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## Proposed Reform of New York's Charities and Nonprofits Laws Would Ease Burdens

By Jerald A. Jacobs and Dawn K. Crowell

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*On May 14, 2013, New York State Attorney General Eric Schneiderman joined with the New York Senate and Assembly Committee Chairs to propose legislative reforms to New York's charities and nonprofits laws. If the reforms are enacted, they will be the first major reforms in more than 40 years.*

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The proposed laws are titled the "Nonprofit Revitalization Act" and the "Executive Compensation Reform Act." Attorney General Schneiderman first proposed the reforms last spring, and they stem from the efforts of the Committee on Nonprofit Revitalization, convened by Mr. Schneiderman in April 2011, and consisting of leaders from the nonprofits sector from across the state.

The Committee's report is available at: [www.ag.ny.gov/sites/default/files/press-releases/2012/NP%20Leadership%20Committee%20Report%20%282-16-12%29.pdf](http://www.ag.ny.gov/sites/default/files/press-releases/2012/NP%20Leadership%20Committee%20Report%20%282-16-12%29.pdf).

The major goals of the new legislation are to improve oversight and governance accountability, while reducing the administrative burdens on nonprofits and allowing them to form and operate in New York State with greater ease. Some key changes in support of those goals include the following.

### **Simplifications to Formation Process**

The new law simplifies corporation "types," reducing from four to two – charitable or non-charitable – the types to choose from, with the goal of reducing confusion and a high incidence of filing rejections. Additionally, the new law clearly provides that nonprofits need only state their corporate purposes, and not specific activities they plan to undertake, in their formation document. The new law also reduces the requirements for agency approvals for formation; schools, libraries, museums, and historical societies will need to obtain advance approval from the State Education Department prior to their incorporation, but other currently affected types of nonprofits would only need to provide notice after incorporation, rather than obtaining advance approval.

### **Reduced Burdens for Corporate Transactions**

A majority vote of a nonprofit's board, or a committee of the board, rather than a two-thirds vote of the entire board, would be sufficient to approve non-substantial real estate transactions; the two-thirds vote would remain a requirement only for transactions involving property that constitutes all or substantially all

of the nonprofit's assets. Nonprofit corporations seeking to merge or to dispose of substantially all of their assets would be subject to a one-step approval process, requiring the approval of the Attorney General, rather than the current two-step process requiring review and recommendation by the Attorney General and then court approval. The Attorney General would likewise have the authority to approve a charitable corporation's plan of dissolution, with the corporation retaining the option to appeal to the courts if the Attorney General does not approve it.

### **Protections Against Conflicts of Interest and Self-Dealing**

Under the new law, all New York nonprofit corporations would be required to adopt written conflict of interest policies, and corporations with 20 or more employees and over \$1 million in annual revenue would also be required to adopt whistleblower policies. In addition to disclosure of transactions between the corporation and related parties, boards would also be required to review and affirmatively approve such transactions. For substantial transactions, a board could do so only after documenting that the transactions are in the corporation's best interest. The Attorney General would also have clearer authority to unwind any transactions that do result in self-dealing.

### **Modernizations to Account for Technology**

Private foundations would no longer be required to pay for advertisements in print newspapers to disclose the availability of their annual financial reports, as such reports are now available to the public online for free. Also, the new law would explicitly allow for electronic transmission of board and membership meeting notices, waivers of notice, and votes by unanimous written consent, and it specifically provides for board members to participate in meetings via conference call, Skype, or other similar forms of electronic communication.

### **Enhanced Financial Oversight**

The new law would require that nonprofit corporations' boards take an active role in supervising financial audits. Boards would be responsible for retaining any independent auditors and reviewing the results of an audit. Larger corporations (with over \$1 million in annual revenue) would be required to follow additional oversight procedures. For their CEO's compensation, boards of all nonprofits would be required to determine that the compensation is fair, reasonable, and commensurate with services provided. Boards of nonprofit corporations with over \$2 million in annual revenue would have to make such determinations for the top five highest-paid officers or key employees, using comparability data.

### **Board Independence**

The new law would prohibit the CEO, or other employee of a nonprofit corporation, from serving as the chair of the corporation's board, in an effort to maintain distinct lines of accountability between management and the board.

Most of the changes to New York's nonprofit law would take effect January 1, 2014. If enacted, the new laws would likely require some revisions to New York nonprofit corporations' organizational documents.

The proposed reforms aim to make New York's nonprofit law a model for other states, and to make New York a more hospitable jurisdiction for nonprofit corporations, while addressing issues of public trust and accountability. Many of the reforms mirror federal requirements and best practices already followed by many nonprofits, such as the requirements for a conflict of interest policy and determinations regarding executive compensation. These state-led reforms, which seem likely to be enacted, could start a trend in state governance of nonprofits, however. Governance and policy changes pursuant to Sarbanes-Oxley, in

2002, were initially confined almost exclusively to publicly traded business corporations; however, in 2008 the Internal Revenue Service revised the Form 990 requirements in an effort to enhance good governance and oversight, so nonprofit corporations' best practices followed suit. Recently, the District of Columbia enacted a new nonprofit corporations act, substantially similar to the American Bar Association's model act, and providing flexibility for nonprofits while also reinforcing standards for good governance. New York's efforts now not only portend major changes for those nonprofits formed or operating in New York, but also may potentially have a broader impact on nonprofits across the nation, as other states might implement similar reforms.

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