



Keeping Up with Recent Governance Law Changes under the Nonprofit Revitalization Act

October 3, 2017

Hedwig O'Hara, Senior Staff Attorney
(212) 219-1800 ext. 226
hohara@lawyersalliance.org

Mary Burner, Staff Attorney
(212)219-1800 ext. 240
mburner@lawyersalliance.org

Resource Call Hotline: (212)219-1800 ext. 224



Background

- New York Nonprofit Revitalization Act (NPRA) went into effect July 1, 2014 and comprehensively overhauled the New York Not-for-Profit Corporation Law (NPCL)
- NPRA amended several times thereafter, with most recent amendments signed into law in 2016 and effective May 27, 2017



Overview

- Related Party Transactions/Conflict of Interest Policy
- Independent Directors (Audit Oversight)
- Whistleblower Policy
- Employee as Board Chair/President
- Formation & Power of Committees of the Board



Related Party Transactions/ Conflicts of Interest Policy



Related Party Transactions

- Reminder: all NY nonprofits must have a **conflict of interest policy**, laying out how to identify and address related party transactions (may also cover other, non-financial conflicts)
- **Related Party Transaction:** a transaction/agreement where
 - a “Related Party” has a financial interest; and
 - the corporation or its affiliate is a party
- A **Related Party** is:
 - *Director, officer, or key person of corporation or an affiliate;*
 - *A relative of any of the above; or*
 - *Any entity in which any of the individuals described above has at least 35% ownership interest, or in the case of partnership/professional corporation, a direct or indirect interest exceeding 5%.*
- Initially, NPRA prohibited corporation from entering into *any* “related party transaction” unless determined by the board to be fair, reasonable, and in corporation’s best interest



NEW: Committee Approval of “Related Party Transactions”

- 2017 Amendments permit the board to authorize a committee to review and approve Related Party Transactions
- Whereas previously, only the full board could review Related Party Transactions



NEW: Exceptions that are Not Considered “Related Party Transactions”

- 2017 Amendments ease rules and now define Related Party Transaction to **exclude**:
 - Transactions where the transaction itself or the related party’s financial interest in the transaction is de minimis
 - Transactions that would not usually be reviewed by the board in the ordinary course of business and is available to others on the same or similar terms
 - Transactions that benefit a related party solely as a member of a class of charitable beneficiaries, where the benefit is available to all similarly situated members of that charitable class on the same terms
- Thus, a corporation can enter into transaction without treating it like a “related party transaction”.



Related Party Transactions: What is *De Minimis*?

- There is no bright-line test for measuring a *de minimis* transaction or financial interest.
- The Attorney General evaluates *de minimis* transactions under a facts-and-circumstances determination that considers the size of the nonprofit's budget and assets, **and** the transaction or interest.
 - Highbridge Housing Co. has annual gross revenue of \$300,000. Highbridge hosts a Halloween party in its community room. A board member of Highbridge has a granddaughter who owns a catering company. Highbridge hires the company to decorate the room and provide lunch and refreshments for \$1,000.



“Ordinary Course of Business” Exceptions to Related Party Transactions

- Highbridge Housing Co. manages 10 supportive housing projects, each with front desk security systems that need to be upgraded. A Highbridge board member owns a security company. Highbridge issues a request for proposals for front desk security systems, then evaluates and documents its selection of the board member’s security company to install security systems at all 10 buildings.
- Highbridge Housing uses the local electric utility for its electrical service at all of its projects. Another board member is a 35% shareholder of the local electric utility
- General counsel of Highbridge Housing Co. has a written and enforced policy for the selection and payment of outside counsel to handle landlord/tenant actions. A board member is a partner in a real estate law firm and has more than a 5% share in one of the firms retained by general counsel.
 - The Transactions above are all in “ordinary course of business” and thus not Related Party Transactions.



Related Party Transactions: Benefitting a Member of a Charitable Class

- 1/3 of the board members of Highbridge Housing Co. are local residents of the Highbridge area. Highbridge has an eviction prevention program that serves local residents that meet specified low-income guidelines. Highbridge accepts a case on behalf of one of its community board members. The decision to take the case is based on the board member meeting the program qualifications, not on board member status.
 - The board member is a member of a charitable class entitled to the benefits of the eviction prevention program.



NEW: Replacing “Key Employee” with “Key Person”

- The 2017 Amendments introduce the broader term “**key person**” in the place of “**key employee**”, which is relevant to:
 - Defining a “related party”,
 - Defining an “independent director”
- A “**key person**”:
 - (i) *has responsibilities or exercises powers or influence over the corporation as a whole, similar to that of directors/officers*
 - (ii) *manages the corporation or a substantial portion of the activities, assets, income, or expenses of the organization*
 - (iii) *controls or determines a substantial portion of the corporation’s capital expenditures or operating budget*



Can the Nonprofit Enter into a Related Party Transaction?

- If a related party has a **substantial financial** interest in a transaction, the board or an authorized committee shall:
 - *consider alternative transactions to the extent available before entering into the transaction,*
 - *only approve related party transactions that are fair, reasonable, and in the best interest of the corporation (by at least a majority vote of the directors or committee members present), and*
 - *contemporaneously document in writing the basis for approval.*
- Director considered a related party may not participate in deliberations or voting regarding the related party transaction (but a quorum will not be lost if one or more directors recuse themselves because of the RPT.)
- The board/committee may request that the related party be present to provide information before deliberations/voting begin.



NEW: Retroactive Approval of RPT

- Initially, NPRA did not allow a nonprofit's board to approve a related party transaction after the fact.
- The 2017 Amendments add a limited statutory defense allowing ratification of a related-party transaction that was not properly authorized in the first instance.
- To benefit from defense, the related party transaction must be ratified before the nonprofit receives any request for information by the Attorney General concerning the transaction.
- Document in writing the failure to consider the RPT in the first instance, the basis for approval of the RPT, and adopt corrective procedures to ensure future compliance.



Independent Directors (for Audit Functions)



Review: Audit Thresholds

- Annual audit required for nonprofits meeting certain annual revenue thresholds:

-**Current** thresholds:

Annual Revenue	Required Annual Filing with NY AG
Under \$250,000	Unaudited financial report
At least \$250,000 but not more than \$750,000	Financial report with independent CPA's <u>review</u> report
More than \$750,000	Financial report with Intendent CPA's <u>full audit</u>

-Thresholds effective beginning **July 1, 2021**:

Annual Revenue	Required Annual Filing with NY AG
Under \$250,000	Unaudited financial report
At least \$250,000 but not more than \$1 million	Financial report with independent CPA's <u>review</u> report
More than \$1 million	Financial report with Intendent CPA's <u>full audit</u>



Independent Directors: Role in Overseeing Audit

- “Independent Directors” relevant only for those nonprofits required to file CPA’s review report or full audit:
 - For such organizations, audit requirements can be handled by the **whole board or delegated to an audit committee**, but regardless:
 - **Only Independent Directors** can oversee accounting and financial reporting processes and the audit
 - If delegated to an Audit Committee, Audit Committee must be comprised only of Independent Directors
 - These independent directors must retain the auditor, oversee the audit, and review results of the auditor’s findings



Who Counts as an Independent Director?

- Director is an independent director if, currently and in the past 3 years, that director:
 - (i) Is not an employee or key person of the corporation/an affiliate;
 - (ii) Does not have a relative* who is/was a key person of the corporation/an affiliate
 - (iii) Has not received more than \$10,000 in compensation from the corporation/an affiliate;
 - (iv) Does not have a relative who received more than \$10,000 in compensation from the corporation/an affiliate;
 - (v) **NEW:** Sliding scale governs payments to/from the corporation and another entity where a director/relative is employed or has a financial interest
 - Director may still be independent, depending on amount of the payments and size of other entity (see next slide)

“Relative”: (1) spouse or domestic partner, (2) ancestors, siblings (whether whole or half blood), children (whether natural or adopted), grandchildren, great-grandchildren, or (3) the spouse or domestic partner of one’s siblings, children, grandchildren, and great-grandchildren.



Payments to/from Other Entities Where Director/Relative is Employed/Financially Interested

- Can still be considered an independent director of the corporation if the director/his or her relative is employed by/financially interested in another entity that pays/is paid by the corporation subject to this **new** sliding scale:
 - (i) If the other entity's gross revenue is less than \$500,000 → director is still independent if payments the entity made to/received from the corporation in any of the last three fiscal years do not exceed the lesser of \$10,000 or 2% of the entity's consolidated gross revenue.
 - (ii) If other entity's gross revenue is \$500,000-\$10,000,000 → director is still independent if payments the entity made to/received from the corporation in any of the last three fiscal years do not exceed \$25,000 or less.
 - (iii) If other entity's gross revenue is \$10,000,000 or more → director is still independent if payments the entity made to/received from the corporation in any of the last three fiscal years do not exceed \$100,000 or less.

**Charitable donations to/from another entity do not count as "payments."*



Independent Directors: Exception re “Payments” to Another Entity

- **New:** Exception for “Payments” by the corporation to another entity that could trigger disqualification as an independent director.
- Do not count payments made by the corporation to another entity (where director/relative is employed/financially interested) at a fixed or non-negotiable rate for services received, as long as the services paid for are available to the public on the same terms and are not available from another source.
 - Rationale: Payments by the nonprofit for routine services (utilities, cable) to companies, whose employees would otherwise not be considered “independent directors” if serving on the board of a nonprofit that receives service from that company



Whistleblower Policies



Whistleblower Policy

- Required for organizations with 20 or more employees and annual revenue in the prior fiscal year of \$1 million+.
- Prohibits intimidation, harassment, discrimination, retaliation, and other adverse employment consequences against director, officer, employee or volunteer who in good faith reports activity/suspected activity in the organization that is illegal, fraudulent or in violation of corporate policies; sets out procedures to report these issues.
- **NEW** in 2017 Amendments:
 - Prohibit director who is also an employee from participating in board/committee deliberations concerning administration of the whistleblower policy.
 - Introduce a whistleblower recusal provision that prohibits a person who is the subject of a whistleblower complaint from attending or participating in any board or committee deliberations concerning the complaint (but can attend at request of the board/committee before deliberations to answer questions.)



Board Leadership and Committees



NEW: Board Chair/President

- As of January 1, 2017, an employee of the corporation may serve as board chair/president only if two-thirds (2/3) of the entire board approves the appointment
 - Prior to 2017 Amendment, NPCL was set to impose absolute bar on employee serving as chair/president
- Board must contemporaneously document basis for this decision in writing



Board Committees: How are Board Committees Established?

- Before 2017 Amendments, vote of majority of *entire* board was needed to establish committees of the board
- Now, board committees can be established by vote of majority of board present at a meeting at which quorum is achieved
 - Except Executive Committee (or committee with similar functioning), which still requires (i) vote of the entire board, or (ii) if the board has 30 or more directors, vote of at least $\frac{3}{4}$ of those present at a meeting at which quorum is achieved



NEW: *Ex officio* Committee Appointments

- The 2017 Amendments now provide that a nonprofit's bylaws may provide that directors who hold certain positions in the organization are *ex officio* (by virtue of their office) members of specific committees.



Board Committees: What Powers do Board Committees Have?

- With some exceptions, committees of the board may exercise authority on behalf of the full board.
- Powers that **cannot be delegated** to board committees:
 - Submission to members of any action requiring member's approval;
 - Filling vacancies in the board of directors or in any committee;
 - Fixing of compensation of a director;
 - Amending, repealing, or adopting new bylaws;
 - Amending/repealing any board resolution which by its terms is not amendable/repealable by a committee

NEW as of the 2017 amendments:

- Amending the certificate of incorporation;
- Electing or removing officers and directors;
- Approving a merger or plan of dissolution; or
- Approving/recommending to the members a disposition of all or substantially all of the assets.



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