Electronic Dispatch

Not-for-Profit Information Memo

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STATE AND FEDERAL CHALLENGES TO COMPENSATION

NYAG Suit

In May, New York State Attorney General Eliot Spitzer sued Richard A. Grasso, the former Chief Executive Officer of the New York Stock Exchange alleging that Mr. Grasso was paid excessive compensation. Attorney General Spitzer also named the Exchange and the former Chair of the Compensation Committee of the Board of Directors as defendants in the suit.

The Exchange is organized under the New York Not-For-Profit Corporation Law, which governs New York not-for-profit corporations and the conduct of their directors and officers.

The lawsuit is based on provisions in the Not-For-Profit Corporation Law which state that compensation paid to officers of not-for-profit corporations is unlawful if the compensation is not “reasonable” and “commensurate with services performed”.

According to the Attorney General’s suit, the Exchange’s Board of Directors was misled on various aspects of Mr. Grasso’s compensation contract. The suit alleges that inaccurate and misleading information in the form of incomplete and incorrect analyses were provided to Board members.

Mr. Grasso was Chairman of the Board of the Exchange as well as CEO. Mr. Grasso appointed the Chair of the Compensation Committee, and, according to the suit, Mr. Grasso could exert improper influence over other members of the Compensation Committee. The suit alleges that there was a fundamental breakdown of corporate governance and numerous breaches of fiduciary duties owed to the Exchange.

Under the Not-For-Profit Corporation Law, the Attorney General is authorized to commence a legal action against a director or officer of a not-for-profit corporation to compel the director or officer to account for his or her official conduct.

IRS Initiative

According to The Wall Street Journal of May 25, 2004, Steve T. Miller, the director of exempt organizations for the Internal Revenue Service (IRS) has indicated that the IRS will be contacting hundreds of not-for-profit corporations over the summer and asking them to justify the amount of money paid to their executives. According to Mr. Miller, the questioning ultimately may lead to audits for some organizations. Since 1996, the IRS has had the power to fine executives at not-for-profit entities who receive excessive salaries and benefits as well as the directors who approve such arrangements.

Issues Raised

Boards of Directors of not-for-profit corporations are under increased scrutiny by the government, by the media and by donors. Some issues which the New York State Attorney General’s recent legal action and the IRS’s initiative raise include:

- How does your not-for-profit corporation review and approve compensation paid to executives?
- Does your Board of Directors have a Compensation Committee?
- What are the best practices for a Compensation Committee?
- Would a media story on your not-for-profit organization’s compensation practices reflect favorably on the organization?

Bond, Schoeneck & King, PLLC has the experience and expertise to advise not-for-profit organizations. If you have any questions about your organization's compensation procedures, please contact your BS&K attorney or one of the attorneys listed below.

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