ALERTS

Further Amendments to the Nonprofit Revitalization Act of 2013 Signed into Law

January 12, 2017

On Nov. 28, 2016, Governor Andrew Cuomo signed legislation further amending the Nonprofit Revitalization Act of 2013 (the "Act"). As discussed in previous *Alerts*,[1] the Act amended New York's Not-for-Profit Corporation Law (the "N-PCL") for the first time in 40 years. The most recent set of amendments (the "Amendments") are expected to ease compliance with the Act's related party transaction and independent director rules. This *Alert* summarizes certain significant provisions of the Amendments, which take effect on May 27, 2017.[2]

Related Party Transactions

The Act provided that an organization may not enter into a "related party transaction," defined as "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," unless the transaction is determined by the board (or committee) to be fair, reasonable and in the corporation's best interest. The Amendments loosen the related party transaction rules to allow for three exclusions:[3]

- Where "the transaction or the related party's financial interest in the transaction is de minimis;"
- Where "the transaction would not customarily be reviewed by the board, or boards of similar organizations, in the ordinary course of business and is available to others on the same or similar terms;" or

- Where "the transaction constitutes a benefit provided to a related party solely as a member of a class of the beneficiaries the corporation intends to benefit as part of the accomplishment of its mission which benefit is available to all similarly situated members of the same class on the same terms."[4]

The Amendments also revise N-PCL 715(a) to allow an authorized committee of the board to ratify related party transactions. This change eases the burdens on full boards regarding related party transaction approval.

Finally, the Amendments add a new section to the N-PCL which provides nonprofit organizations with ratification as a limited statutory defense to an action by the attorney general for violation of related party transaction rules. Previously, the N-PCL did not allow any method for an organization to approve a related party transaction after it was entered into. The new section provides that a nonprofit may use ratification as a defense if: (1) the transaction was fair, reasonable and in the best interests of the nonprofit at the time the corporation approved the transaction; and (2) prior to receiving any request for information regarding the transaction from the attorney general, the board has ratified the transaction following the procedure that should have been utilized before the transaction was entered into, documented in writing the nature of the violation and the basis for the board's approval, and simultaneously put into place remedial procedures to ensure the rules are followed properly in the future.

Independent Directors

The N-PCL provides that certain functions related to accounting and financial reporting must be performed by an audit committee made up solely of "independent directors" (or the independent directors of the full board). The definition of "independent director" excludes individuals who are employees of, or individuals who have a substantial financial interest in, any entity that previously engaged in financial transactions with the organization. The Amendments provide for a sliding scale for disqualification from independence only in certain circumstances based on the entity's gross revenues and the individual's salary. This change permits an individual to serve as an "independent director" where he or she has received an unsubstantial amount of money from the organization.[5]

Additionally, the Amendments provide that the term "payment" will not include payments at "fixed or non-negotiable rates or amounts for services received, provided that such services by and to the corporation are available to individual members of the public on the same terms and such services received by the corporation are not available from another source." This change allows payments for routine services (like utility companies) without concern that employees of such companies cannot serve as independent directors of the organization's board.

Finally, the definition of "independent director" will be expanded by the Amendments to exclude "key persons" of an organization or its affiliates (as defined below), in addition to employees.

Key Person

The Amendments replace the term "key employee" from the Act with the term "key person." The previous definition of "key employee" — any person in a position to exercise substantial influence over the organization (the definition also made reference to the Internal Revenue Code and to Treasury Regulations) — caused a great deal of confusion for nonprofit organizations because certain individuals (i.e., a substantial donor to the organization) could have been considered a "key employee" even having never been employed. Additionally, "related party" previously included "any other person who exercises the powers of directors, officers or key employees over the affairs of the corporation or any affiliate of the corporation," causing confusion because of its repetitiveness and ambiguity. That part of the definition of "related party" has been struck, because the new "key person" definition includes individuals exercising the powers of directors, officers or key employees.

The Amendments now define a "key person" as any individual (other than a director or officer because they are already defined as related parties), whether or not an employee of the organization, who: "(i) has responsibilities, or exercises powers of 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."[6]

Whistleblower and Conflicts Policies

The N-PCL mandates that most nonprofits adopt a conflict of interest policy and a whistleblower policy. The Amendments remove the requirement that the audit committee or a committee composed solely of independent directors oversee the implementation of and compliance with the conflict of interest and whistleblower policies; the board itself must oversee such implementation of and compliance with the policies. Additionally, if the board has not officially voted to adopt the conflict of interest and whistleblower policies, it should do so (before May 27, 2017).

The Amendments prohibit an employee who is also a director from participating in any deliberations concerning the administration of whistleblower policies. Additionally, any person who is the subject of a whistleblower complaint may not be present at or participate in deliberations or voting on the matter (though such individual may present background information or answer questions before the deliberations and voting). Nonprofits should amend their whistleblower policies accordingly.

Committees and the Board

Currently, creation of a committee of the board requires the vote of a majority of the entire board. The Amendments provide that a committee of the board may be established by a majority of directors present at a meeting at which a quorum is present, with the exception of the executive committee, which still requires a majority of the entire board appoint the members.[7] The Amendments also add to the list of powers that may not be delegated to committees. The additional powers that are exclusive to the full board 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 action on the sale, lease, exchange or other disposition of all or substantially all the assets of a corporation or, if there are no members entitled to vote, the authorization of such transaction; and to approve amendments to the certificate of incorporation. Organizations should review their bylaws to ensure that no committee has these powers.

Lastly, while the Act added a provision prohibiting any employee of a nonprofit from serving as the chair of the board of that organization (or any other title with similar responsibilities), the Amendments remove this prohibition and permit an employee to serve as chair if the board

approves the appointment by a two-thirds vote of the entire board, and if the board documents the basis for its approval in writing contemporaneously. This provision, unlike the other changes, became effective on Jan. 1, 2017.

Actions for Nonprofit Boards

While the Amendments do not specifically mandate that nonprofit organizations amend governing documents, we recommend that all New York nonprofit organizations review their bylaws and make changes where appropriate. Additionally, all organizations should review and revise their conflict of interest and whistleblower policies in light of the definitional and other changes provided by the Amendments.[8]

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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] See our prior *Alerts*: "Amendments to the New York Nonprofit Revitalization Act of 2013 Signed into Law," "The Nonprofit Revitalization Act of 2013 Takes Effect on July 1, 2014" and "The Nonprofit Revitalization Act of 2013."

[2] With the exception of the provision regulating the selection of an employee to serve as chair which took effect on Jan. 1, 2017.

[3] These exceptions codify the guidance from the New York attorney general in its Guidance Document issued April 13, 2015.

[4] N.Y. Not-For-Profit Corp. § 102(a)(24).

[5] Where an organization receives payments from or makes payments to another entity subject to the N-PCL, a director may still be "independent" even if employed by, or holding a financial interest in, the other entity if the amount paid or received during each of the past three fiscal years is: (a) less than $10,000 or two percent of the organization's consolidated gross revenues if the organization's consolidated gross revenues are less than $500,000; (b) less than $25,000 (no reference to a percentage of gross revenues) if the organization's consolidated gross revenues are between $500,000 and $10 million; or (c) less than $100,000 (no reference to a

percentage of gross revenues) if the organization's consolidated gross revenues are $10 million or more.

[6] N.Y. Not-For-Profit Corp. § 102(a)(25).

[7] Unless the Board has 30 or more members, in which case the required vote is three-fourths of the directors present at the time of the vote, provided there is a quorum.

[8] In addition to the changes set forth by the Amendments, a New York court recently ruled that the Act contains an implied private right of action for failing to protect whistleblowers from retaliation. See our prior *Alert*: "New York Court Finds Implied Private Right of Action in Nonprofit Revitalization Act's 'Whistleblower Policy.'"

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