

The Nonprofit Revitalization Act of 2013

On December 18, 2013, Governor Andrew M. Cuomo signed into law the Nonprofit Revitalization Act of 2013 (the "Act"), the first major revision to New York's nonprofit laws in over 40 years. Most provisions of the Act will take effect on July 1, 2014; a few provisions, as detailed below, will take effect in 2015, 2017, and 2021. The Act generally applies to nonprofit organizations (both corporations and trusts) formed in New York, but certain new audit and financial reporting requirements apply to all nonprofit organizations registered to make charitable solicitations in New York, regardless of their form or their state of formation.

This Alert summarizes key provisions of the Act. Nonprofit and charitable organizations should review their existing internal controls, by-laws, policies, and any committee charters to ensure compliance with the changes established by the Act. Specifically:

- All nonprofit organizations formed in New York must adopt a conflict of interest policy that conforms to the Act's requirements.
- All nonprofit organizations formed in New York which have twenty or more employees and over \$1 million in revenue must adopt a whistleblower policy.
- Corporate by-laws and charitable trust operating procedures must comply with new requirements regarding audit oversight matters and reviews of related-party transactions, with respect to which only "independent" directors or trustees may participate (as detailed below).
- Charities that solicit contributions within New York State are subject to changed reporting requirements.
- Nonprofit corporations should review their by-laws with respect to voting requirements, committees, and electronic communications (as detailed below).

Policies

Conflict of Interest Policy and Related Party Transactions

The Act requires that every New York nonprofit corporation and charitable trust adopt a conflict of

interest policy covering directors, trustees, officers and key employees. The policy must include: a definition of conflicts of interest; procedures for disclosing such conflicts; a requirement that the conflicted person not be present at or participate in deliberations regarding the conflict; a requirement to document the existence and resolution of conflicts; and procedures for disclosing and addressing related-party transactions. Prior to being elected and annually thereafter, each director or trustee must sign a written statement identifying any potential conflicts of interest known to such director.

The Act prohibits a nonprofit from entering into transactions with related parties or insiders unless the directors or trustees have determined that such transaction is fair, reasonable and in the organization's best interest. Related parties include directors, trustees, officers, key employees (and relatives thereof), affiliates of the organization, or any entity in which such an individual has a controlling interest. If a related party has a "substantial financial interest" in a contemplated transaction, the directors, the trustees, or an authorized board committee must consider alternatives to such transaction; approve the transaction by a majority vote of those present at the meeting; and document the basis for such approval.¹

The Act provides the Attorney General with authority to enjoin, void, or rescind improper related-party transactions or to seek additional damages or remedies.

Whistleblower Policy

The Act requires nonprofit entities with twenty or more employees and revenue in excess of \$1 million to adopt a whistleblower policy. The policy must include procedures for reporting and for the maintenance of confidentiality with respect to matters reported, and must be distributed to all directors, trustees, officers, employees and volunteers who provide substantial services to the organization.

Previously Adopted Policies

If an organization previously adopted a conflict of interest policy, or a whistleblower policy, that complies substantially with the requirements of the Act, it is deemed to be in compliance with the corresponding requirement.

Nonprofits Formed Outside New York

It is unclear whether these requirements regarding the conflict of interest and whistleblower policies are intended to apply to nonprofit organizations formed outside New York that carry on activities in New York. The Charities Bureau of the Attorney General's office has indicated its intention to issue guidance on this question.

Corporate Governance Changes Under the Act

Directors

Effective January 1, 2015, employees of a nonprofit corporation are expressly prohibited from serving as the chair of the board of directors or from holding any other title with similar responsibilities.

The Act adds the defined term "independent director" to the Not-for-Profit Corporation Law and the corresponding defined term "independent trustee" to the Estate Powers and Trusts Law. Only independent directors or trustees may participate in deliberations or voting with respect to specified financial oversight and audit matters.²

Committees

All committees of nonprofit corporations are now either committees of the board, comprised of only directors, or committees of the corporation, which may include directors and non-directors. Only committees of the board have authority to bind the board.

Modernization: Electronic Communication

The Act expressly permits the following types of communications to be transmitted by e-mail or fax: (i) notices of directors' and members' meetings and waivers of notice, (ii) directors' and members' unanimous consents, and (iii) authorization of members' proxies. Facsimile signatures are also expressly permitted. The Act also permits directors to "attend" board meetings via videoconferencing technology (such as Skype), so long as all participants can hear each other at the same time and each director can participate in all matters before the board. Finally, all nonprofits may now submit various filings, including registration forms and annual reports, to the New York State Attorney General's Charities Bureau by electronic means.

Streamlined Processes for Corporate Actions

Fundamental Corporate Actions

Under current law, nonprofit corporations must first seek the approval of the New York Supreme Court, and then notify the Attorney General, prior to taking certain fundamental corporate actions (the sale/lease/exchange/disposition of all or substantially all of a corporation's assets; a merger, consolidation, or dissolution; or a change in charitable purpose). Under the Act, they may seek approval directly from the Attorney General. The expedited process is not available in certain cases (for example, where the corporation is insolvent).

Real Property Transactions

Prior to the Act, a two-thirds vote of the board was required for a corporation to engage in purchases, sales, leases, mortgages, exchanges, or other dispositions of real property; under the Act, a simple

majority of the "entire board"³ or a committee authorized by the board is sufficient, except for transactions involving all or substantially all of the corporation's assets. No board approval is required for a lease of real property from a third party.

Financial

Annual Reporting Requirements

The Act raises the thresholds for certain reporting requirements applicable to New York nonprofits and non-New York nonprofits registered to solicit contributions in New York.⁴ Effective July 1, 2014, organizations with less than \$250,000 of gross revenue (formerly \$100,000) must file an unaudited financial report; organizations with between \$250,000 and \$500,000 of gross revenue (formerly between \$100,000 and \$250,000) must file an annual financial report accompanied by a review report of an independent certified public accountant;⁵ and organizations with more than \$500,000 of gross revenue (formerly \$250,000) must file an independent CPA's audit report in accordance with GAAP. For those organizations that are required to file an independent CPA's audit report, the board or an audit committee composed only of independent directors or independent trustees must oversee the accounting and financial reporting process, and the audit of the organization's financial statements. The Act imposes additional duties on the board or audit committee of organizations with annual gross revenue in excess of \$1 million.

Hughes Hubbard & Reed would be pleased to assist you in answering your questions about this new law and in complying with its requirements.

¹ The new state rules regarding conflicts of interest and transactions with related parties apply in addition to similar rules under federal tax law that continue to apply to nonprofit entities exempt from income taxes under Internal Revenue Code 501(c)(3). These rules impose sanctions on such entities for entering into transactions that provide improper benefits to private individuals. A full discussion of these rules (generally referred to as the "intermediate sanctions rules" with respect to public charities, and as the "self-dealing" rules with respect to private foundations) is outside the scope of this Alert.

² To qualify as independent, a director or trustee (i) must not be, and must not have been in the last three years, an employee of the organization or any of its affiliates; (ii) must not have received more than \$10,000 in direct compensation from the organization or any affiliate in any of the last three years; (iii) must not be a current employee of, and must not have a substantial financial interest in, any entity that has made payments to or received payments (excluding charitable contributions) from the organization or an affiliate for property or services in excess of a threshold amount; and (iv) must not have any relative who is described in (i), (ii) or (iii).

³ The "entire board" means the total number of directors entitled to vote if there were no board vacancies.

⁴ Additional increases in these monetary thresholds will take effect on July 1, 2017 and again on July 1, 2021.

⁵ The Attorney General has the authority to require an organization to file an independent CPA's audit report, regardless of the organization's revenue.

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April 2014



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