



**INTERIM REPORT OF THE OFFICE OF THE
ATTORNEY GENERAL**

CONNECTICUT HUMANE SOCIETY

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Summary

This Interim Report of the Office of the Attorney General (“AGO”) provides a detailed summary of the current findings and conclusions concerning the AGO’s on-going investigation into the Connecticut Humane Society (“CHS”). The AGO’s jurisdiction to investigate this matter derives from Conn. Gen. Stat. § 3-125, which provides that the Attorney General “shall represent the public interest in the protection of any gifts, legacies or devises intended for public or charitable purposes.” The investigation has focused primarily on CHS’s alleged misuse of charitable funds raised from its donor base, but touches on several other issues that could possibly affect CHS’s ability to accomplish its charitable purpose.

Although the AGO’s investigation continues, particularly with respect to the handling of charitable funds for certain purposes and allegations of improper treatment of animals, it is appropriate at this time to issue an interim report on those allegations for which the AGO’s analysis is complete. This Interim Report is intended to apprise the CHS Board of Directors of allegations and findings so that it may conduct a timely and thorough internal review of policies and procedures and institute necessary changes. In light of recent management changes, including particularly the resignation of President and Board Chair Richard Johnston, the CHS Board should be apprised of the AGO’s findings as it considers its future direction. In addition, the report will provide the public and potential donors with the results of the AGO’s initial inquiry, and facilitate review by other appropriate authorities of allegations regarding CHS interference with the employees’ attempt to unionize that are beyond the jurisdiction of the AGO.

Currently, the AGO can make the following relevant findings:

1. CHS has entered into financial transactions with businesses in which members of the CHS Board have a financial interest (“Related Party Transactions”).

For the years 2005, 2006, and 2007, Related Party Transactions made up between 3.3% and 5.2% of CHS’s budget expenses, which is between \$175,000 and \$258,000 of Related Party Transactions per year.

When Related Party Transactions were included in the minutes of the CHS Board, those minutes note the related party’s recusal from voting or the related party’s absence from the meeting.

A letter from the accounting firm of BlumShapiro stated that for the Related Party Transactions “the amount charged is reasonable for the type of services or goods provided and was less than or equal to fair market value for such services from an unrelated party.” Nevertheless, the frequency and amount of Related Party Transactions threatens the integrity and reputation of the CHS and underscores the need to strengthen conflict of interest protocols.

2. The CHS Board has restricted an unnecessary and excessive amount of its assets to the detriment of its essential purposes.

CHS has designated more than \$46 million of its unrestricted fund balance of \$52 million as belonging to a board-designated quasi-endowment fund (the “Quasi-Endowment Fund”).

The CHS Board adopted a policy to add legacy, estate, and other non-recurring gifts and/or income to the Quasi-Endowment Fund, as long as there are no restrictions on the gifts.

The CHS Board adopted a policy pursuant to which it releases 5.5% of the three-year average market value of the Quasi-Endowment Fund, based on quarterly valuations, to be used yearly by CHS for its general purposes.

CHS’s spending restriction, which now applies to fully 88% of CHS’s total unrestricted net assets and about 67% of CHS’s total net assets, appears to be excessive and threatens to deprive it of resources to adequately conduct its core animal care and protection functions.

3. Numerous and credible reports of mismanagement threaten CHS’s charitable mission.

The AGO has received numerous and, in some instances, credible complaints describing a pervasively dysfunctional culture and serious acts of managerial misconduct. Many of these reports involve Richard Johnston, who until recently served as both the President of CHS and as the Chairman of its Board of Directors. This arrangement unnecessarily concentrated both authority and control of CHS in one person and inappropriately wedded the organization to the reputation, priorities, and conduct of a single individual. CHS should give strong consideration as it appoints new leadership to restructuring its management to disperse organizational authority and control.

Many of the reports concerning dysfunctional management at CHS involve direct and tangible effects on the welfare of animals under CHS care. While the AGO’s investigation of these allegations continues, CHS should take the opportunity provided by this transition in management to thoroughly review its practices to prevent misconduct and the perception of misconduct from impeding its primary charitable function of caring for animals.

The AGO has also received written allegations that CHS management has unfairly fired and placed on probation individuals who have participated in unionization. These allegations will be referred to the NLRB.

4. The AGO has not substantiated allegations of misconduct in connection with the use or sale of CHS real property.

The AGO found no evidence that the President of CHS used CHS-owned property in Florida without reimbursing CHS for his use or that CHS even owned any property in Florida. Nor is there any evidence that anyone connected with CHS received any compensation in connection with the sale of CHS's Stamford property.

The AGO makes the following recommendations and has taken the following action:

1. The AGO calls upon the CHS Board to adopt a more robust conflict of interest policy with respect to related party transactions.
2. The AGO calls upon the CHS Board to release from restriction sufficient funds to address the animal welfare needs of animals under its care.
3. The AGO calls upon the CHS Board to immediately review and address all allegations and issues of management actions and composition which adversely affect the mission of CHS.
4. The AGO is referring to the National Labor Relations Board all allegations of interference with the attempt of CHS employees to unionize.

The AGO's investigation will continue with respect to other concerns involving the alleged misuse of charitable funds, mistreatment of animals and alleged misrepresentations in advertising.

Background

The AGO initially received a complaint regarding several financial irregularities within the CHS. There were four distinct questions raised by this complaint:

1. Were there illegal financial transactions that occurred between CHS and CHS board members or relatives of board members? This question requires an analysis of how the CHS Board approved the transactions in question.
2. Is the Quasi-Endowment Fund being under-utilized given CHS's financial needs at this time?
3. Does CHS own real property in Florida, which the President and Chair of the Board used personally without reimbursing CHS?
4. Did any officer, director, or key employee of CHS act as a broker or real estate agent and receive compensation for their services in connection with the sale of CHS's Stamford property?

On February 10, 2009, after having received the initial complaint, the AGO sent an informational request letter to CHS.¹ This letter requested financial information and documents concerning the four questions raised in the initial complaint. On April 1, 2009, the AGO received written responses to the above four issues and over 1,000 pages of documents from CHS.

While reviewing these materials, it became clear that additional financial information was necessary to complete the AGO's inquiry into the issues raised by the initial complaint. Accordingly, the AGO issued a second request letter on July 31, 2009.² This letter sought information specifically related to additions to and transfers from the Quasi-Endowment Fund. CHS responded to this second request on September 25, 2009.

During the AGO's continued review of CHS's written responses and documentary materials, the AGO received numerous additional complaints about former President and Chairman Richard Johnston regarding financial improprieties and managerial dysfunction. Specifically, the allegations include the misuse of charitable funds, management's preference for cost savings over animal welfare, abusive and inappropriate management practices and policies, and retaliatory management practices against employees who voice concerns regarding the welfare of animals at CHS and who are involved with union activities.

Additionally, the AGO received an allegation that Johnston used CHS charitable funds in support of his unsuccessful campaign for State Senator for the 20th senatorial district in the early 1990's. The allegations include Johnston's use of staff to prepare campaign mailings and his use of CHS charitable funds to pay for the postage for these mailings.

In response to this wave of additional complaints regarding CHS and the new, specific allegations regarding Johnston, the AGO issued a third informational request letter to CHS on January 28, 2010.³ This letter targeted the above additional issues, including several others that had come to the AGO's attention; more specifically, it targeted (1) Johnston's alleged personal use of CHS's charitable funds; (2) CHS's advertising regarding its treatment of animals and its efficient use of charitable donations; and (3) CHS's expanded charitable purpose of protecting open space. The AGO received a response from the CHS to this request letter on March 3, 2010.

The AGO continues to examine CHS's financial records for the misuse of charitable funds, including the alleged use of CHS's charitable funds for Johnston's political campaign, and to review all advertisements and statements of charitable purpose for any possible misrepresentations to the donating public. In addition, to the extent it is appropriate, the AGO may refer the allegations regarding Johnston's use of CHS assets for his political campaign to the

¹ The February 10, 2009, informal request letter is appended hereto as Attachment A.

² The July 31, 2009 informal request letter is appended hereto as Attachment B.

³ The January 28, 2010, informal request letter is appended hereto as Attachment C.

State Elections Enforcement Commission. As appropriate and necessary, the AGO will supplement this report after further investigation is completed.

Findings

Conflict of Interest Transactions

It is undisputed by CHS that it has entered into financial transactions with businesses in which members of the CHS Board have a financial interest, including, for example:

1. investment services, including annual administrative fees for 401(k) and deferred compensation plans and trustee services;
2. printing, including animal placement agreement forms, fundraising letters, business cards, etc.; and
3. veterinary services, including spaying and neutering of rabbits, cats, and dogs.

For the years 2005, 2006, and 2007, Related Party Transactions made up between 3.3% and 5.2% of CHS's budget expenses, which amounts to between \$175,000 and \$258,000 of Related Party Transactions per year.

CHS defends its Related Party Transactions in two primary fashions. First, it states that when the CHS Board voted on each of the transactions, there was full disclosure to the voting members of the CHS Board that it was a Related Party Transaction, and the related party either abstained from the vote or was not in attendance at that CHS Board meeting. Our review of CHS Board minutes provided to the AGO confirmed that when Related Party Transactions were included in the minutes, those minutes note the related party's recusal from voting or the related party's absence from the meeting.

Second, CHS states that the Related Party Transactions are at or below fair market value. In support of this claim, CHS provided the AGO a letter from the accounting firm of BlumShapiro that stated that for the Related Party Transactions "the amount charged is reasonable for the type of services or goods provided and was less than or equal to fair market value for such services from an unrelated party."⁴ CHS provided no documents, however, to show that any bids for similar goods or services were obtained from unrelated vendors for Related Party Transactions.

The AGO is concerned with the impression CHS's Related Party Transactions make on the donating public. The Related Party Transactions have been an on-going and regular practice for many years at CHS. CHS, due to its prominent stature and good reputation in Connecticut,

⁴ The BlumShapiro letter is appended hereto as Attachment D.

should hold itself to high ethical standards and create a policy and record that cannot be questioned. CHS's conflict of interest policy⁵ can and should be substantially more robust. At this time the policy simply requires the CHS Board's prior knowledge of the Related Party Transaction. Given that CHS has a significant amount of Related Party Transactions, the AGO believes that its policy should mandate recusal from the vote by the related party and require at least two competing bids for each potential contract with a related party so as to substantiate at the time of the Related Party Transaction that it is at or below the cost of the same goods or services from an unrelated vendor.

CHS Board-Designated Endowment Fund

CHS has created a fund that it identifies as a board-designated quasi-endowment fund, previously identified as the Quasi-Endowment Fund. Generally, the Quasi-Endowment Fund is comprised of unrestricted funds⁶ designated by the CHS Board as belonging to the fund. Specifically, the CHS Board has designated more than \$46 million of its unrestricted fund balance of \$52 million as belonging to the Quasi-Endowment Fund. The CHS Board has itself restricted the use of the principal of the Quasi-Endowment Fund to those expenses approved by the Board.⁷ The Quasi-Endowment Fund is, however, still a part of CHS's unrestricted funds because the CHS Board, not the donor, has restricted the use of the funds.

The CHS Board has adopted a policy which determines which funds are added to the Quasi-Endowment Fund. Its current policy is to add legacy, estate, and other non-recurring gifts and/or income to the Quasi-Endowment Fund, as long as there are no restrictions placed on the gifts by the donor. For example, in 2007, \$415,678 of legacy gifts, \$525,660 from the proceeds of the sale of CHS's Bethany property, and \$213,828 received from a demutualization were all added to the Quasi-Endowment Fund. Additionally, in 2007, \$2,943,616 in investment income and realized gains were added to the Quasi-Endowment Fund, as well as \$55,837 in unrealized gains. In total, for 2007, approximately \$4,000,000 was added to the Quasi-Endowment Fund by the CHS Board.⁸ All of these amounts were unrestricted funds coming into CHS that, pursuant to CHS Board policy, became "restricted" so that none of these funds or the income generated by them would be spent unless the funds were later released by the CHS Board.

⁵ CHS's Conflict of Interest Policy is appended hereto as Attachment E.

⁶ Unrestricted, as used herein, means funds that must be used for the charitable purpose of CHS but are not restricted to a specific use within CHS.

⁷ Apparently, CHS receives relatively few permanently restricted donations. Its permanently restricted fund was valued at seventeen million dollars (\$17,000,000) at the end of 2007. Approximately fifteen million dollars (\$15,000,000) of this restricted fund is made up of investments held by others on behalf of CHS. Only two million dollars (\$2,000,000) in permanently restricted funds are actually held by CHS.

⁸ In 2007, CHS had total unrestricted income from all sources of just over \$7.9 million.

Similarly, the CHS Board adopted a policy that determines the amount of funds that will be released from the Quasi-Endowment Fund each year for use by CHS. Currently, the CHS Board releases 5.5% of the three year average market value of the Quasi-Endowment Fund, based on quarterly valuations, to be used by CHS for its general purposes. For example, in 2007, the average market value of the Quasi-Endowment Fund over the three previous years was \$40,728,914. The CHS Board elected to release 5.5% of the Quasi-Endowment Fund for use by CHS, or \$2,240,090. Depending on the actual return of the Quasi-Endowment Fund, both earnings and principal may be released in any one year. As a result of CHS's Quasi-Endowment Fund policies, the Quasi-Endowment Fund has grown substantially and now makes up about 88% of CHS's total unrestricted net assets and about 67% of CHS's total net assets.

The CHS states that its Quasi-Endowment Fund policies are intended to generate a consistent income stream that will not vacillate as a result of the unpredictable nature of charitable giving. Although the AGO recognizes the need for fiscal prudence and predictability in the face of uncertain financial times, CHS's policies regarding its Quasi-Endowment Fund appear to unnecessarily restrict the resources available for core functions. When the specific needs addressed by a charitable concern are not being met--for example, when staffing or other resources may be insufficient to meet core charitable purposes--a charity should consider releasing additional available funds. The AGO has received credible allegations concerning inadequate care provided to CHS animals. For example, there are complaints that pregnant dogs receive insufficient care, sometimes leading to loss of life of mothers and puppies, and that cats with upper respiratory infections and dogs with heartworm, both treatable diseases, are euthanized to avoid the cost of extended stays and additional treatment. The AGO has also received complaints that there is insufficient staff to properly walk dogs and clean cages.

Given these allegations concerning animal welfare at CHS, the AGO is deeply concerned that the CHS Board has maintained an overly strict spending policy limit. It would be well within applicable legal standards of care for the CHS Board to relax this strict percentage spending policy. The AGO would deem it consistent with fiduciary obligations and financial prudence to do so.

Dysfunctional Management and Labor Relations Complaints

Richard Johnston served until his recent resignation as both the President of CHS and the Chairman of its Board of Directors. The AGO has grave concerns about a charity allowing one person to have both managerial and oversight authority. Although it is common for presidents and executive directors of charities to serve on the board ex-officio, they are rarely allowed to vote, and certainly are not given the powerful position of Chair of the Board. Combining the Chairman's oversight responsibilities with the President's day-to-day management of the organization creates serious potential for conflicts in the fiduciary and management roles of both positions. The lack of true oversight created by such a situation is an open invitation for both a stagnancy of charitable energy and an inability for the Board of Directors to appropriately fulfill their fiduciary obligations.

One of the primary subjects of complaints is that dysfunctional management at CHS is having a tangible, adverse effect on the welfare of animals in CHS's care. Specifically, the allegations concern the following:

- CHS's practices of preferring cost savings to animal welfare;
- aggressive euthanasia policies;
- aggressive use of bleach in animal occupied areas;
- special treatment for senior management for pet adoptions; and
- managerial disregard for leash rules at the shelter.

In addition, the AGO has received numerous allegations of management hostility towards employees who voice concerns about the care and placement provided to the animals in CHS's care, including the verbal reprimand of an employee who objected to the placement of a potentially dangerous dog in close confines with visitors and the placement of a "hold" on a dog, consistent with CHS official policy, that was perfectly matched for an adoptee family. In addition, it is alleged that a volunteer was fired for his failure to abide by the unwritten CHS policy to "hold" an imminently adoptable Labrador puppy aside for management's personal use.

As noted above, the AGO has also received written allegations that CHS management has unfairly fired and placed on probation individuals who have participated in union activities by attempting to join the Machinists' Union (IAMAW). These allegations implicate the protections of the National Labor Relations Act ("NLRA") 29 U.S.C. 151 et seq., administered by the National Labor Relations Board ("NLRB"). Under the NLRA, it is illegal for an employer to discriminate or retaliate against employees for unionization efforts or for an employer to otherwise interfere with attempts to unionize. 29 U.S.C. Sec. 158(a)(3). The AGO is referring allegations of unfair labor practices to the National Labor Relations Board for its attention and investigation.

The AGO's investigation remains on-going with respect to these and other issues. It is apparent, however, that these complaints and the potential for a public perception of pervasive management dysfunction within CHS threaten to jeopardize its fundraising efforts and the accomplishment of its important charitable purposes. As set forth in its mission statement:

The purpose of the Society is to promote humanity and kindness, and to prevent cruelty to man and animals, by information, statistics, appropriate literature, and by all lawful means which they may deem wise and best, and by assisting in prosecution of crimes of a cruel and inhumane nature; and generally to encourage justice and humanity and to discourage injustice and inhumanity.

See Act Incorporating the Connecticut Humane Society, 1881. If true, the alleged management misconduct at CHS would violate the letter and spirit of its own mission statement and could expose CHS to litigation and/or potential liability, detracting from its reputation and fundraising ability and requiring significant expenditures on legal expenses. Moreover, conduct like that alleged would significantly undermine an environment where employees and volunteers focus on the welfare of the animals in their care and on matching those animals to appropriate adoptee families, threatening the loss of valuable employees and volunteers dedicated to the welfare of animals.

In short, while the AGO has yet to complete its investigation of all allegations concerning mismanagement, CHS must act quickly to prevent these pervasive allegations from seriously damaging its charitable mission and functioning. The AGO calls upon the CHS Board to capitalize on the opportunities presented by the present management transition to engage in a comprehensive review of the management and employment concerns that have been raised, and to take any and all necessary action to remedy any areas of concern that impede fulfillment of its mission, including, but not limited to, reviewing/revising written policies, consulting with outside experts as necessary, and implementing any personnel changes that may be necessary.

The Property in Florida and the Compensation for the Sale of Stamford Property

Our investigation revealed no evidence that the President of CHS used CHS-owned property in Florida without reimbursing CHS for his use or that CHS even owned any property in Florida. The documents CHS provided to the AGO relating to the sale of the Stamford property showed that no one connected with CHS received any compensation in connection with the sale.

Conclusion

The AGO calls upon the CHS Board to:

1. Draft a robust conflict of interest policy with respect to related party transactions;
2. Release sufficient funds from the Quasi-Endowment Fund to address the animal welfare needs of those animals brought to CHS; and
3. Review and address relevant practices and policies in light of allegations of mismanagement that, if unaddressed, could adversely affect the mission of CHS.

Based on its review of the information provided to the AGO thus far, the AGO will refer to the NLRB all allegations of interference with the attempt of CHS employees to unionize.