"Interested Director" Transaction
Decision Analysis Sequence

This Guide is intended primarily as a tool for officials charged with compliance reviews. It assumes the governing board has not adopted more restrictive standards beyond statutory requirements.

Step 1: Collect, analyze and understand all pertinent transaction facts. Retain transaction documents.

Step 2: If transaction is to be acted upon by the Board of Directors, skip Step 3 and go to Step 4 -- otherwise, go to Step 3.

Step 3:

   A. Analyze transaction facts against Corporations Code Section 5233(b) *interest* thresholds and other self-dealing exemptions[1] that may apply.

   B. If transaction facts are below Section 5233(b) *interest* thresholds, or other exemptions apply, end analysis. Proceed to consider and act on transaction (not self-dealing). [Record facts and retain documents that support analysis as basis for transaction approval.] See *Case Example I* below*.*

   C. If transaction facts are at or above Section 5233(b) *interest* thresholds (and other exemptions do not apply), use Corporations Code Section 5233(d) validation process to consider and act on transaction. See *Case Example II* below.

Step 4:

   A. For transactions to be considered by the Board, analyze facts against Education Code Section 89908 *validation* thresholds and limitations.

   B. If transaction facts are below Section 89908 *validation* thresholds and other limitations[2] do not apply, AND such facts are also below Corporations Code Section 5233(b) interest thresholds or other exemptions apply, use Education Code Section 89907 validation process for Board to consider and act to approve transaction. See *Case Example III* below.

   C. If transaction facts are below Section 89908 *validation* thresholds and other limitations do not apply, AND such facts are at or above Corporations Code 5233(b) interest thresholds and other exemptions do not apply, use Corporations Code Section 5233(d) validation process for the Board to consider and act to approve transaction. See *Case Example IV* below.

   D. If transaction facts are at or above Section 89908 *validation* thresholds or other limitations apply, Board should NOT approve the transaction since such action is prohibited by Education Code 89906 and the transaction would be void. See *Case Example V* below.

Case Example I: Director Smith holds shares in a local bank valued at an estimated $50,000. Management has delegated authority to invest organization funds in Certificates of Deposit in federally-insured local banks. Would placement of organization-invested funds in a CD at the local bank in which director Smith is a shareholder be a self-dealing transaction? No. Such a transaction is below the Section 5233(b) interest thresholds (and therefore exempt), and the transaction is not one requiring Board action.

Case Example II: Director Jones holds stock in a major computer company valued at $1.5 million. Management has delegated authority to purchase several office personal computers on a competitive bid basis. The computer company in which Director Jones holds stock is the lowest qualified bidder at $140,000. Director Jones is unaware of the bid results. Would awarding the bid to this company be a self-dealing transaction requiring Management to undertake a Section 5233(d) validation process? Yes, if management was aware of Director Jones' holdings in the computer company. Director Jones has a material financial interest in the transaction.

Case Example III: Director Baker holds a 3% shareholder interest in a local stationary store (a corporation). The Board is to consider approving a major contract valued at $75,000 with the store for office products required by the organization. What review and approval process should the Board use? The transaction is below the interest thresholds of the Corporations Code and the validation thresholds and limitations of the Education Code. The Education Code Section 89907 process should be used by the Board to validate the transaction.

Case Example IV: The Board is developing a campus child care program as part of its corporate purpose. Directors Delta and Echo are each holders of shares in a construction company that successfully bid on a child care facility to be built by the organization. The total value of both shareholders interest in the company is less than 5%, but transaction value exceeds 1% of the organization's gross receipts for the preceding fiscal year. The transaction appears to involve a material financial interest by both directors (and no exemptions apply) under Section 5233, and is below the Education Code Section 89908 interest thresholds and other limitations. Which statutory validation process should the Board use to consider and approve the transaction? Since the transaction would constitute self-dealing under Section 5233 unless validated using 5233 standards, the Board should utilize the Section 5233(d) validation process. In so doing, the Board would also remain in compliance with the less stringent validation process under Education Code Section 89907.

Case Example V: Director Charles is also a prominent financial services broker and seeks to become the organization's broker through action by the Board. Is such a transaction permitted under statutory standards? No. Such an action by the Board between a director and the organization is prohibited by Education Code 89906 and the transaction would be void. The Section 89907 validation process is unavailable since the transaction relationship is directly between Director Charles and the organization. See limitation under Section 89908(a).

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[1] Corporations Code Section 5233(b) provides the following <u>interest</u> thresholds and other self-dealing exemptions:
a) Board action fixing director compensation as director or officer;
b) transaction part of public or charitable program, approved in good faith and without unjustified favoritism, and resulting benefit to director or family results from class benefiting from program; or
c) transaction, absent director's actual knowledge, does not exceed lesser of 1% of organization's previous year gross revenue, or $100,000.

[2] Education Code Section 89908 provides the following financial interest <u>validation</u> thresholds and other limitations on Board action when a Section 89907 transaction validation process cannot be used:
a) transaction directly between director and organization;
b) transaction between organization and a partnership or unincorporated association in which director is the owner, a partner, or holder (directly or indirectly) of a proprietary interest;
c) transaction between organization and a corporation in which director is the owner or holder (directly or indirectly) of 5% or more of corporation's outstanding common stock; or
d) the director, absent first disclosing such interest to the Board at a public meeting of the Board, influences or attempts to influence other Board members to enter into transaction.

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