities for Leadership Diversity) Initiative, and is a former Chair of the Greater Washington Research Center. She formerly served with distinction as a Public Life Member of the Internal Revenue Oversight Board appointed by the President of the United States.

Peter Clapman is the CEO of Governance for Owners USA, Inc., the former Senior Vice President and Chief Counsel for Corporate Governance at TIAA-CREF and the Executive Director of the Pace Law School Directors Institute, which offers educational programs for corporate and not-for-profit directors. He is a board member of the National Association of Corporate Directors (NACD) and is on the advisory board of the Weinberg Center for Corporate Governance at the University of Delaware and the Board of Advisors for the Yale School of Management's International Institute for Corporate Governance. Mr. Clapman is a board member of the Investor Responsibility Research Center (IRRC), and a member of the Primary Markets Group of the London Stock Exchange and the NASDAQ Listing Council, and was on the Legal Advisory Committee of the New York Stock Exchange. He was also the past chairman of the International Corporate Governance Network (ICGN), where he served as the ICGN representative on the Task Force of the Office of Economic Cooperation and Development (OECD) that drafted global principles of corporate governance.

Charles Elson is the Edgar S. Woolard, Jr., Chair in Corporate Governance and Director of the John L. Weinberg Center for Corporate Governance at the University of Delaware, a board member of IRRC, and a member of the boards of AutoZone, Inc., Alderwoods Group, and HealthSouth Corporation. He also is the Vice-Chair of the American Bar Association Business Law Section's Committee on Corporate Governance. He has served on the NACD's Commissions on Director Compensation, Director Professionalism, CEO Succession, Audit Committees, Strategic Planning and Director Evaluation, as an adviser and consultant to Towers Perrin, and as a member of the boards of Circon Corporation, Sunbeam Corporation and Nuevo Energy Company.

Margaret M. Foran is the Senior Vice President-Corporate Governance, Associate General Counsel and Corporate Secretary of Pfizer Inc. She is a board member of ICGN and the Girl Scout Council of Greater New York and a member of the Business Advisory Council of YAI National Institute for People with Disabilities. She also is Chair of the American Bar Association Business Law Section's Committee on Corporate Governance and Co-Chair of the Council of Institutional Investors. She serves on the Corporate Directors Institute's Independent Advisory Board of the NACD and is a director of the Association of Corporate Counsel (ACC), and a

member of the Finance and Audit Committee and the past Chair of the ACC's Corporate and Securities Law Committee. She is the former Chair of the Coordinating Committee of Business Roundtable's Corporate Governance Task Force and the current Chair of the SEC Issues Committee.

Jay W. Lorsch is the Louis E. Kirstein Professor of Human Relations at the Harvard Business School and was a speaker at the March 21 Governance Summit convened by the Board of Governors. He has served as Faculty Chairman of the Harvard Business School's Global Corporate Governance Initiative since 1998. Mr. Lorsch is the author of more than a dozen books, including *Back to the Drawing Board: Designing Boards for a Complex World* (with Colin B. Carter, 2003), and he is a consultant to the boards of directors of several Fortune 500 companies. As a consultant, he has advised such companies as Ameritech, Applied Materials, the Bank of Montreal, Citicorp, Chubb and Sons, Coopers & Lybrand, Corning Glass, General Electric, Goldman Sachs, Merck Sharp and Dohme and Petroleos de Venezuela, S.A. He is a director of Computer Associates International, Inc. and a member of the advisory boards of U.S. Foodservice and BoardVantage, Inc.

Patricia McGuire is the President of Trinity University in Washington, D.C. She was formerly Assistant Dean for Development and External Affairs at the Georgetown University Law Center, where she taught courses in tax-exempt organizations. She currently is a member of the boards of directors of the Greater Washington Board of Trade, the Washington Hospital Center, the Washington Metropolitan Consortium of Universities, the Joint Military Intelligence College, the Eugene and Agnes Meyer Foundation, Goodwill of Greater Washington, and the Acacia Mutual Life Insurance Company and its parent the UNIFI Mutual Holding Company. She also serves on committees of the American Council on Education, the National Postsecondary Education Cooperative of the U.S. Department of Education, and the Girl Scout Council of the Nation's Capital.

Paul Neuhauser is Professor Emeritus at The University of Iowa College of Law, where he teaches in the area of corporate law. In addition, he is a board member of the Interfaith Center on Corporate Responsibility (ICCR), an association of predominately faith-based institutional investors such as national denominations and religious communities, a board member of the Investor Responsibility Research Center, a non-profit corporate governance research center, and a former member of the governing board of the Episcopal Church. He has long promoted the use of shareholder proposals and other corporate governance tactics by non-profit organizations to achieve corporate social responsibility.

Exhibit B

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American Cancer Society	Girls, Inc.	National Urban League
American Diabetes Association	Girl Scouts of the USA	National Wildlife Federation
American Heart Association	Goodwill Industries International	The Ford Foundation
American Lung Association	Habitat for Humanity International	The Nature Conservancy
AmeriCares Foundation	JA Worldwide (Junior Achievement)	The New York Community Trust
America's Second Harvest	Juvenile Diabetes Research Foundation International	The Nonprofit Roundtable of Greater Washington
Amnesty International	Kiwanis International Foundation	Planned Parenthood Federation of America
Arthritis Foundation	Leukemia & Lymphoma Society	Ronald McDonald House Charities
Big Brothers Big Sisters of America	Little League Baseball, Inc.	Salvation Army
Boys and Girls Clubs of America	MADD (Mothers Against Drunk Driving)	Shriners Hospitals for Children
Boy Scouts of America	Make-a-Wish Foundation	Special Olympics
Camp Fire Boys and Girls	March of Dimes Birth Defects Foundation	St. Jude Children's Research Hospital
Catholic Charities USA	Muscular Dystrophy Association	U.S. Fund for UNICEF
Catholic Relief Services	National Association of Corporate Directors	United Cerebral Palsy Association
CARE USA	National Audubon Society	United Jewish Communities
Covenant House	National 4-H Council	United States Olympic Committee
Cystic Fibrosis Foundation	National Kidney Foundation	United Way
Easter Seals	National Mental Health Association	Volunteers of America
Epilepsy Foundation	National Multiple Sclerosis	World Vision
Feed the Children	National Organization for Women	YMCA
Food for the Poor		YWCA
Gifts in Kind International		
Ahold	Freddie Mac (Federal Home Loan Mortgage Corporation)	Marriott International, Inc.
Fannie Mae (Federal National Mortgage Association)	General Electric Company	Medtronic, Inc.
Federal Home Loan Bank System	Ginnie Mae	Pitney Bowes Inc.

Exhibit C

Resolution of the Board of Governors

**AMERICAN RED CROSS
BOARD OF GOVERNORS**

**RECITALS AND RESOLUTIONS FOR CONSIDERATION
OF THE BOARD OF GOVERNORS OF
THE AMERICAN NATIONAL RED CROSS**

October 27, 2006

WHEREAS, on February 17, 2006, the Board authorized and commissioned an independent governance audit to be undertaken under the auspices of the Governance Committee of the Board of Governors (“Governance Committee”);

WHEREAS, on February 24, 2006, the Board of Governors of the American Red Cross announced its plan to conduct a comprehensive assessment of its governance model, which would include the governance audit, with the goal of identifying concrete reforms that would streamline the organization’s ability to meet the growing demands of its mission.

WHEREAS, on March 21, 2006, the Red Cross conducted a Corporate Governance summit facilitated by the National Association of Corporate Directors. The Summit brought together for-profit and nonprofit governance experts to provide Board members the most up-to-date information on current governance best practices. The presenters addressed a variety of topics, including recommended governance practices, board size and structure, board and committee meetings, the importance of independence and audit committee and internal control-related matters;

WHEREAS, on March 29, 2006, the Governance Committee approved the establishment and formation of an Independent Governance Advisory Panel (“Advisory Panel”) whose members are listed in Attachment A, to be assisted by independent counsel, to conduct the governance audit. The Committee agreed that Gibson Dunn & Crutcher LLP (“Gibson Dunn”) would serve as the independent counsel and to assist in the Governance Audit;

WHEREAS, as determined by the Governance Committee at its March 29, 2006 meeting: (i) the purpose of the governance audit was to assess the current governance model and governance practices and procedures of the Board of Governors, to examine “best practices” in non-profit and corporate governance, and to consider what governance practices are appropriate for the Red Cross; and (ii) the goal of the governance audit was to identify any appropriate governance changes in the best interest of the Red Cross and the American public;

WHEREAS, also at its March 29, 2006 meeting the Governance Committee determined that the independent governance audit should focus on the following areas:

1. the size and composition of the Board of Governors, participation by and independence of Governors and the process for selecting candidates for the Board;
2. the organization and functioning of the Board of Governors, including the composition, structure and roles of the Board's committees;
3. the roles and relationships of the Board of Governors and management;
4. the Board of Governors' oversight of the governance practices of the local chapters;
and
5. the relationships and lines of reporting between the Audit Committee of the Board of Governors, the outside auditor, and the internal audit function, including the whistleblower process as it applies to Red Cross employees and volunteers, as well as constituencies served by the Red Cross;

WHEREAS, on October 12, 2006, the Governance Committee forwarded to the Board of Governors for review and discussion at the October 27, 2006 Board of Governors' meeting, a Report from the Governance Committee to the Board of Governors, entitled "American Red Cross Governance For the 21st Century" (the "Governance Committee Report");

WHEREAS, the principal recommendations and governance reform actions considered by the Board of Governors at its meeting are set forth in Attachment B to these Resolutions;

WHEREAS, certain of these recommendations and governance reform actions, if approved, adopted and authorized by the Board of Governors, will require conforming amendments to the Congressional Charter, the Bylaws of the Corporation, and the Board of Governors Policy Manual and the adoption of additional governance documents;

WHEREAS, other recommendations, if approved, adopted and authorized by the Board of Governors, will require the Board of Governors to further examine certain processes and implement changes to these processes, if necessary; and

WHEREAS, these recommendations and governance reform actions, if approved, adopted and authorized by the Board of Governors, will require management to take certain actions to implement them in the name and on behalf of the Corporation.

NOW THEREFORE, BE IT RESOLVED, that the Board of Governors of the American Red Cross, having duly considered the Governance Committee Report, hereby approves, adopts and authorizes the principal recommendations and governance reform actions discussed at the Board of Governors' meeting on October 27, 2006, and set forth in Attachment B to these Resolutions;

BE IT FURTHER RESOLVED, recognizing that certain of these recommendations and governance reform actions approved, adopted and authorized by the Board of Governors require conforming amendments to the Congressional Charter, the Bylaws of the Corporation, and the Board of Governors Policy Manuals, the Board of Governors hereby delegates to each of the

Governance Committee and the Executive Committee (with either such Committee acting independently), in consultation with the Chairman of the Board, the full power and authority to approve, adopt and authorize these conforming amendments to the Red Cross governance documents; it being understood and agreed that (i) Section 3.8.1(l) and other applicable provisions of the Bylaws are hereby deemed amended accordingly to the extent necessary to effectuate fully the intent and purpose of such delegation to ensure that each of the Governance Committee and Executive Committee has such full power and authority and (ii) any further notice required under Section 13 of the Bylaws is hereby deemed waived for such purposes;

BE IT FURTHER RESOLVED, recognizing that certain of these recommendations and governance reform actions approved, adopted and authorized by the Board of Governors require the Board of Governors to further examine certain processes and implement changes to these processes, if necessary, (i) the Board of Governors hereby further delegates to the Governance Committee the full power and authority to review and implement changes related to the resolution process and the governance oversight of the chartered units and (ii) the Board of Governors hereby further delegates to the Audit Committee the full power and authority to review and implement changes related to whistleblower processes and internal audit functions; it being understood and agreed that applicable provisions of the Bylaws are hereby deemed amended accordingly to the extent necessary to effectuate fully the intent and purpose of such delegation to ensure that each of the Governance Committee and Audit Committee has such full power and authority; and

BE IT FURTHER RESOLVED, that the Board delegates to the Governance Committee and/or management, in consultation with the Chairman of the Board, the full power and authority, in the name and on behalf of the Corporation, to take all such actions in relation to communications, government relations, legislative changes, transition and related strategies and arrangements, as referred to in or consistent with the Governance Committee Report, as the Governance Committee and/or management deem necessary or advisable in order to effectuate fully the intent and purpose of these Resolutions.

ATTACHMENT A

Independent Governance Advisory Panel Members:

Karen Hastie Williams, Panel Chair, a retired partner in the Washington, D.C. law firm of Crowell & Moring LLP and member of the boards of the NAACP Legal Defense and Education Fund, Amherst College and the Federal National Mortgage Association Foundation.

Peter Clapman, CEO of Governance for Owners USA, Inc., the former Senior Vice President and Chief Counsel for Corporate Governance at TIAA-CREF and the Executive Director of the Pace Law School Directors Institute.

Charles Elson, Edgar S. Woolard, Jr., Chair in Corporate Governance and Director of the John L. Weinberg Center for Corporate Governance at the University of Delaware.

Margaret M. Foran, Senior Vice President-Corporate Governance, Associate General Counsel and Corporate Secretary of Pfizer Inc.

Jay W. Lorsch, the Louis E. Kirstein Professor of Human Relations at the Harvard Business School and Faculty Chairman of the Harvard Business School's Global Corporate Governance Initiative.

Patricia McGuire, President of Trinity University in Washington, D.C.

Paul Neuhauser, Professor Emeritus at The University of Iowa College of Law, where he teaches in the area of corporate law.

The seven Panel members volunteered their time. No member of the Panel had served on the Board or any Red Cross chapter board of directors. All Panel members had extensive governance experience, including service on the boards of numerous non profit organizations and public corporations.

ATTACHMENT B

**AMERICAN RED CROSS
BOARD OF GOVERNORS**

**GOVERNANCE COMMITTEE REPORT
RECOMMENDATIONS AND APPROVED ACTIONS**

Recommendation	Approved Actions
<p>Role of the Board: The Board should be a board that focuses solely on governance and strategic oversight of the organization.</p>	<ol style="list-style-type: none"> 1. The Bylaws will be amended to include a statement clarifying the Board’s role as a governance and strategic oversight board and to outline areas of the Board’s core governance responsibilities, including but not limited to: <ol style="list-style-type: none"> a. reviewing and approving the mission statement for the Red Cross, b. approving and overseeing the Red Cross strategic plan, c. selecting, evaluating and determining the level of compensation of the Red Cross CEO, d. evaluating the performance and establishing the compensation of the senior leadership team, and providing for management succession, e. overseeing the financial reporting and audit processes, internal controls, and legal compliance, f. holding management accountable for performance, g. providing oversight of the financial stability of the organization, h. providing oversight of the protection of the Red Cross brand, i. assisting with fundraising on behalf of the Red Cross, and j. ensuring the inclusiveness and diversity of the Red Cross. 2. The Bylaws will be amended to: <ol style="list-style-type: none"> a. clarify that the “management” responsibilities of the Board under both the Charter and the Bylaws consist of “management oversight”, and

Recommendation	Approved Actions
	<p>b. explicitly delegate to management responsibility for operations and day-to-day management of the Red Cross.</p> <p>3. In addition to amending the Bylaws, the Board will adopt a detailed statement of its core governance responsibilities. This statement will be incorporated into a set of governance principles that would be approved by the Board.</p> <p>4. The Charter should be amended to delete references to Board “management,” or to clarify the nature of the Board’s responsibility for “managing” the Red Cross.</p> <p>5. The full Board will be responsible for strategic oversight of operational matters. The Board will focus the meetings on in-depth discussions and may include outside experts at the full Board meetings.</p>
<p><u>Size and Composition of the Board:</u> Since Board size and composition are so central to governance and because good governance is so critical to the Red Cross’ functioning, a Charter change should be sought quickly.</p>	<p>1. To address issues related to the size and composition of the Board, as part of the transition strategy <i>pending a Charter revision</i>, the following will occur through Bylaw amendments, Board action and otherwise:</p> <ul style="list-style-type: none"> ○ By March 31, 2009 the Board will downsize to a maximum of 25 members. <p>2. The Board will adopt specific standards of independence applicable to Board members, which will include standards governing Board members’ affiliations with organizations that have relationships with the Red Cross. All Board members will be required to be independent.</p> <p>3. The Bylaws will be amended to eliminate non-Governor Board members and <i>ex officio</i> members from the Board and Board committees.</p> <p>4. Charter revisions should include the following:</p> <ul style="list-style-type: none"> a. Amending the Charter to authorize the Board to fix, by resolution, the number of Board members, provided that (i) as of March 31, 2009, there shall be no fewer than 12 Board members and no more than 25 members and (ii) as of March 31, 2012, there shall be no fewer than 12 and no more than 20

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	<p>members constituting the entire board.</p> <ul style="list-style-type: none"> b. Amending the Charter to reflect a single “category” or class of Board members, all of whom, except for the Chairman, would be nominated and elected through the same process (discussed below) to serve staggered, three-year terms. c. Amending the Charter to provide for a Presidentially-appointed Cabinet Council that would consist of no fewer than eight and no more than ten officials of departments and agencies of the United States Government, whose positions and interests qualify them to contribute to carrying out the programs and purposes of the corporation. Such officials shall include the Chairman of the Joint Chiefs of Staff, the Secretary of Defense, the Secretary of Health and Human Services, the Secretary of Homeland Security, the Secretary of State, the Secretary of Education, the Secretary of Commerce, and the Secretary of Veterans Affairs. At least one, but not more than three, of those officials shall be selected from the Armed Forces. <p>5. The Bylaws will be amended, as necessary, to be consistent with the Charter revisions stated immediately above. For example, the Bylaws would reflect that the Cabinet Council would report to the Board and may meet periodically during the year.</p> <p>6. The Bylaws will be amended to establish, as appropriate, councils to advise the Board and/or management. Specifically, a National Leadership Council will be created.</p>
<p><u>Board Selection:</u> The selection process for new Board members should be revised.</p>	<ul style="list-style-type: none"> 1. The Charter should be amended to eliminate the three “classes” of Board members thus creating a single “category” or class of Board members. 2. The Bylaws will be similarly amended to modify the current Nominations Committee process. The entire slate of Board members will be nominated by the Governance and Board Development Committee for approval by the full Board, and except for the Chairman, will then be submitted at the organization’s annual meeting to delegates for election.

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	<p>3. The Governance and Board Development Committee will continue to:</p> <ul style="list-style-type: none"> ▪ Conduct an annual formal Board assessment; and ▪ Formulate and approve and provide to those submitting candidates the skills and attributes desired for Board members each year, based on the formal assessment. <p>4. The Governance and Board Development Committee, in consultation with the Chairman and the CEO, will be responsible for identifying, recruiting, evaluating, and selecting an inclusive and diverse pool of Board candidates.</p> <p>5. Among the skills and attributes to be sought in prospective Board members by the Governance and Board Development Committee, the following guidelines should be considered:</p> <ul style="list-style-type: none"> ▪ proven leadership ability; ▪ previous experience serving on boards (either for-profit or nonprofit); ▪ diversity, including but not limited to gender, ethnicity, race, age, disabilities and geography; ▪ experience with large and complex organizations; ▪ current or prior chief executive officer, chief operating officer, or chief financial officer level experience (either for-profit or nonprofit); ▪ knowledge and experience regarding nonprofit and volunteer organizations (not limited to Red Cross experience); ▪ specific skills such as finance, audit, legal, international, information technology, diversity awareness, governmental affairs, public relations, marketing, leadership development, disaster relief, medical, biomedical, regulated industries and pharmaceutical; and ▪ community experience and knowledge in local Red Cross services. <p>6. The members of the Board of Governors may continue to serve in a volunteer capacity with the American Red Cross, but not in a governance capacity in a</p>

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	<p>chapter or blood services region.</p> <p>7. The current process in the Bylaws permitting nomination of candidates by petition for presentation at the annual meeting will be reviewed for any appropriate modifications, such as changes to the proportion of chartered units required to nominate a candidate for election.</p>
<p><u>Responsibilities and selection of the Chairman of the Board and the Chief Executive Officer:</u> A number of changes relating to the positions of the Chairman and the CEO should be made. At this point, there is no compelling reason for the Red Cross to change its current practice under which the CEO is not a member of the Board. Going forward, the Board has the flexibility to make a determination regarding whether the CEO should serve on the Board based on the individual circumstances. The Board also has flexibility to make a determination regarding whether the CEO should also serve as President (as is currently the case) or whether these roles should be filled by two different individuals.</p>	<p>1. The Charter should be amended to reflect that: (a) the Chairman, when present, will preside at meetings of the Board and will have such other duties and responsibilities as may be set forth in the Bylaws or by resolution of the Board; (b) to remove references to the “principal officer” of the Red Cross; and (c) to provide for a chief executive officer.</p> <p>2. The Bylaws will be amended to: (a) reflect that the Chairman, when present, will preside at meetings of the Board and will have such other duties and responsibilities as may be set forth in the Bylaws or by resolution of the Board; and (b) delete references to the Chairman serving as the “principal officer” of the Red Cross.</p> <p>3. The specific responsibilities to be performed by the Chairman and the CEO will be clearly delineated in written position descriptions approved by the Board.</p> <p>4. The Board will adopt a more specific, written delegation of authority from the Board to the CEO. Both the CEO position description and the delegation of authority will clearly establish the authority and responsibility of the CEO for managing the operations of the Red Cross.</p> <p>5. The Charter should provide that the Board will recommend a Chairman candidate for appointment by the President of the United States.</p> <p>6. The Bylaws will be amended to provide that the Board considers candidates for the position of Chairman and recommends a Chairman candidate to the President of the United States.</p> <p>8. The Bylaws will be amended to provide that the Board selects the CEO.</p> <p>9. The Bylaws will be amended to provide that the position of President and the</p>

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	<p>position of CEO do not need to be held by the same individual. Further, the Bylaws will state that the Chairman may not serve as President.</p>
<p><u>Board Committees:</u></p>	<ol style="list-style-type: none"> 1. The Bylaws will be amended as necessary to provide for the following standing committees: Executive, Audit, Governance and Board Development, Compensation and Management Development, Quality and Regulatory Compliance, and Philanthropy. Committee charters and annual agendas will be adopted for each of these committees. 2. The Executive Committee will include the committee chairs and the chairman of the Board and may perform tasks such as establishing the Board agenda. The Committee will meet between Board meetings and perform the duties delegated by the Board. 3. The Audit Committee will continue to be responsible for oversight of financial reporting, internal controls, internal and external audits and compliance with Red Cross policies and legal requirements. In addition to its current functions, the Audit Committee will receive regulatory compliance reports from management and periodic reports from the Quality and Regulatory Compliance Committee. Functions of the Finance Committee, such as budget approval, will generally be the responsibility of the full Board. 4. The Bylaws will be amended to provide that the Governance and Board Development Committee, in consultation with the Chairman, recommends committee membership to the full Board for approval.

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<p><u>Whistleblower Processes and Internal Audit Function:</u></p>	<ol style="list-style-type: none"> 1. The Red Cross will expand awareness among employees, volunteers and others of its whistleblower processes, including the Concern Connection Line (“CCL”). 2. The Investigation, Compliance & Ethics (“IC&E”) group will oversee and coordinate ethics and compliance training for all chapter personnel, including both employees and volunteers. 3. The Red Cross will revise its Code of Conduct to include the following: <ul style="list-style-type: none"> • information regarding the CCL; • the Red Cross’ policy of encouraging open communication and reporting of potential misconduct to appropriate persons; and • the Red Cross’ no-retaliation policy. 4. The Red Cross will consider establishing an ombudsman position, which would provide an additional avenue for independent review of significant issues within the organization. 5. The Red Cross will designate the General Counsel as the organization’s Compliance Officer responsible for oversight of the Red Cross compliance function. The IC&E group will be responsible for the day-to-day compliance functions and report to the Compliance Officer. 6. The Red Cross will expedite the hiring of a new Chief Audit Executive, who will report administratively to the CEO, and functionally to the Audit Committee. 7. The Board will oversee management in continuing to improve financial systems, controls and reporting for the consolidated organization and, in particular, for all chapters (including through the Shared Services Initiative).
<p><u>Resolutions Process:</u></p>	<p>The existing resolutions process will be maintained and re-examined to strengthen its effectiveness following the next annual meeting in light of the changes in governance practices being implemented.</p>

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<u>Governance Oversight of the Chartered Units:</u>	<ol style="list-style-type: none"> 1. The Red Cross will continue efforts to implement organization-wide internal controls and to promote accountability throughout the organization. 2. The Board will consider the appropriate roles and responsibilities of chapter boards particularly with the implementation of the Community Presence Initiative. 3. The role of the advisory boards for the blood services regions will be clearly defined. 4. The rights of “members” of the Red Cross will be reviewed and clarified so that actual practice and the Bylaws are consistent.
<u>Enhanced Transparency of Governance Principles:</u>	To increase the transparency of the Red Cross’ governance practices and financial reporting, the Red Cross will revise its website and create an easily accessible governance page with extensive information related to governance practices.