



2024 Nonprofit Update: Nonprofit Governance

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NOT LEGAL ADVICE, WHICH REQUIRES AN ATTORNEY-CLIENT RELATIONSHIP

NONPROFIT GOVERNANCE: **LOW HANGING FRUIT**

- **For nonprofits**
- **For regulators**
- **For investigators**
- **For plaintiffs**



Annual Meetings:

1-Election of Directors

2-Annual Report

- Required Information
- Financial Information
- NPCL §§ 519 & 513

Conflicts of Interest/Related Party Transactions:

- **New York has the most demanding regime in the nation**
- **IRS sample Conflict of Interest Policy does not work in New York**
- **The adoption of a policy is required — but not just any policy**
 - ✓ **Required definitions**
 - ✓ **Required processes and procedures**
 - ✓ **“The Magic Words”**
 - ✓ **Written Disclosure**
 - **Before Joining the Board + Annual**
 - **Ongoing**

ALWAYS MONITOR ACTIVITIES AGAINST CORPORATE PURPOSES

- Corporate Purposes are set forth in the Certificate of Incorporation
 - ✓ *A diversion from corporate purposes, no matter how worthy, is a breach of fiduciary duty.*
 - ✓ **Certificate of Incorporation Trap**
 - ✓ *One of the central oversight functions of directors and officers: use of assets consistent with the purposes in the Certificate of Incorporation.*
 - ✓ **Potential Personal Liability of Board Members for failure to strictly adhere to corporate purposes.**

- **Corporate Purposes set forth in the Certificate of Incorporation versus:**
 - ✓ **Corporate purposes set forth in Bylaws**
 - ✓ **Mission Statement**
 - **Note ease of change**
 - ✓ **Box / Fence Metaphor**

NONPROFIT GOVERNANCE: IT'S NOT ROCKET SCIENCE!



- **Discipline**
- **Focus**
- **Attention to Detail**
- **Commitment to Compliance**
- **CONTINUOUS**

DETAILS ARE NOT MERE FORMALITIES

DETAILS HAVE TREMENDOUS AND
DETERMINATIVE PRACTICAL
CONSEQUENCES

Examples:



❑ Notice, including

- who receives notice
- when they receive notice
- how they receive notice
- content of notice

Notice Provisions: Bylaws, NPCL, even Certificate of Incorporation

Improper/deficient notice can cause the meeting and its results to be invalidated – actions not authorized

❑ Committees

- **Surprisingly Technical Area of the Law**
- **Mandatory NPCL Provisions (including limits on committee authority)**
- **Effect of Missteps:**
 - ❖ **actions not authorized**
- **NOTE: FOLLOWING BYLAWS IS NOT ENOUGH IF BYLAWS ARE INCONSISTENT WITH MANDATORY PROVISIONS OF THE NPCL**
 - ❖ **Bylaws Trap**

1-Board Committees

Typical Examples: Executive; Audit; Nominating; Governance; Development; Compensation

- At least 3 directors
- Only board members can vote
- Possess delegated board authority

2-Committees of the Corporation

- Misnomer
 - **Advisory only**
 - **Cannot exercise any sliver of Board authority**
-
- Who is on the committee
 - Description of responsibilities:
 - ✓ Charter, Board resolution or Bylaws

BYLAWS

- Bylaws: Contract between the organization and the Board (and members, if applicable) as to how the organization will operate
- Bylaws are rules by which legitimate corporate decisions are made
- *Following the rules is a roadmap to protect directors from breach of fiduciary duty allegations*
- Not reviewed by the State – so amendments can be too easy!
- Be careful not to create additional unnecessary fiduciary duties!

- ✓ *Always follow the roadmap that your Bylaws provide!*
- ✓ *Make sure that your Bylaws are consistent with the Not-for-Profit Corporation Law of the State of New York!*
 - Bylaws should be drafted by an attorney; no changes except by an attorney
- ✓ *Failure to strictly adhere to the requirements of the Bylaws, or having Bylaws that are inconsistent with the law, is a **breach of the Duty of Obedience**. Consequences can include undermining the validity of corporate decisions and actions.*
- ✓ *Governance mistakes in these areas are a potential trap for nonprofit directors & officers*

Risks of governance mistakes in these areas:

- **Board decisions can be challenged as illegitimate**
- **Breach of fiduciary duty & potential personal liability**



IRS Form 990

Signature Block:

- **Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.**

- **Filed IRS Form 990 is readily accessible and available at no cost from a variety of public sources.**
- **It is ubiquitous.**
- **It is relied on and heavily scrutinized by funders, donors, people with grievances, attorneys, regulators (local, state, & federal), & investigators.**

Part VI, Governance, Management and Disclosure

Section A. Governing Body and Management



➤ Independence

➤ Relationships (family or business)

➤ Members

- ✓ Do members have power to elect the governing body?
- ✓ Are any governance decisions reserved to members or subject to member approval?

➤ Minutes

- ✓ Board

- ✓ Committee

➤ Did the organization become aware during the year of a significant diversion of the organization's assets?

Part VI, Governance, Management and Disclosure

Section B. Policies



“(This Section B requests information about policies not required by the Internal Revenue Code.)”

➤ Governance Body Scan



- Line 11(a): Has the organization provided a complete copy of this Form 990 to all members of its governing body before filing the form?
- Line 11(b): Describe in Schedule O the process, if any, used by the organization to review this Form 990.

❖ **Beware of aspirational answers**

Line 12: **Conflict of Interest Policy**

❖ State law implications

➤ Line 13: Whistleblower Policy

❖ State law implications

➤ Line 14: Document Retention & Destruction Policy

- Line 15: Process for Determining Compensation
 - ✓ CEO, Executive Director, or top management official; other officers or key employees

- Line 16: Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement with a taxable entity?
 - ✓ If “Yes,” did the organization follow a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law, and take steps to safeguard the organization’s exempt status with respect to such arrangements?

✓ **Email Voting Is NOT Permissible**

□ **There are only 2 ways for the board to act under the law:**

- 1. At a meeting (which can be in person; by conference call; by videoconference, or hybrid);**
- 2. By unanimous consent in lieu of a meeting (which can be email, electronic or written)**
 - **Must be unanimous (≠ voting)**

- ✓ NPCL Trap (executive committee; supermajority quorum for removal; member notice)
- ✓ **ADEQUATE OVERSIGHT**
 - ❑ Adequate Oversight ≠ trust
 - ❑ Internal Controls + Active Oversight NOT trust
- ✓ Audit Oversight
 - ❑ NPCL §712-a (mandatory provisions)
 - ❑ Audit Committee or Board (independent directors)

FIDUCIARY DUTIES OF NONPROFIT DIRECTORS

Fundamental Precepts:

1-Directors of Nonprofits have Legal Duties (Fiduciary Duties).

2-There can be Personal Liability to Directors for Breaching these Legal Duties.

3 Fundamental Legal Duties of a Nonprofit Director Under New York Law:

- **Duty of Care**
- **Duty of Loyalty**
- **Duty of Obedience**

Duty of Care:

- ❖ A director must discharge the duties of his/her position in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
- NPCL § 717(a)
 - Oversight function.
 - Requires familiarity with the organization's finances and activities, and regular participation in its governance.
 - ✓ **Healing Arts Initiative lawsuit (April 2016)**

Healing Arts Initiative lawsuit (April 2016)

- New York State Supreme Court, New York County
- **Defendants (Board of Directors)**
 - ✓ D. Leslie Winter
 - ✓ Alan Gettner
 - ✓ Greg Libertiny
 - ✓ Laura Anne Walker
 - ✓ Jonathan Pearlroth
 - ✓ J. David Sweeny
 - ✓ Richard Gomes
 - ✓ Hospital Audiences, Inc. a/k/a Healing Arts Initiative, Inc.

Healing Arts Initiative lawsuit (April 2016)

This is an action to hold accountable the directors of Hospital Audiences, Inc. a/k/a Healing Arts Initiative, Inc. ("HAI") who, in violation of New York Not-For-Profit Corporation Law ("N-PCL") §§ 717 and 720 and other applicable statutory or common law, have neglected, failed to perform, and/or violated their duties, including but not limited to, their duty to act in good faith and with the care of an ordinarily prudent person in a like position would exercise under similar circumstances, in the management of HAI, by permitting \$750,000 to be stolen by three former employees of HAI, hiring non-independent auditors, negligently hiring employees, and otherwise breaching their duties to HAI.

Healing Arts Initiative lawsuit (April 2016)

The foregoing actions constitute, *inter alia*, breach of contract, breach of fiduciary duty, and violations of N-PCL §§ 717 and 720. Plaintiff expressly reserves the right to amend its claims in this action to include other causes of action and other parties as may be appropriate.

PLEASE TAKE FURTHER NOTICE that the relief sought in this action is damages in an amount not less than \$750,000, believed to be foreseeably and proximately caused by Defendants' conduct referenced above, plus attorneys' fees and punitive damages, removal of the board of directors, as well as any other relief the Court deems just and proper.

Duty of Loyalty:

- ❖ A director must act in the interest of the organization.
 - Requires undivided allegiance to the organization's mission when using the power of his/her position, or information concerning the organization or its property.
 - Conflicts of interest; related party transactions.

Duty of Obedience:

❖ Least understood and most often neglected of the 3 primary legal duties

What is the Duty of Obedience?

- ❖ to ensure that the organization complies with applicable laws and regulations and its internal governance documents and policies
 - Compliance with applicable laws and regulations is even more difficult than it sounds
 - Multiple layers of laws and regulations

Duty of Obedience - Compliance with Laws and Regulations :

- **Not-for-Profit Corporation Law**
- **Laws & Regulations – additional layers**

Not-for-Profit Corporation Law:

- **Best efforts under difficult circumstances is not the compliance standard (Misstep)**
- **Law**
- **Mandatory requirements & procedures**
- **Bright lines**
- **Rigid**
- **Inflexible**
- **Unforgiving**

Duty of Obedience - Compliance with Internal Governance Documents and Policies:

- Certificate of Incorporation (Purposes)
- Bylaws
- Policies
- Committee Charters

NONPROFIT GOVERNANCE: IT'S NOT ROCKET SCIENCE!



- ✓ Process, Process, Process
- ✓ Procedures
- ✓ Mandatory Requirements
- ✓ Board Education
- ✓ Awareness – Even Under Extraordinary Circumstances
- ✓ Discipline & Commitment to Compliance

Risks of governance mistakes in these areas:

- **Board decisions can be challenged as illegitimate**
- **Breach of duty & personal liability**

Ostrich defense/Sergeant Schultz
defense will not work under NY
NPCL



Significant Litigations:

- Dowling College
- NRA
- Lutheran Care Network



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