New York State Initiates Efforts to Regulate Executive Compensation by Not-for-Profits

by Jay E. Gerzog and Tamar R. Rosenberg

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New York State Governor Andrew Cuomo has formed the Task Force on Not-for-Profit Entities (the "Task Force") to investigate executive compensation by not-for-profit organizations that receive state funding.[1] Governor Cuomo announced the Task Force on August 3, 2011, and it quickly took its first action on August 25, 2011, by sending a letter requesting extensive compensation information from many organizations that receive state funds.

This Client Alert describes (i) the Task Force's mandate, (ii) the compensation information requested in the Task Force's letter, (iii) several key points to note about the information requested in the letter, and (iv) certain additional insights.

I. The Task Force on Executive Compensation

The Task Force is charged not only with investigating current compensation levels, but also with making recommendations for future rules intended to ensure that taxpayer dollars are not used to fund excessive salaries paid by not-for-profit organizations. The Task Force itself is empowered to determine the protocol and scope of its investigation – presumably including which types of not-for-profit organizations will be reviewed.

The Task Force is being chaired by the Superintendent of the Department of Financial Services, and also includes the following New York State officials: the Inspector General; the Secretary of State; the Medicaid Inspector General; Commissioners from the Department of Health, the Office of Mental Health, the Office of Alcohol and Substance Abuse, and the Office of People with Developmental Disabilities ("OPWDD"); one senator; and one assemblyman.

Although the focus on executive compensation paid by not-for-profit organizations has been increasing for several years, the tipping point that appears to have precipitated the creation of the Task Force was recent newspaper reports of excessive compensation paid by not-for-profit organizations that receive Medicaid funding through the OPWDD and other state agencies.

Not-for-profit organizations have been the subject of similar scrutiny at the federal and state levels and by the media in recent years, relating to executive compensation, use of

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[1] The Governor's press release is available at: www.governor.ny.gov/press/08032011TaxpayerSupportedNOT-For-Profits.

charitable assets, and the level of benefit provided to society in exchange for valuable tax exemptions. A recent example is the media's attention to several charities formed after the Sept. 11, 2001, attacks that have allegedly spent excessive amounts on executive compensation and business or personal expenses and/or disproportionate amounts on compensation and fundraising relative to mission-related expenditures.

II. The Task Force's Request for Information

The Task Force announced, on August 25, that it began mailing an inquiry letter on a rolling basis to organizations selected based on funds received from New York State, including, but not limited to, hospitals, Medicaid providers, other health services providers, and social service providers.

According to *The New York Times*, the letter is initially being sent to over 600 organizations, and the full scope of organizations that may eventually be surveyed is still under consideration.[2] The first wave of organizations that received the letter was given only until September 15, 2011, to respond, despite the extensive scope of data requested.

The Task Force's press release and letter may be viewed here.[3]

The letter requests extensive information related to compensation paid from January 1, 2007, to June 2011, including:

- The names, titles, and a breakdown of compensation paid by the recipient organization and by affiliated organizations to (i) all executives, administrators, and board members (regardless of amount), and (ii) all employees paid total compensation of over $100,000;
- A list of the organization's 25 highest paid executives, administrators, and/or board members;
- A description of bonus/incentive programs, including vesting periods, claw-back provisions, and provisions tying compensation to performance;
- A description and chart of compensation paid to board members;
- A description of policies and protections that the board has instituted to ensure board review of "all such all such company expenditures going forward";
- An accounting of the actions the board plans to take to protect taxpayer funds;
- Annual total work-related reimbursements to employees;
- The comparability data used in determining compensation;
- The compensation consultants who were used;
- A description of the board's view regarding recoupment and/or claw-back of executive and/or board compensation;
- Justifications for the executive compensation paid; and
- Justifications for the organization being a not-for-profit.

[2] See Russ Buettner, *State Seeks Data on Pay of Leaders at Nonprofits*, N.Y. TIMES, Aug. 25, 2011.
[3] http://www.ins.state.ny.us/press/2011/p1108251.htm.

III. Key Points About the Task Force's Requested Information

Important items to note about the information requested by the Task Force include the following:

- Although some of the information requested by the Task Force is also reported on Internal Revenue Service ("IRS") Form 990, there are differences. The Task Force requests information generally about a broader range of individuals and with lower compensation thresholds than the IRS requires to be reported on Form 990. Also, Form 990 reporting is closely tied to the tax treatment of compensation and involves many more technical rules.

- The information requested by the Task Force could potentially be made available to the general public under New York's Freedom of Information Law ("FOIL"), except to the extent that particular information falls under one of the specified exceptions. FOIL contains an exception for "unwarranted invasion of personal privacy," but the exception has limited application and can be difficult to apply.[4]

    - Because the Task Force requests broader data than is reported on Form 990, mid-level managers and other employees whose compensation has not been required to be made public on Form 990 in the past could now have their compensation disclosed to the media and the public.

- Some of the Task Force's questions are unclear in important respects. For example, some of the requested compensation data are for "executives" and "administrators," but definitions of these terms were not provided. Similarly, multiple questions request overlapping compensation data and the differences between the questions are not always apparent.

- The Task Force's request reflects the need for robust recordkeeping regarding the compensation determination process. For example, the Task Force requests the comparables used in determining compensation back to 2007.

- Although the Task Force does not have the power to subpoena the information requested, it will likely be in a position to have meaningful influence on the organizations that are subject to the Task Force's review due to the fact that the Task Force is composed of representatives from the various regulatory bodies that review and/or control financing to the recipient organizations.

- The Task Force's letter is addressed to the recipient organization's board of directors, rather than to management, tying into increased focus on director fiduciary duties and organizational transparency. As a practical matter, however, much of the information requested will be within the purview of, and obtained from, the organization's senior staff.

[4] See Section 82(d) of Article 6 of the Public Officers Law of New York State.

IV. Additional Insights

The wide scope of information requested by the Task Force, and its mandate to recommend new rules to ensure that tax dollars are not used to fund excessive salaries, may herald significant, and likely burdensome, changes for how not-for-profit organizations in New York must address executive compensation.

If New York State imposes new restrictions on not-for-profit executive compensation, the new rules could apply different standards, be stricter than IRS rules, and potentially apply dollar caps on compensation levels. (For example, New York State Assemblywoman Deborah J. Glick, a Democrat from Manhattan, is sponsoring a bill (A06242) that would amend the public health law to limit executive salaries at publicly financed hospitals to $250,000.) If that happens, setting compensation could become more onerous for not-for-profit organizations in New York, and could present challenges to attracting and, equally important, retaining top talent.

The Task Force is not the only effort by New York State focusing on not-for-profit organizations. Attorney General Eric Schneiderman also recently announced the formation of a separate task force charged with presenting recommendations, by year end, to eliminate outdated requirements and unnecessary burdens on not-for-profit organizations while strengthening accountability.

In a similar vein, other states, such as New Jersey and Massachusetts, have also recently initiated efforts to explore and regulate not-for-profit executive compensation. We will separately update you on other state initiatives.

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Next Steps: The not-for-profit corporate, tax, and health care attorneys at Epstein Becker & Green, P.C., have significant experience in counseling our not-for-profit clients on issues relating to executive compensation. Apart from helping organizations deal with disclosure issues associated with IRS Form 990 and the Task Force's letter, we routinely work with our clients to develop best practices, policies, and procedures for ensuring that their executive compensation arrangements withstand government and public scrutiny. We encourage you to reach out to Jay Gerzog, Tamar Rosenberg, or your immediate contacts at EBG to see how we can assist your organization to address any questions you have regarding these important matters.

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