

# EXEMPT AND NONPROFIT ORGANIZATIONS ALERT

December 16, 2013

## New York Non-Profit Revitalization Act

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If you have any questions regarding the matters discussed in this memorandum, please contact any of the attorneys listed on page 5, or call your regular Skadden contact.

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The Non-Profit Revitalization Act of 2013 (the Act) (S5845/A8072), which effects the first major overhaul of the New York Not-for-Profit Corporation Law (the NPCL) in four decades, will be signed into law by New York Governor Andrew Cuomo before the end of this week.<sup>1</sup> The Act is intended to lessen regulatory and administrative burdens on corporations governed by the NPCL,<sup>2</sup> improve governance and increase accountability. For the first time, the NPCL's related party transaction provisions, as amended by the Act, will apply to charitable trusts. Other than certain provisions (as noted below), the Act generally will become effective on July 1, 2014. It is anticipated that a bill proposing technical, non-substantive changes needed to clarify certain provisions of the Act will be introduced in the next session of the New York Legislature. Following is a summary of key changes effected by the Act.

### I. Streamlined Governance Procedures

In some cases, bylaw amendments will be necessary to take advantage of new provisions in the law; in other instances, while not required, it will be helpful for corporations to amend their bylaws to provide for new procedures permitted by the Act.

#### Electronic Communications

The Act allows for electronic (i) notices for board and member meetings and waivers of notice, (ii) board and member unanimous consents, and (iii) member proxies. In addition, directors will be able to participate in meetings through videoconferencing.

The Act also provides that the Attorney General's Charities Bureau may now accept registration forms, annual reports and other submissions by electronic means.

#### Streamlined Approval of Major Corporate Actions

The Act streamlines the approval process for major corporate actions by allowing corporations to obtain approval of such transactions from the Attorney General, instead of having to obtain court approval following Attorney General review and consent. The streamlined approval process is available for amendments to the corporate purposes of Charitable Corporations (as defined below), mergers, consolidations, dissolutions and transfers of all or substantially all assets, except where the Attorney General concludes that court approval is necessary.<sup>3</sup> In all cases, if the Attorney General's approval is withheld, the corporation still may petition the court, on notice to the Attorney General, for approval of the action.

<sup>1</sup> The Act also amends provisions of other New York statutes, including the Education Law, Religious Corporations Law, Executive Law and Estates, Powers and Trusts Law.

<sup>2</sup> New York education corporations are governed by the NPCL to the extent provided under Education Law §216-a, and New York religious corporations are governed by the NPCL as provided under Religious Corporations Law §2-b. Accordingly, a number of the Act's provisions discussed herein also are applicable to New York education corporations and religious corporations. In addition, as discussed herein, certain of these changes affect New York charitable trusts.

<sup>3</sup> For transfers of all or substantially all assets, the option of obtaining only Attorney General approval is not available if the corporation is insolvent or would become insolvent as a result of the transaction.

### Real Property Transactions

Currently, any real estate transaction requires the approval of at least two-thirds of a corporation's entire board of directors, except for boards of 21 or more directors, where a majority vote of the entire board is sufficient. Under the Act, certain real estate transactions, *i.e.*, a purchase of real property or the corporation's, sale, mortgage, lease, exchange or other disposition of its real property, may be approved by a majority of the board or a committee, unless the transaction involves all or substantially all of the corporation's assets, in which case the prior voting requirement is retained. Board approval is no longer needed when leasing real property from a third party.

### Committees

The Act eliminates the distinction between standing and special committees of the board. It also includes a new means for electing members of committees of the corporation: committees of the corporation may now be elected in a manner set forth in the bylaws. If not specified in the bylaws, then members of committees of the corporation shall be elected in the same manner as officers of the corporation, which is the current rule.

### Number of Directors

The Act clarifies the definition of the term "entire board" to mean the number of directors fixed in the bylaws or, where the bylaws provide for a range in the number of directors, the number of directors within that range that were elected as of the most recently held election of directors. It also expands the options available for fixing the number of directors if such number is not fixed in the bylaws.

## **II. Related Party Transactions and Conflict of Interest Policy**

The Act makes significant changes to the current NPCL provision regulating transactions between a corporation and its insiders, *i.e.*, related party transactions. The Act also requires all corporations to adopt a conflict of interest policy that, among other things, includes specific procedures for disclosing, addressing and documenting related party transactions and preventing improper influence by the related party in accordance with the new law. Corporations should be aware that the scope of transactions falling within the purview of the new law does not precisely mirror those regulated by the IRS intermediate sanctions rules. The Act's requirements regarding related party transactions and conflict of interest policies also apply, as noted above, to New York charitable trusts. Accordingly, all corporations and charitable trusts likely will need to amend their conflict policies to comply with the Act.

The Act prohibits a corporation from entering into a related party transaction unless the transaction is determined by the corporation's board of directors or an authorized committee of the board to be fair, reasonable and in the corporation's best interest at the time of the determination. A "related party transaction" includes any transaction, agreement or any other arrangement in which a related party has a financial interest. A "related party" includes any director, officer or key employee of the corporation or an affiliate of the corporation, his or her relatives and any entity in which any such individual has 35 percent or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5 percent.

Where the related party transaction is between a Charitable Corporation (as defined below) and a related party with a substantial financial interest in the transaction, the board or board committee also must: (i) consider alternative transactions to the extent available, prior to entering into the transaction; (ii) approve the transaction by not less than a majority vote of the directors or committee members present at the meeting; and (iii) contemporaneously document in writing the basis for the board or committee's approval, including its consideration of alternative transactions.

The conflict of interest policy must include, in its disclosure requirements, that each director, prior to initial election and then annually, sign and submit to the corporation's secretary a written statement identifying, to the best of the director's knowledge: (i) any entity of which the director is an officer, director, trustee, member, owner (as sole proprietor or partner) or employee and with which the corporation has a relationship, and (ii) any transaction in which the corporation is a participant and in which the director might have a conflicting interest. A board committee comprised solely of independent directors may oversee the adoption of, and compliance with, the conflict of interest policy. If no such committee is designated, either the board or the audit committee must provide such oversight.

To be considered an "independent director," the director may not (i) be or have been within the last three years an employee of the corporation or any affiliate, or have a relative who is or has been within the last three years a key employee of the corporation or any affiliate; (ii) have received or have a relative who received more than \$10,000 in direct compensation from the corporation or any affiliate within any of the last three fiscal years; or (iii) be an employee of or have a substantial financial interest in any entity that has made payments to or received them from the corporation or an affiliate for property or services which, in any of the last three fiscal years, exceeds the lesser of \$25,000 or 2 percent of such entity's consolidated gross revenues, or have a relative who is an officer of or has a substantial financial interest in any such entity.

To establish a committee of independent directors, a corporation will need to implement procedures for collecting from directors the information required to determine whether or not a director is "independent" and ensuring that that information remains current.

The Act also enhances the Attorney General's authority to remedy violations of the related party transaction rules, including authorizing the Attorney General to bring an action to enjoin, void or rescind such transactions and to seek restitution, an accounting and the return of any profits made from the transaction and other relief.

### **III. Audit Oversight**

Corporations governed by the NPCL that solicit contributions in New York State and are required to file a certified public accountant's audit report with the Attorney General now will need to ensure that the audit of the corporation's financial statements, as well as the corporation's accounting and financial reporting processes, are overseen by either the corporation's board of directors (excluding any directors who are not independent directors) or an audit committee comprised solely of independent directors. Such oversight functions include retaining/renewing an independent auditor and reviewing the audit results and any management letter with the auditor. For corporations with annual revenue in excess of \$1 million (either in the prior or current fiscal year), the oversight duties also include: (i) reviewing with the auditor the scope and planning of the audit prior to its commencement; (ii) upon completion of the audit, reviewing and discussing any material risks and weakness in internal controls identified by the auditor, any restrictions on the scope of the auditor's activities or access to requested information, any significant disagreements between the auditor and management, and the adequacy of the corporation's accounting and financial reporting processes; and (iii) annually considering the performance and independence of the auditor. These audit oversight requirements also apply to New York charitable trusts that solicit contributions in New York State and are required to file a certified public accountant's audit report with the Attorney General. Any corporation or charitable trust that had annual revenues of less than \$10 million in its last fiscal year ending prior to January 1, 2014, will not be subject to these audit oversight requirements until January 1, 2015.

#### **IV. Whistleblower Policy**

Under the Act, every corporation and charitable trust that has 20 or more employees and annual revenue exceeding \$1 million in its prior fiscal year must adopt a whistleblower policy that complies with the Act. The whistleblower policy must prohibit intimidation, harassment, discrimination, adverse employment consequences or other retaliation against a director, trustee, officer, employee or volunteer who, in good faith, reports any action or suspected action by or within the corporation that is allegedly illegal, fraudulent or violates any corporate policy. The Act sets forth certain required provisions for reporting violations or suspected violations of law or corporate policies, specifying to whom such violations may be reported and to whom the policy must be distributed. A committee comprised solely of independent directors/trustees may oversee the adoption of and compliance with the whistleblower policy. If no such committee is designated, either the board, the trustees in the case of a trust, or the audit committee must oversee this function.

Corporations and trusts that have a whistleblower policy should review the policy and, unless it is substantially consistent with the Act's requirements, should amend the policy to ensure compliance.

#### **V. Other Changes**

##### Elimination of Types

Under the NPCL, corporations currently are divided into four "types", A through D. The Act eliminates these four types and instead divides corporations simply into either Charitable or Non-Charitable Corporations. A "Charitable Corporation" is a nonprofit corporation formed or deemed to be formed for charitable purposes, *i.e.*, purposes included in the certificate of incorporation that are charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals. Additionally, under the Act, education corporations and religious corporations are Charitable Corporations for purposes of the NPCL.

##### Audit Thresholds

The Act provides some relief for charitable organizations soliciting in New York State by raising the gross revenue thresholds for filing an audit report with the Attorney General to \$500,000 as of July 1, 2014, \$750,000 as of July 1, 2017, and \$1,000,000 as of July 1, 2021.

##### Mergers and Consolidations of Religious and Education Corporations

The Act allows education corporations and religious corporations to enter into mergers in addition to consolidations, creating the option of having a surviving entity rather than having to form a new consolidated entity.

##### Executive Compensation

The Act adds to the NPCL provision permitting a corporation to pay reasonable compensation to its members, directors and officers for services a prohibition against any such person being present at or participating in any board or committee deliberation or vote concerning his or her compensation. However, if requested to do so by the board or committee, such person may be present to provide information or answer questions prior to the commencement of the deliberations or voting.

##### Employee Cannot be Chair

Effective January 1, 2015, the Act will prohibit any employee of a corporation from serving as chair of the organization's board of directors or to hold any title with similar responsibilities.

### Incorporation and Authorization

The Act makes a number of changes that are designed to streamline the process for forming a corporation in New York State and for foreign corporations applying for authority to conduct activities in New York State.

We would be happy to assist you in taking the steps necessary to comply with the Act.

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