NEW YORK CITY BAR

COMMITTEE ON NON-PROFIT ORGANIZATIONS

Public Hearing Conducted by the Senate Standing Committee on Corporations, Authorities and Commissions

S.3755-A/A._____, S.5198/A.7337 and S.5197/A.7338

May 24, 2013

My name is Robert Pigott. I am a member and the incoming Chair of the Non-Profit Organizations Committee of the New York City Bar Association (the "NPOC"). I was, from 1997 to 2008, a Section Chief and ultimately Bureau Chief of the New York Attorney General's Charities Bureau. Since then, I have served as General Counsel of two large nonprofit organizations.

The NPOC is very appreciative of the opportunity to provide testimony at this Senate Committee hearing on the recently-introduced legislation to amend the New York Not-for-Profit Corporation Law (the "N-PCL").

The NPOC is a diverse 40-member committee of the New York City Bar Association. It consists of practitioners vitally concerned with bringing about changes to New York's nonprofit laws so that they do justice to the tremendous richness and variety of the nonprofit sector in New York State. Our members include lawyers with nonprofit clients ranging from billion dollar foundations to social service organizations run on a shoestring, as well as in-house counsel and law school professors.

For that reason, the NPOC has, for many years, followed closely and contributed to the dialogue on revision of the N-PCL. We have provided extensive comments to the New York State Bar Association on its bill to revise the N-PCL that has been introduced several times over the past few years. In 2009, we hosted a public forum entitled *Ideas for Change: A Conversation about Reforming New York Nonprofit Law and Regulations*, to address the need for statutory and administrative change and to review pending proposals, which included as panelists the chief sponsor of the State Bar bill in the Assembly, Assemblyman Richard Brodsky, and leading nonprofit practitioners and scholars.

From the time that Attorney General Schneiderman announced in 2011 that revising the N-PCL would be a priority for his administration, the NPOC, under the leadership of Committee Chair David Lowden, has communicated regularly with his Charities Bureau, both before the Attorney General unveiled his first program bill in May 2012 and subsequently. We have been very gratified by his office's receptivity to the NPOC's suggestions as to how best to revise the N-PCL. Specifically, on May 23, 2011, the NPOC wrote to the Attorney General identifying 10 respects in which the N-PCL should be revised. After the introduction of the Attorney General's program bill in May 2012, the NPOC wrote to his office on two more occasions, September 21, 2012 and March 6, 2013, first generally and then in greater detail, identifying proposed changes to his program bill. Those three letters are annexed to this written testimony, and we submit them for inclusion in the hearing record.

The legislation before this Committee -- the Law Revision Commission bill (the "LRC Bill") and the two Attorney General bills (the "AG Bills") -- responds to calls for reform with varied objectives:

- Eliminating the obstacles and burdens to incorporation in New York State, so as to reverse a trend of nonprofit entities primarily operating in New York State being incorporated in other states such as Delaware.
- Enhancing New Yorkers' confidence in the not-for-profit organizations they so generously support by improving governance practices at New York nonprofits.
- Strengthening the State's enforcement powers by which it polices nonprofit organizations that misuse their charitable assets.
- Eliminating certain statutory ambiguities or inconsistencies to allow not-for-profits to operate in greater confidence that they are complying with the law's more procedural requirements.

While we had an opportunity to review the Attorney General's 2012 program bill and have been advised in general terms of the changes to that bill reflected in his current proposals, our committee has not had a chance to study in depth the bills which were introduced on May 10th at his request, or the bill that was introduced at the request of the Law Revision Commission. Accordingly, we are not in a position to offer detailed comments about the current proposals. We will be studying those bills and plan to issue formal comments on them in the next month or so.

The Attorney General's 2012 program bill contained many worthwhile provisions, including a number identified in the NPOC's May 2011 letter, that have been carried over into his recently introduced legislation:

- The elimination of corporation types and pre-incorporation approvals, about which I will say more shortly.
- Clarification of the rules for board votes to approve certain matters, including substantial revision to the current, onerous requirement that real estate transactions be approved by a supermajority of the entire board of the corporation.
- Allowing electronic notification of member meetings (currently allowed for board meetings) and allowing member and board action by unanimous consent to be done electronically.
- For those corporate transactions that now require court approval upon review by the Attorney General, dispensing with the requirement of commencing a court proceeding to obtain a court order where the Attorney General has reviewed and approved the proposed transaction.

With respect to eliminating burdens, both the AG Bills and the LRC Bill address the two burdens that are most frequently identified as problematic: (a) the need for certain corporations to obtain time-consuming State agency pre-incorporation approvals, which are redundant of the licensure approvals they will ultimately be required to obtain and (b) New York's unique and confusing taxonomy of four letter types of not-for-profit corporations (Types A, B, C & D).

Regarding pre-incorporation approvals, the AG Bills eliminate the approval requirement only with respect to the New York State Education Department ("NYSED"), whereas the LRC Bill eliminates it for additional agencies as well, substituting in its place a requirement to notify the agency as to the nonprofit's formation. While the need for pre-incorporation approval by NYSED is the one encountered most often (since many nonprofits have an arguably educational component) and its elimination will provide more relief than the elimination of any other state agency pre-incorporation approvals, many practitioners would prefer that the scope of the elimination of pre-incorporation approvals extend beyond just NYSED to other State agencies.

The provisions in both the AG Bills and the LRC Bill eliminating types are welcome. Currently, the four letter types found in N-PCL §201 are a source of confusion and create delays at the incorporation stage, particularly if the New York State Department of State's Division of Corporations questions whether a

corporation designated a Type B corporation in a proposed Certificate of Incorporation should be a Type C (or *vice versa*).

Under the overall statutory framework, there will always be a need for two general categories of not-for-profit corporations: those that are more highly regulated because they serve the public and enjoy certain tax advantages (primarily, charitable organizations) and those that are less highly regulated because their activities do not particularly concern the general public (such as private clubs and trade associations). Although they differ on what they would call them, both the AG Bills and the LRC Bill consolidate the four current letter types into two categories. Attention should be given to both bills to ensure that, with this consolidation, no corporation that would have been more highly regulated under the current four-type system is included in the new category of less-highly-regulated corporations (or *vice versa*). To the extent the NPOC's more detailed review of the legislation reveals any such migration, we shall share our observations with the legislation's draftspersons.

The great majority of the NPOC comments on the Attorney General's 2012 program bill expressed in our March 6, 2013 letter concerned changes to the law that would mandate certain governance procedures. The NPOC regards the objective of such proposed changes as laudable. However, our March 2013 letter reflected many Committee members' concern that unneccesary, burdensome, costly and time-consuming procedures would be imposed on organizations without sufficient regard to whether they have the wherewithal (both in terms of finances and staff) to implement the required procedures or whether the transactions themselves were sufficiently significant to warrant such heightened procedures.

While the NPOC has only just begun a detailed review of the Attorney General's revised N-PCL reform bills, it appears he has been very responsive to comments received from both the NPOC and others proposing that materiality thresholds be established so that certain governance requirements and procedures be imposed only on larger not-for-profit entities with the wherewithal to implement them.

Certain changes the Attorney General has made to his bill seem, in particular, responsive to the NPOC's March 2013 letter:

- Limiting the new, enhanced procedures for the review of related party transactions to situations where the interested director has a "substantial financial interest" in the transaction.

- Permitting a board to rely on review of executive compensation performed by its compensation or other appropriate committee.
- Establishing a threshold of $150,000 in total compensation for the new, heightened approval procedures for executive compensation.
- Scaling back the requirement that a board review alternative transactions before approving related party transactions.

The Law Revision Commission, by introducing its own bill to amend the N-PCL, has significantly advanced the goal of meaningful N-PCL reform. The great weight attached by the Legislature to any Commission decision to undertake reform should convince legislators who are not particularly focused on the nonprofit sector that the time has finally come to improve and update the N-PCL, a law which has not been significantly updated since it was passed over 40 years ago.

If reforms are adopted, more nonprofits will opt to form in New York, rather than in sister states, which will greatly assist the efforts of the Attorney General and others in regulating such organizations.

The NPOC is delighted with the current interest in reforming the N-PCL and grateful for the opportunity to share its perspectives based on many years of working with the nonprofit community -- so that the citizens of this state can benefit from a thoughtful, practical and effective legal framework for the regulation of its nonprofit community, as they deserve.

EXHIBIT 1

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May 23, 2011

Honorable Eric Schneiderman
Attorney General of the State of New York
120 Broadway
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Re: Nonprofit Initiative

Dear Attorney General Schneiderman:

We have read with great interest about your recent announcement in a speech to the Association for a Better New York of a new initiative by your office to revamp New York State laws affecting nonprofits to make them less burdensome. We understand that you are proposing to form a working group of nonprofit, government and labor representatives to develop proposals and recommend reforms.

We heartily congratulate you on this undertaking and would like the opportunity to work with you in this endeavor. The role that nonprofits play in the state has been crucial to New York's economy and its cultural and political importance and this proposal has the promise of lessening the needless burdensome regulation that New York nonprofits currently face.

As a committee of the New York City Bar Association composed of lawyers serving a broad spectrum of nonprofit organizations with extensive experience with nonprofit-related laws, we feel that we can be of great assistance in this process.

We especially would like to note the urgent need to reform the Not-for-Profit Corporation Law (N-PCL). As you are probably aware, the N-PCL imposes needless hurdles related to the formation, operation and dissolution of nonprofits that are not present in the laws of other states. As a result, there is a growing trend among New York nonprofit lawyers to incorporate New York-based nonprofits outside of New York, especially in Delaware (a state where many New York corporate lawyers already incorporate many of their business clients).

As New York lawyers, we would rather form those corporations under New York law. Furthermore, while the Attorney General's office may exercise some degree of authority over nonprofits qualified to conduct activities in New York, its authority over those organizations is far more constrained than it is over organizations incorporated in New York. Accordingly, we feel that it is imperative that the N-PCL be reformed so as to discourage this migration out of state.

For several past legislative sessions a bill has been introduced in the State Legislature to revamp the N-PCL in it entirely. The most recent version of this bill is A-5727/S-4611. The bill had its genesis in a proposal of the New York State Bar Association (State Bar). Our committee studied the bill, and, among other things, held a public forum on November 2, 2009 entitled *Ideas for Change: A Conversation About Reforming New York Nonprofit Law and Regulations*. That session consisted of a two and half hour panel discussion with representatives from the legislature, practitioners, academics and regulators on the bill and administrative issues relating to nonprofits' activities in New York. We conducted a section-by-section analysis of the N-PCL and the State Bar bill and we are currently working with the State Bar with the goal of preparing a draft bill that both bar associations can jointly sponsor. We look forward to educating your office on the status of the proposal.

The N-PCL, based in large part on the existing Business Corporation Law (BCL), was adopted in 1970, over 40 years ago. While certain provisions have changed over the years, it has not been updated as much as the BCL. It is ripe for a full scale review and revision. As we learned in our review of the existing law, many of its provisions are confusing or burdensome (or both). While lawyers who regularly practice in this field are familiar with the sometimes counterintuitive and arcane aspects of the N-PCL, they are often a surprise to lawyers less experienced in this field (including many business lawyers familiar with the BCL); this can lead to errors or unintentional violations of the N-PCL. As you probably know, due to their limited finances many nonprofits rely on the *pro bono* services of these lawyers instead of seeking the counsel of more seasoned nonprofit specialists. It would be helpful for all New York lawyers if the N-PCL was revised for more clarity and to eliminate unnecessary burdens.

These unnecessary burdens arise under the current law in all aspects of a nonprofit's life – its formation, operation and eventual dissolution. These include:

- Delays in the formation stage (and the corresponding process of qualifying out-of-state nonprofit corporations to conduct activities in New York) created by requirements such as the need to determine a nonprofit's "type" (with confusion over the correct "type" often leading to rejection of certificates of incorporation and certificates of authority for foreign corporations) and to obtain pre-formation consents from one or more state agencies, which can be a lengthy process. 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 in the operational phase including high vote requirements for certain board actions, cumbersome provisions for determining the number of directors and forming

committees, uncertainty as to whether boards can act by electronic consent and required state agency consents for certain changes.

- Although recently improved, the cumbersome dissolution process.

While many of the unnecessary burdens faced by nonprofit corporations formed in New York arise from the provisions of the N-PCL, some of them are found at the administrative level, where nonprofit corporations frequently experience delays and other costly obstacles to obtaining necessary governmental consents. This combination of statutory and administrative challenges 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.

While we support the virtues of a re-write of the N-PCL, we would alternatively support efforts to modify specific provisions of the law pending any total revision. These include:

1. Replacement of pre-formation consent requirements under Section 404 with post-formation notification and approvals to conduct regulated activity.

2. Replacement of "types" under Section 201 with a simpler distinction between "public benefit" and "mutual benefit" type corporations.

3. Replacement of the requirement of approval by a majority (or, in certain instances, two-thirds) of the "entire board"[1] for any real estate transactions (Section 509 – two-thirds for boards of 20 members or less), asset sales (Section 510 – two-thirds for boards of 20 members or less), change in the number of directors (including change by way of amendment of the by-laws) (Section 703), formation and composition of board committees (Section 712) and setting of officer salaries (Section 715) with the approval by a majority (or higher) vote of the board members present at a meeting at which a quorum exists.

4. Revision of the provisions under Sections 605, 614, 708 and 711regarding member and director action to allow electronic communications for notice of meetings and member and director action.

5. Revision of the provisions under Section 702 regarding board size to allow the by-laws of all corporations to provide a range rather than a fixed number (currently, only nonprofits with members who have approved such by-law provision are allowed to use a range but, in fact, the by-laws of many, if not most, nonprofits allow the board to fix the number within a range).

6. Revision of provisions under Section 712 regarding committees to allow the by-laws to set more practical procedures for the appointment of the members (subject to full board

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[1] 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, meaning these actions cannot take place at that meeting even if everyone in attendance concurs with the proposed action.

oversight) and eliminate the requirement that all committees (excepting the executive committee) consist of at least three members.

7. Simplification of the procedures for (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. One idea would be to permit an alternative to the current process of seeking court approval for such transactions on notice to the Charities Bureau, which would allow nonprofits to seek approval from the Attorney General (instead of the courts), using application forms and paperwork established by the Charities Bureau, with the Attorney General's decision being subject to administrative review. This approach, it is hoped, would be simpler, especially for smaller nonprofits without access to nonprofit specialists. The nonprofit would retain the right, as currently set forth in the law, to seek court approval (on notice to the Attorney General), which would avoid the need to take an appeal from an adverse administrative determination under this alternative approach.

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

9. Streamlining of corporate filing procedures, including (a) requiring the Department of State to review filings solely on the basis of whether they satisfy the requirements of the N-PCL, such as the requirement that the certificate of incorporation sets forth the purposes for which the corporation is formed, and not, as is currently the case, requiring that the certificate of incorporation describe the activities of the corporation or questioning the appropriateness of a name of the corporation otherwise in compliance with the N-PCL requirements, (b) authorizing (for a fee) the Department of State to "preclear" filings prior to formal submission and (c) allowing the Department of State to make hand corrections to filings to correct minor errors with the consent of the filer.

10. Reformulation of the provisions of the N-PCL to better clarify the role and fiduciary duties of directors and officers. 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 believe that inclusion of all such provisions in one location would also help convince legislators as to why reform of the N-PCL would be wise.

We would appreciate an opportunity to be a part of the process that you envision to modernize New York's nonprofit practices and look forward to the opportunity to work with your office on this worthwhile project.

Sincerely,

David Lowden

cc: Harlan Levy, Esq. First Deputy Attorney General
Jason Lilien, Esq., Bureau Chief of the New York State Attorney General's Charities Bureau
Robert Pigott, Esq., Chair of the Subcommittee on N-PCL Reform

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* did not take part in the consideration or approval of this report

EXHIBIT 2

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September 21, 2012

Jason Lilien, Esq.
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Re: Attorney General Program Bill - S.B. 7431

Dear Mr. Lilien:

On behalf of the Committee on Non-Profit Organizations of the New York City Bar Association (the "Committee"), I am writing to provide preliminary comments on the Attorney General's Program Bill, S.B. 7431, The Non-Profit Revitalization Act. While the Committee as a whole looks forward to offering more detailed comments in the future, at present we wish to make only a few initial but, we believe, important points.[1]

First, we thank you for your willingness to meet with us to discuss the proposed legislation. We look forward to further discussions.

Second, we applaud the work of the Charities Bureau and the Attorney General's Committee to Revitalize Nonprofits (the "AG's Committee") in proposing steps to simplify and modernize aspects of New York's Not-for-Profit Corporation Law ("N-PCL"). Provisions that would, for example, eliminate unhelpful corporate "types" and instead treat nonprofits based on more commonsensical "purposes," streamline procedures for forming corporations, including the elimination of the need for certain pre-formation consents, and expressly permit the use of electronic communications for corporate proceedings, are very welcome. We will, individually and collectively, suggest further changes to some of the bill's provisions,

[1] A number of members of the Committee have submitted or will be submitting comments in their individual capacity. These individual comments are not meant to reflect the views of the Committee or the Association of the Bar of the City of New York.

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but we wish to be clear that we consider your efforts to be important steps towards making New York a better home for existing not-for-profit corporations and a more attractive location for the formation of new nonprofits. As you know, many New York lawyers now encourage nonprofits to organize in more charity-friendly states, such as Delaware, to avoid the extraordinary and sometime capricious burdens of current New York law and procedure; we would like to be able to tell our clients that they no longer need to follow such procedure.

Third, we also share the goals you espouse with the new governance aspects of the bill, including the proposed amendments to §715 (Related Party Transactions) and proposed new §§712-a (Audit Committee), 712-b (Compensation Committee) and 715-a (Conflict of Interest and Whistleblower Policies) of the N-PCL. But we are concerned that certain aspects of these proposals may create new, substantial and, for many nonprofits, unwarranted burdens on New York charities, particularly smaller charities.

These proposals of course build on U.S. Internal Revenue Service guidance and IRS Form 990 questions that encourage similar efforts to support appropriate board oversight, manage conflicts of interest, and ensure that compensation is reasonable. But, as you acknowledge, the IRS promotes such efforts by requiring disclosure and offering safe harbors if certain procedures are followed, while the bill would mandate that many nonprofits follow IRS-style procedures, in many cases without regard to the size (and resources) of the charitable entity or the magnitude of the transaction involved. For example, the proposed compensation rules would require a full compensation review even if an organization paid no one more than an obviously low salary. The proposed revisions to the conflicts rules would require a review by the full board (even when a proposed transaction is clearly below market or *de minimis);* for example, such procedures would appear to require a college to perform a full review before buying for its library a single book written by the President or a highly compensated faculty member. Further, the requirement that the full board consider alternative transactions even if the transaction at issue is clearly below market, *de minimis* or the result of a competitive selection process will result in delays and potentially missed opportunities. We suspect that this is not what the AG's Committee or the Charities Bureau intended.

Whether mandating detailed "best practices" is appropriate is something as to which there can be reasonable disagreement. We suspect that New York would be unique among the states in enacting such requirements and wonder if that will not further discourage nonprofits from forming in this state, a problem which your other proposed reforms address.

In the spirit evidenced in the recommendations of the AG's Committee and the changes that the bill proposes to existing provisions of the N-PCL to relieve needless burdens from nonprofits, we encourage you to revamp these governance provisions to avoid their being needlessly burdensome and to make them more entity-appropriate. We look forward to the opportunity to further review any redraft.

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Again, we thank you for the time that you have already spent with us and look forward to working with you towards achieving true reform of the N-PCL.

Very truly yours,

David W. Lowden

EXHIBIT 3

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March 6, 2013

Jason Lilien, Esq.
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Re: Attorney General Program Bill - S.B. 7431 (2012 session)

Dear Mr. Lilien:

On behalf of the Committee on Non-Profit Organizations of the New York City Bar Association, we write to comment on the Attorney General's Program Bill, S.B. 7431, the Non-Profit Revitalization Act, which was introduced in 2012. We wrote an initial comment letter to you on September 21, 2012, and we appreciate your openness to hearing further from us and other representatives of the nonprofit community.

We are writing now to flesh out the concerns and recommendations that we expressed in our earlier letter. We understand that the Attorney General may be revisiting the 2012 bill in anticipation of introducing a new version in 2013, and we offer these comments in that context and in the hope that the 2013 bill might be strengthened by our suggestions.

By way of background, the Committee on Non-Profit Organizations (NPOC) is a diverse 42-member committee of the New York City Bar Association.[1] Some of us are law firm attorneys representing nonprofits, some are in-house counsel for charitable organizations, and a few are legal scholars. We represent multi-million dollar institutions and tiny charities, institutions in many parts of the charitable sector, and institutions that have been serving New York for more than a century as well as groups now seeking to incorporate as non-profits in New York or elsewhere.

[1] Members of the Attorney General's staff have long contributed to the work of the Committee, but the current Charities Bureau representative on the Committee has not participated in developing this letter.

Our comments seek to address the implications of the proposed changes for these diverse charities, with particular concern for the new burdens that they might place on smaller and more modestly-sized charities.

We fully support the bill's stated goals, reduction of "unnecessary and outdated burdens on non-profits" and "enhanced nonprofit governance and oversight." In our view, many of the proposed amendments further those goals, but as we explain below, we are concerned that some will substantially increase the burdens on non-profits, requiring them to focus significant time and resources on technical compliance obligations without a significant payoff in enhanced governance and oversight. While we work with our clients to develop and meet "best practices," we question whether best practices can or should be legislated, especially if the same practices are to be required of all types and sizes of organizations.

As we indicated in our earlier letter, we applaud the efforts of the Charities Bureau and the Attorney General's Committee to Revitalize Nonprofits to simplify and modernize aspects of New York's Not-for-Profit Corporation Law (N-PCL) and other laws applicable to nonprofits. We welcome provisions that would, for example, eliminate unhelpful corporate "types" and substitute more commonsensical "purposes" (most of sections 1, 2, 3 and 10 and other conforming amendments), streamline procedures for forming corporations (including sections 4 and 5) and for approving real estate transactions (section 24), and expressly permit the use of electronic communications for corporate proceedings (sections 32-35, and 39-40). We have attached some suggested technical changes that might further simplify some of these aspects of the law without compromising the Bureau's important oversight and enforcement goals.

As we stated last year, we are concerned that many New York lawyers now encourage non-profit clients to organize in more charity-friendly states to avoid the extraordinary and sometime capricious burdens of current New York law and procedure. We believe that the streamlined procedures the Attorney General has proposed might persuade lawyers to reconsider the benefits of forming nonprofits outside of New York.

We are concerned, however, that some of the governance and oversight proposals in the bill are so broad and burdensome that they would weigh heavily against choosing to incorporate in New York and, perhaps more significantly, place extraordinary burdens on existing New York charities, including many that do not have the resources to meet those new requirements. We are concerned that some of these new requirements will force charities to refocus energy and resources best used for their charitable purposes on overly detailed compliance obligations.

The bill as introduced in May 2012 appears to require many New York charities (and not merely a small number of charities with significant resources) to adopt conflict of interest and whistle blower policies compliant with very specific requirements and follow detailed and unnecessarily onerous procedures for reviewing <u>all</u> related party transactions (no matter how minor or obviously advantageous to the charity), <u>all</u> potential conflict of interest decisions (no matter how inconsequential) and <u>all</u> decisions regarding compensation of officers and the five most highly compensated key employees (no matter how modest that compensation may be). We oppose such

provisions as they are currently drafted.

We address certain of these individual issues in more detail below, but we have a overarching set of concerns applicable to most of the bill's governance proposals:

- These proposed requirements are, to our knowledge, unique among the states. While the Internal Revenue Service encourages similar policies and procedures by requiring disclosure and providing safe harbors, it does not require that charities meet such detailed requirements. If the changes proposed in the May 2012 bill were adopted, many New York charities would have a significant set of new obligations that are not borne by charities incorporated in any other state. We encourage the Attorney General to propose safe harbors rather than absolute requirements.

- While some of the proposed requirements apply only to charities with more than specified budgets or numbers of employees, the thresholds are quite low, so that relatively modest-sized charities might, for example, be compelled to devote substantial time and resources to elaborate reviews of the compensation of even those officers and key employees whose compensation is obviously well below market rates. If the Attorney General continues to believe that it is necessary to impose additional procedural requirements, we encourage the Attorney General to consider placing the requirements only on the largest charities with the possibility of phasing them in for mid-sized entities over time, while continuing to exempt smaller entities.[2]

- The proposed requirements do not have materiality standards and, indeed, eliminate the existing N-PCL section 715(a) requirement of a "substantial financial interest." Thus, as we noted in our prior letter, the proposed revisions to sections 715 and 715-a would appear to require a college to perform a full review before so much as buying a book written by the President or a highly compensated faculty member. As the Attorney General notes in the publication *Right from the Start: Responsibilities of Directors of Not-for-Profit Corporations:* "the board is generally not involved in the day to day activities of the organization." The new rules, however, would appear to require all directors to do just that. Similarly, transactions that are truly *de minimis* or patently favorable to the nonprofit should not be subject to wasteful "hoop jumping" requirements.

- The amendments frequently require an act of the full board and prohibit reliance on committee determinations. Requiring committees to report their actions to the full board is appropriate but requiring duplicative levels of approval is wasteful and unlikely to yield

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[2] While the Committee is not in complete agreement on where the lines should be drawn, we suggest that the Attorney General consider treating nonprofits with over $10,000,000 in revenue or over 100 employees as "large" and nonprofits with less than $1,000,000 in revenue as "small" and the other nonprofits as "mid-sized." If the Attorney General's office concludes that mid-sized nonprofits should become subject to some of the new governance requirements, we urge the Attorney General to provide a period of years (perhaps five) after implementation for the large nonprofits so that standard policies and Charities Bureau guidance would have been developed and the burden on the mid-sized charities would be less onerous. There should also be a reasonable phase-in period for the larger charities that would be initially subject to any new requirements.

significant benefits. Indeed, the requirement of an essentially *de novo* review by the full board undercuts the important benefits of streamlined and generally more nimble committee structures.

- Many proposed new definitions appear to be based on existing regulations (notably the Internal Revenue Code) but with slight changes. These small differences significantly increase the administrative burden of compliance, with little if any discernible benefit. To the extent possible, the definitions should be consistent so that nonprofits can more easily ensure compliance with both state and federal regulations on the same basis.

We address the major new regulatory burdens in turn:

Audit Oversight (proposed section 712-a). The Committee would support a requirement that large charities appoint audit committees if the proposal (i) is limited to charities with over $1,000,000 in revenue, (ii) provides charities with a reasonable period of time in which to adopt a charter and appoint a committee, (iii) permits charities to assign this responsibility to alternative committees of independent directors, and (iv) provides for a phase-in period under which the largest charities are the first required to adopt these provisions and mid-sized charities have additional time to do so. To avoid undue burden on nonprofits with small boards, the provision should also permit all independent members of the full board to perform the functions of an Audit Committee.

Executive Compensation Oversight (proposed section 712-b). We support the goal of board oversight of executive compensation, but we are concerned that the specific amendments take a "one size fits all" approach that is inappropriate for many charities, particularly those that pay clearly modest (and often significantly below-market) salaries.

- We respectfully submit that the focus should be on the amount of compensation paid rather than the process by which it is determined. Internal Revenue Code Section 4958 already encourages the procedures the bill would mandate. But if the compensation is manifestly reasonable, the failure to follow technical procedures should not give rise to liability.

- Requiring elaborate procedures even when there are no highly compensated employees requires charities to waste resources on unnecessary procedures and consultants. We understand the Attorney General's position that non-profit corporations can do their own benchmarking, but we know from experience that many boards feel obligated to retain consultants to ensure that they are meeting the detailed requirements of the new law and insulate board members from liability. These resources are better spent on the charities' missions; consultants' fees will not buy improved oversight.

- Similarly, boards should continue to be able to delegate responsibility for reviewing and approving executive compensation to committees of independent directors. Boards, particularly larger boards, act through committees so that they make more efficient use of their members, who can develop expertise in, and devote necessary time to, particular

areas of governance. Requiring the full board to take direct responsibility for executive compensation effectively eliminates the utility of a compensation committee.

- We urge adoption of a materiality standard modeled on that of the IRS 990, which limits disclosure requirements to individuals paid more than $150,000 annually. (We also support defining key terms, such as independence, key employees, and relatives, by reference to the definitions of those terms used by the IRS.) Requiring detailed review of the salaries of those who make less than this threshold places an unnecessary burden on directors and seems likely to require them to focus undue effort on scrutinizing modest compensation.

Related Party Transactions (proposed sections 715). We agree that related party transactions and other conflicts of interest are serious matters that require board or committee oversight. We would support a requirement that material related party transactions be disclosed to the full board, but we are concerned that the exhaustive procedures set forth in the draft amendments would waste board time with immaterial transactions and arrangements that obviously benefit the charity, distracting the board from more critical work. The proposed amendments as written would prohibit any related party transaction, no matter how immaterial or beneficial absent elaborate board review including examination of alternative transactions and a two-thirds vote of the entire board.[3]

We encourage the Attorney General to consider instead adopting a rebuttable presumption under which independent review of transactions would provide the charities with some protection, but boards would not be required to review minor or clearly beneficial transactions merely to ensure compliance with technical requirements.

Should the Attorney General conclude that board review of related party transactions is required, we recommend that such required review only apply to material transactions. As we have noted, board review should not be required for small or routine transactions like the purchase of a library book or a transaction where a related party is waiving fees or charges. Similarly, the purchase of goods or services at evidently below market prices should not require review.

We also urge the Attorney General to remove the requirement that the board affirmatively consider alternative transactions. Consideration of alternatives will sometimes be an appropriate part of a board or committee's review of an interested party transaction, but there are many situations in which such review is impractical (where, for example, the transaction involves the acquisition of a unique good or service or the provision of needed services at clearly below market prices or there is an urgent need for the goods or services) or unnecessary (as where the transaction was competitively bid or is otherwise patently in the charity's best interests). Procedure for the sake of procedure benefits neither charities nor the public.

We also urge the Attorney General to let charities continue to rely on committees of independent

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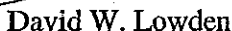
[3] We have long noted the difficulties of imposing such high levels of director approval, especially since many nonprofits have large boards with quorums as low as one-third.

directors to vet and, where appropriate, approve related party transactions. Requiring review by the full board is less likely to result in truly careful scrutiny than assigning this responsibility to a dedicated committee. Such an approach also limits charities' ability to divide board work among committees.

Whistle Blower Policies (proposed section 715-a and related changes). Existing New York law (including Labor Law §740) provides some whistleblower protections; whistleblowers are also protected by certain provisions of the Sarbanes-Oxley Act. We are concerned that the detailed requirements of the bill would place undue burdens, particularly on smaller charities. We urge the Attorney General to rely instead on existing law. Should the Attorney General conclude that some further whistleblower protections are necessary, we submit that the employee threshold for requiring such protections should be substantially higher than five and suggest fifty employees, a common threshold for many employee protections (such as the Family and Medical Leave Act).

Again, we appreciate your willingness to consider the views of charitable organizations and look forward to continuing to work with you to make New York law hospitable to nonprofits while encouraging and promoting best governance practices for nonprofits.

Very truly yours,



David W. Lowden

Suggested Technical Corrections to AG N-PCL Reform Bill

Nonprofit Organizations Committee of the New York City Bar Association

March 6, 2013

This chart sets out technical comments on existing provisions of the N-PCL that are proposed for revision by the AG bill. The chart does not include comments on new governance provisions proposed by the AG, as to which our general comments are set forth in the accompanying letter, or changes on sections not otherwise proposed for revision.

Section	AG's Amendment	Comment
102	Adds language in new paragraph 6-A to the effect that if the bylaws say the board may consist of a range between a minimum and maximum, the entire board shall be the number of directors elected at the last election of directors	We applaud the proposed change, but additional changes would more fully address the issue: (a) Section 702(a) limits the right to have such a bylaw provision to corporations with members who have approved such bylaw provision. Section 702(a) should be amended should allow any corporation's bylaws to authorize a range of board members (b) As the N-PCL authorizes in section 704, some nonprofits elect board members for multi-year terms, thus electing only one class each year. Additionally, directors can die, resign or be removed and the board can vote to increase the size of the board. To address these cases, words to the following effect should be added: "…(PLUS, IN THE CASE OF CLASSIFIED BOARDS, DIRECTORS FROM CLASSES NOT UP FOR RE-ELECTION), AS ADJUSTED TO REFLECT ANY DEATHS, RESIGNATIONS, REMOVALS OR PRIOR ELECTIONS)." (c) If the bylaws allow the board to fix its size within a range, then the "entire board" should be the size so fixed by the board; the proposed provision that sets the "entire board" at the number of directors elected at the last election should only apply if the board has not fixed its size within the range.

Section	AG's Amendment	Comment
	Adds new paragraph 9-B, defining "non-charitable purposes"	The definition requires the non-charitable purposes to be "non-business" (in one instance) and "non-pecuniary" (in another). We suggest using the same term in both instances.
	Adds new paragraph 21, defining "independent director"	The definition excludes any person who received payments from or made payments to the nonprofit of more than $10,000 over the past three years. Charitable contributions and expense reimbursements should be excluded from the sum.
404	The Commissioner of Education's consent would not be required under paragraph (d), but notice would be given within 10 business days after receipt of confirmation of formation, as is the case now with nonprofits described in paragraph (b)(2).	Paragraph (b)(2), regarding procedures for child care entities, should be conformed with the new wording of paragraph (d) to require the notice be given within 10 "business" days after the corporation receives confirmation of filing.