Non-Profit Revitalization Act of 2013: Corporate and Governance Changes and Implications

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Summary

• Non-Profit Revitalization Act of 2013 ("NPRA") effective July 1, 2014

• Significant governance changes:
  – Audit committee with “independent directors” required
  – Substantial new “related party transactions” rules (revising existing conflicts rules)
  – Required written conflicts policy and whistleblower policy
  – Electronic action authorized for some governance documents

• Significant transactional changes:
  – Simplified state consents and approvals for mergers, asset transactions, dissolutions, etc.
  – Simplified classification ("charitable" and “non-charitable”) and incorporation

• Significant reporting changes:
  – Charities Bureau review and audit thresholds increased

• Recent developments:
  – Questions emerging from nonprofit community about scope and application of conflicts and audit rules
  – Bills introduced in Legislature to postpone or repeal some changes
I. Audit Changes

• New audit committee:
  – Oversee accounting and financial processes
  – Retain auditor
  – Work with auditor to plan audit
  – Review results of audit and management letter
  – Review auditor independence and performance
  – Review related party transactions (conflicts of interest)
• Composed of at least 3 “independent directors” on committee
• No non-directors on committee
Independent Director Test

• Employment of Director:
  – Not employed by corporation or affiliate (if any) in last 3 fiscal years
  – “affiliate” means entity controlled by or under common control with corporation
    • “Control” not defined

• Other compensation of Director:
  – Not paid >$10,000 in direct compensation (e.g., as contractor) in any of last 3 fiscal years by corporation or affiliate
Independent Director, cont’d

• Director not “current employee” of (nor have “substantial financial interest” in) an entity that:
  – Received OR was paid lesser of $25,000 or amount equal to 2% of such entity’s gross revenues in any of last 3 FY’s
• “Substantial financial interest” not defined
Independent Director, cont’d

• “Relatives” of Director also must be checked:
  – Spouse/domestic partner
  – ancestors
  – siblings, grand- and great-grandchildren, and spouses of same

• Test for Relatives:
  – not “Key Employee” of corporation or affiliate in last 3 FY’s
  – Not paid >$10,000 in direct compensation (e.g., as contractor) within last 3 fiscal years by corporation or affiliate
  – Not a current officer of, and does not have a “substantial financial interest” in, entity referred to in preceding slide
Review/audit reporting changes

• For organizations required to file reviews or audits with Charities Bureau
• Review threshold goes to $250,000 on July 1
• Audit threshold goes to:
  – $500,000 on July 1, 2014;
  – $750,000 on July 1, 2017;
  – $1,000,000 on July 1, 2021
• Takes effect for filings due after above effective dates, per Charities Bureau guidance
• AG may require audit within 120 days even if nonprofit is below threshold (but above $250,000)
• Query whether some funders will still require audit even if below above thresholds
II. Related Party Transactions

• “Related Party Transactions” must be approved by board or audit committee
• Independent directors required for approval
• Definition of “Related Party”:
  – Director, officer or “Key Employee” of corporation or affiliate, and Relatives of same
    • “Key employee”: “any person who is in a position to exercise substantial influence over the affairs of the corporation” under IRS rules
    • Can include “substantial contributors”
  – Entity in which any of above persons has 35% or greater “ownership or beneficial interest”
Related Party Transaction: Definition

- “Related Party Transaction”:
  - Any “transaction, agreement or other arrangement”
    - Between corporation or affiliate and any third party
    - In which a Related Party has a “financial interest”

- Omitted in new statute:
  - New rule by its language does not apply to mere overlapping director, officer, or key employee of both corporation and third party where such person does not have financial interest in transaction between corporation and third party, unlike current law
Related Party Transaction: Review

- Board or committee of independent directors must review and approve transaction
- Standard: “fair, reasonable and in best interests” of corporation
- If related party has “substantial financial interest,” must also consider “alternative transactions to extent available”
- Document basis for approval
- Related Party must not participate in review process except to provide information
- Note: above is similar to approval process in parallel IRS “excess benefit” rules except for independent director requirement
Related Party Transactions: Consequences

• Attorney General may seek court order to:
  – Account for and repay profits of transaction
  – Void transaction for any violation of statute
  – Recover or repay improper benefits or value of use of property
  – Recover double amount owed if wilful and intentional conduct to obtain improper benefit

• Violation not necessarily just improper benefit. Could include failure to approve transaction.

• Contrast IRS “excess benefit” rules, under which organization can demonstrate transaction is reasonable even if not approved in advance
Related Party Transactions: Action

• **Action Item:**
  – Adopt written Conflict of Interest Policy consistent with statute
  – Familiar element: annual certification for directors
  – Note: Policy will apply to Key Employees as well as directors and officers.
  – After adoption, distribute new policy and collect certifications

• **Action Item:**
  – Identify “Related Parties” and “Related Party Transactions”
  – Review transactions to identify whether subject to new rules
  – Careful application of rules needed re above
  – Collect necessary information and submit transactions to board for ratification
III. Whistleblower Policy

• Widely publicized new requirement
• But policy required only if corporation has $ \geq 20 \text{ employees and } > $1,000,000 \text{ revenues in preceding FY}
• Note: if corporation receives funds from NYS, new “NYS Grants Gateway” has many specific policy requirements
• Action item: adopt or revise policy if required.
IV. Electronic action changes

- NPRA permits electronic mail for board (or member) meeting notices and waivers and unanimous written consents
  - Note: e-mail or fax are the only electronic means permitted for same. Thus, for example, DocuSign cannot be used.
  - Member proxies may also be authorized by e-mail
- Arguably this narrows current State Technology Law and federal Electronic Signatures in Global and National Commerce Act
- NPRA also permits video conferencing in addition to telephone conferencing for board or committee meetings
- **Action item**: amend relevant provisions of bylaws to incorporate new requirements
VI. Committee changes

• Relatively minor changes to committees
• “Standing” and “special” distinctions eliminated for board committees
• Majority of entire board must establish board committees (no appointment by President)
• “Committees of the corporation” cannot “bind board”
• Action item: add or revise committee provisions
VII. Officer change

• Employee cannot be the board chair (or equivalent office) effective 1/1/2015

• Bill introduced to repeal same
  – Some organizations, such as some churches, have internal requirements that may be inconsistent (e.g., pastor chairing board)
  – Difficult to say chance of success

• Note: this is perceived as a “good governance” issue
VIII. Transaction changes: real estate

• Board vote on real estate simplified.
• Old rule: 2/3 of entire board must approve every mortgage, lease, sale, “other disposition.”
• New rule: majority of entire board unless more than 21 directors or transaction is sale, lease, or other disposition of “all or substantially all” assets
Transaction changes: court and Attorney General approvals

- Transactions: sales of substantially all assets; mergers/consolidations; amendments of purposes; dissolution
- Old rule (in most cases): court approval upon notice to Attorney General
- New rule (in most cases): choice of court approval (upon notice to AG) or Attorney General approval
Transaction changes: agency consents

• In addition to court or AG approval for above transactions, some state agencies required to approve transactions (including incorporations) implicating their jurisdiction
• Education Dept was most commonly required consent
• Simplified now to notice to Educ. Dept. after filing is made
IX. Corporate structure changes: Types

• Old rule: four “Types:
  – Type A: civic, social, trade associations, etc.
  – Type B: corresponds to charitable
  – Other types created confusion and legal issues, e.g., Type C (“lawful business purpose” for “lawful public objective”)

• New rule:
  – Just “charitable” and “non-charitable”
  – Type C language gone
  – Charitable corresponds to current Type B
Corporate structure changes: incorporation

• New rule: permissible to form corporation for any charitable or non-charitable purpose (Senate Bill 6249 signed recently as part of technical amendments to NPRA)

• Also permissible to include statement that no agency consents are required

• Should both simplify and speed up incorporations, put NY in step with other states
X. Other issues

• Lack of guidance from Charities Bureau on governance and transaction changes
  – Bureau reportedly working on guidance

• Whether legislature will revisit independent directors, related party transactions, and other governance changes
  – Trade groups are raising issues with new law
  – Bills introduced to delay or repeal some changes

• Significant proposals not adopted:
  – Clause protecting directors from monetary liability for non-intentional fiduciary duty breaches
    • long permitted for NY business corporations and business and nonprofit corps in other states
  – Elimination of agency consent process (defer to regulatory laws instead)