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NON-PROFIT ORGANIZATIONS

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Re: Legislation in Relation to Implementing the Non-Profit Revitalization Act of 2013 (A9600/S7341) and Further Recommended Refinements of the Non-Profit Revitalization Act

Dear Senator Ranzenhofer and Assemblyman Brennan:

On behalf of the Committee on Non-Profit Organizations of the New York City Bar Association, we write to comment on proposals to revise the Non-Profit Revitalization Act (the "Revitalization Act," the "Act" or "NPRA"), which was enacted in 2013, amending the Not-for-Profit Corporation Law (the "N-PCL") and Estates, Powers and Trusts Law (the "EPTL"), among other laws and to suggest additional refinements NPRA.

In prior communications with Jason Lilien, then the head of the Charities Bureau of the Department of Law, and Governor Cuomo[1] we supported enactment of NPRA. We continue to support NPRA

[1] See our letters to Eric Schneiderman dated May 23, 2011, available at http://www2.nycbar.org/pdf/report/uploads/20072312-LettertoNYSAGsofficeonNon-ProfitRevitalizationAct.pdfj, to Jason Lilien dated September 21, 2013, available at http://www2.nycbar.org/pdf/report/uploads/20072312-LettertoNYSAGsofficeonNon-ProfitRevitalizationAct.pdf, and March 16, 2003, available at http://www2.nycbar.org/pdf/report/uploads/20072429-CommentonAGsNonProfitRevitalizationAct.pdf, and to Governor Cuomo, July 16, 2014, available at http://www2.nycbar.org/pdf/report/uploads/20072540-LetteronNonprofitRevitalizationAct.pdf, as well as our testimony before the Senate Standing Committee on Corporations, Authorities and Commissions on May 23, 2013, available at http://www2.nycbar.org/pdf/report/uploads/20072499-StateSenatePublichearingonNot-forProfitCorporationLaw.pdf.

but feel that it is appropriate to adopt certain refinements. As is customary when major legislation is first enacted, when the implications of the legislation are further analyzed, the need for technical corrections and other revisions becomes apparent.

By way of background, the Committee on Non-Profit Organizations (NPOC) is a diverse 40-member committee of the New York City Bar Association. 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 small 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. Our comments seek to address the implications of NPRA for these diverse charities.

A. The NPOC Supports Pending Legislation to Further Refine NPRA (A9600/S7341).

We note that S6249/A9117, which makes various technical changes to NPRA, was introduced at the request of the Governor, as referenced in his actions approving NPRA in 2013, approved by both the Senate and Assembly and signed by the Governor on May 20th. The NPOC supports S6249/A9117.[2]

Additional legislation has been introduced refining NPRA. A9600/S7341 is a bill newly-introduced that would delay the effective date of the following sections of the Act until March 31, 2015: 72 (regarding audit review procedures), 73 (regarding an employee acting as Chair of the Board or in a position with similar responsibilities, 74 (regarding related party transactions), 75 (regarding conflicts and whistleblower policies) and 130 (regarding audits, related party transactions, conflict of interest polices and whistleblower policies for trusts).[3] We strongly

[2] While most of the provisions in S6249/A9117 are truly technical, we note that one provision may represent a major substantive change. S6249/A9117 amends subparagraph 2 of paragraph (a) of Section 402 (the provision setting out what must appear in a certificate of incorporation), to add after "the purpose or purposes for which it is formed" the words ", it being sufficient to state that the purpose of the corporation is any purpose for which corporations may be organized under this chapter as a charitable or non-charitable corporation." This seems to eliminate the requirement that specified purposes be set forth in the certificate of incorporation. Instead, it would be sufficient to state "the purpose of the corporation is any purpose for which corporations may be organized under this chapter as a charitable][or, if applicable 'non-charitable'] corporation." If our reading is correct, this substantive change may have major implications for the administration of charitable assets. We look forward to guidance from the Department of State or Attorney General regarding the scope of this new language.

[3] We note that the New York Council of Nonprofits, Inc. (NYCON) had proposed delaying effectiveness of all of NPRA for six months, to January 1, 2015, in order for the New York nonprofit community to have further time to implement the many changes required by the Act. We feel, however, that the approach taken with A9600/S7341, to delay the new governance provisions only is more appropriate, leaving the July 1, 2014 effective date with respect to the other changes, which are urgently needed in order to alleviate nonprofits from current burdensome requirements. A9600/S7341_leaves in place the July 1st effective date for the provisions, among others, raising the threshold for audits, changing the current four types of nonprofits into two (charitable and noncharitable), modifying the consent requirements for formation and corporate changes, revising requirements regarding the statement of purposes in certificates of incorporation, revising the required voting procedures for real estate transactions, allowing communication and consents to be done electronically, redefining the "entire board," and adjusting provisions for

support A9600/S7341. We would, however, also encourage delaying the effective date of Sections 70 and 71 (regarding board committees) due to difficulties with such provisions that we point out later in this letter.

This delay would give the boards of not-for-profit corporations time to adopt policies, recruit additional directors (or trustees of charitable trusts) to ensure that they can adequately staff committees and have sufficient independent and unrelated party directors (or trustees) and revise their by-laws or other governance documents to conform to these new requirements. It will also give the Attorney General's office more time to establish its guidance and will enable the Legislature to have time to make corrective amendments to NPRA as we propose in this letter. It will also avoid possible complications arising in connection with the procedure for implementing by-law changes under the NYS Grants Gateway process.

B. <u>The NPOC Believes NPRA Should Be Further Refined</u>.

We believe that additional changes to the Act are needed to reflect properly the goals that the law espouses. These changes include revisions to address substantive issues that arose from the new requirements put in place by the Act and other changes of a more technical nature.

As elaborated below, we believe that the following changes should be made:

- **The Key Employee Definition Needs to be Revised**. The definition of "key employee" should be changed to track the easy-to-understand Internal Revenue Service definition of that term instead of the current definition that, counter-intuitively, covers people who are not employees.

- **Requirements for Board Committees Should be Relaxed**. Board committees should be easier to form and more flexible in size to better facilitate their usage. The requirement that they be appointed by a majority of the entire board and that there be no fewer than three members of each committee should be eliminated or limited to only certain committees.

- **Annual Conflict Certification Procedures Should be Revised**. Certification requirements regarding conflicts policies should be relaxed. These include the provisions that small nonprofits require annual certification by the directors, that such certifications must be provided to the secretary even if the corporation has a compliance officer and that directors must provide such certifications prior to election. Such requirements should also be revised to simplify corporate compliance with related-party transaction rules.

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the determination of board size.

- **Related Party Transaction Provisions Should be More Practical**. The rules regarding related party transactions need to be made more practical: (a) the requirement that the directors approve all transactions between a corporation and its related parties should be limited to transactions that would normally be subject to board approval, not routine or *de minimis* transactions; (b) the need for approval by the board of a corporation of transactions between related parties and affiliates of such corporation should be limited only to transactions with affiliates that are controlled by the corporation, not all affiliates; (c) compensation transactions should not be subject to the related party transaction rules; and (d) that persons leaving a meeting due to conflicts should not cause an existing quorum to be lost.

- **Further Technical Changes Should be Made**. Additional changes should be made to clarify the intended meaning of certain provisions as well as for internal consistency.

While we also would like to see other N-PCL provisions, which were not the subject of NPRA reform, amended so New York law can better serve the nonprofit community and those benefiting from the services of nonprofits, our comments at this time relate solely to the provisions of the N-PCL amended by NPRA.

1. Certain Changes Made by NPRA Have Created Complications and Should Be Revised.

In the process of making needed reforms of the N-PCL, many of the changes to the N-PCL made by NPRA have given rise to other concerns. These include the following:

(a) The definition of "key employee" should be changed to track the easy-to-understand Internal Revenue Service Form 990 definition of that term instead of the current open-ended hard-to-understand definition tied to the Internal Revenue Code "excess benefit" rules, which is imprecise and covers people who are not current employees.

The definition of "key employee" in subparagraph (25) of paragraph (a) of Section 102 of the N-PCL, as added by NPRA, is counter-intuitive and not appropriate. Drawing upon an Internal Revenue Code definition created for a materially different purpose, it defines key employee as any person who "is a "in a position to exercise substantial influence over the affairs of the corporation," to which is added "as referenced in" certain cited portions of the Internal Revenue Code (the "Code") and corresponding regulations, which are applicable to "disqualified persons" under the excess benefit rules.[4]

[4] The Act defines "key employee" under N-PCL § 102(a)(25) as "any person who is in a position to exercise substantial influence over the affairs of the corporation, as referenced in 26 U.S.C. § 4958(f)(1)(A) and further specified in 26 CFR § 53.4958-3(c), (d) and (e), or succeeding provisions." (A similar definition appears in new EPTL Section 8-1.9.) According to 26 U.S.C. § 4958(f)(1)(A), a disqualified person is "any person (including members of their families and controlled entities, as further described in the regulation) who was, at any time during the 5-year period ending on the date of such transaction, in a position to exercise substantial influence over the

The definition of disqualified persons found in the Code and regulations is overly broad, in the context of the Act, in that it means any person who was, at any time during the prior five year period, in a position to exercise substantial influence over the affairs of the organization, determined according to a facts and circumstances test. This definition covers people who are not employees, possibly including substantial donors. It also covers persons who were employees or in a position of influence in the past.[5]

The term "key employee" as used by the Internal Revenue Service for its Form 990 annual reports[6] is a more appropriate source for the definition. This definition is precise: it applies only to employees who earn over a dollar threshold who have certain defined senior staff responsibilities, powers or influence. The Form 990 definition is, most likely, what nonprofits and their advisors think of when they hear the term "key employee."

The expansive definition of disqualified persons is reasonable for the Code provisions governing excessive compensation, purchases and sales of assets, and other similar transactions, since such situations do not occur on a regular basis. NPRA, however, uses this term to apply to numerous transactions. Since a key employee is a "related party" (as defined), every transaction with such person must be approved by the board according to a mandated procedure. Furthermore, the corporation's conflicts policy must apply to every so-called key employee, whether or not they are actual current employees. The term "key employee" as used in the context of the enhanced governance provisions of NPRA logically should apply only to actual employees of the nonprofit.

NPRA's definition of key employees is not consistent with common understanding of the term. It should be conformed to the Form 990 definition. This could be stated as "… any

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affairs of the organization" and, as further specified in the cited regulations, including but not limited to all directors or trustees, presidents, chief executive officers, chief operating officers, treasurers, chief financial officers and persons with a material financial interest in a provider-sponsored organization. Any person who is not specifically described in the regulation as a disqualified person with respect to a transaction may still be a disqualified person based on all relevant facts and circumstances, as further described in the regulation. .

[5] Whether the New York definition covers past employees and persons of influence in the past five years is ambiguous. The Code definition does cover such people but the New York statute, by using words "is [rather than "was"] in a position to substantially influence…" may not cover them. But the reference to the Code provision implies that the Code definition applies.

[6] The Form 990 definition appears in the IRS's instructions to the form. It is any employee (other than an officer or director [because they are already subject to reporting in such roles]) who (i) receives reportable compensation from the organization and all related organizations in excess of $150,000 for the calendar year ending with or within the organization's tax year; (ii) either (a) has responsibilities, powers or influence over the organization as a whole that are similar to those of officers or directors, (b) manages a discrete segment or activity of the organization that represents 10% or more of the activities, assets, income or expenses of the organization, as compared to the organization as a whole or (c) has or shares authority to control or determine 10% or more of the organization's capital expenditures, operating budget or compensation for employees and (iii) is one of the 20 employees with the highest reportable compensation from the organization and related organizations for the calendar year ending with or within the organization's tax year.

employee having the duties and income level specified in, and otherwise satisfying the requirements of, the definition of 'key employee' as such term is or was most recently defined in instructions to the IRS Form 990." If there is concern that the income threshold in the IRS definition ($150,000) is too high or not relevant, a lower threshold could be used in the Act (this could be done by deleting the words "and income level" and adding the words "with an annual income in such person's last tax year of $xxx or more") or the income threshold could be eliminated (this could be done by deleting the words "and income level" and adding the words ", excluding, however, any threshold income level," after "'key employee.'" While the definitions would then not be identical, at least they would be readily translatable.[7]

If the definitions are not conformed, conflicts policies for New York corporations will need to use two separate definitions for key employees (one to satisfy the IRS Form 990 requirements and one to satisfy the New York requirements) and nonprofits will have to gather information on numerous people, including those who are not employees, officers or directors but were in any position of influence at any time during the past five years.

(b) *Board committees should be easier to form and more flexible in size to better facilitate their usage.*

Under the historic phrasing of Section 712 of the N-PCL, there are two types of board committees: "standing" and "special." Both must be composed solely of directors, but the appointment procedures and minimum number of directors for each type of committee are different. Members of standing committees must be named by a vote of a majority of the "entire board" and there have to be at least three committee members, but members of special committees can be named as set forth in the by-laws (or, if there is no by-law procedure, by the chairman of the board with the consent of the board) without the need to satisfy the majority-of-the-entire-board requirement and the size of such committees can be less than three.

The Act eliminates the differences between standing and special board committees, and requires all board committees to meet the current requirements for "standing" committees. This change has several unintended consequences that should be rectified:

(i) *The establishment and naming of members to all board committees should not require the approval by a vote of the majority of the entire board, as required under NPRA.*

The NPRA requirement that all board committees be formed, and all members appointed to such committees be approved, by a vote of a majority of the entire board eliminates the possibility of alternative appointment procedures being set out in the

[7] Alternatively, the definition of key employee could be revised to change the words "any person who ..." to "any current employee who ...". This would at least limit the definition to current employees in a position of influence.

by-laws (as was previously allowed for special committees) and means that no board committees can be formed, nor can any directors be named to committees, if a majority of the entire board is not in attendance at a board meeting. Some large boards have quorums of one-third (or lower) and may thus rarely if ever have a majority of the entire board in attendance. While a requirement that members of the executive committee must be approved by a majority of the entire board may be appropriate due to the fact that it has the power to act in all respects for the board, the procedure to name members of other board committees should be more flexible by allowing the by-laws to set forth appropriate procedures for forming and staffing such committees. Section 712 should be amended by adding the words "with respect to any executive committee" after "adopted by a majority of the entire board."

(ii) ***While it may be appropriate for executive and audit committees to have at least three members, other smaller committees may be appropriate.***

If all board committees must have three members, smaller boards will find it difficult to act through multiple board committees since those few directors will have to serve on multiple committees and there will often be much overlap between committees. The three-member requirement could also be especially problematic with respect to situations where directors have a conflict of interest; in such cases it may be appropriate to delegate decisions regarding such transactions to specially formed committees. But this may not be possible if there are not three disinterested directors. The three member requirement makes sense for executive committees (due to their plenary powers as noted above) and audit committees (as required under NPRA). Accordingly, Section 712 should be amended to add the words "executive committee and audit committee" before "consisting of three or more directors."

(c) ***The rules regarding related party transactions and conflicts of interest need to be made more practical.***

NPRA amends the N-PCL and EPTL to create new requirements to protect against self-dealing or other abusive related party transactions. Section 715 prohibits a nonprofit from engaging in any "related party transaction"[8] unless certain procedures are followed. If the related party has a "substantial financial interest" (not defined) and the nonprofit is charitable, additional procedures are required. In addition, new Section 715-a requires each nonprofit to adopt a conflicts policy that satisfies the requirements of NPRA, which policy must address the related-party-transaction requirements. These provisions raise

[8] Defined as a transaction, agreement or other arrangement in which any "related party" [defined as a director and trustee of a charitable trust, officer, or "key employee" or a "family member" of such person or an entity in which such person or family member has a 35% or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5%] has a "financial interest" [not defined] if the nonprofit or any "affiliate" [defined as an organization controlled by, in control of or under common control with the corporation] of the nonprofit is a participant.

numerous issues:

(i) ***<u>The requirement that the directors approve all transactions between a corporation and its related parties should be limited to transactions that would normally be subject to board approval, not routine or de minimis transactions.</u>***

If the term "financial interest" includes <u>any</u> interest, regardless of how minimal, such provision is not workable. As written, <u>all</u> transactions by the nonprofit or its affiliates that involve a related party (generally officers, directors and key employees, but also their family members and certain entities in which such persons have an ownership interest) must be voted on by the board or a board committee, whether or not the transaction is large enough to otherwise warrant consideration by the board. In a literal sense, a related party could have a *de minimis* interest (such as might arise from owning a single share in a public company – or even having a 401(k) investment in a mutual fund which invests in such a company – which has a transaction, agreement or arrangement with a nonprofit, or the nonprofit's buying a book written by a related party if the related party could receive a royalty from such sale). Routine transactions, such as the purchase of utilities from a power company at standard rates when an officer of that company is on the nonprofit's board may also be subject to the related party transaction requirements. These transactions should be excluded from the related party transaction rules. Routine transactions or transactions where the related party has a truly *de minimis* financial interest should not trigger the need to follow these procedures if the transaction would not otherwise be brought to the board.

If the transaction is so small or routine as not generally to warrant board consideration, the board should not have to waste its time reviewing the transaction. Boards of directors should be devoting their limited time to important matters: setting and monitoring compliance with policies, establishing the direction of the corporation, making major decisions, approving budgets, overseeing management, etc. The board should not have to review every financial transaction that in some *de minimis* or otherwise nonmaterial manner implicates a director, officer or key employee. That level of involvement in day-to-day actions distracts the board and is not consistent with good governance.

To effect the change we recommend, the wording in Section 715 which states "No corporation shall enter into any related party transaction unless ..." could be changed to "The board may not approve a related party transaction unless...."

(ii) ***The need for approval by the board of a corporation of transactions between related parties and affiliates of such corporation should be limited only to transactions with affiliates that are controlled by the corporation, not all affiliates.***

The related party provision is written arguably to require that the nonprofit follow the related party transaction procedures even if it is not a party to the transaction, so long as an "affiliate" of the nonprofit is, whether or not the affiliate is a for-profit or nonprofit entity. In the definitions set out in Section 103 a related party includes an officer, director or key employee of any affiliate of the nonprofit. A related party transaction is any transaction in which a related party has a financial interest and in which the corporation or any of its affiliates are participants. Paragraph (d) of Section 713 says that no corporation shall enter into a related party transaction unless the transaction satisfies certain tests. Accordingly, this provision could be read to apply to a transaction between an affiliate of the nonprofit and an officer, director or key employee of the nonprofit or any of its affiliates, even if the nonprofit is not in a position to influence the transaction. The provision makes sense if the transaction is with the nonprofit or an affiliate controlled by the nonprofit, but not if the nonprofit does not control the affiliated entity and accordingly can do nothing about the transaction! While disclosure of interests in transactions with affiliated entities is appropriate, the requirement for such transactions to be approved by a board that is not in any way associated with the transaction makes no sense.

The related party transaction rules should apply only to affiliates that are controlled by the nonprofit. Accordingly, paragraph (d) should be revised to add the words "with the corporation or an affiliate controlled by the corporation" after "any related party transaction."

(iii) ***The disclosure provisions of the annual certification required under the conflict of interest provisions of the Act, Section 715-a, should include disclosures required to satisfy the related party transaction rules under Section 715.***

The required annual certification under the conflict of interest provisions does not require disclosure of information necessary to determine if a transaction is a related party transaction, including dealings with affiliates of the nonprofit and entities in which a related party holds an equity interest sufficient to trigger the related party transaction rules (*i.e.*, 35% or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of 5%). Such disclosures should be required to be made on the initial and annual conflicts certificates. Paragraph (c) of Section 715-a currently requires disclosure of (a) any entity of which a director is an officer, director, trustee, member, owner (either as sole proprietor or a partner [note: not

as a shareholder or other equity holder] or employee with which the corporation has a relationship and (b) any transaction in which the corporation is a participant and in which the director might have a conflicting interest. It should be amended to require disclosure or information sufficient to enable the nonprofit to know if the director may be engaging in a related party transaction by adding as an additional disclosure item the following words from the definitions of "related party transaction" and "related party": "any transaction, agreement or other arrangement (or proposed transaction, agreement or other arrangement) in which the corporation or an affiliate of the corporation is a participant and in which the director, a relative of the director or any entity in which the director or a relative of the director has a 35% or greater ownership or beneficial interest (or with respect to a partnership or a professional corporation, a direct or indirect ownership interest in excess of 5%) has a financial interest (separately indicating, if the corporation is charitable, whether such person considers such financial interest to be significant)."

(iv) ***Compensation transactions should be separately addressed, not encompassed in the related party transaction rules.***

Although the NPRA related party transaction provisions do not expressly reference the hiring of or compensation paid to key employees or officers, in the broadest sense, such acts could be viewed to be related party transactions and thus covered by NPRA's related party transaction rules. Paragraph (b) of Section 515 sets out appropriate language regarding approval of compensation and paragraph (f) of Section 715 sets out language regarding salaries of officers. This could be done by adding the following at the end of subparagraph (25) of paragraph (a) of Section 102: "other than those related to the hiring of employees and the compensation of employees and officers."

(v) ***The fact that persons must leave a meeting due to conflicts should not cause an existing quorum to be lost.***

Paragraph (d) of Section 708 states that, except as otherwise provided in the N-PCL, a majority of the directors present at the time of the vote is the act of the board but only "if a quorum is present at such time." This means that directors who are obligated to leave the meeting due to a conflict may not be counted in determining if a quorum exists to vote on the matter, thereby creating the risk that a valid quorum will be lost. Paragraph (c) of Section 715 as effective before July 1, 2014 states that "[c]ommon or interested directors may be counted in determining the presence of a quorum at a meeting of the board or of a committee which authorizes such contract or transaction." This provision, which will no

longer be effective after June 30, 2014, allowed the board to act on a matter even if a quorum might be lost by the removal of interested directors during the discussion and vote.

Without language as previously found in paragraph (c), board meetings may lose their quorum when voting on conflict situations, if one or more directors must recuse themselves. Accordingly, language should be added back to Section 715 to make it clear that a quorum is not lost if people have to leave the meeting due to a conflict. This could be done by adding a sentence which states "Directors who are present at a meeting but not present at the time of a vote due to conflicts shall be determined to be present at the time of the vote for the purposes of paragraph (d) of Section 708."

(d) ***Certification requirements regarding conflicts policies should be relaxed.***

(i) ***The requirement for annual certification by smaller corporations should be eliminated.***

Section 715-a requires all nonprofits to adopt conflict policies that require annual certifications from each director. The IRS Form 990, through its governance disclosure questions, effectively requires annual certifications from organizations obligated to use the full Form 990 (*i.e.*, those with annual gross receipts at or above $250,000 or total assets at or above $500,000), but not for smaller nonprofits eligible to utilize a simpler Form 990-EZ or Form 990-N, which do not ask about conflicts policies.[9]

Larger nonprofits can effectively handle the paperwork of annual certifications but smaller ones may find that difficult and they may therefore ignore the requirement. It is not good policy to impose a procedure that has a good chance of being widely ignored. This annual certification requirement should be applicable only to nonprofits that have to file the Form 990, not the Form 990-EZ or 990-N (an alternative would be to limit this requirement to those corporations that are obligated to file audited financials with the Charities Bureau, the same standard as is applicable to the audit committee requirements). What is more important is that all conflicts be disclosed as they arise.

Accordingly, paragraph (c) of Section 715-a should be amended to add then words ", for corporations required to file with the Internal Revenue Service a Form 990 (and not a Form 990-EZ, 990-N or other shortened form)," after "The conflict of interest policy shall require" or, if the audit committee requirement is

[9] By requiring disclosure of the absence of a conflicts policy, the IRS Form 990 effectively requires one, as the typical exempt organization would sooner adopt one than admit in a public filing that it lacks one.

the threshold, the added words could be "for corporations required to have an audit committee."

(ii) ***<u>Certifications should be allowed to be given to compliance officers</u>.***

NPRA requires that the annual certification must be provided to the "secretary" of the corporation, although the N-PCL does not require a corporation to have a secretary. The conflict policies of many nonprofits, however, require monitoring by a designated compliance officer (such as is required under whistleblower policies mandated by Section 715-b), who may not be the secretary. The statute should allow such certification to be provided to the secretary or another designated compliance officer. Accordingly, paragraph (c) of Section 715-a should be amended to add the words "(or a designed compliance officer" after "the Secretary" in the two places where it appears.

(iii) ***<u>Certifications should be deliverable promptly after election</u>.***

Paragraph (c) of Section 715-a of the N-PCL requires that all newly elected directors provide a conflicts policy certification <u>prior to their election</u>. This new requirement is especially problematic where directors are nominated and elected from the floor at a membership meeting, as may often be the case with larger membership organizations. Even where directors are nominated by the board, a candidate for election may not have sufficient knowledge about the nonprofit and the entities with which it does business to provide an accurate certification before election. Accordingly, paragraph (c) should be amended to add "or promptly after" after "prior to."

2. <u>Various Technical Revisions are Needed</u>.

Certain nonsubstantive technical corrections are appropriate. These changes are needed to clarify ambiguities or to make similar sections consistent. These changes are not intended to change the intended meaning of the law. They include the following:

(a) ***<u>Language Regarding Board Committees' Ability to Approve Related Party Transactions Should be Added in Section 715</u>.*** The new subparagraph (a) of N-PCL Section 715 (and EPTL Section 8-1.9(b)(3)) state that "[n]o corporation shall enter into any related party transaction unless the transaction is *determined by the board* to be fair, reasonable and in the corporation's best interest at the time of such determination." The subsequent text of subparagraph (a), together with the text of the new subparagraph (b), however states that related party transactions may also be approved by an authorized committee of the board. For clarity, the words "*or an authorized committee of the board*" should be added after the word "board" in the first sentence of subparagraph (a).

(b) ***The Term "Entire Board" in Section 102 Needs to be Clarified.*** Under the definition of "entire board" in subparagraph 6-a of paragraph (a) of Section 102, if the by-laws provide that the board may consist of a range between a minimum and maximum number of directors, then the "entire board" shall consist of the number of directors within such range that were elected as of the most recently held election of directors." This language can easily be misinterpreted. While it is understood that the directors elected "as of" such meeting date include any directors who continue in office since their term has not expired (as is the case when a board is classified so that only a portion of the board is up for re-election in any one year), that point should be made more clearly. Accordingly, the phrase should read "as of the most recently held election of directors (including directors whose term has not yet expired)."

(c) ***The Term "Majority of Directors of the Board" in Section 509 Needs to be Clarified.*** In Section 509, regarding real estate transactions, the phrase "vote of a majority of directors of the board" is used here for the first and only time in the statute. It is confusing and needs to be clarified. Was it meant to be "a majority of the entire board," the phrase consistently used elsewhere in the N-PCL, or a majority of the number of directors then in office? If this term is meant to mean only the directors then in office, the requirement may be slightly less onerous than the majority of the entire board requirement if the corporation has empty board seats. It should mean only the sitting directors. The wording should be changed to "vote of a majority of the directors of the board then in office."

(d) ***The Provision Regarding Procedures for the Number of Directors in Section 702 Needs to be Revised.*** The language used in paragraph (a) of Section 702 is confusing. It states: "such number [of directors] may be fixed by the by-laws or by action of the members or of the board under the specific provisions of a by-law allowing such action, or by any number within a range set forth in the by-laws."

The first two situations are expressed in a grammatically understandable way ("by the by-laws" and "by action of the members or of the board…"), but the third one is not ("such number may be fixed … by any number within a range…"). The intent is clear but the phrasing is poor. It should read (new language is underlined; deleted language is in brackets): "such number may be fixed by the by-laws or by action of the members or of the board under the specific provisions of a by-law allowing such action, or if not so fixed, be [by] any number within a range set forth in the by-laws."

Additionally, the Act amends paragraph (a) of Section 702 to allow boards that do not have members to have by-laws which allow the board to set its size within a range. However, paragraph (b) still references by-laws "adopted by the members." All references to members should be eliminated in paragraph (b). If not eliminated, a board can fix its own size only once; it cannot fix it at a different number later. That was not the intent of NPRA.

(e) ***Interested Directors Should Be Able to Make Comments and Answer Questions under Paragraph (e) of Section 712-a and Subparagraph (3) of Paragraph (a) of Section 715-a.*** The language in paragraph (b) of Section 515(b) and paragraph (g) of Section 715 allowing interested directors to answer questions ("*provided that nothing in this section shall prohibit the board or designated audit committee from requesting that a person with an interest in the matter present information as background or answer questions at a committee or board meeting prior to the commencement of deliberations or voting relating thereto*") should also be added to Sections 712-a(e) and 715-a(a)(3) for consistency.

(f) ***The Timing and Method of Notice to Agencies Should Be Consistent in Sections 404, 909 and 1304.*** Certain phrasing regarding the timing of notice to state agencies in Sections 404, 909 and 1304 of the N-PCL as amended by NPRA (and Section 1 of S6249/A9117 amending Section 216 of the Education Law) is inconsistent, both in terms of the event triggering the notice (filing of a certificate or receipt of confirmation of filing) and the number of days after the triggering event (30 business days, 30 days and 10 business days). Section 404, paragraph (d) requires that a certified copy of the certificate of incorporation be provided to the Education Department within "thirty business days after the corporation receives confirmation from the department of state that the certificate has been accepted for filing." The change provided by Section 1 of S6249/A9117, however, requires that the same notice be provided within "thirty days," not "thirty business days." Furthermore, existing paragraph (b)(2), regarding day care centers, requires that such copy be provided within thirty days after filing. Section 909(a), regarding mergers, requires that a copy of the filing be provided within thirty days after receipt of confirmation. Section 1304, regarding foreign corporations, requires notice be sent within ten business days after receipt of confirmation of filing and this notification has to be by certified mail, return receipt required.

The language in all these provisions should be uniform -- we suggest thirty days (not thirty business days) after receipt of confirmation of filing, since it often takes several weeks to receive confirmation of filing of documents if expedited service is not requested, with a certified mail requirement. The words "provide a copy" should be changed to "mail a copy," so it is clear that the thirty day period ends on the mailing date, not on the date that the agency is provided with (*i.e.*, receives) the notice.

(g) ***Procedures to Clarify Charitable or Noncharitable Status of Type D and C Corporations in Section 201 Should be Adopted.*** By virtue of Section 201, Type C corporations are automatically converted to be charitable corporations and Type D corporations are automatically converted to be either charitable or non-charitable, depending on their purpose.

It may, however, be possible that some Type C corporations are noncharitable, such as trade association-type nonprofits that were required by the Department of State to form as Type C corporations since one activity was deemed to be of a business nature. We understand that most Type D corporations are charitable but some may not be so. There are implications to being one type or the other. For instance, Section 908(a) allows mergers of noncharitable corporations with business corporations.

Accordingly, it would be advisable if such Type C or Type D not-for-profits were deemed to be charitable corporations unless the corporation files a notification stating that it is noncharitable. This is akin to the procedure now set forth in Section 113 for corporations in existence when the N-PCL became effective in 1970 where an existing nonprofit could file a "certificate of type" but if it did not do so it would be converted to be a Type B corporation. This procedure has the virtue of preventing nonprofits that are non-charitable from being inadvertently characterized as charitable and allows the public to know, from the filings with the Department of State, whether the entity is or is not charitable. If it is feared that charitable corporations would seek to avoid the higher level of scrutiny applicable to charitable corporations by declaring themselves to be non-charitable (or amending their certificates of incorporation to state that they are noncharitable), a process for approval by the Attorney General could be imposed.

(h) ***Language Regarding Disclaimed Purposes in Certificates of Incorporation in Section 404 Should Be Clarified.*** Section 404(w) as revised reads: "A statement in the certificate of incorporation … that the corporation's purposes … do not include any of those described in paragraphs (a) through (v) … shall be sufficient to satisfy the approval and notice requirements contained in this section…".

The provision should be clarified so that a corporation which disclaims the purposes and powers listed in some but not all of the paragraphs of Section 404 is deemed to have satisfied the approval and notice requirements in those paragraphs. This can be done by changing the provision to read: "A statement in the certificate of incorporation … that the corporation's purposes … do not include any one or more of those described in paragraphs (a) through (v) … shall be sufficient to satisfy the approval and notice requirements contained in such paragraph or paragraphs."

(i) ***Language Regarding Procedures to Approve Compensation of Directors in Section 515 Should be Revised.*** Paragraph (b) of Section 515, regarding distributions, says compensation may be paid by a nonprofit to its members, directors or officers in a reasonable amount for services rendered. NPRA then adds new language stating that no such compensated person may be present at or participate in any deliberation or vote concerning such person's compensation.

Section 715(e), however, allows a board to approve compensation for the directors without a similar requirement that the persons to be compensated not be present for the

discussion or vote. The new language in Section 515 effectively precludes compensation for directors unless the board goes through a charade of having compensation for some directors approved by other directors and the other directors approve the compensation for the first group of directors. It should be noted that the IRS does not allow such "round robin" voting in the context of approving transactions under the excess benefit "safe harbor" rules.

Accordingly, paragraph (b) of Section 515 should not apply to compensation to directors for board service, or it should provide for an exclusion from the voting requirements for compensation approved pursuant to paragraph (e) of Section 715. Any such compensation must still meet the reasonableness standard.

(j) ***The Definition of Relative in Section 102 Should be Revised to Include Adopted Children of Other Descendants and Spouses and Domestic Partners of All Relatives.*** Subparagraph (22) of paragraph (a) of Section 102 defines "relative" of any director, officer or key employee to be such person's "(i) spouse, ancestor, brothers and sisters (whether whole or half blood), children (whether natural or adopted), grandchildren, great-grandchildren and spouses" of such siblings and descendants and (ii) "his or her... domestic partner" as defined in the Public Health Law. As drafted, the spouse of an ancestor (who is not an ancestor) is not covered nor is a domestic partner of an ancestor, sibling or descendant. Additionally, it is unclear if adopted grandchildren and great-grandchildren are covered since the parenthetical only applies to the term "children." The definition should be clarified to extend to the adopted children of other descendants and the spouses and domestic partners of all such relatives since they are also likely to be improperly favored. While these proposed changes are not part of the IRS definition of "family members," the current New York definition is not consistent with such definition since it expands the family to include the person's domestic partner.

(k) ***Minor Drafting Errors Should be Corrected.***

(i) ***Sex-Based Language Should be Removed in Sections 304, 606 and 614.*** Section 43 of NPRA made certain changes to Section 304 of the N-PCL, regarding the designation of the Secretary of State as agent, mainly to delete references to Article Four of the N-PCL. S6249/A9117 repeals Section 43 of NPRA, meaning the N-PCL changes to that section have been reversed. While we have no problem with the elimination of the deletion of references to Article Four, we note that Section 43 of NPRA also changed one reference in paragraph (d) to "him" to "him or her." That change has been lost. Consistent with other sex-based language changes, such change should be retained.

Furthermore, in Sections 606 and 614 the reference to "his" signature should be "his or her" signature.

(ii) ***Misplaced Language in Sections 614 and 711 Should be Corrected.*** In paragraph (a) of Section 614 a new provision is added allowing the consent of members to be obtained through electronic means. It states, "the consent must be executed by the member or the member's authorized officer, director, employee or agent by signing such consent or causing his signature to be affixed to such *waiver* by any reasonable means…" The word "consent" should replace the word "waiver."

New language in Section 711 allows directors to waive notice by electronic means. The sentence, however, says "the transmission of the consent must be sent by electronic mail." Here, "waiver" should replace the word "consent."

(iii) ***Language Regarding Committees of the Corporation Should be Made Consistent in Section 712.*** Paragraph (e) of Section 712 adds a new sentence stating that the members of committees of the corporation "shall be elected or appointed in the manner set forth in the by-laws, or if not set forth in the by-laws, in the same manner as officers of the corporation." However, the Act neglects to delete the prior text in paragraph (e) of Section 712 stating that committees of the corporation "may be elected or appointed in the same manner as officers of the corporation." The new sentence should instead be inserted in the text in lieu of the earlier phrase.

(iv) ***"Chair of the Board" Should Be Used in Section 713.*** In paragraph (a) of Section 713, the word "chair" should be changed to "chair of the board" for consistency.

(v) ***Redundant Language Should be Removed in Section 715-a.*** The language regarding annual certification under conflict policies in the second sentence of Section 715-a(c) is redundant of language in the first sentence.

(vi) ***Missing Words Should be Added in Sections 715-b and 804.*** The word "and" should be added between "officers," and "employees" in subparagraph (3) of paragraph (b) of Section 715-b. The words "a justice of" should be added before "the supreme court" in the last sentence of subparagraph (ii) of paragraph (a) of Section 804 for consistency.

(vii) ***Language Regarding Dissolution Filings in Section 1003 Needs to Reflect New Approval Procedure.*** In line with the changes to Article 10 allowing a plan of dissolution to be approved by either the Attorney General or a justice of the supreme court, the sentence in subparagraph (a) of paragraph (8) of Section 1003 stating that a copy of the "order" approving the plan of dissolution shall be attached to the certificate of dissolution should be revised to say the "approval of the Attorney General or the court order" shall be attached to the certificate of dissolution.

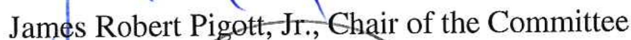
(viii) ***Terminology Regarding Applications for Authority in Section 1304 Should be Consistent.*** References to "certificate" and "certificate of authority" in paragraph (d) of Section 1304 should be changed to "application" and "application for authority."

(ix) ***Changes Should be Made to the Education Law.*** Subparagraph (c) of paragraph 4 of Section 216-a of the Education Law as amended makes certain N-PCL provisions inapplicable to education corporations. It now lists "section five hundred twenty-one to the extent that it refers to [section five hundred eighteen,]" -- an incomplete and therefore confusing phrase. Given that Section 518 was repealed in 1990, the reference to Section 521 should be eliminated.[10]

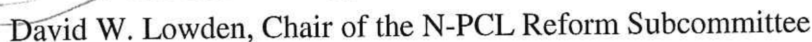
(x) ***Changes Should be Made to the Mental Hygiene Law.*** Sections 16.32 and 31.31 of the Mental Hygiene Law as amended eliminate the initial reference to a "Type B" corporation, replacing it with the words "charitable corporation." The second reference in each to a "Type B" corporation in the same sentence also should be replaced with the words "charitable corporation."

Thank you in advance for considering our comments and suggestions. We make these with the expressed intent that they will make the law better by making the law easier to understand and implement. We would be happy to work with your staff if they need assistance in drafting, or reviewing, proposed changes.

Very truly yours,



James Robert Pigott, Jr., Chair of the Committee



David W. Lowden, Chair of the N-PCL Reform Subcommittee

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[10] We also question whether one aspect of the relationship between the N-PCL and the Education Law was overlooked. Subparagraph (d) of paragraph 4 of Education Law Section 216-a modifies various provisions of the N-PCL as they apply to education corporations. Clause (9) of subparagraph (d) amends Section 720 to provide that the Attorney General can bring an action against the directors and officers of an education corporation only "at the request of the regents of the university of the state of New York." Similar language appears in clauses (1) [with respect to actions by the Attorney General under N-PCL Section 112] and (5) [with respect to actions by the Attorney General under N-PCL Section 520]. However, new paragraph (f) of Section 715 of the N-PCL giving the Attorney General broad powers to bring an action to enjoin, void, or rescind any "related party transaction" that was in violation of the N-PCL or was "otherwise not reasonable or in the best interests of the corporation" was not modified in the new law by a corresponding amendment to Education Law Section 216-a. Such an amendment would provide that the Attorney General can bring such an action with respect to an education corporation only "at the request of the regents." This omission may have been an oversight, as it is not generally consistent with restrictions on the Attorney General 's role set forth in Education Law Section 216-a. Care should be taken with respect to the changes to the N-PCL made by NPRA, and any further changes to the N-PCL, including changes which we suggest in this letter, to consider whether appropriate changes should also be made to subparagraph (d) of paragraph 4 of Education Law Section 216-a.