

2016 Amendments to the Nonprofit Revitalization Act

The Nonprofit Revitalization Act (the “NPRA”), signed into law by Governor Cuomo in 2013 was a groundbreaking and long-overdue change to the Non-Profit Corporation Law of the State of New York that both sought to modernize and streamline key provisions for nonprofits doing business in New York. Going one step further, on November 29, 2016, Governor Cuomo further amended key provisions of the Act, responding to feedback and concerns from nonprofit constituents.

Excerpted from an article posted in the National Law Review, the following outline neatly summarizes the additional amendments passed in late November. Of particular interest to NYSCA Grantees is the recent amendment pertaining to employees serving as Board Chairs. The new language does not create a prohibition against a senior leader of an organization from serving in a dual capacity. However, the amendment now requires that the election of an employee to the Board Chair seat must be ratified by a two-thirds vote of the Board and that the decision be memorialized in a contemporaneous writing.

At NYSCA, we strongly encourage a separation of duties between the senior executive staff managing an organization and those serving on the Board whose role it is to oversee the policies, procedures and activities of the organization and help guide the actions of senior staff. However, should your organization elect to have an employee to serve as the Chair or President of your Board, we advise that you consult with a legal advisor to ensure that you are fully in compliance with the new requirements of the NPRA.

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On November 28, 2016, Governor Cuomo signed into law Chapter 466 of the Laws of New York of 2016 (Assemb. Bill 10365B) (the “2016 Amendment”). The 2016 Amendment is intended to “improve and make clarifying amendments to the Nonprofit Revitalization Act of 2013” (the “NPRA”)¹ in order to “correct certain inconsistencies, and . . . make the statute operate more smoothly and efficiently,”² most notably to the “related party” provisions and the prohibition in the NPRA against employees serving as the chair of the board of a corporation organized under the New York Not-for-Profit Corporation Law (“NPCL”). The 2016 Amendment amends certain provisions of the NPCL and corresponding provisions of the Estates, Powers and Trusts Law.³ The changes go into effect on May 27, 2017, 180 days after the Governor signed the law,

except for the amendment to NPCL § 713(f), described below, relating to the chair of the board, which is effective on January 1, 2017.

Set forth below is a summary of certain of the most substantive changes made to the NPCL by the 2016 Amendment.

Related Party Transaction Provisions

The most significant changes made by the 2016 Amendment are the amendments to the provisions of the NPCL governing related party transactions. As originally enacted, the NPRA prohibited a corporation subject to the NPCL from entering into a “related party transaction,” defined to mean “any transaction, agreement or any other arrangement in which a related party has a financial interest and in which the corporation or any affiliate of the corporation is a participant,”⁴ unless the transaction is “determined by the board, or an authorized committee thereof, to be fair, reasonable and in the corporation’s best interest.”⁵ The 2016 Amendment will ease the related party transaction rules in certain key respects. First, it redefines “related party transaction” to exclude transactions (1) where the transaction itself or the related party’s financial interest in the transaction is de minimis, (2) that would not customarily be reviewed by the board or boards of similar organizations and are available to others on the same or similar terms, or (3) that constitute a benefit provided to a related party only as a member of a class of the beneficiaries that the corporation intends to benefit as a part of its mission, as long as the benefit is available to similarly situated members of the same class on the same terms.⁶ This change codifies and extends guidance published by the Attorney General on April 13, 2015.⁷

Second, the 2016 Amendment will revise NPCL § 715(a) to permit the board to authorize a committee to approve a related party transaction when previously only the board had such power. The 2016 Amendment will also revise NPCL § 715 to create a very limited statutory defense where a related party transaction is not properly authorized in the first instance. Specifically, NPCL § 715(j) will provide that, in the case of an action brought by the Attorney General, the corporation will have a defense if, prior to the receipt of any request for information by the Attorney General concerning the transaction, the board ratified the transaction as fair, reasonable and in the corporation’s best interest at the time of approval, and, if the related party transaction involves a charitable corporation where the related party has a substantial financial interest, the board considered available alternative transactions and approved the transaction with no less than a majority vote of the directors or committee members present, and documented in writing the nature of the violation and basis for approval of the transaction while also putting into place procedures to ensure that such violations will not occur again.⁸

Key Person

In defining who qualifies as a “related party” for purposes of the restrictions, the 2016 Amendment will replace the term “key employee” with the broader term “key person” in NPCL § 102(a)(25). As suggested by the change, the new term expressly includes individuals other than employees.⁹ The 2016 Amendment defines a “key person” as an individual (other than

officers or directors who are otherwise defined as a “related party”), “who (i) has responsibilities, or exercises powers or influence over the corporation as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a substantial portion of the corporation’s capital expenditures or operating budget.”¹⁰

Independent Director

The NPRA requires certain functions to be carried out by a board or audit committee comprised solely of “independent directors,” including overseeing the accounting and financial reporting process of the corporation.¹¹ The 2016 Amendment will revise the definition of “independent director” to provide a sliding scale to trigger disqualification in certain limited situations.¹² In the case of entities that receive payments from, or make payments to, a corporation subject to the NPCL, a director may still be independent even if he/she is employed by, or has a financial interest in, the other entity if the amount paid or received during each of the past three fiscal years is less than \$10,000 or 2% of the entity’s consolidated gross revenues and the amount of such gross revenues is less than \$500,000. For entities with consolidated gross revenues between \$500,000 and \$10,000,000, the amount of the payments to the entity or from the entity to the corporation subject to the NPCL may not exceed \$25,000 (without reference to a percentage of the entity’s gross revenues). Finally, in the case of entities with consolidated gross revenues of \$10,000,000 or more, the amount of the payments to the entity or from such entity to the corporation subject to the NPCL may not exceed \$100,000 (without reference to a percentage of the entity’s gross revenues). Further, “compensation” does not include reimbursement for expenses reasonably incurred as a director or compensation for service as a director permitted by NPCL § 202(a)(12).

The 2016 Amendment further amends the independent director standard by removing from consideration “payments made by the corporation at fixed or non-negotiable rates or amounts for services received” as long as such services are available to the public on the same terms and the services are not available from another source.¹³ This change contemplates payments for routine services such as those to utility companies, whose employees would otherwise not be considered independent if they served on the boards of not-for-profit corporations serviced by such companies.

Chair of the Board

The 2016 Amendment will also revise the provision of the NPRA that would have absolutely prohibited an employee of a corporation organized under the NPCL from serving as chair of the board of the corporation. As amended, NPCL § 713(f) will allow employees to serve as chair of the board, or hold a title with similar responsibilities, provided that the board approves the election by a two-thirds vote of the entire board and “contemporaneously documents in writing the basis for the board approval.”¹⁴ Unfortunately, the 2016 Amendment does not define or

clarify the phrase “basis for the board approval.” Importantly, NPCL § 713(f) will go into effect on January 1, 2017, prior to the other provisions of the 2016 Amendment.¹⁵

Conflict of Interest and Whistleblower Provisions

The 2016 Amendment will revise the conflict of interest and whistleblower policy provisions added by the NPRA to prohibit an employee who also holds a position as a director from taking part in any board or committee deliberations concerning the administration of whistleblower policies.¹⁶ In addition, the 2016 Amendment will provide that any person who is the subject of a whistleblower complaint may not be present at or participate in board or committee deliberations or voting on the matter relating to the complaint (although the board or committee will be allowed to request that person present background information or answer questions prior to the commencement of deliberations or voting).¹⁷

Committee Formation and Operational Provisions

The 2016 Amendment will make a number of changes to NPCL § 712(a) with respect to the formation and powers of committees. Section 712(a) will now provide that a majority of the directors present at a board meeting at which a quorum is present can create committees (other than the executive committee), where previously a majority vote of the entire board was required to create a committee. In the case of the executive committee (or a committee that serves the same function, regardless of name) the requirement of a majority vote of the entire board will survive, except if the board has 30 or more members, in which case a vote of at least three-quarters of those present will be sufficient if there is a quorum of the board present.¹⁸ In addition, NPCL § 712(a) will expressly allow a corporation’s by-laws to provide that directors who hold certain positions in the corporation are ex-officio members of specific committees.

The 2016 Amendment will also add to the list of powers that may not be delegated to committees in NPCL § 712(a). These additional “non-delegable” powers include the authority to elect or remove officers and directors, to approve a merger or plan of dissolution, to adopt a resolution recommending to the members a sale of all or substantially all of the assets of a corporation or authorizing such transaction if the corporation has no members, and to approve amendments to the certificate of incorporation.¹⁹

As a general matter, the revisions made to the NPCL by the 2016 Amendment provide further clarity with respect to provisions added by the NPRA. Changes to the related party transaction rules, in particular, provide needed clarification and should ease the burden of conducting business. Although the amendments do not expressly require corporations to amend any governing documents in response, corporations may wish to update their by-laws in order to take advantage of the new changes.

¹ Previous Clients and Friends Memoranda have discussed the Act and subsequent changes. See *Clarifying Amendments to the Nonprofit Revitalization Act Signed Into Law* (Dec. 21, 2015), ; *Nonprofit Revitalization Act Employed Board Chair Prohibition Delayed to 2017* (Oct. 29, 2015); ; *Nonprofit Revitalization Act of 2013 – Best Governance Practices Made Mandatory* (Jan. 10, 2014).

2 N.Y. St. Sen., Introducer’s Memorandum in Support of Sen. Bill 7913B (May 25, 2016), which was substituted by the 2016 Amendment.

3 This memorandum is limited to the amendments to the NPCL.

4 N.Y. Not-for-Profit Corp. Law §§ 102(a)(24) and 715(a).

5 N.Y. Not-for-Profit Corp. Law § 715(a).

6 N.Y. Not-for-Profit Corp. Law § 102(a)(24).

7 See https://www.charitiesnys.com/pdfs/Charities_Conflict_of_Interest.pdf.

8 In an action by a person or entity other than the Attorney General, the 2016 Amendment will add a new subsection setting forth a defense where the procedures set forth in NPCL § 715 are not followed provided the transaction “was fair, reasonable and in the corporation’s best interest at the time the corporation approved the transaction.” N.Y. Not-for-Profit Corp. Law § 715(i).

9 Prior to the effective date of the 2016 Amendment, NPCL § 102(a)(25) defines “key employee” by reference to the Internal Revenue Code and Treasury Regulations governing excess benefit transactions, which included any person in a position to exert substantial influence over the organization, resulting in confusion. See 26 U.S.C. § 4958(f)(1)(A); 26 C.F.R. § 53.4958-3(c).

10 N.Y. Not-for-Profit Corp. Law § 102(a)(25).

11 N.Y. Not-for-Profit Corp. Law § 712-a(a).

12 N.Y. Not-for-Profit Corp. Law § 102(a)(21).

13 *Id.*

14 N.Y. Not-for-Profit Corp. Law § 713(f).

15 On November 28, 2016 the Governor vetoed legislation that would have delayed the effectiveness of NPCL §713(f) until January 1, 2018. N.Y. S.B. 8041 (June 7, 2016). The effective date of the prohibition was previously delayed from January 1, 2015 to January 1, 2016, and again from January 1, 2016 to January 1, 2017. See *Nonprofit Revitalization Act Employed Board Chair Prohibition Delayed to 2017* (Oct. 29, 2015),

16 N.Y. Not-for-Profit Corp. Law § 715-b(b)(2).

17 N.Y. Not-for-Profit Corp. Law § 715-b(b)(3).

18 N.Y. Not-for-Profit Corp. Law § 712(a).

19 The NPCL expressly prohibits delegation to committees of authority to take the following actions: (1) submission to members of any action requiring members’ approval under the NPCL, (2) filling of vacancies in the board of directors or in any committee, (3) fixing of compensation of the directors for serving on the board or any committee, (4) amendment or repeal of the by-laws or the adoption of new by-laws, and (5) amendment or repeal of any resolution of the board which by its terms shall not be so amendable or repealable. N.Y. Not-for-Profit Corp. Law § 712(a)(1-5).

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