Amendments to the New York Non-Profit Revitalization Act

SUMMARY

On November 28, 2016, Governor Cuomo signed into law Assembly Bill A10365B (the “Amendment”), which amended the New York Not-for-Profit Corporation Law (the “N-PCL”) and Estates Powers & Trusts Law (the “EPTL”) in order to simplify and improve non-profit governance and oversight. Most provisions of the Amendment are effective May 27, 2017. The Amendment comes three years after the New York Non-Profit Revitalization Act of 2013 (the “NPRA”), which introduced substantial changes to the laws governing non-profits, and the Amendment makes some refinements to changes enacted by the NPRA. This memorandum discusses key aspects of the Amendment with respect to the corporate governance and oversight of New York charitable corporations and trusts.

Specifically, the Amendment revises the prohibition on an employee serving as board chair, revises the concept of “independent” directors and trustees, and modifies the law regarding related party transactions. The Amendment also introduces a concept of “key persons” – expanding the previously more limited concept of “key employees.” Certain changes have also been made to the requirements for adoption of Conflict of Interest and Whistleblower Policies.

CHANGES AFFECTING GOVERNANCE

Board Governance

Previously, the NPRA had included a blanket prohibition on any employee of a non-profit corporation “serv[ing] as chair of the board or hold[ing] any other title with similar responsibilities.” The Amendment relaxes this prohibition by allowing an employee to serve as chair if the board approves such employee’s serving as chair of the board by a two-thirds vote of the entire board and memorializes the basis of such approval in writing. This provision took effect on January 1, 2017.

Board Committees

The Amendment loosens the requirements for the creation of a committee of the board of a non-profit corporation to allow creation of a committee by a majority of the directors present at a meeting instead of the previously higher threshold of action by a majority of the entire board. Also, under the Amendment,
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the by-laws may provide that directors who hold certain positions in the corporation shall be ex officio members of committees by virtue of their positions. However, the appointment of members of an executive committee still requires action by a majority of the entire board, except in the case of a board with more than thirty members, in which case at least three-quarters of the board members present (provided that there is a quorum) are required.

The Amendment also expands the list of actions that committees may not take on the board’s behalf. In addition to previously prohibited actions, the following may not be delegated to any committee of the board: (i) the election and removal of officers, (ii) the approval of a plan of dissolution or merger, (iii) the adoption of a resolution recommending to the members, or if there are no members, approving, the sale, lease, exchange or other disposition of substantially all of the organization’s assets, and (iv) the approval of amendments to the certificate of incorporation.

Independent Directors and Trustees

The NPRA introduced the concepts of “independent directors,” “independent trustees” and “key employees” in the context of whether such directors, trustees, or key employees of the organization have certain relationships, or engage in certain transactions, with the organization; only independent directors, trustees, and key employees were qualified to serve on the audit committee or perform certain oversight functions. The Amendment broadens the category of directors, trustees, and other persons who may qualify as independent by narrowing the list of transactions with the organization or its affiliates which disqualify a director, trustee, or other person from being “independent,” graduating the threshold value of those transactions which disqualify as follows: (i) the lesser of $10,000 or 2% of consolidated gross revenue for organizations with consolidated gross revenue less than $500,000, (ii) $25,000 for organizations with consolidated gross revenue of at least $500,000 but less than $10,000,000, and (iii) $100,000 for organizations with consolidated gross revenue of $10,000,000 or more.

In addition, the Amendment replaces the term “key employee” (which is used in the provisions relating to independent directors and trustees, as well as conflicts of interest and related party transactions) with the term “key person,” modifying and expanding the definition of the term to include any person other than a director, trustee, or officer, whether or not an employee of the organization, who (i) has responsibilities, or exercises powers or influence over the organization as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the organization, or a segment of the organization that represents a substantial portion of the activities, assets, income, or expenses of the organization; or (iii) alone or with others controls or determines a substantial portion of the organization’s capital expenditures or operating budget. The N-PCL and the EPTL will now use a more practical approach to determining independence based on function, rather than title.
RELATED PARTY TRANSACTIONS

Under the NPRA, related party transactions\(^1\) were defined and restricted, with the implementation of enhanced review and approval requirements for related party transactions involving a non-profit corporation or trust in which a related party has a substantial financial interest. The Amendment clarifies the definition of related party transactions by expressly carving out from it (i) *de minimis* transactions,\(^2\) (ii) transactions that “would not customarily be reviewed by the board or boards of similar organizations in the ordinary course of business” which are available to others on similar terms, and (iii) transactions in which the related party receives a benefit solely as a function of being a member of the class of persons that the organization seeks to benefit as part of its mission. With these narrower parameters, non-profits may be able to operate more efficiently in routine matters without observing the requirements applicable to related party transactions introduced under the NPRA.

With respect to the procedures for review or approval of related party transactions, the Amendment clarifies that a related party transaction may be approved in advance either by the board or an authorized board committee. In addition, the Amendment implements a mechanism for ratification of related party transactions not approved in advance. In any action by the attorney general with respect to a related party transaction that does not satisfy the advance approval requirements of the NPRA, the fact that “the transaction was fair, reasonable and in the [organization]’s best interest at the time” will be a defense to such action if, prior to receiving any request for information by the attorney general, the board or committee had: (A) ratified the transaction by majority vote after finding in good faith that it was fair, reasonable, and in the organization’s best interest and having considered alternative transactions; (B) documented the nature of the violation and the basis for its ratification; and (C) put into place procedures to ensure that, going forward, the organization complies with the related party transaction advance approval procedures.

POLICIES

The NPRA required the audit committee or another committee of independent directors or trustees, or if no such committee is so authorized, the board, to oversee the adoption of and compliance with conflict of interest and whistleblower policies. However, the audit oversight provisions introduced under the NPRA do not apply to all non-profit corporations and charitable trusts that must adopt conflict of interest and whistleblower policies. Moreover, the Directors responsible for such adoption and compliance need be

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1 Under the N-PCL, a related party transaction is defined as “any transaction, agreement, or any other arrangement in which a related party has a financial interest and in which the corporation or any affiliate of the corporation is a participant.” Under the EPTL, a related party transaction is defined as “any transaction, agreement or any other arrangement in which a related party has a financial interest and in which the trust or any affiliate of the trust is a participant.”

2 The term “*de minimis*” is not defined in the Amendment or the N-PCL generally.
only disinterested, not independent, directors or trustees. The Amendment clarifies that the audit function is the responsibility of the board, which may be delegated to an authorized committee of the board.

**Conflict of Interest Policy**
The NPRA required that organizations adopt a conflict of interest policy meeting certain requirements. The Amendment requires that such policies, in addition to providing procedures for disclosing conflicts of interest, should also provide procedures for the board or a committee to discover whether conflicts of interest exist and, therefore, requires disclosure both prior to initial election to the board and annually thereafter.

**Whistleblower Policy**
The Amendment strengthens the whistleblower policy protections required under the NPRA by specifying that directors and trustees who are employees may not participate in the administration of the whistleblower policy. Moreover, the subject of a whistleblower complaint is prohibited from attending or participating in board or committee meetings relating to the complaint (except, at the request of the board, to provide background or answer questions prior to any deliberation).

**COMMENTS**
Although the Amendment loosens some of the more restrictive requirements of the NPRA for certain non-profit organizations, organizations governed in compliance with the NPRA do not need to amend their by-laws. Some organizations nevertheless may wish to do so if greater flexibility on any of the amended issues is a priority. Charitable organizations to which the NPRA and Amendment apply may wish to re-examine their conflict of interest and whistleblower policies to ensure that they meet the new requirements of the Amendment. In addition, organizations subject to the N-PCL and/or EPTL should revise governance provisions to be consistent with the Amendment’s changes when next effecting changes to their by-laws.

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