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New State Measure Amends Nonprofit Revitalization Act of 2013

By Jeremy Wolk

In December 2013, Governor Andrew Cuomo signed into law the Nonprofit Revitalization Act of 2013. The NPRA contained many welcome changes for nonprofit organizations and eased the burdens relating to certain major corporate transactions. The NPRA also included changes directed at increasing operational transparency and optimizing fiduciary oversight, duplicating at the state level many safeguards in place in federal tax law for decades.

On November 28, Governor Cuomo signed into law legislation further amending the New York Not-for-Profit Corporation Law to improve and clarify the NPRA. While the amendments provide some relief, New York continues to impose extraordinary governance challenges on nonprofit organizations formed in the state. Most of these amendments go into effect on May 27, with the exception of the provisions relating to an employee serving as chair, which became effective on January 1.

To comply with the new law, nonprofit organizations will again need to update their bylaws and various policies, including those pertaining to conflicts of interest, whistleblower claims, and audit committee functions. Organizations may also want to adopt contract approval policies to set specific standards that are not defined by law.

Refined fiduciary standards

Related party transaction: the N-PCL amendments expand the “related party transactions” and prohibit nonprofits from entering into “related party transactions” without a prior finding of a governing board that such transaction was “fair, reasonable, and in the best interests” of the nonprofit. Under the NPRA, the failure to identify, assess, and address a “related party transaction” could constitute a breach of fiduciary duty. The difficulties experienced by fiduciaries in complying with the NPRA prompted the Attorney General’s Charities Bureau to subsequently publish non-binding guidance that excluded certain transactions from the “related party transaction” definition.

While nonprofits must still ensure that insider transactions are fair, reasonable, and in the best interests of the nonprofit, a failure to use the proscribed process in the NPRA no longer results in breach of fiduciary duty allegations, with one sole exception. The Charities Bureau may, however, still allege a breach where a nonprofit fails to (i) identify the related party transaction before receiving any pertinent request from the attorney general, (ii) ratify the transaction in accordance with an enhanced approval regime, (iii) memorialize the ratification in writing (including the nature of the “violation” and the basis for ratification), and (iv) institute procedures to ensure that the nonprofit will continue to satisfy the prior approval requirement in the future.

The 2016 amendments to the N-PCL redefine “related party transactions” to exclude (i) de minimis transactions, (ii) transactions not customarily reviewed by the board and offered on terms available to the public, and (iii) benefits provided to individuals as a member of a charitable class served. Nonprofits should establish written procedures to identify and approve related party transactions with the new statutory exceptions, and include standards for defining de minimis and “not customarily reviewed by

the board" transactions which are not defined in the amendments. It is unclear to what extent the prior guidance from the Charities Bureau still pertains.

Independent Director: the NPRA created a new standard of "independent directors" for the approval of specified corporate actions, bifurcating the governing board into those who possess full fiduciary oversight and those who do not. The identification of independent directors must be done prospectively, not based on the circumstances of any particular transaction or relationship before the board.

The 2016 amendments establish a sliding scale of financial thresholds based on gross revenue, and a director may still be independent if employed by, or having a financial interest in, an entity if the amount paid by or received from the nonprofit during each of the last three fiscal years is (i) less than $10,000 or 2% of the entity's consolidated gross revenues for entities with less than $500,000 in consolidated gross revenue, (ii) less than $25,000 for entities with more than $500,000 but less than $10 million in consolidated gross revenues, and (iii) less than $100,000 for entities with more than $10 million in consolidated gross revenue.

The amendments carve out from the amounts paid by or received from the nonprofit by the independent director any charitable contributions, expense reimbursements, and reasonable director compensation. There is also a new exception for fixed payments for services received, provided that such services by and to the nonprofit are available to individual members of the public on the same terms and are not "available from another source." How such standard can be satisfied in practice remains unclear.

Key persons: The amendments also revise the standard to determine individuals that are a "related party" to focus on individuals, whether or not they are employees, who have actual authority or influence over decisions the nonprofit organization makes by (i) having responsibilities, or that exercised power or influence over the nonprofit similar to those exercised by directors and officers; (ii) managing the nonprofit or a part of the nonprofit that represents a substantial portion of the activities, assets, income or expenses of the nonprofit; or (iii) controlling, alone or with others, or determines a substantial portion of the nonprofit's capital expenditures or operating budget. As the term "substantial" is not defined in the N-PCL, nonprofits are left to establish a standard that is reasonably defined and easily implemented.

Committee updates

The 2016 amendments expand the powers that cannot be delegated to committees, such as the authority to elect or remove officers or directors, or to approve strategic transactions like a merger or sale of substantially all of the nonprofit's assets. The amendments also refine the formation of committees, as the executive committee can now only be elected by a majority of the entire board unless there are 30 or more directors which would require a ¾ vote of directors present. All other committees of the board may now be elected by a majority of a quorum, similar to other board actions.

Employee as chair

Despite a prohibition originally contained in the NPRA, an employee may now serve as chair with documented approval by 2/3 vote of the entire board. The amendments also clarify that such an employee is not an independent director.

Policies

The NPRA required conflict of interest and whistleblower policies to be overseen and adopted by only "independent directors," but now these policies may be adopted by the board or designated committee of the board without reference to whether directors are independent. In addition, directors who are employees may no longer participate in deliberations relating to administration of a whistleblower policy and individuals subject to a whistleblower complaint cannot participate in deliberations relating to such complaint.