

NEW YORK CORPORATION LAW



Supplement to 2018 Edition

Instructions: Attach this Supplement to the inside of the back cover of your copy of *New York Corporation Law 2018 Edition*.

Currency of Laws: This Supplement updates *New York Corporation Law 2018 Edition* with amendments to the Not-for-Profit Corporation Law that were enacted during the remainder of the 2017 Legislative Session subsequent to publication of the main volume (main volume current through Laws 2017, ch. 402, signed Oct. 23, 2017). Additional information is also included. As updated with the amendments to the Not-for-Profit Corporation Law contained in this Supplement, the text of the Business Corporation Law, Limited Liability Company Law, Not-for-Profit Corporation Law, and Selected Statutes in *New York Corporation Law 2018 Edition* is current through Laws 2018, ch. 3 (signed March 2, 2018).

Feature Article: This Supplement also includes a Feature Article entitled “Around the Block with the N-PRA”, providing in-depth discussion and analysis of the Non-Profit Revitalization Act of 2013 (“N-PRA”).



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**Table of Sections Affected by
Legislation Subsequent to Publication of Main Volume
(through L. 2018, ch. 3, signed March 2, 2018)***

Law/Section	Amendatory Legislation	Date
N-PCL § 404, par (i) amended	L 2017, ch 405, § 2	Eff 120th day [03/11/2018] after becoming law [became law 11/11/2017], as provided L 2017, ch 405, § 3.
N-PCL § 1502, pars (r), (s), added	L 2017, ch 442, § 1	Became law 11/29/2017, eff immediately, as provided L 2017, ch 442, § 3.
N-PCL § 1513-a, pars (d), (f), amended; pars (i) thru (l), added	L 2017, ch 442, § 2	Became law 11/29/2017, eff immediately, as provided L 2017, ch 442, § 3.

* This Supplement also sets forth sections additional to those listed in the table. The additional sections are included for reasons other than amendments enacted after publication of the main volume, e.g., to provide supplemental information concerning effective dates of certain amendments.

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**New York Corporation Law
(Whitebook)
Supplement to 2018 Edition
FEATURE ARTICLE**

Around the Block with the N-PRA

*By Shveta Kakar and Dan Kurtz**

*** About the Authors**

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Further, Dan represents nonprofit clients in litigation matters, particularly those involving issues of governance and fiduciary responsibility. He has conducted numerous internal investigations and handled litigations brought by civil enforcement and regulatory authorities, playing a key role in many groundbreaking cases in this area.

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§ 1 Introduction to the N-PRA

The Non-Profit Revitalization Act of 2013 (“N-PRA” or the “Act”), which has been characterized as the most sweeping legislation to affect nonprofit organizations in New York in over 40 years, was signed into law on December 18, 2013.¹ Most of the provisions became effective on July 1, 2014.² The N-PRA amends certain provisions of the New York Not-for Profit Law (“N-PCL”) and the Estates, Trusts and Powers Law (“EPTL”), and applies to New York nonprofit corporations, and, in certain cases, to New York charitable trusts, New York education corporations, and New York religious corporations. Among the provisions and other amendments introduced by the N-PRA are:

- Provisions eliminating or otherwise reducing unnecessary and outdated burdens, such as the elimination of the four different types of nonprofit corporation (i.e., A, B, C, and D).
- Elimination of the requirement that certain nonprofit corporations obtain the advance approval of the State Education Department prior to incorporation.
- Provisions enhancing governance and oversight, and provisions reducing unnecessary and outdated burdens.
- Provisions easing voting requirements for real estate transactions.
- Provisions simplifying procedures for certain transactions, such as changing the purposes or powers set forth in the certificate of incorporation; asset sales; merger; consolidations; and dissolutions.
- Introduction of new corporate governance standards, including the required adoption of a conflict of interest policy and adoption of a whistleblower policy.
- Guidelines regarding related party transactions.
- Provisions enhancing the Attorney General’s enforcement authority.
- Provisions mandating board oversight of the auditing process.

¹ L. 2013, ch. 549 (Dec. 18, 2013).

² L. 2013, ch. 549, § 132 (Dec. 18, 2013).

- Provisions increasing regulation and oversight of employees, officers, and directors.

§ 2 Examination of the N-PRA Provisions

[1] Provisions Eliminating or Reducing Unnecessary and Outdated Burdens

Traditionally the purposes for which nonprofits could be formed were categorized functionally or economically.³ The functional approach enumerates the purposes for which nonprofit corporations can be formed or activities in which they can engage.⁴ A problem with the functional approach is that the functional categories are necessarily incomplete and ambiguous. A second approach, the economic approach, permits the nonprofit corporation to be formed for any lawful purpose other than bestowing profit or pecuniary benefit on members, officers, or directors unless a more limited purpose is set forth in the certificate of incorporation.⁵ The economic approach encompasses the non-distribution constraint, and the prime issue is how to identify profit. A third classification system, adopted by California, divides nonprofits on the basis of organizational purpose: public benefit corporations (traditional charities), mutual benefit corporations (private associations or social clubs), and religious corporations (a catch-all category to avoid First Amendment problems).⁶ New York adopted a hybrid economic and functional approach: “Not-for-profit” accents the nonprofit-seeking character of New York nonprofits though such an organization can be formed for a business, but not a profit-seeking,

³ Note, *New York's Not-for-Profit Corporation Law*, 47 N.Y.U. L. Rev. 761, 767–768 (1972).

⁴ Purposes typically included charitable, social, government, religious, and scientific. Note, *Permissible Purposes for Nonprofit Corporations*, 51 Colum. L. Rev. 889, 890–92 (1951).

⁵ Model Nonprofit Corporation Act (3rd ed. 2008) § 3.01(a); Note, *New York's Not-for-Profit Corporation Law*, 47 N.Y.U. L. Rev. 761, 768; 6 White, *New York Business Entities* ¶ N201.02 (14th ed. 2017).

⁶ The California approach was adopted by the Model Nonprofit Corporation Act (2d ed. 1987), but was not retained by the Model Nonprofit Corporation Act (3d ed. 2008).

purpose.⁷

Until the effective date of the majority of the provisions of the N-PRA on July 1, 2014, there were four different “types”⁸ of corporations⁹ formed under the N-PCL, each “type” designated by the letters A,¹⁰ B,¹¹ C,¹² and D.¹³ All of those types of corporations were

⁷ Note, *New York's Not-for-Profit Corporation Law*, 47 N.Y.U. L. Rev. 761, 774; Revisers' Notes, § 204.

⁸ Until July 1, 2014, N-PCL § 201 provided for classification of not-for-profit corporations into four types (A, B, C, and D), all of which were subject to different degrees of state regulation.

⁹ A “corporation” or “domestic corporation” as defined in N-PCL § 102(a)(5) must meet two tests: (1) it must be formed under the N-PCL, or exists on its effective date and was formed under any other general statute or by any special act of New York State, exclusively for a purpose or purposes, not for pecuniary profit or financial gain, for which a corporation may be formed under the N-PCL, and (2) no part of its assets, income, or profit of which is distributable to, or enures to the benefit of, its members, directors, or officers except to the extent permitted under N-PCL.

¹⁰ Type A corporations were intended to encompass the usual membership-type organization, such as a social club, where the support of the organization was derived from a limited class called “members” and where the non-pecuniary benefits flow primarily to this limited class. They could be formed for any lawful non-business purpose.

¹¹ Type B corporations were traditional charities as developed by common law and the most strictly regulated. They were a class limited to one or more of a specified list of non-business purposes: charitable, educational, religious, scientific, literary, cultural, or for the prevention of cruelty to children or animals. The benefited group is the public or some broad segment of it. Therefore, an organization that benefited to a limited number of people would not be granted Type B status. For example, in the case of *In re Howard Beach Appeal Fund, Inc.*, 141 Misc. 2d 735, 534 N.Y.S.2d 341 (Sup. Ct. 1988), the purpose of a proposed Type B not-for-profit corporation was to pay for the legal expenses of three individuals who were convicted of crimes. The Supreme Court of the State of New York denied approval because the proposed corporation was intended for the specific benefit of the three named persons. Additionally, there was no provision for using any portion of funds for benefit of the public or any class of the public, so the purposes could not be characterized as charitable. The Type B classification was justifiably criticized as vague, as are the principles of I.R.C. § 501(c)(3) on which purportedly it was based. See Henry Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. Pa. L. Rev. 497, 531 (1980).

¹² Type C corporations could be formed for any lawful business purpose to achieve a lawful public or quasi-public objective. The Type C category was created to fill the gap that existed in the former New York corporate statutes by permitting a not-for-profit corporation to be formed to conduct a lawful business purpose. The

subject to different degrees of state regulation. As of July 1, 2014, each corporation formed under the N-PCL is now designated as either a charitable corporation or a non-charitable corporation.¹⁴

The terms “charitable corporation” and “non-charitable corporation” are defined in N-PCL § 102(a). A charitable corporation means any corporation, formed or previously formed, for charitable purposes.¹⁵ Charitable purposes are purposes contained in the certificate of incorporation that are charitable, educational, religious, scientific, literary, cultural, or for the prevention of cruelty to children or

corporation had to meet the requirements of the definition of “not-for-profit corporation” in N-PCL §§ 102(a)(5) and (10), which required that the purposes be non-pecuniary and that there be no flow-through to individuals except as permitted in the statute. This meant that even though the corporation was formed for a purpose normally carried on by businesses, its objective was other than making money. Type C corporations were used for community development and anti-poverty corporations. The Type C category was criticized for its ambiguity. For example, what would happen to organizations formed for a business purpose that did not meet the requirement of having a “public or quasi-public objective?” And what did “business purpose” mean? Did it refer to activities conducted normally by for-profit firms, the motivation of the nonprofit, or the relationship of the organization’s customers or purchasers of the entrepreneurial activity? The statute did not render assistance in answering these questions. Some organizations that considered themselves Type B were reclassified by the Department of State as Type C and vice versa.

¹³ Type D corporations were connectors to other statutes that governed nonprofits. A Type D corporation was a not-for-profit corporation that could be formed under the N-PCL if and when authorized by any other corporate law of the state for any purposes specified by such law and subject to the provisions of the other law. This permitted the use of the N-PCL as the basic law for such matters as internal governance, financial powers, or dissolution for the special provisions particular to a certain type of not-for-profit corporation and eliminated the necessity of including in the special law all the general provisions found in a full-blown corporate statute. Type D corporations were regulated as strictly as Type B corporations, unless otherwise provided in the laws authorizing their formation. Type D corporations were sometimes authorized by other statutes for any business or nonbusiness, or pecuniary or nonpecuniary, purposes specified by the other law, whether or not such purposes were also within Types A, B, and C. Typical Type D corporations were certain religious or private housing finance corporations. *See* N.Y. Priv. Hous. Fin. Law § 573, amended L. 2013, ch. 549, § 121(2014).

¹⁴ N-PCL § 201(a).

¹⁵ N-PCL § 102(3-a).

animals.¹⁶ A charitable corporation may elect to have or not have one or more classes of members, provided that such election is set forth in either the charitable corporation's certificate of incorporation or by-laws.¹⁷

A non-charitable corporation means any not-for-profit corporation, other than a charitable corporation, including but not limited to one formed for any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, or animal husbandry, or for the purpose of operating a professional, commercial, industrial, trade, or service association.¹⁸ A non-charitable corporation must have one or more classes of members and the provisions regarding such class(es) of members must be set forth in either the certificate of incorporation or the by-laws of the non-charitable corporation.¹⁹ A non-charitable corporation is subject to less regulation from the state because most exist for the mutual benefit of its members, who presumably can monitor organizational affairs in some ways analogous to shareholders of the business corporation and these types of organizations have less contact with the public.²⁰ There are statutorily listed exceptions to the lesser regulation. Some non-charitable corporations require approvals or consents. These include

¹⁶ N-PCL § 102(a)(3-b).

¹⁷ N-PCL § 601(a) ("A corporation shall have one or more classes of members, or, in the case of a charitable corporation, may have no members, in which case any such provision for classes of members or for no members shall be set forth in the certificate of incorporation or the by-laws. Corporations, joint-stock associations, unincorporated associations and partnerships, as well as any other person without limitation, may be members.").

¹⁸ N-PCL § 102(9-a).

¹⁹ N-PCL § 601(a) ("A corporation shall have one or more classes of members, or, in the case of a charitable corporation, may have no members, in which case any such provision for classes of members or for no members shall be set forth in the certificate of incorporation or the by-laws. Corporations, joint-stock associations, unincorporated associations and partnerships, as well as any other person without limitation, may be members.").

²⁰ The shareholder analogy can be seen on dissolution. N-PCL § 1005(b)(3)(B), which permits upon dissolution assets to be distributed to members after holders of certificates of subvention and capital certificates have been satisfied, and N-PCL § 502(d), which permits members' certificates to be transferable to other members upon specified terms and conditions.

chapters of the American Legion;²¹ associations of insurance agents, brokers, and underwriters;²² associations promoting savings banks or life insurance;²³ labor organizations;²⁴ political parties;²⁵ trade and business associations;²⁶ and YMCAs.²⁷ Several special act corporations in Article 14 of the N-PCL have been statutorily classified as non-charitable corporations. They include alumni corporations,²⁸ boards of trade and chambers of commerce,²⁹ and medical societies.³⁰ Agricultural and horticultural corporations are statutorily classified as non-charitable corporations except if they have received money from the state, have acted as agent for the state in disbursing monies from the state, or have acquired real property by condemnation; then, they become charitable corporations.³¹

A nonprofit corporation formed prior to July 1, 2014 is not required to amend its certificate of incorporation to conform to the new categories, rather: (i) N-PCL § 201(b) provides that a former Type A corporation will be deemed to be a non-charitable corporation; (ii) N-PCL § 201(c) provides that a former Type B corporation will be deemed to be a charitable corporation; (iii) N-PCL § 201(c) provides that a former Type C corporation will be deemed to be a charitable corporation; (iv) N-PCL § 201(d) provides that a Type D corporation formed for charitable purposes will be deemed to be a charitable corporation; and (v) N-PCL § 201(d) provides that a Type D corporation formed for non-charitable purposes will be deemed to be a non-charitable corporation. In addition, any corporation formed for

²¹ N-PCL § 404(n).

²² N-PCL § 404(l).

²³ N-PCL § 404(k).

²⁴ N-PCL § 404(j).

²⁵ N-PCL § 404(m).

²⁶ N-PCL § 404(a).

²⁷ N-PCL § 404(h).

²⁸ N-PCL § 1407(b).

²⁹ N-PCL § 1410(b).

³⁰ N-PCL § 1406(b).

³¹ If the corporation has not filed as a charitable corporation, upon receipt of monies, acting as agent, or acquiring property, it must amend its certificate. N-PCL § 1409(b).

both charitable purposes and non-charitable purposes will be deemed to be a charitable corporation for purposes of the N-PCL.³²

[2] Elimination of the Requirement that Certain Nonprofit Corporations Obtain Advance Approval of State Education Department Prior to Incorporation

Certain nonprofits which have educational purposes no longer must obtain approval of the Commissioner of Education but now only must submit to that commissioner a certified copy of the filed certificate of incorporation, within 30 days after the certificate is filed with the Department of State.³³

[3] Provisions Enhancing Governance and Oversight, and Provisions Reducing Unnecessary and Outdated Burdens

One of the major frustrations of the incorporation process prior to the enactment of the N-PRA was the idiosyncratic administration by the Department of State in its supposedly ministerial review of filings of documents. For example, though the N-PCL did not contain any provision requiring that a corporation list its activities in the certificate of incorporation, the Department of State required this to be included (presumably to determine the appropriate type, i.e., A, B, C, or D). With the N-PRA's elimination of the four different types, there was no justification for the Department of State to reject a certificate without such a description. In addition, in order to explicitly clarify that a nonprofit corporation is not required to include a list of its activities in the certificate of incorporation, the N-PRA introduced amended N-PCL § 402(a)(2) to confirm that the certificate of incorporation does not need to describe the activities the organization will engage in or otherwise state how the corporation's purpose will be achieved. In addition to imposing requirements that were not provided in the statute, the Department of State would also reject of a certificate for any mistake no matter how insignificant. Finally, the N-PRA now clarifies that the Department of State can correct any typographical or non-material error on the certificate prior to its filing without sending it back to the organization for correction and re-filing. See N-PCL §

³² N-PCL § 201(b).

³³ N-PCL § 404(d).

105(a). The Division of Corporations has indicated that, at this time, it is not equipped to make the corrections contemplated by revised N-PCL § 105(a).

[4] Provisions Easing Voting Requirements for Real Estate Transactions

The voting requirements for most real estate transactions are lowered from the two-thirds of the entire board threshold to a majority of the directors of the board or a majority of a committee authorized by the board. However, if the transaction involves the sale or purchase of all or nearly all of the organization's assets, the two-thirds of the entire board requirement remains. See N-PCL § 509. It is uncertain whether the phrase "majority of the board" means a majority of the entire board, a majority of directors in office, or a majority of directors at the meeting at which the vote takes place. If there are 21 or more directors, then approval of a majority of the entire board shall suffice for purchase or disposition of all or substantially all assets. See N-PCL §§ 509–510. Committee authorization is not permitted for purchase or sale of all assets.

[5] Provisions Simplifying Procedures for Certain Transactions

The N-PRA introduced amendments to the N-PCL enabling a nonprofit organization to elect whether to seek approval from the Attorney General or the court for each of the following transactions: changes of powers or purposes (804(a)(ii)), sale or lease of all or substantially all of a nonprofit's assets (N-PCL § 511-A), mergers and consolidations (N-PCL §§ 907, 907-A, 907-B), and non-judicial dissolutions under Article 10 (N-PCL §§ 1001, 1002, 1002-a, 1003, and 1007). Prior to the effective date of the N-PRA, court approval was mandated for each of the foregoing transactions. Note, however, that if attorney general approval is requested and the attorney general objects to the transaction or if the attorney general otherwise concludes, after reviewing the transaction, that court approval is appropriate, then that transaction must be approved by the court.

[6] Amendments and Provisions Facilitating Communications with Members and Directors

The N-PRA introduced provisions to the N-PCL authorizing the use of electronic means for: (a) notices of meetings (N-PCL § 605), (b)

waivers of notice by members (N-PCL § 606); (c) proxy distribution and voting (N-PCL § 609); and (d) unanimous written consents (N-PCL § 614). The N-PRA also amended the N-PCL to enable: (1) organizations with over 500 members to give notice on the organization's website (in addition to publication notice), see N-PCL § 605; (2) organizations to specify the manner in which notices will be sent to directors in the by-laws, see N-PCL § 711(c); and (3) the directors of organizations to participate in board and committee meetings through various forms of video communication, see N-PCL § 708(c).

[7] Amendments to Financial Reporting Provisions

N.Y. Exec. L. § 172-b(1) was amended by the N-PRA to raise the gross revenue threshold that requires not-for-profit corporations and charitable trusts to file with the Attorney General an annual independent certified public accountant's audit report from revenue and support in excess of \$250,000 to \$500,000. N.Y. Exec. L. § 172-b(1) provides that additional threshold increases for independent CPA audits will occur July 1, 2017 to \$750,000 and on July 1, 2021 to \$1,000,000. The N-PRA also introduced amendments to N.Y. Exec. L. § 172-b(2) changing the fiscal year gross revenue threshold that require organizations to file an independent CPA review report or audit with the Attorney General's office from \$100,000 to \$250,000. In addition, N.Y. Exec. L. § 172-b(2) provides that, notwithstanding the requirements of § 172-b and EPTL § 8-1.4, if upon review of an independent CPA's review report filed, the attorney general determines that a charitable organization should obtain an independent CPA's audited report, the organization must file such a report within 120 days of the attorney general's request.

[8] New Corporate Governance Standards, Including Conflict of Interest and Whistleblower Policies

N-PCL § 715-a provides that all nonprofits of any size, charitable or non-charitable, corporation or trust, must adopt a conflict of interest policy. At a minimum the policy must contain: a definition of the circumstances that constitute a conflict of interest; procedures for disclosing a conflict of interest to the audit committee, or if there is no audit committee, to the board; the person with the conflict must not be present at or participate in board or committee deliberation or vote on the matter giving rise to the conflict; the person with the conflict is prohibited from improperly influencing the deliberation or voting on

the matter giving rise to the conflict; the existence and resolution of the conflict must be documented in the organization's records, including in the minutes of any meeting at which the conflict was discussed or voted upon; and procedures for disclosing, addressing, and documenting related party transactions. See N-PCL § 715-a(b). Effective as of May 27, 2017, N-PCL § 715-a has been amended to: (1) allow conflict of interest disclosures to be made to the board or any committee of the board (not just the audit committee); (2) require that the conflict of interest policy include procedures for disclosing a conflict of interest or possible conflict of interest to the board or a committee of the board; and (3) require that the conflict of interest policy include procedures for how the board or a committee of the board will determine when a conflict of interest (or possible conflict of interest) exists.

N-PCL § 715-b provides that every corporation that has twenty or more employees and in the prior fiscal year had annual revenue in excess of \$1 million must adopt a whistleblower policy to protect from retaliation persons who report suspected improper conduct. The policy must include procedures for reporting such claims. Effective as of May 27, 2017, N-PCL § 715-b has been amended to clarify that: (1) the person administering the whistleblower policy may report to the board or "an authorized committee" of the board, except that "directors who are employees may not participate in any board or committee deliberations or voting relating to administration of the whistleblower policy;" and (2) the subject of a whistleblower complaint may not be present or participate in board or committee deliberations or votes on any related matter. Such individuals may, however, present background information or answer questions upon request prior to the start of deliberations.

[9] Guidelines Regarding Related Party Transactions

The provision in the New York statute that most directly addresses the duty of loyalty is N-PCL § 715, which regulates "related party transactions."³⁴ Prior to the effective date of the N-PRA, N-PCL § 715 provided that if there had been a "good faith disclosure" to the board

³⁴ N-PCL § 715 deals only with the obligations of corporate law and does not deal with obligations imposed by tort (e.g., not to engage in fraud) or contract law (e.g., not to engage in unconscionable behavior). ALI, Principles, cmt. to § 5.01. Members, by statute, are immune from contractual liability. N-PCL § 517(a).

of a director's or officer's interest in a contract or transaction involving the corporation, and the interested director or officer had not participated in the vote authorizing the transaction, the corporation could not subsequently avoid or cancel the transaction based solely on the fact that it was an interested party transaction.³⁵ Fairness at the time the contract or transaction was authorized was a defense to transactions that did not comply with these prophylactic requirements. The N-PRA made significant changes to this provision. The scope of transactions falling within the purview of N-PCL § 715 has been significantly expanded. N-PCL § 715 now also applies to transactions between the corporation or any of its affiliates and key persons, in addition to directors and officers, relatives of such individuals and certain entities owned by such individuals or their relatives.³⁶ In addition, prior board or authorized board committee approval of such transactions, following specific procedures set forth in N-PCL § 715, now is required.

Under the N-PRA, a "related party transaction" is defined as any transaction, agreement, or other arrangement in which a related party has a financial interest³⁷ and in which the corporation or an affiliate

³⁵ This codification reversed an old common law doctrine that required the voiding of all contracts between corporations and their directors (whether business or nonprofit). See, e.g., *Munson v. Syracuse, Geneva & Corning R.R. Co.*, 103 N.Y. 58, 8 N.E. 355 (1886). For an article tracing the history of this doctrine under the common law, see Note, *The Status of the Fairness Test Under BCL 713*, 76 Colum. L. Rev. 1156 (1976).

³⁶ The definition of "relative" as set forth in the N-PRA, which is codified in N-PCL § 102(a)(22), provides that a relative of an individual means (i) his or her spouse or domestic partner as defined in Section 2994-a of the New York Public Health Law; (ii) his or her ancestors, brothers and sisters (whether whole or half-blood), children (whether natural or adopted), grandchildren, great-grandchildren; or (iii) the spouses or domestic partners of brothers, sisters, children, grandchildren, and great-grandchildren.

³⁷ The term "financial interest" is not defined either in the N-PRA or N-PCL. There have been very few cases discussing the parameters of self-interest in the nonprofit context.

Case law generally suggests that, in the nonprofit world, if directors serving on a nonprofit board have a financial interest in the entity with which a transaction is contemplated or has been executed, they are considered "interested" and the transaction is suspect. See *Scheuer Family Foundation v. 61 Assocs.*, 179 A.D.2d 65, 70, 582 N.Y.S.2d 662, 664 (1992) ("We conclude that the allegations that each of the individual defendants participated in or had a significant interest in 61 Associates as

thereof is a participant. A “related party,” in turn, is (i) any director,

well as the Foundation are sufficient to plead precisely the type of dual interest and potential for self-interest which would create an exception to the shield provided by the business judgment rule.”); *Higgins v. New York Stock Exch., Inc.*, 10 Misc. 3d 257, 806 N.Y.S.2d 339 (Sup. Ct. 2005) (in merger between a nonprofit and for-profit corporation, facts plaintiffs alleged in support of their claim that the directors of the nonprofit were self-interested, which included the fact that the CEO/director of the nonprofit was the former president and CEO and currently a large shareholder of the company that served as advisor for both the nonprofit and for-profit in connection with the merger, that that company also had a significant financial interest in the for-profit involved in the merger and that a number of other board members had personal or business relationships with that company, raised doubts regarding board members’ independence sufficient to overcome motion for dismissal). *See Shapiro v. Rockville Country Club*, 2 Misc. 3d 1002(A), 784 N.Y.S.2d 924, 2004 N.Y. Misc. LEXIS 124 (Sup. Ct. 2004) (director is interested in the transaction if (i) he or she is an officer or director of another corporation involved in the transaction; (ii) he or she receives a direct financial benefit from the questioned transaction that is different from the benefit received generally by all shareholders; or (iii) the director is controlled by a director who has an interest in the transaction), *aff’d*, 22 A.D.3d 657, 802 N.Y.S.2d 717 (2005); *Auerbach v. Klein*, 19 Misc. 3d 1102(A), 859 N.Y.S.2d 901, 2008 N.Y. Misc. LEXIS 1252 (Sup. Ct. 2008) (a director is considered to have lost his independence when he is dominated or otherwise controlled by an individual or entity interested in the transaction at issue), *aff’d*, 66 A.D.3d 805, 887 N.Y.S.2d 248 (2009); *Patrick v. Allen*, 355 F. Supp. 2d 704, 711 (S.D.N.Y. 2005) (director considered interested in a transaction if he/she stands to receive “a direct financial benefit from the transaction which is different from the benefit to shareholders generally”).

That view is generally reflected in N-PCL § 715, both before and after its amendment by the N-PRA. In the business world, however, it is generally accepted that directors must benefit from the transaction in order to be considered interested. *See, e.g., Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980) (all the directors but one did not stand to gain from merger that they had approved, as they had not been guaranteed any future employment and could therefore could not be considered interested). *Compare Crouse-Hinds Co. v. InterNorth, Inc.*, 634 F.2d 690 (2d Cir. 1980) (fact that directors would survive merger does not mean that they were “interested” and that they consequently had to prove fairness of merger; however, if plaintiff could have proved that retention of control was motive behind directors’ approval of transaction, requisite self-interest would have been demonstrated). *See also Brayton v. Ostrau*, 561 F. Supp. 156 (S.D.N.Y. 1983) (fact that defendant directors were compensated for services, held significant amount of stock, and wished to retain control of company was not sufficient to prove requisite self-interest).

Several cases decided in Delaware suggest a more expansive view of the parameters of self-interest in the business world. In *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917 (Del. Ch. 2003), *summ. judgment granted*, 867 A.2d 904 (Del. Ch. 2004), the Delaware Court of Chancery concluded that a special litigation committee—on its face

officer or key person of the corporation or any affiliate of the corporation; (ii) any relative of any individual described in clause (i); or (iii) any entity in which any individual described in clauses (i) and (ii) has a thirty-five percent or greater ownership or beneficial interest or, in the case of a partnership or professional corporation, a direct or indirect ownership interest in excess of five percent.³⁸

N-PCL § 715, as amended by the N-PRA, now prohibits a corporation from entering into a related party transaction unless the board or an authorized committee of the board determines that the transaction is fair, reasonable, and in the corporation's best interest at the time of the determination.³⁹ Accordingly, related party transactions must be approved by the board or an authorized board committee before the corporation enters into the transaction. Approval or ratification by the board after the corporation has entered into the transaction is no longer permissible. N-PCL § 715 now also prohibits participation by a related party in any deliberations or voting related to the related party transaction. The board or authorized committee, however, may request that the related party provide information as background or answer questions concerning the related party transaction at the board or committee meeting prior to commencement of deliberations or voting related to the related party transaction. N-PCL § 715 also requires all directors, officers, and key persons who have an interest in the related

an "independent committee"—could not terminate a derivative lawsuit because the committee's members, while seemingly independent, in fact, were not. The Court concluded that the committee's members were not independent because they were associated with Stanford University, which had received substantial support both from Oracle and its senior executives, including its Chairman and CEO. The court noted that while much of the jurisprudence on independence "focuses on economically consequential relationships . . . treating the possible effect on one's personal wealth as the key to the independence inquiry . . . [t]he law should not be based on a reductionist view of human nature." *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, *supra*, at 936, 938. The Court concluded that "[a]t bottom, the question of independence turns on whether a director is, for any substantial reason, incapable of making a decision with only the best interests of the corporation in mind." *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917, *supra*, at 938. Social relationships, viewed as potentially compromising independence, also played a role in *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275 (Del. Ch. 2003), *aff'd*, 906 A.2d 27 (Del. 2006).

³⁸ N-PCL § 102(a)(23).

³⁹ N-PCL § 715. The N-PRA also imposes these related party transaction requirements on New York charitable trusts. *See* EPTL § 8-1.9(c).

party transaction to disclose in good faith all material facts concerning such interest to the board or an authorized committee thereof.⁴⁰ Fairness is not a defense in the case of related party transactions that do not comply with the requirements of N-PCL § 715.

Pursuant to the N-PRA, if a related party transaction involves a charitable corporation and a related party having a “substantial financial interest” in the transaction, the board or authorized board committee also must: (i) consider, prior to entering into the transaction, alternative transactions to the extent available; (ii) approve the transaction by not less than a majority vote of the directors or committee members present at the meeting; and (iii) “contemporaneously” document in writing the basis for the approval, including the board or committee’s consideration of alternative transactions. The term “substantial financial interest” is not defined in the N-PCL and the N-PRA provides no guidance as to the meaning of the terms “financial interest” or “substantial financial interest.”⁴¹

The N-PCL, as amended by the N-PRA, requires a director, officer, or key person who has an interest in a related party transaction to “disclose in good faith to the board, or an authorized committee thereof, the material facts concerning such interest.”⁴² The requirement

⁴⁰ The Attorney General issued guidance providing that such disclosure should be made before the board authorizes the transaction. N.Y. Att’y Gen., Guidance Document 2015-4, V. 1.0, Conflicts of Interest Policies Under the Nonprofit Revitalization Act of 2013 (Apr. 13, 2015), which is available on the Charities Bureau website at www.charitiesnys.com. The guidance issued by the Charities Bureau indicates how the New York State Attorney General currently interprets, and may enforce, provisions of the N-PCL. The guidance does not constitute either law or regulation, and is subject to revision from time to time.

⁴¹ While on its face, N-PCL § 715 does not address compensation, guidance issued by the Attorney General clarifies that compensation and reimbursement of expense transactions with directors, officers and employees are not “related party transactions” in the view of the Attorney General’s Office unless the recipient is a related party based on some other status, such as being a relative of another related party. Moreover, such transactions still must be analyzed, however, for reasonableness (see N-PCL § 202(a)(12) and § 515(b)) and the related party may not participate in the compensation decision. *See* Conflicts of Interest Policies Under the Nonprofit Revitalization Act of 2013, Guidance Document 2015-4, V.10 available at https://www.charitiesnys.com/pdfs/Charities_Conflict_of_Interest.pdf last visited March 13, 2018.

⁴² N-PCL § 715(a). *Cf.* Model Nonprofit Corporation Act § 8.60(a)(1) (3d ed.

that material facts must be disclosed literally applies only to the director's, officer's, or key person's interest and not to the transaction itself (i.e., the impact of the transaction on the organization). That also was the case under N-PCL § 715 prior to the effective date of the N-PRA, and some have argued that this significantly weakens the disclosure requirement, as does the fact that the term "material" is not defined.⁴³ However, while the disclosure appears just to relate to the "interest" itself, any such disclosure necessarily requires disclosure of facts about the transaction in order to understand why there is a conflict. The leading case on disclosure under New York common law also requires disclosure of adverse information, including possible consequences, about the transaction itself, based on the theory that the self-interested director frequently has knowledge superior to that of the disinterested directors.⁴⁴ In any case, disclosure of information about the transaction itself is needed to enable disinterested directors to fulfill their duties.⁴⁵ Because the board must make a determination that a related party transaction is fair, reasonable, and in the corporation's best interest before the corporation enters into the transaction, the disclosure must be made before or at the time the contract is authorized;⁴⁶ subsequent disclosure will not cure the defect. ⁴⁷

2008) requires that "the material facts as to the relationship or interest and as to the contract or transaction" be disclosed. N-PCL § 715 seems to deal just with the material facts of the interest and not the contract itself (although to understand the conflict, you need to know about the transaction).

⁴³ James J. Fishman, *Standards of Conduct for Directors of Nonprofit Corporations*, 7 Pace L. Rev. 389 (1987). Because none of the terms are defined, it is unclear as to the specificity of disclosure required. Is it sufficient for a director to disclose that she is a partner in a firm that provides professional services to the nonprofit organization or must she disclose the monetary value of her interest?

⁴⁴ *Globe Woolen Co. v. Utica G. & E. Co.*, 224 N.Y. 483, 121 N.E. 378 (1918). In this case, a decision by Judge Cardozo, the self-interested director, who exerted a dominating influence, was required to disclose any potential adverse consequences that were visible to him alone because of his superior knowledge of the facts and circumstances involved.

⁴⁵ *Barr v. Wackman*, 36 N.Y.2d 371, 380, 368 N.Y.S.2d 497, 507, 329 N.E.2d 180, 187 (1975).

⁴⁶ See note 37 *supra*.

⁴⁷ Model Nonprofit Corporation Act § 8.60(a)(3) (3d ed. 2008) provides that a conflicting interest transaction is not void or voidable solely because it is a conflicting

As noted above, the New York statute does not define what it means by “material” facts. There is case law that for information to have been material, there must be a substantial likelihood that a reasonable disinterested director would have found the missing information of actual significance in his deliberations.⁴⁸ For example, if at the time a director bought a parcel of property owned by the corporation he or she knew that the owner of adjoining property planned to build a shopping center in six months, an action that would substantially increase the value of the organization’s property, that fact would be considered material, and by failing to disclose it, the director could be held liable under N-PCL § 715. The director’s failure to disclose would be grounds for action to enjoin, rescind, or void the transaction, seek restitution or an accounting and/or removal of the director.⁴⁹ On the other hand, if the director did not know about the neighbor’s plans at the time he or she bought the property, the director would not have breached the disclosure requirement of N-PCL § 715 and would be entitled to the windfall created by the neighbor’s plans. In *Scheuer Family Foundation v. 61 Associates*,⁵⁰ the court held that the withholding of financial information about transactions between the directors and an investment management company that they controlled and that managed the foundation’s assets indicated a possible breach of loyalty.

In *Martha Graham School & Dance Foundation, Inc. v. Martha Graham Center of Contemporary Dance, Inc.*,⁵¹ a federal district court found that a board member had violated his duty of loyalty to two

interest transaction if the transaction is fair to the corporation as of the time it is authorized, approved or ratified by the board or members.

⁴⁸ See *TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S. Ct. 2126, 48 L. Ed. 2d 757 (1976); *Brayton v. Ostrau*, 561 F. Supp. 156 (S.D.N.Y. 1983).

⁴⁹ N-PCL § 715(f), N-PCL § 623, N-PCL § 720(b).

⁵⁰ 179 A.D.2d 65, 582 N.Y.S.2d 662 (1992).

⁵¹ 224 F. Supp. 2d 567 (S.D.N.Y. 2002), *aff’d in part, rev’d in part on other grounds*, 380 F.3d 624 (2d Cir. 2004). See *People v. Merkin*, 26 Misc. 3d 1237(A), 907 N.Y.S.2d 439, 2010 N.Y. Misc. LEXIS 523 (Sup. Ct. 2010) (motion to dismiss not granted where allegations were that Merkin, as a director/investment committee member of several nonprofit corporations, breached his fiduciary duties to those corporations in violation of N-PCL §§ 112, 717, and 720 by, among other things, (i) failing to disclose Bernard Madoff’s role in Merkin’s investment companies and (ii) failing to disclose the conflicts of interest Merkin had in recommending investments).

related nonprofit corporations on whose boards he served when he failed to reveal certain “material” facts in connection with a license agreement between the board member’s personal trust and the nonprofit corporations. In this case, a personal trust established by the sole legatee of Martha Graham’s will entered into a license agreement with two related nonprofit corporations founded by Ms. Graham. Under the agreement, the trust granted the nonprofit organizations a non-exclusive performance license to certain of Ms. Graham’s dances and a non-exclusive use license to sets, costumes, and other properties used for such performances. The court found that the uncertainty that existed with respect to the board member’s ownership of the copyright in the dances and the theatrical properties, of which the board member was aware, was a “material” fact that should have been disclosed to the nonprofit organizations’ boards. Other examples of material facts that should have been disclosed include the fact that an insurance brokerage firm wholly owned and operated by a trustee intended that its initial consulting role become a long-term business relationship and, in fact, was charging for its services.⁵²

Once material facts have been disclosed and the potential conflicts become known, the board must take action to protect the organization’s interest, and, in the case of a related party transaction, must comply with the procedural requirements set forth in N-PCL § 715. Failure to do so may result in a finding that the duty of loyalty or N-PCL § 715 has been violated.⁵³

The N-PCL now limits a director’s, officer’s, or key person’s participation in decision-making related to a related party transaction to good faith disclosure of the material facts concerning his or her interest. The N-PRA’s amendments to N-PCL § 715 require that related parties not participate in the deliberation or vote on a “related party” transaction. The corporation’s board or an authorized board committee,

⁵² *Comm. to Save Adelphi v. Diamandopoulos*, decision of the Board of Regents of the University of the State of New York (Feb. 5, 1997). Held liable here were both the trustee who owned the insurance brokerage firm who maneuvered the deal and the trustee (and chief executive officer) who knew of the fee arrangement and concealed it from the remaining trustees. In this same case, a trustee who failed to disclose to the board that he was charging for his marketing services was found to have breached his duty of loyalty.

⁵³ *Id.* See also N-PCL § 715, N-PCL § 720.

however, may request that a related party present information as background or answer questions concerning the related party transaction at a board or committee meeting prior to the commencement of deliberations⁵⁴ or voting relating thereto.⁵⁵ In addition, the N-PRA's provisions governing conflict of interest policies, set forth in N-PCL § 715-a, specify that an interested director also may not be present during deliberation or vote on the matter in which he or she has an interest provided that the board or committee may request that the person with the conflict present information as background or answer questions at a board or committee meeting prior to deliberation or voting on the conflict of interest matter.⁵⁶ N-PCL § 715-a also provides that a corporation's conflict of interest policy must include a provision that prohibits any person with a conflict from attempting to "influence improperly" the deliberation or voting on the matter giving rise to the conflict.⁵⁷ The board of directors of a corporation governed by I.R.C.

⁵⁴ There is nothing that addresses, however, when deliberations commence.

⁵⁵ N-PCL § 715(a), (h).

⁵⁶ N-PCL § 715-a(b)(3). N-PRA's provisions governing conflict of interest policies (N-PCL § 715-a(b)(3)) and approval of executive compensation (N-PCL § 515(b)) include a requirement that the person with the conflict of interest both (i) "not be present at" the board or committee deliberation or vote, and (ii) "not participate in" such deliberation or vote. In contrast, N-PCL § 715 requires only that no related party participate in deliberations or voting relating to a related party transaction, and not that these individuals "not be present" at the applicable meetings. N-PCL § 715(h). All three provisions allow the person with the conflict or the related party, if so requested by the board or committee, to present information as background or answer questions at the board or committee meeting prior to the commencement of deliberations or voting relating to the conflict or related party transaction.

⁵⁷ N-PCL § 715-a(b)(4). The New York State Attorney General recommends that the term "influence improperly" in N-PCL § 715-a(b)(4) be interpreted in a manner similar to that used in 17 CFR § 240.13b2-2 with respect to the "improper influence" of audits:

"Improperly influence" (sic) in this context should have a meaning similar to that used by the Securities and Exchange Commission in addressing improperly influencing audits: "coercing, manipulating, misleading, or fraudulently influencing (collectively referred to herein as "improperly influencing") the "decision-making" when the officer, director or other person knew or should have known that the action, if successful, could result "in the outcome which the officer or director could not deliberate or vote on directly.

N.Y. Att'y Gen., Guidance Document 2015-4, V. 1.0, Conflicts of Interest Policies

§ 4958 also must ensure that interested directors are not present during the debate and vote on the interested transaction if it wishes to take advantage of the safe harbor provision of I.R.C. § 4958.

Finally, N-PCL § 715, as amended by the N-PRA, provides that any related party transaction involving a charitable corporation and a related party having a substantial financial interest in the transaction must be approved by not less than a majority vote of the directors or committee members present at the meeting.⁵⁸ Although not specifically stated in N-PCL § 715, a quorum should be present at the time of the vote.⁵⁹ N-PCL § 715 is silent as to the vote required to approve other related party transactions, i.e., those transactions that do not involve both a charitable corporation and a related party with a substantial financial interest in the transaction. Presumably, the vote of a majority of the directors present at the time of the vote, if a quorum is present at that time, will be sufficient unless the corporation's certificate of incorporation or by-laws require a greater vote.⁶⁰ The N-PRA creates some ambiguity as to who on the board may act with respect to conflict matters. While N-PCL § 715 allows the board or an authorized committee of the board to make decisions regarding related party transactions, N-PCL § 712-a, which governs audit oversight, provides that the adoption and implementation of, and compliance with, the corporation's conflict of interest policy shall be overseen by the audit committee or other board committee comprised solely of independent

Under the Nonprofit Revitalization Act of 2013 at p. 4 (Apr. 13, 2015) (internal citations omitted), which is available on the Charities Bureau website at www.charitiesnys.com. The guidance issued by the Charities Bureau indicates how the New York State Attorney General currently interprets, and may enforce, provisions of the N-PCL as amended by the N-PRA. The guidance does not constitute either law or regulation, and is subject to revision from time to time.

⁵⁸ N-PCL § 715(b)(2).

⁵⁹ N-PCL § 708(d) provides that, except as otherwise provided in the N-PCL, the vote of a majority of the directors present at the time of the vote, if a quorum is present at such time, shall be the act of the board. N-PCL § 708(d) further provides that directors who are present at a meeting but not present at the time of the vote due to a conflict of interest or related party transaction shall be deemed present at the time of the vote for purposes of N-PCL § 708(d). There is nothing in the legislative history of the N-PRA to suggest that the vote specified in N-PCL § 715(b)(2) is intended to establish a lower voting requirement for the approval of such related party transactions.

⁶⁰ See N-PCL §§ 708, 709.

directors, as defined by the N-PRA,⁶¹ or by the board. N-PCL § 712-a further provides that only independent directors may participate in any board or committee deliberations or voting relating to matters set forth in N-PCL § 712-a. In any case, only “disinterested directors” may approve related party transactions.

Under N-PCL § 715, prior to its amendment by the N-PRA, if a transaction was challenged because the statutory requirements of disclosure and approval by a disinterested majority were not met, the contract could still stand if the parties to the contract proved that it was fair and reasonable at the time it was authorized.⁶² Fairness was only a defense; it was not stated as a requirement, as were disclosure and approval by a disinterested body, in self-dealing transactions.⁶³ *The N-PRA amended N-PCL § 715 to make a determination of fairness a prerequisite to approval of a related party transaction.*⁶⁴ And so the business judgment rule does not protect decisions or transactions that involve self-interest,⁶⁵ such as related party transactions;⁶⁶ thus if a

⁶¹ N-PCL §102(a)(21).

⁶² The excess benefit transaction rules are similar in that failure to comply with the safe harbor procedural requirements is not dispositive; a penalty will be imposed only if the transaction is an excess benefit transaction. This is a sharp contrast to the private foundation self-dealing rules, codified in I.R.C. § 4941, which prohibit absolutely certain transactions between a private foundation and its disqualified persons, regardless of fairness to the foundation. For a discussion of these rules, see *New York Nonprofit Law and Practice, With Tax Analysis*, Third Edition, Chapter 17, Tax Aspects—Private Foundations (Matthew Bender).

⁶³ N-PCL § 715, prior to the effective date of the N-PRA, had a narrow purpose; it only established that no transaction was automatically void because of a director’s interest. It was not intended to provide a basis for validating for all purposes a transaction between an interested director and the organization. N-PCL § 715, as amended by the N-PRA, now provides a regime that must be adhered to for approving all transactions or arrangements between the corporation and a director, officer, key person, or other related party who has a financial interest in the transaction.

⁶⁴ N-PCL § 715(a).

⁶⁵ *Scheuer Family Foundation v. 61 Assocs.*, 179 A.D.2d 65, 582 N.Y.S.2d 662 (1992) (because complaint pleaded a conflict of interest, court declined to consider whether business judgment rule should be applied to nonprofit corporations); *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980) (under the business judgment rule, directors are presumed to have acted properly and in good faith; however, if it can be shown that they have engaged in self-dealing, they must prove that their decision was fair and reasonable; self-interest is always present in transactions intended to affect

plaintiff alleges and can prove that a transaction benefited a defendant director, the director may not successfully claim that the decision met the minimal requirements of the business judgment rule. In decisions involving a conflict of interest, the more stringent standard of fairness replaces that of the business judgment rule or the duty of care.⁶⁷

[10] Provisions Enhancing Attorney General's Enforcement Authority

The N-PRA introduced provisions authorizing the Attorney General to bring a legal action to enjoin, void, or rescind a related party transaction that violates the statutory provisions or was otherwise not reasonable or in the best interest of the corporation at the time the

control). *See also* *Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557, 483 N.Y.S.2d 667, 473 N.E.2d 19 (1984); *Bayer v. Beran*, 49 N.Y.S.2d 2 (Sup. Ct. 1944) (the business judgment rule yields to rule of undivided loyalty); *Comm. to Save Adelphi v. Diamandopoulos*, decision of the Board of Regents of the University of the State of New York (Feb. 5, 1997) (for the business judgment rule to apply, the decision making must be honest and disinterested, albeit misguided); *Lichtenberg v. Zinn*, 260 A.D.2d 741, 687 N.Y.S.2d 817 (1999) (while business judgment rule shielded substance of special litigation committee's decision from judicial inquiry, court could inquire into the disinterested independence of the committee members); *Ench v. Breslin*, 241 A.D.2d 475, 659 N.Y.S.2d 893 (1997) (business judgment doctrine does not foreclose court inquiry into the disinterested independence of directors); *Shapiro v. Rockville Country Club*, 2 Misc. 3d 1002(A), 784 N.Y.S.2d 924, 2004 N.Y. Misc. LEXIS 124 (Sup. Ct. 2004), *aff'd*, 22 A.D.3d 657, 802 N.Y.S.2d 717 (2005); *Higgins v. New York Stock Exch., Inc.*, 10 Misc. 3d 257, 287, 806 N.Y.S.2d 339, 363 (Sup. Ct. 2005) (where plaintiffs alleged facts establishing conflicts of interest and self-dealing in connection with merger of a nonprofit corporation and for-profit corporation, together with facts showing board's decision to approve merger was uninformed, allegations were sufficient to overcome presumption of the business judgment rule at the pleading stage); *Gray & Assoc., LLC v. Speltz & Weis LLC*, 22 Misc. 3d 1124(A), 880 N.Y.S.2d 223, 2009 N.Y. Misc. LEXIS 332, at *8 (Sup. Ct. 2009) (the business judgment rule "does not protect corporate officials who engage in fraud or self-dealing or corporate fiduciaries when they make decisions affected by inherent conflict of interest").

⁶⁶ Compliance with the requirements of N-PCL § 715 may not be sufficient to meet the I.R.C. § 4958 safe harbor requirements applicable to I.R.C. § 501(3) and § 501(4) organizations either.

⁶⁷ *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255 (2d Cir. 1984) (once self-interest is demonstrated the duty of loyalty supersedes the duty of care; the transaction must be fair and reasonable and the presence of legitimate corporate motives or interests will not be sufficient).

transaction was approved. Specifically, N-PCL § 715(f) provides that the Attorney General has the ability to seek restitution and removal of directors or officers for self-dealing violations or to seek to require any person or entity to: (1) account for profits made from the transaction and pay them to the corporation; (2) pay the corporation the value of the use of any of its property or other assets used in the transaction; (3) return or replace property or other assets that the corporation lost because of the transaction along with income or appreciation, with interest; and/or (4) in the case of willful and intentional conduct, pay an amount up to double the amount of any benefit improperly obtained. N-PCL.

[11] Provisions Mandating Board Oversight of Auditing Process

N-PCL § 712-a requires that an audit committee or the independent members of the not-for-profit corporation's board review and discussion of the auditors' annual report and retention. N-PCL § 712-a(c) charged the board or designated audit committee of the board to oversee the adoption, implementation of, and compliance with any conflict of interest policy or whistleblower policy adopted by the corporation if this function is not otherwise performed by another committee of the board comprised solely of independent directors. N-PCL § 712-a(c) was repealed as of May 27, 2017. In addition, effective as of May 27, 2017, the conflict of interest (N-PCL § 715-a) and whistleblower policy (N-PCL § 715-b) provisions have been amended to confirm that disinterested directors (rather than independent directors) are responsible for overseeing the implementation of, and compliance with, the conflict of interest and whistleblower policies.

[12] Provisions Increasing Regulation and Oversight of Employees, Officers, and Directors

Several provisions of the N-PCL which refer to "key employees" have been changed to "key persons," which is far more expansive. See, e.g., N-PCL §§ 309 and 720.

§ 3 Amendments to the N-PRA

[1] September 2015 Technical Corrections

Certain technical corrections to the N-PRA were enacted on Sep-

tember 25, 2015.⁶⁸ These technical corrections included making certain terms gender neutral, correcting inconsistent terms, and amending certain provisions of the N-PCL, the Education Law, and the Mental Hygiene Law to conform to the provisions of the N-PRA.

[2] October 2015 Amendment

On October 26, 2015, Governor Cuomo signed into law a bill that delayed until January 1, 2017 the effective date of the provision of the N-PRA that prohibits an employee from serving as Chair of the Board of Directors of a not-for-profit corporation.⁶⁹ This was the second time the effective date of this provision was postponed,⁷⁰ reflecting strong opposition from many in the not-for-profit community, especially small organizations which often have the founder, who is the chief executive officer, serve as chair of the board. In 2016, this absolute prohibition pursuant to N-PCL §713(f) against any employee serving as chair of the board was relaxed.⁷¹

[3] December 2015 Amendments

On December 11, 2015, Governor Cuomo signed into law another bill that amended the N-PRA with respect to certain provisions:⁷²

Participation by Interested Persons. The law clarifies that independent directors, related parties and those with a conflict of interest who cannot be part of the deliberations or vote, may, however, present information as background or answer questions at a meeting prior to the commencement of deliberations or voting.

Conflicts of Interest. Conflict of interest statements may now be given to either the Secretary or a designated compliance officer.

Approval of Board Compensation. Pursuant to amended N-PCL §515(b), where compensation is being provided to all directors on the same or substantially similar terms, no director will be prohibited from participation in any Board or committee deliberation or vote regarding

⁶⁸ L.2015, ch. 358 (September 25, 2015).

⁶⁹ L. 2015, ch. 388 (October 26, 2015).

⁷⁰ The effective date of N-PCL §713(f) was previously delayed from January 1, 2015 to January 1, 2016. *See* L. 2014, ch. 81 (June 30, 2014).

⁷¹ *See infra* [4], 2016 Amendments.

⁷² L. 2015, ch. 555 (Dec. 11, 2015).

compensation for board service, including his/her own.

Action by the Board. Pursuant to amended N-PCL §708(d), a director who is present at a meeting but who has recused him or herself from a vote due to a conflict of interest or a related party interest will still be considered present for purposes of determining quorum,

Committees of the Corporation. Non-directors may serve on committees of the corporation pursuant to amended N-PCL §712(e).

Whistleblower Policy. One of the ways by which an organization now may comply with the distribution requirement of its whistleblower policy is by posting the policy on its website or at its offices in a conspicuous location accessible by employees and volunteers.

Religious Corporations and Dispositions of Real Property. Similar to the N-PRA, which simplified the approval process for major corporate actions by allowing corporations to obtain approval of such transactions solely from the Attorney General, a religious corporation may also now seek approval solely from the Attorney General to sell, mortgage or lease its real property for a term exceeding five years.

Additionally, the definitions of independent director,⁷³ related party,⁷⁴ key employee, relative,⁷⁵ affiliate⁷⁶ and entire board⁷⁷ were amended as follows:

“Independent director” now also excludes a director who is or has a relative who is a current owner, director, officer or employee of the corporation’s outside auditor or who has worked on the corporation’s audit at any time during the past three years. The amended definition also clarifies that “payments” do not include dues or fees paid to the corporation for services which the corporation performs as part of its nonprofit purposes, provided that such services are available to the public on the same terms.

The definition of “related parties” is broadened to include “any other person who exercises the powers of directors, officers, or key employ-

⁷³ N-PCL 102(a)(21).

⁷⁴ N-PCL § 102(a)(23).

⁷⁵ N-PCL § 102(a)(22).

⁷⁶ N-PCL § 102(a) (19).

⁷⁷ N-PCL § 102(a) (6-a).

ees over the affairs of the corporation or any affiliate of the corporation.”

The definition of “key employee” under the N-PRA referenced the excess benefit/intermediate sanctions rules under the federal tax laws which apply to “disqualified persons.” The amendment only provides—without further clarification—that the federal tax law rules govern “to the extent such provisions are applicable.” This confusion has been somewhat cleared up, however, by the 2016 Amendments replacing the term “key employee” with “key person,”⁷⁸ which is defined somewhat similarly, but is not identical, to the treasury regulations on who would be considered disqualified persons for purposes of Section 4958 of the Internal Revenue Code covering excess benefit transactions.⁷⁹

The definition of “relative” has been expanded from only spouse to include domestic partners (as defined in Section 2994-a of the Public Health Law) as well as an individual’s brothers, sisters, children, grandchildren and great-grandchildren.

The definition of “affiliate,” which was added by the N-PRA in connection with the related party transaction and independent director rules, now excludes entities that are under common control with the organization (i.e., entities that have a common parent).

What constitutes the “entire board” can be established by setting a range in the by-laws and having the board set a specific number of directors within such range. If the by-laws provide for such a range and the board has not set a number within that range, then the “entire board” will consist of the number of directors within the range that were elected or appointed as of the most recently held election of directors, as well as any directors whose terms have not yet expired.

[4] 2016 Amendments

On November 28, 2016, Governor Cuomo signed into law yet another set of clarifying amendments to New York’s Nonprofit Revitalization Act of 2013 (the “2016 Amendments”) which generally became effective May 27, 2017.⁸⁰ These include the following changes:

[a] Related Party Transactions

The 2016 Amendments make changes to the related party transaction

⁷⁸ N-PCL § 102(25).

⁷⁹ See *infra* [4][b], 2016 Amendments.

⁸⁰ L. 2016, ch. 466 (November 28, 2016).

rules, which were among the key provisions of the N-PRA, in three significant ways:

First, while previously it was just the board, now an authorized committee also may approve a related party transaction as being in the corporation's best interest.

Second, the 2016 Amendments add to the definition of related party transactions certain exceptions. The following are not related party transactions: (a) where the transaction or the related party's financial interest in the transaction is de minimis; (b) transactions that would not customarily be reviewed by the board or boards of similar organizations in the ordinary course of business and is available to others on the same or similar terms ("ordinary course of business transactions"); and (c) the transaction constitutes a benefit provided to a related party solely as a member of a class of 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. These exceptions essentially are a codification of exceptions listed in the Guidance issued by the Charities Bureau of the New York State Attorney General on April 13, 2015.⁸¹ And, while not law, examples set forth in the Guidance as to what kinds of transactions would likely not be considered related party transactions are a useful guide. An example of ordinary course of business transactions would be where the library of a nonprofit university buys a book written by a member of the board, pursuant to a library acquisition policy or where a nonprofit hospital uses the local electric utility for its electrical service and supply, and a 35% shareholder of the local electric utility is a member of the board.⁸² And, an example of a transaction in the

⁸¹ See Conflicts of Interest Policies Under the Nonprofit Revitalization Act of 2013, Guidance Document 2015-4, V.10 available at https://www.charitiesnys.com/pdfs/Charities_Conflict_of_Interest.pdf (last visited March 13, 2018).

⁸² Other examples of ordinary course of business transactions are the following:

- General counsel of a health system has a written, established, and enforced policy for the selection, retention, evaluation, and payment of outside counsel. A board member is a partner of and has a greater than 5% share in one of the firms retained by general counsel.
- The curatorial department of a museum has a paid summer intern selection process involving resume review and evaluation and group interviews. The daughter of a board member is selected pursuant to the process as a summer intern.

third exception listed i.e., a transaction which constitutes a benefit provided to a related party solely as a member of a class of beneficiaries that the corporation intends to benefit as part of the accomplishment of its mission, would be where a legal services program agrees to handle the eviction case of one of its board members who is eligible to be a client and who is serving as one of the minimum number of client-eligible board members that is required by federal regulations.⁸³

Third, the 2016 Amendments provide a limited statutory defense for violation of the related party transaction rules. In the case of an action by the Attorney General, if procedures set forth in N-PCL § 715(a) or (b) were not followed, it shall now be a defense, pursuant to new N-PCL § 715(j), if: (1) the transaction was fair, reasonable and in the corporation's best interest at the time the corporation entered into the transaction⁸⁴ and (2) prior to the receipt of request for information by the Attorney General regarding the transaction, the board has: (A) ratified the transaction in good faith as being fair, reasonable and in the corporation's best interest at the time the corporation approved the transaction, and, in the case where a related party has a substantial

- The grandson of a board member of a hospital has just graduated from a university nursing school. He applies for and is selected by the Nursing Department of the hospital for a tuition repayment benefit and will receive a salary and overtime, consistent with the hospital's written policy regarding recruitment of new nursing graduates.

- A board member is the sole owner of a fuel delivery company. In the ordinary course of business, the facilities department of a nonprofit housing project puts out a written request for proposals for fuel supply for its properties, evaluates, and documents the selection of the board member's company based upon cost and service.

- A university board member owns a 35% share of a restaurant conveniently located near the campus of the university. Some faculty members responsible for arranging staff holiday lunches buy food from this restaurant, using university credit cards. Each department has a modest authorized budget for these lunches, and faculty members have discretion about where to buy food for the lunches.

See Id. at pp.6-7.

⁸³ *Id.* at p.7.

⁸⁴ The 2016 Amendments also add section (i) to N-PCL § 715 which provides that if the transaction was fair, reasonable and in the corporation's best interest at the time the corporation entered into the transaction, it shall be a defense in an action by any person or entity other than the attorney general.

interest, the board considered alternative transactions to the extent possible, approving the transaction by not less than a majority vote of the directors or committee members present at the meeting; (B) documented the nature of the violation and the basis for the board's or committee's ratification; and (C) put procedures into place to ensure that the corporation complies in the future.

[b] “Key Employee” Changed to “Key Person”

The 2016 Amendments replace the term “key employee” with “key person”. The new term is expressly broader and defined as: “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. (Emphasis added).” This is somewhat similar, but not identical, to the treasury regulations on who would be considered disqualified persons for purposes of Section 4958 of the Internal Revenue Code covering excess benefit transactions. The treasury regulations under IRC § 4958 contain examples of individuals who are deemed to manage a segment of corporation that represents a substantial portion of the activities, assets, income or expenses of the corporation as a whole, which may be instructive here. The examples include the dean of a college of law at a large university, because the dean manages a discrete segment of the university, plays a key role in hiring and firing of faculty and in determining a substantial portion of the capital expenditure and operating budget of the law school, which represents a substantial portion of the budget of the university, or the head of the cardiology unit at a major hospital who manages the cardiology department and has authority to allocate the budget for the unit.⁸⁵ The treasury regulations also include an example where an entirely unrelated business corporation was a disqualified person, e.g., where a bingo company managed the promotion and operation of bingo activity and paid the exempt organization a percentage of the revenue

⁸⁵ See Treas. Reg. Section 53.4958-3(e), 26 C.F.R. § 53.4958-3(e).

and the annual gross revenue from the bingo operation represented more than half of the exempt organization's revenue. In other words, if there is a transaction with a person/entity that contributes a substantial portion of the nonprofit's overall revenue, it may be considered a related party transaction that requires board approval.

[c] Independent Director

The 2016 Amendments revise the definition of "independent director" to be more expansive taking into account "key persons." An independent director is someone who is not, and has not been within the last three years, an employee or a key person of the corporation or affiliate and does not have a relative who is, or has been within the last three years, a key person of the corporation or affiliate.

The 2016 Amendments also revise the definition such that a director, officer or key person also may not be considered independent by virtue of his/her association with an entity that does business with the nonprofit which such director, officer or key person serves. In cases where the corporation provides payments, property or services to or receives them from another entity, a director still may be independent, however, even if he/she is employed by, or has a financial interest in the other entity, if the amount paid or received in any of the last three fiscal years is less than \$10,000 or 2% of the such entity's consolidated gross revenues if such revenue was less than \$500,000; where the entity's consolidated gross revenues is between \$500,000 and \$10 million, the amount paid or received by the corporation in any of the last three fiscal years may not exceed \$25,000; and in cases where the entity's consolidated gross revenues are more than \$10 million, the amount paid or received by the corporation in any of the last three fiscal years may not exceed \$100,000. The 2016 Amendments also clarify that the word "payments" excludes "payments made by the corporation at fixed or non-negotiable rates or amounts for services received" as long as such services are available to individual members of the public on the same terms, and such services received by the corporation are not available from another source.

While the definition of independent director also includes someone who has not received, and does not have a relative who has received, in any of the last three fiscal years, more than \$10,000 in direct

compensation from the corporation or affiliate,⁸⁶ the 2016 Amendments clarify that “compensation” does not include reimbursement for expenses reasonably incurred as a director or reasonable compensation for service as a director as permitted by N-PCL §202(a)(12).

[d] Non-Executive Chair of the Board

The absolute prohibition pursuant to N-PCL §713(f) against any employee serving as chair of the Board has been relaxed by the 2016 Amendments. As amended, an employee may serve as Board chair if the Board approves such an arrangement by a two-thirds vote of the entire board and contemporaneously documents in writing the basis for the board approval. Importantly, this provision went into effect on January 1, 2017, prior to the all the other 2016 Amendments.⁸⁷

[e] Committees of the Board

The 2016 Amendments make changes to the formation of board committees. It no longer is necessary for the certificate of incorporation or bylaws to provide the authority to create such committees. The board may form and appoint members to such committees and it no longer needs to be by majority of the entire board (except for the executive committee) but, rather, a majority of those present at a board meeting if there is a quorum. In the case of appointing members to the executive committee, however, the requirement that it be by majority of the entire board is still needed, except if the board has 30 members or more, in which case, 3/4 of the directors present at the time of the

⁸⁶ Independent director also includes someone who is not, and does not have a relative who is a current owner, whether wholly or partially, a director, officer or employee of the corporation’s outside auditor, or who has worked on the corporation’s audit at any time during the past three years. *See* N-PCL §102 (21).

⁸⁷ *See* L. 2016, ch. 466, § 21 (“This act shall take effect on the one hundredth eightieth day after it shall have become a law; provided, however, that the amendments to paragraph (f) of section 713 of the not-for-profit corporation law made by section six of this act shall take effect on the same date and in the same manner as section 132 of chapter 549 of the laws of 2013, as amended, takes effect.”). The effective date of N-PCL § 713(f) was previously delayed from January 1, 2015 to January 1, 2016, and again from January 1, 2016 to January 1, 2017. *See* Chapter 81 of the Laws of New York of 2014 (Assembly Bill 10027-A/Senate Bill 7799-A) and Chapter 388 of the Laws of New York of 2015 (Assembly Bill A7641/Senate Bill 5738). Furthermore, Bill S8041, to change the effective date of N-PCL § 713(f) yet again to January 1, 2018, was vetoed by the Governor on November 28, 2016.

vote is required, if a quorum is present. In addition, N-PCL § 712(a) now expressly allows the bylaws to provide that directors who hold certain positions in the corporation shall be ex-officio members of specific committees.

While now allowing a committee to authorize a related party transaction, the 2016 Amendments also specify the limitations on the powers of such committees. Pursuant to N-PCL § 712(a), committees cannot do certain things, which now include among the list of “non-delegable” powers of the board, the following: (i) the election or removal of officers and directors; (ii) the approval of a merger or plan of dissolution, (iii) the adoption of a resolution recommending to the members action on the sale, lease, exchange or other disposition of all or substantially all the assets of the corporation, or if there are no members entitled to vote, the authorization of such transaction, and (iv) the approval of amendments to the certificate of incorporation.

[f] Implementation and Oversight of Conflict of Interest and Whistleblower Policies

The 2016 Amendments clarify that it is the board’s responsibility to adopt, oversee the implementation of and ensure compliance with the conflict of interest and whistle-blower policies. See N-PCL §§ 715-a and 715-b. In conjunction with the repeal of N-PCL § 712-a(c), the 2016 Amendments strip the committees, in particular, the audit committee, of these specific responsibilities, although they still may be delegated to an audit or other committee.

In addition, amendments to N-PCL § 715-b (Whistleblower Policy) prohibit a director who is also an employee from participating in any board or committee deliberations or voting relating to the administration of the whistleblower policy. Furthermore, similar to N-PCL 715(g) which provides that no “related party” may participate in deliberations or voting on a related party transaction (but he/she may be required to provide information beforehand), amendments to § 715-b provide that the person who is the subject of a whistleblower complaint cannot be present at or participate in board or committee deliberations or vote on the matter relating to such complaint (although the person who is the subject of the complaint may be required to provide information beforehand).