

# Executive Compensation, Related Party Transactions and Intermediate Sanctions

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Edward T. Chaney, Associate, Schell Bray PLLC

James F. Wynn, Principal, Quatt Associates



## Introduction

- Part I: Overview of governing law and other considerations for executive compensation and other related party transactions
- Part II: Practical considerations for governance structures and processes – especially with respect to compensation
- Part III: Best practices for setting and approving compensation



# Governing Law and Considerations

- State Level
  - Fiduciary duties
  - Conflict of interest transactions/self dealing
- Federal Tax Law
  - Private inurement and private benefit
  - Intermediate Sanctions (for applicable 501(c)(3) and 501(c)(4) organizations)
  - Self-dealing (for private foundations) (not explored in this presentation)
- Court of Public Opinion



## State Law: Fiduciary Duties

- Duty of Care: requires nonprofit directors to act in good faith and with the care of an ordinary prudent person
  - Requires independent judgment
- Duty of Loyalty: requires directors to act in the best interests of the corporation and not their personal benefit
  - Must disclose and handle conflicts of interest according to law and organization policies and procedures
  - Should not seize business opportunities that the nonprofit might take



## State Law: Conflict of Interest/Self Dealing

- Conflict of interest laws generally relate to the integrity of a transaction but may not necessarily prohibit it
  - Generally require that a conflicted transaction be approved following:
    - disclosure, and
    - approval by disinterested members of governing body or authorized body knowing all material facts
  - May also contain a standard for approval, but can vary from jurisdiction to jurisdiction
- Some states further regulate certain self-dealing transactions, such as prohibiting or limiting loans to officers or directors



## Model Nonprofit Corporation Act (2008 revisions)

### § 8.60 CONFLICTING INTEREST TRANSACTIONS; VOIDABILITY

(a) A contract or transaction between a nonprofit corporation and one or more of its members, directors, members of a designated body, or officers or between a nonprofit corporation and any other entity in which one or more of its directors, members of a designated body, or officers are directors or officers, hold a similar position, or have a financial interest, is not void or voidable solely for that reason, or solely because the member, director, member of a designated body, or officer is present at or participates in the meeting of the board of directors that authorizes the contract or transaction, or solely because his or their votes are counted for that purpose, if:

(1) the material facts as to the relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors and the board in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors even though the disinterested directors are less than a quorum;

(2) the material facts as to the relationship or interest of the member, director, or officer and as to the contract or transaction are disclosed or are known to the members entitled to vote thereon, if any, and the contract or transaction is specifically approved in good faith by vote of those members; or

(3) the contract or transaction is fair as to the corporation as of the time it is authorized, approved, or ratified by the board of directors or the members.



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