

# Conflicts of Interest & Related Party Transactions

(NO GRAPHICS VERSION)

# PLEASE NOTE

## Not Legal Advice

This presentation is provided as a **general informational** service to clients and friends of Pro Bono Partnership and Certilman Balin. It should **not** be construed as, and does not constitute, **legal advice** on any specific matter, nor does this presentation create an attorney-client relationship. You should **seek advice** based on your particular circumstances from an **independent legal advisor**.

# Fair Use Act Disclaimer

RE: Copyright

This presentation may contain copyrighted material which has not been specifically authorized by the copyright owner. The Pro Bono Partnership is a nonprofit 501(c)(3) exempt organization that is making this material available for **educational purposes only**. Certilman Balin is a limited liability partnership that is making this material available for **educational purposes only**. As such the Partnership and Certilman Balin believe this constitutes "fair use" of any such copyrighted material as provided for in Title 17 U.S.C. § 17 (The Copyright Act of 1976).

# PROBONO<sup>®</sup>

P A R T N E R S H I P



Volunteer Lawyers Strengthening  
Nonprofits & Our Communities

## Pro Bono Partnership

Judy Siegel, Esq.

(914) 328-0674, ext. 337; [jsiegel@probonopartner.org](mailto:jsiegel@probonopartner.org)

# Brief Overview of Pro Bono Partnership

- Our mission:
  - strengthen nonprofits and communities
  - **free** legal services
- Our clients:
  - serve the disadvantaged
  - enhance the quality of life
  - unable to pay
  - NY, NJ, CT
- Our volunteers
  - Practice in their field of expertise
  - choose their projects



# CERTILMAN BALIN

ATTORNEYS

## **Certilman Balin Adler & Hyman, LLP**

Nonprofit/Tax Exempt/Religious Organizations Practice  
Group

**David Goldstein, Esq.**

(516) 296-7811; [dgoldstein@certilmanbalin.com](mailto:dgoldstein@certilmanbalin.com)

# Today's Agenda

- What is a Related Party Transaction?
- Definitions/Terms
- Conflict of Interest Policies
- Process, Process, Process
  - Incredibly detailed mandatory processes & procedures
- Pragmatic Considerations



# Can We Enter Into a Related Party Transaction?

**MAYBE !!!!!**

# What Do We Have to Consider?

- What kind of transaction is it
- Who is a party to the transaction
- Relationships
- **NPCL Definitions**

# The Legal Definition of a Related Party Transaction

Any transaction, agreement or any other arrangement in which a related party has a **financial interest** and in which the corporation or any affiliate of the corporation is a participant

(but some exceptions we will talk about later)

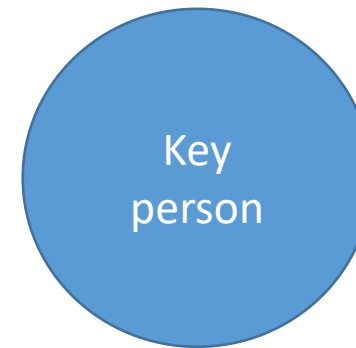
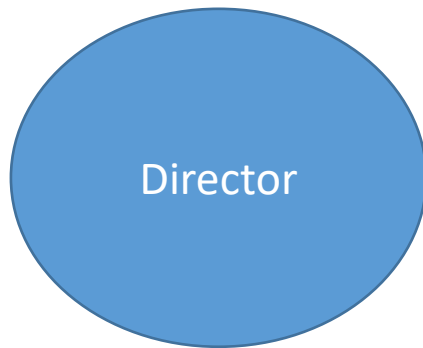
**(NO GRAPHICS VERSION)**

# Breaking Down the Legal Description

# Financial Interest

- Not defined
- No limit to amount
- Dollar value can trigger other requirements

# Who is a Related Party?



# Anybody Else?

Relatives

Entities in which any of the other people own a 35% or more ownership or beneficial interest

If a partnership or professional corporation, a direct or indirect ownership interest greater than 5%



# Who is a Relative?

- A spouse or domestic partner
- Ancestors, brothers and sisters (whether whole or half blood)
- Children (whether natural or adopted), grandchildren, great-grandchildren;
- The spouse or domestic partner of a person's brothers, sisters, children, grandchildren, and great-grandchildren

# So, Who is a Key Person?

- Any person, other than an officer or director who:
  - Has **responsibilities or power or influence** over the nonprofit as if he or she were a director or officer
  - **Manages** the corporation or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the nonprofit
  - Alone or with others **controls or determines** a substantial portion of the capital expenditures or operating budget

# What is an Affiliate of the Corporation?

*Any entity controlled by,  
or in control of, the corporation*

Not as easy as  
it seems

Many different  
definitions of  
control

If you have to  
ask the  
question, you  
probably know  
the answer

**Let's pause to take a step back, and to think about:**

- what all of these definitions,**
  - what all of these rules and requirements,**
  - what all of these processes and procedures,**
- are trying to address.**

# Let's Dig a Little Deeper

# Criteria to Enter Into a Related Party Transaction

It Must Be:

- Fair
- Reasonable
- In the nonprofit's best interest

## ✓ PROCESS PLUS SUBSTANCE

- ❖ No corporation shall enter into any related party transaction unless the transaction is determined by the Board, or an authorized committee thereof, to be fair, reasonable and in the corporation's best interest at the time of such determination. These are essentially “magic words” - with substantive significance - that need to be in the Board resolution approving the transaction.
- ❖ No related party may participate in deliberations or voting relating to the RPT.

# Special Rules for Substantial Financial Interests\*

\*(involving a charitable nonprofit)

- Substantial is in the eye of the beholder
- Consider alternative transactions
- Approve transaction by not less than a majority of directors present
- Contemporaneously document basis for decision, including consideration of alternative transactions



# Those Exceptions We Mentioned:

## Exception #1

Not a related party transaction if

- De minimis

# Exception #2

## Not a related party transaction if

- Not customarily reviewed
- By the boards of similar organizations
- In the ordinary course of business
- & is available to others on same or similar terms

# Exception #3

## Not a related party transaction if

- Benefit provided to the RP solely as a member of a class of beneficiaries
- That corporation intends to benefit as part of accomplishment of its mission
- Benefit is available to the others on same or similar terms

# Things to Keep in Mind

Think broadly re:  
Who it applies to

Is money the only thing that matters

Time and Circumstances matter

Size is irrelevant and matters

# Conflict of Interest Policies

# Good News - It's all Spelled out for You

- NPCL §715-a
- **Financial** transactions between Officer, Director, Key Person or Relative (**RPT §715**)
- Will you cover other, non-financial situations? (NPCL §715-a) (see next slide)
  - ❑ Examples

NPCL §715-a mandates that the Board of every corporation adopt, and oversee the implementation of, and compliance with, a Conflict of Interest Policy applicable to directors, officers & key persons – **“to ensure that its directors, officers and key persons act in the corporation’s best interest and comply with applicable legal requirements”**

➤ ***Note breadth & scope; non-financial conflicts***

# Governance: Who's Involved with Conflicts Policy?

- The Board of Directors or
- An authorized committee of the Board



# What Must the Board Do?

- Adopt a policy
- Oversee implementation
- Oversee compliance

# Content of a Conflict Policy

- What constitutes a conflict
- Procedures for disclosing conflict or possible conflict
- Procedures for determining whether a conflict exists
- Person with the conflict can't be present or participate in deliberation or vote (note: questions; information)
- No improper influence
- Documentation requirements (minutes; vote)
- Procedures for disclosing & addressing RPTs (§715) ...

More required contents: Annual Disclosure Statement (plus)

- Each officer, director and key person
- Submit to secretary or compliance officer (& sign)
- Identifies any entity in which the person is an officer, director, trustee, member, owner or employee
- Disclose your relationship & transaction details
- Any relationship or transaction in which the nonprofit is a participant & in which the disclosing party might have a conflicting interest - Note Breadth & Scope
- Prior to initial election; annually + not static!

# Process, Process, Process

- What happens when a disclosure is submitted?
- How does a Board Committee fit in?
  - What is a Board Committee?
  - Parameters, including who is on a Board Committee
  - Delegation (including limits)
  - Best Practices: written description of committee responsibilities, powers, duties and authority
- Critical importance of record-keeping; minutes; exhibits

# What if We Made a Mistake?!!!!

# Retroactive Review and Approval (vis-à-vis AG)

- Establish that transaction was fair, reasonable & in the corporation's best interest at the time it was approved
- Prior to AG requesting info the Board has:
  - Ratified the transaction in good faith
  - Found that transaction was fair, reasonable and in the corporation's best interest at the time it was approved
  - If there is a substantial financial interest, considered alternatives and approved the transaction by not less than a majority of the board or committee members present (Note: applies to charitable nonprofits)
  - Documented in writing the nature of the violation & basis of ratification
  - Put into place procedures to ensure future compliance

# Some Perspective

Prior to July 1, 2014, New York nonprofits were not even required to have a Conflict of Interest Policy.

As of July 1, 2014:

- ✓ Every New York nonprofit must have a Conflict of Interest Policy.
- ✓ Not just any Conflict of Interest Policy will do.
- ✓ In fact, the **sample Conflict of Interest Policy promulgated by the IRS** is unquestionably inadequate and deficient under New York law - and a violation of the New York statute.
- ✓ What New York nonprofits are required to have in place is a Conflict of Interest Policy that complies with the very detailed and demanding requirements of the NPCL.

# Additional Considerations



# Best Interest of the Corporation

- It's Not Always About the Money
  - Court of Public Opinion
  - Appearance of Impropriety