

Still More Changes Affecting Not-For-Profit Corporations

July 6, 2017

In 2016, New York amended its Not-For-Profit Corporation Law once more, building upon the New York Non-Profit Revitalization Act of 2013 (“the Act”), and the changes (“the Amendment”) took full effect as of May 27, 2017. This advisory summarizes the Amendment’s most important changes.

Streamlined Committee Formation Procedures and Additional Non-delegable Powers

The Amendment makes it easier to create board committees; to do so, only a majority vote at board meetings where there is a quorum is needed. Previously, a majority vote of the entire board was required. To form committees with executive powers (regardless of whether they have the name), a majority vote of the entire board is still required; for boards with 30 or more members, executive committees can be formed by a three-quarters majority of those present where there is a quorum.

The Amendment also adds four non-delegable powers to the existing list. They are:

- approving amendments to the nonprofit’s certificate of incorporation;
- approving plans of merger or dissolution;
- electing and removing nonprofit officers and directors; and
- adopting resolutions recommending to members of the nonprofit the sale of all or substantially all corporate assets, or authorizing such a transaction if the nonprofit has no members.

Relaxed “Related Party Transaction” Provisions

The Amendment relaxes slightly the Act’s restrictions on “related party transactions.” The Act allowed all such transactions only where the board found them fair, reasonable, and in the corporation’s best interests. Now, the Amendment further allows such transactions where:

- the transaction itself or the related party’s financial interest in the transaction is *de minimis*;
- the transaction customarily would not have been reviewed by the nonprofit’s board or boards of similar organizations, and its terms are available to others on the same or similar terms; or
- the transaction benefits a related party who realizes such a benefit solely by being of a class the nonprofit seeks to benefit through executing its mission, and the transaction’s terms are available to similarly situated members of that class on those same terms.

It is important to note that there has been no guidance since the Amendment took effect as to what

kinds of transactions will be deemed *de minimis* or how the degree of similarity between various boards and nonprofits is to be assessed.

The Amendment also streamlines an organization's ability to review the propriety of these transactions. Before, the Act conferred this power to the board alone; now, under the Amendment, boards may delegate this reviewing power to committees. For situations where the transaction was improper, the Amendment also provides a limited defense. To invoke it, a board must have:

- ratified the improperly authorized transaction prior to receiving the Attorney General's request for information as fair, reasonable, and in the corporation's best interests;
- documented the nature of the violation and the basis for ratification; and
- adopted procedures to prevent future violations.

Broader Definition of a "Related Party" in Related Party Transactions

Here, the Amendment may potentially be more restrictive than the Act by having a broader definition of "related parties". While the Amendment keeps the Act's inclusion of directors and officers, it replaces the Act's category of "key employee" (a Federal tax concept) with the arguably broader one of "key person." This new definition confirms that related parties include not only employees but also nonemployees who:

- have responsibilities, or exercise powers or influence over the corporation as a whole similar to those of a director or an officer;
- manage the corporation, or a substantial portion of the corporation's activities, assets, income, or expenses; or
- control or determine a substantial portion of the corporation's capital expenditures or operating budget either alone or with others.

The Amendment may now affect transactions that were once beyond the scope of the Act.

More Flexible Guidelines for Determining Directors' Independence

The Act originally required that certain oversight functions like financial auditing, resolving whistleblower issues, and addressing conflicts of interest be conducted by committees or boards consisting solely of independent directors. The Amendment removes this independence requirement.

The Amendment also revised the standards for evaluating a director independence. Key persons of a nonprofit and its affiliates are, by definition, not independent. Directors' independence is determined on a scale. They are not independent if, in any of the three prior fiscal years, their financial interest in an outside entity making payments to or receiving payments from the nonprofit exceeds these levels:

<i>External Entity's Annual Consolidated Gross Revenue</i>	<i>Disqualifying Threshold of Director's Financial Interest in Entity (Not to Be Exceeded in Any of the Three Preceding</i>
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	<i>Fiscal Years)</i>
Less than \$500,000	Lesser of \$10,000 or 2% of the entity's consolidated gross revenue
\$500,000 to \$10,000,000	\$25,000
More than \$10,000,000	\$100,000

When calculating whether a director's financial interest exceeds the threshold and is no longer independent, payments for services set at fixed or nonnegotiable rates are excluded, provided that the services are available to others on the same terms and cannot be obtained from another source.

Employees May Serve As Chairs of Boards

The Amendment removes the Act's prohibition on employees serving as chairs of their nonprofits' boards or acting in similar capacities. They can serve if two-thirds of the entire board approve the election and contemporaneously document in writing the basis for approval.

Addressing Whistleblowers and Conflicts of Interest

The Amendment prohibits directors from participating in board or committee deliberations regarding administration of whistleblower policies within the nonprofit. It further prohibits any employee who is the subject of a whistleblower complaint from participating in board or committee deliberations regarding the disposition of the complaint; such boards or committees, however, are permitted to request information from the employee prior to the start of their deliberations or voting.

Going forward, organizations may want to review their bylaws and policies to ensure that they are within the Amendment's strictures while taking full advantage of its increased flexibility.