

# COMMITTEE ON NON-PROFIT ORGANIZATIONS

November 2, 2016

JENNIFER REYNOSO CHAIR

SIMPSON THACHER & BARTLETT LLP 425 LEXINGTON AVENUE NEW YORK, NY 10017 (212) 455-2287 jreynoso@stblaw.com The Honorable Andrew M. Cuomo Governor of the State of New York Capitol Building Albany, NY 12224

Re: Reaffirmed Support of A.10365-b/S.7913-b

Dear Governor Cuomo:

KEVIN ROE SECRETARY

SIMPSON THACHER & BARTLETT LLP 425 LEXINGTON AVENUE NEW YORK, NY 10017 (212) 455-2647 kevin.roe@stblaw.com On behalf of the Non-Profit Organizations Committee of the New York City Bar Association (the "NPOC"), I write to encourage you to sign the legislation approved by the Senate and Assembly to revise the Non-Profit Revitalization Act of 2013 ("NPRA"), which amended the Not-for-Profit Corporation Law (the "N-PCL") and other laws. The NPOC supports such legislation, A.10365-b/S.7913-b (the "Bill"), as it furthers the important work that the Legislature undertook in 2013 in enacting NPRA.

The NPOC is a diverse committee of the New York City Bar Association with approximately 40 members. Some NPOC members are law firm attorneys representing nonprofits, some are in-house counsel for charitable organizations and a few are legal scholars. The committee's members represent multi-million dollar institutions, as well as tiny charities, operating across the nonprofit sector. Some of these institutions have been serving New York for more than a century; others are in their infancy, taking their first steps to launch their charitable missions.

The NPOC wrote you previously in July of this year to encourage you to sign the Bill. We are writing you today to reaffirm the NPOC's continuing support of the Bill and to again encourage you to sign the Bill into law. In particular, we are writing again to emphasize our disagreement with some recent opposition to the Bill from one stakeholder group.

On August 10, 2016, the New York Council of Nonprofits ("NYCON") wrote to you to oppose the Bill. We have reviewed NYCON's objections to the Bill, and we respectfully dissent from their conclusions. We believe that NYCON's concerns are misplaced and do not provide a basis for objecting to the Bill. We agree with the responses to these criticisms expressed in the joint memorandum submitted to you by the Lawyers Alliance for New York and the Nonprofit Coordinating Committee of New York and attached hereto as Exhibit A.

In particular, the NPOC disagrees that the Bill reduces the substantive protections put in place by NPRA. The revisions to the definitions of "independent director," the changes to the persons able to administer an organization's conflicts and whistleblower policies, and the adjusted procedural requirements for appointing committees resolve administrative difficulties—particularly for small organizations—without any detriment to the goals of NPRA. The Committee also supports the re-enactment of "ratification" procedures, which existed prior to NPRA and which protect an organization that inadvertently fails to follow correct procedures so long as the underlying transaction is fair, reasonable, and in the best interest of the organization.

We continue to endorse the Bill in the belief that it will greatly benefit the nonprofit community and the people of New York.

Please feel free to contact me with any questions you may have regarding this enclosed letter. Your consideration of this submission is greatly appreciated.

Sincerely,

Jennifer Reynoso

Chair, Non-Profit Organizations Committee

Enclosure





#### ADDITIONAL MEMORANDUM OF SUPPORT

Subject: A.10365-B/S.7913-B

Position: Strongly Support

Date: October 3, 2016

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Nonprofit organizations are critical partners in the State's efforts to reduce poverty, improve education, enhance economic development, and meet other critical needs. For these organizations to be as effective as possible, the State must strike the right balance between necessary regulations that ensure integrity and unnecessary red tape that impedes efficient and effective board action. A.10365-b/S.7913-B strikes the right balance—a view shared not only by the Lawyers Alliance for New York ("Lawyers Alliance") and Nonprofit Coordinating Committee of New York ("NPCC"), but also by the Greater New York Hospital Association, New York City Bar Association, New York Society of Association Executives, New York State Bar Association, and other voices within the legal and non-profit communities.

Lawyers Alliance and NPCC, which have already urged signature of this bill, submit this supplemental memo to respond to concerns raised by the New York Council of Nonprofits ("NYCON"). We would respectfully submit that their concerns are misplaced for the following reasons.

### Oversight of Conflicts of Interest and Whistleblower Policies

Sections 8, 9, 10 and 11 of A.10365-B/S.7913-B strengthen both the process by which individual conflicts and whistleblower complaints are resolved, and the process of adopting and overseeing the administration of conflicts and whistleblower policies.

Once the bill is adopted, directors, officers, and key persons with an interest in a conflict transaction or a whistleblower complaint will be prohibited from any involvement in the resolution of that transaction or complaint. Section 11 of the bill closes a loophole in the current statute, by explicitly barring a person who is the subject of a whistleblower complaint from involvement in the resolution of that complaint.

The bill also strengthens board involvement in overseeing the adoption and implementation of, and compliance with, the conflicts and whistleblower policies, by requiring the board itself to adopt both policies, rather than allowing management to play that role. This places

liability for weak policies and procedures squarely on the board members and ensures that they are familiar with the policies.

Contrary to NYCON's implication, however, the bill does not remove a requirement that only independent directors can resolve individual conflicts or whistleblower complaints, because there is no such requirement in the current law. What it does do is to remove the entirely unnecessary requirement that only independent directors can oversee the adoption and implementation of, and compliance with, these policies. The "independent director" category was created to ensure that the *audit* process is overseen by people who have no business interest that might color their judgment regarding the audit. A person employed by a company that receives significant revenue from the nonprofit may well have an incentive to influence the presentation in an auditor's note calling those transactions into question. That person does not have the same ability to exercise bias when she is overseeing the administration of the conflicts and whistleblower processes, because she is overseeing the administration of those processes and not voting to approve a transaction in which she has an interest or ignoring a whistleblower complaint in which she is implicated.

## **Independent Directors**

The Charities Bureau urges nonprofits to select "audit committee members who have sufficient financial expertise to understand [the audit] processes."<sup>2</sup> Under current law, however, many nonprofits, particularly in small communities, often find it impossible to recruit such audit committee members, because the NPRA prohibits audit committee service by local business owners and employees if they, or members of their extended families, have certain relationships with a company that does even a small amount of business with the nonprofit. For instance, the chief financial officer of a bank with multibillion dollar revenues would be prohibited from serving on the audit committee of a nonprofit that has taken out a small line of credit from the bank, and an executive from a local utility company would be precluded from service on the audit committee of a nonprofit if that organization purchased \$25,000 in electric or gas service from that company.

Section 1 of A.10365-B/S.7913-B ensures that employees and people with a financial interest in a very large business are not precluded from serving on the board of a nonprofit if the nonprofit's transactions with the business are extremely small in comparison to the size of the business. This is a sensible balance given the high value to the nonprofit of having knowledgeable people on the audit committee, and the minimal likelihood that a director will violate her fiduciary duty over a trivial transaction.

It is simply wrong that a nonprofit cannot ascertain the revenues of an outside entity associated with a director. This is the sort of information that directors routinely disclose, and the suggestion that a director would withhold such information in order to serve on a nonprofit's audit committee without compensation seems highly unlikely. The further

<sup>&</sup>lt;sup>1</sup> N-PCL § 712-a(c) provides that the Board or designated audit committee of the Board shall "oversee the adoption and implementation of, and compliance with" a conflict of interest or whistleblower policy, but does not require directors to review individual conflict transactions or whistleblower complaints.

<sup>&</sup>lt;sup>2</sup> See NY Charities Bureau, Audit Committees and the NPRA (2015), p. 4, https://www.charitiesnys.com/pdfs/Audit Committees.pdf.

objection that the assessment of independence should be based on the extent of the nonprofit's interest in the business relationship, and not the interest of the outside entity, is debatable but irrelevant, inasmuch as the statute currently focuses on the interest of the outside entity rather than that of the nonprofit, and A.10365-B/S.7913-B has no bearing on this issue.

#### **Board committees**

Nonprofit boards need to be able to form committees to handle challenges and opportunities that arise unexpectedly, such as a request by a state agency that the organization expand so it can carry out a new state program, the resignation of the organization's chief executive, or a sudden funding shortfall.<sup>3</sup>

When the board is large or spread out across the country or the globe, , it may be very difficult to convene a majority of the entire board (even via remote technology) at any time other than an annual meeting. That is why section 4 of A.10365-B/S.7913-B allows the board to form a new committee at a normal board meeting where a quorum, but not the entire board, is present.

Allowing this change will increase flexibility without eroding board governance. Any organization worried about capture by a small number of board members can increase its quorum requirement or provide in its bylaws that committee formation requires the vote of a majority of the entire board. And of course a board member who opposes the formation of a committee need only participate in the board meeting and vote against it.

### Ratification of Related Party Transactions

Current law contains a disincentive for companies to do business with nonprofit organizations: even a transaction that is fair, reasonable and in the nonprofit's best interest could be unwound if it is later determined that the transaction involved a related party and the nonprofit's board had not followed the proper approval procedure. This could happen innocently: a director is unaware that her granddaughter's estranged spouse has an interest in the transaction, or the board approves the transaction after considering alternatives but fails to contemporaneously document the basis for its approval. A nonprofit that later discovers that it has failed to follow the proper approval procedure has a disincentive to correct the error, because if it does it risks leaving a paper trail that could later be used to challenge and unwind the transaction – even if it is fair, reasonable, and in the corporation's best interests.

Section 7 of A.10365-B/S.7913-B creates both a mechanism for a board to ratify a procedurally defective transaction, and an incentive for the board to improve its procedures going forward. This mechanism will not insulate a board that repeatedly violates the procedures. On the contrary, a board that fails to "put in place procedures to ensure" that it

<sup>&</sup>lt;sup>3</sup> See Michela M. Perrone, Governing the Nonprofit Organization (Georgetown Center for Public & Nonprofit Leadership 2009), p. 10 ("The key is to shape the board structures to fit the needs of the organization and maintain flexibility as needs, opportunities and challenges change."), <a href="http://www.cippusa.com/wp-content/uploads/2014/06/Governing-the-Nonprofit-Organization.pdf">http://www.cippusa.com/wp-content/uploads/2014/06/Governing-the-Nonprofit-Organization.pdf</a>.

follows the procedural rules in the future will have no defense against an action by the Charities Bureau challenging the initial procedural failure or any subsequent failures.

## Conclusion

In these and many other ways, A.10365-B/S.7913-B will enhance the ability of nonprofits to carry out their charitable missions and to partner with the State to carry out State programs. We again respectfully urge the Governor to approve the legislation and would welcome any questions you may have concerning any of the issues above.