ALERTS

The Nonprofit Revitalization Act of 2013

October 1, 2013

The Nonprofit Revitalization Act of 2013 (the "Act"), a bill reforming New York not-for-profit law based on the input of several leaders in the nonprofit community, has passed the New York State legislature unanimously. If signed by Governor Cuomo, the Act will become effective on July 1, 2014 and will be the first major modification of New York not-for-profit law in over 40 years.

The Act amends the New York Not-for-Profit Corporation Law, in addition to several other statutes relevant to nonprofit organizations, and seeks to reduce bureaucracy, enhance oversight and modernize governance. It applies to all nonprofits incorporated in New York.[1] This *Alert* summarizes several key provisions of the Act.[2] All New York not-for-profit organizations should review the Act and evaluate any changes it may necessitate to their existing governance structure and oversight procedures.

Classifications

Under the Act, theType A, B, C and D classifications[3] are eradicated, and nonprofits will be classified as either "charitable" or "non-charitable." Nonprofits that have already formed as Type A, B, C or D are not required to make any submissions or filings with a new classification. Type B and C organizations, as well as Type D organizations formed for a charitable purpose, will be automatically considered "charitable." Type A and all other Type D entities will be considered "non-charitable."

Electronic Communication

The Act provides that copies of board and membership meeting notices may be transmitted by fax or email and posted on the homepage of any website maintained by the nonprofit organization. Electronic communication may also be used for waiver of notice, proxy designations by members and for members and directors to give unanimous written consent in lieu of an in-person meeting. The Act also permits board members to participate in meetings through video communication (such as Skype), unless restricted by the corporation's certificate of incorporation or bylaws. Participation through such means shall constitute in-person presence at a meeting, provided that all members can hear each other at the same time.

Mandatory Conflicts of Interest Policy

The Act creates a new Section 714-a which mandates that all nonprofits adopt a conflict-of-interest policy requiring its directors, officers and key employees to act in the nonprofit's best interest. The conflict of interest policy must at a minimum include the following: (1) a definition of the circumstances that constitute a conflict of interest; (2) procedures for disclosing a conflict to the audit committee or the board; (3) a requirement that the individual with the conflict of interest not be present at or participate in board or committee deliberations or voting on the matter considering such conflict; (4) a prohibition on any attempt by the person with the conflict to influence board deliberations; (5) procedures for documenting the existence and resolution of the conflict; and (6) procedures for disclosing and addressing related-party transactions. Prior to the initial election of a director, and annually after that, such director must complete a written statement identifying any potential conflict of interest known to the director.

Related-Party Transaction

The Act prohibits nonprofits from entering into a transaction with a related party unless the nonprofit's board determines that the transaction is fair, reasonable and in the nonprofit's best interest.

A "related party transaction" is defined by the Act as any transaction, agreement or 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. The definition of a "related party" is: (1) any director, officer or key employee of the corporation or any affiliate of the corporation; (2) any

relative[4] of any director, officer or key employee; or (3) any entity in which any individual defined in (1) or (2) has a 35 percent or greater ownership or beneficial interest, or for a partnership or professional corporation, a direct or indirect ownership interest in excess of five percent.

For charitable nonprofits, an independent board, or committee of the board, must: (1) consider alternative transactions to the extent available; (2) approve the transaction as fair and reasonable through a majority vote; and (3) contemporaneously document its approval of the transaction and consideration of alternative transactions. A related party is prohibited from participating in the deliberations or vote concerning the transaction, but may provide information relating to the transaction if requested. The Attorney General may bring an action to enjoin, void or rescind any transaction or proposed transaction between a nonprofit and a related party that was unreasonable or not in the best interest of the nonprofit at the time the transaction was approved.

Mandatory Whistleblower Policy

The Act creates a new Section 715-b which requiresnonprofits with 20 or more employees and an annual revenue in excess of $1 million in the prior fiscal year to adopt a whistleblower protection policy. The whistleblower policy must include: (1) procedures for reporting violations and suspected violations of laws or policies, including procedures for preserving the confidentiality of reported information; (2) a designated employee, officer or director tasked with administering the policy and reporting to the audit committee or other committee of independent directors[5] or if no such committees exist, to the board; and (3) a requirement that copies of the policy be provided to employees, officers, directors and volunteers.

Audit and Financial Procedures

All organizations subject to registration for charitable solicitation that have gross revenues in excess of $500,000 per year and are subject to the requirement to file an independent auditor's report with the Attorney General[6] must have a designated audit committee of the board comprised of independent directors responsible for retaining an independent auditor and reviewing the results of the audit. The audit committee is also responsible for overseeing adoption, implementation and compliance with the conflicts of interest and whistleblower policies.

The Act also raises the revenue thresholds for organizations conducting charitable solicitations in New York which are required to file financial reports with the Attorney General. Organizations with gross revenues under $250,000 (previously $100,000) must file unaudited financial statements signed by the chief financial officer and president or other authorized officer, under penalties of perjury. The Act raises the threshold from $250,000 to $500,000 for organizations that must file annual financial statements accompanied by an independent CPA's audit report with an opinion that the financial statement and balance sheet fairly present the financial operations and position of the organization. Organizations with gross revenues in the $250,000 to $500,000 range must file audited financial reports with an independent CPA's review report.

Real Estate Transactions and Approval Requirements

Currently, many nonprofits must obtain the approval of the New York Supreme Court and provide notice to the New York Attorney General before they may engage in certain transactions such as sale, lease, exchange or other disposition of substantially all assets. The Act provides a simplified process where the organization may seek approval of the Attorney General instead of going through a court proceeding for transactions such as dissolution, merger, consolidation and change of purposes. The Attorney General may either grant the action or require it to be submitted for the approval of the New York Supreme Court.

In addition, the Act changes the requirement that organizations with an education purpose as defined by the New York Education Law seek approval of the New York Commissioner of Education prior to incorporation. Under the Act, only those organizations whose purpose is to operate a "school, university, library, museum, or historical society" must seek such approval. Other organizations need only provide notice to the Commissioner of Education within 10 days of incorporation.

The Act lessens the voting requirements for certain real estate transactions. Under the Act, a simple majority vote will be required (instead of the current two-thirds vote) for any real estate transaction where the property does not constitute all, or substantially all, of the non-profit's assets. If the property does constitute all or substantially all the

assets, the voting requirement remains at two-thirds vote (unless there are 21 or more board members, in which case a majority is sufficient).

Other

The Act prohibits an employee from serving as chair of the board or in an officer position with similar responsibilities.[7] In addition, individuals may not be present or participate in any board or committee deliberation or vote concerning compensation if that individual may benefit from such compensation subject to the deliberation or vote. The Act further requires that all compensation paid to members, directors and officers, as well as key employees, be fair, reasonable and commensurate with the services provided to the organization. "Key employee" is defined as "any person who is in a position to exercise substantial influence over the affairs of the corporation."

The Act includes a new definition of "entire board." If the board size is provided as a range between a minimum and maximum number of trustees, any reference to the "entire board" refers to the number of trustees elected as of the most recent election. Finally, the Act simplifies the classification of board committees by eliminating any distinction between standing and special committees.

If the Act becomes effective as anticipated, nonprofits incorporated in New York — and those required to register in New York to solicit contributions — should familiarize themselves with the Act's extensive reforms.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] The provision of the Act concerning financial audits and financial reporting to the Attorney General (as described herein and in the Act) applies more broadly to *all* nonprofits required to register in New York in order to solicit contributions.

[2] The full text of the Act can be found at: http://open.nysenate.gov/legislation/bill/A8072-2013.

[3] Previously, nonprofits were classified as either: Type A (formed for any lawful non-business purpose including but not limited to civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, animal husbandry, and for a professional, commercial, industrial, trade or service association); Type B (formed for any one or more of the following non-business purposes: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals); Type C (formed for any lawful business purpose to achieve a lawful public or quasi-public objective); or Type D (when such formation is authorized by any other corporate law of the state for any business or non-business, or pecuniary or non-pecuniary purpose specified by such other law).

[4] A "relative" includes an individual's spouse, domestic partner, child, grandchild, great-grandchild, sibling, half-sibling, ancestor or the spouse of the individual's child, grandchild, great-grandchild or sibling.

[5] The Act includes a new definition of "Independent Director": an individual who meets all of the following: (1) has not been an employee of, or does not have a relative that was a key employee of, the corporation or an affiliate of the corporation in the past three years; (2) has not received, or does not have a relative that has received, $10,000 or more in direct compensation from the corporation or an affiliate in the last three years (with the exception of expense reimbursement or reasonable compensation as a director); (3) is not a current employee of or does not have substantial financial interest in an entity that made or received payments from the corporation or an affiliate of more than $25,000 or two percent of the corporation's gross revenue for property or services (whichever is less) in the last three years; and (4) does not have a relative who is a current officer of or has a substantial interest in an entity making or receiving payments of a similar amount to the organization in the past three years.

[6] Pursuant to Section 172-b of the New York Executive Law.

[7] This provision has an effective date of Jan. 1, 2015.

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