



ROSEMARY E. FEI
INGRID MITTERMAIER
DAVID A. LEVITT
STEPHANIE L. PETIT
NANCY E. MCGLAMERY
ERIC K. GOROVITZ
MATTHEW A. CLAUSEN
SHIRLEY J. McLAUGHLIN

ROBERT A. WEXLER - SENIOR COUNSEL
ERIK DRYBURGH - SENIOR COUNSEL
STEVEN CHIODINI - OF COUNSEL
EMILY CHAN - OF COUNSEL
AMY A. RODRIGUEZ - OF COUNSEL
JINNA KWAK - OF COUNSEL
ANDREW SCHULZ - OF COUNSEL
GREGORY L. COLVIN - EMERITUS

135 MAIN STREET, 20TH FLOOR • SAN FRANCISCO, CALIFORNIA 94105
TEL: 415.421.7555 • WWW.ADLERCOLVIN.COM

June 20, 2024

VIA E-MAIL

Joel H. Siegal, Esq.
Attorney at Law
Siegal & Richardson, LLP
436 Fourteenth Street, Suite 1106
Oakland, California 94612
[REDACTED]

Re: Board Governance Concerns

Dear Mr. Siegal:

I am a principal of Adler & Colvin, a law firm that specializes in the law of nonprofit and tax-exempt organizations. We regularly advise directors of nonprofit corporations on their individual fiduciary duties with respect to corporate governance and the proper functioning of the board of directors.

I have been consulted on behalf of Life Chiropractic College West (the "College") regarding certain actions that the Board of Regents (the "Board") and individual Regents, referred to herein as directors, have taken in connection with their management of the College. I have spoken to two potential whistleblowers, both of whom are considering legal action, and I have reviewed a letter to the Board summarizing a discussion that the directors had with another attorney, Natasha Baker, that summarizes concerns she identified with respect to the Board's management of the College.

The Board activities described in the earlier letter could expose the individual directors to personal liability, including the possibility of excise taxes imposed by the Internal Revenue Service (the "IRS") on certain benefits that the directors have received. In addition, the College could be at risk of an Attorney General or IRS audit, and the College's tax-exempt status as a charity could be at risk, as well as its accreditation from the WASC Senior College & University Commission ("WSCUC").

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Without prompt action from the Board, both the College, and the directors personally, are at risk.

I have described the concerns in turn below.

The potential whistleblowers identified numerous issues regarding the Board's oversight and financial management of the College, including the following:

- directors' use of a College credit card for personal expenses and unauthorized travel;
- travel by directors to Board meetings held outside of California, in particular in Spain and Las Vegas, paid for by the College, including the expenses of spouses and significant others;
- director compensation in violation of the College's bylaws;
- general mismanagement of the Board's annual budget;
- excessive payments to directors and a failure by directors to properly itemize expenses for reimbursement;
- the engagement of a former director as a consultant without properly addressing potential conflicts of interest or vetting the compensation to be paid;
- directors exceeding Board term limits in violation of the College's bylaws; and
- a failure by directors to annually disclose conflicts of interest as required by the College's conflict of interest policy.

The Board has a fiduciary responsibility to address these concerns that have been brought to its attention. **Not taking action in light of these allegations itself could be deemed a breach of fiduciary duty.**

Risk of California Attorney General Audit

The office of the California Attorney General (the "OAG") oversees charities in California to protect charitable assets for their intended use and to ensure that charitable funds are not misapplied and squandered through fraud or other means. The OAG can pursue charity directors *personally* for perceived breaches of fiduciary duty, as described in more detail below. **The directors may be held personally accountable for the misappropriation, waste, or misuse of charitable assets if the loss was the result of deficient internal controls, lack of due care, or reasonable inquiry.**

In deciding whether to pursue an investigation, the OAG takes into account complaints and leads from sources such as a charity's directors, officers, or employees. During

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the audit process, the OAG's auditors may interview directors, officers, and other interested parties, such as complainants, volunteers, current and past employees, and accountants. The OAG may subpoena records from third parties and can recover attorney fees, audit expenses, and expert costs in successful enforcement actions. An OAG audit therefore is an expensive and time-consuming process that the College, and the Board governing the institution, should avoid.

In addition, a director can be held personally liable for authorizing or receiving a prohibited distribution of charity assets. Examples of prohibited distributions include payment of excessive or non-contractual benefits, including travel and entertainment expenses, and other uses of corporate assets that violate the charitable trust under which the charitable assets are held. The OAG may view the Board meetings in Las Vegas and in Spain, including first class travel and accommodations for members and their families, as an inappropriate use of charitable assets.

In addition to bringing a formal enforcement action seeking the recovery of charitable funds, the OAG also may seek injunctive relief such as removing directors from the board and prohibiting future service on the board of directors of a California nonprofit corporation. Any College officer or director also independently can pursue an action in court alleging financial mismanagement or a breach of a charitable trust.

Finally, you should be aware that the College insurance policy contains certain exclusions (e.g., for claims brought "by, on behalf of, or in the name or right of" any of the College's directors or officers, or for willful misconduct), such that **the directors may not be covered with respect to these allegations and as a result may have to pay their own legal expenses.**

Risk of IRS Audit, Excess Benefit Transactions, and Possible Loss of Tax-Exempt Status

In addition to California state law governing nonprofit organizations, the College is subject to federal tax law governing tax-exempt public charities. The IRS may audit a tax-exempt organization if concerns have been raised, including by individuals who file complaints directly with the IRS, regarding the proper use of charitable assets or management by the governing body. As directors of a tax-exempt organization, they have a fiduciary responsibility to protect and properly use the College's assets.

As part of its oversight of tax-exempt charities, the IRS may impose taxes on an arrangement it deems to be an "excess benefit transaction" between a charity and a charity insider, including directors or their family members. As an insider, you can be liable for a tax of 25 percent on any deemed excess benefit. If the excess benefit transaction is not corrected (e.g., any excess payment returned to the charity), a second-tier tax of 200 percent on the excess

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benefit is imposed. **Officers and directors who approve the transaction also may have personal tax liability.**

Furthermore, if a charity failed to substantiate that a benefit is being provided to the insider as compensation, the IRS may treat the payment as an “automatic” excess benefit transaction, in which the amount is taxable as an excess benefit without regard to whether the benefit was reasonable. Therefore, a charity must clearly indicate its intent to treat a benefit as compensation at the time the benefit was paid in order to avoid an excess benefit transaction. This issue often arises when an organization provides certain fringe benefits but does not report the benefits as compensation. Paying for spousal travel, for instance, can be deemed an excess benefit payment.

Expense reimbursements that are not made in compliance with an “accountable plan” also may be deemed an automatic excess benefit transaction. An accountable plan requires that reimbursed expenses have a business connection and be properly documented, as well as any excess amounts be returned within a reasonable amount of time. The College’s counsel concluded that director reimbursement has not been subject to an accountable plan and that directors did not properly itemize expenses for reimbursement. Therefore, these payments are at risk of being deemed by the IRS to be excess benefits, and the IRS can impose a tax on the directors who received the benefits and require repayment to the College.

Also, with respect to conflicts of interest, the Form 990 filed each year with the IRS, which is also a publicly available document, asks if officers, directors, and key employees are required to disclose annually interests that could give rise to conflicts and if the organization consistently monitors and enforces compliance with the organization’s conflict of interest policy. **If directors are not properly disclosing potential conflicts of interest, this lack of disclosure could increase the likelihood of an IRS audit of the College.** In addition, any conflicts that exist but have not been disclosed could involve self-dealing transactions that are significant but have not been detected and therefore have not been addressed by the Board or properly disclosed on the Form 990. The whistleblowers with whom I have spoken believe that conflicts of interest are going unreported, and decisions of the Board (such as a hiring a former director as a consultant on a project without reviewing other bids) may reflect a disregard for potential conflicts.

If the IRS audits the College and determines that there is a pattern of excess benefit transactions involving directors or other insiders to the charity, or conflicts of interest that have not been properly addressed, **the IRS can revoke the College’s tax-exempt status.**

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Board Governance under the WSCUC Standards of Accreditation

Katherine Lee Carey of Cooley, the College's regulatory counsel, also has reviewed the allegations described above and has provided the following analysis regarding the College's compliance with the WSCUC standards of accreditation:

Maintaining a strong and independent governance structure is a key element of the WSCUC Standards and is also separately highlighted in two policy documents: the *Governing Board Policy* and the *Governing Board Policy Implementation Guide*. WSCUC also requires that institutional boards comply with applicable state and federal laws and regulations that govern non-profit corporations. The Board should recall that in March 2023, WSCUC identified a lack of diverse backgrounds and governance capacity as bases for a shortened reaffirmation period; however, in the year following, the Board has not recruited any new (or diverse) members to the Board. This lack of responsiveness to WSCUC's concerns may result in sanctions against the College.

Shared Governance

WSCUC requires that the Board allow the institution to operate with appropriate autonomy, while taking responsibility for "mission, integrity, and oversight of planning, policies, performance, and sustainability." **The Board must delegate day-to-day management of the institution to the chief executive officer, and must maintain and honor clear policies on shared governance with the institution's leadership.**

The whistleblowers allege that the Board has convened Board meetings without notifying the CEO or involving the institution in preparation, and not inviting the CEO to governance and other important committee meetings, is a direct violation of WSCUC policy. The Board is expected to share governance with the leadership of the institution, and the Board should not convene any meeting without notifying the CEO.

Board Size and Diversity

In addition, the Board is expected to have a range of backgrounds, knowledge and skills, and be large enough to allow for sufficient members to manage the various committees that WSCUC expects institutional governing boards to have. The Board currently has only five members, all of whom are men, and the majority are chiropractors. The Board lacks expertise in academic matters and reportedly ignores, in large part, the advice provided by the only qualified financial expert on the Board. WSCUC's policy states clearly that a board with only five members is too small to meet the requirements of WSCUC:

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A very small board, such as one with only five members, will, by definition, not have enough qualified persons with expertise in finances, planning, audit, and academic matters, to populate all the committees[...]

Conflicts of Interest

WSCUC also requires that the Board be independent and that its decisions reflect the best interests of the institution and its students, while also ensuring a consistent adherence to each director's fiduciary responsibility to the institution. As such, independent directors must be free of any financial interest in the institution, including any form of compensation (whether as an employee or contractor) and directors must disclose any conflict of interest to the membership and abstain from discussion and voting on any matter which might create such a conflict. WSCUC policy states:

Board members have an ethical responsibility and duty to disclose their interests and, where the Board member has an actual or apparent conflict with an action of the Board, to refrain from participating in discussions about or voting on any matters that relate to the conflict.

It is alleged that members of the Board have refused to disclose conflicts of interest when requested (via an annual certification) which is a violation of the director's ethical duties, as well as violating WSCUC policy.

Additionally, the appointment of a former Board member, and friend, as a consultant on a project for which he has no expertise, and apparently without any form of bidding process, brings the commitment to ethical practices further into question. To then ask that same director to return to the Board, while still being paid as a consultant, is highly questionable, and in no event can that director be considered independent.

Board Compensation

Directors are not expected to be compensated, but reasonable, modest stipends are permitted by WSCUC. The purpose of this policy is to ensure that Board members are not receiving benefits that would create a conflict of interest, or provide incentive to serve on the Board for reasons other than the best interests of the institution. Again, WSCUC's policy is clear:

As set forth in the Governing Board Policy, the Commission believes that compensation for board participation can reach amounts that create a conflict of

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interest and deprive the receiving board member of the status of being disinterested for purposes of governing board independence.

While it is permissible to provide minimal compensation and travel reimbursement under WSCUC's Standards, it must be reasonable and fiscally responsible. Using the institution's funds to pay for Board meetings in Las Vegas and Spain, including first class travel and accommodations for members and their families cannot be considered reasonable. The Board must institute a strong travel and expenses policy that is reasonable and prevents unnecessary over-spending of college resources on Board expenses. If WSCUC were to determine that the benefits noted above are excessive, the Commission could deem the Board to be insufficiently independent, which is a direct violation of WSCUC's governance requirements.

Ms. Lee Carey concludes that the recent actions of the Board are highly concerning and potentially violative of the WSCUC Standards and Governance Policies.

She also warns that governance violations are taken very seriously by the Commission, and could result in serious sanctions against the College, such as adverse actions against its accreditation, including Warning or Show Cause status. **Adverse actions against accreditation must be reported to the U.S. Department of Education ("ED") and can result in the institution being forced to submit a teach-out plan and post a letter of credit, and ED may mandate the institution be moved to provisional certification status which limits program and institutional growth.** ED may also put the College on heightened cash monitoring, which is cumbersome and frequently causes delays in student aid disbursements for extensive periods, negatively impacting tuition revenue.

College Policy Requirements

I have also reviewed the College's policies and procedures manual. The Board of Regents Code of Conduct and Ethics provides that all members serving on the Board of Regents "are responsible for sustaining the highest ethical standards of the institution and of the broader community in which the Board Members function." **Pursuant to this Code, violation of certain rules may lead a director to be removed for cause, including any use by a director of the College's resources for personal gain or profit or for personal use,** except in a manner that is incidental and reasonable in light of the director's duties; and failure or refusal to cooperate in or interference with an investigation by the College.

In addition, the College's Policy For Investigations Regarding Code of Conduct Violations requires that where directors may have failed to comply with the Code of Conduct, or failed to fulfill their fiduciary duties, a member of the staff, a faculty member, or a director

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may notify the Chairman of the Board about the possible violation of the Code of Conduct or other policy. **According to this Policy, the Chairman "is then obligated to take action regarding the possible violation."** We therefore strongly advise that the Board address the allegations that have been raised in order to comply with this Policy.

Conclusion

Each director of the College individually has a legal obligation to act in good faith, in what he believes to be in the College's best interest, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. **Each director a fiduciary responsibility to address the concerns that have been brought to the Board's attention.**

Based on my conversations with the two whistleblowers, it seems likely that a complaint will be filed with the California Attorney General, the IRS, or the WSCUC, if the Board does not take prompt, decisive action. **A complaint of this type would be detrimental to the College and also may reflect poorly on all Board members who do not act to address these allegations.** In addition, the potential media attention to certain questionable transactions and how they were or were not addressed by the Board is a risk that can result in personal embarrassment and reputational damage for individual Regents, as well as a significant decline in goodwill and donor support of the College and an increased likelihood of a regulatory audit.

The directors have a fiduciary obligation to the College; each director should take action both to protect the charitable mission and tax-exempt status of the College as well as to meet his fiduciary duties as a director and protect himself from any risk of liability. The directors must hold themselves and their fellow Board members to the required standard of care. As I stated at the beginning of this letter, if Board members choose not to act, they too could be in violation of their fiduciary responsibilities. Therefore, I urge the directors to please act promptly to address these concerns.

Very truly yours,



David A. Levitt

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