

HEALTH LAW

Expert Analysis

Revising the 2013 Reforms To The Not-For-Profit Corporation Law

In 2013, the New York State Legislature enacted and Gov. Andrew Cuomo signed into law the Non-profit Revitalization Act¹ (NRA), the most extensive set of revisions to the Not-for-Profit Corporation Law (NPCL) in more than 40 years. We summarized those revisions in an earlier Health Law column.² While the NRA provided many needed improvements to the NPCL, it also created a few problems for not-for-profit organizations. The NRA was amended twice in 2015,³ among other things to extend to Jan. 1, 2017 the effective date of the prohibition on an employee serving as the chair of the board of directors of a not-for-profit corporation; to amend the definitions of “independent director,” “related party,” “key employee,” and other terms; and to clarify provisions related to approval of board member compensation, board quorums, board committees, and participation in board meetings where related party transactions are considered.

The 2015 amendments, while helpful, neither accomplished all

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of the NRA’s goals, nor resolved all of the obstacles to compliance by not-for-profit organizations with the NRA. Accordingly, the Legislature

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enacted more extensive revisions to the NRA, which were signed into law by Governor Cuomo on Nov. 28, 2016⁴ (amendment).

Definitions

The amendment changes the term “key employee” in NPCL §102(a)(25) to “key person” and revises the definition to mean any person other than a director or officer, whether or not an employee of the

corporation, who (i) has responsibilities, or exercises powers or influence over the corporation as a whole similar to the responsibilities, powers, or influence of directors and officers; (ii) manages the corporation, or a segment of the corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a substantial portion of the corporation’s capital expenditures or operating budget.⁵

The amendment revises the definition of “independent director”⁶ to a key person (or relative) who does not have a substantial financial interest in any entity that has provided to or received from the not-for-profit organization (or affiliate) payments, property or services if the amount paid or received in the last three years exceeded:

- The lesser of \$10,000 or 2 percent of the not-for-profit organization’s consolidated gross revenue if such revenue was less than \$500,000; or
- \$25,000 if the not-for-profit organization’s consolidated gross revenue was \$500,000 or more but less than \$1,000,000; or

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- \$100,000 if the not-for-profit organization's consolidated gross revenue was \$10,000,000 or more.

Board Committees

The NRA enacted in 2013 spelled out the requirements for the creation of an executive committee and other committees, and prohibited committees from taking certain actions (filling vacant board seats, amending bylaws, etc.) that are within the exclusive purview of the full board. The amendment further specifies that the board must appoint all board committee members; and that the appointment of executive committee members must be made with the approval of the majority of the board, or in the case of a board with 30 members or more, by at least three-quarters of the directors present at the time, provided a quorum of the board is present.⁷ The amendment adds to the list of actions that are solely within the purview of the board and may not be taken by any committee:

- The election or removal of officers or directors;
- The approval of a merger or plan of dissolution;
- The adoption of a resolution recommending to the members action on the sale, lease, exchange or other disposition of all or substantially all of the assets of a corporation, or if there are no members entitled to vote, the authorization of such transaction; and
- The approval of amendments to the certificate of incorporation.⁸

Board Chair

One of the NRA's more controversial provisions was a prohibition on

any employee of the not-for-profit organization serving as its board chair or holding any other title with similar responsibilities. The amendment revises this outright prohibition, and requires instead that any employee serving as board chair must be approved by a two-thirds vote of the entire board, and may not be considered an independent director. The board must also contemporaneously document in writing the basis for the board's approval of having an employee serve as board chair.⁹ It is important to note that these changes took effect on Jan. 1, 2017.

Related Party Transactions

The amendment modifies the definition of "related party transaction" to exclude a transaction or financial interest that is de minimis; a transaction that would not customarily be reviewed by the board of the not-for-profit organization or boards of similar organizations in the ordinary course of business and that is available to others on the same or similar terms; and a transaction that "constitutes a benefit provided to a related party solely as a member of a class of the beneficiaries that the corporation intends to benefit as part of the accomplishment of its mission which benefit is available to all similarly situated members of the same class on the same terms."¹⁰

In addition to the board, the amendment permits an authorized board committee to determine if a related party transaction is fair, reasonable and in the best interest of the not-for-profit organization,¹¹ and to approve it. The amendment also creates defenses to challenges

to related party transactions. In the case of challenges by private individuals or entities, the amendment creates a defense to a claim of violation of the NPCL's provisions governing related party transactions if the transaction was "fair, reasonable and in the corporation's best interest at the time the corporation approved the transaction."¹²

In the case of a challenge by the attorney general to a related party transaction not approved in accordance with NPCL §715(a) or (b), the amendment creates a defense if:

1. The transaction was fair, reasonable and in the corporation's best interest at the time the corporation approved the transaction; and
2. Prior to receipt of any request for information by the Attorney General regarding the transaction, the board has:

A) Ratified the transaction by finding in good faith that it was fair reasonable and in the best interests of the corporation at the time it was approved;

B) If the related party transaction involves a charitable not-for-profit organization and the related party has a substantial financial interest in the transaction, the board considered alternative transactions to the extent available, and approved the transaction by not less than a majority vote of the directors or committee members present at the meeting; and

C) Documented in writing the nature of the violation and the basis of the board's or committee's ratification of the transaction; and

D) Put into place procedures to ensure that the corporation

complies with the NPCL's provisions regarding related party transactions in the future.¹³

Conflicts and Whistleblowers

The amendment revises the requirement that a not-for-profit organization have a conflict of interest policy to place direct responsibility on the board not only to adopt but also to oversee the implementation of the not-for-profit organization's compliance with the conflict of interest policy.¹⁴ To the requirement that the not-for-profit organization have in place procedures for disclosing a conflict of interest it adds "or possible conflict of interest"; adds a requirement that such disclosure can be made either to the board or a board committee; and mandates that the not-for-profit organization have in place procedures for the board or committee to determine whether a conflict of interest exists.¹⁵

To the existing requirement that a not-for-profit organization with more than 20 employees or more than \$1 million in annual revenue have a policy in place to protect whistleblowers from retaliation, the amendment places direct responsibility on the board not only to adopt but to "oversee the implementation of, and compliance with" the whistleblower policy.¹⁶ To the requirement that an employee, officer or director of the not-for-profit organization be designated to administer the policy the amendment adds that the whistleblower policy must include a requirement that the conflict be reported to the board or authorized board committee, and prohibits board members who are employees from participating in "any board or committee

deliberations or voting relating to administration of the whistleblower policy."¹⁷ The amendment further requires that the whistleblower policy contain a requirement that the subject of a whistleblower complaint "not be present at or participate in board or committee deliberations or vote on the matter relating to such complaint ..." but allows the board or committee to request that such subject present information or

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answer questions prior to the commencement of deliberations or voting relating to how the complaint will be handled.¹⁸

Effective Date

Except for the provisions affecting an employee who serves as board chair, which as mentioned earlier, took effect on Jan. 1, 2017, the rest of the amendment's provisions take effect on May 27, 2017.

EPTL Revisions

The amendment makes many of these changes applicable to corresponding provisions in the Estates, Powers and Trusts Law.

Conclusion

Since the enactment and implementation of the 2013 NRA, not-for-profit organizations and their

boards have had to make significant revisions to their corporate documents and to their operating policies and procedures. The amendment will require further revisions to these documents, as well as further orientation of board members, officers, management and employees as to these new provisions and their implementation. Not-for-profit organizations, particularly in the health care industry, are grappling with many important legal, financial, and operational challenges. Nonetheless, most of these new requirements take effect in a little over four months, and it is advisable to make compliance with them a priority.

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1. Chapter 549 of the Laws of 2013.
2. Francis Serbaroli, "Major Changes to Not-for-Profit Law Impact Health Care Sector," 251 NYLJ No. 18, Jan. 28, 2014, p. 3.
3. Chapters 388 and 555 of the Laws of 2015.
4. Chapter 466 of the Laws of 2016.
5. NPCL §102(a)(25).
6. NPCL §102(a)(21).
7. NPCL §712(a).
8. *Id.*
9. NPCL §713(f).
10. NPCL §102(a)(24).
11. NPCL §715(a).
12. NPCL §715(i).
13. NPCL §715(j).
14. NPCL §715-a(a).
15. NPCL §715-a(b)(2).
16. NPCL §715-b(a).
17. NPCL §715-b(b)(2).
18. NPCL §715-b(b)(3).