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PROPOSED NONPROFIT REVITALIZATION ACT AMENDMENTS

To: Senator Ranzenhofer and Assemblymember Brennan

From: Sean Delany, Executive Director, and Laura Abel, Senior Policy Counsel

Re: Amendments to the Nonprofit Revitalization Act

Date: April 28, 2015

This memo describes amendments that should be made to the Not-for-Profit Corporation Law ("N-PCL") to accomplish the goals of the Non-Profit Revitalization Act of 2013 (the "Act"). We provide these suggestions on behalf of the Law Revision Commission, Lawyers Alliance for New York, New York City Bar Association, New York State Bar Association, and Nonprofit Coordinating Committee of New York. Our organizations have engaged in an extensive collaborative drafting process, resulting in this document which reflects a consensus on the reforms needed in the Act.

The Act undertook the first comprehensive revision of the N-PCL since its adoption in 1969. It enables nonprofit organizations to organize more easily and, in many respects, operate more efficiently, freeing up resources for their important charitable missions. At the same time, the Act also imposes significant new governance obligations on nonprofit organizations.

With any new regulatory scheme, no matter how carefully drafted, practical problems, oversights and inconsistencies will be apparent only after the statute has been in place for some time. That is the case here. Now that the Act has been in effect for over nine months, it is apparent that it contains ambiguities that complicate compliance and enforcement, and difficulties that arise because the Act unnecessarily departs from the approach taken in the federal tax code regarding the same activities. In addition, the wording of some provisions has led to unintended consequences. Finally, a few of the burdens the Act imposes on small nonprofits are entirely unnecessary to achieve, and in some cases inconsistent with, the expressed goal of the Act's drafters to encourage nonprofits to form in New York instead of in other states.

Our suggestions are intended solely to alleviate problems that have arisen due to the Act. There are other substantive and technical revisions to the N-PCL which would also be appropriate to continue the process of reform, but we do not address them here.

Below, we provide a summary of our proposals, followed by a more detailed analysis of the problems we want to address and proposed revisions to the N-PCL. The first seven items, which are the most important, are listed in order of importance; thereafter, we discuss issues in the order they appear in the N-PCL.

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Executive Summary

Related Party Transactions: The Act's provisions regarding related party transactions present definitional and other issues which complicate their application. Our simple proposal is to incorporate as a safe harbor the existing regulatory regime from the federal tax code, which penalizes tax exempt organizations that engage in "excess benefit transactions," and which uses familiar terms and definitions that have withstood the test of time. For noncharitable corporations that are not currently subject to those provisions of the tax code and do not voluntarily choose to follow the procedures contained therein, we propose that a transaction shall be compliant with state law if it is fair, reasonable, and in the corporation's interest at the time it is entered into. Our proposal will also preserve the broad enforcement powers that the Act bestowed on the Attorney General, allowing him to enjoin, void or rescind any insider transaction that harms the corporation. Indeed, we would expand the definition of "related party" to include anyone who exercises the powers of officers, directors or key employees, although lacking formal authority to do so.

Definition of "Independent Director": The Act's overly narrow definition of "independent director," and its requirement that only independent directors may oversee conflict of interest and whistleblower policies, make it unnecessarily difficult for nonprofit boards to function. Our proposal would more closely align the definition with that used by the New York Stock Exchange, on which we understand the Act's definition was based. It would also be more stringent than the NYSE in several ways, including by using lower dollar thresholds. In addition to changing the definition of "independent director," we propose to limit the role of the independent director to serving on the audit committee and overseeing the audit function. There is no reason to require independent directors to oversee conflict transactions or whistleblower complaints; we would leave in place the more important requirement that a director may not vote on a transaction in which he or she has an interest.

Committees: We propose several amendments to remove unnecessary obstacles that the Act places on the ability of boards to delegate matters to committees composed of qualified knowledgeable people in order to work efficiently and effectively. The requirement that a majority of the entire board must approve the formation, and name the members of all board committees is unwarranted; that requirement should apply only to an executive committee or other committee that operates with the full authority of the board. The board should be able to delegate specific authority to a committee of the corporation (which may contain people who are not directors), just as it may grant specific authority to a specific officer, staff member, or other agent of the corporation. We also propose to make clear that the by-laws may establish that certain officers and committee heads will constitute the members of specific board committees by virtue of their offices. Additionally, we propose to expand the list of matters that may not be delegated to a committee, to cover limitations implied by the existing N-PCL but not now contained in the section of the N-PCL defining the powers of committees.

Definition of "Key Employee": In order to determine who is an important employee (for conflict management and other purposes), the Act incorporates a provision of the Internal Revenue Code ("IRC") referring to people who are "disqualified persons" for purposes of excess benefit transactions. As a result, the Act inadvertently treats as a "key" employee *anyone* in a position to substantially influence the affairs of a nonprofit, whether an employee or not. We

propose to limit the definition to an employee who would be considered a "disqualified person" with "substantial influence" over the affairs of the corporation under the IRC and Treasury Regulations defining those terms with respect to employees.

Audit Oversight: We propose to make clear that the board or audit committee may request information from people with relevant information, even when those people may not vote on the matter at hand.

Conflict of Interest Policy: We propose to limit to larger organizations the new requirement of annual conflict disclosure, since only those larger nonprofits are currently subject to IRS reporting rules relating to annual disclosures, leaving in place requirements that all potential conflicts must be disclosed prior to any board action regarding such matters. We suggest allowing initial conflict certifications to be made promptly after a director's election, not requiring them to be done before a director's initial election as currently required, and allowing them to be received by a compliance officer as an alternative to the secretary. Additionally, we propose to make clear that during a review of a conflict the board or a committee may request and obtain information from the person with the conflict.

Whistleblower Policy: We propose to allow an organization to make its policy available to employees and volunteers on its web site or in its offices, as an alternative to distributing it to individual employees and volunteers.

Definition of "Charitable Purposes": The Act's definition of "charitable purposes" excludes several categories of organization that are covered by IRC § 501(c)(3). We propose to expand the definition of "charitable purposes" to include all corporations that are exempt from tax under IRC § 501(c)(3), and any other corporation with charitable purposes.

Definition of "Entire Board": We propose a technical correction to avoid a potential inconsistency with § 702(a) and allow boards to designate a number within a range set in the by-laws, rather than the number of directors as of the most recent election.

Definition of "Affiliate": The term "affiliate" is used in the definition of "independent director" and "related party transaction." In both places, it makes sense to limit coverage of affiliates to those that control or are controlled by the corporation, while excluding those that are under common control, with which the corporation's relationship may be tenuous.

Definition of "Relative": We propose to retain the Act's definition of relative, while expanding it to include domestic partners of brothers, sisters, children, grand and great-grandchildren.

Purposes: We propose a procedure for corporations formerly classified as type B or C to file a notice of intent to operate as non-charitable after receiving the Attorney General's consent.

Real Property Transactions: We propose to eliminate the requirement of special board approval for certain real property transactions. Our proposal would leave intact the procedures for transactions involving disposition of all or substantially all assets. We also propose to extend to a religious corporation desiring to sell, mortgage or lease real estate the option of obtaining Attorney General approval in lieu of leave of court.

Compensation to Private Foundation Managers: We propose an amendment to make clear that it is permissible to provide uniform director fees (*e.g.*, annual and/or per meeting and/or per committee and/or per role) pursuant to a policy, subject to the reasonableness requirement.

Number of Directors: We propose to permit the number of directors to be changed by action of the board of a non-membership corporation under the specific provisions of a by-law, which is currently allowed for membership corporations.

Action by the Board: In order to avoid a board meeting losing its quorum if one or more directors must recuse themselves due to a conflict, we propose to count as present at the time of a vote directors who are present at a meeting but not present at the time of a vote due to a conflict, as was allowed by the N-PCL before the Act.

Alumni Corporations: Alumni corporations should be classified as charitable because the purposes of such corporations typically do not solely serve the interests of members.

Discussion

1. N-PCL § 715 & EPTL § 8-1.9(c): Related Party Transactions

The Act's provisions creating the most consternation are the new related party transactions provisions. They present a host of definitional and other issues complicating the application of what should be straightforward rules to assure fairness and reasonableness in corporate transactions with insiders. The new rules also force the board to waste time scrutinizing minor transactions and applying both N-PCL § 715 (or EPTL § 8-1.9(c)) and the federal tax code to the same transaction.

The best solution is the simplest: the N-PCL should include as a safe harbor the existing regulatory regime from IRC § 4958 (and its counterpart, § 4941, for private foundations), which penalizes tax exempt organizations, including charitable or social welfare organizations, that engage in certain abusive related party transactions that the tax code calls "excess benefit transactions." This regime has withstood the test of time, and it has created workable definitions for many of the related party transaction concepts that are unnecessarily confusing. It specifies certain procedures for the board to follow to ensure that the corporation does not overpay for goods or services. These procedures are similar to those in the Act, and achieve the same purpose, but they are more familiar to most nonprofits. Applying the federal framework will allow nonprofit organizations to implement strong internal mechanisms to scrutinize insider transactions, while avoiding the danger that they will be hopelessly confused by the need to comply with two separate legal regimes for a single transaction.

We also propose that a transaction shall be deemed to comply with § 715 (or EPTL § 8-1.9(c)) if it is fair, reasonable, and in the corporation's interest at the time it is entered into. This default position is a central feature of IRC §§ 4958 and 4941, which avoid penalizing exempt organizations for purely procedural lapses as to transactions which meet the substantive standard in the tax code. For those corporations that are not already subject to IRC §§ 4958 or 4941 and do not voluntarily choose to follow the procedures in those sections, this protection will prevent

purely procedural lapses from becoming violations of law when the underlying transaction is unobjectionable, as is the case with IRC § 4958 itself.

Importantly, our proposal will preserve the broad enforcement powers that the Act bestows on the Attorney General, allowing him or her to go to court to seek to enjoin, void or rescind any insider transaction that is unfair, unreasonable, or otherwise harms the corporation, without shifting the burden of proof or extending the protection of any presumption to the corporation or its board. In at least one respect, we propose to expand those powers. Under the Act, the Attorney General has power over transactions with directors, officers, and key employees, but any authority to bring an action against a person who usurps the powers of individuals in such positions is not specified. Accordingly, we propose to make clear that the Attorney General's powers extend to unfair transactions with people who exercise influence so substantial that it is equivalent to that of an officer, director or key employee.

At the same time, we propose a few small tweaks to the procedures required by the Act. First, the words "determined by the board" should be deleted. The current language requiring that the board must determine that each related party transaction satisfies the standard of fairness, etc. creates a situation where even the most trivial related party transaction must be board-approved. There is no *de minimis* exception. What is important is that transactions which would normally come before the board be subject to appropriate scrutiny. This is consistent with the approach taken by IRC § 4958. Any related party transaction (even minor ones) must still be fair, but the determination can be made at an appropriate management level for minor matters. A board should not have to deal with trivia – that is a waste of its time and talents.

Second, we propose to change the requirement that a transaction be in the corporation's "best interest," to instead require that it must be in the corporation's interest. The term "best interest" confounds corporate decision makers, who are unsure about how much time they are required to spend to ensure that they have obtained the best possible terms.

Third, the requirement in N-PCL § 715(b) (and EPTL § 8-1.9(c)) that the board apply closer scrutiny to certain transactions should apply to transactions in which the corporation, not the related party, has a substantial interest. This change will ensure that matters of importance to the corporation are brought to a board vote, under an enhanced procedure. Otherwise, the board could end up having to closely scrutinize transactions of minimal value to the corporation. Using the size of the related party's interest as the relevant metric could also require the corporation to assess the related party's net worth or other financial criteria in order to determine whether an interest is substantial to that person, and require a level of financial disclosure not usually required of board members and other related parties.

Fourth, read literally, N-PCL § 715(g) (and EPTL § 8-1.9(c)(5)) could lead to the conclusion that all directors and officers (all of whom are related parties) are barred from deliberations and voting regarding any related party transaction. This could leave the board powerless to review and approve such transactions. The language we suggest would clarify that directors and officers may deliberate and vote regarding transactions in which they have no interest, which was clearly the intent of the Act.

Finally, we also propose changing the provision currently requiring board approval of officers' "salaries" to cover their "compensation," which is a broader and more modern concept. That language is also consistent with the requirements of IRC § 4958.

We propose:

a. *Related Party Transactions:* Amend N-PCL § 715 to read:

(a) No 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~~ the corporation enters into such ~~determination~~ transaction. Any director, officer or key employee who has an interest, either directly or indirectly, in a related party transaction shall disclose in good faith to the board, or an authorized committee thereof, the material facts concerning such interest.

(b) With respect to any related party transaction involving a charitable corporation and in which ~~a related party~~ the corporation has a substantial financial interest, the board of such corporation, or an authorized committee thereof, shall:

(1) Prior to entering into the transaction, consider alternative transactions to the extent available;
(2) Approve the transaction by not less than a majority vote of the directors or committee members present at the meeting; and
(3) Contemporaneously document in writing the basis for the board or authorized committee's approval, including its consideration of any alternative transactions.

~~(c)~~ The certificate of incorporation, by-laws or any policy adopted by the board may contain additional restrictions on related party transactions and additional procedures necessary for the review and approval of such transactions, or provide that any transaction in violation of such restrictions shall be void or voidable.

(~~d~~c) Unless otherwise provided in the certificate of incorporation or the by-laws, the board shall have authority to fix the compensation of directors for services in any capacity.

(~~e~~d) The fixing of ~~salaries~~ compensation of officers, if not done in or pursuant to the by-laws, shall require the affirmative vote of a majority of the entire board unless a higher proportion is set by the certificate of incorporation or by-laws.

(~~f~~e) The attorney general may bring an action to enjoin, void or rescind any related party transaction or proposed related party transaction that violates any provision of this chapter or was otherwise not reasonable or in the ~~best~~ interests of the corporation at the time the transaction was entered into, or to seek restitution, and the removal of directors or officers, or seek to require any person or entity to:

(1) Account for any profits made from such transaction, and pay them to the corporation;
(2) Pay the corporation the value of the use of any of its property or other assets used in such transaction;

(3) Return or replace any property or other assets lost to the corporation as a result of such transaction, together with any income or appreciation lost to the corporation by reason of such transaction, or account for any proceeds of sale of such property, and pay the proceeds to the corporation together with interest at the legal rate; and
(4) Pay, in the case of willful and intentional conduct, an amount up to double the amount of any benefit improperly obtained.

(f) The powers of the attorney general provided in this section are in addition to all other powers the attorney general may have under this chapter or any other law.

(g) No related party may participate in deliberations or voting relating to ~~matters set forth in this section~~ a related party transaction in which he or she has an interest; provided that nothing in this section shall prohibit the board or authorized committee from requesting that a related party present information as background or answer questions concerning a related party transaction at a board or committee meeting prior to the commencement of deliberations or voting relating thereto.

(h) A transaction that is fair, reasonable and in the corporation's interest at the time the corporation entered into the transaction shall be deemed to comply with this entire section. Any transaction that (i) if IRC Section 4958 applies or were applied to such corporation would not subject the corporation to tax thereunder, or (ii) with respect to any private foundation, would not subject the private foundation to tax under IRC Section 4941, shall be deemed to be fair, reasonable and in the corporation's interest at the time the corporation entered into the transaction.

Similarly, amend EPTL § 8-1.9(c) as follows:

(c)(1) Notwithstanding any provision of the trust instrument to the contrary, no trust shall enter into any related party transaction unless the transaction is ~~determined by the trustees to be~~ fair, reasonable and in the trust's ~~best~~ interest at the time the trust enters into ~~of~~ such ~~determination~~ transaction. Any trustee, officer or key employee who has an interest, either directly or indirectly, in a related party transaction shall disclose in good faith to the trustees, or an authorized committee thereof, the material facts concerning such interest.

(2) With respect to any related party transaction in which ~~a related party~~ the trust has a substantial financial interest, the trustees, or an authorized committee thereof, shall:
(A) Prior to entering into the transaction, consider alternative transactions to the extent available;
(B) Approve the transaction by not less than a majority vote of the trustees or committee members present at the meeting; and
(C) Contemporaneously document in writing the basis for the trustees' or authorized committee's approval, including consideration of any alternative transactions.

~~(3)~~ The trust instrument, by-laws or any policy adopted by the trustees may contain additional restrictions on related party transactions and additional procedures necessary

for the review and approval of such transactions, or provide that any transaction in violation of such restrictions shall be void or voidable.

(4~~2~~3) The attorney general may bring an action to enjoin, void or rescind any related party transaction or proposed related party transaction that violates any provision of this article or was otherwise not reasonable or in the ~~best~~ interests of the trust at the time the transaction was entered into, or to seek restitution, and the removal of trustees or officers, or seek to require any person or entity to:

(A) Account for any profits made from such transaction, and pay them to the trust;
(B) Pay the trust the value of the use of any of its property or other assets used in such transaction;
(C) Return or replace any property or other assets lost to the trust as a result of such transaction, together with any income or appreciation lost to the trust by reason of such transaction, or account for any proceeds of sale of such property, and pay the proceeds to the trust together with interest at the legal rate; and
(D) Pay, in the case of willful and intentional conduct, an amount up to double the amount of any benefit improperly obtained.

(~~5~~4) The powers of the attorney general provided in this section are in addition to all other powers the attorney general may have under this chapter or any other law.

(~~6~~5) No related party may participate in deliberations or voting relating to ~~matters set forth in this paragraph~~ a related party transaction in which he or she has an interest; provided that nothing in this section shall prohibit the trustees or designated audit committee from requesting that a related party present information or answer questions concerning a related party transaction at a trustees or committee meeting prior to the commencement of deliberations or voting relating to the related party transaction.

(h) A transaction that is fair, reasonable and in the trust's interest at the time the trust entered into the transaction shall comply with this entire section. Any transaction that (i) if IRC Section 4958 applies or were applied to such trust would not subject the trust to tax thereunder, or (ii) with respect to any private foundation, would not subject the private foundation to tax under IRC Section 4941, shall be deemed to be fair, reasonable and in the trust's interest at the time the trust entered into the transaction.

b. *Definition of "Related Party":* Amend N-PCL § 102(a)(23) to read: "'Related party' means (i) any director, officer or key employee of the corporation or any affiliate of the corporation, or any other person who exercises the powers of directors, officers, or key employees over the affairs of the corporation or any affiliate of the corporation; (ii) any relative of any individual described in clause (i) ~~director, officer or key employee of the corporation or any affiliate of the corporation~~; or (iii) any entity in which any individual described in clauses (i) and (ii) of this subparagraph has a thirty-five percent 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 five percent."

Similarly, amend EPTL § 8-1.9(a)(6) to read: "'Related party' means (i) any trustee or key employee of the trust or any affiliate of the trust, or any other person who exercises the powers of directors, officers, or key employees over the affairs of the trust or any affiliate of the trust; (ii) any relative of any individual described in clause (i) ~~director, officer or key employee of the corporation or any affiliate of the corporation~~; or (iii) any entity in which any individual described in clauses (i) and (ii) of this subparagraph has a thirty-five percent 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 five percent."

2. N-PCL §§ 102(a)(21), 712-a(c), 715-b & EPTL 8-1.9: Definition and Function of "Independent Director"

The Act's overly narrow definition of "independent director," together with the requirement that only independent directors may oversee the adoption and implementation of conflict of interest and whistleblower policies, make it unnecessarily difficult for nonprofit boards to function. The Act's restrictive definition makes it difficult to recruit and retain directors -- especially in smaller communities outside of New York City, where the pool of qualified candidates is limited. For example, an employee of a local utility, bank, insurance brokerage, healthcare system, or public relations agency could not be an independent director of a nonprofit served by his or her employer (if payments of $25,000 or more were involved) even though the employment relationship was unlikely to affect such person's ability to act with impartiality as a member of the nonprofit's audit committee. Business professionals have traditionally been an excellent source of candidates for service on audit committees of nonprofit boards, and the Act's new restrictions unduly limit their ability to serve the nonprofit sector in that capacity.

The definition of independent director that appears in the Act was reportedly based upon New York Stock Exchange rules; however, there are many unexplained deviations from those rules that disqualify many persons who would be capable of serving as independent directors. Our proposal would align more closely with the NYSE's approach in several ways. It would characterize as non-independent only a director who is employed by an entity that has provided significant property or services to, or received significant property or services from, the corporation (as opposed to those who only provide or receive small payments). It would also add a provision that would disqualify a director from being independent if such director had certain specified relationships with the corporation's auditing firm. By amending N-PCL § 102(a)(19), it would also limit coverage of affiliates to those that control or are controlled by the corporation, excluding those that are under common control (as the corporation's relationship with those entities may be tenuous and hard to ascertain).

The proposed amendment is more stringent than the NYSE's rules in that the dollar threshold for receiving compensation from the corporation is lower ($10,000 rather than $120,000), as is the dollar threshold for an entity that provides property or services to, or received property or services from, the corporation. Additionally, we would characterize as non-independent a director who has a substantial financial interest in (as opposed to solely those who are employed by) an entity that has provided or received significant payments or services from the corporation.

Currently, a director may lose independent status merely because he works for a company that purchases routine services from, or pays dues to, the nonprofit. This poses particular problems for organizations that rely on fees for services to sustain their charitable mission, and for trade associations whose members pay dues. The suggested language allows a director to maintain independent director status in these situations. We would also raise the financial threshold to the "greater of" instead of the "lesser of" $25,000 or 2% of the entity's revenues because there are many larger nonprofits in which the current threshold captures transactions that are *de minimis*.

In addition to changing the definition of "independent director," we propose that the role of the independent director will be solely to serve on the audit committee and oversee the audit function. There is no reason to limit to independent directors the oversight over conflict transactions or whistleblower complaints. The fact that they have an employment or other economic relationship with the nonprofit is of no consequence when they oversee unrelated conflicts or actions triggering a whistleblower policy. The more important protection is that a director with a conflict of interest must recuse him or herself from deliberations and voting on the matter as to which he or she has a conflict, as required by N-PCL §§ 715(a) and 715-a(b)(3), and a person who is the subject of a whistleblower complaint should not participate in reviewing that complaint. This is also consistent with the procedures under IRC § 4958 for board review of excess benefit transactions.

We propose:

a. Amend N-PCL § 102(a)(21) to read: "Independent Director" means a director who (i) is not, and has not been within the last three years, an employee of the corporation or an affiliate of the corporation, and does not have a relative who is, or has been within the last three years, a key employee of the corporation or an affiliate of the corporation; (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than ten thousand dollars in direct compensation from the corporation or an affiliate of the corporation (other than reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director as permitted by paragraph (a) of section 202 (General and special powers)); ~~and~~ (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or has a substantial financial interest in, any entity that has ~~made payments~~ provided property or services to, or received ~~payments~~ property or services from, the corporation or an affiliate of the corporation ~~for~~ if the amount paid by the corporation to the entity or received by the corporation from the entity for such property or services ~~in an amount which,~~ in any of the last three fiscal years, exceeds the ~~lesser~~ greater of twenty-five thousand dollars or two percent of such entity's consolidated gross revenues; and (iv) is not and does not have a relative who is a current partner or employee of the corporation's outside auditor or who has worked on the corporation's audit at any time during the past three years. For purposes of this subparagraph, "~~payment~~ property and services" do~~es~~ not include charitable contributions or dues, or fees paid to the corporation for services which the corporation performs as part of its nonprofit purposes.

   Similarly, amend EPTL § 8-1.9(a)(7) as follows:

"Independent trustee" means a trustee who: (i) is not, and has not been within the last three years, an employee of the trust or an affiliate of the trust, and does not have a relative who is, or has been within the last three years, a key employee of the trust or an affiliate of the trust; (ii) has not received, and does not have a relative who has received, in any of the last three fiscal years, more than ten thousand dollars in direct compensation from the trust or an affiliate of the trust (other than reimbursement for expenses or the payment of trustee commissions or reasonable compensation as permitted by law and the governing instrument); ~~and~~ (iii) is not a current employee of or does not have a substantial financial interest in, and does not have a relative who is a current officer of or have a substantial financial interest in, any entity that has ~~made payments~~ provided property or services to, or received ~~payments~~ property or services from, the trust or an affiliate of the trust ~~for~~ if the amount paid by the trust to the entity or received by the corporation from the entity for such property or services ~~in an amount which,~~ in any of the last three fiscal years, exceeds the ~~lesser~~ greater of twenty-five thousand dollars or two percent of such entity's consolidated gross revenues; and (iv) is not and does not have a relative who is a current partner or employee of the trust's outside auditor or who has worked on the trust's audit at any time during the past three years. For purposes of this subparagraph, "~~payment~~ property and services" do~~es~~ not include charitable contributions or dues, or fees paid to the corporation for services which the trust performs as part of its nonprofit purposes.

b. Delete N-PCL § 712-a(c), which states, "The board or designated audit committee of the board shall oversee the adoption, implementation of, and compliance with any conflict of interest policy or whistleblower policy adopted by the corporation if this function is not otherwise performed by another committee of the board comprised solely of independent directors."

   Similarly, delete EPTL § 8-1.9(b)(3), which reads, "The trustees or designated audit committee shall oversee the adoption, implementation of, and compliance with any conflict of interest policy or whistleblower policy adopted by the trust if this function is not otherwise performed by another committee comprised solely of independent trustees."

c. Amend N-PCL § 715-b(b)(2) to read: "A requirement that an employee, officer or director of the corporation be designated to administer the whistleblower policy and to report to the audit committee or other committee of the board ~~independent directors~~ or, if there are no such committees, to the board...;"

   Similarly, amend EPTL § 8-1.9(e)(2)(b) to read: "A requirement that a trustee, officer or employee of the trust be designated to administer~~,~~ the whistleblower policy and to report to the audit committee or other committee of ~~independent~~ trustees, or to the trustees."

3. N-PCL § 712: Executive Committee and Other Committees

In order to work efficiently and effectively, a board must be allowed to delegate certain matters to one or more committees composed of qualified knowledgeable people. Indeed, good governance guidelines encourage boards to fully utilize committees. The Act, however, contains several restrictions on committees that impose unnecessary obstacles.

The requirement that a majority of the entire board must approve the formation, and name all members, of all board committees is often unworkable; instead, the majority of board members present at a meeting at which a quorum is present should suffice in most circumstances.

We recognize one exception -- a majority of the entire board must name the members of the executive committee, which has the full authority of the board on all matters that can be delegated.

The requirement that a majority of the entire board must approve the formation of the other committees and the naming of their members is especially problematic with nonprofits that have quorums as low as one-third of the board or even lower, where it may be difficult to get a majority of the board to attend the meetings where committees are structured and members elected. While boards should be able to form any executive committee at the annual meeting, when a greater attendance can be expected, other committees can be formed and staffed whenever appropriate, even when less than a majority of the entire board is present.

Under the Act, committees of the corporation, which may include non-directors as voting members, cannot bind the board. But in some situations a committee containing non-board members is the best vehicle for decision making. For example, all or most board members may otherwise be conflicted, or the directors may lack the time or expertise to make such a decision. The board should be able to specifically delegate such decision to a committee of the corporation, just as it may grant specific authority to a specific officer, staff member, or other agent. The board retains the fiduciary duty to monitor the action of those committees to determine that the committee has acted only within the scope of its specifically delegated authority.

Additionally, we propose to expand the list of matters that may not be delegated to any committee, to cover limitations consistent with other sections of the existing N-PCL: election or removal of officers and directors, approval of mergers or plans of dissolution, disposition of all or substantially all the assets, and amending the certificate of incorporation.

We note that many by-laws establish that certain officers and committee heads will constitute the members of specific board committees (*i.e.*, *ex officio* members). Under the N-PCL, such members must still be elected by board vote. No vote should be needed where the membership of a committee is set forth in a corporation's by-laws.

We have also added language that clarifies that the fiduciary duties imposed on officers are also applicable to members of committees who are not directors (as implied by the current language of paragraph (e)).

We propose: Amend § 712 to read:

(a) ~~If t~~The certificate of incorporation, ~~or~~ the by-laws ~~so provide~~, or the board~~, by resolution adopted by a majority of the entire board,~~ may ~~designate from among its members an executive committee and other committees~~ create committees of the board, each consisting of three or more directors. The board shall designate the members of such committees of the board (in the case of any executive committee, or similar committee however denominated, by action of a majority of the entire board). The by-laws may provide that directors who are the holders of certain offices shall be members of specific committees. ~~and e~~Each such committee ~~of which, to the extent provided in the resolution or in the certificate of incorporation or by-laws,~~ shall have ~~all~~ the authority of the board to the extent provided in a board resolution or in the certificate of incorporation or by-laws, except that no ~~such~~ committee of any kind shall have authority as to the following matters:

(1) The submission to members of any action requiring members' approval under this chapter.
(2) The filling of vacancies in the board of directors or in any committee.
(3) The fixing of compensation of the directors for serving on the board or on any committee.
(4) The amendment or repeal of the by-laws or the adoption of new by-laws.
(5) The amendment or repeal of any resolution of the board which by its terms shall not be so amendable or repealable.
(6) The election or removal of officers and directors.
(7) The approval of a merger or plan of dissolution.
(8) The issuance of a recommendation for member action regarding, or the authorization of, the sale, lease, exchange or other disposition of all or substantially all the assets.
(9) The approval of amendments to the certificate of incorporation.

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(e) Committees, other than committees of the board, whether created by the board or by the members, shall be committees of the corporation. ~~Such committees of the corporation may be elected or appointed in the same manner as officers of the corporation, but n~~ No such committee shall have the authority to bind the board except to the extent that such authority has been expressly delegated to such committee by the board with respect to specific matters. Provisions of this chapter, including Section 717, applicable to officers generally shall apply to members of such committees. Members of s~~S~~uch committees of the corporation, who may be non-directors, 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.

4. N-PCL § 102(a)(25) & EPTL § 8-1.9(a)(3): Definition of "Key Employee"

The term "key employee" is used throughout the N-PCL to define a person (other than an officer or director) who has a sufficient connection to the corporation that he or she: (a) cannot be an independent director, (b) is subject to an obligation (such as the obligation to disclose a related party transaction or to abide by a conflict of interest policy), or (c) may be sued in a New York court for violating the N-PCL. N-PCL §§ 102(a)(23), 114, 309, 715(a), 715-a, 720(a).

However, by incorporating the Internal Revenue Code and regulations defining people who are "disqualified persons" for purposes of excess benefit transactions, the Act includes as a "key employee" not just employees but *anyone* who is, or was in the recent past, in a position to substantially influence the nonprofit's affairs. For instance, it could include a person who makes substantial contributions to the organization but does not work there. *See* 26 C.F.R. §§ 53.4958-3(a)(1), 53.4958-3(e)(2)(ii). We do not know if the drafters intended to include in the definition of "key" employees people who are not employees. Whether it was intended or not, the common understanding of the average layman reader would be that an "employee" must be an employee. Indeed, this is the logical reading of the term. (The current definition also creates redundancies in the N-PCL, since it includes voting members of the governing body, 26 C.F.R. § 53.4958-3(c)(1), while the N-PCL refers in many places to "director, officer or key employee." N-PCL §§ 102(a)(23), 114, 309, 715(a), 715-a, 720(a).)

Our suggested definition makes clear that a person is a "key employee" only if he or she is an employee and would be considered a "disqualified person" with "substantial influence" over the affairs of the corporation under the specific provisions of the Internal Revenue Code and Treasury Regulations defining that term with respect to employees.

At the same time, as we discuss above in section 1, we would expand the definition of "related party" to include not only directors, officers, key employees, but also anyone who usurps the power of officers, directors or key employees. This will allow the Attorney General to unwind unfair transactions with elected officials and other substantial contributors who improperly influence the organization.

We propose: Amend N-PCL § 102(a)(25) to read: "'Key employee' means any ~~person~~ employee 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)(2) & (3), (d)(3) and (e)(1) & (2)(iii), (iv) & (v), or succeeding provisions, to the extent these provisions refer to employees."

Similarly, amend EPTL § 8-1.9(a)(3) to read: "'Key employee' means any person who is in a position to exercise substantial influence over the affairs of the ~~corporation~~ trust as referenced in 26 U.S.C. Section 4958(f)(1)(A) and further specified in 26 C.F.R. Section 53.4958-3(c)(2) & (3), (d)(3) and (e)(1) & (2)(iii), (iv) & (v), or succeeding provisions, to the extent these provisions refer to employees."

5. N-PCL § 712-a & EPTL § 8-1.9(b)(5): Audit Oversight

We propose to clarify the undefined term "deliberations," to make clear that people who have information valuable to the board or audit committee's decisions but may not vote on that decision may still participate in preliminary discussions. This change is necessary for consistency with N-PCL §§ 515(b) (payment of reasonable compensation to members, directors, or officers) and 715(g) (related party transactions), which allow a board or committee to request information from people with relevant information, even when those people may not vote on the matter at hand. Requesting and obtaining such information is essential during the audit oversight function, during which the board or committee must obtain information about the organization's

accounting and financial reporting processes with which staff may be uniquely familiar, and about related party transactions as to which those related parties are knowledgeable.

We also propose to allow directors who are not independent to remain in the room during deliberations and voting, although not participating in those activities.

We propose: Amend N-PCL § 712-a(e) to read: "Only independent directors may participate in any board or committee deliberations or voting relating to matters set forth in this section; provided that nothing in this subdivision shall:

(1) 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, or

(2) require that directors who are not independent shall leave the meeting during any deliberations and vote."

Similarly, amend EPTL § 8-1.9(b)(5) to read: "Only independent trustees may participate in deliberations or voting relating to matters set forth in this paragraph; provided that nothing in this paragraph shall:

(1) prohibit the trustees 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 trustees meeting prior to the commencement of deliberations or voting relating thereto, or

(2) require that trustees who are not independent shall leave the meeting during any deliberations and vote."

6. N-PCL § 715-a & EPTL § 8-1.9(d): Conflict of Interest Policy

a. *Board request for information*: Allowing the board or committee to request and obtain information from a person with a conflict of interest is essential during a review of that conflict, because much of the relevant information is likely to be in the possession of that person. For this reason, N-PCL § 515(b) allows a board or committee deliberating regarding the payment of reasonable compensation to members, directors, or officers to request information from people with relevant information, even when those people may not vote on the matter at hand.

We propose: Amend N-PCL § 715-a(b)(3) to read: "a requirement that the person with the conflict of interest not be present at or participate in board or committee deliberation or vote on the matter giving rise to such conflict, provided that nothing in this section shall prohibit the board or committee from requesting that the person with the conflict of interest present information as background or answer questions at a committee or board meeting prior to the commencement of deliberations or voting relating thereto."

Similarly, amend EPTL § 8-1.9(d)(2)(c) to read: "a requirement that the person with the conflict of interest not be present at or participate in any deliberation or vote on the matter giving rise to such conflict, provided that nothing in this section shall prohibit the

board or committee from requesting that the person with the conflict of interest present information as background or answer questions at a committee or trustees meeting prior to the commencement of deliberations or voting relating thereto."

b. *Initial and annual disclosure requirement*: The Act's new requirement that directors must disclose conflicts annually should be limited to larger organizations with sufficient revenue to require an annual audit. This is what the IRS does: larger organizations required to file a Form 990 annual return are asked whether they require annual certification, while smaller organizations filing a Form 990-EZ or 990-N are not. Even with this change, board members of smaller organizations will still be required to disclose all conflicts prior to a vote on the matter.

   We propose requiring that initial conflict certifications for directors, which now must be made before the director takes office, should also be limited to larger organizations and may be made after a director's election. Prior to election, a candidate may not have sufficient information about the organization to disclose all potential conflicts. Additionally, some organizations elect their directors at a meeting of the members based on nominations put forward by members; prior to the meeting people may not even know that they will be nominated and they therefore cannot complete the form prior to election.

   Finally, we suggest allowing the certifications to be provided to a designated compliance officer, as an alternative to the secretary.

   We propose: Amend N-PCL § 715-a(c) to read: "For any corporation that in the prior fiscal year had annual revenue in excess of one million dollars, ~~T~~the conflict of interest policy shall require that ~~prior to~~ promptly after the initial election of any director, and annually thereafter, such director shall complete, sign and submit to the secretary of the corporation, or a designated compliance officer, a written statement ... The secretary of the corporation or a designated compliance officer shall provide a copy of all completed statements to the chair of the audit committee or, if there is no audit committee, to the chair of the board."

   Similarly, amend EPTL § 8-1.9(d)(3) to read: "For any trust that in the prior fiscal year had annual revenue in excess of one million dollars, ~~T~~the conflict of interest policy shall require that ~~prior to~~ promptly after a trustee's initial appointment, and annually thereafter, such trustee shall complete, sign and file with the records of the trust a written statement ...."

7. N-PCL § 715-b & EPTL § 8-1.9(e): Whistleblower Policy

It should not be necessary to distribute a whistleblower policy to individual employees and volunteers if an organization makes its policy available to the public on its web site or to employees and volunteers in its offices.

We propose: Amend N-PCL § 715-b(a)(3) to read: "A requirement that a copy of the policy be distributed to all directors, officers, employees and to volunteers who provide substantial

services to the corporation. For purposes of this subparagraph, posting the policy on the corporation's website or at the corporation's offices in a conspicuous location accessible to employees and volunteers are among the methods a corporation may use to satisfy the distribution requirement."

Similarly amend EPTL § 8-1.9(e)(2)(c) to read: "A requirement that a copy of the policy be distributed to all trustees, officers, employees and volunteers, with instructions on how to comply with the procedures set forth in the policy. For purposes of this subparagraph, posting the policy on the trust's website or at the trust's offices in a conspicuous location accessible to employees and volunteers are among the methods a trust may use to satisfy the distribution requirement."

8. N-PCL § 102(a)(3-a): Definition of "Charitable Purposes"

While the Act's definition of "charitable purposes" largely tracks IRC 501(c)(3), the Act excludes several categories of organization that are covered by 501(c)(3). We propose to expand the definition of "charitable purposes" to include all corporations that are exempt from tax under IRC § 501(c)(3), and any other corporation with charitable purposes.

We propose: Amend N-PCL § 102(a)(3-b) to read: "'Charitable purposes' of a corporation means purposes contained in the certificate of incorporation that are charitable, educational, religious, scientific, literary, cultural, ~~or~~ for the prevention of cruelty to children or animals, to test for public safety, or to foster national or international amateur sports competition."

9. N-PCL § 102(a)(6-a): Definition of "Entire Board"

As currently framed, § 102(a)(6-a) creates a potential inconsistency with § 702(a): the number of directors fixed by the board and the number as of the most recent election of directors may be different. We suggest these changes to give preference to the number fixed by the board to ensure that there is no conflict with § 702(a). We also propose to include reference to appointed as well as elected directors, consistent with the wording of § 703, and to clarify that the number includes directors whose term has not yet expired.

We propose: Amend last sentence to read: "If the by-laws of any corporation provide that the board may consist of a range between a minimum and maximum number of directors, and the number within that range has not been fixed in accordance with subsection 702(a), then the 'entire board' shall consist of the number of directors within such range that were elected or appointed as of the most recently held election of directors, as well as any directors whose terms have not yet expired."

10. N-PCL § 102(a)(19) & EPTL § 8-1.9(a)(4): Definition of "Affiliate"

The term "affiliate" is used in the definition of "independent director," "related party" and "related party transaction." In those places, it makes sense to limit coverage of affiliates to those that control or are controlled by the corporation, while excluding those that are under common control, with which the corporation's relationship may be tenuous.

We propose: Amend N-PCL § 102(a)(19) to read: "An 'affiliate' of a corporation means any entity controlled by~~,~~ or in control of~~, or under common control with~~ such corporation."

Similarly, amend EPTL § 8-1.9(a)(4) to read: "An 'affiliate' of a trust means any entity controlled by~~,~~ or in control of~~, or under common control with~~ such trust."

11. N-PCL § 102(a)(22) & EPTL § 8-1.9(a)(5): Definition of "Relative"

We propose to retain the Act's definition of relative, but expand it to include domestic partners of brothers, sisters, children, grandchildren, and great-grandchildren, to be consistent with modern practice.

We propose: Amend N-PCL § 102(a)(22) to read: "'Relative' of an individual means his or her (i) spouse or domestic partner as defined in section twenty-nine hundred ninety-four a of the public health law; or (ii)~~,~~ ancestors, brothers and sisters (whether whole or half-blood), children (whether natural or adopted); grandchildren, great-grandchildren, and spouses or domestic partners of brothers, sisters, children, grandchildren, and great-grandchildren~~; or (ii) domestic partner as defined in section twenty-nine hundred ninety-four-a of the public health law~~."

Similarly, amend EPTL § 8-1.9(a)(5) to read: "'Relative' of an individual means his or her (i) spouse or domestic partner as defined in section twenty-nine hundred ninety-four a of the public health law; or (ii)~~,~~ ancestors, brothers and sisters (whether whole or half-blood), children (whether natural or adopted); grandchildren, great-grandchildren, and spouses or domestic partners of brothers, sisters, children, grandchildren, and great-grandchildren~~; and (ii) his or her domestic partner as defined in section twenty-nine hundred ninety-four-a of the public health law~~."

12. N-PCL § 201(c): Purposes

The Act deems as charitable all type B or C corporations formed prior to July 1, 2014. However, there are some type B or C corporations that are more properly considered non-charitable. We propose a procedure for such corporations to file a notice of intent to operate as a non-charitable corporation after receiving the consent of the attorney general.

We propose: Add at the end of § 201(c): If a type B or C corporation formed prior to July first, two thousand fourteen wishes to be considered a non-charitable corporation it shall deliver to the department of state a signed certificate, entitled "Certificate of intent of ... (name of corporation) to be a non-charitable corporation under section 201 of the Not-for-Profit Corporation Law." The certificate shall have endorsed thereon or annexed thereto the consent of the attorney-general. The certificate shall set forth:

(1) The name of the corporation and, if it has been changed, the name under which it was formed.

(2) The date of the filing of its certificate of incorporation by the department of state.

(3) The law under which it was formed.

(4) That it elects to be a non-charitable corporation.

13. N-PCL § 509 & Religious Corporations Law § 12.1: Purchase, sale, mortgage and lease of real property

Prior to the Act, N-PCL § 510 required a charitable corporation to obtain leave of court prior to disposing of all or substantially all of its assets. The Act added an alternative option of obtaining Attorney General approval. We propose extending the option of obtaining Attorney General approval in lieu of the leave of court for a religious corporation desiring to sell, mortgage or lease real estate. We understand that this was an oversight the Act's drafting.

Moreover, the provisions of N-PCL § 509 requiring board approval for real estate transactions constituting less than all or substantially all assets of the corporation confound nonprofit boards and provide little beneficial effect. While the Act simplified the approval procedure in some respects for corporations other than religious corporations, it bestows on real estate an importance that seems excessive. It is no longer true that real estate is a special type of asset warranting special procedures. N-PCL §§ 510 and 511 appropriately deal with transfers of all or substantially all the assets of a nonprofit corporation, a standard which has been interpreted by New York courts to look not at a quantitative or percentage approach but at the significance of the asset to nonprofit operations. *See Rose Ocko Foundation, Inc. v. Lebovits*, 259 A.D. 685, 686 N.Y.S.2d 861 (2d Dep't 1999).

We propose:

a. Amend RCL § 12.1 to read: "A religious corporation shall not sell, mortgage or lease for a term exceeding five years any of its real property without applying for and obtaining leave of the court or the attorney general therefor pursuant to section five hundred eleven or section five hundred eleven-a of the not-for-profit corporation law ...."

b. Delete N-PCL § 509.

14. N-PCL § 515: Compensation to managers of private foundations

Read literally, § 515 could preclude a board from paying director compensation. It would not be appropriate to approve such arrangements by "round robin" voting, in which directors approve each others' compensation, while abstaining from voting on their own compensation – the IRS specifically bars that practice. We propose an amendment to make clear that it is permissible to provide uniform director fees (*e.g.*, annual and/or per meeting and/or per committee and/or per role) pursuant to a policy, subject to the reasonableness requirement.

We propose: Amend the second sentence of N-PCL § 515(b) to read: "No person who may benefit from such compensation may be present at or otherwise participate in any board or committee deliberation or vote concerning such person's compensation; provided that nothing in this section shall prohibit the board or authorized committee from requesting that a person who may benefit from such compensation present information as background or answer questions at a committee or board meeting prior to the commencement of deliberations or voting relating

thereto; nor shall anything in this section or section 715(g) prohibit a director from deliberating or voting concerning compensation that is to be made available or provided to directors on the same or substantially similar terms."

15. N-PCL § 702(b)(1): Number of Directors

As amended by the Act, § 702(a) allows the number of directors to 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. However, § 702(b) allows the number of directors to be changed by action of the board pursuant to the by-laws only if the corporation is a membership corporation. We understand that this was an oversight in the drafting of the Act, since those two provisions are inconsistent. For purposes of consistency, § 702(b) should likewise permit the number of directors to be changed by action of the board under the specific provisions of a by-law regardless of the type of corporation.

We propose: Amend § 702(b) to read: "The number of directors may be increased or decreased by amendment of the by-laws or~~, in the case of a corporation having members,~~ by action of the members, or of the board under the specific provisions of a by-law ~~adopted by the members~~, subject to the following limitations:

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

16. N-PCL § 708: Action by the Board

The Act deleted former § 715(c), which stated 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." In the absence of that language, board meetings may lose their quorum when voting on conflict situations, if one or more directors must recuse themselves.

We propose: Amend § 708(d) to read: "Except as otherwise provided in this chapter, the vote of a majority of the directors present at the time of the vote, if a quorum is present at such time, shall be the act of the board. Directors who are present at a meeting but not present at the time of a vote due to a conflict shall be determined to be present at the time of the vote for purposes of this subsection."

17. N-PCL § 1407: Alumni Corporations

While the Act deemed alumni corporations non-charitable, they should be charitable based on their power, under N-PCL § 1407(c), to create, manage and control a fund, which may be given to the associated college or university, or may be used by the corporation to assist the college or university.

We propose: Amend § 1407(b) to read: "An alumni corporation is a ~~non-~~charitable corporation."