27TH ANNUAL NATIONAL CONFERENCE ON LAW AND HIGHER EDUCATION
The Center for Excellence in Higher Education Law and Policy at Stetson University College of Law
Tuesday, February 21, 2006

PRIVATE COLLEGE & UNIVERSITY FORUM

– – – – – – – – – –

GOVERNING BOARD ISSUES: WHAT SHOULD ADMINISTRATORS KEEP IN MIND?

Charles F. Carletta, J.D.
Rensselaer Polytechnic Institute
Troy, NY

There is an array of issues relating to the management of private colleges and universities that have emerged over the last year.[1] Some are anticipated progeny of Sarbanes/Oxley while others are attributable to problems arising directly from the not-for-profit sector itself such as the controversy that recently publicly engulfed American University.

NONPROFIT GOVERNANCE

Board Compensation

- Not major concern, currently, for universities except if there is an affiliated foundation or business.
- Many private foundations pay board members.
- The Panel on the Nonprofit Sector[2] suggests that as a general practice nonprofits should not pay board members.
- 990 forms need to be detailed with respect to board members that also provided paid services for the university.

Executive Compensation

- Senate finance committee staff has suggested that executive compensation should follow the government pay scale and be limited by some upper bracket.
- The Panel's report[3] suggests that the burden of proof for reasonableness for executive compensation falls on the organization's board.

[1] This paper is intended to supplement the excellent presentation authored by Sheila Trice Bell, Esq. for this Forum.

[2] *Strengthening Transparency Governance Accountability of Charitable Organizations, A Final Report to Congress and the Nonprofit Sector,* The Panel on the Nonprofit Sector (The Independent Sector ISBN #0-929556-31-3), 64 (June 2005)

Travel Expenses

- Senate finance committee staff suggested limiting travel expenses to the government per diem.
- The Panel instead suggests: 990 reporting, no spousal or dependent travel, and a clear "cost effective" travel policy.[4]

Governing boards and size of boards

- Senate staff report suggested no fewer than four (4) and no more than 15.
- The Panel suggests: no legislation on board size, but recommends at least three (3) board members, 1/3 of board members should be "independent," and every board should have an extensive member education program (members need to understand fiduciary responsibility).[5]

Audit Committees

- Senate staff report had no major suggestions in this area.
- The Panel suggests a series of best practices.[6]
- The Audit Committee should be comprised of people not on the finance committee.

Conflict of Interest

- Senate staff report had no major suggestions.
- The Panel again suggests a series of best practices.[7]
- Each institution should have written policies affecting all constituencies.

STATE ISSUES

New York, California, Massachusetts – AG offices are starting to look at non-profit activities. We can expect many investigations in the next year as the U.S. Senate plans to hold hearings on the American University case.

---

[3] Id at 71
[4] Id at 74
[5] Id at 77
[6] Id at 79
[7] Id at 81

PRESIDENTIAL COMPENSATION

The Marketplace

- There are consultants who specialize in this; many conduct compensation reports on college presidents' salaries for clients.
- Major changes in the last 30 years in the profile of college presidents. Previously boards looked for: Ivy League, male, academic, manager. Today boards look for: fundraiser, manager, credibility with faculty, PR savvy.
- Marketplace challenges: boomers are retiring and the number of quality candidates for college president positions is smaller…this leads to higher pay and protectionism.
- Many boards are recruiting from the Midwest where executive pay is traditionally less.
- Boards must realize that colleges and universities are also businesses and CEOs must be competent to manage the entire enterprise. Boards must be willing to pay for this expertise and then be prepared to justify it. Many have consultants to analyze presidential compensation. Presidents should never be put in the position to defend their own compensation. The chair of the board should be the designee to respond.

Board of Trustees

- Who are they and how do they function? Today's boards are much more business savvy and market driven.
- Business leaders bring their expertise.

Elements of the President's Package

Job Security

- Three (3) years is most popular initial contract. Five (5) years for renewal.
- Tenure is a bit controversial; some newer presidents want to come in as a manager not an academic, but others still want it (tenure is not well understood outside academia). [8]

Compensation

Base Salary

Should always be based on market surveys that are performed by independent third parties.

Bonuses

- Signing bonuses – designed to make president whole if leaving another institution.
- Performance bonuses – straight forward on metrics (fundraising, ranking, etc.).
- Retention bonuses – if president stays for length of contract.

[8] See: Freda, Diane; *IRS's EO Initiative Highlights Omissions, Errors in Reporting Executive Compensation.* Tax Budget, & Accounting (No. 230) G-11, BNA 12-1-05.

Deferred Compensation

Current compensation moved to the future if certain goals are met (another kind of retention bonus).

House (or housing allowance)

Almost every president has this kind of benefit.

If the contract says the president must live in a university home and use it for university purposes, the benefit can be tax exempt. This is a high value benefit.

Any staff used to maintain the grounds of university owned homes are not considered a taxable benefit to the president. Staff for inside the house (housekeeper, secretarial services to the spouse) can be counted as a taxable benefit to the president.

Car (driver)

Should keep a log of official travel vs. personal travel/errands.

Corporate Directorship

Presidents are encouraged not to serve on for profit boards due to Sarbanes/Oxley conflicts. But many presidents still do.

Spouse

Compensation – Universities should be careful. Some universities are keeping executive pay artificially low by paying large subsidies to spouses (this practice should be discouraged).

The professional trailing spouse remains either a problem or, for those schools willing to provide for it, a recruiting opportunity. Are not consortial approaches the better answer?

Tuition for Children

Wide variety in this benefit category – many universities approved payment somewhere else at the equivalent to the sending school's tuition (many president's kids don't want to go to parent's school).

Moving Expenses

This is standard in the corporate world and is an accepted and useful benefit.

The Media

We need to push the supply and demand argument with the media.

Media says presidential compensation is too high.

The Media often compare to salaries of the President of the United States or to Governors.

In general, the media knows very little about the subject.

Give the media a look at "a day in the life" of college presidents.

Compare these salaries to that of top NCAA coaches.

Congress

Colleges and Universities need to stress that the scandal at American University is an extreme case, consisting of multiple mistakes over many years. There have been over 60 major news reports on the American University situation.[9]

INFORMATION SECURITY

Other governance type issues are generated by various laws which impose compliance obligations regarding the security of information. They include the following:

- FACTA
- FERPA
- GLBA
- HIPAA
- Credit Card Agreements
- CALEA
- Some suggest personal liability

FACTA

FACTA is the Fair and Accurate Credit Transactions Act (15 USC Section 6081a (d)) and the Disposal Rule, promulgated thereunder (16 CFR Part 682), which addresses the privacy of consumer credit reports. It is intended to fight identity theft and mandates the proper disposal of consumer information .

Applicability

FACTA applies to any person or entity that "maintains or possesses consumer information for business purposes." Therefore, colleges and universities that offer any kind of financial services need to comply with FACTA.

[9] See: Hechinger, Deborah; *A Cautionary Tale for Trustees*; Chronicle of Philanthropy (2005)

Requirements

Covered institutions must "take reasonable measures to protect against unauthorized access to or use of the information in connection with its disposal." The Federal Trade Commission provides several examples of what it believes would be reasonable measures to comply with this requirement. They include: implementing and monitoring programs to destroy paper files by burning, pulverizing or shredding, implementing and monitoring programs to erase electronic data. All such programs must render the information unreadable and unusable.

Penalties

A private right of action for individuals who feel their rights are violated is <u>not</u> conferred – and penalties for violation are not addressed in the Disposal Rule, so it is unclear at the moment exactly what penalties will apply.

FERPA

The Family Educational Rights and Privacy Act of 1974 (20 USC Section 1232g), or FERPA as it is commonly called, governs how educational institutions hold, use, and disclose student educational records.

Requirements for information security

Generally, under FERPA, colleges and universities may not release educational records without student consent. FERPA also requires colleges and universities to provide students with information about their rights related to their educational records each year. Colleges and university must have a plan in place to ensure that educational records subject to the obligations of FERPA are kept secure and private.

Penalties

FERPA does <u>not</u> give aggrieved individuals a right to bring a private cause of action. There are administrative remedies only. The Secretary of Education may withhold further payments under any applicable program, compel compliance through a cease-anddesist order, or terminate the institution's eligibility to receive funding under any applicable Federal program.

GLBA

The Graham-Leach-Bliley Act, (20 USC Section 6801 et. seq.), through its privacy and security regulations, addresses the privacy and security of customer information.

Applicability

Only those colleges and universities that qualify as “financial institutions," as that term is defined by GLBA, are subject to the Act. To be considered a financial institution, a college and university must provide (or offer to provide) students, employees or others financial services such as cashing checks or extending credit.

Most colleges or universities that are subject to the GLBA are as a result of the check cashing services they offer to faculty, staff or students, or because of the financial aid they offer students in the form of loans. It is important to note that the mere act of offering individuals the option of paying for college or university services by credit card is not sufficient, standing alone, to cause the school to be subject to GLBA.

Security regulations, not privacy regulations are applicable

Although GLBA has both corresponding security and privacy regulations, the privacy regulations, which require GLBA-covered institutions to provide certain notices to their customers, do not apply to higher education institutions. When it created the GLBA privacy regulations, the FTC determined that colleges and universities already protected student information sufficiently – so the FTC decided to exclude them from coverage under privacy regulations. However, the FTC declined to follow the same concept regarding the security regulations. As a result, most higher education institutions will be subject to those regulations.

Requirements Generally

The Safeguards Rule requires all covered financial institutions to have in place by May 23, 2003 a written information security program designed to:

(i) ensure the security and confidentiality of customer records,

(ii) protect against any anticipated threats or hazards to the security of such records, and

(iii) protect against the unauthorized access or use of such records or information in ways that could result in substantial harm or inconvenience to customers.

Sample GLBA information security plans have been post on the internet by the National Association of College and University Business Officers (NACUBO) and are available for download at http://www.nacubo.org/x325.xml

Specific Requirements

In order to "develop, implement and maintain" the required written information security program, the Safeguards Rule requires each institution to:

- designate one or more employees to coordinate the program;
- identify "reasonably foreseeable" internal and external risks to the security and confidentiality of customer information that could lead to unauthorized disclosure, use, alteration, destruction or other compromise of such information and "assess the sufficiency" of the institution's safeguards in place to control these risks. Such risk assessment must include, at a minimum, risks in areas of operation such as:
  - -employee training and management,
  - -information systems, and
  - -detecting, preventing, and responding to attacks against the institution's systems;
- implement safeguards to manage the identified risks and regularly test or monitor such safeguards;
- oversee the institution's service providers by:
  - -selecting and retaining service providers that are capable of maintaining appropriate safeguards for the customer information at issue, and
  - -requiring service providers by contract to implement and maintain such safeguards; and
- evaluate and adjust the institution's security program in light of such risk assessment, any material change to institutional business operations or any other circumstances that may have a material impact on the institution's information security program.

Penalties

Like FERPA, the statute does not confer upon an aggrieved individual a private cause of action and only administrative remedies are available.

HIPAA

The Health Insurance Portability and Accountability Act of 1996, in addition for providing for the portability of health care, directed the US Secretary of Health and Human Services to create regulations to address the privacy and security of health information. The HIPAA privacy and security regulations, promulgated in April of 2003 and April of 2004 govern how covered entities receive, use and disclose individually identifiable health information (also referred to as protected health information, or "PHI").

Applicability

HIPAA typically applies to colleges and universities in one of two ways. A school can qualify as a "Covered Entity" if it provides health care services, for example, a student health center, clinics or a counseling service within the university. Even if a school does not operate one of these facilities, a school may be under the regulations as a "hybrid entity" because they meet this definition of health insurer, healthcare clearinghouse, or healthcare provider that engages in one of several electronic transactions addressed by HIPAA.

General Security Requirements

Aside from privacy obligations (which will not be covered here) the security regulations promulgated under HIPAA require Covered Entities to establish written rules and procedures to document their compliance with the Security Standards. These Security Standards are comprised of four main categories of requirements: (1) *administrative procedures*; (2) *physical safeguards*; (3) *technical security services*; and (4) *technical security mechanisms*

Penalties

A violation of HIPAA privacy and security rules can subject a school to either civil or criminal penalties, some quite severe. However, like FERPA and GLBA, the statute does not provide a private cause of action to an aggrieved individual as a result of violation of the statute.

Credit Card Agreements

The credit card industry standards, sometimes referred to as the Payment Card Industry (PCI) Data Security Standards, were developed, as part of a joint effort, by MasterCard International Inc. and Visa U.S.A., Inc. to ensure the security of their customer's credit card data. The PCI standards went into effect on June 30, 2005.

Applicability

MasterCard and Visa now require all entities that collect credit or debit card payments, process such payments, or store credit or debit card information to comply with the PCI security standards. Entities that engage in such activities, but fail to conform to the PCI security standards, may be subject to significant fines or have their right to process credit card transactions revoked by the major credit card companies.

Security Requirements

The PCI standards consist of twelve requirements within six major categories: build and maintain a secure network, protect cardholder data, maintain a vulnerability management program, implement strong access control measures, regularly monitor and test networks, maintain an information security policy. The twelve requirements are as follows:

- Install and maintain a firewall configuration to protect data
- Do not use vendor-supplied defaults for system passwords and other security parameters
- Protect stored data
- Encrypt transmission of cardholder data and sensitive information across public networks
- Use and regularly update anti-virus software
- Develop and maintain secure systems and applications

▪Restrict access to data by business need-to-know
▪Assign a unique ID to each person with computer access
▪Restrict physical access to cardholder data
▪Track and monitor all access to network resources and cardholder data
▪Regularly test security systems and processes
▪Maintain a policy that addresses information security.

How each institution responds to each of these requirements is not specified, thus giving the individual institutions the ability to shape a compliance plan that fits their environment, abilities, and needs.

PCI Standards Penalties

Violation of the Standards is a breech of the contact between the school and the credit card company and may subject the school to liquidated or actual damages for breech as well as denial of future use of credit card vendor services.

CALEA

This ACT is known as the Communications Assistance for Law Enforcement Act. The original act was passed in 1994 and requires providers of commercial voice services to engineer their networks in such a way so as to assist law enforcement agencies in executing wiretap orders. Higher education institutions were exempt from CALEA compliance under the 1994 act because they were considered “private networks” However, on August 5, 2005 the Federal Communications Commission issued an Order which extended CALEA compliance to include “facilities based Internet service providers". This would include most colleges as a result of their providing access to students, faculty and staff to the Internet.

The basic requirement of the FCC Order is to require Internet service providers to engineer their systems to make wiretapping easier and less expensive – however, it does not change the legal requirements to obtain wiretap authority in the first place. The obligations of CALEA will apply in full to universities in 18 months. It is noteworthy that the American Council on Education (ACE) as well as many other associations of colleges and universities has filed court proceedings seeking to overturn this Order, so it is unclear at present whether this requirement will survive court challenge. The cost ramifications of compliance are extensive and probably not capable of being accomplished within eighteen months.

Export Control Laws

Export control laws are federal laws which have been implemented by the Department of Commerce through its Export Administration Regulations (EAR), the Department of State through its International Traffic in Arms Regulations (ITAR), and the Department of Treasury through its Office of Foreign Asset Controls (OFAC).

- The Department of State regulates export of technologies relating to military applications listed on the Munitions Controls List (MCL) under the International Traffic in Arms Regulations (ITAR).

- The Department of Commerce regulates export of technologies relating to civilian applications listed on the Commerce Control List (CCL) under the Export Administration Regulations (EAR). This list is sometimes also called the "Dual-Use" list.

- Finally, the Department of the Treasury administers the Office of Foreign Asset Control, (OFAC) which prohibits outright any transactions (including exports) to certain designated embargoed foreign countries, such as Afghanistan, Armenia, Azerbaijan, Belarus, Cuba, Iran, Libya, North Korea, Sudan, Syria, Tajikistan, and Vietnam without a (very rarely granted) license.

Significant criminal sanctions (including money and/or prison sentences for individuals) can apply in the case of violations. It is therefore essential that faculty and other researchers in departments, laboratories and centers understand their obligations under these regulations and adhere to them.

The "Deemed Export" Rule"

By far the biggest concern for universities is the fact that the term "export" can mean not only technology leaving the shores of the United States (including transfer to a U.S. citizen abroad whether or not it is pursuant to a research agreement with the U.S. government), but also transmitting the technology to an individual other than a U.S.

citizen or permanent resident within the United States. A disclosure to a foreign researcher or student in a laboratory is considered a "deemed export." If research involves protected technologies, the ITAR and/or EAR may therefore require universities to obtain a license from the responsible federal agency before allowing foreign nationals to participate in the research or to receive any research related information – orally or in writing.

Note that *regardless* of export control restrictions, Federal Law *prohibits* foreign nationals from embargoed countries from participation in federally funded activities.

Fundamental Research

In the case of academic or research institutions, there is an very important exclusion from the requirements of export controls under ITAR and EAR – the exclusion for materials or information that is created as a result of fundamental research, the results of which are or are about to be in the public domain.

Fundamental research is generally defined under export control laws as basic or applied research in science and/or engineering taking place at an accredited institution of higher education within the United States when the resulting information is expected to become part of the public domain, i.e. when there are *no restrictions on publication* beyond those intended to protect pre-existing proprietary information or intellectual property rights.

It is *critically important* to recognize that research projects are *not eligible* for the fundamental research exemption if the federal government designates the research results as classified, administratively controlled, or otherwise restricted or sensitive.

Therefore, it is ***essential*** *to seek the removal of clauses in sponsored research agreements which either: (1) seek to limit the performance of the work to US citizens only; or (2) seek to impose any restriction on publications other than a short delay to allow for the redaction of sponsor confidential information or an opportunity to secure appropriate intellectual property protection on the developed technology.*

Therefore, if an Institution uniformly removes all publication and access restrictions from sponsored research agreements, most of the research activities in which it is involved, and the resulting deliverables, would be excluded from export controls because it can assert the fundamental research exclusion.

Use of Equipment

It has historically been understood by the university community that export-controlled equipment or software that was either purchased by the campus for educational or research use, or was transferred to the school by an industrial sponsor, would nevertheless be freely usable by members of the campus community (including foreign nationals) so long as the use was in conjunction with conducting fundamental research on U.S. university campuses or while studying at the institution.

However, two recent reports submitted to Congress by the current Administration made the claim that a deemed export license is required before foreign nationals engaged in fundamental research on U.S. university campuses may receive any technology or technical data that is beyond basic and general marketing materials on the “use” (i.e., “operation, installation…maintenance…repair, overhaul and [/or] refurbishing,”) of EAR or ITAR-controlled equipment. These reports understandably raised significant concern amongst universities. The Administration, through its Department of Commerce, then followed up in March 2005 with a draft amendment to the EAR regulations which would have the effect, among other things, of substantially tightening up the rules along the lines proposed by the reports. There was a record-breaking amount of comments filed against this proposed regulation and the Department of Commerce is currently evaluating these comments, and it appears that the regulation may be substantially revised. At the moment, the issue of what constitutes permissible use of export-controlled equipment in fundamental research activities is unclear.

OTHER FINANCIAL ISSUES

There are continuing issues generated at the Federal level that could have severe repercussions for the private not-for-profit sector of higher education.

FY 06 Budget Reconciliation

- Leave at 6.8% the fixed rate that borrowers pay to consolidate multiple student loans, and set at a 6.8% fixed rate what borrowers pay for Stafford loans.
- Increase to 8.5% from the current 7.9% the interest rate that parents pay on their loans (PLUS loans).
- Move the funds that the Education Department uses to cover the administrative costs of running loan programs (most of which are for the direct lending program) from the "mandatory" part of the federal budget to the "discretionary" part. That would increase the competition for already tight funds for higher education.
- Create a new two-part grant program aimed at increasing the number of students studying science and math.
- Increase loan limits for first- and second-year students and allow graduate students, for the first time, to take out PLUS loans.
- Repeal the "50%" rule that requires colleges to offer at least 50% of their courses in person (to which institutions heavy into distance education have objected). N.B. watch for government imposed (financially incentivated) mandatory acceptance of credits for students transferring from proprietary distance education schools to residential programs in the not-for-profit sector.

Department of Health and Human Services proposed compliance guidelines

- On November 28, 2005 the Inspector General (IG) of the Department of Health and Human Services requested comments on the draft compliance guidelines it has developed for recipients of extramural research grants from the NIH and other Public Health Service agencies. The net effect would be more extensive compliance programs at participating colleges.
- The deadline for comments on the draft compliance guidelines has been extended to January 30, 2006.

Recommendations of Joint Committee on Taxation (JCT)

- In January 2005, the JCT released its 430 page report on "Options to Improve Tax Compliance and Reform Tax Expenditures."
- Includes a proposal to eliminate advance refunding of government and 501 (C) (3) bonds. This would eliminate ability of colleges to realize debt service savings when interest rates fall.

- Bond ratings are a critical third party generated benchmark of an institution's fiscal health and, therefore, affect its ability to borrow.[10] This, in turn, can affect an institution's ability to attract new faculty that require "start up packages" as well as its ability to construct new facilities in order to attract a sizable student applicant pool.

Both ACE and NAICU Keep a Watchful Eye on These Issues

_ _ _ _ _ _ _ _ _ _ _ _ _ _ _ _

The presenter wishes to thank Jeffrey R. Armstrong, L.L.M., a principal in the law firm of Pattison, Sampson, Ginsberg, and Griffin, PC at 22 First Street, Troy, NY and Deborah E. Altenburg, Director of Federal Relations, Rensselaer Polytechnic Institute, Hall of States, 400 N. Capitol Street, NW, Suite 590, Washington, DC – for their research and assistance in the preparation of this paper.

---

[10] Kurz, Kathy and Scannell, Jim: *Bond Rating: Beyond the Balance*, University Business.com, page 29 (January 2006)