NEW YORK CITY BAR

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January 21, 2010

Frederick G. Attea
Phillips Lytle LLP
3400 HSBC Center
Buffalo, NY14203-2887

Re: Proposed Revisions to New York's Not-for-Profit Corporation Law

Dear Mr. Attea:

The Committee on Non-Profit Organizations (the NPO Committee) of the Association of the Bar of the City of New York has had the opportunity to review proposed state legislation (the 2009 Bill) to totally revamp the Not-for-Profit Corporation Law (N-PCL) introduced in the state legislature during the 2009-2010 session by Assemblyman Brodsky (Bill No. A5855) and Senators Flanagan and Volker (Bill No. S3678).[1] The 2009 Bill is based on a proposal approved by the Executive Committee of the New York State Bar Association in March 2007.

The NYSBA shared an earlier draft of its proposed bill with the NPO Committee in 2006. The NPO Committee sent comments to the NYSBA on that earlier draft by a letter dated December 14, 2006.[2] The 2009 Bill reflects many of the comments noted in our 2006 letter.

We are submitting this letter and attachments regarding the 2009 Bill to you (as a representative of the NYSBA) rather than commenting to the state legislature on the bill since we believe that it would be beneficial for our two groups to work together to discuss and prepare a revised proposal for submission to the legislature. We hope that your group is receptive to this idea.

[1] The bill was introduced in the Assembly on February 20, 2009 and in the Senate on March 27, 2009. A copy of the bill and a legislative summary are available at http://assembly.state.ny.us/leg/?bn=A05855. A similar bill was introduced in 2008 (A11042).

[2] Available at http://www.nycbar.org/pdf/report/NYCBar.pdf.

As you know, on November 2, 2009 the NPO Committee hosted a public forum at the City Bar, entitled *Ideas for Change: A Conversation About Reforming New York Nonprofit Law and Regulations*, which consisted of a two and half hour panel discussion with representatives from the legislature, practitioners, academics and regulators.[3] In preparation for the session, a subcommittee of the NPO Committee prepared an analysis of the 2009 Bill, which was circulated to the panelists. That analysis, however, did not represent a formal position by the NPO Committee. Following the November 2nd forum, the NPO Committee reviewed the prepared analysis and comments made at the forum and, on the basis of such information, has prepared this comment letter and its attachments.

Why Reform of the N-PCL is Timely

New York has long been one of the premier locations in the country for nonprofits.[4] The role that nonprofits play in the state has been crucial to New York's economy and its cultural and political importance.

The N-PCL was adopted in 1970, almost 40 years ago, replacing the Membership Corporation Law.[5] It is a blending of the provisions of the Business Corporation Law, enacted in 1961, and the prior Membership Corporation Law. New York's N-PCL includes many provisions unique to New York, which, presumably unintentionally, create delays in forming and burdens in operating New York nonprofit corporations.

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[3] The panelists were Frederick G. Attea, Phillips Lytle LLP and Michael A. de Freitas, William C. Moran & Associates, P.C. of the Committee on Revision of the Not-for-Profit Law, New York State Bar Association; Assemblyman Richard L. Brodsky, the Chairman of the NYS Assembly Standing Committee on Corporations, Authorities, and Commissions; Allen Bromberger of Perlman & Perlman, LLP; the author of *Getting Organized* and *Advising Nonprofits* and former Executive Director of Lawyers Alliance for New York; James Fishman, a professor at Pace University School of Law and co-author of New York Nonprofit Law and Practice; Pamela Mann of the Law Offices of Pamela Mann, LLC, a former Chief of the Charities Bureau of the NY State Attorney General's Office; Barbara Schatz, a professor at Columbia Law School and the Director of the Columbia Law School Nonprofit Organizations/Small Business Clinic and Chair of the Nonprofit Working Group. The panel was moderated by David W. Lowden of Stroock & Stroock & Lavan, LLP on behalf of the NPO Committee. Representatives of the Division of Corporations, State Records and Uniform Commercial Code of the New York State Department of State (Gary M. Trechel, Associate Attorney), the Education Department (Erin O'Grady-Parent, Acting Counsel and Deputy Commissioner for Legal Affairs) and the Charities Bureau of the Office of the Attorney General (Karin Kunstler Goldman) were also in attendance as acknowledged observers.

[4] According to the National Center for Charitable Statistics, there were 98,503 New York-based nonprofit corporations as of December 2008, the highest number of nonprofit corporations of any state other than California. New York nonprofits are larger, however, with total revenue of $244 billion compared to California's $217 billion. See http://nccsdataweb.urban.org/NCCS/V1Pub/index.php – Registered Nonprofit Organizations by State.

[5] The Membership Corporation Law (MCL) was adopted in 1895. It consolidated into one statute the laws applicable to all corporations not organized for pecuniary profit, excluding religious corporations and educational corporations. Another law, the General Corporation Law (GCL), applied to all corporations (whether stock, municipal or charitable) but the provisions of the Membership Corporation Law that applied to the covered institutions would supersede any contrary provision in the GCL. The applicable internal governance provisions were generally set forth in the GCL. The MCL superseded an 1848 general incorporation statute applicable to all charitable organizations; charitable corporations formed prior to that time were generally incorporated directly by the legislature. Many corporations formed under the MCL and a few corporations formed by legislative act remain in New York.

Delays in the formation stage (and the corresponding process of qualifying out-of-state nonprofit corporations to conduct activities in New York) are created by requirements such as the need to determine what "type" the nonprofit is (with confusion over the correct "type" often leading to rejection of certificates of incorporation and certificates of authority for foreign corporations) and also the need to obtain pre-formation consents from one or more state agencies, which can be a lengthy process. Experience has demonstrated that the process of obtaining consents, while time-consuming, is also a meaningless exercise since consents are rarely, if ever, rejected. Until these various requirements are met, the organization cannot commence the groundwork that must be done before it can start operations, including obtaining Internal Revenue Service recognition of its tax exempt status and registering with state agencies to solicit funds. Burdens that exist in the operational phase include high vote requirements for certain board actions, cumbersome provisions for determining the number of directors and forming committees, required state agency consents for certain changes and, although recently improved, a very cumbersome process for dissolution.

Due to the difficulties faced in formation and operation, as well as potential dissolution, many New York nonprofit lawyers counsel their nonprofit clients to incorporate outside of New York even if the organization plans to be based in New York. While the need to determine a type and obtain consents will resurface when the entity later makes application to conduct activities in New York as a foreign corporation, by incorporating elsewhere the organization can, at least, start the process of obtaining IRS clearance and laying the groundwork for operations sooner.

Furthermore, such out-of-state corporations are free from the burdensome operational requirements imposed by New York law. A key fact to always bear in mind is that under the principles of federalism a nonprofit can be formed in any state (such as a state that does not require as many cumbersome provisions as are required under New York laws and practices) and another state cannot bar such nonprofits from conducting activity in their state so long as the nonprofit satisfies the relatively modest requirements to qualify to conduct activities in such state. Furthermore, under the internal affairs doctrine, the laws of the state of formation generally govern the corporate procedures for such organization.

While many of the difficulties faced by nonprofit corporations formed in New York arise from the provisions of New York's N-PCL, some of these difficulties are found at the administrative level, where nonprofit corporations frequently experience delays and other costly problems in obtaining necessary governmental consents. This combination of statutory and administrative hurdles make it more difficult for nonprofit corporations to perform the services for which they were (or hope to be) established and discourage them from forming, and in some cases from operating, in New York.

Accordingly, many New York nonprofits form outside of New York. By being too strict in trying to supervise nonprofits, New York drives them out of state, thereby having less ability to supervise such nonprofits.

The NPO Committee supports the efforts to revise New York's nonprofit law to better help the nonprofit community and those it serves. The goal to be achieved is not to have a "pro corporation," "pro public" or "pro regulatory" law; it is to have a workable law that will serve the interests of New Yorkers by not encouraging nonprofit corporations to form under the laws of other states or leave the state..

Alternative Approaches to Reform

The NYSBA's proposal is to do a top-to-bottom revision of the N-PCL. Others might prefer to reform the specific provisions of the N-PCL that are the most problematic (you might call this a "top 10 list" approach), either as one bill targeting the provisions that should be changed or separate bills addressing each issue. We note that some legislators are proposing amendments to specific sections of the N-PCL.[6]

In the attachments to this comment letter we have expressed our views on all aspects of the N-PCL, including the changes proposed by the NYSBA and additional changes that we support (or think should be considered), and leave for later decision whether it is strategically better to support a top-to-bottom revision of the N-PCL or to advocate a "top 10 list" approach.

We note that proposals to reform the N-PCL have not generally met with success in the state legislature and any reforms that have been made have taken numerous years of concerted action. We saw this with the revisions to the dissolution procedure that only passed the legislature in 2006 after efforts undertaken by the NPO Committee[7] (and others) during the tenure of three separate chairs (each of whom had a three year term). While there is much benefit to be derived from a top-to-bottom rewrite, since both large and small problems can be addressed, such approach is obviously a more complex undertaking than legislation to address specific issues. The former approach requires more study on the part of the legislators and may give rise to more opposition since someone opposing one change may then oppose all changes. The latter approach may have a greater likelihood of success, since the proposals are more easily understood and those in opposition to one change may not oppose other changes. It became apparent at the November 2nd forum that even the legislator who introduced the 2009 Bill may feel that a top-to-bottom rewrite is too complex and too hard to explain.
Which approach is better depends on real world factors. While we may prefer to see all of the flaws of the current law fixed, it may be more expeditious to push to fix only the most problematic provisions. As has often been noted in other contexts, sometimes the "best" is the enemy of the "good."

Whatever approach is taken, it is clear that a stronger case needs to be made for why reform is crucial. It is not sufficient to merely point out the problems with existing provisions; it is imperative to show that, unless New York's law is reformed, it will be ignored – either by more sophisticated organizations going out-of-state to form or by smaller organizations totally ignoring the requirements of the law. A constituency that includes others in the nonprofit community (not just lawyers and accountants) will need to be made aware of why reform is something they should lobby for and legislators will need to be convinced that reform is beneficial for all New Yorkers, not just managers of or professional advisors to nonprofits. It will also be crucial to get input from the Charities Bureau of the Department of Law, and from

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[6] So far during the 2009-2010 legislative session, bills have been introduced to eliminate the Type C corporation (A6381), to allow corporations to exculpate directors and officers from liability for certain damages (S2138), to require certain provisions regarding conflicts of interest and director training to appear in the certificate of incorporation (A5927) and to eliminate the requirement that addresses of the initial directors appear in the certificate of incorporation (A6381).

[7] The NPO Committee was chaired at that time that such legislation passed by David G. Samuels of Duval & Stachenfeld LLP.

other affected agencies (including the Department of State and Education Department) so that any legislative proposal could have a chance of success.

If a more focused approach is to be taken, we would suggest that it at least include the following topics. (We view the first nine as important provisions that should be addressed to avoid the current situation which encourages new nonprofits to form out-of-state; we view the tenth as important to strengthen governance practices.)

1. Elimination of consent requirements prior to formation under Section 404 (this is a component of the 2009 Bill).

2. Elimination of types under Section 201 (this is a component of the 2009 Bill).

3. Elimination of vote requirements based on a majority (or higher) of the "entire board,"[8] including for real estate transactions (Section 509), asset sales (Section 510), formation and composition of board committees (Section 712) and officer salaries (Section 715); such actions should be approvable by majority vote at a meeting at which a quorum is present or some lesser standard than a majority of the entire board (this is an expansion of the position taken in the 2009 Bill, which only addresses Section 715).

4. Revision of the provisions regarding member and director action to allow electronic notice of meetings for members and directors and member and director action by electronic communications under Sections 605, 614, 708 and 711 (this is an expansion of the position taken in the 2009 Bill, which only addresses the use of electronic communications for notice of member meetings).

5. Revision of the provisions regarding boards to allow the size to be set by the board, instead of being required to be set in the by-laws under Section 702 (this is not reflected in the 2009 Bill).

6. Revision of provisions regarding committees under Section 712, including allowing more practical procedures for the appointment of the members of board committees while still requiring that the members of key committees be approved or ratified by the directors , and eliminating the requirement that all committees (excepting an executive committee) have at least three directors as members (this is an expansion of the position taken in the 2009 Bill, which only eliminated the distinction between standing and special committees).

7. Elimination of the need for court approval (but not Attorney General approval) of (a) asset sales under Section 510, (b) changes of purposes under Section 806, (c) mergers and consolidations under Article 9 and (d) dissolutions under Article 10, and, in some instances, other changes to expedite or simplify such procedures; we would, however, support a right to appeal to the courts should the Attorney General deny approval (this is an expansion of the position taken in the 2009 Bill).

[8] The "entire board" is the number of directors fixed by the by-laws, including vacancies. Since the quorum for board meetings can be set as low as one-third of the entire board, meetings are often validly held without a majority of the entire board being in attendance.

8. Elimination of the need to give names and addresses of initial directors in the certificate of incorporation under Section 404, as well as reduction of other rights to obtain such names and addresses under Section 718 (these are components of the 2009 Bill).

9. Modernization of Department of State filing procedures, by clarifying that the certificate of incorporation does not need to describe the activities of the corporation, authorizing (for a fee) the Department of State to "preclear" filings prior to formal submission and allowing the Department of State to make hand corrections to filings to correct minor errors with the consent of the filer (these issues are not addressed in the 2009 Bill).

10. Reformulation of the provisions of the N-PCL regarding fiduciary duties of directors and officers and conflicts of interest. While these provisions do not, we feel, impact on the initial decision of nonprofits to form in New York or elsewhere, the current environment calls for a greater emphasis on good governance practices. We feel that inclusion of provisions to clarify the role and responsibilities of directors and officers would also help convince legislators as to why reform of the N-PCL would be wise.

While we believe that adoption of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) should also be part of any "top 10 list,"[9] we have not commented on such matter in the context of the 2009 Bill. We understand that legislation has been introduced in the 2009/2010 session which would adopt UPMIFA.[10]

The Form of Our Comments

First and foremost, we agree with the NYSBA that reform of the N-PCL is crucial, whether the change comes through a top-to-bottom rewrite of the existing statute or, alternatively, by changes to the most problematic provisions.

As will be seen from our comments, we support most of the changes recommended by the 2009 Bill. We think, however, that certain other crucial changes should also be added to the reform bill to address existing problems not addressed by the proposed bill (some of these are noted in our listing of topics that should be addressed by any "top-10" approach).

Our commentary consists of this cover letter and two attachments:

- a brief summary of the major changes proposed by the 2009 Bill and further changes which the NPO Committee believes are appropriate (Attachment One), and

- a more detailed section-by-section summary of those provisions of the N-PCL proposed to be changed by the 2009 Bill and our additional suggestions (Attachment Two).

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[9] See the letter dated August 10, 2007 from the NPO Committee to the Drafting Committee on UPMIFA, a copy of which is available at http://www.nycbar.org/pdf/report/Charitable_organizations.pdf, and the NPO Committee's Report in Support of New York's Adoption of the Uniform Prudent Management of Institutional Funds Act, with Suggested Modifications (April 7, 2009), a copy of which is available at http://www.nycbar.org/pdf/report/UPMIFA_09.pdf.

[10] S4778, introduced by Senator Liz Krueger, and A.7907, introduced by Assemblyman Jonathan Bing. It would amend various provisions of Article 5 (including Sections 512, 514 and 522) and certain definitions in Section 102 regarding management of endowments and other investment funds.

Our commentary on the 2009 Bill and on additional changes which we propose are noted on the attachments in italics. While we have proposed wording changes for some sections, other sections of our commentary do not include detailed language. We hope to be able to discuss such detailed comments at a later time at meetings between representatives of our two groups.

We have also prepared a copy of the 2009 Bill marked to show changes from the existing statute, which we enclose with this letter.

Please note that we may have additional comments on the 2009 Bill beyond those set forth in the attachments as we continue our review and we are not at this time taking a position on whether to support adoption of the bill as currently proposed, pending an opportunity to further work with you in revising the reform proposal.

As noted in our December 14, 2006 letter, we stand ready to work with the NYSBA to advance the worthy goal of N-PCL reform.

Respectfully submitted,

Eliot P. Green, Chair

cc: David W. Lowden

Committee Members:

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Kenneth W. Sussman, Non-Voting Secretary

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Edward Berkovitz, member
Sally Blinken, member
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ATTACHMENT ONE

SUMMARY OF MAJOR CHANGES PROPOSED BY THE 2009 BILL AND FURTHER IDEAS FOR CHANGE

A. Major Changes Proposed by the 2009 Bill

Major changes to the N-PCL as proposed by the 2009 Bill include the following (NPO Committee comments are noted in italics):

- **Elimination of Consent Requirements Prior to Formation**. The 2009 Bill would eliminate the need to obtain most forms of consent currently required prior to incorporation of a new nonprofit; the nonprofit corporation would instead need to give notice shortly after incorporation to the agencies that relate to the purpose of the organization and, as always, the nonprofit would need to abide by the regulatory requirements of such agencies. See Section 404. New language would be added to emphasize that nonprofit corporations would still be subject to substantive requirements of, and regulation by, state agencies and therefore should not commence activities until such requirements are satisfied. See Section 103-A. Similar provisions would apply for foreign corporations. See Section 1304(c).

  We support the elimination of the requirement to obtain certain consents prior to incorporating or qualifying in New York. Such requirement is one of the prime deterrents for nonprofits forming in New York. The delay created by this requirement is often so lengthy that many nonprofits that want form in New York give up and instead incorporate elsewhere. Experience has demonstrated that the process of obtaining consents, while time-consuming, is also a meaningless exercise since consents are rarely, if ever, rejected.

  All state agencies will need to be queried as to their reaction to this proposal; without their approval it is unlikely that this change will be enacted. The theory of the bill is that state agencies can still impose substantive requirements on the activities of nonprofits in New York. The bill requires that prompt notice be given to regulatory agencies after formation by all nonprofits that currently have to seek consent from such agencies. It is logical to expect those agencies to then contact the new nonprofit to alert the nonprofit as to the need to satisfy regulatory requirements. We note, however, that some agencies may currently use the pre-formation consent process as a way to require nonprofits to accede to agency requirements that are not otherwise memorialized in regulations. Consideration should therefore be given as to whether there should be a delayed effective date for such provision in order to give state agencies a chance to issue new regulations memorializing these agency requirements. The need for such a

delayed effective date may be lessened if the process of this change is drawn out, thereby providing state agencies time to adopt revised regulations.

See our proposal in Section 404 of Attachment Two to require new nonprofits to identify in their certificates of incorporation or an accompanying form filed with the Department of State to the state agencies that they will be notifying, thereby allowing the Department of State to fulfill an audit function in its review of the certificate to ensure that all appropriate agencies receive such notice.

It may be necessary to revise other laws such as the Education Law, Social Services Law and Religious Corporations Law were consent requirements are set forth, to make conforming changes; a full review of such laws should be undertaken to ascertain what changes will be necessary.[11]

Pursuant to the Education Law certain corporations (primarily schools, museums and libraries) must be formed under that law through a charter issued by the Regents of the University of the State of New York. In addition, other corporations may receive a certificate of incorporation from the Regents under the Education Law. Currently the N-PCL and Education Law require that the Education Department consent to the formation under the N-PCL of any corporation that "might be chartered by the regents" under the Education Law. The two laws need to be refined on this point.

It is necessary to distinguish between "true" educational corporations, as to which the N-PCL should state that they must be formed under the Education Law, and those for which education is so peripheral that consent should not be

[11] For instance, **Section 216 of the Education Law** states, in part: "Charters. Under such name, with such number of trustees or other managers, and with such powers, privileges and duties, and subject to such limitations and restrictions in all respects as the regents may prescribe in conformity to law, they may… incorporate any university, college, academy, library, museum, or other institution or association for the promotion of science, literature, art, history or other department of knowledge, or of education in any way, associations of teachers, students, graduates of educational institutions, and other associations whose approved purposes are, in whole or in part, of educational or cultural value deemed worthy of recognition and encouragement by the university. No institution or association which might be incorporated by the regents under this chapter shall, without their consent, be incorporated under any other general law. An institution or association which might be incorporated by the regents under this chapter may, with the consent of the commissioner of education, be formed under the business corporation law or pursuant to the not-for-profit corporation law if such consent of the commissioner of education is attached to its certificate of incorporation." (emphasis added). See also **Section 460-A of the Social Services Law**, which states: "1. Unless the written approval of the department shall have been endorsed on or annexed to a certificate of incorporation, no such certificate shall hereafter be filed which includes among its corporate purposes the care of destitute, delinquent, abandoned, neglected or dependent children; the establishment or operation of any aged care accommodation, as defined in the private housing finance law, or adult care facility; the placing-out or boarding-out of children, as defined in this chapter; the establishment or operation of a home or shelter for unmarried mothers or a residential program for victims of domestic violence, as defined in subdivision four of section four hundred fifty-nine-a of this chapter; or the solicitation of contributions for any such purpose or purposes, provided, however, that the approval of the department shall not be required for filing of a certificate of incorporation which is restricted in its statement of corporate purposes to the establishment or operation of a facility for which an operating certificate is required by article twenty-three, nineteen, thirty-one or thirty-two of the mental hygiene law, or to the establishment or operation of a hospital, residential health care facility, or a home health agency, as those terms are defined in article twenty-eight of the public health law."

required. Currently, if the purpose clause in any way mentions "education," the Department of State has required a consent from the Education Department to file a certificate, even if it is otherwise clear that "education" is not used in the sense that would require that the organization receive a charter from the Regents.

We would suggest that the dividing line be drawn between those organizations which, under Education Department practice, are required to obtain a charter (i.e., colleges, universities, and other post-secondary institutions of learning, schools offering instruction at the levels from pre-kindergarten through secondary, libraries, museums, and historical societies and possibly public television and/or radio corporations), and those that can obtain a certificate of incorporation (i.e., "all other institutions and organizations having educational purposes deemed worthy of recognition and encouragement by the Regents"[12]). If the N-PCL is revised to eliminate the consent requirement for corporations that might be formed by the Regents but the Education Law is not similarly revised, the situation will only become more troublesome since a legal requirement for formation of nonprofit corporations will be buried in a law other than the N-PCL.

- **Elimination of Types**. The bill would eliminate the four "types" of nonprofit corporations that currently exist: Types A, B, C and D. Type A corporations include organizations for civic, political, social, fraternal, athletic, agricultural, or similar purposes or professional, commercial, trade or similar associations; Type B corporations are charitable organizations; Type C corporations are organizations formed for any lawful business purposes to achieve a lawful public or quasi-public; and Type D corporations are formed under the requirements of other laws. While the types would be eliminated, some of the provisions of the N-PCL that currently apply only to Type B and C corporations would still apply only to those entities as such provisions would, under the 2009 Bill, be applicable to "corporations with charitable purposes." See Section 201.

  As with consents, the use of detailed "types" in the N-PCL is confusing and problematic, especially as it relates to Type C entities. We support the elimination of types.

  The problem is most egregious as it relates to Type C corporations. Traditionally nonprofits that are eligible to obtain recognition of tax exempt status under §501(c)(3) of the Internal Revenue Code characterize themselves as a Type B corporation, the most common type for charities, rather than as Type C corporations. The Department of State, however, has been rejecting many filings by nonprofits claiming to be Type B corporations, such as dance and theater companies, on the theory that these types of entities can and do operate as for-profit entities and therefore such entities need to be a Type C corporations. The Type C corporation was initially envisioned to be a true

[12] See Section 320 of the Rules of the Regents, described in Law Pamphlet No. 9, The University of the State of New York / The State Education Department, Part I and appearing in Appendix B, available at http://www.counsel.nysed.gov/pamphlet9/lp9.pdf. Note that Section 320 does not include public television and radios in the charter category but the summary of the rule in Part I of the pamphlet includes them in that charter category.

business corporation located in a community needing economic development (such as an "incubator" wherein a landlord rents offices to nonprofits or start-up businesses or a small business in a underdeveloped community lacking basic business infrastructure); it was thought that the business could be run on a not-for-profit basis at inception and then later, if it achieved success, it could be converted, through merger, into a for-profit business (as shown by the fact that Type C corporations were allowed to merge with for-profit businesses). That historic basis for the type seems to have become lost.

The Department of State seems to be confusing "purposes" with "powers" or "activities." (See our discussion below regarding Section 404, the provisions that must appear in a nonprofit's certificate of incorporation, for the claim by the Department of State that a certificate has to include a list of activities so as to determine the type of the corporation.) The N-PCL states that an organization is a Type C if it has for-profit type purposes, not if it conducts for-profit type activities. Many charities conduct activities that may be the same as activities conducted by for-profits, but that does not automatically mean that their purposes are for-profit.

While a nonprofit formed as a Type C corporation should still be able to qualify for Section 501(c)(3) status if its purpose is charitable (even if it achieves that nonprofit purpose through activities that could be conducted by for-profits), there is a risk that an IRS examiner may question whether a Type C corporation is truly charitable if he or she concludes that its forming as such a type means that it has for-profit purposes. There are also delays when a nonprofit that originally filed as Type B corporation is required to recirculate a certificate of incorporation for resignature and resubmission as a Type C. Furthermore, the nonprofit must have members if it is a Type C corporation, which is not a requirement for Type B corporations.

The approach taken by the 2009 Bill is to eliminate types completely but to make certain provisions of the law as revised applicable only to nonprofits with charitable purposes. So long as the provisions of the law that are applicable to corporations with charitable purposes are appropriate, we can support the approach taken by the 2009 Bill. See, however, our comments regarding the definition of charitable purposes in Section 102.

As pointed out at the November 2nd forum, however, in eliminating the definition of the four types of nonprofits and the corresponding description of each type of nonprofit, too many words may have been eliminated from Section 201 describing the types of organizations that can be formed as nonprofits under the N-PCL. Assemblyman Brodsky voiced a concern at the November 2nd forum that the remaining language does not fully define what types of entities can be formed under the N-PCL. Without the language defining the purposes for which nonprofits may be formed found in the listing of types, almost any entity could incorporate as a nonprofit. Accordingly, either the description of each type of entity should be left (without, however, giving such categories of nonprofits formal "types") or the language describing what types of entities can be formed

as New York nonprofits should be reformulated to clarify the purposes for which a nonprofit may be formed under the N-PCL.

- **Making All Nonprofit Corporations Subject to the "Visitation" of the Supreme Court**. The revision would subject all nonprofit corporations, not just Type B and C corporations, to the "visitation" (*i.e.*, supervision) of a justice of the New York supreme court. See Section 114.

  The NPO Committee does not have a formal opinion on this issue. We understand that this provision, which allows the court to appoint someone to review a nonprofit's books and records and investigate allegations of misappropriation of funds or ultra vires *actions, is a powerful although rarely used remedy.*

- **Allowing Exculpation of Damages**. The bill would allow nonprofit corporations to include language in their certificates of incorporation exculpating directors and officers from liability for certain damages, equivalent to provisions currently available under the Business Corporation Law for directors of for-profit corporations, so long as their behavior is not in bad faith or the result of intentional misconduct or a knowing violation of law or their behavior does not result in a personal financial gain or other advantage for the individual to which he or she was not entitled or such action violated Section 719 of the N-PCL. Directors would still be liable for claims by the Attorney General and for actions for equitable relief. See Section 402.

  The NPO Committee has issued a committee report supporting a separate bill proposing this change, S2138. Nevertheless, we think it may be helpful in getting support for N-PCL reform to propose that the fiduciary duties of directors be set forth more clearly in the statute. See our comments to Section 717. Since it may be perceived as weakening the fiduciary duties of directors, this language may be counterproductive for passage of the 2009 Bill. In addition, we doubt that this provision by itself is the reason why a nonprofit may choose to incorporate in a state like Delaware, which allows similar exculpatory language to be used. We note that Delaware's provision (Section 102(b)(7) of the General Corporation Law) does not permit exculpation for breaches of the duty of loyalty, which has proven to be a major limitation on the scope of exculpation.

- **Changes in Allowable Names**. The bill would allow nonprofit corporations to use more forms of entity indicator (*e.g.*, association, foundation, club, fund, institute, union or society) instead of just the corporate indicators now required (*i.e.*, corporation, incorporated, limited or their abbreviations). The bill would also allow nonprofits to use the word "cooperative," which is currently precluded. See Section 301.

  First, the NPO Committee has some concerns regarding this change. We generally think there is merit to requiring the use of a name that clearly indicates that an entity is a corporation – it serves to advise the world of the limited liability nature of the entity. The additional words proposed could create confusion since those are words more commonly used with unincorporated associations. Second, the bill would eliminate current language allowing Type B corporations to have no entity indicator in their names. Whether this was

intentional is not clear. At a minimum, Section 302(b)(1)of the N-PCL should be revised to "grandfather" the names of existing nonprofits (it currently grandfathers only names existing on the date of effectiveness of the N-PCL), so as to avoid imposing a burden on a large number of existing charities to change their names.

- **Elimination of Need to Give Names and Addresses of Initial Directors in Certificate of Incorporation and Reduce Other Rights to Obtain Such Names and Addresses.** The bill would eliminate the need to include the names and addresses of the initial directors in the certificate of incorporation. The bill would also eliminate a provision giving creditors the ability to obtain the names of directors and officers and members the ability to obtain the home addresses of directors and officers. See Sections 402 and 718.

  The NPO Committee supports these changes. There are strong public policy reasons for why names and addresses should not be required. Board members may be reticent to disclose home addresses out of a concern for identity theft, personal security or other valid reasons. Security may be a particular concern when the nonprofit addresses controversial issues, such as reproductive rights or other high profile issues, or if the director is an individual of means or a celebrity. Furthermore we believe that the need to provide the name is also of no value. First, the current requirement can be easily avoided by installing nominee directors to serve as the initial directors, and then have them step down in favor of new directors during the first board meeting (this was the standard practice with for-profit corporations in "the old days," when addresses were required for those corporations). Second, New York nonprofits are the only corporate entities that must satisfy such a requirement. Neither the New York Business Corporation Law nor the laws of other states (including Delaware) have such a requirement — instead, the incorporator names the directors after the certificate is filed. Third, eliminating this requirement makes practical business sense, as most entities are formed first with a general business idea or mission as a skeleton, and then later fleshed out with directors, officers, employees, agreements, etc.

- **Elimination of Subventions**. The bill would eliminate what was thought to be an archaic financial instrument, the subvention (basically a type of low-interest subordinated debt). See Section 504.

  We understand that subventions are used by some nonprofits, especially healthcare organizations. We suspect that there may be accounting advantages to the use of subventions that warrant further exploration. Accordingly, subventions may still be a useful way to capitalize a nonprofit, especially if they are the only alternative to capital contributions. We feel that further investigation is necessary to determine if they have any value as well as viability. At a minimum, it needs to be retained for any existing subventions.

- **Granting Transferable Membership Interests; Promises to Make Capital Contributions.** Under the 2009 Bill, all nonprofit corporations may allow membership interests to be transferable. In addition, nonprofits that are not charitable corporations may allow capital certificates to be transferable and they may allow different classes of

capital contributors to have different rights, preferences and limitations. For charities, the voting rights would still have to be one-member, one-vote and capital certificates could only be redeemable for the amount contributed, thereby obviating the issue of inappropriate distributions by charities. The bill would also allow capital contributions to be made by promises to pay funds or to perform services; currently capital contributions can only consist of cash contributed or past services performed. See Sections 501 and 502.

The NPO Committee does not object to transferable membership interests or different classes of capital contributors so long as language is added to make sure that members of charitable corporations cannot receive any consideration for the transfer of such membership interests and that the distributions regarding capital contributions for charitable corporations do not violate the Internal Revenue Code requirement that no part of the assets, income or profits of the corporation can be distributed to or inure to the benefit of any member of the corporation. Furthermore, language needs to be included reflecting the fact that nonprofits may impose conditions on transferability. The committee also supports the concept of promises to provide funds or services constituting valid consideration for capital certificates.

- **Elimination of Requirement for Members in Non-Charitable Corporations**. The bill would allow all nonprofit corporations to operate without members; currently only Type B corporations can operate without members. See Section 601.

  The NPO Committee supports this change.

- **Elimination of Publication Requirement for Private Foundations**. The bill would eliminate the publication requirement for private foundations, a provision which merely provides a source of revenue for certain newspapers. See Section 406.

  The NPO Committee supports this change. The only purpose of such a publication requirement appears to be for the benefit of newspaper publishers. While some business entities, such as limited partnerships and limited liability companies (but not corporations), must make such publication, there is no justification for charging nonprofit corporations for any benefit that this may yield. The IRS has eliminated a similar publication requirement.

- **Modification of Approval Requirements for Certain Asset Sales**. Currently New York supreme court approval is required for sales of substantially all of the assets of Type B and Type C corporations. The 2009 Bill would require court approval if the corporation has charitable purposes or if the organization "holds assets received for specific purposes." See Section 510.

  Under the 2009 Bill, if the entity has any restricted assets it must get approval for the sale of nonrestricted assets that constitute all or substantially all of the assets even if the restricted assets are not being transferred. While it may be appropriate to require court approval for the transfer of the restricted assets, we do not believe that it is appropriate to require court approval of the transfer of the non-restricted assets where the organization is not charitable.

While the statute only requires court approval, New York practice is to first get approval by the Charities Bureau of the Office of the Attorney General. Often, but not always,, once such AG approval is obtained, court approval follows as a formality (although supreme court justices will frequently modify previously agreed on terms of court orders). The NPO Committee supports elimination of court approval, instead requiring only Attorney General approval.

Currently the supreme court plays a significant role in the approval process for certain transactions and major structural changes, such as sales of substantially all assets, mergers and consolidations, amendments to certificates of incorporation and dissolutions. We propose that the supreme court's role in all of these transactions be eliminated, while retaining the approval role of the Attorney General. We do, however, believe that there should be a right of appeal to the supreme court of any action by the Attorney General, thereby converting the role of the court from an initial approval role to an oversight role. Without such an express appeal right, the only right to go to court would be to bring an Article 78 proceeding against a state agency or officer in the nature of a writ of mandamus, which is effective only in very limited circumstances. The NPO Committee does not have a view at this time as to whether the court should have the right to review the AG's action de novo *or whether another standard should apply.*

While court approval may be perfunctory if the Charities Bureau approves the proposed change, we think that the elimination of court approval with respect to this requirement and other similar requirements (see our comments below on changes of purposes, mergers and dissolutions) could help to simplify the documentation and formality that currently exists and thereby make the AG approval procedure less formalistic and more expeditious. It would also reduce the cost of the approval process, since it would no longer be necessary for the nonprofit to purchase an index number in the approval process.

We would also hope that the Attorney General would adopt simplified procedures for transfers to another New York chartered charity that is required to report to the New York Attorney General's office (and is current in such reports), on the theory that there should be less regulatory concerns if the assets remain under the New York Attorney General's supervision. The Attorney General may properly condition such approval on the New York transferee being current in its reporting to the Charities Bureau.

- **Allowing Written Consent by Less Than All Members**. The bill would allow written consents by less than all of the members in lieu of approval at a meeting; currently written consent has to be unanimous. Notice of changes adopted by less than all the members would have to be provided to the nonconsenting members. See Section 614. Unanimous consent would still be required for action by the board of directors. See Section 708.

The NPO Committee supports this change. Issues presented to members for a vote are generally limited in number and easy to explain; just as the members may approve such matters at a meeting without unanimity, so too should they be able to approve them by consent without unanimity. We agree that such procedure should not apply to action by directors.

- **Allowing Electronic Notice of Meetings for Members**. The bill would allow e-mail and other forms of electronic notices for membership meetings. See Section 605. Since the N-PCL does not set standards for transmitting notice to directors, but instead defers to the by-laws, the bill does not propose any changes to the procedure for notice to directors. See Section 711.

  The NPO Committee supports this change. We believe that it would be appropriate to make specific mention regarding director notice of the ability to use any form of notice as set forth in the by-laws, including electronic notice. As discussed more fully below (under "C. Other Changes That Should Be Made" below), we also believe that electronic communications are appropriate with respect to action by consent at the member and board levels.

- **Elimination of the Differences Between Standing and Special Board Committees**. The bill would eliminate the differences between standing and special board committees. See Section 712.

  While we do not oppose this change, we feel that much more work needs to be done regarding the procedure for establishing committees and choosing the members of those committees. See the discussion below under "C. Other Changes That Might be Considered" below regarding our additional proposed changes pertaining to board committee matters.

- **Elimination of High Vote Requirement for Approval of Officer Salaries.** The bill would eliminate the requirement for approval of the compensation of salaries by a majority vote of the entire board. Instead, the standard majority of a quorum vote requirement would apply. See Section 715.

  In general, we support the elimination of a requirement that approval be by a majority of the entire board since that standard may be difficult to satisfy, as noted in the discussion below under "C. Other Changes That Might be Considered." where we note other provisions that require similar approval levels which we think should be revised We think, however, that certain actions (including, at a minimum, approval of compensation of senior management, especially in light of current public concerns regarding excessive compensation) should be subject to approval at a level greater than merely a majority of the directors in attendance at a meeting, especially since with a low quorum threshold this could mean that about one-sixth of the directors approve the compensation.

- **Allowing Directors to Consider Multiple Factors in Making Decisions.** The bill would allow directors, when making decisions regarding a corporation, to assess both

long- and short-term considerations and the effect of the proposed action on employees, retired employees, beneficiaries of services, creditors and communities served. See Section 717.

The NPO Committee supports this change subject to the addition of language that such considerations must be consistent with the charitable purposes of charitable nonprofits.

- **Eliminating the Requirement to Obtain Court Approval of Changes of Purposes or Powers and Allowing Funds Raised for a Purpose to be Used for Another Purpose**. While language would be added to the effect that no amendment to the certificate of incorporation could be adopted if the effect would be to use any assets received for a specific purpose in a manner inconsistent with such purpose, the bill would eliminate the need for court (and, in practice, Attorney General) approval of changes of purposes or powers. Another section of the bill states that when the certificate of incorporation is amended to change the purposes, funds acquired prior to such amendment could be used for the new purposes unless they were restricted by a gift instrument. See Sections 801 and 804 (new Section 806).

  The elimination of the need for court (and, in practice, Attorney General approval is a significant change from current practice, which requires court approval of <u>any</u> change of purposes; as a condition to giving its assent, the supreme court will require the approval by the Attorney General, which requires an affidavit from an officer of the corporation stating that current assets will be used for current purposes and powers and future assets will be used for purposes and powers as stated in the certificate of amendment. We note that this affidavit procedure is no where set forth in the statute although it is noted in the Attorney General's guide to formation of nonprofits.[13] *While we note that a nonprofit can be formed in New York for any nonprofit purpose without the need for court or Attorney General approval, we believe that it is appropriate to retain Attorney General (but not court) approval requirements for changes in purposes, so as to have a check on the use of previously-acquired funds. Explicit language needs to be added, however, clarifying that the approval function relates solely to the use of funds. As noted above with respect to supreme court visitation, we believe that there should be a right to appeal to the supreme court regarding any denial of approval by the Attorney General.*

  We agree that changes in powers that do not constitute changes in purposes should not require the need for prior approval.

  We think the new language in Section 801 regarding amendments of the certificate is inconsistent with the language in Section 806 allowing funds raised for one purpose to be used for another purpose if they were not restricted by a gift instrument are inconsistent. We do not think that funds should be so restricted only if they are subject to terms in a written gift instrument.

[13] *Procedures for Forming and Changing Not-for-Profit Corporations in New York State*, available at http://www.charitiesnys.com/pdfs/how_to_incorporate.pdf.

- **Simplification of the Procedures for Certain Nonprofit Mergers and Dissolutions**. The 2009 Bill would simplify the process for merging nonprofit corporations. Under the bill, court approval would only be required for mergers or dissolutions of corporations that are organized for charitable purposes and that hold assets received for specific purposes. Under the current N-PCL, court (and Attorney General) approval is required for the dissolution of all Type B, C and D nonprofit corporations, whether or not they hold assets received for a specific purpose. Mergers between charitable nonprofit corporations and for-profit corporations would be allowed, but only if court-approved (if both of the conditions noted above are present); currently such mergers are only allowed for Type B and C corporations. See Sections 907 and 1001.

  We think some approval requirement should be continued for all charities and for all corporations that have restricted assets, rather than just for charities with restricted assets (as the 2009 Bill states). We believe, however, that the approval process should be simplified by eliminating the need for court approval in all instances, relying instead on Attorney General approval where appropriate. As noted above with respect to supreme court visitation, we believe that there should be a right to appeal to the supreme court regarding any denial of approval by the Attorney General.

  We would also think it appropriate for the Attorney General to adopt some form of simplified merger and dissolution procedures for solvent charities that are seeking to merge with or transfer remaining assets to other solvent charities, so long as both entities are current in their New York filings, as a way to encourage consolidation of existing nonprofits in times of lessened resources.

B. Nonsubstantive Changes in the 2009 Bill

The 2009 Bill includes many changes that are of a nonsubstantive nature. These include the following:

- Changing the name of the statute from the term "not-for-profit" (which is unique to New York) to the more customary term "nonprofit."

  While it is not a major issue, the NPO Committee prefers the retention of the current usage, as we believe that it better expresses the true nature of existing nonprofit corporations.

- Making the statute gender neutral.

  We support this change.

- Changing certain (but not all) cross-references to other sections of the N-PCL and of other New York statutes from spelled-out form to numeric form (*e.g.*, "two hundred six" to "206"), which is more readable (this change appears to have been made after the NYSBA's draft was submitted).

This change enhances readability and should be carried out throughout the draft – for example, see Section 520 where sixty is spelled out and Sections 602, 604 and 605 where a double numbering system (e.g., "twenty (20)") is used. There is no need for double numbering.

- When other sections are cross-referenced, eliminating the parenthetic title to the referenced section and adding "of this chapter" (this change also appears to have been made after the NYSBA's draft was submitted).

  This change is not desirable, since the existence of the short title helps the reader understand what is being cross-referred to.

- Renumbering certain provisions to reflect sections that had been previously eliminated or that are now proposed to be eliminated (this change also appears in certain instances to have been made after the NYSBA's draft was submitted), such as the renumbering of Section 404 to reflect a prior elimination of paragraph (s) in the list of consents that must be obtained.

  We support this change.

C. Additional Changes That the NPO Committee Thinks Should be Made

The NPO Committee believes that the following additional changes should be added if the N-PCL is rewritten:

- **Allowing Board Size to be Set by the Board**. Under a literal reading of Section 702, the size of boards of corporations without members must be "fixed" (*i.e.*, set out) in the by-laws, meaning changes in the size can only be done by amending the by-laws. Corporations should be able to have by-laws that allow the board to set its size from time to time within a range (*e.g.*, "the size of the board shall be determined from time to time by the board but shall not be less than three nor exceed [15]") rather than requiring amendment of the by-laws each time the number of directors changes; currently that procedure is only available to nonprofit corporations with members where the by-law provision approving such procedure was adopted by the members (or the incorporator prior to the existence of members). Many nonprofit corporations fail to abide by the procedure requiring the absolute number of directors to be named in the by-laws but instead fix the number within a range set in the by-laws by board action from time to time. This is not just an academic issue, since failure to validly constitute the governing board could lead to questions as to whether board-approved action is valid. While some practitioners believe that there is merit to requiring the exact number of directors to be stated in the by-laws since there is then one place where the number can be found, we feel that practical considerations, as set forth in our detailed comments to Section 702 in Attachment Two, outweigh this benefit and therefore the law should be changed to give all nonprofits (not just certain membership corporations) the flexibility to vary the number of directors as determined by the board without the need to repeatedly amend the by-laws.

- **Reducing the Threshold of Approval Required for Certain Actions**. In some instances, action must be approved by a majority (or a higher percentage) of the entire

board (that is, the number of directors of the board as fixed by the by-laws, including positions then vacant) even if a meeting can be validly held with fewer than a majority of the directors present. This means that if a majority of the board is not present, such action cannot be approved even if all the directors present vote for it. As discussed above, the 2009 Bill changes this threshold for approving compensation arrangements to a regular majority of those present, but not for other matters, such as real property transactions (Section 509 – see our next point for a fuller discussion), transfers of substantially all the assets (Section 510),committee formation and appointments (Section 712) and amendments to the certificate of incorporation (Section 802). (It is interesting to note that there is no such high approval requirement at the board level for mergers (Article 9) or dissolutions (Article 10), but such actions are subject to court approval.)

We support elimination of the requirement that such actions be approved by a majority (or supermajority) of the entire board. We believe, however, that it may be appropriate for some of these actions (such as fixing compensation or constituting the members of board committees) to require a level of approval which is higher than a majority of the directors present at a meeting at which a quorum is present since a quorum for board action could be as low as 33% (or even lower for boards in excess of 15 members). If there is such a low quorum, an action could theoretically be approved by as few as approximately one sixth of the entire board.

We would therefore propose that approval requirements for these important actions should be heightened (for example, by either requiring approval (i) by a majority of the sitting directors or (ii) by the lesser of a supermajority (*e.g.*, two-thirds) of those present or a majority of the entire board. Other approaches that might be considered to ensure that action on important matters is acted on in an informed manner and not done against the wishes of a majority of the board, would be to require that the matter be included in the notice of meeting. Alternatively, the attendance of a majority of the board could be required for action on such matters (this requirement would not affect those corporations which set the quorum at a majority). See our detailed comments to Sections 509, 510 and 712, as well as 715 as already proposed, in Attachment Two.

Any higher vote requirements should be set forth or cross referenced in Section 708(d), which states that the vote of a majority of directors present at a meeting at which a quorum is present shall be the act of the board except as otherwise provided in the N-PCL.

- **Modifying the Requirement that All Real Estate Transactions, Including Routine Transactions, Be Approved by a High Percent of the Board.** The high approval requirement discussed under the prior bullet point is irksome with respect to routine real estate transactions since, under Section 509, all transactions involving real estate (including routine leases, both as lessor and lessee[14]) must be approved by two-thirds of the entire board (or a majority if the board has over 21 members). This threshold is too

[14] Although an argument can be made that approval is only required for actions by lessors, not lessees, under for leases since the leasing language appears in a portion of the provision relating to dispositions (Section 509 states "No purchase of real property shall be made by a corporation and no corporation shall sell, mortgage or lease real property, unless authorized by the vote of two-thirds of the entire board, provided that if there are twenty-one or more directors, the vote of a majority of the entire board shall be sufficient.").

high and overlooks the fact that for many nonprofits certain real estate transactions (*e.g.*, leases) are routine. While a high vote requirement may make sense with respect to the purchase or sale of significant property or its mortgaging, it does not make sense for routine actions such as minor leases. At a minimum, there should be some sort of *de minimus* threshold (maybe expressed as a percentage of an organization's assets for purchase and sale transactions and as a percentage of expenses or income, depending on whether the lease is as lessee or lessor, for lease transactions) for any higher approval requirement. See the discussion under the prior bullet point regarding alternatives for higher approval thresholds and other procedures.

- **Simplifying the Procedure to Name Committee Members and Other Revisions of Committee Provisions.** In the current law, all of the members of standing committees must be named by, and (except as otherwise set forth in the by-laws) all members of special committees must be approved by, a majority of the "entire board" (*i.e.*, a majority of the number of directors of the board as fixed by the by-laws, including positions then vacant), a practice that few nonprofit corporations follow. By eliminating the distinction between standing and special committees, the 2009 Bill requires that all board committee members be approved by the full board. This requirement means that no committee member can be named if less than a majority of the directors are in attendance, even if those present constitute a quorum and could act on other matters.

  The use of committees is crucial to good board governance. The procedures to establish and name the members of committees should be practical. The NPO Committee thinks that a more workable process of choosing committee members is necessary. First, as noted above, the requirement that any board approval be by a majority of the entire board should be eliminated. Second, we think that it is necessary to retain the requirement for some level of board approval in the process of forming and staffing key board committees since otherwise management of a nonprofit (or a strong chairman, even if not part of management) may be able to too easily dominate committees, thereby undercutting the supervisory obligation of the board. Such board approval should be necessary for committees with governance responsibility and committees with delegated board authority but not necessarily for more operational or temporary committees. We would therefore propose that the committee provision of the N-PCL be revised to require that all members of the committees with governance responsibilities and committees with delegated board authority be approved by the board. Whether the approval level required should be greater than a mere majority of a quorum, as commented on above, we leave for further discussion.

  In addition, the requirement that all board committees be composed of a minimum of three directors, as proposed by the NYSBA bill (under current law only standing committees must have three directors as members) should be eliminated or limited to a select listing of committees, such as the executive committee. See our detailed comments to Section 712 in Attachment Two.

- **Eliminating Required Annual Notices to Members Regarding D&O Insurance**. Under Section 726, a nonprofit has to provide information to members regarding directors and officers liability insurance policies on an annual basis; this requirement is in addition to a requirement under Section 725 to provide notice of any payouts under such a policy. These requirements are probably rarely followed. The annual notification

requirement, and maybe the payout notification requirement, should be eliminated. See our detailed comments to Sections 725 and 726 in Attachment Two.

- **Reforming the Statutory Annual Reports to Members and Directors Procedures**. The annual report requirements, found in Section 519, should be revised to allow pre-meeting distribution of financial statements (reviewed or audited if so required under the Executive Law) in lieu of making the report at the meeting. Additionally, cross references to the provisions of Section 519 (and the annual reports required regarding restricted assets in Section 513) should be included in the sections of Articles 6 and 7 regarding annual meetings since they are now "buried" in sections unrelated to annual meetings. See our detailed comments to Sections 513, 519 and 603 in Attachment Two.

- **Eliminating or Revising the Back-Door Requirement for Annual Meetings to Be Held Within Six Months of Year End**. While the provision of the N-PCL regarding annual meetings (Section 603) does not set forth a time period in which the meeting must be called after the fiscal year end, the provision regarding the annual report to the members (or the board if there are no members) set forth in Section 519 requires that 12 month financials that are not older than six months be presented at the annual meeting. This effectively means that the annual meeting has to be held within six months after year end or financials for a more current 12-month period must be prepared for the meeting; if those financials are not prepared on a consistent 12-month basis, year-to-year financials will not be comparable. It should be noted that many nonprofits do not have their financial statements ready prior to the extended due date of the annual Form 990 information return filed with the Internal Revenue Service (and the corresponding annual CHAR500 filing with the New York Charities Bureau); such filings can generally be made up to 10-1/2 months after the nonprofit's fiscal year end. Section 519 should be therefore be amended to eliminate the requirement as to the age of the prior year's financials; if it is not eliminated, the time period should be extended to 11 months after year end and an explicit requirement to hold annual meetings within such time period should be added to Sections 603 and 710.

- **Allowing Member and Director Action by Electronic Communications**. As noted above with respect to electronic notice to members, we believe that it would be appropriate to allow members and directors to act by electronic communications as well as by written consent. In the case of communications via email, the e-mails would all need to include the same language, as is the case with written consents. There is currently uncertainty under New York law as to whether such electronic communications constitute "written consent," with some holding the view that the e-signature laws of New York treat electronic communications as writings. Delaware has sanctioned such electronic communications for several years. Each email should include or reference the text of the resolution and is "signed." See our detailed comments to Sections 614 and 708 in Attachment Two.

- **Reformulating the Provisions of the N-PCL Regarding Director Duties.** The N-PCL states, in Section 717, that directors and officers shall discharge the duties of their positions "in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." This is a phrasing of the duty of care which is owed to the nonprofit by its directors and officers. Two other duties are commonly held to apply to directors of nonprofits; these are the

duty of loyalty (*i.e.*, to act in the best interests of the organization) and the duty of obedience (*i.e.*, to ensure that the organization acts in furtherance of its mission). The N-PCL is silent, however, as to the duties of loyalty and obedience other than to set forth provisions (see Section 715) regarding conflicts of interest and provisions (see Section 520) as to a director's duty to cause the corporation to file reports with the state. We believe that the duties of the directors should be stated fully in one place, preferably in Article 7.

- **Allowing Any Nonprofit That Has Either a Single Member or Other Nonprofits as Its Members to be Formed as a Limited Liability Company.** A nonprofit entity can be formed as a limited liability company (LLC) under the Delaware Limited Liability Company Act and, based on recent changes, in California, Ohio and Missouri. But this form of entity is generally thought to be not available for nonprofits in New York, which requires that LLCs be organized for a "business purpose." [15] The IRS recognizes nonprofit LLCs that have a single member or, if certain criteria is met, if its only members are other nonprofits. The LLC form is ideal for subsidiary or joint venture entities. Such nonprofit LLCs would have to meet the substantive requirements applicable to not-for-profit corporations as set forth in the N-PCL. We would support the ability of nonprofits to form as LLCs in the appropriate circumstances. We understand that this change might also need to be set forth in the Limited Liability Company Law in addition tothe N-PCL.

- **Adding Language to Section 402 Clarifying that the Certificate of Incorporation Does Not Need to Describe the Activities of the Corporation.** The Department of State's website, at http://www.dos.state.ny.us/corp/nfpguide.htm, states the "purpose or purposes [set forth in the certificate of incorporation] must clearly and fully describe the activities of the corporation." The Department of State has said that it needs the certificate to include a list of activities to be conducted in order to determine (a) if the name meets the requirements of Section 301, (b) whether the correct type is indicated and (c) whether any state agency or other consents are required. Such requirement is not set forth in Section 402, regarding the contents of the certificate of incorporation. (We note, however, that Section 1304(a)(4) states that an application for authority by a foreign corporation must include a "statement of its purposes to be pursued in the state and of the activities which it proposes to conduct in this state." The Department of State seems to be reading the Section 1304 requirement into Section 402.) The requirement to describe activities as well as purposes leads to certificates including needlessly detailed minutia. It also often leads to confusion between what is a purpose and what is a power (or how the nonprofit intends to achieve its purpose). If types and consent requirements are eliminated, as proposed, the only remaining reason (in the eyes of the Department of State) to require a description of activities would be to determine if the name meets the requirements of Section 301. But a reading of Section 301, regarding names, discloses

[15] See Section 201 of the New York Limited Liability Company Law ("A limited liability company may be formed … for any lawful business purpose …). California Corporations Code Section 17002, which allows LLCs to engage in any lawful business activity, was expanded to clarify that a business purpose can be found whether or not the company's actions are for profit, thereby allowing California nonprofits to use the LLC form; the entity must otherwise meet the requirements of the California Revenue and Tax Code Section 23701. In 2008 Ohio passed legislation that clarifies that nonprofits can be in LLC form and that single member LLCs with a sole nonprofit member shall be treated "as part of the same legal entity as its nonprofit member."

the fact that whether a specific name can be used depends only on the "purposes" of the nonprofit, not its activities. Accordingly, language should appear in the legislative history, if not in the N-PCL, to the effect that the purpose clause does not need to include a listing of planned activities.

- **Adopting Procedures to Ease the Administrative Processes with the Various State Agencies, Including the Department of State, Charities Bureau and Education Department, Including:**

  - **Making changes to the formation procedures allowing the Department of State to establish administrative procedures to coordinate any necessary consents.** The Department of State must now review all filings to ascertain if the consent of another state agency or organization is required to be attached to the certificate of incorporation, as required by N-PCL § 404. This requirement is imposed by law, so it is not something the Department of State can ignore. But so long as this requirement is in place, ideally there should be some expedited procedure to ascertain which consents are required; it may require some interagency protocol so that a proposed certificate could be circulated simultaneously to all possibly affected agencies for a determination as to whether formal consent must be sought. Currently, the process of ascertaining what consents are necessary can be overly protracted and informal, with queries having to be made to each separate state agency, which may then refer the applicant to another agency. State agencies say they cannot adopt procedures to expedite processing, claiming that they lack statutory authority. Efforts should be made to work with these agencies to ascertain what authority they think is lacking and to obtain such authority, where appropriate, through law changes.

  - **Making changes to the formation procedures to allow the Department of State and any state agencies that must give consent to "preclear" filings prior to formal submission.** It should also be possible for nonprofits to seek an "advance ruling" or "preclearance" on whether filings are satisfactory without having to first finalize, sign and submit a formal certificate of incorporation or application for authority. Delaware's Secretary of State will preclear any certificate of incorporation or other corporate filing; New York does not follow such practice. If such a procedure existed, lawyers could finalize documents prior to circulation for execution and be assured that the signed filing will be promptly accepted upon submission as drafted. The agencies may be able to use this procedure as a revenue source.

  - **Adding language to the statute allowing the Department of State to make hand corrections to filings to correct minor errors, with the consent of the filer.** Often times the reason for rejection is a minor typographical error, which should be correctable by authorized action at the department. The agency should be able to accept a telephonic authorization to add that marking by hand and then file the form rather than requiring a formal resubmission. The Department, however, states that it lacks statutory authority to make such corrections. Language could be added to Section 104 (dealing with general requirements for certificates) authorizing such procedure.

  - **Eliminating the regulatory requirement for a backer or, if such requirement is not eliminated, moving such provision to the statute so that filers can see the**

requirement. The Department of State's regulations found in Section 150.1 of the New York Codes, Rules and Regulations require that a certificate of incorporation include a backer that provides the name and address of the submitter. Such requirement should either be eliminated by statute or set forth in the statute so filers can be aware of its existence.

- **Adding statutory provisions requiring agencies to set up procedures for electronic filing of documents, including by email or by fax**. In 2007 the Department of State said that it will implement a system of PDF filing in the future, but no progress has been announced on that front. The Department of Education does not accept faxed or electronic filings and it is not clear if any other state agencies do. The statute should be revised to establish a procedure for electronic filing. This might be a service that is available only for an additional fee.

The various state agencies, including the Department of State, Department of Law and Education Department, should be queried as to what other changes they would think necessary in order to expedite the filing of required documents with such agencies and process for obtaining required approvals.

ATTACHMENT TWO

Detailed Comments[16]

Article 1
Definitions; Application; Certificates; Miscellaneous

Section **Changes *(Comments)***

101 **Short title**

The 2009 Bill changes the name of the statute to the Nonprofit Corporation Law.

As noted in Attachment One (B) above, the NPO Committee favors retention of the current terminology.

102(a) **Definitions**

Consistent with the elimination of types, some provisions of the statute are made applicable only to corporations with "charitable purposes." A definition of charitable purposes is added as clause (6): "purposes contained in the certificate of incorporation of the corporation that are charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals." This is similar to the listing that appears in Section 501(c)(3) of the Internal Revenue Code but it is not identical. That listing also includes testing for public safety, fostering of national or international amateur sports competition, and promotion of the arts (in lieu of "cultural"). Consideration should be given to either tracking the IRC language or using the provision that appears in the Model Nonprofit Corporation Act, Third Edition:

"Charitable purpose" means a purpose that: (i) would make a corporation operated exclusively for that purpose eligible to be exempt from taxation under Section 501(c)(3) or (4) of the Internal Revenue Code, or (ii) is considered charitable under law other than this [act] or the Internal Revenue Code.

The Model Act provision also considers (c)(4) corporations to be charitable. Such organizations are "[c]ivic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes." It is unclear under the New York definition whether (c)(4) social welfare organizations would be viewed as having "charitable

[16] We have not generally commented n Attachment Two on the numerous nonsubstantive changes (*e.g.*, changes of title, changes to make the law gender neutral, changes regarding cross referencing, etc.)

purposes."

Since certain provisions of the 2009 Bill apply only to corporations with charitable purposes, it would be beneficial to have some clarity as to this issue. Under the current version of the N-PCL, such provisions would apply to Type B and Type C corporations. It is easier to determine if a corporation is a Type B or Type C corporation since the Department of State would have approved such classification than it would be to determine if its purpose is charitable.

Technical Drafting Comment

- *The definition of "person" needs to be put in alphabetical order.*

103 **Application**

No substantive changes are proposed by the 2009 Bill to this section.

The revised provision talks about the "effective date of this chapter." The statute needs to be reviewed to ensure that the adoption of this amended law does not change the "effective date of this chapter" from the date when the N-PCL first became effective, i.e. September 1, 1970.

Article 14 of the N-PCL includes special provisions for certain categories of nonprofits, including cemeteries (which are also governed by Article 15), fire corporations, anti-cruelty organizations, Christian associations, solders' monument corporations, medical societies, alumni corporations, historical societies, agricultural and horticultural corporations, boards of trade and chambers of commerce, local development corporations and university faculty practice corporations. It would be helpful if there was a cross reference in the forepart of the statute to the categories of companies subject to those provisions since few readers may otherwise be alert to look there for specific provisions.

Technical Drafting Comment:

- *In the spirit of the other changes, the term "heretofore formed" might be changed to "formed before the effective date of this chapter."*

103-A **Relationships to other laws**

A new § 103-A would be added to clarify that elimination of the Section 404 duty to obtain consents does not change any duty to meet the substantive requirements of state agencies. It would note that where the NPCL and other "regulatory laws" may conflict, the "regulatory law" governs.

The provision giving the regulatory law precedence could be problematic as it could be used to add a duty to get prior approval of an agency before formation; this situation would be even worse than the current requirement since the requirement might be buried in a state regulation rather than being expressly stated in the statute. Maybe the following language should be added at the end of paragraph (d): "but in no event shall the approval of any agency be required prior to incorporation of the corporation except as set forth in

section 102."

It may be appropriate to specifically reference the obligations to obtain any necessary approvals from agencies as to which notification of the formation would still need to be given under Section 404.

With the elimination of Section 115 and its references to the need to register with the Attorney General under the Executive Law, it would be appropriate to add in this section a reference to the duties under the Executive Law, as well as the Estates, Powers and Trusts Law (EPTL), to register with the Department of Law.

Clauses (b) (2) and (3) are confusing – it is unclear if failure to comply with regulatory law results in the disincorporation of the entity.

Technical Drafting Comment:

- *The new definition "regulatory law" should be part of Section 102(a). That term also uses the word "organic law," which term is not defined – its meaning is currently unclear. Under the Model Nonprofit Corporation Act, Third Edition, it is defined as "the statute principally governing the internal affairs of a domestic or foreign business or nonprofit corporation or unincorporated entity."*
- Note that Sections 103-A and 104-A use upper case "A"s but Sections 720-a and 1002-a use lower case "a"s. The style should be consistent]

104(e) **Certificates; Requirements, Signing, Filing, Effectiveness**

The requirement to attach consents from other departments currently contained in §104(e) would be removed, consistent with the proposal to eliminate the need for such consents.

No comment.

104-A **Fees**

No change is proposed by the 2009 Bill to this section.

We would support an increase in fees if that would provide greater resources to enable the state agencies to better coordinate and provide faster services. The filing fees now are miniscule compared to the cost of the lawyer's time and the cost of seeking an IRS determination letter (generally $850, starting in 2010). As noted in Attachment One above, we also support the addition of certain services, such as pre-clearances, for which the Department of State could charge significant fees.

Technical Drafting Comment:·

- *Note that Sections 103-A and 104-A use upper case "A"s but Sections 720-a and 1002-a use lower case "a"s. The style should be consistent.*

108 **When notice or lapse of time unnecessary; notices dispensed with when delivery is prohibited**

No change is proposed by the 2009 Bill to this section.

Technical Drafting Comment:·

- *Clause (c) should be conformed to the notice provision to members (Section 605) which, as proposed to be amended, allows notice in writing or electronically.*

112 **Actions or special proceedings by attorney-general**

With the elimination of types, the prior requirement that the Attorney General obtain court approval before instituting actions against Type A corporations would be eliminated.

The revised language is confusing – whether court approval is now required for all actions or for none is unclear. This needs to be clarified.

The existing clauses (a)(7) and (9) (corresponding to the new clause (8)) allow the Attorney General to enforce the rights of members, directors and officers of Type B and C corporations without any need for court approval but require court approval when a Type A corporation is involved. With the elimination of "types," the provision as now written (allowing an action under clause (7) in the stead of a member, director or officer against any nonprofit without any court authorization and allowing the same action under clause (8) only with court approval) is confusing. Either the provision for needing court approval needs to be eliminated (which would be a major substantive change from current law) or the provision needs to be revised to clarify that court approval is required if the corporation does not have "charitable purposes" (which would be consistent with other provisions in the draft).

Technical Drafting Comment:·

- *At a minimum, the first part of clause (a)(7) as it is proposed to be revised by the 2009 Bill should be revised to read: "To enforce any right given under this chapter to members, a director or an officer of a corporation. The the attorney-general shall have the same status as t~~he~~ such member~~s~~, director or officer." to clarify that the AG's status is not just with respect to members.*

113 **Certificate of type of not-for-profit corporation**

The provisions regarding certificates of type would be removed in the wake of the elimination of "types."

No comment.

114 **Visitation of supreme court**

The 2009 Bill would make all nonprofit corporations subject to the visitation of a justice of the supreme court; currently only Type B and C corporations are so subject.

The NPO Committee does not have a formal opinion on this issue; we assume that the Charities Bureau would endorse this change. This provision allows the court to appoint someone to review a nonprofits books and records and investigate allegations of misappropriation of funds or ultra vires *actions, is a powerful although rarely used remedy.*

115 **Power to solicit contributions for charitable purposes**

This section, which currently requires that the power to solicit contributions for charitable purposes be specified in the certificate of incorporation and states that it is illegal for a not-for-profit corporation to solicit contributions unless it is registered with the Charities Bureau, would be removed. The Executive Law provisions requiring registration prior to charitable solicitation activity are not affected.

See further discussion at Section 202 below. The existing provision practically requires that the certificate of incorporation of the corporation include language giving the corporation the power to solicit charitable contributions. Some charities are formed without such provision since this requirement is buried. The removal of such requirement may therefore avoid inadvertent problems. But it is important that nonprofits realize that they may have an obligation to register with the Charities Bureau if soliciting charitable contributions. We therefore think that it is appropriate to specifically recite such obligation in Section 103-A and to recite in Section 112 that the Attorney General may take action to enforce obligations under the cited sections of the Executive Law. It is also appropriate to add the power for charitable corporations to solicit charitable contributions as a statutory power under Section 202.

Article 2
Corporate Purposes and Powers

Section **Changes *(Comments)***

201 **Purposes**

All references to types of corporations would be eliminated under the 2009 Bill. Current Section 204 would be moved up as new Section 201(b).

The NPO Committee, in its letter of December 14, 2006, supported simplification of corporate typing but not its complete elimination. The Committee recognized that not-for-profit corporations generally fall into two categories: public-benefit corporations and mutual-benefit corporations. This is a distinction existing in the California nonprofit law. The Committee proposed in 2006 that any revision of the N-PCL recognize this distinction to facilitate the effective regulation of charitable organizations and said that if distinctions between public-benefit and mutual-benefit corporations are not set out in the substantive provisions of the bill, it would recommend retaining Type A and Type B corporations, noting that Type C corporations can definitely be eliminated and saying that further study was needed regarding Type D corporations.

It appears that the 2009 Bill reflects the 2006 concerns of the NPO Committee by expressly making certain provisions applicable (or not applicable) to corporations formed for charitable purposes. See, however, our comments above regarding the definition of "charitable purposes."

A bill has been introduced (S3698, 2009-2010 Regular Session) to eliminate Type C corporations. This bill is supported by the Department of State. Our committee has issued a report supporting such bill.

Technical Drafting Comment:·

- *The words "as provided in paragraph (b)" in Section 201 are now superfluous.*

202 **General and special powers**

The power of the board in paragraph (a) to establish membership criteria would be added by 2009 Bill to the statutory powers.

The NPO Committee recommends that a statutory power for charitable corporations to solicit charitable contributions be added, especially with the removal of old Section 115.

Reference to the limits on the amount of property a corporation may have in paragraph (b) would be deleted.

No comment.

Technical Drafting Comment:·

- *The reference to "wilful" in paragraph (d) should be "willful"*

203 **Defense of ultra vires**

The requirement for approval by a judge, court or administrative department or agency in order that actions, such as the transfer of property, be valid notwithstanding that they were otherwise *ultra vires* would be eliminated.

We support the change. Such actions would still be subject to attack by a member, the corporation or the Attorney General. This primarily avoids the ability of a counterparty to the transaction to later back out.

205 **Conveyance of real property to members for dwelling houses**

Language allowing conveyance of dwelling houses to members would be eliminated.

The reason for the provision (and for its elimination) is unclear.

Article 3
Corporate Name and Service of Process

Section Changes *(Comments)*

301 **Corporate name; general**

The section would be amended to require nonprofit corporations to have words of "entity status" but it would allow additional words to be used, including association, club, foundation, fund, institute, union or society. Current law requires that corporation use only certain corporate status identifiers (corporation, incorporated or limited or short form versions of those words) but provides an exclusion for charities, religious organizations and bar associations or approvals of commissioner of social services or public health council.

The NPO Committee has some concerns regarding this change. First, we generally think there is merit to requiring the use of a name that clearly indicates that an entity is a corporation – it serves to advise the world of the

limited liability nature of the entity. If the name can include the other words allowed by the 2009 Bill, it could create confusion since those are words more commonly used with the organizations formed not as separate juridical entities but rather as unincorporated associations. (We would not object to those words appearing in a corporation's name so long as the corporate indicator also appears in the name (e.g., "ABC Association, Inc."). Second, the bill would eliminate current language allowing Type B corporations to have no entity indicator in their names. Whether this was intentional is not clear. We feel that this language should remain regardless of whether the general more liberal naming approach of the 2009 Bill is to be followed or, if our approach to require corporate indicators is adopted, we feel that , Section 302(b)(1)of the N-PCL should be revised to "grandfather" the names of existing nonprofits (it currently grandfathers only names existing on the date of effectiveness of the N-PCL), so as to avoid imposing a burden on a large number of existing charities to change change their names.

Technical Drafting Comment:·

- *Names cannot be used if they cannot be distinguished from the name of existing business entities or fictitious names of foreign business entities. It is interesting to note that there is no prohibition on the forming of a new corporation with a name similar to the fictitious name (d/b/a) of a domestic corporation. It is not clear if the Department of State blocks the use of such names, even though their use may not technically be violative of Section 301. Reference to such d/b/a's would be appropriate.*

Article 4
Formation of Corporations

Section **Changes *(Comments)***

402(a) **Certificate of incorporation; contents**

The 2009 Bill would eliminate the requirement to include in the certificate of incorporation (i) the type of corporation (*i.e.*, A, B, C or D, which would no longer exist under the new proposal) and (ii) the names and addresses of the initial directors of the corporation. The second change would conform the N-PCL to the BCL (and other states' practices).

The NPO Committee supports this change. The provision requiring that directors be named is not necessary and creates security concerns (especially with the need to also provide an address). Note that legislation has been separately introduced to modify the current requirement to provide the address of the named director (A6381, 2009-2010 Regular Session). See our discussion in Attachment One above regarding reasons why such names and addresses should not be required. We understand that the names of directors will generally be available for nonprofits that have to file a Form 990 with the IRS but the address that can be used is the address for the entity or another business address of the director.

As discussed in Attachment One (c) above, the Department of State requires the purpose clause to also "clearly and fully describe the activities of the corporation." There is no such requirement in Section 402. The Department of State states that it needs such information to make sure that necessary

consents are obtained, the right type is elected and the name meets statutory requirements. With the elimination of the consent and type provisions, we feel that such information should no longer be required (if it ever even should have been required). Accordingly, we think that language should be included in the legislative history, if not the N-PCL, to the effect that no description of activities should be required. See also our comments below regarding Section 1304(a)(4), pertaining to applications for authority by foreign corporations.

402(c) The 2009 Bill would add the ability (but not the requirement) to include in the certificate of incorporation any provision "relating to matters that are required or permitted to be set forth in the by-laws" (with the exception of any provision inconsistent with the NPCL).

The NPO Committee supports this change but thinks it should also include language allowing the certificate to include anything not inconsistent with the N-PCL, similar to the provision that appears in the BCL.

There is currently some uncertainty as to whether provisions may be included in the certificate of incorporation if they are not called for by the N-PCL. The language of Section 402 does not say that any language not required to appear in the certificate may be included except that paragraph (c) states the certificate may include provisions not inconsistent with the statute if the language is for " the regulation of internal affairs, including types or classes of membership and the distribution of assets on dissolution or final liquidation or required by an agency which has the right to give consent." The language does not allow the inclusion of provisions required by the Internal Revenue Code to obtain tax exemption other than dissolution language, but such language is routinely added. The implication of paragraph (c) is that other language is not allowed. But the Department of State states that a "Certificate of Incorporation may include other provisions consistent with law" (see http://www.dos.state.ny.us/corp/nfpguide.htm). The BCL allows certificates of incorporation to include any provision not inconsistent with the statute "relating to the business of the corporation, its affairs, its rights or powers, or the rights or powers of its shareholders," which is broader language than appears in the N-PCL. The Model Nonprofit Corporation Act, Third Edition, similarly allows a broad (but not unlimited) category of optional information:

"(6) provisions not inconsistent with law regarding:(i) the purpose or purposes for which the nonprofit corporation is organized;(ii) managing the business and regulating the affairs of the corporation; (iii) defining, limiting, and regulating the powers of the corporation, its board of directors, any designated body, and the members, if any; (iv) the characteristics, qualifications, rights, limitations, and obligations attaching to each or any class of members; or(v) the distribution of assets on dissolution;… [and] (9) provisions required if the corporation is to be exempt from taxation under federal, state, or local law."

Consideration should be given to clarifying this issue either by tracking the BCL or Model Act language or by otherwise expressly granting the ability to include language which is not required to appear in the certificate or, alternatively, by clearly stating that only language allowed by Section 402 can be included.

402(d) The 2009 Bill would allow for the elimination or limitation of personal liability

of directors to the corporation and/or its members provided that their behavior is not in bad faith or the result of intentional misconduct or a knowing violation of law or that the behavior does not result in a personal financial gain or other advantage for the individual directors or officers in question to they were not entitled or such action violated Section 719 of the N-PCL. Directors would still be liable for claims by the Attorney General and for actions for equitable relief. Personal liability may not be limited or eliminated for any act or omission prior to the adoption of this new section.

As discussed in Attachment One above, we think it may be helpful in getting support for N-PCL reform to propose that the fiduciary duties of directors be better set forth in the statute. Since it may be perceived as weakening the fiduciary duties of directors, this language may be counterproductive for the bill. While we note that exculpatory language appears in the Delaware General Corporation Law (Section 102(b)(7) of the General Corporation Law), which is applicable to both for-profit and non-profit corporations formed in Delaware (and therefore might be a reason for management wanting to form a new nonprofit in Delaware), we doubt that the inclusion of such language would be a major factor for new nonprofits in deciding whether to form in Delaware if the other provisions of New York's nonprofit statute were not so burdensome. We also note that the Delaware provision includes an additional exception from the exculpatory provision for breaches of the duty of loyalty, which has proven to be a major limitation on the scope of exculpation.

Note that legislation has been separately introduced to allow corporations to eliminate such liability of directors (S2138, 2009-2010 Regular Session).

403 **Certificate of incorporation; effect**

The 2009 Bill would add new language that allows the certificate of incorporation to include a specific date in the future on which corporate existence will begin, provided that the date selected is not more than 90 days after filing.

No comment.

404 **Notices, approvals and consents**

The 2009 Bill would replace the requirement that certain agencies consent to the filing of a certificate of incorporation with a requirement that the nonprofit notify relevant state agencies of the filing of the certificate of incorporation if it contains language that previously required consent.

The NPO Committee, in its letter of December 14, 2006, supported the elimination of agency consent, saying that it afforded the public with little additional protection. The fact that New York requires such preapproval is one of the several reasons why many nonprofit practitioners recommend that new New York-based nonprofits be formed outside of New York. While approvals will still need to be obtained for qualification to conduct activity, at least the entity is legally existent and it can start the process of obtaining IRS approval.

The NPO Committee, however, did not support a requirement present in the

initial draft of the proposed legislation that the Secretary of State's office notify the affected agencies, thinking that would place an undue burden on that office. Instead, the NPO Committee recommended that each corporation be required to notify the proper agencies within one month of incorporation. The NPO Committee felt that advance approval may still be appropriate for certain activities that are crucial to public health and safety.

The 2009 Bill reflects the elimination of this proposed duty of the Secretary of State and instead properly requires that the corporation shall provide a copy of the as-filed document to the various relevant agencies. We note that if any agency does not agree with a provision of the filed certificate, it can condition its approval of the activity to be conducted by the corporation upon submission of an amendment to the certificate.

We note that there is no procedure under the 2009 Bill to ensure that new nonprofits actually provide the required notice to the proper agencies. In order for the Department of State to perform whatever audit function it desired to ensure that notice was being given to the appropriate agencies, we would support a requirement to include in a new certificate of incorporation or in an accompanying form a listing of the agencies that the nonprofit will be notifying (it could be done as a "check the box" or as a listing). Tthe Department of State could then, in its review of the certificate, indicate whether it felt that notification should also be given to other agencies. If the certificate is rejected because the Department of State feels that notification to another agency is required, all that would need to be done by the new nonprofit would be to submit a revised certificate or form that includes that agency. This is a much simpler process than is present under the current regime, where the nonprofit would need to get approval from that agency. If felt crucial to obtaining agency support for the proposal, it would also be possible to require that a second filing be made with the Department of State providing proof of notification to such agencies with failure to file such proof resulting in a loss of authority to conduct activity (similar to the requirements now existing under the Limited Liability Company Law to file proofs of satisfaction of the publication requirement). This procedure, while cumbersome, would nevertheless allow the nonprofit to be formed more quickly than under the current regime, thereby allowing it to seek IRS clearance and start operations sooner.

It is interesting to note that the obligation to provide notice after filing (instead of obtaining consent prior to filing) currently applies to child day care centers (under paragraph (2)). Note, however, that such duty also applies to each certificate of amendment, merger, consolidation or dissolution. The provisions of the N-PCL regarding amendments (and provisions of the 2009 Bill regarding other actions) reiterate this requirement; whether the requirement should be here only, elsewhere with respect to amendments, etc. or in both places, the requirements for all state agencies should be parallel.

Under the 2009 Bill, for fire corporations and political party corporations preincorporation consent would still be required. We do not know what the rationale is for these exceptions.

Section 404(w) currently precludes the use of certain names without Education Department consent. Since the Education Law governs the use of such names, it is appropriate to keep the restrictions in place but the restrictions should be moved to Section 301(a) regarding words in corporate names.

*All state agencies will need to be queried as to their reaction to this proposal. It is expected that some agencies will continue to insist on preapproval. This may be appropriate where the corporation must be formed under another law overseen by that agency. For instance, many corporations must be formed under the Education Law (*i.e.*, schools, museums and libraries) or the Religious Corporation Law. The N-PCL needs to expressly state (maybe as a new first paragraph in this section) that corporations required to be formed under those other cited laws must be formed under those laws instead of the N-PCL. This limited carve-out is less expansive that current paragraph (d), which applies to any corporation that "might" be formed under the Education Law; unless the corporation is required to be formed under another law, it should have the right to be formed under the N-PCL. Where there is a potential issue of whether the corporation should be formed under the N-PCL or another law, a procedure should be added to get an advance ruling from the agency, based on a description of the purposes of the corporation (rather than needing to submit an executed certificate of incorporation), as to whether it must be formed under the special law or could be formed under the N-PCL.*

Since pre-approval is now required, it is possible that agencies that have to give consent may not have procedures in place for requiring registration in order to conduct activities, instead relying on the preclearance rules, and those agencies may therefore need to adopt new rules. Accordingly, it may be appropriate to have a provision in this section stating that the new procedures shall only become effective after some period following the general effective date of the new provisions (e.g., one year later) and, until that date, the consents currently required shall still need to be obtained.

Technical Drafting Comment:

- *For consistency and readability, change "thirty" to "30."*

405 **Organization meeting**

No change is proposed by the 2009 Bill to this section.

It is interesting to note that the N-PCL has long included language in this section envisioning the need for a meeting of the incorporators if the initial directors were not named in the certificate of incorporation; but such provision was irrelevant since Section 402 required that the initial directors be named in the initial certificate of incorporation. This provision would now make sense if the 2009 Bill is adopted.

406(a) **Private foundation, as defined in the United States internal revenue code of 1986, as amended: provisions included in the certificate of incorporation**

The 2009 Bill would change the words "are hereby included" to "shall be included" for certain provisions specific to certificates of incorporation for private foundations. The provisions are those listed in Internal Revenue Code

§ 508(e).

The NPO Committee did not approve this change when it previously commented on December 14, 2006 and it still does not approve the change. The apparent purpose of the section is to provide New York private foundations with the protection of a default under New York law that ensures that the foundation meets the requirements of IRC § 508(e). The NPO Committee does not support the proposed change since we think this should remain a default provision instead of being made a requirement. As now proposed to be written, it may be that such words have to appear physically in the certificate, whereas under the current wording they are automatically included. If the intent was to say that the words "shall be hereby deemed included," which would make the provision automatic, we would support the change.

The reference to the US Internal Revenue Code has been updated from the Code of 1954 to the Code of 1986.

This change is obviously appropriate.

406(b-1) The current provision requiring that a private foundation formed under the NPCL must publish an annual notice in a newspaper stating that its annual return is available for inspection would be eliminated.

The NPO Committee supports this change. See the discussion above in Attachment One of this issue.

Article 5
Corporate Finance

Section **Changes *(Comments)***

501 **Stock and shares prohibited; membership certificates authorized**

If the certificate of incorporation or by-laws permit it, membership certificates – and the rights that go with them – may be made freely transferable under the 2009 Bill.

Since membership interests could be transferable under the 2009 Bill, the statute should note that the by-laws can include provisions regarding conditions for transfer, such as consent by the corporation. Since most nonprofits require some corporate approval before someone becomes a member, it is logical to assume that such nonprofits would require consent to such transfer of w membership interests. We propose adding after "or transferable" in the second sentence, the words: "(and any provisions in the by-laws, or a reference to such provisions, setting conditions, such as consent by the corporation, or otherwise restricting transfer)".

If membership interests in a charity may be transferrable, language needs to be added to make it clear that the member should not receive any consideration for the transfer of such interest. If the member received payment, there may be adverse tax consequences to the corporation. Alternatively, the statute might prohibit the transfer of membership interests in corporations with charitable purposes. If the transfer of membership certificates is to be allowed, we

propose adding a proviso at the end of the last sentence as follows: "; provided, however, the transferor of a membership certificate in a corporation with charitable purposes shall not be entitled to receive any payment or other consideration in connection with such transfer."

502 **Members' capital contributions**

The 2009 Bill expands provisions dealing with capital contributions by members and makes clear that the certificate of incorporation may authorize the issuance of different classes of capital certificates with different rights to assets of the corporation upon dissolution.

The NPO Committee, in its letter of December 14, 2006, said that the proposal would permit not-for-profit corporations to accept capital contributions that would entitle the contributors to certain rights with respect to the property of the recipient corporation, and these rights could be evidenced by capital certificates or membership certificates which would be freely transferable. In several other areas, the holders of such certificates would have rights roughly analogous to the rights of shareholders in a business corporation. The committee said that while this statutory change might be appropriate with respect to for-profit corporations, it is not appropriate for not-for-profit corporations, because individuals (including contributors) cannot (as a matter of law) be provided with any rights with respect to the property of a not-for-profit corporation. The NPO Committee, therefore, opposed this proposal.

It is acknowledged that the N-PCL currently allows capital contributions by members of any not-for-profit corporation, including charities. The Model Nonprofit Corporation Act, Third Edition, does not allow capital contributions by members of charitable corporations (see Section 6.42).

The holders of such capital certificates in charities should only be entitled to a return of capital, not any appreciation thereon. Since the capital certificates of charitable entities are not transferable under the 2009 Bill, the holders cannot sell them for a gain. Similarly, payment on dissolution or otherwise is limited to the amount of capital paid in. Though denominated "capital," it is really non-interest bearing debt. Therefore, so long as certain protections are added regarding charitable corporations, it may not be problematic to allow variable rights for capital contributors. Capital contributions of services may be a viable way for a nonprofit to raise needed working capital from members.

Language needs to be added to clarify that assets may not be distributed upon dissolution to members of charitable nonprofits so as to satisfy the requirements of the Internal Revenue Code that no part of the assets, income or profits of the corporation can be distributed to or inure to the benefit of any member, of the corporation.

It would also be appropriate to indicate in Article 6 (in Section 612 or 613) that each member shall be entitled to one vote unless otherwise allowed by those sections.

The 2009 Bill would allow a legally binding obligation to pay money or

perform services to serve as a valid capital contribution (currently only money paid and services actually performed are acceptable) and provides that the corporation could sue to enforce that obligation or pursue such other remedies as are contained in the agreement that creates the obligation.

The NPO Committee supports this change; it brings the N-PCL into conformity with the BCL.

Technical Drafting Comment:

- *In the newly added wording in paragraph (a), the words "… limitations of such certificate" probably should be "… limitations arising from such capital contribution."*

503 **Capital certificates**

The 2009 Bill allows transfer without corporate consent of transferrable certificates; currently such transfers, if allowed, can only happen with corporate consent.

We question why such consent requirement was eliminated in all instances. The statute should say that if there are restrictions on transfer in the by-laws, such as the need for corporate consent, the certificate should reflect such conditions.

504/ 505 **Subvention/ Subvention certificates**

Subventions and subvention certificates, which may entitle the holder to a payment from corporate assets upon the happening of a circumstance or event other than dissolution specified in the subvention certificate, would be eliminated.

*While we understand that the NYSBA was unable to find any nonprofits that have subventions, we understand that they are used by some nonprofits, especially healthcare organizations. We suspect that there may be accounting advantages to the use of subventions (*e.g*, possibly with respect to calculation of debt coverage ratios) that warrant further exploration. Accordingly, subventions may still be a useful way to capitalize a nonprofit, especially if they are the only alternative to capital contributions. We feel that further investigation is necessary to determine if they have any viability, perhaps with program related investments (PRIs). At a minimum, it needs to be retained for any existing subventions. Accordingly, the references to subventions should not be deleted from these sections (and the many other sections where they were deleted in the 2009 Bill).*

506 **Bonds and security interests**

The 2009 Bill would allow a not-for-profit corporation to place in escrow any bond issued as security for the performance of services that will be used to make a capital contribution.

No comment.

507 **Fees, dues and assessments; fines and penalties**

No change is proposed by the 2009 Bill to this section. Paragraph (d) gives members "distributive rights" in a nonprofit's assets if the certificate of incorporation says that members paying fees, dues or assessments have such distributive rights. This requirement is "[s]ubject to the provisions of this chapter."

Such right should not be allowed for corporations with charitable purposes.

509 **Purchase, sale, mortgage and lease of real property**

No change is proposed by the 2009 Bill to this section.

The bill makes no change in the requirement for approval by two-thirds of the entire board (or a majority of the entire boards for boards with 21 or more directors) for any purchase, sale, lease (as lessor or lessee[17]) or mortgaging of real property.

This is a very onerous requirement, especially as to routine transactions. Since nonprofits may adopt low thresholds for a quorum (e.g., 33% of the board, or even lower for boards with more than 15 members), many meetings are held without the presence of a supermajority of the board (or even a majority of the board), meaning no real estate actions could be approved. This provision is often ignored by nonprofit corporations, especially as to leasing of property as a tenant (and especially so when such leasing is a normal course activity). The NPO Committee believes that such actions should generally be approvable like any other routine corporate action – i.e., by majority action at a meeting at which a quorum is present.

Some high vote requirement may make sense with respect to the purchase or sale of significant property or its mortgaging or the entering into of significant lease transactions, but not for routine or low value transactions. At a minimum, there should be some sort of di minimus *threshold (maybe expressed as a a percentage of an organization's assets for purchase and sale transactions and a percentage of expenses or income, depending on whether the lease is as lessee or lessor, or a term over a certain threshold (*e.g.*, five years) for lease transactions). If a higher vote is thought necessary, it may be more appropriate to allow approval by the lesser of a supermajority of those present (e.g., two-thirds of those present) or a majority of the entire board or approval by a majority of the number of directors currently in office. If there is concern that important action could be taken against the wishes of a majority of the board, it might be appropriate to require that the proposal be included in the notice of meeting.*

Any high vote requirement on this issue should be set forth in, or referenced in,

[17] Although an argument can be made that only lesses as lessor need to be board approved since the leasing language appears in a portion of the provision relating to dispositions (Section 509 states "No purchase of real property shall be made by a corporation and no corporation shall sell, mortgage or lease real property, unless authorized by the vote of two-thirds of the entire board, provided that if there are twenty-one or more directors, the vote of a majority of the entire board shall be sufficient.").

Section 708(c), the general provision of the N-PCL regarding board approval requirements.

Note that under the Religious Corporation Law, court approval is required if the transaction is a sale, mortgage or lease for a term in excess of five year (excluding purchase money mortgages, foreclosures or deeds in lieu of foreclosure; certain denominations require court approval but do not require notice to the Attorney General. Whether these requirements of the Religious Corporation Law should also be reviewed is a matter for consideration. It may be appropriate to include a cross reference in the N-PCL to this requirement for religious corporations.

510 **Disposition of all or substantially all assets**

The requirement that approval of the State supreme court or a county court needs to be obtained in order to sell all or substantially all of a not-for-profit corporation's assets would be eliminated if the transferee is another corporation organized for charitable purposes that is controlled by or under common control with the corporation.

A prior version of the State Bar proposal totally eliminated the requirement for court approval of all or substantially all the assets of a Type B or Type C corporation (no such approval is currently required for transfers by other corporations). The NPO Committee, in its letter of December 14, 2006, said that it supported such elimination with respect to mutual benefit corporations but did not support it for public benefit corporations since such review is appropriate to ensure that the transfers are consistent with the organization's charitable mission and made in a reasonable manner and for adequate consideration.

As revised, the bill would require court approval of the sale of all or substantially all of its assets if the corporation has charitable purposes or if the organization "holds assets received for specific purposes," whether or not the restricted assets are proposed to be transferred. As written, if the entity has any restricted assets it must get approval for the sale of the nonrestricted assets; the NPO Committee thinks it appropriate to require approval for the transfer of any restricted assets by any nonprofit e corporation and substantially all of the assets of charitable corporation (whether or not restricted), but does not think that it is appropriate to require court approval of the transfer of nonrestricted assets where the organization is not charitable. The following language would be more appropriate:

> If the corporation is …. organized for charitable purposes or holds assets received for specific purpose, ~~such~~ the sale, lease, exchange or other disposition of the assets (or, in the case of assets received for specific purpose, such assets) other than to another corporation organized for charitable purposes and controlled by, or under common control with, the corporation, shall in addition require leave of the supreme court …

The NPO Committee also supports elimination of the court approval requirement in favor of a requirement for approval by the Attorney General (currently AG approval is practically required before the supreme court will

approve a sale). We believe that there should be a right to appeal to the supreme court regarding any denial of approval by the Attorney General. We would hope that the Attorney General would adopt simplified approval procedure if the transfer is to another New York chartered charity that is current in its reporting to the New York Attorney General's office, on the theory that regulatory concerns should be less if the assets are going to stay in New York's control and the transferee organization is "good."

We note that the Model Nonprofit Corporation Law, Third Edition (Section 12.03) only requires court and/or Attorney General approval with respect to property "held in trust or otherwise dedicated to a charitable purpose."

We have commented elsewhere that the requirement that matters be approved by a majority of the entire board, as is required here if there are no members, should be modified by eliminating the requirement that approval by based on the size of the entire board. See our discussion in Attachment One above regarding possible alternative thresholds that are more practical to achieve and other protective procedures that might be adopted.

511 **Petition for leave of court**

The phrase "other than to another corporation organized for charitable purposes and controlled by, or under common control with," was added to the provision requiring court approval of the transfer of all or substantially all of a corporation's property.

Such addition is surplus, since that exclusion already exists in Section 510 and therefore organizations making such transfer are not required to obtain court leave.

513 **Administration of assets received for specific purposes**

No substantive change is proposed by the 2009 Bill to this section. This section relates to the administration of assets received for a specific purpose.

As noted below regarding Section 519, an annual report must be given each year to the members or, if there are no members, to the board of directors. Section 519 details the requirements of that report. Section 513(b) requires that an annual report be given concerning the assets held under this section. As noted below regarding Section 519, references to the annual report requirements of this section and Section 519 should be added to the annual meeting provisions of the N-PCL.

Technical Drafting Comment:

- *We think that it be better to change the words "assets consisting of funds or other real or personal property of any kind, that may be given, granted, bequeathed or devised to or otherwise vested in such corporation in trust for, or with a direction to apply the same to, any purpose specified in its certificate of incorporation" to "assets received for specific purposes," since it is now a defined term (see Section 102).*

515 **Dividends prohibited; certain distributions of cash**

No change is proposed by the 2009 Bill to this section.

While paragraph (a) makes it clear that a corporation could not pay a" dividend" or "distribute any part of its income or profit" to its members, directors or officers, paragraph (c) states that distributions may be made of cash or property to members, directors or officers prior to dissolution "as authorized by this article." The NPO Committee thinks it appropriate to add a prohibition in paragraph (c) on payments in dissolution of charitable corporations if such distribution would jeopardize the entity's tax exempt status.

519 **Annual report of directors**

No change is proposed by the 2009 Bill to this section. This section requires that a financial and membership report be given at the annual members or directors meeting and such report must include financials for a "twelve month fiscal period terminating not more than six months prior to" the meeting.

Many nonprofit corporations fail to give such annual report. To encourage compliance with the requirement, the NPO Committee believes that language should be added in Articles 6 and 7 (relating to shareholder and director meetings) cross-referring to this requirement and the similar requirement of Section 513.

The NPO Committee also believes that a corporation, in lieu of an annual report given at the meeting, should be able to distribute to all of its members and directors a copy of its financial statements and information about membership with the notice of meeting.

The statute requires that the financials cover a 12-month period ending no later than six months before the report. This would logically cover the previously-ended fiscal year. If the year-end numbers are to be provided, it means that the nonprofit must hold the annual meeting within six months of the year end. Otherwise it would have to prepare financials for another 12- month period ending sooner.

It should be noted that many (maybe most) nonprofits do not have their financial statements ready prior to the extended due date of the annual information return filed with the Internal Revenue Service (and corresponding filings with the New York Charities Bureau); such filings can generally be made up to 10-1/2 months after the nonprofit's fiscal year end. Section 519 should be amended to eliminate the six month requirement; if it is not eliminated, the time period should be extended to 11 months after year end.

The annual report is required to provide data regarding the members of the organization "as of the date of the report." It is unclear if "date of the report" means the last date of the period being reported on or the date that the report is given. It is suggested that the words "number of members … as of the date of the report" be changed to "number of members …as of the end of the period being reported on" (and the words "increase or decrease in such number during said fiscal period" be changed to "increase or decrease in such number from the prior period end) and the reference to "current members" be

changed to "members as of the record date for the meeting."

The provisions regarding memorialization of the report should be the same whether the report is given at a meeting of the members or the board (make paragraph (c) paragraph (b) and add a new paragraph (c) which reads:

> The annual report ~~of directors~~ shall be filed with the records of the corporation and either a copy or an abstract thereof entered in or made an attachment to the minutes of the proceedings of the annual meeting of members or directors, as applicable.

Technical Drafting Comment:

- *A comma should be added between "purposes" and "during" in clause (3).*

520 **Reports of corporation**

The 2009 Bill would remove the statement that a willful failure to file required reports to the state (especially under the Estates, Powers and Trusts Law) is a violation of the director's duty of care which may result in involuntary dissolution of the corporation, and would replace it with language which states the Attorney General may issue an order compelling the issuance of an annual report if the corporation willfully fails to file it, and that the corporation may only be dissolved if it fails to file the report within 60 days of receiving the order from the Attorney General's office.

The NPO Committee believes that it is appropriate to note this duty to file such reports in Section 103-A.

The revision eliminates language stating that it shall be a breach of each director's duty if the corporation willfully does not file a required report. Though not expressly so stated, the directors duty stated here is a statement of the duty of obedience. Such duty would be better stated in Section 717. See our discussion of Section 717 below.

The new language that requires that the attorney general first issue an order before bringing an action for judicial dissolution may be refined to clarify that failure to abide by such an order could be viewed as a breach of a director's duty.

Technical Drafting Comment:

- *"Sixty days" should be "60 days" (and other spelled out numbers in the document should be changed to numbers, as was started earlier in the document)*

Article 6
Members

Section **Changes *(Comments)***

601(a) **Members**

Under the proposal, all not-for-profits could have one or more classes of members or no members. Under the current statute, not-for-profits are required to have members unless they are a Type B corporation. This proposed change follows from the overall eradication of type classifications.

The statute is unclear on what, if any, approvals are required for Type B corporations that have members to eliminate the membership requirement or for Type B corporations that do not have members that wish to establish a membership structure. Since the requirements for members of Type B corporations can be set forth in the by-laws, and by-laws can generally be amended by both the board and members (see Section 602(b), presumably the directors could vote to eliminate the membership structure, thereby eliminating the rights of existing members. Members of the NPO Committee have often encountered conflicting advice from the Charities Bureau In certain instances the Charities Bureau has required that approval of existing members be obtained for the elimination of the membership structure and it has also required approval of the bureau for the establishment of a membership structure where one did not previously exist (such approval requirement being imposed in the context of AG approval of a related asset sale). The NPO Committee recommends that the statute be clarified on what approvals, if any, would be necessary in these instances. This issue may be more relevant with any elimination of the requirement that Type A, C and D corporations have members.

601(d) New language would be added to the effect that membership in a not-for-profit would not be transferable unless otherwise provided in the certificate or by-laws. Membership cards would not be transferable, however.

Provisions should be added that membership in a charitable corporation may not be sold. See our comments to Section 501.

601(f) Language would be added to clarify that, unless otherwise provided in the certificate or by-laws, a corporate member's membership in a not-for-profit automatically would be terminated upon such corporate member's dissolution.

No comment.

602(c) **By-laws**

Paragraph (b) under the existing N-PCL gives both the members and, unless the certificate of incorporation or by-laws say otherwise, the board the ability to adopt, amend and repeal the by-laws. The 2009 Bill does not substantively revise that provision. Under paragraph (c) of the existing N-PCL, the members may amend or repeal any board-approved by-laws and, unless the certificate of incorporation or by-laws say otherwise, the board may amend or repeal any member-approved by-law. The 2009 Bill makes certain changes to paragraph (c).

First, by-laws (whether adopted by the board or the members) could be amended or repealed by a "majority of members at the time entitled to vote in the election of any directors." The current statute allows such changes by a majority of the members who are voting at a meeting.

The NPO Committee opposes this change, as it establishes a threshold for approval of amendments to by-laws which is too high. Many membership

corporations have a high number of members (in the hundreds or thousands) and therefore have a very low quorum requirement, with action to be taken by a majority of the quorum. Having to obtain the approval of a majority of those present is a more manageable approval level than having to obtain a majority of the entire voting membership. It would be appropriate to require that notice of any change of by-laws has to be set out in the notice of meeting.

Second, under the 2009 Bill by-laws adopted by the members could be amended or repealed by the board only if so provided in the certificate or by member-approved by-laws (The certificate or by-laws could specify that the board vote required to amend or repeal the by-laws can be higher than the vote required for other actions of the board.

It appears that the proposed changes are aimed to reflect § 601 of the BCL, which requires the certificate or by-laws to affirmatively give the board the right to amend/repeal the by-laws (in other words, if the certificate and by-laws are silent as to the board's right to amend/repeal the by-laws, the proposed revision would prevent the board from doing so, whereas under the current statute, the board has this right unless otherwise provided in the certificate or by-laws – i.e. the default has changed).

The NPO Committee does not support this change since most nonprofit corporations assume the board can always change the by-laws, even in a membership corporation. We think the existing rule, which removes the board right to amend if so stated in the certificate of incorporation or by-laws, is adequate and should not be changed.

Third, language is added that a by-law adopted by members includes by-laws adopted by the incorporator.

We support this last change. It is consistent with exiting Section 614, allowing incorporator to consent to action when there are no members.

Technical Drafting Comment:

- *It may be appropriate to add the words "this article," between "provided in" and "the certificate" in paragraph (b).*
- *Paragraph (c) as revised is now confusingly similar to paragraph (b). The last sentence of paragraph (c) is redundant of the last sentence of paragraph (a).*
    - *The by-law provision comes in an article captioned "Members." That is not a logical place for it, although that is also where it is in the BCL (in the context of the BCL however, at least corporations have the equivalent of members, i.e., shareholders). It would be appropriate to move the by-law provision to an earlier section (e.g., Article 4, dealing with formation) or to add the words "and By-Laws" to the article title.*

603(b) **Meeting of members**

No substantive change is proposed by the 2009 Bill to this section.

As noted in our comments above regarding Section 519, financial information that is included in the annual report required to be presented to the annual

meeting must be no less than six months old at the time of the meeting. Unless that timing requirement is eliminated, Section 603 should be revised to cross reference this requirement.

603(c) The 2009 Bill would change the time-frame during which a special meeting demanded by members entitled to cast 10% of the votes must be held from a minimum of two months from the date of demand to the shorter period of 20 days from the date the demand is made (and a maximum of three months from the demand to the shorter period of 60 days from the date the demand is made.

We question whether the new time frames were intended to be 60 days (instead of two months, which is what the law currently requires) and 90 days (instead of three months as the law currently reads), instead of 20 and 60 days respectively. A change to 60 days and 90s would be consistent with the changes proposed for Section 604 and how the provision of the BCL corresponding to Section 603(c) is written. If that is what was intended, the NPO Committee supports the change.

If, however, the change as it appears here was in fact as intended, the NPO Committee opposes such change as it relates to the earliest time when the meeting could be called since it does not give the corporation adequate time to distribute the notice of meeting. Section 605 requires that notice of member meetings must be give at least 10 days before the meeting. If a member using the provision of Section 603(c) specifies that a meeting be held within 20 days from the date of its written demand, the corporation may not have adequate time to prepare and send out the notice and still provide the minimum of 10 days notice prior to the meeting (especially since the 20 days would start from the date of the written demand, not the date of receipt of such demand by the corporation and the number of days involved is calendar days, not business days.

603(e) The 2009 Bill proposes to add language stating that, unless otherwise provided, by-laws may designate reasonable procedures for the calling and conduct of a meeting of members, included but not limited to specifying: (i) who may call and who may conduct the meeting; (ii) the means by which the order of business to be conducted shall be established; (iii) the procedures and requirements for the nomination of directors; (iv) the procedures with respect to the making of member proposals; and (v) the procedures to be established for the adjournment of any meeting of members. The proposed language mirrors § 602(d) of the BCL.

No comment.

Technical Drafting Comment:

- *In this section and in sections 604 and 605 double numbering (e.g., "sixty (60)") is used. That is needlessly duplicative. As noted earlier, it would be better if just the numeric version was used.*

604(a) **Special meeting for election of directors**

The 2009 Bill would change the minimum two-month and the maximum three-month period for advance notice of a member-called meeting for the election of directors to conform to the analogous provision of the BCL, which provides for a time-frame of 60 and to 90 days advance notice.

No comment.

605(a) **Notice of meeting of members**

The 2009 Bill would allow notice of a meeting of members to be given in electronic form as well as in writing. The proposed revision mirrors changes made to BCL § 605(a).

We support such electronic notification.

The proposed language requires that the member have provided an electronic mail address for delivery of such notice ("such notice is given when directed to the member's electronic mail address as supplied by the member to the secretary of the corporation or as otherwise directed pursuant to that member's authorization or instruction"). The statute does not include any express provision for revocation of such notice but presumably the words "authorization or instruction" would allow the member to revoke such instruction. We note that the Model Nonprofit Corporation Act, Third Edition, allows electronic notice (see Section 1.41(h)) but includes express provisions regarding revocation of the right to communicate electronically (see Section 1.41(i)):

"An authorization by a member of delivery of notices or communications by email or similar electronic means may be revoked by the member by notice to the nonprofit corporation in the form of a record. Such an authorization is deemed revoked if (i) the corporation is unable to deliver two consecutive notices or other communications to the member in the manner authorized; and (ii) the inability becomes known to the secretary or other person responsible for giving the notice or other communication; but the failure to treat the inability as a revocation does not invalidate any meeting or other action."

We recommend adding a provision regarding revocation.

The NPO Committee, in its letter of December 14, 2006, supported the change allowing electronic notice of members meetings. It also supported a similar change regarding directors meetings, as well as allowing electronic voting at both the member and board levels (provided that a procedure for effective deliberative process is preserved).

The current provision allows notice "personally" or "by mail." The new provision instead allows notice "in writing" or "electronically" without reference to whether it is mailed, given personally or delivered otherwise. We do not object to this change.

The NPO Committee suggests that the phrase "provided, however, that such notice may be given by third class mail not fewer" be rewritten to read: "provided, however, that if such notice is not given personally or electronically or sent by first class, priority or express mail (or its private or public

equivalent, however, denominated), it shall be given not fewer."

Electronic communication could also include fax. Accordingly, add "or facsimile telecommunication number"[this term is used in Section 609] after "member's electronic mail address."

Technical Drafting Comments:

- *The words "or of a transfer agent of the corporation" should be eliminated since it is rare that membership interests are transferrable. The words "or other person giving notice" is broad enough to cover mailing agents.*
- *We would recommend moving the new proviso in the fourth sentence of paragraph (a) to the end of the sentence.).*
- *Note that the new language includes both spelled-out and numeric references (e.g., (ten (10)," which is inconsistent with the style used elsewhere.*

606 **Waivers of notice**

The 2009 Bill would permit a waiver of notice of a meeting of members to be written or electronic, and specifies the procedures for valid waiver of notice in each medium. The proposed revision mirrors the language in BCL § 606 permitting electronic waiver of notice.

No comment.

610(a) **Selection of inspectors at meeting of members; duties**

The 2009 Bill would specify that the term "inspector" includes a person performing the function of an inspector, whether or not so denominated by the corporation.

No comment.

610(c) The 2009 Bill would add new language which specifies the data which inspectors may examine in determining the validity and counting of proxies, ballots and consents at a meeting of members. The proposed revision closely mirrors the language in BCL § 611(b).

No comment.

Technical Drafting Comment:

- *For stylistic consistency, "(proxies)" should be deleted in the phrase "section 609 of this article (proxies)" unless the deletion of the parenthetical references done elsewhere is reversed, as we recommend..*

610(d) Revised section 610(d) would specify the protocol for the opening and closing of the polls for each matter upon which the members will vote at a meeting of the members. The proposed revision closely mirrors the language in BCL § 611(c).

No comment.

611(e) Under the 2009 Bill, members in noncharitable corporations could have more or less than one vote if so provided in the certificate of incorporation (or, as set

forth in the last sentence of this paragraph, the by-laws). It also states that references to corporate action by a majority or other percentage of members shall be construed to mean that percentage of member votes, if the certificate of incorporation or by-laws provide for more or less than one vote per member.

The proposed revision would also delete the language specifying that if a corporation has an organization as a member, the by-laws may provide that such organization shall be entitled to votes substantially proportionate to its membership. Instead, it allows such proportionate voting only if so specified in the certificate of incorporation.

The NPO Committee, in its letter of December 14, 2006, took issue with language that allowed a nonprofit to assign voting power other than on a "one member, one vote" method (other than as allowed by Section 612), for example, voting based on percentage of capital contributions, as it relates to public-benefit corporations, where corporate governance should not properly be based on considerations such as capital contributions. The 2009 Bill seemingly responds to this comment by limiting deviations from this rule to noncharitable nonprofits . It would also allow, as current law does, voting rights to be assigned to corporate members on a basis other than one member, one vote. Any such rule must be set forth in the certificate of incorporation, and not (as now allowed for corporate members of nonprofits) in the by-laws. Language would also be added to clarify that references in the statute to action approved by a majority of the members is determined based on voting interests, not per capita.

Technical Drafting Comment:·

- *We would recommend adding "or by-laws" after "as otherwise provided in the certificate of incorporation" so that the last sentence agrees with the first sentence. We would also recommend eliminating the semicolon between "one vote" and "except."*
- *The semicolon between "one vote" and "except as otherwise provided" in paragraph (e) should be replaced with a comma.*
- *The words "Except as otherwise set forth in Section 612" should start off the wording in paragraph (e).*

612 **Limitations on right to vote**

No change is proposed by the 2009 Bill to this section.

It would be appropriate to indicate in Section 612 or in Section 613 that each member shall be entitled to one vote unless otherwise allowed by the certificate of incorporation or by-laws in accordance with Section 611(e).

613 **Vote of members**

The 2009 Bill provides that regular corporate actions requiring a vote other than by a majority vote of the members could be specified in the certificate of incorporation or by-laws adopted by the members (as opposed to by-laws

adopted by the board, as currently allowed). This proposed change mirrors the language in BCL § 614(b).

As noted in other contexts, requiring such by-law to be member-approved may be problematic for nonprofit corporations.

Technical Drafting Comment:·

- *Delete "or" after "certificate of incorporation" in paragraph (b).*
- Paragraph (c) is confusing. It states that corporate action by a majority vote or two-thirds vote requires that the number of votes in favor of the proposal equal, at a minimum, the quorum for the meeting. But it states that this does not apply to action approved under paragraph (b), which provides that "any corporate action" other than the election of directors can be taken by majority vote. This exception may be an attempt to recognize that approval percentages other than a majority or two-thirds vote may be set by paragraph (b); but that problem can be addressed by rewriting the paragraph to eliminate the exception language at the beginning and to add words to the effect that any corporate action by majority vote or two-thirds vote or any other percentage vote shall require at least a quorum in favor of such action.

614(a) **Action by members without a meeting**

The 2009 Bill would allow, if so provided in the certificate of incorporation, action to be taken without a meeting if approved by a written consent of members having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all members entitled to vote thereon were present and voted. Actions now may be taken by members without a meeting only by unanimous written consent of the members. This proposed change mirrors the language in BCL § 615(a).

The NPO Committee supports this change. Such action is allowed under the Delaware General Corporation Law; we note that it is not allowed under the Model Nonprofit Corporation Act, Third Edition (see Section 7.04). Issues presented to members for a vote are generally limited in number and easy to explain; just as the members may approve such matters at a meeting without unanimity, so too should they be able to approve them by written consent without unanimity. We do not, however, support an extension of such procedure to director action.

Technical Drafting Comment:

- *With the inclusion of language allowing action upon majority written consent, the following language now appears redundant (in addition to being confusing, as it is in the current law, since any approval by less than majority action is "inconsistent" with the chapter: "This paragraph shall not be construed to alter or modify any provision in a certificate of incorporation not inconsistent with this chapter under which the written consent of less than all of the members is sufficient for corporate action."*
- *The semicolon between "thereon" and "or, if less" in paragraph (a) should be removed.*

614(b) Under the 2009 Bill, if action is taken without a meeting by less than unanimous written consent, prompt notice of such corporate action would need to be given to all members who have not consented in writing. This proposed change mirrors the language in BCL § 615(c).

The NPO Committee, in its letter of December 14, 2006, approved the concept of allowing a not-for-profit corporation's certificate of incorporation or by-laws to allow for action without a meeting upon written consent of the number of members required to take action if a meeting were held, so long as prior notice of the proposal and a subsequent notice of action taken is given to all the members. The 2009 Bill as introduced, however, only requires subsequent notice to nonconsenting members (presumably on the theory that no such notice is currently required with respect to unanimous action and, if everyone consented, no one would object), which is consistent with the corresponding BCL provision. The NPO Committee does not oppose this provision but notes that some people may prefer that written notice go to all members, even those who vote to approve.

614(c) The 2009 Bill states that actions taken by the written consent of members in accordance with the provisions of § 614(a) would have the same effect as a vote of members. These changes are conforming changes. This paragraph was formerly part of paragraph (a).

No comment.

614(d) Under the 2009 Bill, when a nonprofit has no members, corporate action could be taken on the written consent signed by a majority in interest of the subscribers for capital certificates whose subscriptions have been accepted or their successors in interest (as in the current law) or, if no subscription has been accepted, on the written consent signed by "the directors or majority of directors" (which is a new provision), or if there are no directors, by the incorporator or a majority of incorporators (as in the current law). This provision was formerly paragraph (c).

The change to allow written consent signed by directors is not reflected in BCL § 615(e).

The NPO Committee questions whether, as in the existing provision, subscribers for capital certificates should have the ability to take action when there are no members. This seems to be an unthinking carryover from the BCL, where subscribers are shareholders-in-waiting, i.e., persons who will become shareholders when their shares are paid for and issued. Under Section 502, capital contributions may be required "upon or subsequent to admission" as members; it is not the practice to "subscribe" for capital certificates.

Furthermore, we think that this provision needs substantial clarification to make it clear that the right of subscribers, directors and incorporators to so act only applies when the corporation is intended to have members but there are no members at the time when members need to act. As it is now written, the provision would also apply to organizations that do not intend to have members. Accordingly, the phrase in the 2009 Bill that says "When there are no members, such action" should be changed to "When action is required to be permitted to be taken by members but there are no members, member action."

See our comments below regarding Section 708, pertaining to whether

directors should generally be allowed to act by majority consent.

Technical Drafting Comment:

- *The words "the directors or majority of directors" are confusing. The word "the" as modifying" directors" implies "all of" the directors but that implication is then rendered moot by allowing action by a majority of the directors." We suspect that this structure was intended to parallel the language regarding incorporations, which says "the incorporator or a majority of the incorporators." The context is different, however, between these two categories of actors: in practice, it is common to have only one incorporator but, by law, you have to have at least three directors. We would recommend using the words "written consent signed by a majority of the directors, or…"*

615(a) **Greater requirement as to quorum and vote of members**

The current statute bases votes on a proportion of members or members within a certain class. The 2009 Bill bases proportions on the percent of the votes of members, corresponding with the revision to Section 611 which moves away from the one vote per member model for noncharitable corporations to a model where members can have more or less than one vote per member.

No comment.

621(a) **Books and records; rights of inspection; prima facie evidence**

No substantive change is proposed by the 2009 Bill to this paragraph.

The second sentence in the current provision, which reads "A corporation may keep its books and records of account in an office of the corporation without the state, as specified in its certificate of incorporation," seems to require that a corporation cannot keep its books and records outside of New York unless that fact is noted in its certificate of incorporation. The first sentence of this section says that the books and records and the minutes shall be kept "at the office of the corporation" without stating that such office must be in-state *but then says that a list of members must be kept "at such office or at the office of its transfer agent or registrar in this state," implying that "such office" should be in-state*

Such requirement makes no sense. The corresponding provision of the BCL does not state where the books and records and minutes shall be kept; it only requires that a list of shareholders be maintained in New York State . Accordingly, the second sentence should be deleted, the words in the first sentence ", at the office of the corporation," should be eliminated and the words modifying the list of members should be revised to track the BCL provision, which states that the corporation "shall keep at the office of the corporation in this state or at the office of its transfer agent or registrar in this state" such list.

621(b) The language limiting access to a nonprofit's books and records to those persons who either have been members for six months or hold (or are authorized by the holders of) at least five percent of the outstanding capital certificates would be changed under the 2009 Bill to allow any member to

access such information and eliminate the ability of capital certificate holders to obtain such information

The NPO Committee does not support this change. The elimination of the holding requirements may lead to harassment by people who become members solely to go on a fishing expedition. We also see no reason to eliminate the current right of holders of capital certificates so long as their interest is significant. If a person has been a member for a longer period or holds a significant portion of the capital certificates, it is more likely that he or she will act in accordance with the interests of the institution rather than the member's personal interest.

Language would be added, mirroring BCL § 624(b), regarding the format in which books and records must be provided to a member pursuant to this section. The new language says that the company has to provide the requested information "in written form and in any other format in which such information is maintained by the corporation."

As written, this means that the information may be required to be produced in two forms; it would be better to change "and" to "or," which would allow the corporation to provide it in written form or the other form (e.g., electronic), as it wishes or, alternatively, to change the words "written form and in any other format …" to "in the format …"

Technical Drafting Comments:

- *A comma should be added between "demand" and "shall."*
- *The words "or its transfer agent or registrar" are not appropriate for a nonstock company.*
- *In paragraph (e), the words "balance sheet" and "profit and loss statement" should be changed to "statement of financial position" and "statement of activities and changes in net assets or comparable statements" since they do not make "a profit."*

Article 7
Directors and Officers

Section **Changes *(Comments)***

701(a) **Board of directors**

No change is proposed by the 2009 Bill to this paragraph.

It is interesting that the only scout or youth groups that can have directors below the age of 18 are three enumerated organizations (Girl Scouts, Camp Fire Girls and members of Aspira); it would seem logical to generalize the language for scout and similar youth groups so that other groups, such as Boy Scouts, could similarly have youth members of the board.

701(b) Changes proposed in the 2009 Bill would strengthen the protections afforded to parties to whom the management of the corporation is delegated so that they can enjoy the same protections enjoyed by the board; presumably this would

include the Business Judgment Rule and other similar doctrines.

No comment.

702 **Number of directors**

No change is proposed by the 2009 Bill to this section.

The language regarding the size of the board of not-for-profit corporations should be revised. While it tracks similar language for for-profit corporations, it does not work the same for nonprofit corporations since the circumstances surrounding the two types of entities are different.

As the law now reads, if read precisely, nonprofit corporations without members (or nonprofit corporations with members where this by-law provision was not approved by the members or the incorporator acting in lieu of the members) must "fix" the number of directors in the by-laws and, if they want to change that number, must formally amend the by-laws (satisfying the prior notice and, in some cases, higher vote provisions generally applicable to by-law changes).

Some commentators, however, look beyond the precise words of the statute to read the words of the statute which say the by-laws shall "fix" the size of the board to allow the board to pick a number within a by-law set range, since otherwise the law would require a "practice [which] would be unduly onerous and contrary to efficient governance." See Victoria Bjorklund, Victoria, James J. Fishman, James J. and Daniel L. Kurtz. New York Nonprofit Law and Practice: With Tax Analysis, Second Edition, Section 10.02[1][a], p. 10-16. But that view is contradicted in White on New York Corporations (Volume 7, 702.02), which states that a "close reading of Section 702 leads one to believe that in corporations having no members the number of directors must be fixed in the bylaws rather than left for determination by resolution of the board."

While not in conformity with the statutory requirement, many nonprofit corporations have by-laws which track customary provisions found in for-profit corporate by-laws saying that the board may fix its own size within a range, so that the number of directors may be changed without having to formally amend the by-laws to specify a certain number of directors. Such by-law provisions are in violation of this statutory provision if the literal wording of the provision is followed.

The statutory procedure works in the for-profit world since all for-profit corporations have shareholders (similar to members) and the initial by-laws are adopted by the incorporator (which has the same effect as adoption by the shareholders) since the certificate of incorporation does not name the initial directors. Most nonprofits, however, do not have members or, even if they have members, the by-laws are initially adopted by the initial board of directors since they are named in the certificate (and therefore the incorporator ceases to act).

While some practitioners believe that there is merit to requiring the exact

number of directors to be stated in the by-laws since there is then one place where the number can be found, we feel that practical considerations outweigh this benefit and therefore the law should be revised to allow all nonprofits (not just certain membership corporations) to have by-law provisions that allow the board to fix its size within limits set forth in the by-laws. (While such a provision would eliminate the need to repeatedly amend the by-laws, the board would still need to take formal action to fix its size from time to time to ensure that the number of elected directors does not exceed the number fixed or that there are too many vacancies on the board, which could create a problem with statutorily-required votes that have to be a majority (or more) of the entire board.). If a corporation preferred the certainty of having the number of directors fixed in the by-laws, it would be free to so say in its by-laws.

The provisions of the Delaware General Corporation Law (Section 141 – the " number of directors shall be fixed by, or in the manner provided in, the bylaws …") and the Model Nonprofit Corporation Act (Section 8.03 – "the number [shall be]specified in or fixed in accordance with the articles of incorporation or bylaws. … The number may be increased or decreased …. In the manner provided in … the articles of incorporation or bylaws") allow the board size to be determined pursuant to a procedure set forth in the by-laws, as we propose.

If a corporation violates the existing requirement that the number of directors be fixed by the by-laws, issues may arise as to whether action was validly approved. For instance, legal counsel may not be able to opine that an action was validly approved if there are issues as to the size of the board of directors.

Note that copies of amended by-laws must be filed with the IRS with the annual Form 990; many nonprofit corporations probably forget to make such filing when the only change is in the number of directors.

Accordingly, the provision should be revised to read:

(a) The number of directors constituting the entire board shall be not less than three. Subject to such limitation, such number may be fixed by the by-laws or~~, in the case of a corporation having members~~, by action of the members or of the board under the specific provisions of a by-law ~~adopted by the members~~. If not otherwise fixed under this paragraph, the number shall be three. As used in this article, "entire board" means the total number of directors entitled to vote which the corporation would have if there were no vacancies.

(b) The number of directors may be increased or decreased by amendment of the by-laws~~, by action of the board in a corporation without members,~~ or~~, in the case of a corporation having members,~~ by action of the members, or of the board under the specific provisions of a by-law adopted by the members, subject to the following limitations:

(1) If the board is authorized by the by-laws to change the number of directors, whether by amending the by-laws or by taking action under the specific provisions of a by-law ~~adopted by the members~~, such amendment or action shall require the vote of a majority of the entire board.

(2) No decrease shall shorten the term of any incumbent director.

703 **Election and term of directors**

No change is proposed by the 2009 Bill to this section.

The statute specifies that the default term of office shall be "one year." Since annual meetings are not usually held on the same date each year, it may be more appropriate to say "until the next annual meeting" as used in the BCL and in Section 704 of the N-PCL.

704 **Classification of directors**

The bill would remove the requirement that each class of directors with a classified board must have at least three members.

The NPO Committee, in its letter of December 14, 2006, noted that the proposal eliminates the requirement that if a corporation has different classes of directors with staggered terms and cumulative voting is allowed, each class of directors must have at least three members. It asked why the language regarding cumulative voting was eliminated.

This section states that class sizes should be "as nearly equal … as possible." There are many nonprofit corporations that have classes that are disproportionate; nonprofit corporations should be allowed to adopt by-laws that make proportionality optional or, if such provision is not added, language should be added to the effect that failure to have equal sized boards should not undermine the validity of action taken by such board. We would support adoption of a provision as appears in the Model Nonprofit Corporation Act, Third Edition (Section 8.06) to the effect that "[t]erms of office and number of directors in each group do not need to be uniform."

706 **Removal of directors**

No substantive change is proposed by the 2009 Bill to this section

The statute allows removal of directors for "cause" by the members or the board or, if so allowed by the certificate or by-laws, by the members without cause. We note that the Model Nonprofit Corporation Act, Third Edition (Section 8.08(b)) allows the board of a nonmembership corporation to remove directors without cause. Consideration should be given to adopting such a provision in the N-PCL. The Model Act (Section 8.09(c)) also allows the board of any nonprofit, whether or not it has members, to remove directors who are of unsound mind (as determined by a final court order), convicted of a felony, been found by a final court order to have breached a duty as a director, missed a number of meetings specified in the articles or by-laws if such requirement was in place at the beginning of such directors term or does not satisfy qualifications for directors in place at the time of such director's current term (so long as such determination of failure to meet qualifications is made by a majority of the directors who meet such qualifications). We support inclusion of such a provision so as to avoid the existing ambiguity of whether or not such

actions constitute "cause."

Technical comments:

- *The words in paragraph (c)(1) that are proposed to read: "… no director may be removed when the director's ~~votes cast against his~~ removal would be sufficient to elect him or her if voted cumulatively at an election at which the same total number of votes were cast, ~~and the entire board, or the entire class of directors of which his is a member~~, were then being elected" should instead say "… no director may be removed when the votes cast against ~~his~~ the director's removal would be sufficient to elect him or her if voted cumulatively at an election at which the same total number of votes were cast and the entire board, or the entire class of directors of which he is a member, were then being elected." The word "director's" is put in the wrong place and the elimination of the words "and the entire board …. member" make the sentence meaningless. The wording proposed in the prior sentence tracks the BCL.*

708 **Action by the board**

No change is proposed by the 2009 Bill to this section. Section 708(b) allows action by a "consent in writing" by all members of the board or committee. Section 708(d) states that "Except as otherwise provided in this chapter, the vote of a majority of the directors present at the time of the vote, if a quorum is present at such time, shall be the act of the board."

General Rule:

If a matter must be approved by a vote greater than a majority of those in attendance at a meeting where a quorum is present, such requirement should be set forth or cross referenced in this section. The current law sets forth high vote approval requirements for real estate transactions (Section 509), asset transfers (Section 510, formation and composition of board committees (Section 712), approval of management salaries (Section 715) and amendments of certificates of incorporations (Section 803) by requiring that approvals be by a majority (or more) of the entire board. By burying such provisions in provisions of the law that readers might not think to consult, they are often ignored or overlooked.

Note that an action must be approved by a majority of the directors present at the meeting, not a majority of the directors voting. This may create problems when there are directors who abstain on a matter (note that directors who are conflicted should leave the room at the time of the vote and therefore should not be considered "present at the time of the vote," even though they may be "present" for quorum purposes). For purposes of member action, a majority vote is determined based on the number of members voting, not the number present. It would be advisable to have similar standards for both actions.

Electronic Notice and Consents:

The NPO Committee, in its 2006 letter supporting the change allowing electronic notice of members meetings (Section 605), also supported a change allowing electronic voting at both the member and board levels (provided that a procedure for effective deliberative process is preserved). Since action can be taken at the member and director levels by written consent (and, at the

member level, by proxy) without any deliberation, the prior comment that an "effective deliberative process" is necessary should not be required.

We believe that action by email or other forms of electronic consent should be allowed so long as it is clear that all the members are consenting to the same exact words. Delaware allows electronic consent (see Section 141(f) of the Delaware General Corporation Law, which allows action by "electronic transmission" with the electronic transmissions to be "filed with the minutes of proceedings."). It is not clear if electronic consent is allowed under the Model Nonprofit Corporation Act, Third Edition -- Section 8.21 states that such action may be approved if "each director signs a consent in the form of a record describing the action to be taken" and a record is defined as "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form."

There is some uncertainty under current law as to whether email voting is allowable. It is clearly acceptable to send out a form of written consent and have signatures returned by fax or as PDF attachments but traditionally email voting has not been thought acceptable. Relying on provisions of New York law that say that certain documents can be signed by electronic signatures (see the Electronic Signatures and Records Act (ESRA), available at http://www.oft.state.ny.us/esra/esra.htm# for information) ,however, it may be possible to argue that a resolution sent by email to all directors which is then signed and returned by such directors either in paper (including PDF or fax form) or via an electronic medium is valid. The Lawyers Alliance for New York is of the opinion that this satisfies the requirement under N-PCL Section 708 which allows unanimous "consent in writing" in lieu of action at a meeting. Such conclusion, however, is not without question. We would therefore support wording in the N-PCL which sanctions such electronic procedures, subject to requirements to ensure that it is clear what is being voted on.

The emailed response should include the resolution being approved and other evidence showing a director's signature (ideally, words to the effect that "I hereby consent to the adoption of the following resolution: [TEXT]" [OR: "I hereby consent to the adoption of the resolution set forth in the email from AAA dated x/y/z"], with the name of the emailing director in a form indicating that it is in lieu of a written signature following). All of the documents showing such unanimous consent, including the full text of all emails, would need to be included in the minute book.

Approval by Majority Consent.

The language in the 2009 Bill allows members to act by a written consent signed by the members having a majority of the voting rights (see Section 614), but it does not propose to allow directors to so act. We agree that written consents by directors (and committees of directors) should be unanimous. The theory of action by directors is that they need to have a deliberative process and for that reason cannot take action without a meeting, where there can be a full discussion of all issues and a minority of directors could change the mind of the majority, unless the actions are so non controversial that all directors have consented. Member and shareholder action, however, is different, since

members and shareholders are only given a limited choice (approve or disapprove) as to a limited number of matters, which should be described in the meeting materials in such a way that the members can make an informed decision and no deliberative process is necessary.

711 **Notice of meetings of the board**

No change is proposed by the 2009 Bill to this section.

The notice provision for meeting of members (Section 605) is detailed. The corresponding provision for notice of board meetings has always lacked such detail, allowing the procedure to be set forth in the by-laws. In the spirit of the changes to the shareholder provision to allow electronic notice, we think that it is appropriate to add language here expressly blessing such type of notice.

In connection with matters that currently now must be approved by a majority (or higher) of the entire board, we have proposed that such high vote requirement be eliminated or modified to, among other things, possibly require that the notice of meeting include a reference to the proposed action, to ensure that it any such action if controversial is adequately noticed. If any such notification requirement is adopted, it should be mentioned or cross referenced in this section.

This section references "alternate director" but the term does not appear anywhere else in the N-PCL. The N-PCL does envision alternate members of committees, however. Accordingly, the words "alternate director, nor to any" should be deleted.

712 **Executive committee and other committees**

The 2009 Bill would eliminate the distinction between standing and special committees.

The use of committees is crucial to good board governance. The procedures to establish and name the members of committees should be practical.

The NPO Committee has no objection to the elimination of the distinction between standing and special committees but, as discussed below, thinks that there may still be merit in having two types of board committees We believe that further revision of this section is appropriate. The existing provisions regarding committees are very confusing and the practice of many nonprofit corporations does not conform to the statutory requirements, especially in terms of how committee members are chosen.

Currently there are two undefined types of board committees: "standing" and "special," both of which must be composed solely of directors, but the procedure to appoint members of each is different - the members of standing committees have to be named by the board but the members of special committees can be named as set forth in the by-laws (or, if not so specified, by the chairman of the board "with the consent of the board," whatever that means). Only standing committees can have the authority of the board. In

addition to board committees, there are "committees of the corporation," which can have members who are not directors, which are appointed or elected in the same manner as officers.

The 2009 Bill would eliminate the distinction between standing and special board committees but would otherwise keep in place most of the other provisions. By eliminating the concept of special committees, however, the proposal places more restrictions on how all board committees are constituted. For instance, under the proposal all board committees would have to have a minimum of three directors and all the members would have to be named by the board, not by the chairman or as otherwise set forth in the by-laws for special committees.

While an executive committee should probably have a minimum of three members, there is no legal reason why all the committees should have to have three members. It can sometimes be hard to get people to work on committees and, if each committee has to have three members, the work that can be done in committee by smaller nonprofit corporations is limited. The Model Nonprofit Corporation Act (Section 8.25) allows all committees to be as small as one member.

In practice many (if not most) nonprofit corporations allow the members of committees to be chosen by the chairman and rarely is that choice voted on by the full board – although such members are legally required by the statute to be "designated" or (unless the by-laws say otherwise regarding special committees) "consented to" by the board. Furthermore, any designation of the committees and their members has to be approved by a majority of the entire board, a threshold which may be hard to achieve if the quorums for board meetings (and attendance rate) is less than a majority of the board, not just a majority of the directors at a meeting at which a quorum is present. We note that the Model Nonprofit Corporation Act, Third Edition (Section 8.25) has a similar requirement, requiring approval of the creation of a committee and the members of such committees by a majority of all the directors in office when the action is taken; Delaware's General Corporation Law (for corporations formed after July 1, 1996 or otherwise electing to follow such procedure) also requires that committees be formed and members selected by the board but does not require that such action be by a majority of the entire board (older corporations that do not elect such procedure must act by a majority of the whole board).

The NPO Committee thinks that a more workable process of choosing committee members is necessary. First, as noted above, the requirement that any board approval be by a majority of the entire board should be eliminated. Second, we think that it is necessary to retain the requirement for some level of board approval since otherwise management of a nonprofit (or a strong chairman, even if not part of management) may be able to too easily dominate committees, thereby undercutting the supervisory obligation of the board. Such board approval should be necessary for committees with governance responsibility (such as executive, audit, finance, nominating, search and compensation committees) and committees with delegated board authority but

not necessarily for more operational committees. Ironically, this may bring us back to the existing dichotomy between "standing" and "special" committees. A problem that exists currently with these two categories of committees is that the terms are not defined in the law.

We would therefore propose that the committee provision of the N-PCL be revised to require that all members of the "committees with governance responsibilities (including, without limitation, any executive, audit, finance, nominating, search and compensation committees, however titled) and committees with delegate board authority" must be approved by the board, either by being named in the first instance by the board or by being first named by a chairman or president and then approved at the next board meeting held after such the appointment of such persons. The second approach would allow the chairman to take a more active role in the process but still subject his or her decisions to board approval. A person could serve on a committee when appointed but if that person is rejected or not approved, his or her role on the committee would cease at the time of the board meeting. Whether the approval level required should be greater than a mere majority of a quorum, we leave for further discussion. See our comments in Attachment One regarding possible alternative approval levels and procedures.

We would also recommend that nondirectors be allowed to serve on board committees in an advisory role, without the ability to vote.

The provision for nonboard committees (called "committees of the corporation") is also confusing. The statute states that they "may be" elected or appointed in the same manner as officers. It does not say that they "shall be" so elected or appointed. We suspect that most of these committees are advisory or operational, rather than governmental. In practice we also suspect that most of them consist of persons appointed by the chair or president, not "elected" by the board. Accordingly, we would recommend that the second sentence of paragraph (d) should be revised to read: **"** ~~Such committees~~ Members of such committees shall be selected by the chairman of the board (or if there is no chairman, by the president) unless otherwise set forth in the by-laws ~~may be elected or appointed in the same manner as officers of the corporation~~" *and the third sentence should be deleted.*

While it should be noted that the N-PCL provision tracks the provisions of the BCL, there are important distinctions between the practices of business and non-business corporations to justify different practices. First, the boards of business corporations tend to be more tightly organized, with board committees composed once a year (at the annual meeting). Second, management does many of the tasks that are, for nonprofits, done at the board and committee level. Third, the members of committees of public corporations are usually compensated for committee service, meaning they are eager and willing to serve on such committees; .. in nonprofit companies, however, it is often difficult to get directors to commit to serve on board committees and there is a greater degree of change in committee composition over the year. Fourth, nonprofits are more likely to involve nondirectors on committees, thinking that such activity is often a good way to see how potential new directors perform before adding them to the board.

713 **Officers**

No change is proposed by the 2009 Bill to this section.

A prior proposal eliminated the prohibition against one person serving as both president and secretary. The NPO Committee, in its letter of December 14, 2006, opposed such a proposal based on concerns of good governance and best practices for a non-for-profit corporation. The draft as submitted does not eliminate such prohibition.

While it is not traditional in corporate laws to so require, we furthermore suggest that the offices of treasurer and president should be separated. Consistent with evolving standards of good governance, it is imperative that there be checks and balances regarding financial matters that come from separating these two offices.

The N-PCL provision does not require that any specific officers be appointed (it states the board "may elect or appoint a president," etc.). Consideration should be given to requiring that the board elect a president, secretary and treasurer (or other officers, however titled, filling the functions of such offices) but making other offices optional. For purposes of filing an annual report with the Charities Bureau, the Form CHAR500 must be signed by the president and the treasurer (or CFO) pursuant to requirements of the Executive Law and/or the Estates, Powers and Trusts Law.

The statute allows the by-laws to include a provision allowing appointment of certain officers by the president, subject to approval by the board. This procedure works well if there is a need for numerous subordinate officers, such as vice presidents. It would be appropriate to revise the law to give such power to others, such as the chairman of the board or the executive director, if there is no president. The time period in which such appointment should be approved is currently unclear. We would recommend adding language that such approval shall occur at the next board meeting and that the consequence of failure to obtain such approval would mean that the designee no longer holds the office.

Accordingly, this provision may be rewritten as follows:

> "… or it may authorize the president (or alternatively the chairman of the board of the executive director or another officer holding a position comparable to president) to appoint the other officers, or some of them, subject to approval by the board at the next board meeting."

714 **Removal of officers**

No substantive change is proposed by the 2009 Bill to this section, regarding removal of officers. *Since some officers may be appointed by an officer and "approved" by the board, a provision to cover such situations is appropriate. We would recommend the addition of the following words: "*Any officer appointed by another officer may be removed by such officer or by the board with or without cause."

715 **Interested directors and officers**

No substantive change is proposed by the 2009 Bill to this section, regarding transactions between a nonprofit and its officers and directors. As the current law is written, there are no prohibitions on transactions between the entity and its fiduciaries; instead, it assumes that such transactions are suspect and sets forth procedures to avoid having such arrangements be void or voidable. The statute also does not require a nonprofit to adopt any conflicts of interest policies or procedures.

The NPO Committee understands that there is significant concern by the public and nonprofit regulators regarding the need for good conflicts of interest policies, practices and procedures. This concern has most recently been reflected in new requirements for larger nonprofits to report on their Form 990 whether they have a conflicts of interest policy and whether such policy requires annual disclosure by the affected individuals. We trust that this IRS requirement will lead to a greater sensitivity by most nonprofits regarding these conflicts concerns. We note, however, that such IRS disclosure does not require nonprofits to adopt any specific form of conflicts policy or procedure and that smaller nonprofits and private foundations are exempt from any of such requirements. We are not prepared at this time to take a position on whether there should be statutory changes having the effect of requiring each nonprofit to adopt conflicts policies (as part of by-laws or as a separate policy) or practices but we note that such issue might be appropriate for legislative review, especially as part of a total package for legislative reform of nonprofit law and practice We are not aware of any such requirement under the laws of any other state or the Model Nonprofit Corporation Act but we note that legislation was introduced in the 2009-2010 session (A5927 and S402) to require conflict of interest policies and executive officer training requirements regarding fiduciary duties.

715(b) The 2009 Bill proposes significant wording changes with respect to situations where a conflict was not previously disclosed but we understand that such wording changes are only intended to clarify, not to change, the effect of the existing words.

No comment.

715(d) Paragraph (d) envisions the possibility of corporations adopting additional restrictions in their certificate of incorporation.

Consideration should be given to allowing a corporation to include more strenuous conflicts requirements in its by-laws or in a board-approved conflicts policy. Counterparties, if they know that such requirements might be set forth in other governance documents, could ask to see such policies and obtain certifications of compliance with such policies, if appropriate. If this approach is taken, the words "by-laws or board-approved conflicts policy" could be added in paragraph (d) after "certificate of incorporation."

715(f) He current statute states that the fixing of salaries of officers, "if not done in or pursuant to the by-laws," shall require approval of a majority of the entire board (unless a higher percentage is set forth in the certificate of incorporation or by-laws). The 2009 Bill would remove the specific language in Section 715 that requires a majority vote of the entire board to fix the salaries of officers,, thereby allowing such approval to be done by a majority of a quorum.

The NPO Committee supports the elimination of a requirement that approval be by a majority of the entire board since that standard may be difficult to satisfy, as noted in the discussion in Attachment One under "C. Other Changes That Might be Considered.", We think, however, approval of compensation of officers and senior management, especially in light of current public concerns regarding excessive compensation, should be subject to approval at a level greater than merely a majority of the directors in attendance at a meeting with a low quorum threshold. See the discussion in Attachment One regarding alternatives for higher levels of board approval and additional procedures that might be required. We think that all issues which are subject to a higher level of approval by the board should be set forth in the general provision of the N-PCL regarding action by the board (Section 708) rather than being buried in provisions such as Section 715 that might not be reviewed when the board is reviewing the statutory requirements for board approval.

716 **Loans to directors and officers**

The 2009 Bill would replace language in Section 716 that permits loans between Type B corporations with language that would permit such loans if both parties are "organized for charitable purposes."

This is consistent with the elimination of corporate types.

717(a) **Duty of directors and officers**

No substantive change is proposed by the 2009 Bill to this paragraph, regarding duties of officers and directors.

The statute states that directors and officers shall discharge the duties of their positions "in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions." This is a phrasing of the duty of care which is often said to be owed by nonprofit directors and officers.

*Two other duties are commonly held to apply to directors of nonprofits; these are the duty of loyalty (*i.e.*, to act in the best interests of the organization) and the duty of obedience (*i.e.*, to ensure that the organization acts in furtherance of its mission). For a discussion of these three duties, see the publication by the Charities Bureau of the New York State Office of the Attorney General titled* Right From The Start: Responsibilities of Directors of Not-for-Profit Corporations. *pages 3-6.*[18] .

[18] Available at http://www.charitiesnys.com/pdfs/Right%20From%20the%20Start%20Final.pdf.

The N-PCL is silent, however, as to the duties of loyalty and obedience other than to set forth provisions (see Section 715) regarding conflicts of interest and provisions (see Section 520) as to a director's duty to cause the corporation to file reports with the state. We believe that all of the duties of the directors should be stated in one place, preferably in Article 7.

We note that the Model Nonprofit Corporation Act, Third Edition sets forth both the duty of care and the duty of loyalty in Section 8.30 (a), which requires directors to act "(1) in good faith, and (2) in a manner the director reasonably believes to be in the best interest of the nonprofit corporation." The second duty reflects the duty of loyalty. The Model Act goes on to state that the directors "must discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances" (similar to the language appearing in N-PCL Section 717). While not affirmatively phrased as a director's duty, Section 8.31 of the Model Act (captioned "Standards of Liability for Directors") states that a director is not liability to a corporation or its members unless the party asserting liability establishes, among other things, that the challenged conduct was the result of a "sustained failure of the director to devote attention to ongoing oversight of the activities and affairs of the corporation, or a failure to devote timely attention, by making (or causing to be made) appropriate inquiry, when particular facts and circumstances of significant concern materialize that would alert a reasonably attentive director to the need therefore …".[19] *This is a statement of the duty of obedience. Section 8.42 imposes similar duties on officers.*

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[19] The full text of that section is:

(a) A director is not liable to the nonprofit corporation or its members for any decision to take or not to take action, or any failure to take any action, as a director, unless the party asserting liability in a proceeding establishes that: (1) none of the following, if interposed as a bar to the proceeding by the director, precludes liability:(i) subsection (d) or a provision in the articles of incorporation authorized by Section 2.02(c); (ii) satisfaction of the requirements in Section 8.60 for validating a conflicting interest transaction; or (iii) satisfaction of the requirements in Section 8.70 for disclaiming a business opportunity; and (2) the challenged conduct consisted or was the result of: (i) action not in good faith; or (ii) a decision: (A) which the director did not reasonably believe to be in the best interests of the corporation, or (B) as to which the director was not informed to an extent the director reasonably believed appropriate in the circumstances; or (iii) a lack of objectivity due to the director's familial, financial or business relationship with, or a lack of independence due to the director's domination or control by, another person having a material interest in the challenged conduct: (A) which relationship or which domination or control could reasonably be expected to have affected the director's judgment respecting the challenged conduct in a manner adverse to the corporation, and (B) after a reasonable expectation to such effect has been established, the director has not established that the challenged conduct was reasonably believed by the director to be in the best interests of the corporation; or (iv) a sustained failure of the director to devote attention to ongoing oversight of the activities and affairs of the corporation, or a failure to devote timely attention, by making (or causing to be made) appropriate inquiry, when particular facts and circumstances of significant concern materialize that would alert a reasonably attentive director to the need therefor; or (v) receipt of a financial benefit to which the director was not entitled or any other breach of the director's duties to deal fairly with the corporation and its members that is actionable under applicable law.

(b) The party seeking to hold the director liable: (1) for money damages, also has the burden of establishing that: (i) harm to the nonprofit corporation or its members has been suffered, and (ii) the harm suffered was proximately caused by the director's challenged conduct; or (2) for other money payment under a legal remedy, such as compensation for the unauthorized use of corporate assets, also has whatever persuasion burden may be called for to establish that the payment sought is appropriate in the circumstances; or (3) for other money payment under an

To make it clear to directors and officers that the three classic duties apply to them, we believe that Section 717(a) hould be revised to clearly set out the applicability of such three duties, and to move the language in Section 520 regarding the duty to ensure that government filings are made to this section.

717(c) The 2009 Bill would add a new Section 717(c) that would specifically allow the board to consider a broad range of factors in deciding whether or not to take action. Matters which the board could consider in making any determinations include the effects on various constituencies or situations, such as the effect on the corporation's future, current employees, retired employees, recipients or beneficiaries of the corporation's services and creditors.

The NPO Committee supports the change subject to the addition of language that such considerations must be consistent with the charitable purposes of nonprofits with charitable purposes.

718 **List of directors and officers**

The 2009 Bill would eliminate the ability of creditors to obtain a list of directors and their residential addresses from the corporation and the ability of members to obtain the residential addresses of directors from the corporation.

We support the changes.

The NPO Committee, in its letter of December 14, 2006, reporting on a prior draft which eliminated the right of all creditors and members to obtain home addresses of directors, approved the change as it related to home addresses but thought that a business address or postal address of the corporation (redirected to the director) should have to be provided. The draft as introduced reflected this comment by requiring that an address be provided but not requiring that it be a residential address (and requiring the corporation to forward any mail that it receives).

The bill as introduced eliminated all rights of creditors to obtain such information, consistent with the BCL provision. The BCL counterpart requires only that the name of the directors and officers be provided, not any address.

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equitable remedy, such as profit recovery by or disgorgement to the corporation, also has whatever persuasion burden may be called for to establish that the equitable remedy sought is appropriate in the circumstances.

(c) Nothing contained in this section: (1) in any instance where fairness is at issue, such as consideration of the fairness of a transaction to the nonprofit corporation under Section 8.60(a)(3), alters the burden of proving the fact or lack of fairness otherwise applicable, (2) alters the fact or lack of liability of a director under another section of this [act], such as the provisions governing the consequences of an unlawful distribution under Section 8.33, a conflicting interest transaction under Section 8.60, or taking advantage of a business opportunity under Section 8.70; or (3) affects any rights to which the corporation or a director or member may be entitled under another statute of this state or the United States.

(d) Notwithstanding any other provision of this section, a director of a charitable corporation shall not be liable to the corporation or its members for money damages for any action taken, or any failure to take any action, as a director, except liability for: (1) the amount of a financial benefit received by the director to which the director is not entitled; (2) an intentional infliction of harm; (3) a violation of Section 8.33; or (4) an intentional violation of criminal law.

720 **Actions on behalf of the corporation**

No substantive change is proposed by the 2009 Bill to this section.

Technical Drafting Comment:

- *As noted above in the discussion of Section 402, the 2009 Bill proposes to amend the N-PCL to allow corporations to include in their certificates of incorporations provisions exculpating directors and officers from liability in certain situations. As noted above, we have not taken a position at this time regarding such proposal. We note, however, that such change is similar to the change proposed in Senate Bill 2138 introduced in the 2009-2010 Regular Session of the legislature. That bill, in addition to amending Section 402, also includes a change of subdivision 1 of paragraph (a) of Section 720 to eliminate "To" and add "Subject to any provision of the certificate of incorporation authorized pursuant to paragraph (d) of section 402 (Certificate of incorporation; contents), to." If the final version of the 2009 Bill includes the change to Section 402, this section should also be revised as noted in Senate Bill 2138.*

720-a **Liability of directors, officers and trustees**

No substantive change is proposed by the 2009 Bill to this section.

Technical Drafting Comment:

- *Note that Sections 103-A and 104-A use upper case "A"s but Sections 720-a and 1002-a use lower case "a"s. The style should be consistent.*

725(d) & 726(d) **Other provisions affecting indemnification of directors and officers & Insurance for Indemnification of Directors and Officers**

No change is proposed by the 2009 Bill to this section.

Under the current language of Section 726(d), all membership corporations must mail a notice at each time a new directors and officers liability policy is obtained or an old policy is renewed to all members stating information about any D&O insurance policies, including the carrier, the cost of the insurance and the corporate positions insured, among other items. If the organization is not a membership corporation, it must maintain such information in its "publicly available records" (presumably meaning that outsiders could obtain it). It is safe to assume that most membership corporations do not provide such notice (the similar statement required by for-profit corporations is probably also not provided) or provide it on demand to others. Such requirement should be eliminated. We do not object as strenuously to the requirement in Section 725(d) requiring notice to members, and public availability for nonmembership corporations, when there are payments to insureds under such policies, but consideration should also be given to eliminating that requirement as well.

Article 8
Amendments And Changes

Section **Changes *(Comments)***

801(a) **Right to amend certificate of incorporation**

The bill would add a prohibition against amending a certificate of incorporation

to provide that assets received for a specific purpose may be used in a manner inconsistent with the specific purpose.

The NPO Committees does not oppose this change, but see the discussion at Section 804 below, which notes that the draft includes contradictory language. This provision appears to have been inserted in connection with the elimination of a requirement for court approval.

802(a) **Authorization of amendment or change, class vote**

The draft would clarify that if a certificate requires a supermajority to amend a certificate in a certain matter and the NPCL would not, the certificate's requirement takes precedence.

No comment on the proposed change.

We have commented elsewhere that the requirement that matters be approved by a majority of the entire board, as is required here if there are no members, should be modified by eliminating the requirement that approval by based on the size of the entire board. See our discussion in Attachment One above regarding possible alternative thresholds that are more practical to achieve and other protective procedures that might be adopted.

Technical Drafting Comment:

- *The words ", class vote" should be removed from the title to Section 802 since those matters were moved to new Section 803.*

803 (new 804) **Certificate of amendment; contents**

The bill would remove the requirement to designate in the certificate of amendment that the secretary of state is agent for purposes of service of process.

The NPO Committee thinks this change requires further study and coordination with the office of the Secretary of State. It is possible that this provision was added since corporations created under the prior Membership Corporation Law did not have to have such designation; it would be more appropriate to include language to the effect that this designation is not necessary if such designation had been previously made, either in the certificate of incorporation or a prior amendment.

804 (new 806) **Approvals and effect**

Conforming amendments would be made to current § 804 for the removal of corporate types and elimination of the need to obtain consents from agencies regulating the corporation for certificates amending the "purpose, power or provision" of a certificate of incorporation or the name of a corporation. Instead, notice needs to be given within 30 days after the certificate is filed.

No comment.

The need for court (and, in practice, Attorney General) approval of amendments that change or eliminate a "purpose or power" of Type B or C corporations would also be eliminated.

Neither Delaware nor the Model Nonprofit Corporation Act require any court, Attorney General or other agency approval (for amendments that change a nonprofit's purposes of powers. New York is unique in requiring such approval. The need for consent made sense when the Attorney General and court had to approve all formations and to the extent state agencies had to consent to such formations. The need for court and Attorney General approval of new nonprofits was eliminated many years ago and the 2009 Bill proposes to eliminate consents by other agencies. Accordingly, the general predicate for the approval requirement therefore disappears.

Nevertheless, while we are in favor of eliminating needless consents, the NPO Committee thinks that the proposed change may be too aggressive. The process of obtaining Attorney General approval of amendments of purposes has long been a mechanism which ensured that funds raised for one purpose are not used for another. While language is added to Section 801 to the effect that no amendment to the certificate of incorporation could be adopted if the effect would be to use any assets received for a specific purpose in a manner inconsistent with such purpose, another section of the proposal states that when the certificate of incorporation is amended to change the purposes, funds can be used for the new purposes unless they are contractually restricted by a gift instrument. This is a significant change from current practice.

Accordingly, we believe that the Charities Bureau's consent (but not court approval) should still be required for changes of purposes, but not for changes in powers. Language should be added, however, to limit such consent procedure to ensuring that funds raised for one purpose are not to be used for other purposes (i.e., to ensure that the provisions of Section 801(a) are honored). As noted above with respect to supreme court visitation, we believe that there should be a right to appeal to the supreme court regarding any denial of approval by the Attorney General.

Technical comments:

- *The contradiction between the language in Section 801(a) saying assets "received for a specific purpose" could not be used in a manner "inconsistent with such purpose" and the language in Section 806(d) allowing such use so long as it did not violate a deed of gift, needs to be resolved.*

Article 9
Merger or Consolidation

Section **Changes *(Comments)***

901 **Power of merger or consolidation**

The 2009 Bill would add language about mergers between one or more domestic corporations and one or more foreign corporations.

Such change is not necessary, since that possibility is already addressed by Section 906.

It might be helpful to add language clarifying that this section addresses the merger of two domestic nonprofit corporations; language regarding merger with foreign nonprofit corporations or for-profits are addressed in other sections.)

902 **Plan of merger or consolidation**

The existing subparagraph (a)(3) states that a plan of merger or consolidation needs to include, among other things, information about payments to members in exchange for membership. We would recommend adding language barring payments to members of charities in excess of any payments made for such membership.

Subparagraph (a)(6) of the 2009 Bill would allow the plan of merger or consolidation to include (in addition to those things required to be set forth in the certificate) such other provisions with respect to the proposed merger or consolidation as the board considers necessary or desirable. This revised language comes from BCL § 902(5).

No comment.

Technical Drafting Comment:

- *The reference to "clause (d)" in subparagraph (a)(5) should be changed to "clause (D)"*

904(a) **Certificate of merger or consolidation; contents**

In addition to nonsubstantive changes, the draft would require that the certificate of merger include the provisions from the plan of merger regarding the terms and conditions of the merger or consolidation, including the manner of converting membership interests and any payments to be made in exchange for membership.

The NPO Committee opposes this change. This change is not reflected in the analogous provision of the BCL, and such information is generally thought to not be appropriate for a publicly-filed document

905(b)(2) **Effect of merger or consolidation**

The 2009 Bill would remove a reference to New York's Estates, Powers and

Trusts Law, the requirement that that person be domiciled in NYS in order for a disposition from that person's will to inure to the surviving corporation, and the phrase "[S]o far as is necessary for that purpose, or for the purpose of a like result with respect to a disposition governed by the law of any other jurisdiction, the existence of each constituent domestic corporation shall be deemed to continue in and through the surviving or consolidated corporation" and adds the phrase "Except as the court may otherwise direct, any obligation with respect to any assets received for specific purposes shall be deemed to continue in and through the surviving consolidated corporation."

The NPO Committee does not know the reason for these changes.

906(d)(2)(A) **Merger or consolidation of domestic and foreign corporations**

This provision would require, in the case of mergers or consolidations where a domestic corporation is merged into a foreign corporation, that the information required to be included in the plan of merger under Sections (1),(2), (3), (4) and (5) of Section 902(a) also be included in the certificate of merger or consolidation filed in New York. The statute currently only requires that the information satisfying clauses (1) and (2) of Section 902(a) be reflected in the certificate of merger.

The NPO Committee opposes this change as unnecessary. As noted above regarding Section 904(a) (where the out-of-state corporation merges into the New York corporation), clause (3) should be deleted. Clause (4),which describes changes to be made to the certificate of incorporation to reflect any agreement reached in the plan of merger, is not necessary since the only surviving certificate will be that of the foreign corporation. Since clause (5) refers to the information already required to be included in the certificate of merger pursuant to § 906(d)(2)(D), it is duplicative.

Current language requires notice to "such persons as may be interested" and any "person interested may appear." The redraft states that such notices shall be given to "such persons as the court may deem interested" and only such interested parties may appear.

This change has the virtue of greater certainty but may serve to reduce the universe of persons who could appear. We await comments from the Attorney General's office on this change.

Section 906(d)(2)(E) removes the phrase "or special proceeding" and replaces it with "in such action."

The phrase "such action" probably is broad enough to include "special proceedings" but "special proceedings" might stay in so as to avoid confusion.

906(e) The draft states that a corporation may provide in its certificate for an effective date up to 90 days after the filing of the certificate of merger or consolidation with the department of state, a change from the current 30 day period, to

conform with the BCL.

No comment.

907(a) **Approval by the supreme court**

The draft would keep the court approval requirement (upon notice to the Attorney General and other interested parties) for plans of merger or consolidation for each "corporation that is organized for charitable purposes and that holds assets received for specific purposes."

The NPO Committee thinks "and" should be "or." If "and" is used, the corporation must be charitable and have restricted assets. With "or" approval would be required in either case, which we think is correct.

We think, as similarly noted above with respect to other actions requiring approval, that the need for court approval should be eliminated, relying instead on Attorney General approval. We note that there are no court or agency approval requirements under the Delaware General Corporation Law or the Model Nonprofit Corporation Act. We believe that there should be a right to appeal to the supreme court regarding any denial of approval by the Attorney General.

It would extend such approval requirement to mergers with business corporations under Section 908 (the current version of Section 907 is silent on this point; current Section 908 requires such approval only if the organization is a Type C corporation.

See further discussion below regarding Section 908.

Under the bill, the petition would only need to be made by any domestic nonprofit, not all the parties.

The NPO Committee questions the reason for this change.

The bill also deletes certain requirements that were in the old statute regarding the contents of the application to the supreme court including, among other things, a statement of the objects and purposes of the constituent corporations, the property owned by and the liabilities of the constituent corporations, and whether any votes were cast against the merger/consolidation by the members.

The NPO Committee does not know the reason for these changes. If the need for court approval is eliminated, the contents of required filings with the Attorney General could be left for agency determination. It is hoped that the Attorney General would not impose stringent requirements where the surviving entity is already an existing New York chartered entity in good standing.

907(b) Under the draft, the court may, but does not need to, require notice of the hearing to members who voted against the resolution adopting the plan of merger or consolidation.

No comment.

907(c) The existing statute states that if the court finds that any of the assets of a constituent corporation "are held for a purpose specified as Type B … or are legally required to be used for a particular purpose, but not upon a condition requiring return, transfer or conveyance," the court may direct that such assets be transferred to the surviving entity or to other entities engaged in substantially similar activities "upon an express trust that the terms of which shall be approved by the court." The proposed language would drastically simplify this language to say that if the assets "will be adversely affected by the merger" the assets may be transferred to one or more other corporations engaged in substantially similar activities.

The NPO Committee thinks that the changed language is overly simplified and would prefer to retain the existing wording instead of making the noted changes.

907(d) The draft would eliminate a provision which said that the court could disapprove or modify a plan that substantially prejudiced non-consenting members.

Without further explanation as to why it is appropriate, we oppose this change. The reason for this change is unclear. It eliminates substantial rights. As noted above, however, such approval rights should rest with the Attorney General.

907(e) This subsection from the old statute would be deleted in its entirety in the draft – it provides that "if it shall appear, to the satisfaction of the court, that the provisions of this section have been complied with, and that the interests of the constituent corporations and the public interest will not be adversely affected by the merger or consolidation, it shall approve the merger or consolidation upon such terms and conditions as it may prescribe."

The NPO Committee questions the reason for these changes.

908 **Merger or consolidation of business and non-profit corporations**

Under the current statute, only Type A and Type C corporations can merge with for-profit corporations. The new proposal would allow all nonprofit corporations to so merge but, as set forth in Section 907, court approval would be required.

The NPO Committee questions whether mergers of charitable organizations into noncharitable business organizations should be allowed.

These proposed changes should take into account the 1998 amendments to analogous provisions of the BCL allowing mergers with limited liability companies. The NPO Committee thinks that nonprofits should be allowed to be formed as, or merge with, LLCs under proper protocols.

909 **Filing notices, approvals or consents**

Under current law, if the purposes of any of the constituent corporations

required approval by any governmental or other body, the merger or consolidation shall not be effected without that agency's approval; the draft would change this to a post-filing notice requirement if there was no pre-approval required for formation, consistent with changes to Section 404.

The NPO Committee supports the concept. The 2009 Bill does not, however, delete surplus language requiring that approval or consent be endorsed on the certificate; such endorsement should only be required if pre-approval is still required. Additionally, language regarding notice to the office of children and family services could be eliminated since such notification procedure is now the standard arrangement – currently, only such agency gets post-filing notice; all the others have to give pre-filing approval.

910(e) **Merger or consolidation of corporations formed under the religious corporations law and certain other corporations formed for religious purposes.**

Similar to the change in Section 906(e), the maximum time for delayed effectiveness of mergers with religious corporations would be extended from 30 to 60 days.

It is not clear why the 90 day period set forth in Section 906(e) was not used here as well.

Article 10
Non-Judicial Dissolution

Section	Changes *(Comments)*

1001 **Plan of dissolution and distribution of assets**

Currently court approval is required for the dissolution of nonprofit corporations that fall into Types B, C and D. Under the revision, only nonprofit corporations that have a charitable purpose and hold assets received for a specific purpose would be subject to the court approval requirement.

The NPO Committee thinks "and" should be "or", as set forth in the official bill description.

As noted elsewhere, we would prefer it if only the Attorney General's approval was required. We believe that there should be a right to appeal to the supreme court regarding any denial of approval by the Attorney General. We note that the only requirements for agency involvement regarding dissolutions under the Model Nonprofit Corporation Act, Third Edition[20] is the need to "give the attorney general notice in the form of a record [i.e., in writing or electronically] that it intends to dissolve before the time it delivers articles of

[20] Available at http://www.abanet.org/rppt/meetings_cle/2008/jointfall/Joint08/ExemptOrgCharitablePlanOrganGroup/BlackLetter.pdf.

dissolution to the secretary of state." See Section 14.02(g). The Model Act is silent on how much prior notice has to be given. As with asset sales, the Model Nonprofit Corporation Law, Third Edition (Section 14.05(c)) requires court and/or Attorney General approval with respect to property "held in trust or otherwise dedicated to a charitable purpose."

We believe that further changes are appropriate to the dissolution procedure since the current procedure, even after the 2006 changes, is cumbersome and burdensome. While we feel that the courts should be removed from the process, we are open to additional ideas to further expedite the dissolution process.

1002 **Authorization of plan**

Pursuant to the draft, notice would need to be given to agencies after the dissolution if the pre-formation approval requirement was eliminated. The court's approval would only need to be attached to the certificate of dissolution if the organization holds assets received for a specific purpose, not if it is charitable without such assets.

As noted with respect to Section 1001, approval should also be required if a charitable corporation without restricted assets seeks to dissolve, but the only approval required should be AG approval.

Language would be added allowing an approved plan of dissolution to be abandoned prior to filing a certificate of dissolution.

No comment.

Technical Drafting Comment:·

- *The words "merger or consolidation" should be changed to "dissolution, after filing."*

1002-a **Carrying out a plan of dissolution and distribution of assets**

No substantive change is proposed by the 2009 Bill to this section.

Technical Drafting Comment:

- *Note that Sections 103-A and 104-A use upper case "A"s but Sections 720-a and 1002-a use lower case "a"s. The style should be consistent.*

1003 **Certificate of dissolution; contents; approval**

The 2009 Bill would eliminate the need to include in the certificate of dissolution language regarding the manner of approval of the dissolution, a statement as to required court approval and language regarding no- or small-asset corporations.

No comment.

Language to the effect that approvals by government agencies must be endorsed on the certificate would remain from the existing law (as expressed currently: "if such approval is required."

It would be helpful to clarify that "if required" means "if consent is required

under Section 404.")

Language regarding notice to the office of children and family services would also remain.

It should be eliminated since it is covered by language in Section 1002 of the draft.

The existing language regarding necessary Attorney General approval for all Type B, C and D corporations would be changed to require such approval if "organized for charitable purposes and holds assets … received for specific purposes."

As noted above, "and" should be "or."

1005 Procedure after dissolution

The legislation would pick up language that was repealed effective April 9, 2006, since the State Bar draft had been submitted prior to the effective repeal date. All of such language was repealed since nonprofit corporations now have no authority to conduct activities after certificates of dissolution are filed.

This is presumably an inadvertent error; the repealed language should be dropped.

1008 Jurisdiction of supreme court to supervise dissolution and liquidation

The proposal would eliminate certain language regarding the jurisdiction of the supreme court following dissolution.

Some of the changed language tracks the new language in Section 1001 and may need to be revised if that language is changed.

Article 11
Judicial Dissolution

The bill would make no substantive changes to Article 11 that are not consistent with other changes made in the statute.

Article 12
Receivership

The bill would make no substantive changes to Article 12 that are not consistent with other changes made in the statute.

Article 13
Foreign Corporations

The bill would make no substantive changes to Article 13 that are not consistent with other changes made in the statute applicable to New York chartered nonprofits other than with respect to Section 1321.

Section 1304(a)(4) states that applications for authority by a foreign corporation must include a "statement of its purposes to be pursued in the state and of the activities which it proposes to conduct in this state." As noted above regarding Section 402, we do not see any need for a discussion of proposed activities in the certificate of incorporation or qualification application. Accordingly, we think that the words "and of the activities which it proposes to conduct in this state" should be eliminated.

The 2009 Bill makes changes to Section 1321. In eliminating distinctions between types, the criteria that a charitable corporation have its principal activities or the greater part of its property outside the state in order to be exempt from certain provisions of the N-PCL for a foreign charitable corporation (former Type B or C corporations) would be eliminated. Under the 2009 Bill, it would be exempt if less than one-third of its members are New Yorkers (previously a criteria that was not relevant to Type B corporations) or less than 10% of its income is from in-state solicitations or one-half of its revenue was derived from New York. The NPO Committee is not sure that this change is appropriate. Note that a charitable corporation could get the benefit of this exemption merely by electing to have members if more than one-third are not New York residents.

Article 14
Special Not-for-Profit Corporations

The bill would remove all references to corporate type for specific categories of corporations. Otherwise, no substantive changes would be made to Article 13.

Article 15
Special Not-for-Profit Corporations

There are no substantive changes to Article 15.