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State Legislature Passes Bill Changing Law Regarding Nonprofits' Related Party Transactions, Independent Directors, and Governance Committees

In June 2016, at the end of this year's state legislative session, the Assembly and Senate passed A.10365-B/S.7913-B, to continue the important work that the legislature undertook in 2013 with the passage of the Nonprofit Revitalization Act, which became effective July 1, 2014 (the "NPROA"). The new bill would resolve issues that nonprofits have encountered regarding the NPROA's approach to related party transactions, independent directors, and the formation and operation of committees. Lawyers Alliance for New York supports the bill and hopes that the Governor will sign it. The bill will become effective 180 days after it is signed.¹

If the bill is signed, nonprofits will want to review their bylaws, conflict of interest and whistleblower policies, audit committee charter, and governance practices to comply with the amendments. Below is a summary of the changes:

Related party transactions and conflicts of interest

- Exempt from the definition of related party transactions those transactions that: 1) are of limited monetary value, 2) would not usually be reviewed by the board in the ordinary course of business and is available to others on the same or similar terms, or 3) provide a charitable benefit to a member of a charitable class where the benefit is available to others on similar terms (section 1 of the bill)
- Replace the term "key employee" with the term "key person," and clarify that a person who exercises powers similar to those of a director or officer is a "key person" subject to the related party transaction rules, as is an employee or independent contractor who manages a significant portion of the corporation (section 1 of the bill)
- Allow an authorized committee of the board to approve a related party transaction (section 7 of the bill)
- Allow ratification of related party transactions that are fair, reasonable and in the organization's best interests, if the board discovers that it has inadvertently failed to review such a transaction (section 7 of the bill)
- Ensure that potential conflicts and whistleblower complaints are overseen by disinterested board members, and that conflicts and whistleblower policies are adopted by the board, while removing the requirement that only *independent* directors may be involved (sections 8 to 11 of the bill)

¹ The new act, if enacted, like NPROA, would amend New York's Not-for-Profit Corporation Law and Estates, Powers and Trusts Law in relation to the governance of nonprofit corporations. Bill details, including the full text, are available at: <https://www.nysenate.gov/legislation/bills/2015/S7913/amendment/B> and <https://www.nysenate.gov/legislation/bills/2015/A10365/amendment/B>.

Independent directors and the audit committee

- Allow audit committee service by a business' employees and people owning a substantial interest in the business if:
 - the business (for instance a utility) provides services to the nonprofit at fixed or non-negotiable rates and those services are not available from another source, or
 - the nonprofit and the business exchange payments in an amount that is insignificant to the business given the size of its revenue (according to a sliding scale capped at \$100,000) (section 1 of the bill)

Committees

- Allow the board to form committees (other than an executive committee), and appoint members to them, by majority vote following the procedures designated for other types of action by the board in N-PCL § 708 (section 4 of the bill)
- Require members of an executive committee to be appointed by either: 1) a majority of the entire board, or 2) if the board has 30 members or more, by at least 3/4 of the directors present at the time of the vote, if a quorum is present at that time (section 4 of the bill)
- Automatically place ex officio directors on certain committees of the board (section 4 of the bill)
- Eliminate the requirement that volunteer members of committees of the corporation have the obligations and liabilities of an officer (section 4 of the bill)

Employee as board chair

- Allow an employee to serve as board chair only if approved by a 2/3 vote of the entire board and the board contemporaneously documents in writing the basis for this approval (section 6 of the bill) (this provision would take effect January 1, 2017, except that if the Governor signs an additional bill, A.10555/S.8041, this provision will take effect January 1, 2018)

This alert is meant to provide general information only, not legal advice. If you have any questions about this alert, please contact Laura Abel, Senior Policy Counsel, Lawyers Alliance for New York, (212) 219-1800 ext. 283, label@lawyersalliance.org.

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