NOT-FOR-PROFIT LEGAL ALERT

NONPROFIT GOVERNANCE:

NONPROFITS FACE INCREASED RISKS DUE TO NON-COMPLIANCE WITH CONFLICT OF INTEREST & RELATED PARTY TRANSACTION REQUIREMENTS

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The conflict of interest and related party transaction provisions of The Non-Profit Revitalization Act, effective July 1, 2014, require continuing vigilance and attention. First, your nonprofit must have a conflict of interest policy that complies with the extensive mandatory provisions of the Revitalization Act. Among these provisions are the following:

- ✓ the Policy must be applicable not only to directors and officers, but also to "key employees," as defined in the Revitalization Act *(and it should be noted that a "key employee" under the broad and counterintuitive definition in the Revitalization Act could be an individual who has never been an employee of your organization in the first place)*;

- ✓ the Policy must include:

  - ➢ a definition of the circumstances that constitute a conflict of interest;

  - ➢ procedures for disclosing a conflict of interest to the audit committee or, if there is no audit committee, to the board;

  - ➢ a requirement that the person with the conflict of interest not be present at or participate in board or committee deliberation or voting on the matter giving rise to the conflict;

  - ➢ a prohibition against any attempt by the person with the conflict to influence improperly the deliberation or voting on the matter giving rise to the conflict;

- ✓ the Revitalization Act requires very specific additional procedures in the event of a proposed "related party transaction" (for instance, the board must make an affirmative determination, after disclosure of the material facts, that the proposed transaction is fair, reasonable and in the organization's best interest at the time of

the determination); and related party procedures can include, under certain circumstances, a requirement that your organization consider alternative transactions prior to entering into a related party transaction.

Even if your organization has adopted a fully compliant conflict of interest policy, you cannot rest there. Some organizations make the effort to understand and adopt a compliant conflict of interest policy, but then tuck this policy away and fail to systematically implement its provisions. Implementation will require continuous vigilance and ongoing compliance actions. For instance, under the Revitalization Act conflicts and related party transactions must be disclosed in writing as they arise. They must then be analyzed and handled pursuant to the explicit requirements of the Revitalization Act and your Policy. Compliance with these requirements must be very carefully documented in the meeting minutes. In addition, directors are not only required to submit a conflict of interest disclosure statement annually, but also *prior* to each director's *initial* election to the board. It is essential for your organization to utilize a disclosure statement that is carefully calibrated to the requirements of your Policy so that it collects the information necessary for compliance with your Policy and the Revitalization Act. Finally, it should also be noted that many existing conflict of interest policies (including the IRS Sample Conflict of Interest Policy, which is used by many nonprofits) are not compliant with the heightened requirements and procedures contained in the Revitalization Act.

Not only does the Revitalization Act provide the Attorney General with enhanced enforcement powers for violations of the related party transaction requirements, but we have also seen a trend whereby the conflict of interest and related party transaction provisions are used aggressively in internal corporate disputes. Under New York nonprofit law, each member of the board of directors has a fiduciary duty to ensure that the organization complies with applicable laws and regulations, including the laws with respect to conflicts of interest and related party transactions. This provides potent ammunition for disgruntled directors, officers and members to pursue breach of duty claims against directors, who could have personal liability under the law, even where there is no improper personal benefit to the individual director. We have also seen these provisions used aggressively by donors and other stakeholders as leverage to press their agenda.

Lack of compliance with these relatively new and undeniably complex requirements can have extremely adverse consequences for both the organization and the individual members of the board. Our experience indicates that board and officer education in tandem with an ongoing commitment to diligent compliance are essential to the twin imperatives of protecting the interests of the nonprofit, while simultaneously shielding the board from exposure and personal liability.

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If you have questions about this Not-For-Profit Legal Alert or about your organization's governance practices and compliance with the Not-for-Profit Corporation Law and the Revitalization Act, please contact David Goldstein at the phone number or email address below. Also contact us to request to receive future mailings.

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