



U.S. SENATE COMMITTEE ON

Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

<http://finance.senate.gov>

MEMORANDUM

To: Reporters and Editors
Re: American University's response to May 17 letter
Da: Tuesday, June 6, 2006

Sen. Chuck Grassley, chairman of the Committee on Finance, is conducting a broad review of tax-exempt organization practices. He made the following comment on American University's response to his May 17 letter. Grassley's May 17 letter follows here.

"The board has taken some steps in the right direction, but I'm disappointed with some of the comments in its response. On whistleblowers, and the votes on the Ladner compensation package, as well as other votes cited in my letter, it seems the board is more interested in excuses than meaningful reform. I fear some board members are still wearing rose-colored glasses. The board's response underscores for me that the D.C. City Council is right on target to look at giving real teeth to the city's oversight of non-profits. On my next steps, my understanding is that the American University student leaders are preparing a letter to me on the board's actions so far, and I look forward to reading their analysis. I'm preparing broad-based legislative reforms for charitable governance based in part on the recommendations of the Panel on the Nonprofit Sector of the Independent Sector. The nonprofit panel, composed of the leaders of the nation's top charities, has given Congress recommendations that will enhance board governance, improve transparency, and build accountability from non-profits to the public."

May 17, 2006

Gary M. Abramson, Chair of the Board
Thomas Gottschalk, Vice Chair of the Board
Office of the President
American University
4400 Massachusetts Ave., NW
Washington, D.C.

Dear Mr. Abramson and Mr. Gottschalk:

I am writing to you regarding the Finance Committee's review of governance issues at American University ("AU"). AU is a federally chartered non-profit, tax-exempt educational organization. Congress enacted the law in 1893 that first incorporated AU, appointed its initial individual corporate members, and specified the size and composition of its board of trustees. Act of Feb. 24,

1893, ch. 160. In 1953, Congress enacted legislation, altering, among other things, the process by which the AU board of trustees is elected. Act of Aug. 1, 1953, Pub. L. No. 183, ch. 309. The Finance Committee's review is predicated on this unique history of the legislative relationship between the federal government and AU as a congressionally chartered institution, as well as on the Committee's general legislative and oversight jurisdiction over tax-exempt charitable organizations.

In conducting its governance review, the Finance Committee has reviewed the numerous documents provided by AU and material provided by other sources, as well as discussions with current and former board members, faculty, students and AU employees. In addition, I have heard concerns raised by AU students from Iowa and their parents. To allow students, faculty and staff, and the public to have a better understanding of the governance issues still facing AU, I am today releasing relevant material provided to the Finance Committee. It says volumes about problems of AU governance that students, faculty, and supporters often have to learn about the work of the AU board from the U.S. Senate Finance Committee rather than from the board itself. I understand that governance changes are to be proposed that proponents claim will ensure that there will be greater openness and transparency at AU. I look forward to meaningful reform in this area and expect to be informed of the details of those proposals.

While I am releasing quite a bit of information today, I am frustrated that there is certain key material that I cannot release today. When the Committee began this investigation on October 27, 2005, I received assurances of cooperation. The Washington Post stated on October 28, 2005, "Gottschalk said yesterday that the board would do everything it could to cooperate." Unfortunately, those words have not always been met by deeds. While AU has over time provided material requested, AU continues to redact material provided and most frustratingly labels key documents 'confidential' and not to be released to the public. This is not what I would expect from a university that benefits from tax-exempt status and was chartered by act of Congress. I call on you to hold to your public commitments of full cooperation and allow for public release of all documents without redaction that have been requested. AU students, faculty and supporters have a right to a full understanding of the board's actions.

One of my principal governance concerns relates to the legal structure and composition of the AU board. The Finance Committee, during its roundtable discussion on charitable governance, heard from AU student leaders, faculty, and former board members, a number of whom called for the removal of certain AU board members – particularly focusing on members serving on the ad hoc committee that took actions regarding former AU president Dr. Ladner without the knowledge of key board members.

In reviewing the material, I understand the views of those who believe the members of the ad hoc committee should be removed. In the course of our review, I have also focused on several key votes by some AU board members. In particular, given all related information reviewed by the Finance Committee, I am seriously troubled by votes cast in October 2005: 1) to amend the audit committee's recommendation and secondly to reject the audit committee's recommendations on a vote for reconsideration; 2) to reject three identical recommendations from counsel, including Manatt Phelps as well as Arnold & Porter, that had concluded that Dr. Ladner's 1997 employment agreement was invalid; 3) not to terminate Dr. Ladner for cause; and 4) to increase cash severance to Dr. Ladner by an additional \$800,000 over eight years – after the board had already voted to increase Dr. Ladner's cash severance by \$950,000.

It is important to bear in mind that these votes were made after the findings from protiviti independent risk consulting reports, which I am releasing today, were known to the board and that provided in detail the expenses of Dr. Ladner and his wife that he charged to AU. The report shows expenses that would make for a good episode of ‘Lifestyles of the Rich and Famous’ – a lifestyle paid for by AU students and their parents. In addition, as noted above, the board members were aware of the findings of two respected law firms that found that Dr. Ladner’s 1997 employment agreement was invalid.

While I fully understand that as Chairman of the Senate Finance Committee, I’m not here to direct the management of the affairs of AU or its board, I do want you to know that I am considering proposing federal legislation that would require changes in the structure, composition, and governance of the AU board, as Congress has done previously. In particular, in discussions with Finance staff, AU board members have noted that they do not view that under current federal law the AU board has the authority to compel a board member to resign. Please confirm if that is accurate, and please also provide your views about the wisdom of Congress amending the law to provide the AU board such authority and, if so, suggested changes to the law.

In addition, I want to draw your specific attention to a board meeting that discussed Mr. Ladner’s compensation package. In general, under federal tax laws, outside review and justification for the salary of a highly compensated individual at a public charity provides a safe harbor from penalties under Section 4958 of the Internal Revenue Code. My review of tax-exempt organizations and corporations has found that in the overwhelming number of cases outside consultants provide a justification for the salary request that is being considered. In fact, the AU situation is the only example Finance Committee staff have seen of an outside consultant stating that a salary of an individual at a public charity is too high.

However, in calling for a salary for Dr. Ladner higher than that recommended by outside consultants, some AU board members appear to have rejected concerns about complying with the laws passed by Congress and instead described financial penalties for violating federal law as “de minimis.” Comments that suggest that federal laws should be disregarded because penalties are “de minimis” are stunning when I hear them from members of for-profit corporate boards; they are shocking when they come from board members of a tax-exempt university. Do you believe this is the appropriate message AU should send to students – it is all right to violate the law if the penalty is de minimis? Please provide a complete explanation of these events and your views of them, as well as all related material.

The issue of whistleblower protection at non-profit institutions has also been of great concern to me in the course of the Committee’s work. Whistleblowers in certain situations are protected from retaliation under state and federal law. A series of aggressive emails to other AU board members by one AU board member appear to attack whistleblowers trying to do the right thing regarding the situation at AU. They include the following language: “You are right in citing a Nixon era example. People do not tolerate leaks any more. No one is so naive anymore to think that unidentified ‘whistleblowers’ are public servants. You are right in saying there always must be a process for people to report wrongdoing but this is not the way.”

As a champion of whistleblowers in Congress for years, I can state categorically that not only are whistleblowers public servants, they are often heroes – saving lives and taxpayers billions. I commend you, Mr. Gottschalk, and former board chair Ms. Bains, for taking a strong line against

any effort to bring the Salem witchcraft trials to northwest D.C. But again, that a board member might propose retribution against whistleblowers, as appears from some of these emails, is inexcusable. I would appreciate your general views on the benefit of whistleblower protection at tax-exempt organizations, as well as your specific views on the series of emails appearing to support aggressive efforts to search, find, and punish those who try to speak out against what is wrong. In particular, do you believe such efforts send the appropriate message to AU students – especially given that a large number of AU graduates will be employed in public service?

Finally, let me return to the overall issue of governance. In meetings with my staff, AU representatives have given assurances that AU will have in place governance reforms that will provide students and faculty a meaningful and substantive voice at AU. I view this as a vital part of AU governance reforms coupled with greater sunshine and transparency that I mentioned at the beginning of my letter. Please inform me in detail what the governance reforms are as to students and faculty.

Given that Congress is currently considering reforms to provisions of the tax code affecting charities as part of the conference on the pension bill, I ask that you provide answers to this letter within 10 working days. Thank you for your time and courtesy.

Cordially yours,

Charles E. Grassley
Chairman

cc: Senator Baucus
Chairman Thomas
Delegate Norton
Commissioner Everson