

Written Comments Submitted By:

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Before the:

**New York State Senate**

**Committee on Investigations and Government Operations**

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My name is Michael Cooney. I am a partner with the law firm of Nixon Peabody LLP and head of its Higher Education and Exempt Organizations practice.

My practice concentrates on the affairs of nonprofit and tax-exempt organizations, their donors and supporters. I have had the privilege of serving on many nonprofit governing Boards as a volunteer. I recently had the honor of serving on Attorney General Eric Schneiderman's Leadership Committee for Nonprofit Revitalization.

As one who strongly believes in the value of the nonprofit sector to the people of the state of New York, I urge the members of the Committee to evaluate and incorporate in their decision-making the existing processes and structures intended to insure the fidelity of executive compensation in the sector to mission and performance.

In my personal experience, the vast majority of nonprofit executives are undercompensated for the value they bring to their organizations and the communities they serve. Importantly, there is already a legal structure and practices in place to assure the reasonableness of this compensation. What is needed in the State, in my opinion, is a better understanding of this structure and vigorous enforcement of the laws that are already in place.

At the time of this writing, the Governor has promulgated an Executive Order limiting the amount of state funding to the first \$199,000 of compensation to provider executives. The definition of "compensation" and "executive" have been left to the rule-making authority of at least nine different state agencies. The basis for the \$199,000 figure is unclear. The State budget contains similar limitations as a condition of funding. The people of the State of New York and its nonprofit providers deserve a better system. Through legislative action, it would be possible to bring greater certainty and impact to the expenditure of State funds.

### **Existing standards**

New York law imposes on nonprofit corporate governing boards the responsibility to assure that executive compensation is "reasonable" and "commensurate with services performed."<sup>1</sup> New York law generally provides that officer salaries must be fixed by a majority of the entity's governing board.<sup>2</sup> Loans to nonprofit executives are generally prohibited.<sup>3</sup> And, most importantly, as demonstrated in the case of Adelphi University in 2007, the State has the power to remove fiduciaries of nonprofits for, among other things, approving excessive compensation.

Currently, state law does not delineate procedures to ensure compliance with these requirements. But those organizations which are public charities under Section 501(c)(3) of the Internal Revenue Code are already familiar with the decade-old regime under Code Section 4958 for establishing reasonable compensation. That statute sets forth a process, which, if used,

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<sup>1</sup> Not-for-Profit Corporation Law ("N-PCL") Section 202(a)(12).

<sup>2</sup> N-PCL Section 715(f).

<sup>3</sup> N-PCL Section 716.

creates a rebuttable presumption that the compensation approved is reasonable. That rebuttable presumption of reasonableness<sup>4</sup> has three core requirements that create a reasonable and efficient rubric for setting executive compensation:

- Board fiduciaries review the complete compensation packages, independent of any conflicts of interest with those being compensated. The common approach for assuring reasonable executive salaries is to use a compensation committee comprised of independent, educated board members. This delegation is often done pursuant to the organization's by-laws. The charge to the compensation committee should be clear and unambiguous, with committee members having unfettered access to all relevant financial and performance information, which must be complete and comprehensive. The fiduciaries work under a compensation policy declaring that all compensation must be reasonable and setting the percentiles in which compensation may be set.
- Board or committee members must be empowered to consult outside resources to determine what is paid for comparable services by comparable nonprofits. In comparing the board-adopted compensation goals of the institution, the fiduciaries can survey comparable positions at comparable institutions—whether through compensation surveys and salary studies or even from the publicly available IRS Forms 990—in order to establish the bounds of reasonableness. The list of comparables must be reviewed frequently with respect to each position under review. Any outside compensation consultant retained to provide expert advice must report to the compensation committee, free from any taint of management influence.
- Finally, all compensation committee deliberations and actions should be fully documented in minutes, approved at the subsequent committee meeting, and available to the full board.

Well-governed nonprofits have followed these best practices for many years.

## **Transparency**

Compensation levels are not hidden from public view, as one might suspect from news reports. Most charities are required to report, in detail, compensation of board members, officers, key employees, and others on the recently enhanced IRS Form 990, which is also incorporated in annual filings with the New York State Attorney General Charities Bureau. These Form 990 reports must be made available to the public, commonly at the charities' offices and usually online at sites like Guidestar.org. Therefore, state regulators and the public currently have ready access to compensation information for many of these entities.

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<sup>4</sup> 26 CFR 53.4958-6.

## **Enforcement**

All these approval and reporting mechanisms are of little value, however, if the State fails to pursue a consistent and vigorous enforcement path.

The Governor's creation of the task force in August of this past year occurred in the context of serious questions about the million-dollar salaries and benefits paid to two brothers running the Young Adult Institute. Concerns about high levels of compensation at the organization were already well-known.<sup>5</sup> Indeed, it appears that there was already a corporate integrity agreement in place, with the requirement for periodic reports on compliance.<sup>6</sup> Why these compensation practices were allowed to continue is a question not only for your Committee, but for right-minded nonprofits and their boards all across the State. The exception should not provide the rule.

## **Conclusion**

I respectfully ask the Committee to consider the proposals emanating from the nonprofit sector, which is eager for guidance and indeed greater enforcement where appropriate. New York law should supplement and strengthen existing federal requirements without imposing significant new costs and burdens. The nonprofit sector in New York State understands the importance of demonstrating the appropriate use of the scarce and precious resources entrusted to it. The imposition of blanket rules or limitations on executive compensation would do more to harm that process than help it, to the detriment of all New Yorkers.

Thank you for allowing me to comment on this important issue.

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<sup>5</sup> See the editorial on page 4 of the *New York Nonprofit Press*, vol. 10, issue 2 (February 2011) at [http://www.nynp.biz/current/archives/nynparchives/0211\\_February\\_2011%20Edition.pdf](http://www.nynp.biz/current/archives/nynparchives/0211_February_2011%20Edition.pdf)

<sup>6</sup> [http://www.omig.ny.gov/data/images/stories/cia/cia\\_for\\_yai\\_12111.pdf](http://www.omig.ny.gov/data/images/stories/cia/cia_for_yai_12111.pdf)