

NEW YORK  
CITY BAR

COMMITTEE ON NON-PROFIT  
ORGANIZATIONS

December 14, 2006

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Re: Proposed Revisions to Not-for-Profit Corporation Law

Dear Mr. Abernethy:

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The Committee on Non-Profit Organizations (the "NPO Committee") of the New York City Bar Association (the "Association") submits this letter to communicate the NPO Committee's limited endorsement of the proposal by the Business Law Section of the New York State Bar Association (the "State Bar") to revise the New York Not-for-Profit Corporation Law (the "N-PCL"), subject to the inclusion in the proposal of the changes suggested herein.

The NPO Committee: The members of the Association's NPO Committee are lawyers in the New York City area with an interest in legal issues affecting non-profit organizations. NPO Committee members include attorneys in private practice, attorneys who serve as "in-house" counsel to non-profit organizations, current and former regulators, and prominent academics. A list of committee members is attached to this letter. The NPO Committee believes the collective professional experience of its members provides a perspective that is pertinent to the State Bar's consideration of the proposal to revise the N-PCL. However, the views expressed in this letter reflect the views only of the NPO Committee, not necessarily the views of any law firms or non-profit organizations, with which members of the NPO Committee are affiliated or whom they represent.

Background: On September 14, 2006, the NPO Committee met with representatives of the State Bar's Business Law Section to discuss the latter's draft proposal substantially to revise the N-PCL.

The State Bar's proposal was three years in development, is quite comprehensive, and includes many proposals relating to a variety of provisions interwoven throughout the N-PCL. The NPO Committee has been reviewing the document for the

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intervening three months and finds the proposal has much merit. However, a few of the proposal's changes deserve greater deliberation than the NPO committee has been able to afford them to date. Nonetheless, the NPO Committee has identified a number of proposed changes worthy of its support, a number of others that it could support with modification, and a number it must oppose.

Reason to Change Law: The NPO Committee agrees that the N-PCL warrants substantial revision. Many concepts embedded in the N-PCL are unique to New York and no longer afford the public the protection once intended. In addition, technology and streamlining of the regulatory processes of the state government make a number of N-PCL revisions desirable.

### NPO Committee's Recommendations:

#### 1. Role of State Agencies in the Formation of Not-for-Profit Corporations (N-PCL § 404).

Current law requires that various state agencies consent to the filing of a not-for-profit corporation's certificate of incorporation. This process makes the formation of not-for-profit corporations in New York significantly more involved than in other states, while affording the public little additional protection. The State Bar proposal would remove this requirement and replace it with the requirement that the Secretary of State's office notify the appropriate state agencies when a not-for-profit corporation is formed with powers regulated by such agencies.

While the NPO Committee does support the elimination of required agency consent in advance of most incorporations, the Committee does not support placing a requirement on the Secretary of State's office to notify the affected agency. The NPO Committee believes the proposal, if enacted, would place an undue burden on the Secretary of State's office. Instead, the NPO committee recommends that each newly formed not-for-profit corporation be required to notify the proper agency or agencies within one month of incorporation.

In addition, the NPO Committee recognizes that there may be some activities that are so crucial to public health and safety that the advance-consent process remains necessary with regard to corporations about to engage in those activities. The NPO Committee recommends that the advance consent process be retained for these corporations.

#### 2. Elimination of Current Not-for-Profit Corporation Categories (N-PCL § 201).

The State Bar proposal entirely eliminates the not-for-profit corporation categories of Types "A", "B", "C", and "D". The NPO Committee supports simplification of corporate typing, but not its complete elimination. The NPO Committee recognizes that not-for-profit corporations generally fall into two categories: public-benefit corporations and mutual-benefit corporations. The term "public-benefit corporation" is not a term in general use in New York at present and refers to what is currently recognized as a "type B corporation" or a

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“charity.” The NPO Committee proposes that any revision of the N-PCL recognize this distinction to facilitate the effective regulation of charitable organizations.

### 3. Not-for-Profit Corporation Membership Requirements (N-PCL § 601).

Current law requires all not-for-profit corporations to have members except “Type B” corporations. The proposal would make membership optional for all not-for-profit corporations. The NPO Committee supports this change.

### 4. Capitalization of Not-for-Profit Corporations (N-PCL Article V).

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

### 5. Elimination of Private Foundation Publication Requirement (N-PCL § 406(b--1)).

Current law imposes a publication requirement on private foundations. The proposal eliminates this publication requirement. The NPO committee strongly supports this change.

### 6. Attorney General and Supreme Court Advance Approval for Certain Sales of Not-for-Profit Corporation Assets (N-PCL § 510 and 511).

Current law requires that the Attorney General and the State Supreme Court approve all transactions involving the sale of “all or substantially all” of a not-for-profit corporation’s assets. The proposal would eliminate this requirement. The NPO Committee opposes this change with respect to public-benefit corporations, but supports it with respect to mutual-benefit corporations. Public-benefit corporations, which are charitable in nature, should properly be regulated by the Attorney General with respect to the sale of all or substantially all of their assets, to assure that any such sales or other transfers of assets are (a) consistent with the charitable mission and (b) made in a reasonable manner and for adequate consideration. Furthermore, the NPO Committee notes that any N-PCL changes in this area must take into account changes made to the Uniform Prudent Management of Institutional Funds Act (UPMIFA) in New York.

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7. Electronic Forms of Notice and Voting (N-PCL § 605(a)).

Current law has not kept pace with electronic forms of communication. The proposal would permit electronic notice of membership meetings, but is silent regarding meetings of governing bodies. The proposal is also silent regarding electronic voting by members or directors. The NPO Committee supports amending of the N-PCL to permit effective electronic notice of both members' and directors' meetings. Also, the NPO Committee supports amendment of the N-PCL to accommodate electronic voting by members, and, where an effective deliberative process is preserved, also by directors.

8. Proposed Relaxation of "One Member, One Vote" Rule for Not-for-Profit Corporations (N-PCL § 611(e)).

Current law imposes a "one member, one vote" standard on not-for-profit corporations. The proposal would enable not-for-profit corporations to assign voting power, for example based on percentage of capital contributions. Such an arrangement would not be appropriate, particularly for a charitable, public-benefit corporation, where corporate governance should not properly be based on considerations such as capital contributions. The NPO Committee strongly opposes this change.

9. Expansion of the Ability of a Not-for-Profit Corporation to Take Action Without a Meeting (N-PCL § 614(a)).

The proposal introduces the concept that a not-for-profit corporation's certificate of incorporation or bylaws could provide for action without a meeting upon written consent of the number of members required to take action if a meeting were held. The NPO Committee supports this change with the proviso that the concept apply only for actions taken by members – the approach should not be permitted for directors – and that both prior notice of the vote and subsequent notice of the result be made to the entire membership.

10. Disclosure of Directors' Residential Addresses (N-PCL § 718).

Current law gives creditors and members the right to obtain the residential addresses of directors. The proposal eliminates this members' and creditors' right. The NPO Committee approves this change with modification. While the NPO Committee favors the elimination of residential address disclosure, the Committee believes an alternative must be provided, such as disclosing a business address for the director or providing a postal address of the corporation with the requirement then placed on the corporation that mail be redirected to the director.

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11. Elimination of Distinction Between Standing and Special Committees (N-PCL § 712).

Current law distinguishes between standing and special committees. The proposal eliminates this requirement. The NPO Committee supports this change, believing that to the extent that such distinctions remain relevant today, designation of a parliamentary authority in the organization's bylaws or by Board action can address any need.

12. Prohibition Against One Person Serving as President and Secretary (N-PCL § 713).

Current law prohibits the same person from holding the offices of President and Secretary. This prohibition is appropriate for a number of reasons, including (a) assuring that one person cannot hold all offices in a not-for-profit corporation and thereby control the organization in a dictatorial manner, (b) placing the responsibility for providing notice of corporate meetings, preparing board minutes, and maintaining corporate records in the hands of someone other than the president, and (c) enabling a corporation to have a sufficient number of officers to formally execute corporate documents. The proposal eliminates this prohibition. The NPO Committee opposes this change, which would not be consistent with principles of good governance and best practices for a not-for-profit corporation.

13. Reliance on Outside Experts (N-PCL § 717(b)).

Current law permits directors to rely on the advice of and representations by outside experts. The proposal would clarify that a director or officer would not be considered to be acting in good faith if he or she had knowledge that would cause such reliance to be unwarranted. The NPO Committee supports this change.

14. Not-for-Profit Corporation Mergers (N-PCL Article 9).

Several changes are proposed to the rules governing mergers of non-profit corporations, especially mergers between foreign and domestic non-profits and non-profit and for-profit corporations. The NPO Committee takes no position on these changes to Article 9 at this time, but intends to revisit the area in the future and provide comments then.

15. Dissolution of Not-for-Profit Corporations (N-PCL Article 10).

The proposal contained a number of changes to Article 10 on dissolution of not-for-profit corporations. These proposals need to be revisited in light of the recent amendment of the N-PCL, strongly supported by the NPO Committee and the Association, providing for certain simplification of and new provisions regarding not-for-profit corporation dissolution.

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16. Limitation on Personal Liability of Directors or Members (Proposed N-PCL § 402(d)).

The proposal would permit a not-for-profit corporation's certificate of incorporation to provide for elimination of or limitation on personal liability of directors or members, provided their behavior (i) is not in bad faith, (ii) is not the result of intentional misconduct or a knowing violation of law, or (iii) does not result in a personal financial gain or other advantage to which the individual director or member in question was not entitled. The proposal would also provide that personal liability may not be limited or eliminated for any act or omission prior to the adoption of this new provision. The Committee is concerned that this proposal would limit the ability of the Attorney General and other potential complainants to hold directors or members accountable for acts of misconduct, and is certain that this proposal would understandably be opposed by the Attorney General. The NPO Committee opposes this proposal.

17. Proposed Change to Protective Language for New York Private Foundations (N-PCL § 406(a)).

Current law provides that certain provisions found in the federal statute pertaining to private foundations [26 U.S.C. § 508(e)] "are hereby included" in the corporation's certificate of incorporation. The proposal would change the quoted language to "shall be included". The NPO Committee opposes this proposal because the proposed language may result in the unintended removal of a protective default provision intended to bring the governing documents in compliance with the federal statute.

Conclusion:

The NPO Committee supports the substantial revision of the N-PCL and commends the State Bar's Business Law Section for its Herculean efforts in this direction. While the NPO Committee can support many of the revisions proposed by the Business Law Section, there are a number of proposals that the NPO Committee must oppose, or support only with modification. Additionally, while there are several proposals that have not been commented on at this time, the NPO Committee may wish to do so at a later time. The NPO Committee stands ready to work with the State Bar as it advances this worthy project.

Respectfully submitted,



David G. Samuels  
Chair

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