RECENT CHANGES TO THE NEW YORK NONPROFIT CORPORATION LAW

In late December, New York Governor Cuomo signed into law The Non-Profit Revitalization Act of 2013 (the "Act"), which is the first major amendment of the New York Not-for-Profit Corporation Law in more than 40 years. The Act not only could impact nonprofits that are incorporated in New York, but some provisions of the Act apply to non-profits that are registered, or that are required to be registered, under the state's charitable solicitation laws because they solicit contributions from residents of the state.

The goals of the Act are to reduce burdens on the nonprofit sector while strengthening nonprofit governance and accountability. To those ends, New York nonprofits will benefit from provisions in the Act that provide flexibility in governance and increased ability to use technology.

Most of the Act's provisions begin to take effect on **July 1, 2014**, but non-profit organizations should begin to analyze now whether any changes to organizational documents and corporate policies and practices are required so as to be able to plan any requisite board or member approval processes accordingly. Given the fundamental changes to current law, it is likely that many nonprofits incorporated in New York will, at a minimum, have to implement changes to current governance policies.

Many of the Act's provisions are based on the work of the Leadership Committee on Nonprofit Revitalization, which was convened at the request of the New York Attorney General. The report of this Leadership Committee, which provides background on much of the Act, can be viewed at:

http://www.ag.ny.gov/sites/default/files/NP%20Leadership%20Committee%20Report%20%282-16-12%29.pdf.

The following memorandum contains a summary of certain significant provisions of the Act. The full text of the Act is available at:

http://open.nysenate.gov/legislation/bill/A8072-2013.

EXECUTIVE SUMMARY

All nonprofit organizations incorporated in New York or subject to registration under New York's charitable solicitation laws should review their organizational documents and governance policies and practices for compliance with the Act's provisions. The following are some areas for initial focus:

- Review organizational documents (*e.g.* Certificate of Incorporation and Bylaws) and practices to ensure that the corporation can utilize electronic methods of communication for meetings, notices, proxies and consents that are newly allowed under the Act. In particular, consider removing prohibitions on using electronic communications for these purposes, which the Act allows to be used unless restricted in the corporation's organizational documents.

- Ensure that the corporation has a conflict of interest policy that conforms to the Act's requirements. Note the Act's new definition of "independent directors" and requirements regarding approval of compensation arrangements and related party transactions.

- For corporations with 20 or more employees and greater than $1 Million in annual revenues, adopt a whistleblower policy or revise your existing whistleblower policy to protect good faith reporters of corporate wrongdoing from retaliation and otherwise conform to the Act's requirements.

- Review revised approval processes for real estate transactions and, particularly for charitable nonprofit corporations, major corporate actions. The Act in many cases streamlines these processes, so it is important to align organizational documents to the new provisions.

- For corporations subject to registration under New York's charitable solicitation laws, be aware of the Act's new auditing and reporting thresholds, and if an audit is required, confirm that an Audit Committee of "independent directors" exists.

- Even if the corporation is not required to submit audited financials to the New York Attorney General pursuant to charitable solicitation laws, the corporation may be required by the Act to maintain an audit or other committee comprised solely of "independent directors" to oversee the required conflict of interest and whistleblower policies. Alternatively, such function may be performed by a subset of the Board composed only of "independent directors."

GOVERNANCE CHANGES

The Act abrogates the four "letter type" New York not-for-profit corporations and simplifies the classifications within the law to two types: "charitable" and "non-charitable." The simplification does not require any action by existing New York nonprofit corporations. Types B and C entities, and Type D entities formed for a charitable purpose will henceforth be classified as "charitable" and all others will be classified as "non-charitable."

New York corporations will benefit from provisions of the Act that modernize certain provisions of the New York Not-for-Profit Corporation Law. Organizations should review their

bylaws and certificate of incorporation and consider removing any prohibitions on using electronic communications. For example, a New York nonprofit will, unless prohibited by its organizational documents, be able to (1) hold board meetings via video conference, as, for example, by Skype; (2) send meeting notices and waivers by facsimile or email in addition to by regular mail or in person delivery; and (3) utilize facsimile or email for proxies and board and member consents .

The Act also attempts to clear up confusion about the meaning of the term "entire board" for purposes of voting. The "entire board" means the "total number of directors entitled to vote which the corporation would have if there were no vacancies." If a corporation's bylaws provide that the board consists of a fixed number of directors, then the "entire board" consists of that number of directors. If the bylaws state that the number of directors consists of a "range" (e.g. "no less than five and no more than eleven") then the "entire board" is "the number of directors within such range that were elected at the most recently held election of directors."

Beginning January 1, 2015, an employee of a New York nonprofit corporation may not serve as the Chair of the Board of Directors – nor may he or she serve "or hold any other title with similar responsibilities."

CONFLICT OF INTEREST POLICY MANDATORY; ADDITIONAL CONFLICT OF INTEREST CHANGES

New York nonprofit corporations that have adopted a Conflict of Interest Policy that is substantially similar to the Internal Revenue Service sample policy will likely need to adopt changes to their policy in order to conform to the Act's requirements.

The Act requires that all nonprofit corporations adopt a conflict of interest policy, and this policy must contain, at a minimum, the following: (1) a definition of conflict of interest; (2) guidelines for how to determine the existence of a conflict of interest and how such conflicts are to be resolved; (3) guidelines that describe procedures for disclosing conflicts of interest to the nonprofit corporation's Audit Committee, or to the Board if there is no Audit Committee; (4) a prohibition on any person who is the subject of a conflict of interest being in attendance at a Board or committee meeting when the conflict is being discussed or voted on; (5) a rule that disallows a party who is the subject of a conflict of interest from engaging in any activity that might improperly influence the nonprofit's Board; (6) a requirement that the existence and resolution of the conflict be documented in the corporation's records, including minutes of the Audit Committee or Board; and (7) guidelines for dealing with issues determined to be "Related Party Transactions."

Directors must, prior to being elected to the Board and annually thereafter, sign a declaration as to any known or potential conflicts and submit the same to the Corporation's

Secretary. The Corporate Secretary is required to submit all completed statements to the Chair of the Audit Committee, or to the Board if there is no Audit Committee.

The Act defines "Related Party" for purposes of transactions with the nonprofit corporation as any director, officer or key employee and relatives thereof, and any entity in which any of such persons has a 35% or greater ownership interest or, in the case of a partnership or professional corporation, an ownership interest in excess of five percent. Related Parties may not participate in deliberations or voting on Related Party Transactions.

Prior to entering any Related Party Transaction, the Act requires that the Board determine that the transaction is fair, reasonable and in the corporation's best interest. Related Parties must disclose in good faith to the Board the material facts concerning their interest in the transaction. Further, as to charitable corporations, the Act affirmatively requires the Board, or an authorized committee thereof, to consider alternate transactions to the extent available prior to entering any transaction in which a Related Party has a substantial financial interest and contemporaneously document the consideration of the same. The Act gives the Attorney General substantial powers to void Related Party Transactions and to seek restitution and removal of directors who approved any such transaction in violation of the Act's requirements.

The Act proscribes any member, director or officer who may benefit from a compensation arrangement with the corporation from being present at the Board or committee deliberation and vote on such arrangement, although the person can be requested by the Board or committee to be present prior to the deliberation and vote to provide background information.

WHISTLEBLOWER POLICY MANDATORY FOR MANY NONPROFITS

Like the Conflict of Interest Policy, many organizations will need to adjust their Whistleblower Policy and adopt revisions to conform to the Act's requirements.

Organizations with more than twenty (20) employees and annual revenue over $1 million dollars will be required to adopt a whistleblower policy that protects against retaliation of persons who report in good faith improper conduct or activities of the corporation, including fraudulent or illegal conduct. The Act lists certain provisions that must be included in any such whistleblower policy, including reporting procedures and confidentiality requirements, as well as appointment of an administrator of such policy.

The Act also requires that copies of such whistleblower policy be distributed to all directors, officers, and employees and to all volunteers providing substantial services to the corporation.

"INDEPENDENT DIRECTORS" IMPORTANT UNDER THE ACT

The adoption, implementation and compliance with conflict of interest and whistleblower policies must be overseen by the Board, or Audit Committee or other committee composed solely of "Independent Directors."

The Act newly defines "Independent Directors," with detailed and somewhat unique requirements. For example, a director is not considered "independent" if:

- he or she is, or within the previous three years has been, *an employee of the corporation or an affiliate*, or if he or she has a relative that has been a key employee of the corporation or an affiliate.
- he or she (or a relative) has received in any of the last three years more than $10,000 in direct compensation from the corporation or an affiliate (excluding reasonable expense reimbursements and reasonable compensation for service as a director as permitted under the New York Not-For-Profit Corporation Law); or
- he or she is an employee of, or has a substantial financial interest in (or a relative is an officer of or has a substantial financial interest in), any entity that has made payments to or received payments from the nonprofit corporation or an affiliate in any of the prior three years that exceeds the lesser of $25,000 or two percent of gross revenues of the entity (payments exclude charitable contributions for this purpose). Note: This requirement could have a particular impact on associations, as employees of member companies that pay dues to the association traditionally have served on association boards and committees.

APPROVAL PROCESS FOR CERTAIN FUNDAMENTAL TRANSACTIONS EASED

The procedure for approving certain fundamental transactions such as mergers, dissolutions, and dispositions of substantially all of a corporation's assets has been simplified under the Act. Pursuant to the Act, in most cases, charitable organizations will be able to seek Attorney General approval, rather than engage in the two step process that currently includes initiating a court proceeding.

Most real estate transactions no longer will need a two-thirds approval from an organization's Board. Rather, a majority vote of the Board or a designated committee will suffice. A two-thirds approval (or majority if the Board is composed of 21 or more directors) is still needed for transactions that involve substantially all of an organization's assets, however. Any committee designated by the Board to approve a real estate transaction must report promptly to the Board all actions taken, no later than the next regularly scheduled Board meeting.

Additionally, for certain organizations with an educational purpose, the Act removes the need to seek the approval of the Commissioner of Education prior to incorporation, and such organizations merely will be required to notify the Commissioner of Education upon their incorporation.

UPDATED AUDITING AND FINANCIAL REPORTING REQUIREMENTS

Thresholds for audit and financial reporting requirements generally have been adjusted upward for charitable corporations that are subject to registration under the New York Charitable Solicitation Registration statute. The Act progressively raises the threshold requiring an audit report from the current $250,000 in gross receipts to $500,000 in 2014, $750,000 in 2017 and $1 Million in 2021. It also removes the requirement that *any* charitable organization (regardless of the amount of annual gross receipts) that pays an outside fundraiser must furnish an audit report. For 2014 and beyond, the Act also raises the threshold that allows a charitable corporation merely to furnish unaudited financials from $100,000 to $250,000. Organizations with over $250,000 in gross receipts, but less than the thresholds requiring an audit, will be required to furnish an independent CPA's review report.

Charitable corporations required to file an audit report with the Attorney General are required to have the audit, as well as their accounting and financial reporting processes, overseen by the Board or an Audit Committee, in each case made up of "independent directors". The audit review process requirements are enhanced for any corporations with annual revenues in excess of $1 Million.

CONCLUSION

The degree to which a particular organization will be affected by this recent legislation will depend on a variety of factors, but all nonprofit organizations incorporated or doing business in New York should be aware of these developments and review their organizational documents, policies and practices. If you have questions regarding this recent legislation and its impact on your organization, please contact Webster, Chamberlain & Bean, LLP.

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