



Cerini & Associates, LLP 2020 Nonprofit Update

June 30, 2020

Certilman Balin Adler & Hyman, LLP

Nonprofit/Tax Exempt/Religious Organizations Practice Group

David Goldstein, Esq.

(516) 296-7811; dgoldstein@certilmanbalin.com

THE IMPACT OF THE PANDEMIC ON YOUR ORGANIZATION'S CORPORATE GOVERNANCE

Legal Update

- ❑ What has changed permanently?
- ❑ What has been adjusted temporarily?
- ❑ What to focus on
 - ❖ Traps for the unwary

What has changed permanently?

NOTHING

What has been adjusted temporarily?

There have been 3 types of legal & regulatory relief during the pandemic:

- Governor's Executive Orders
- Bill Enacted by the Legislature
- Attorney General's Charities Bureau Guidance

Governor's Executive Orders

EO 202.18 (April 16, 2020):

- Modifies, during the State disaster emergency, Section 603(b) of the Not-for-Profit Corporation Law to the extent necessary to permit **annual meetings** of **members** to be held **remotely or by electronic means**.

Extended to July 7, 2020 (EO 202.29; 202.39)

- First Action by the State in the realm of nonprofit governance:
 - annual meetings of members
 - importance of members' rights in the governance scheme
 - in particular, the annual meeting, which is the fundamental nonprofit governance event:
 - ✓ Election of Directors
 - ✓ Annual Financial Report

Temporarily Allows Participation By

- ✓ Videoconference

- ✓ Conference call

Without this temporary modification of the law, and once this temporary modification is no longer in effect, annual meetings of **members** need to be held at a “place” (in person at a physical location)

- ✓ No Videoconference
- ✓ No Conference call

What about non-member nonprofits (board only)?

1. **Primacy of the annual meeting**, which is the fundamental nonprofit governance event:
 - ✓ Election of Directors
 - ✓ Annual Financial Report
2. Participation by videoconference and conference call are **always permissible**, as long as they are not prohibited by your bylaws or certificate of incorporation

June 17, 2020, Governor Cuomo signs Bill No. S.8412 into law:

- Effective immediately
- For the duration of the State disaster emergency, the board may determine that meetings of **members** be held partially or solely by means of electronic communication
- Includes annual meeting and special meetings

The board shall implement reasonable measures to:

- (1) verify that each person participating electronically is a member or a proxy of a member;
- (2) provide each member participating electronically with a reasonable opportunity to participate in the meeting, including an opportunity to propose, object to, and vote upon a specific action to be taken by the members, and to see, read or hear the proceedings of the meeting substantially concurrently with those proceedings; and
- (3) record and maintain a record of any votes or other actions taken by electronic communication at the meeting.

Note: A similar provision allowing membership meetings by electronic communication, with some important technical distinctions, was added to the Religious Corporations Law

- The need for membership approvals arises more frequently under the RCL, so this is important relief

Back to nonprofits: what have we seen so far?

Both the Governor's Executive Orders and the State Legislature's pandemic enactment address only membership meetings.

Attorney General's Charities Bureau Guidance, April 2020

- Guidance for Conducting Virtual Meetings of Members of New York Not-for-Profit Corporations
 - ✓ Applies to **member** meetings

Highlights of Attorney General's Charities Bureau Detailed Guidance For A Member Meeting Via Videoconference:

- Give the members the option to dial in (video + dial-in available)
- Test the system in advance
- Assure the ability of attendees to participate
- Appoint someone to assist members having trouble joining the meeting in real-time
 - Disseminate the phone number in advance
- Attention to Notice, Attendance, Voting, Minutes

What does all of this tell us about board meetings?

- Board meetings via videoconference have become ubiquitous during the pandemic
- But no executive orders, legislation or guidance has been issued on board meetings.

**THE LAWS AND PROCEDURAL
REQUIREMENTS REGARDING
BOARD MEETINGS HAVE NOT
CHANGED.**

- ✓ Notice
- ✓ Quorum**
- ✓ Voting (including supermajority requirements)**
- ✓ Oversight Responsibility
- ✓ Etc.
- ✓ **NEVER USE PROXIES**

- ✓ Participation by **videoconference** and **conference call** are always permissible, as long as they are not prohibited by your bylaws or certificate of incorporation
- ✓ The recent legislation and Charities Bureau guidance, while aimed at membership meetings, can provide incredibly useful **best practices for board meetings**

- option to dial in to the videoconference
- Appoint someone to assist board members having trouble joining the meeting in real-time
 - Disseminate the phone number in advance
 - (in the meeting notice)

In General:

- Attention to Notice, Attendance, Voting, Minutes
- Provide each board member participating electronically with a reasonable opportunity to participate in the meeting, including an opportunity to propose, object to, and vote upon a specific action to be taken by the board, and to see, read or hear the proceedings of the meeting

GOVERNANCE: IT'S NOT ROCKET SCIENCE!

Actual Questions Posed During The Pandemic:

- ❖ *Board member in the hospital with coronavirus; he gave another board member his proxy*
- ❖ *2 board members are sick & unable to participate; the board chair sent an email to the board suspending the quorum requirement for the next meeting*
- ❖ *At the board meeting, the board voted to suspend the applicability of the bylaws for just this meeting due to the pandemic*

Actual Questions Posed During The Pandemic:

❖ *large board;*

decorum for a videoconference is challenging;

lots of background noise, and board members don't keep themselves muted, in spite of requests;

going to keep everyone muted but the board chair and anyone presenting a report to the board, and we will unmute others for votes.

Primacy of the annual meeting, which is the fundamental nonprofit governance event, even in a **board-only** nonprofit.

1. **The Annual Meeting Is Mandatory**

2. **Mandatory components** of the annual meeting:

- ✓ Election of Directors
- ✓ Annual Financial Report

Traps for the Unwary

Annual Financial Report:

- Mandated by §519 and §513 of the NPCL
- Specific information required by law

Annual Financial Report Timing Trap

- The annual financial report requirement mandates that the financial information presented be for a twelve-month fiscal period terminating not more than six months prior to the meeting
- So, if your fiscal year is the calendar year, then for your financial information not to be stale, you need to have your annual meeting, and present the annual financial report, before the end of June

- ❖ Because of this rule, June tends to be my busiest month of the year, as many of my clients schedule their annual meeting in June to maximize the amount of time their accountant has to prepare the financial data, but still meet the “not older than 6-month requirement.”

Traps for the Unwary

continued

- ED's and board chairs tell me that their inclination is to cut back on the amount of information flowing to directors and the length of meetings.
- Conscious effort to keep meetings held via videoconference more manageable.
- Assumption that too much information, and meetings that are too lengthy, are less tolerable in video format than in person.
– *continued . . .*

Traps for the Unwary

continued

- An understandable adjustment, but this is a dangerous dynamic.
- **Timely and adequate flow of information to the board is required for the board's mandatory oversight function.**
 - **Unintended Consequence: breach of fiduciary duty claim.**

FIDUCIARY DUTIES OF NONPROFIT DIRECTORS

Fundamental Precepts:

1-Directors of Nonprofits have Legal Duties (often referred to as 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)**

Duty of Care: A Roadmap:

- ✓ **Right From The Start: Responsibilities of Directors of Not-for-Profit Corporations (Charities Bureau, 2015)**
- ✓ **The Committee to Save Adelphi, et al. v. Diamandopoulos, et al. (Board of Regents, 1997)**
- ✓ **Unsecured Creditor Trustee of Dowling College v. 13 individuals being sued in their capacity as board members (trustees) of Dowling College (and also as CFO)**
- ✓ **Internal Controls**
 - ❑ **Internal Controls And Financial Accountability For Not-For-Profit Boards (Charities Bureau, 2015)**
- ✓ **Policies & Procedures**
- ✓ **Critical Role of Audit Oversight**
 - ❑ **Independence Requirement**

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
- ❖ Why? The other 2 primary legal duties exist in the for-profit world, but the Duty of Obedience is strictly a not-for-profit law concept

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**
- **Law**
- **Mandatory requirements & procedures**
- **Bright lines**
- **Rigid**
- **Inflexible**
- **Unforgiving**

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

- Certificate of Incorporation
- Bylaws

Another Trap for the Unwary

Duty of Obedience - Compliance with Certificate of Incorporation

- 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.*
 - ✓ *One of the central oversight functions of directors and officers: use of assets consistent with the purposes in the Certificate of Incorporation*

Another Trap for the Unwary

continued

- Phone call last week from an accountant who has a client that has started a wonderful new program in response to the pandemic. The program addresses food insecurity and food needs in the community.
- One problem. This activity, though vitally important, falls outside of the purposes set forth in the Certificate of Incorporation.

Another Trap for the Unwary *continued*

- ✓ *A diversion from corporate purposes no matter how worthy is a breach of fiduciary duty.*
- ✓ **Potential Personal Liability of Board Members for failure to strictly adhere to corporate purposes**

continued . . .

Another Trap for the Unwary

continued

- ✓ **There is an answer that allows the organization to engage in this vital activity, and at the same time, allows the board and officers to fulfill their fiduciary duties and be protected from liability:**

**AMEND THE CORPORATE PURPOSES IN
THE CERTIFICATE OF INCORPORATION**

continued . . .

Another Trap for the Unwary

continued

- Process to amend Certificate of Incorporation
 - ❖ Internal: Approval of board & membership (if applicable)
 - ❖ External: Petition for approval to the Attorney General (chartable nonprofit)
- Fundamental tension between the desire to have nonprofits evolve to meet needs that they encounter, and the static purposes in the Certificate of Incorporation
- Note: July 1, 2014 amendments to NPCL (Nonprofit Revitalization Act) address this endemic problem

More Traps for the Unwary

- **Recent call from a concerned board member (the nonprofit is not a client);**
- **board chair had asked the board to vote by email on nominations;**
- **chair states in an email to the board that, while normally the board would have a meeting to vote on nominations, because of the pandemic, the board would vote by email instead**

continued . . .

More Traps for the Unwary

continued

Email voting by the board of directors – another impermissible shortcut to avoid

- ✓ 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; or by videoconference);
 2. By unanimous consent in lieu of a meeting (which can be email or written)
 - Must be unanimous (≠ voting)

- ✓ Effect of missteps

DOCUMENTING CORPORATE ACTION & COMPLIANCE

As important now as ever; no dispensation for extraordinary circumstances

Minutes, Minutes, Minutes

➤ Too much detail

➤ Too little detail

➤ Checklist to demonstrate that the board fulfilled its fiduciary duties

Conflicts & Related Party Transactions (annual + ongoing)

Effect of missteps

GOVERNANCE: IT'S NOT ROCKET SCIENCE!

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

CENTRAL ROLE OF 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 these rules is a roadmap to protect directors from breach of fiduciary duty allegations
- Not reviewed by the State – so amendments can be too easy!

- ✓ *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 requirements of 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 another potential trap for nonprofit directors & officers*

Risks of governance mistakes in these areas:

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

➤ **NPCL TRAP**

(Examples: supermajority requirement for officer compensation; executive committee; supermajority quorum for removal; member notice; notice requirements for dissolution)

➤ **PROCESS TRAP**

(Required filings; amend purposes; mission statement in Bylaws)

GOVERNANCE: IT'S NOT ROCKET SCIENCE!

COMMITTEES

➤ Board Committees

Examples: Executive; Audit; Nominating & Governance; Development

- At least 3 directors
- Only board members can vote

➤ **Committees of the Corporation**

- Misnomer
- **Advisory only**

Who is on the committee

Description of responsibilities:

✓ Charter, board resolution or Bylaws

ADEQUATE OVERSIGHT

- Adequate Oversight \neq trust
- Volunteers doing good
- Smart and accomplished board
 - ✓ Dowling; Adelphi

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

Oversight:

- Audit Committee
- Audit Process
- Auditor

OVERKILL

➤ Provisions that are too demanding

-- examples

- ✓ Bylaws: frequency of meetings; quorum
- ✓ Conflicts Policy: application too broad in terms of covered persons

FILE CABINET SYNDROME

- Develop, review, approve & file away
 - ✓ Live with these documents & procedures
 - ✓ Know them
 - ✓ Follow them (continuous commitment & focus)