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September 25, 2015

Testimony of Lawyers Alliance for New York Before
the New York City Council Contracts Committee
in Opposition to Int. 288A

by Laura Abel, Senior Policy Counsel

On behalf of Lawyers Alliance for New York, I respectfully submit this testimony in opposition to Int. 288A, which would amend section 111 of the City Charter.

Lawyers Alliance is the leading provider of business and transactional legal services to nonprofit organizations that are improving the quality of life in New York City neighborhoods. Each year our legal staff, joined by more than 1,500 volunteer attorneys from more than 125 law firms and corporate legal departments, serves thousands of nonprofits working in all five boroughs. Lawyers Alliance provides legal assistance to help nonprofit corporations operate ethically and transparently to further their charitable purposes. We also run workshops and webinars to educate nonprofit executives about their governance obligations.

We oppose Int. 288A because it would duplicate, and in some instances contradict, federal and state laws already in effect. We urge:

- *Reject* the requirements that nonprofits must disclose the material terms of a self-dealing transaction to the City and obtain approval from both the City and 2/3 of the organization's board should be rejected.
  Alternative proposal: Reserve the right in funding contracts to require recipients to reimburse the City for a transaction that is unfair or unreasonable in violation of the related party transaction provisions of the New York Not-for-Profit Corporation Law.
- *Reject* the requirement that nonprofits must disclose the home address and sources of income of board members and the president or CEO.
  Alternative proposal: Require nonprofit and for-profit funding recipients to disclose the amount of time above twenty hours per week that the CEO or president spends in any employment or consulting position outside the organization.

As an initial matter, it is unclear that Int. 288A would have any effect, because City Charter § 111 is not currently in force. Charter § 111 applies to a "charitable institution" receiving any funding from the "New York city charitable institutions budget." Currently, there is no such budget line and there are, accordingly, no nonprofits receiving such funding. However, even if Int. 288A did apply to some nonprofits, we would oppose it for the reasons explained below.

I. Approval

A. Board Approval

Int. 288A's requirement that "self-dealing" transactions must be approved by 2/3 of the organization's board should be rejected because it conflicts with the State's recently enacted Nonprofit Revitalization Act of 2013, which requires majority approval.[1] Notably, the City has embraced the State standard in its human services contracts, which reserve the right to recoup any overpayments that result from a related party transaction that violates the NY Not-for-Profit Corporation Law.[2] Majority approval is sufficient to ensure that insider transactions are fair and reasonable, particularly since all board members are obligated to act in the organization's best interests, the interested person is barred from deliberations and voting on the transaction, and for transactions in which the interested person's interest is substantial the board must consider alternative transactions whenever possible.[3] The State law is enforced by the Attorney General's Charities Bureau, which can unwind the transaction, require the insider to pay up to double the amount of any benefit improperly obtained, and remove board members or officers who approved the transaction.[4] Int. 288A's requirement of approval by 2/3 of the board is thus entirely unnecessary.

Transactions with well-intentioned insiders can be extremely beneficial for a nonprofit organization. A board member may provide office space at a far-below-market rent. Another board member's catering company may provide free food preparation and waitstaff for the organization's gala, charging only the actual cost of the raw ingredients. Indeed, 58% of small nonprofits report that they obtain below market goods and services from their board members.[5]

The City should not make these desirable transactions unnecessarily difficult. A 2/3 approval requirement would make it impossible for nonprofits to enter into such transactions in a timely manner, particularly when board members are scattered around the state or country or the full board meets only once or twice each year.

B. City Approval

Int. 288A's requirement of prior approval by the City should be rejected because it is unnecessary and unworkable. More than 2,100 nonprofits receive City funding.[6] Without an enormous infusion of resources, City personnel will not have the time to assess and approve appropriate transactions with each one in a timely manner.

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[1] NY Not-for-Profit Corporation Law ("N-PCL") § 715(a).

[2] *See* Human Services Performance Based Standard Contract (June 2014), §§ 1.01(J), 4.07, http://www.nyc.gov/html/hhsaccelerator/downloads/pdf/Human%20Services%20Performance%20Based%20Standard%20Contract%20June%202014.pdf.

[3] N-PCL §§ 715(b), (g), 717.

[4] *Id.* § 715(f).

[5] Francie Ostrower, Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study (2007), p. 8, http://www.urban.org/sites/default/files/alfresco/publication-pdfs/411479-Nonprofit-Governance-in-the-United-States.PDF.

[6] Mayor's Office of Contract Services, Procurement Indicators FY 2014, p. 29, http://www.nyc.gov/html/mocs/downloads/pdf/2014%20Annual%20Procurement%20Indicators.pdf.

Moreover, it is inappropriate for a funder such as New York City to oversee transactions by independent organizations that do not involve City funding. Nonprofit organizations frequently receive funding from multiple federal, state and municipal government bodies, as well as from foundations and private individuals. If each funder were to undertake to review and approve all of the organization's insider transactions, the organization would be forced to spend enormous amounts of time seeking each approval, diverting staff time from the organization's core charitable mission.

Instead, we urge an approach similar to the approach already taken in the City's model human services contract: reserve the right in City contracts and grant agreements to require the funding recipient to reimburse the City, or to withhold for the purposes of set-off any monies due to the funding recipient under the agreement, resulting from a related party transaction that violates the Not-for-Profit Corporation Law because it is unfair or unreasonable to the nonprofit.

Allowing the City to use State law as a basis to recoup misspent City funds makes much more sense than imposing yet another set of standards on nonprofit contractors. By reducing confusion, this approach will increase compliance. It will also reduce nonprofits' administrative costs associated with compliance, allowing them to fulfill their government contracts more efficiently and effectively.

II. Disclosure of Transactions

Int. 288A's requirement that "self-dealing" transactions must be disclosed should be rejected because the IRS Form 990 already requires annual disclosure of "excess benefit transactions" and other transactions with insiders. This form is disclosed publicly on www.guidestar.org. For charitable organizations administering charitable assets or soliciting donations in New York State, the 990 is also available on the Attorney General's Charities Bureau website.[7] In addition, nonprofits with City human services contracts must make all documents related to transactions with insiders available to the City funding agency upon request.[8]

Not only would Int. 288A duplicate this disclosure, but because it uses different definitions than both the IRS and NY State it would require nonprofits to track and disclose an additional set of transactions. This would increase nonprofits' administrative expenses, without any corresponding increase in useful information. For instance, Int. 288A would require nonprofits to track small, routine transactions that benefit the corporation; nonprofits do not need to track or disclose those transactions to comply with state law or to fill out the IRS 990.[9] Likewise, Int. 288A would require nonprofits to track transactions with entities in

[7] *See* http://www.charitiesnys.com/RegistrySearch/search_charities.jsp.

[8] *See* Human Services Performance Based Standard Contract (June 2014), § 5.01, http://www.nyc.gov/html/hhsaccelerator/downloads/pdf/Human%20Services%20Performance%20Based%20Standard%20Contract%20June%202014.pdf.

[9] *See* Instructions to IRS 990 Sched. L, http://www.irs.gov/pub/irs-pdf/i990sl.pdf (requiring reporting of business transactions involving interested persons only if all transactions with that person exceed $100,000 in a year, or if a single transaction exceeds $10,000 or 1% of the organization's revenue; requiring reporting of transactions with "disqualified persons" only if the disqualified person receives an excess benefit as a result);

which a person in a leadership position holds 10% or more of the common stock; for the most part, the State law and IRS 990 apply only to entities in which the person has a 35% or more ownership or beneficial interest.[10]

III. Disclosure of Sources of Compensation

Finally, Int. 288A would require disclosure of "business interests" from which the individual, or the individual's spouse or domestic partner, received 10% or more of their aggregate gross income during the previous year. The phrase "business interests" is vague, and it is unclear if the 10% calculation should be made with reference to the income of a single person, or with reference to the combined incomes of the organization's leader and his or her spouse or domestic partner.

More importantly, the home address and income of a volunteer board member are completely irrelevant and a requirement to disclose them would deter many potential board members from volunteering for organizations receiving City funds. Home addresses are likewise irrelevant for CEOs and presidents of nonprofits.

We recognize that the amount of time a CEO or president spends on outside work may provide some indication about the extent of that employee's work for the organization. This concern is, of course, equally relevant to for-profit organizations providing services to the City. However, the amount of outside income is the wrong indicator: a psychiatrist or lawyer can earn a large amount of money for just a few hours of outside work, while another CEO may spend much more time on outside work but earn less. Instead, the City could require contractors to disclose the amount of time that the CEO or president spends working outside of the organization, above a minimal level (such as 20 hours per week) that would not interfere with his or her ability to perform full-time duties for the organization.

For these reasons, Lawyers Alliance urges the Committee to vote against Int. 288A.

NYS Charities Bureau, Conflict of Interest Policies Under the Nonprofit Revitalization Act of 2013 (April 13, 2015), pp. 5-6, http://www.charitiesnys.com/pdfs/Charities_Conflict_of_Interest.pdf (discussing de minimis and routine transactions).

[10] Instructions to IRS 990 Sched. L, *supra*; NY N-PCL § 102(a)(23) (requiring a 35% interest unless the entity is a partnership or professional corporation, in which case a 5% interest applies).