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New York Non-Profit Revitalization Act

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Governor Andrew Cuomo signed the New York Non-Profit Revitalization Act of 2013 (the "Act") into law on December 18, 2013. The Act marks the first major amendment to the New York Not-for-Profit Corporation Law ("N-PCL") since it was passed in 1970, over 40 years ago. The Act's goal is two-fold: to reduce outdated regulatory burdens on nonprofits, thereby encouraging greater efficiency, and to enhance corporate governance, accountability and oversight of those nonprofits. The Act mandates a number of internal procedures which previously were optional "best practices" and applies these governance rules to charitable trusts. Given the breadth and significance of the Act's provisions, all New York not-for-profit corporations should become familiar with the law's changes and take steps to come into compliance before the Act becomes effective on July 1, 2014.

Applicability to Charitable Trusts

In addition to amending the N-PCL, the Act also creates a new section under Article 8 of the New York Estate Powers and Trust Law ("EPTL"). EPTL section 8-1.9 makes applicable to charitable trusts certain sections of the Act, including the provisions addressing related party transactions, mandatory conflict of interest and whistleblower policies, and audit oversight. These provisions are discussed in greater detail below. Imposing these standards on charitable trusts is a major change in the law affecting all charitable trusts. Trustees of charitable trusts would be advised to consult with counsel to assure compliance with the Act.

Related Party Transactions

The Act creates certain requirements with which every nonprofit corporation and charitable trust must comply when entering into any transaction with a related party. A related party is defined as any director, officer or key employee of the company, relatives of such individuals, any corporation in which that person has 35% or more ownership, or any partnership or professional corporation in which that person has a 5% or greater interest. Importantly, the Act includes "key employees" –those who exercise "substantial influence" over the nonprofit's affairs, regardless of title—within the group of individuals who must disclose their interested transactions. A related party must i) disclose to the nonprofit his or her material interests in the transaction in good faith and ii) abstain from participation in the vote and deliberations regarding the interested transaction.

The Act requires the board, in considering a related party transaction, to i) consider alternative transactions, ii) approve the transaction with a majority vote of those present at the meeting, and iii) document the basis for its approval of the related party transaction at the time of the vote.

In addition, the Act gives the Attorney General heightened enforcement powers with respect to related party transactions, including the power to void or rescind any related party transaction, seek financial relief or damages, and/or remove the board members who approved such a transaction. Given this enhanced regulatory authority, it is doubly important that any board approving a related party transaction stringently adhere to the requirements and contemporaneously document the transaction and its approval.

Appointment of an Audit Committee

A nonprofit organization that raises more than $500,000 from the public must submit audited financial statements as part of its filing with the Attorney General, pursuant to Article 7A of the NY Executive Law. The Act requires all such corporations and trusts to create an internal audit committee to oversee the corporation's financial reporting processes, hire and oversee the independent auditor, and review the findings of the audit upon its completion. The audit committee is also responsible for implementing both the required conflict of interest and whistleblower policies described below. The full board may act as the audit committee as long as all members are independent, as defined in the Act. For covered organizations with yearly revenues of over $1 million, the Act imposes additional oversight procedures. For those corporations with revenues of less than $10 million per year, the Act's audit committee requirement will become effective on January 1, 2015.

Mandatory Conflict of Interest Policy

The Act requires that all nonprofit corporations and charitable trusts adopt a conflict of interest policy. For those corporations and trusts that already had such a policy pursuant to federal, state, or local law prior to the Act's enactment, that policy will be deemed satisfactory under the Act if it is substantially consistent the requirements of the Act. Under the Act, the policy must include the following: i) a definition of conflict of interest, ii) procedures to disclose conflicts to the audit committee or board, iii) a requirement that the conflicted individual refrain from participating in deliberation or votes regarding the interested party transaction, iv) a prohibition on the conflicted officer or director improperly influencing the deliberation or voting, and v) a requirement that the conflict be documented in the organization's records. The conflict of interest policy must be created and implemented by the audit committee comprised of non-interested individuals, or if there is no audit committee, by the board. Each director and officer must disclose his or her conflicts of interest annually.

Mandatory Whistleblower Policy

All nonprofit corporations and charitable trusts with twenty or more employees and annual revenues of over $1,000,000 are required to adopt a whistleblower policy that protects from retaliation employees who in good faith report action by or within the corporation that is illegal, fraudulent or contrary to any policy of the corporation. As with the conflict of interest policy, the audit committee, or, if there is no audit committee, the board, must adopt and implement the policy. This policy must contain the following: i) a procedure for reporting violations while maintaining employee confidentiality, ii) a procedure to appoint an individual to investigate the violation, and iii) a requirement that the policy be distributed to all directors, officers, employees and volunteers of the corporation.

Modern and Rational Governance Procedures

The Act also modernizes procedural rules and eliminates some of the N-PCL's traps for the unwary. The Act clarifies that meeting notices and other organizational communications may take place via email and fax and allows videoconference meetings. Nonprofits will need to amend their bylaws to assure that they can take advantage of these changes.

The Act eliminates the burdensome requirement that all real property transactions be approved by a two thirds majority of the board. Most real estate dispositions and mortgages may now be undertaken with approval of a majority of the board or a designated real estate committee of the board. Only if the transaction involves substantially all of the assets of the nonprofit must it be approved by at least two thirds of the full board or a majority of the full board if there are more than twenty-one board members. Similarly, the N-PCL's arcane rules defining the "entire board" have been changed to avoid quorum-achievement problems that arise in organizations with vacant board seats, and the distinction between standing committees and special committees of the board has been eliminated.

Finally, the Act simplifies the procedures for approving dispositions of substantially all assets, dissolutions, and mergers and consolidations. Where in the past court approval was required, only Attorney General approval is now necessary.

Other Regulatory Provisions

The Act removes some of the N-PCL's anomalies with respect to the incorporation of nonprofit corporations. Discarding the prior law's division of nonprofits into four types (A through D), there will now be two types: charitable and non-charitable corporations. Charitable corporations are

nonprofits with a "charitable purpose," defined as educational, religious, scientific, literary, cultural or prevention of cruelty to children or animal purposes, while "non-charitable" corporations are all other corporations formed under the N-PCL. For charities incorporated prior to July 1, 2014, the following rules apply: types B and C and type D corporations with a charitable purpose will now be deemed charitable corporations, and type A corporations and type D corporations with a non-charitable purpose will be non-charitable corporations.

Second, where previously any nonprofit whose certificate of incorporation made any reference to education or training was required to receive consent from the State Department of Education prior to incorporation, under the Act, those nonprofits need now only provide notice to the Department of Education. This change should help to streamline the incorporation process and eliminate a burdensome and time-consuming step.

Applicability to Foreign Entities

As discussed above, the Act works significant changes on the operations and governance structure of nonprofit corporations and charitable trusts formed under the laws of New York State. Provisions that relate to governance, e.g., the related party transaction provisions, almost certainly would not apply to foreign organizations (those formed in states other than New York and doing business here). It is less clear whether any of the provisions of the Act relating to the manner in which foreign organizations carry out their operations, e.g., whistle-blower protections, will be deemed applicable to foreign organizations.

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