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Nonprofit Compensation and Employment Law Update

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There are significant developments in compensation and employment law relating to charitable organizations of which attorneys counseling New York charities should be aware. This list is illustrative and not inclusive.

Compensation Issues

New York's Prohibition on Loans to Officers and Directors. Questions about possible excess compensation for executives and insiders of charitable organizations have long been of concern to state and federal regulators, including New York state regulators.
More recently, the New York Attorney General's Charities Bureau has been focusing on the New York prohibition on any loans to officers or directors of nonprofit corporations.

Not-for-Profit Corporation Law (N-PCL) Section 716 has long barred any loans by a nonprofit corporation "to its directors or officers, or to any other corporation, firm, association or other entity in which one or more of its directors or officers are directors or officers or hold a substantial financial interest, except a loan by one charitable corporation to another charitable corporation." The statute specifies that "[a] loan made in violation of this section shall be a violation of the duty to the corporation of the directors or officers authorizing it or participating in it." Nevertheless, violations of this express statutory prohibition (which has no counterpart in federal law) continue.

Part X on the IRS Form 990 requires disclosures relating to whether such loans have been made. The Charities Bureau has been reviewing those filings with respect to New York charities and following up in circumstances where the answer is in the affirmative. According to the bureau chief, the office has sent letters to 35 such organizations identified in the filings, asking questions such as: (i) How did this happen? and (ii) What is your plan to address the issue? It is not clear whether the Charities Bureau is initiating enforcement actions in this area, but New York charities should be vigilant in observing the long-standing prohibition on such loans.

New York's Executive Order 38. Another significant development with respect to compensation was Governor Andrew Cuomo's issuance of Executive Order 38 (EO 38) on Jan. 18, 2012 (with regulations taking effect on behalf of 13 New York state agencies on July 1, 2013). EO 38 provided, in essence, that "Effective at the start of 2013, contractors that receive at least 30 percent of their revenue from the state cannot use more than $199,000 in state funds to pay their leaders. Any wages above that figure must come from private sources."[1]

Regulations issued pursuant to that executive order have clarified certain of the original provisions. Most significantly, the annual cap on compensation to charity executives at those government-funded organization who are covered by the executive order applies only to administrative work and, if an employee is only a part-time administrator, to the administrative portion of the work (and not to program services). Thus, with respect to a physician who is also an administrator, the cap only applies to the compensation for administrative work and not to the practice of medicine. For example, a physician who works half-time in the administrative area (earning $99,000) and half-time in a lucrative medical specialty as a physician (earning $250,000) is in compliance with the executive order and regulations even though total compensation is $349,000, because the cap applies only to the administrative portion.

Moreover, the regulations permit compensation in excess of the $199,000 cap under certain circumstances, provided that a proper compensation survey has been obtained by the nonprofit's board of directors and the executive's compensation is not "greater than the 75th percentile of that compensation provided to comparable executives in other providers of the same size and within the same geographic area."

The EO 38 regulations also require that a covered provider's executive compensation given to a covered executive in excess of $199,000 per annum was reviewed and approved by a process including "an assessment of appropriate comparability data." Under certain circumstances, the nonprofit may decide (consistent with the regulations) to formally apply for a waiver from the cap in the executive order.
There have been legal challenges to EO 38, one resulting in a determination by Supreme Court, Nassau County, that the executive order was invalid and could not be enforced. However, in a recent Second Department, Appellate Division decision, the trial court order was reversed and EO 38 was declared valid.[2]

Employment Law Issues

New York State Whistleblower Protection. Non-profit corporations and charitable trusts with 20 or more employees and annual revenue of over $1 million must now, under New York law, adopt a whistleblower policy to protect persons who report suspected improper conduct. This requirement is imposed by the Nonprofit Revitalization Act of 2013 (Section 715-b of the N-PCL), and goes well beyond the whistleblower protections afforded by prior New York law. It provides protection for directors, officers, employees, or volunteers who in good faith report any action or suspected action that is illegal, fraudulent, or in violation of company policy.

Intimidation, harassment, discrimination, or retaliation (including terminating or disciplining employees) is forbidden. There must be a procedure for preserving the confidentiality of

reported information. Notice of the policy must be provided to all officers, directors, and employees, and to volunteers who provide substantial services to the organization.

It can be inferred from the statute that if a purported whistleblower is not acting in good faith, adverse employment consequences might be appropriate. The audit committee (if there is one) or the full board must oversee implementation of and compliance with the whistleblower policy.

There are grounds for concern that this new whistleblower protection can be relied on inappropriately by (for example) a poorly performing or insubordinate executive. Such an executive might file a purported whistleblower complaint (such as with the employer or the Charities Bureau) and assert that a subsequent adverse employment action by the employer violates the whistleblower law.

The employer might properly respond that, because a terminated employee had severe performance issues, or acted in bad faith (or did not tell the truth) in making a complaint, the employee was not terminated or disciplined in violation of the whistleblower statute. It is not clear whether the statute provides a private right of action for a purported whistleblower who claims to have been improperly terminated, and the statute is not explicit on this question.

Moreover, the Office of the New York Attorney General (OAG) has suggested that it might, in what it views as appropriate circumstances, upon receipt of a purported whistleblower complaint from a nonprofit executive, advise the organization or its counsel that it would be unhappy if the employer took action against the employee/complainant (and the employer should at least speak to the OAG first). N-PCL 715-b does not explicitly confer on the OAG the right to take legal action against a nonprofit which it believes has retaliated improperly against a whistleblower. However, the OAG is understandably concerned that people do not like whistleblowers who could be the subject of adverse action after coming forward.

If a whistleblower is subject to what it views as improper retaliation, the Charities Bureau has pointed out that it could use its dissolution power where the organization has thereby violated social policy. The bureau could also rely on N-PCL Section 112, which gives the attorney general's office broad authority to step in the shoes of an officer or director and take legal action requiring a corporation to follow its own rules (which would include complying with its own whistleblower policy and not engaging in improper retaliation).

New York nonprofits should be aware of the new protections afforded to whistleblowers, and take steps to assure that (i) where required, they have a proper whistleblower policy in place which is disseminated as required by law, and (b) no adverse employment action is taken against any whistleblower, unless it is clear that there are good grounds for the action (totally unrelated to, and not in any way connected to or the result of the whistleblower activity).

New York State Increase in Minimum Wage. New York State, at least partly in response to the "Fight for $15" movement across the country (pressing for a $15 minimum wage for workers), saw a significant development through legislation signed by Governor Cuomo on April 4, 2016. The 2016/2017 state budget includes a historic increase in the minimum wage, ultimately reaching $15 an hour for all workers in all industries across the state. For workers in New York City employed by large businesses (those with at least 11 employees), the minimum wage would rise to $11 at the end of 2016, then another $2 each year after, reaching $15 on Dec. 31, 2018.

For workers in New York City employed by small businesses (those with 10 employees or fewer), for all workers in Nassau, Suffolk and Westchester Counties, and for workers in the rest of the state, the minimum wage increases are more gradual depending on where the worker is employed. This difference in treatment stems from concern, particularly by upstate

legislators, that the mandated increases could adversely impact employers in areas where wages and the cost of living are lower than in the downstate area.

Changes Affecting Right to Overtime Under FLSA. The federal overtime provisions contained in the Fair Labor Standards Act (FLSA) provide that employees covered by the act must receive overtime pay for hours worked over 40 in a workweek at a rate not less than time and one-half their regular rates of pay. The act does not require overtime pay for work on Saturdays, Sundays, holidays, or regular days of rest, unless overtime is worked on such days. There has been concern (both at the state and the federal level) that many employers try to evade overtime requirements by misclassifying employees as exempt "executives" or "professionals," even though the employees' responsibilities would not entitle them to such a classification.

The U.S. Department of Labor in June 2015 announced a proposed rule that would extend overtime protections to nearly five million white-collar workers within the first year of its implementation. It raises the level below which an employee can NOT be deemed exempt from the overtime rules. Until the promulgation of this new proposed rule, employees earning as little as $23,660 per year could be deemed ineligible for overtime pay if properly classified as executive, administrative, or professional employees.

On May 18, 2016, President Barack Obama and Secretary of Labor Thomas Perez announced the publication of the Department of Labor's final rule updating to $47,476 per year (or $913 per week) the salary and compensation levels needed for executive, administrative, and professional employees to be exempt from the overtime rules. The final rule also establishes a mechanism for automatically updating the salary and compensation levels every three years. The effective date of the final rule is Dec. 1, 2016, and the future automatic updates at three-year intervals will begin on Jan. 1, 2020.

Thus, a person earning less than $47,476 per year cannot be classified as an employee exempt from the overtime rules irrespective of his or her duties and responsibilities. In issuing its final rule, the Labor Department pointed out that "[n]either the FLSA nor the Department's regulations provide an exemption from overtime requirements for nonprofit organizations. While some non-profits may not be covered under the FLSA, it is likely that many employees of non-profits are entitled to FLSA protections." This could result in financial strain for charities with tight budgets which might have to pay overtime to formerly exempt employees or, in the alternative, raise their pay above the new threshold to permit continued treatment of such individuals as exempt.

Service by an Employee on a Nonprofit Board. As originally enacted, the Nonprofit Revitalization Act provided that no employee may serve as the chair of the board of a nonprofit corporation (a reasonable limitation whatever the status of current law.) Subsequent legislation deferred this limitation, which now takes effect Jan. 1, 2017. Section 713(f), to take effect in 2017, provides: "No employee of the corporation shall serve as chair of the board or hold any other title with similar responsibilities."

Endnotes:

1. Chronicle of Philanthropy (online): May 17, 2012.
2. *Agencies for Children's Therapy Services v. New York State Department of Health*, 136 A.D.3d 122 (2d Dept. 2015).