PRIVATE LAWMAKING AND THE ARCHITECTURE OF CONFIDENTIALITY IN NONPROFIT BOARDROOMS

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Abstract

Placement of the boundary line between transparent and confidential deliberation inside a boardroom affects the quality, efficiency, and fairness of corporate decision making. Policies which do not insist upon confidentiality can improve the perceived legitimacy of decisions and of those who make them; confidentiality can improve the ability to implement decisions effectively. The degree of transparency facilitated by these policies affects the volume and quality of available information. In the nonprofit boardroom, the boundaries that are set by governance rules also reflect and give shape to institutional structures and cultural norms.

This article explores justifications for changing from a governance perspective which encourages the non-confidentiality of decision making in nonprofit board rooms to a rule such as proposed Section 340(b) of the draft Principles of Nonprofit Organizations, which would create presumptive confidentiality. In addition to presenting historical and cultural claims, it presents an analytic model to estimate the most likely outcome of a default confidentiality rule that is not subsequently reversed by a nonprofit in advance of controversy. This article will strive to predict the resulting scenarios that follow if confidentiality becomes the default position established through private lawmaking, and further illustrates the costs that nonprofits will likely incur. From multiple perspectives this study maintains that it would be regrettable to establish a default position that would dissolve an important distinction between the culture of much of the nonprofit corporate world and for-profit corporate culture.

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By making a structured effort to determine whether rules and presumptions will incentivize socially constructive outcomes, the Article develops a more general appreciation, building on the work of Sunstein, Thayer, Ayres and others, of the possibilities for applying an institutional “choice architecture” to private lawmaking.

TABLE OF CONTENTS

I. Current Boardroom Confidentiality Norms
   A. Introduction: Closed Group Decision Making……………………………………3
   B. For-Profit Boards and Confidential Deliberation ………………………………5
   C. Nonprofit Non-confidentiality Norms………………………………………6

II. CHALLENGING A PROPOSED REVISION TO THE NORM
   A. Revision of the Norm by the ALI Principles of Nonprofit Governance……11
   B. Justifications for Board Confidentiality Placed into Perspective………………13

III. A THEORETICAL PERSPECTIVE ABOUT PRIVATE LAWMAKING
   A. A Coasean Approach to the Confidentiality Presumption……………………17
   B. The Effect of Reversing the Presumption…………………………………….23

IV. CONCLUSION………………………………………………………………………..28
I. Current Norms In Decision Making

A: Introduction: Closed Group Decision making

When should decisions that affect others be made behind closed doors and kept secret? This inquiry occupies legislators, judges, prosecutors, and corporate governance specialists as well. Placement of the boundary line between non-confidentiality and permissible confidentiality affects the quality, efficiency, and fairness of institutional decision making. Non-confidentiality can improve the perceived legitimacy of decisions; confidentiality can affect the ability to implement decisions effectively. The breadth of non-confidentiality affects the volume and quality of information that is available. In the nonprofit boardroom, the boundaries that are set by governance rules reflect, and also give shape to, institutional structures and cultural norms.

In nonprofit decision-making, the default is non-confidentiality which facilitates transparency. This default reflects the cultural and historical norms developed by a large number of nonprofits over time.

Considered more generally, confidentiality norms differ depending on their...

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2 See note 21, infra.
historical and cultural context. When policy matters are deliberated upon by government regulators and elected officials, theories of civic involvement support non-confidentiality. These have propelled passage of sunshine laws, open meetings rules, and public notice requirements in administrative rules and codes. In criminal proceedings, on the other hand, the principle of presumptive innocence cuts in the opposite direction: accused persons receive a presumptive right to prosecutorial silence in grand jury proceedings. When mass torts are alleged, secret court settlements are permissible in certain situations—but the practice of sealing settlements has been condemned by civil procedure scholars and public interest groups. In several areas of intellectual property development, the practice of protecting formulas and trade secrets is not without criticism—but it is driven by economic incentives and legal entitlements for patent protection that demand, among other things, proof of originality. Whether they operate in favor or against openness, confidentiality norms are supported by default legal rules.

By making a structured effort to determine whether rules and presumptions will incentivize socially constructive outcomes, the Article seeks to develop an appreciation of the possibilities for applying an institutional “choice architecture” to

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3 See, e.g., David A. Anderson, Freedom of the Press, 80 Tex. L. Rev. 429, 486 (there are instances of legitimate government secrecy restrictions, but these are “islands in a sea of openness”); Sunshine Review, Sunshine Review, http://sunshinereview.org/index.php/ United States (providing links to descriptions and reviews of each state's Sunshine Laws).


private lawmaking. Parts II and II identify distinctions between for-profit and nonprofit practices. Part IV examines a proposed section of the ALI Principles of Nonprofit Governance. Part V considers the justifications proffered by the rule change. Part VI takes a Law and Economics approach to understanding whether the proposed rule is designed to promote social welfare. The article concludes that private lawmaking projects might usefully incorporate a more systematic approach to “choice architecture” when setting default rules and similar incentives.

B. For-Profit Boards and Confidential Deliberation

In the boardrooms of for-profit corporations, expectations of secrecy and confidentiality are believed to be essential if directors are to be expected to engage in candid discussions of important matters.\(^8\) Capitalizing on new business opportunities, for example, frequently requires confidential decision making. To build confidence in the honesty of markets, the securities laws prohibit divulgence of insider information.\(^9\) Rival companies can gain strategic advantages if they learn about certain board policy disagreements.\(^10\) The likelihood of hostile takeovers and aggressive competition will increase if outsiders know about factional disputes on a corporate board.\(^11\) Entrepreneurial motives and confidentiality imperatives appear to go hand-in-hand.

For-profit corporations have been known to take extraordinary measures to ferret out and stop board leaks.\(^12\) As a matter of precaution, public corporations extract nondisclosure agreements from new and continuing directors, who are thereby barred from speaking or disclosing unauthorized information about anything that transpires at a board meeting to staff or to management.\(^13\) The confidentiality

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\(^8\) See Holly J. Gregory, Dealing with Board Dysfunction and Crisis, 1622 PLI/Corp 393, 407 (2007)(“Boardroom confidentiality is critical if a board is to create and maintain an atmosphere in which full and frank discussion can thrive, and consensus can ultimately be reached. A failure of board confidentiality can undermine the ability of a board to make timely and deliberated decisions. It also may signal more significant difficulties within a board. If individual directors were free to determine for themselves unilaterally when and what confidential information to disclose, corporations would lose the ability to protect non-public (often proprietary and strategic) information and to control the timing of disclosures, leading to significant potential for corporate harm.”); Simon A. Rodell, Plumbing in the Boardroom: Plugging Boardroom Leaks Through a Good Faith Duty of Confidentiality, 59 FL. Rev. 631 (2007)(advocating a general duty of confidentiality).


\(^12\) See, e.g., James Fanto, Keeping Quiet Outside the Boardroom, 2008 Emerging Issues 1063 (2007).

\(^13\) See, e.g., Dice Holdings, Inc., Corporate Governance Guidelines,
obligations of directors frequently persist after the service of an officer or director has ended.\(^\text{14}\)

Opposition to confidentiality in the corporate boardroom may emerge from different sources. Outsiders—news organizations, advocacy groups, tort claimants, and attorneys general, for example—challenge the enforceability of such nondisclosure agreements and the concealment of particular documents by boards.\(^\text{15}\) Insiders—employees and officers of an organization itself, dissenting board members, labor unions—challenge for-profit boardroom confidentiality rules, hoping to gain access to board minutes, consulting reports, or to obtain the authorization of board members to speak freely about their differences.\(^\text{16}\) Law enforcement agents, especially attorneys general, exercise broad subpoena powers and in some cases are subrogated to the hypothetical informational rights of the public.\(^\text{17}\) During past decades the informational rights of some stakeholders have been enlarged; but privileges and exceptions to the scope of discovery hem in these rights.\(^\text{18}\)

C. Nonprofit Non-confidentiality Norms

In distinction to for-profits, consider the existing patterns of adherence to norms of confidentiality on nonprofit boards. Some types—for example private foundations, hierarchical religious organizations, and some of the more entrepreneurial nonprofits—operate with little non-confidentiality at the top, in ways that resemble for-profit businesses. In general, however, nonprofit board members communicate more openly and directly with their stakeholders about board activities.

\[^{14}\] See, e.g., Confidentiality and Non-disclosure Policy, Derek Oil Company, at http://www.derekoilandgas.com/pdf/ConfidentialityNon-Disclosure200612.pdf (visited 5/26/2011) (“Departing Employees shall be reminded of their obligations regarding Derek’s Confidential Information.”).


\[^{16}\] See Fed.R.Civ.P. 26(b)(1) (“Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action . . . .” (emphasis added)).

\[^{17}\] The oversight role of Attorney General, in most states, includes the power to issue and enforce subpoenas, see, e.g. NY Executive Law Sec. 63(12 & 175(b); N-PCL Sec 112(b)(6).

\[^{18}\] See, e.g., In re Dow Corning Corp., 261 F.3d 280 (2001).
Nonprofit boards do not report to shareholders; they are accountable for pursuing their chartered missions to benefactors and to enforcement authorities in the states in which they operate. Directors owe a duty of care to pursue the best interests of their organization. In membership organizations, furthermore, members have rights and play some part in governance—when directors make decisions that affect the fortunes of their organization or their members, these duties cannot be fulfilled by directors acting by themselves, for themselves, from within a bubble.\(^\text{19}\)

Nonprofit bylaws and informal policies accordingly establish types of information that directors can share with non-board members, and types that cannot be shared. In many organizations, directors feel free to discuss with non-board members much of what is on a board’s upcoming agenda or transpires at a meeting. In such organizations, board members might discuss questions of substance with members of the staff, former board members, colleagues and experts in relevant fields, advisory committees, donors, and the media, among others.\(^\text{20}\)

The designated ownership of the work product of a board—including minutes, consulting reports, and investment statements—is also non-uniform.\(^\text{21}\) In


\(^{20}\) See, e.g., Stephanie Strom, Charity Invites Donors to ‘Kick the Tires’ and Squeeze the Cash Register, N.Y. TIMES, May 26, 2006, at A14; or Victor B. Flatt, Notice and Comment for Nonprofit Organizations, 55 Rutgers L. Rev. 65, 72–79 (2002) (proposing a procedure, along the lines of the Administrative Procedure Act, to improve accountability within nonprofit organizations); Joseph Valenti, A Lawyer’s Duty to a Nonprofit Entity During an Internal Investigation, 22 St. Thomas L. Rev. 504 (2010)(“The nonprofit entity must sometimes sacrifice its privileges - and sometimes even itself, like in Shorter College - to serve the public in the best manner possible. Thus, disclosure should be the preferred choice, although some rare mission statements may require a director to follow utilitarian public policies and preserve evidentiary privileges.”) Id.

\(^{21}\) The term “non-confidentiality” is used throughout because the meanings given to “transparency” in the context of board governance cannot be understood as the dichotomous opposite of confidentiality. In its weakest form, transparency may only mean that the Attorney General, who is privileged by statute to represent the public, is statutorily empowered to discover board minutes and work products through legal proceedings; and that the records and books of a nonprofit, including board minutes, are available for inspection. In stronger forms, the customs, practices, and governing instruments of nonprofits entitle various nonprofit constituencies to briefing and consultation in advance of board meetings, to attendance at meetings, to the right to participate at such meetings, and to access to reports and other work product related to board actions.

In other Western nations, values of transparency appear to be well entrenched. For example, in Australia, the recommended confidentiality policy of Our Community (an important nonprofit social enterprise organization linking community organizations) contains a preamble conveying the view that the organization “is committed to openness, transparency, and accountability, and the view that “policies shall reflect its wish to release all information it holds as far as this is consistent with the protection of individual privacy, the effective management of its business, and relevant legislation.” See [http://www.ourcommunity.com.au/boards/boards_article.jsp?articleId=1453](http://www.ourcommunity.com.au/boards/boards_article.jsp?articleId=1453).
most settings in membership organizations, the information that has been gathered, generated, debated and discussed at the board level is treated as the property of the charity, and is held by the board as trustees for the organization, although generated for the nonexclusive use of the board. In other settings – for example where holding onto membership lists or medical records is at issue—an overriding concern with preventing the disclosure of membership secrets is evident, and when discovery demands are made in litigation, they are steadfastly resisted.

Boardroom transparency norms can take a strong form (with board meetings open with notice to members or the public at large); or a weak form (with the minutes of closed sessions made available subsequent to meetings); or something in between. Some nonprofit boards share information about actions they intend to take at upcoming meetings, in order to solicit advice from a range of stakeholders. Nondisclosure or confidentiality agreements are rare in nonprofit organizations.

Illustrations of motion practice litigation between private parties over discovery of nonprofit records may be found in Armenian Assembly of Am., Inc. v. Cafesjian, 2011 U.S. Dist. LEXIS 49208 (2011) (Summers v. Cherokee Children & Family Servs., 112 S.W. 3d 486, 522 (2002); Olson V. Automobile Club Of Southern California, 2006 Cal. App. 13 Unpub. LEXIS 3297 (2006 uncertified). Board work product is generated at the charity’s expense and as a matter of principle can be said to belong to the organization and held beneficially by the board. Materials related to meetings in executive session are sometimes held under lock and key by the board secretary or the attorney to the organization. The question of who owns work product and who can waive a work product privilege, in the for-profit corporate context, is unsettled and complex, particularly when conflicts arise between individual clients, board members, shareholders, and corporations, and government. See, e.g., Thomas J. Moyer, Interpreting Ohio’s Sunshine Laws: A Judicial Perspective, 59 N.Y.U. Ann. Surv. Am. L. 247 (2003); Fred C. Zacharias, Who Owns Work Product?, 2006 U. Ill. L. Rev. 127 (2006).

See, e.g., NAACP v. Alabama ex rel Patterson, 360 U.S. 20 (1959)(refusal to divulge membership lists).

See for example the strict confidentiality policy of the Nonprofit Center, a group located in Tacoma, WA., which provides that “It is the policy of The Nonprofit Center that trustees and employees of The Nonprofit Center may not disclose, divulge, or make accessible confidential information belonging to, or obtained through their affiliation with The Nonprofit Center to any person, including relatives, friends, and business and professional associates, other than to persons who have a legitimate need for such information and to whom The Nonprofit Center has authorized disclosure. Trustees and employees shall use confidential information solely for the purpose of performing services as a trustee or employee for The Nonprofit Center. This policy is not intended to prevent disclosure where disclosure is required by law....” http://www.npcenter.org/statements_of_ethical_standards.html.

See, e.g., the website of 20,000 community association leaders, HOATALK.com, http://www.hoatalk.com/Forum/tabid/55/Forumid/1/postid/89473/view/topic/Default.aspx, visited 1/28/2010. (“Do any boards have a formal confidentiality agreement and/or a conflict of interest statement that they have their members sign or at the very least have as principles for the board? If you do would you be willing to share with the rest of us? Barbara K. Why would you want the board to sign a confidentiality agreement? Nothing is confidential with a board except for meeting with attorneys. . . .”) Barbara.
many cases these norms are legally mandated. Nonprofits that do business or receive grants from many localities, states and the federal government are legally required by open meetings laws and freedom of information laws to conduct much of their business in the open. In the absence of such mandates, responsible board leaders in the more transparent organizations view blanket secrecy rules—under which minutes are never kept and all staff members must leave the room—as culturally unacceptable, except for narrowly confined situations.

Even in organizations that place a great stock in transparency, situations arise in which discussions are held in strict confidence. If directors or

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26 See, e.g., N.Y. Public Officers Law, Article 7, Open Meetings Law, Art. 7 (The Open Meetings Law applies to "public bodies." That term is defined to include entities consisting of two or more people that conduct public business and perform a governmental function for New York State, for an agency of the state, or for public corporations . . ."). http://www.dos.state.ny.us/coog/openmeetinglawfaq.html (visited 6/1/2011).


Q: I have recently joined a board where the executive director frequently states that all board meetings, minutes and activities are to be considered confidential. I thought that we lived in an era where Sunshine Laws are the norm and transparency is the watchword of the day.

A: This is an important issue that cannot come down to either/or. There are circumstances that require transparency and others that require confidentiality and each organization must make the right choice at the right time. While most nonprofits are not bound by Sunshine Laws, it behooves all of us to act as if we were. Between the pressures of the public, our donors and regulators we are operating today in an atmosphere that demands transparency. Financial records and in some case meetings and minutes must be made public. People want to feel comfortable that there is no self-dealing and that there are no improprieties or even the appearance of such. Even if this were not our reality, as trustees for the community we have a moral obligation to ensure our dealings are aboveboard at all times. That being said, if we want our boards to really grapple with critical issues we expect them to be honest, expose their feelings and float ideas that might be unpopular or “out there.” If they are going to open up in this manner they must be able to trust their colleagues that what is said in the boardroom remains in the boardroom.”

Temkin, id.

28 See, e.g., Hemenway & Barnes firm, Nonprofit Board: Real Questions, Real Answers A Guide for Directors of Nonprofit Organizations: What about Confidentiality? http://www.hembar.com/practice/governance.pdf (“A board member should retain in confidence all nonpublic information the director receives in connection with his or her service. Confidential matters discussed at board meetings are just that – confidential. Information should not be disclosed other than to those with a legitimate need to know. Generally, individuals such as former directors, volunteers, donors, relatives etc., do not have a legitimate need to know the organization’s affairs.”); see also http://www.probonopartner.org/publications/confidentiality.htm (detailed and restrictive nonprofit confidentiality policy); Joshua Harman, Oversight of State Open Records Laws—A Study of Pennsylvania’s New Right to Know Law and the Office of Open Records, 79 PA Bar Assn. Quarterly 93, 106 (2008) (deliberative process privilege in FOIA and state records laws exists because “it would be impossible to have any frank discussion of legal or policymatters in writing if all such writings were subjected to public scrutiny,” and “efficiency of Government would be greatly hampered if, with respect to legal and policy matters, all Government agencies were prematurely
appropriately authorized officers decide that confidentiality is required, then meetings and all pertinent documents including reports and records are closed. Deliberations and work products pertaining exclusively to them are then as private as is permitted by the rules of evidence and the general laws pertaining to confidentiality.  

The most common means for closing a meeting, of course, is to invoke an executive session. Few nonprofit organizations conduct all their business in an executive session. Roberts’ Rules of Order provides procedural protocols that are followed by many boards for invoking and conducting an executive session in the middle of a regular meeting. The uses put to executive session rules have not been

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30 See Robert’s Rules of Order Newly Revised (10th ed.), pp. 92, 93. Under Robert’s Rules, which many nonprofit organizations formally adopt, a motion to go into executive session is ordinarily a main motion, §10, pp. 95ff. It requires a second, is debatable, and requires a majority vote for adoption. Under RRONR, the conduct of business in executive session follows the regular rules of order, including the form and content of the minutes, pp. 451-456. See Sands v. Whitnall Sch. Dist., 2008 WI 89 (2008).

31 There are practice guides to holding executive sessions, but the author is unaware of any that advises that all meetings be held in executive session. There is a considerable amount of advice about executive sessions on Internet blogs. See e.g., Garber, Beth Grim, California Condo and HOA Law, Meeting Confidentiality - Here We Go Again March 24, 2006, http://garberconsulting.com:

When a board of directors must discuss matters of a confidential nature, such as personnel or property issues, it may do so in a private session called an executive session or "in camera" (from the Latin legal term meaning "in chambers"). . . . A board member moves that the board go into executive session. If the motion is adopted by a majority of members, all present who are not members, or essential to the matter to be considered, may be excluded from the meeting. . . . The secretary records in the minutes that the motion was carried. . . . The board conducts its confidential business. Anyone not a board member must be invited by the board to attend. In a board that is highly polarized, the question of who gets to attend the executive session may be a contentious issue. . . . It is a good idea to be prepared with a bylaw or policy specifying the procedure for inviting a non-member into an executive session. . . . Minutes of the executive session are taken and kept separate from the public minutes. In some organizations, these minutes are taken and kept by the organization's lawyer and protected by lawyer-client privilege. . . . Executive session minutes should be reviewed approved at the next executive session. If, while in executive session, you have decided that secrecy should be lifted from a decision, the secretary records the decision in the "public" minutes. Otherwise, all directors are bound to respect the confidentiality of the session.

Gerber, id.

32 See supra, note 29.
studied extensively—and the law limiting those uses is underdeveloped—but typical reasons for taking up business in an executive session include the consideration of personnel performance and compensation matters, real estate transactions, and threatened or pending litigation.\(^{33}\)

As of 2009 there were approximately 1 million Sec. 501(c)(3) incorporated nonprofit public charities; 120,000 private foundations; perhaps 800,000 churches; a half-million other 501 groups, and an unknown, but undoubtedly larger number of unincorporated nonprofit associations.\(^{34}\) Due to the absence of reliable survey information it is not known how many of these groups operate under a blanket rule of board confidentiality; it is unlikely that a great many groups in any but the foundation category do so.\(^{35}\) Executive sessions are exceptional because, with respect to most matters, more open board decision-making is considered functionally desirable and valuable to fostering the quality and legitimacy of decisions.

Overall, the traditional presumption in nonprofits is in favor of openness—except in discrete circumstances when information and deliberations are privileged or when the sensitivity of information indicates to directors or officers that deliberations should be closed.\(^{36}\)

II. CHALLENGING A PROPOSED REVISION OF THE NONPROFIT NORM

A. The Proposed Revision contained in the ALI Principles of Nonprofit Governance

The Reporter and drafters of the Principles of Nonprofit Governance propose to change the behavioral norm that the relatively open quality of board meetings of nonprofit organizations accords with good governance. This would be accomplished by adopting the black letter language and commentary in Section 340(b) of the

\(^{33}\) The type of matter considered for an executive session varies depending on the sort of nonprofit. Consider, for example, homeowners' meetings. The matters discussed at an open meeting are not confidential when homeowners are allowed to attend, as they should be unless a meeting qualifies as an "executive session", as described in Civil Code Section 1363.05(b): "Any member of the association may attend meetings of the Board of the association, except when the board adjourns to executive session to consider litigation, matters relating to the formation of contracts with third parties, member discipline, personnel matters, or to meet with a member upon the member's request, regarding the members payment of assessments as specified in Section 1367 or 1367.1. The Board shall meet in executive session, if requested by a member who may be subject to a fine, penalty, or other form of discipline and the member shall be entitled to attend the executive session." Garber, supra, note 31.


\(^{35}\) Id. Note however that within certain subgroups, the story is different. Foundations, hospitals and entrepreneurial nonprofits might constitute exceptions as well.

\(^{36}\) See Supra.
Principles, titled "Informational Rights and Obligations of Governing Board Members." This rule would provide that each director or officer of a nonprofit "$[m]ust preserve the confidentiality of information that the board member knows or has reason to know is confidential."\textsuperscript{37} The rule establishes an imperative duty to preserve confidentiality ("must preserve") and connects it to a double-barreled test which triggers the duty to preserve confidence when the board member either "knows" (subjective) or "should reasonably know" (objective) that information is confidential.\textsuperscript{38} The test effectively limits an excuse for sharing confidential information to something like an affirmative showing of "justifiable ignorance".\textsuperscript{39}

The proposed Official Comment expands the duty of a director to maintain secrecy by enlarging the default definition of what is "confidential information." It is defined as "nonpublic information that a board member . . . has been given or learned in his or her capacity as a board member." Nonpublic information "generally includes details of board deliberations and opinions expressed by and votes of fellow board members, and institutional work product, information from oral presentations, and opinions expressed by management, advisers, and retained experts."\textsuperscript{40} Most board meetings, other than annual meetings of members, are not held in public or open meetings. This definition would therefore require that nonprofit board members share nothing they learn as board members at a private board meeting without first establishing that pursuant to a prior established policy or on an \textit{ad hoc} basis, the information, notwithstanding the private meeting, can be characterized as "public" in nature. This is designed to have a deterrent effect on the transmission of "nonpublic" information about the decision making process of a board and the material it uses to reach its decisions.

A corollary to the deterrent effect the Principle can be expected to have on those directors who might otherwise share information is the heightened cost to non-board members of learning about board affairs. Staff workers, donors, reporters, managers and others who come to believe that certain nonpublic information warrants disclosure, in order to obtain it, must transform the nonpublic, confidential

\textsuperscript{37} See Am. L. Inst., Principles of the Law of Nonprofit Orgs. § 340(b), at 311 (Tentative Draft No. 1, Nov. 1, 2007). Section 340, subsection (b) states that each member of the governing board "must preserve the confidentiality of information that the board member knows or has reason to know is confidential," with an exception for a board member to disclose in good faith "to the attorney general or other regulator or to a court confidential information that he or she reasonably believes appropriate to prevent, mitigate, or remedy harm to the charity." Id. Section 340(a) concerns the informational rights of members.

\textsuperscript{38} Principles of the Law of Nonprofit Organizations, Tentative Draft 1 (Sept. 2007), Sec. 340. Informational Rights and Obligations of Governing-Board Members.

\textsuperscript{39} The comment to subsection (b) explains that confidential information "includes details of board deliberations and opinions expressed by and votes of fellow board members." Id. § 340(b) cmt. c, at 315. This language imposed somewhat more stringent confidentiality rules than the 2006 draft.

\textsuperscript{40} Comment c., Sec. 304(b).
information into publicly accessible information, either by an internal appeal procedure or legal action. This transformation requires a larger amount of time, money, and perseverance than most outsiders have to spend.

In short, by imposing a duty of confidentiality upon a board member, and linking the duty to a rule defining confidential information as all nonpublic information, the proposal effectively creates a presumption that everything occurring at a typical private nonprofit board meeting is confidential. If confidentiality becomes the default condition, then, under such a regime, the burden of moving to a more transparent set of norms shifts to the information seeker. The information seeker will then succeed only if the nonprofit adopts transparency oriented - governance instruments which condone non-confidentiality, ex ante, or makes adjustments on an ad-hoc basis when a particular problem arises.

B. The Justifications for Board Confidentiality in Perspective

The justification provided by the Comment for a broad presumption of confidentiality emphasizes the need for frankness and candor in the boardroom.41 The Commentary adopts the policy position that “robust, candid discussion leads to sounder decision-making”:

Maintaining the confidentiality of information is important to charity governance for the same reasons it is important to governance in the business and government sectors: Robust, candid discussion leads to sounder decision making. Neither board members nor those providing them with information (including senior management) will be as frank in the absence of this trust. If one or more board members use selective or even public leaks as a weapon to control the agenda or the outcome, the board could find itself split into rival factions that are unwilling to engage in full and open information-gathering and debate. (Of course, legislatures might determine that other values are more important, and enact open-meetings or open-records requirements for government-created or -funded entities. . .).42

The Comment favors a confidentiality rule in preference to a non-confidentiality rule as the best default position on the basis of the intuitively plausible proposition that transparency norms tempt board members to reveal too much about board deliberations and thereby chill honest communication. Referring to the work of Gail Aidinoff Scovell,43 the Reporter’s Comment observes that “even responsible

41 Principles Sec. 340, Comment c. (2) to Section (b).
42 Id.
43 ALI Draft p. 322, citing Scovell, “Disclosure of Confidential Information by Directors: Is There a Duty of Confidentiality and Should There Be?” (paper presented at The Nonprofit Forum,
management and board leaders acting in good faith may be tempted to conceal difficult issues from all but the most loyal board members if they cannot rely on disgruntled Board members to keep information confidential to the extent appropriate.\footnote{Id.}

Assertions about the superiority of a presumption of concealment presuppose at least five sub-assertions:

(1) that a board’s awareness that a deliberation which is entirely private produces more candid conversation at a boardroom table than the candor which results because board members are aware that the public knows about or might soon learn of what has transpired;

(2) that it is necessary to deprive outsiders of virtually all information generated by or for the board in order to achieve a sufficient degree of “robustness” or “candor” to maximize the effectiveness of a nonprofit board;

(3) that there is a significant problem with “disgruntled” board members who air policy differences “inappropriately” without a justification grounded in the best interest of the organization; and that imposition of an absolute duty of confidentiality is more effective than other means to patrol the problem of excessive information-sharing, if it exists;

(4) that an increase in the amount of candor at board meetings is more important, in service to a nonprofit mission, than everything else it will cost to obtain the marginally greater degree of candor than the current level of confidentiality provides; and

(5) that boards should (through stronger confidentiality norms) transfer responsibility for mandating values that might be in tension with board confidentiality to legislatures rather than accept such responsibility themselves.

The plausibility of these claims is not self-evident. Indeed an intuitive case can be built to reject each of them.\footnote{Each of these claims can easily be turned around: (1) a key premise of open meetings and sunshine laws is not only that they promote democracy in a theoretical sense, but that they enhance...} The comment, furthermore, does not address whether

\footnote{Id.}
the costs and benefits attached to openness varies depending upon the subjects that are deliberated; whether stronger and better board members are less concerned about blanket confidentiality than weaker and poorer members; or whether the costs of diminishing communication between a board and the outside world outweigh benefits of candor.

Neither the text nor the commentary attached to proposed Principal 340(b) entertain the possibility that the principal outcome of a presumption of confidentiality might have little to do with candor. A stronger presumption of confidentiality could lead to the elevation of the convenience and protection of the board or the officers of the nonprofit above the best interests of the organization. A stronger secrecy rule could allow nepotism to flourish without public awareness; or make it harder for donors to discover management problems; or it might decrease the likelihood of detection of fraud or abuse; or release a board from the necessity to explain its conduct to those who support the organization’s mission. None of these outcomes would result in serving the best interests of a charity or of social welfare more generally.

The comment to Section 340(b) does acknowledge conflict between its’ approach and the approach to openness reflected in various open meeting laws, sunshine laws and the Freedom of Information Act—all of which substantially affect many nonprofits. Acknowledgement of involuntary submission to legal transparency requirements understates the voluntary commitment made by many nonprofits to transparency.\footnote{See supra n. 7.} Consider, for example, the University of Medicine and Dentistry of New Jersey, which posts committee meeting minutes, bylaws, contracts, resolutions of all sorts, along with bylaws and conflict statements, on its websites. According to Professor Boozang, the attitude taken by these nonprofits provide “a stark contrast to the inadequate concept of transparency embraced by the ALI.”\footnote{Thomas L. Greaney and Kathleen Boonzang, Mission, Margin and Trust in the Nonprofit Healthcare Enterprise, 1 Yale L.J. Health Pol’y, L. & Ethics 38 (2005).}

Three possible rationales for the proposed rule might conceivably be offered by public accountability which encourages candor; (2) there is no reason to think that to maximize the effectiveness of nonprofit boards would require the proper trade-off between open and closed decision-making; (3) one might reasonably believe that since disgruntled board members who make serious public charges of poor decision making face ostracism and the destruction of their board relationship, the problem would be to a large degree self-policing; (4) it would appear reasonable to subtract from the benefits of frankness the losses due, for example to a lower volume of work product that would be available throughout an organization; a decreased amount of communication between board and staff; and (5) it would be reasonable, given the fact that nonprofit corporations are chartered in the public interest, to assume that they have the responsibility for more in the way of value mandates than decision making efficiency.
proponents, but they remain to be demonstrated. First, the proposed change might be a successful effort to define a default position of confidentiality as the most probable position nonprofits would want to take. Or the proposed change might be a utilitarian solution designed to calibrate a proper degree of transparency. Or third, the proposed change might offer a default position more compatible with nonprofit cultural norms than the present position. None of these is established; and so, without a more systematic analysis of costs and benefits, the assumptions embedded in the proposal about the net gains to the new board confidentiality rule look a lot like a leap of faith about the net impact of the ALI rule on increased candor. If the object of the Project is better achievement of mission objectives and/or the promotion of social welfare, then the problem merits further exploration.

III. A THEORETICAL PERSPECTIVE ABOUT PRIVATE LAWMAKING

A. A Coasean Approach

If we desire to design a better set of confidentiality rules, it will merit our

48 Conjecture as to why the insertion of this strengthened rule was proposed might include a concern, on the part of many legal counsel to nonprofit boards who serve as advisors and consultants to the Project, to cabin the growing jurisprudence and legislation which has expanded the reach of the government sunshine and open meeting laws. As noted, supra, the open meeting laws of many states apply to any nonprofit that does business with government, and they require, with copious exceptions, different kinds of notice about all board meetings and public access to them; they also limit the invocation of executive sessions, typically to employment and hiring matters, real estate appraisals, specified types of attorney-client communications, terrorist response plans, and other categories. They have in recent decades been applied not only to government bodies, per se, but also to nonprofits that receive a proportion of their funding from, or operate as, “vehicles for” public entities. See, e.g., Okla. Open Meeting Act, Okla. Laws 1977, c. 214, § 1; Fla. Sunshine Act, Fla. Stat. sec. 119.011(2) (1995); Tenn. Open Meetings Act, Title 8, Ch. 44.

At broader level, although the Principles themselves do not offer this rationale, it is argued that inroads on confidentiality impair the ability of boards to act independently and swiftly. Evelyn Brody, the Reporter for the Principles Project, has on this basis argued for better public understanding of, and a clearer differentiation between, private “eleemosynary” and truly public charities. See, e.g., Evelyn Brody, Whose Public? Parochialism and Paternalism in State Charity Law Enforcement, 79 Ind. L.J. 937 (2004).


50 The need for a more systematic analysis is especially evident in the present instance because of the risk of feeding the popular backlash against nonprofits. When nonprofit board secrecy agreements come to light, they are frequently greeted by the media, the public, and nonprofit stakeholders as violations of trust. The draft commentary alludes to this problem: it draws attention to commentary offered by the Securities and Exchange Commission to the effect that “While no comparable legal duty applies beyond publicly traded companies, the public purpose of charities, in particular, argues generally for more transparency rather than less.”
attention to ask whether a new default position will improve or diminish social welfare. As Professors Thaler and Sunstein have observed, “if, for a given choice, there is a default option—an option that will obtain if the chooser does nothing—then we can expect a large number of people to end up with that option, whether or not it is good for them.”

Legal presumptions such as the one created by Section 340(b) create initial privileges; it may be expected that a large number of institutions will end up with that option, whether or not it is beneficial. Our inquiry maps this established understanding of the impact of default rules to private lawmaking: Would it be welfare-enhancing to adopt the proposed ALI principle, or to retain the initial privilege of openness?

Presumptions do not in themselves establish final positions. But if openness is not the default position, those who want openness must incur a cost to achieve it. Secrecy, furthermore, is a peculiar sort of commodity. Those who aren’t privy to a secret don’t know the actual cost they would be willing to pay to have access to it. This problem lends itself to a simplified Coasean analysis that compares the costs attached to a regime in which either disclosure or a secrecy regime is privileged. Changing the legal presumption, other things being equal, might increase the cost of bargaining for changes in the status of information and thereby decrease welfare.

As students of law and economics learn, Coasean approaches are helpful in situations where, *inter alia*, two producers of goods or services experience a “localized negative externality” either in the form of company A (often imagined, for example, as railroad locomotive) imposing an externality on B (often imagined as a farmer concerned about fire resulting from the sparks from the locomotive). This permits evaluating the impact of a liability rule (e.g., should the railroad pay the farmer or should the farmer bear uncompensated losses?) on overall social utility, usually by factoring in the increased or decreased social value of the production of goods or services that would result from the imposition of a given legal rule. A similar approach can be useful to address the impact of a presumption on a nonprofit or on overall social utility.

In the present case, we are interested in the consequences, for a given nonprofit entity and also for its community of the mission beneficiaries and other community stakeholders (hereafter collectively referred to as “stakeholders”), of a presumption of either confidentiality or transparency. The nonprofit entity (imagine, for example, a hospital or a private school) is presumed to provide services for the stakeholders who are the beneficiaries of its mission activities (imagine, for example, patients or students). The nonprofit’s existence, as well as its preferential treatment under tax and regulatory regimes relative to private firms, is generally justified by the gains it brings to these beneficiaries and to social welfare more generally. The Principles of Nonprofit Governance Project favors a particular presumption; and because the law of nonprofit organizations must choose either to require nonprofit boards to opt into

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51 Thaler and Sunstein, *Nudge: Improving Decisions About Health, Wealth and Happiness* (2009) 85; the literature about choice architecture includes
confidentiality or opt out of it (that is to say, these presumptions are dichotomous), the typical Coasean approach to maximizing mutual utility—by identifying the quantities of production of each involved party—must be adjusted to take the dichotomies into account.

As observed above, there are not infinite possibilities for a general presumption; the rule will either establish that boards of directors of nonprofits must presume that all proceedings are confidential (understanding that the board could later act to permit transparency), or else the rule will establish that boards must assume that all proceedings are open for public debate and consultation (unless the board should explicitly make proceedings confidential via the use of executive sessions, specific nondisclosure or “gag” agreements, or pre-existing, binding confidentiality agreements, etc.). There is, in professional terms, a binomial decision tree. The goal of ALI Principle Sec. 340 is for these purposes the maximization of social utility; but rather than “quantity-targeting,” (as a typical Coasean approach would target to measure various levels of output under different rules), it is “state-targeting” (trying to measure whether an initial state of privacy or of transparency will subsequently lead to the most well-being for the entity and its constituents).

We will therefore try to estimate the social utility of a confidentiality rule based on two different situations: state “alpha,” in which the presumption of confidentiality expressed in Section 340 is assumed; and then we will model in state “beta,” in which the more traditional assumption of transparency is the default rule. It soon becomes apparent that the default positions are critical to understanding the value of the two different presumptions because, unlike most Coasean examples, the transaction costs (i.e., the costs attached to changing from transparency to privacy, or from privacy to transparency) are dynamic, not static, and they will vary extremely depending on which legal presumption is embraced.

B. Two Theories of Social Utility

Under a general Coasean framework, if transaction costs are zero, equilibrium is unaffected by the choice of a default position and objective is to maximize “social utility” through legal rules that facilitate bargaining. In the present case, however, there are two possible ways to think about what “social utility” means. Are we measuring only the impact of a legal presumption on the community stakeholders of a nonprofit (the patients in a hospital or the students in a school, for example); or are we, in addition, trying to maximize the utility of the presumption to nonprofit institutions themselves? The latter possibility assumes nonprofit groups exist as “utility-bearing entities” that are independently valuable for their own sake—that is, that they provide some amount of social capital above and beyond the value they impart to beneficiaries.
To give some mathematical expression to these ideas:

Either \( \text{Social Utility} = \text{Community Stakeholder Utility} \)

OR \( \text{Social Utility} = \text{Nonprofit Utility} + \text{Community Stakeholder Utility} \)

From a public policy perspective, the existence of nonprofits as privileged organizations may recommend considering only the net impact of a legal presumption on the particular beneficiaries of nonprofits. If one considers nonprofits as means to the end of increasing public utility, then the impact of a presumption on community stakeholders suffices as an appropriate approximation of impact on social utility.

If, however, nonprofits are independently meaningful organizations, in the sense that even a nonprofit providing nominal benefit to the surrounding community can provide utility for employees and directors, then it makes sense to internalize the utility of nonprofits in the determination of overall social utility. For the sake of giving all possible benefit to the argument for confidentiality, and because we accept the view that properly functioning nonprofits generate “social capital” that is independent of mission service, and because the author and others have elsewhere argued in favor of the larger purposes that nonprofits serve,\(^2\) we will proceed under the assumption that nonprofits are forces for good (have a positive utility) independent of any benefit they may provide to community stakeholders outside of the organizations.

The Setup Prior to any Presumption:

Assume that the social utility of a functioning nonprofit is equal to the good it does for its own members, plus that which it does for the community at large:

\( \text{Social Utility} = \text{Nonprofit Utility} + \text{Community Stakeholder Utility} \)

Nonprofit Utility can be broken down further, into the utility to an Individual Director, and the utility to the Organization, which includes the utility to the non-director employees of a nonprofit. Therefore:

\( \text{Social Utility} = \text{Individual Director Utility} + \text{Organization Utility} + \text{Community Stakeholder Utility} \)

The Setup Including the Presumptions:

\( \text{Social Utility} = \text{Individual Director Utility} + \text{Organization Utility} + \text{Community Stakeholder Utility} \)

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It may be helpful at this point to introduce a hypothetical situation in which to test out these variables. Suppose a city hospital, not constrained by sunshine or freedom of information laws, is considering closing its emergency room due to cost constraints. In state “alpha,” this hospital’s board has taken on the proposed presumption of confidentiality. In state “beta,” the hospital’s board retains the presumption of transparency with respect to board proceedings.

Applying the definition above to such a scenario, we could imagine that “Individual Director Utility” might be the value of the rule to the productiveness and willingness to serve of an individual board member. “Community Stakeholder Utility” would be the full value of the medical care provided by the hospital to the community surrounding the hospital. “Organization Utility” might be the impact of the hospital itself on civic life, employment, safety and economic activity.

Each of the utilities in the model will be likely be higher or lower depending on the net benefit of confidentiality (“alpha”) or transparency (“beta”) presumptions. Thus:

Individual Director Utility.

A. Under a presumption of confidentiality: Individual directors will on one hand have freer board deliberations increasing their ability to learn from fellow board members; but on the other hand they will have greater difficulty consulting with non-director stakeholders, decreasing their ability to learn from them.

B. Under a presumption of non-confidentiality: Individual board members will be able to enjoy benefits to decision-making of consultation with non-director stakeholders, but from this gain should be subtracted the costs associated with more inhibited board deliberations. The individual directors who wish to make deliberations or work product private will need to experience costs attached to going through the procedures for doing so.

In the hospital example, imagine a board discussion about foreseeable actions that might be taken against the hospital by employees and community activists if it decides to shut down its emergency room. Under a presumption of confidentiality a board member should have no concern about conversations and opinions getting out. Individual directors in a minority who opposed the shut-down, and who wished to consult with non-board members, on the other hand, would be obliged to endure the tangible and intangible costs of seeking to open up confidential proceedings—including monetary expenses and estrangement from others on the board.

If the board decision-making process is transparent, however, the proposed shut-down could be a matter for public discussion and feedback, and an individual board

53 Transparenct in the context of this article shall mean the situation where board members and directors do not necessarily have the duty to proactively disclose information, but rather the information is available upon request and in some cases will be anticipatorily made open to the public.
member’s reputation could rise or fall accordingly. Board members might have an incentive to refrain from taking unpopular positions that they knew could become matters of public knowledge. Under a presumption of confidentiality a board member would be foreclosed from soliciting views about the contemplated activity, from encouraging opposition, or possibly from preempting adverse community responses through negotiation.

Organizational Utility

A. Under a presumption of confidentiality, information formerly divulged but now secretized may strengthen the organization itself because of reduced public pressure on decision-making and less public awareness of organizational weaknesses. The hospital, for example, might not be worried about public pressures or its image during the decision making process. It would not need to use resources to address the public’s concern.

On the other hand, deduct from this gain any valuable information that would have come to the attention of the board and strengthened the organization in a transparent regime but which is now secretized, making the organization weaker—due to inadequate public input and reduced incentives to improve the institution. In the hospital scenario it could be that the hospital board will not have a grasp on public opinion about the decision to close the emergency room. This could potentially heighten the reputational cost and affect financial donations and grants if the public and funders disapprove.

Subtract from this net benefit, further, the transaction cost of making confidential information open. This cost could include the added pressure and scrutiny of the newly opened information, because it is the only information available and because disclosure was resisted.

B. Under a presumption of non-confidentiality: The converse of A. Some information that is divulged to the public makes an organization stronger than otherwise as noted above; but subtract from this gain any cost attached to information that is divulged (advertently or inadvertently) which makes an organization weaker, for example, public opinion may delay deliberations on the decision. Subtract from the net benefit, further, the transaction cost of making open information confidential, including any cost associated with conducting an executive session.

And finally:

Community Stakeholder Utility

A. Under a presumption of confidentiality: Information formerly divulged to the public but now secretized could conceivably make the public better off. For example, the public may waste time and money protesting the idea of cutting the emergency room, but it may not have an effect on the final decision and thus be a waste. But subtract information previously divulged but now secretized that makes the public worse off. A community would likely benefit by being able to plan for the closure of
emergency room services. Subtract, further, the cost to the public of opening up confidential proceedings the public believes it has a participatory stake in. The public may only access the information through filing a grievance with the hospital or in some other manner that takes time and expense.

B. Under a presumption of non-confidentiality: The converse of A. Information divulged can make the public better off. The public will not need to spend money or time to extract information about closure of the emergency room; it may mobilize the community to change the board’s decision. But subtract information divulged which makes the public worse off. For example, the effect of exposing an impending closure on the community’s reputation and its economic development.

The text above indicates the state-dependent transaction costs in a Coasean framework. In essence, costs will be incurred when the relevant party feels it must make a costly decision to treat information in a manner contrary to the legal presumption. For instance, under a presumption of confidentiality, board members (especially those in a minority) will find it difficult to get permission to consult with stakeholders on an issue in order to better inform them. They inevitably will attempt to do so if they are good board members sincerely interested in the well-being of their organization, but there will be large costs in time, energy, and reputation to doggedly attempting to get permission especially if legal action becomes necessary. On the other hand, if the presumption is in favor of transparency, board members will incur reputational risks and tension with other members that are attached to moving and voting for executive session.

These costs are very different and entirely dependent upon the presumption: if the presumption is in favor of confidentiality, the entire onus falls on any minority members in any issue who want permission to open up an issue under deliberation to specific outside stakeholders for consultative purposes; members wishing to keep information secret need only vote (confidentially from the public) to not allow proceedings to be opened, and thus incur no tangible costs. Conversely, if the presumption is in favor of transparency, members wishing to consult with non-directors will face no tangible obstacles to doing so; and the only party facing any cost is a director wishing to close deliberations in order to minimize outside input and knowledge.

The incidence of the costs is thus clearly state-dependent: under a presumption of confidentiality, a cost for non-confidentiality (Pt) must be incurred by information seekers and by board members in order to open up any board matters whatsoever; under a presumption of non-confidentiality, board members must incur the cost for confidentiality (Pc) in order to close board proceedings and prevent disclosure to or input from non-directors.

C. Asymmetries
These costs would usually be assumed to be mirror images of one another in a Coasean framework; however, information asymmetry and the more expensive means needed to open up closed records suggest a different assertion, that:

**Unless default rules are reversed ex-anti the cost for non-confidentiality (Pt) for board members will always be larger than the cost for confidentiality (Pc).**

The information asymmetry (the difficulty of an outsider learning what information would be worth trying to convert to public information in a confidentiality regime; but the ease with which a director can immediately know the answer in either regime) is the most influential factor in the cost asymmetry. Interestingly, the asymmetry itself is asymmetric; that is to say that there is only an information asymmetry under a presumption of confidentiality because, under a presumption of non-confidentiality, background information (outside executive sessions) and general outlines of the board’s agenda are known to not only the board, but also accessible to non-director stakeholders within an organization and community stakeholders outside of an organization. Therefore, all parties can make educated guesses about the subject matter, substance, and importance of a specific executive session. In the hospital scenario, the community and other non-director stakeholders would not know that the closure of the emergency room is being debated. Because they do not know the subject matter of the information, they would not be able to value their need for it.

The approximate value of keeping a sensitive opportunity or budget issue confidential is known to both the board members seeking confidentiality and those seeking to maintain non-confidentiality, and therefore Coasean assumptions (equal knowledge of the costs on both sides) hold. In addition, the transaction costs for those seeking to make information confidential in a non-confidentiality regime are very low, simply a board vote in favor of executive session; each party can gauge the value of confidentiality and non-confidentiality since background information is presumed transparent and available. If, for example, several board members propose moving into executive session during a discussion about trimming expenses by closing a program, and the budget is otherwise transparent to community stakeholders and non-director internal stakeholders, informed stakeholders can infer that sensitive cost cutting and revenue raising issues are on the table. In the hospital hypothetical, this would mean that the community would be able to at least put an estimated value on the information and decide whether or not to attempt to gain access to it.

Under a presumption of confidentiality, however, a board majority on an issue holds all of the relevant information and all of the relevant cards. Under rules like those proposed in Section 340, all board deliberations and presentations are

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54 *But see infra* where this article discusses the effect of presumption and thus the rule change would have the affect of decreasing the likelihood that a board would reverse the default rule ex-anti.
presumed to be confidential. As a result, board members in the minority on a particular issue are not at liberty to either seek outside consultation in order to strengthen their case or inform non-board stakeholders of matters under deliberation to encourage them to proffer input or act to show community opinion.

The absence of available background information means that both community stakeholders and within-organization non-director stakeholders have no ability to surmise when they have an interest in attempting to open a debate to non-director input and consultation. The cost of non-confidentiality is thus prohibitively high—and unless a minority-opinion board member illegally leaks information to non-director stakeholders, community stakeholders will be unable to proffer input until after a decision has been voted on and publicly announced, leaving non-directors to do little more than cry over proverbial spilled milk. In the hospital hypothetical, an unanticipated announcement that a community’s emergency room will be closing could cause little reaction, or it could cause a huge outcry that could cause significant damage to the hospital’s reputation and eventually profitability.

The information asymmetry means either that under a confidentiality regime, stakeholders must be constantly demanding non-confidentiality, for example through protests and the encouragement of negative media attention by publicizing the excessive secrecy, or stakeholders abandon hope of providing consultative advice or input. Because the cost of a continual movement for openness is likely to be prohibitive, it is reasonable to assume that the costs of gaining non-confidentiality in a confidentiality regime will ordinarily be prohibitive, and thus Coasean assumptions (that bargaining costs will be equal on both sides) fall apart; under a presumption of confidentiality, the burden falls entirely on minority-opinion board members and community stakeholders, who are unable to legally communicate or coordinate and thus are rendered toothless.

Mathematically, this can be expressed as follows:

With a Presumption of Confidentiality:

\[
\text{Social Utility} = \text{Individual Director Utility} - \text{Cost for non-confidentiality to minority-opinion Directors} + \text{Organization Utility} + \text{Community Stakeholder Utility} - \text{Cost for non-confidentiality to Community Stakeholders}
\]

With a Presumption of Non-confidentiality:

\[
55 \quad \text{This supposes that the cost for non-confidentiality to an Organization when a board deliberation is made confidential by going into an executive session is negligible. If a board establishes a high threshold for going into executive sessions, then the analysis would include a subtraction for the cost of moving into executive sessions.}
\]
Social Utility = Individual Director Utility – Cost for confidentiality to Directors who wish to keep a specific deliberation private + Organization Utility – Cost for confidentiality to Organization when a board deliberation is specially made confidential + Community Stakeholder Utility

In all cases, the preceding discussion indicates that, unless default rules favoring confidentiality are reversed ex-anti, the Cost of Obtaining Non-confidentiality will be greater than the Cost of Obtaining Confidentiality (as discussed above):

\[ Pt > Pc \]

As long as we do not treat the decisions made at board meetings as determined by the confidentiality presumptions themselves, we are left to worry solely about transaction costs. From this perspective only one conclusion follows: transaction costs are much larger under a presumption of confidentiality (which is not reversed ex ante) than under a presumption of non-confidentiality. Since transaction costs are here (for the moment) entirely frictional, meaning they do not work to improve or even alter final decisions but rather reflect costs forced upon parties that feel obligated to move against the presumption, larger transaction costs represent a pure loss of social utility; a deadweight loss. In this case, the information asymmetry previously noted renders a presumption of confidentiality less efficient than a presumption of non-confidentiality.

We can again visit our hypothetical hospital for an illustration. Assume that the community stages a protest to gain information and consultative opportunities concerning possibly adverse decisions they presume the hospital is making or will be making. The costs incurred by the community during this effort are not being expended in an effort to prevent the closure of the emergency room. On the contrary, the community is only trying to gain access to the information that will inform them that the closure may take place. Likewise, the minority board member who communicates the information illegally to the public is also not trying to alter the final decision of a closure. He or she is only trying to move against the presumption of confidentiality by leaking some information out to the public, albeit, illegally. Thus all of the costs associated with these efforts are as mentioned above, a deadweight loss.

A static analysis is not entirely appropriate, however. We may quite reasonably assume that the presumption can affect final decisions. As discussed (somewhat critically) in an earlier Part of this essay, this is the justification provided for Section 340(b) in the Comment. It is possible that under a presumption of non-confidentiality, increased consultation with stakeholders in the community might lead a board, for example, to make temporizing service adjustments that a closed
board would not decide to make, leading to ruinous economic consequences. By the same token, on the other hand, a presumption of confidentiality might make it possible for a group to hide collective misdeeds which would eventually ruin the organization.

Actual data collection and historical trend observations are needed to determine the relative impact on social utility from presumption shifts. However, it reasonably can be concluded that even where candor leads to better decisions because of confidentiality, only when an increase in social utility from a decision made under confidential conditions exceeds the size of the deadweight loss from confidentiality-induced transaction/friction costs would it be socially optimal to pursue a presumption of confidentiality.

Where Pt is the price of obtaining non-confidentiality and Pc is the Price of obtaining confidentiality, the situation can be modeled as follows:

**Condition for presumption of confidentiality to be optimal social choice:**

\[
Pt \text{ to minority-opinion Directors} + Pt \text{ to Community Stakeholders} - Pc \text{ to board} - Pc \text{ to Organization reputation} < \text{social gains from enhanced revenue and insular board deliberations under a presumption of confidentiality.}
\]

This can be simplified as:

**Condition for confidentiality as the optimal choice:** \( Total Pt - Total Pc < \text{Gains from confidentiality} \)

The conclusion to be drawn from this analytic approach is that if we assume a null hypothesis in which the social utility from nonprofit resources and board decisions is essentially unchanged regardless of the presumption, then a presumption of non-confidentiality is clearly optimal; if we assume that there are decision-quality gains from increased consultation under non-confidentiality, then a presumption of non-confidentiality is even more clearly optimal; if we assume that there are decision-quality gains and revenue gains from board confidentiality, then we must weigh those gains against the deadweight losses incurred on minority-opinion directors and community stakeholders to determine the optimal presumption.

The analysis and accompanying hypothetical above help to explain why changing the presumption as the ALI draft suggests is more likely than not to be welfare-diminishing. The answer is principally because there are noncontroversial asymmetries in transaction costs: it is much harder and time consuming to seek to open access to information that is confidential (through a grievance procedure or legal process) than to close what is generally open (through an executive session or other means).

**D. The Effect of Reversing the Presumption**
Principle 340(b) does not purport to establish a non-modifiable fiduciary duty of confidentiality, of course. The proposal only takes a “principled” stand against the nonprofit cultural grain, and many procedural customs. There is nothing to stop a board from authorizing or pre-authorizing whichever non-confidentiality and confidentiality rules it deems to be desirable. This permissive approach is quintessential private lawmakering: the Principles of Nonprofit Governance Project can impose neither a statutory mandated presumption nor a judicially constructed one. And so, given the fact that any nonprofit governing board that wishes to can create a non-confidentiality regime, what is the great concern about proposing a different default position?

The answer flows from the work of Sunstein and Thayer, and others, pertaining to the influence of default rules and the importance of the architecture of choice. Although there has been very little attention thus far to the importance of improving the process of choice architecture that leads to the construction of private law, it seems clear that the imposition of a new presumption of the sort recommended by an ALI Principles Project in this case—makes a difference in at least three ways: as a gap-filler; as an inferential signal about the existing norms of practice; and as an indicator of what is a “best practice”. As a gap-filler, the Principle will be resorted to in cases involving organizations who have not with self-awareness addressed the matter of confidentiality and non-confidentiality. As a signal of existing norms for proper behavior, the Principle will be understood to express, as the Supreme Court reasoned in a different context, “the normal balance of probability” – which is what presumptions are said to do. In the “best practices” context of a Principles of Governance Project, it may be well for drafters to deviate from attempting to create a presumption that reflects the normal balance of probability; but in that case, the commentary should reflect this deviation of intention.


Finally, establishing a presumption in a Principles Project is tantamount to a recommendation that blanket confidentiality should be implied, unless otherwise decreed, at the opening of any board meeting, without need for an executive session.  

Application of the principle can be expected to influence general standards and practices for communication between directors and other actors including senior management, professional staff, general employees, members, donors, clients, the government, and the public at large. Some nonprofits can be expected to choose to restate their traditional approaches to confidentiality. It can be anticipated that others will conform their historic patterns of governance to adjust to the perception of an enlarged fiduciary duty to maintain confidences.

IV. CONCLUSION

In sum, the benefits to adopting a tougher position on confidentiality are not likely to materialize; but the costs are readily identifiable. Considering the likelihood that the result of the change will not be beneficial from a social welfare perspective, it would be regrettable to dissolve an important distinction between the culture of much of the nonprofit corporate world and the for-profit corporate culture. At a broader level, it appears that private legislators would benefit by evaluating the placement of initial default rules with analytical tools and welfare increasing perspectives like those that public legislators have begun to embrace.

58 See Christopher B. Mueller & Laird C. Kirkpatrick, Modern Evidence: Doctrine and Practice 184-85 (1995). Calling for an executive session in a meeting at which everything is already confidential is either redundant or a request for “super-confidential” precautions to be taken.