



CONFIDENTIAL LEGAL MEMORANDUM

To: Board of Governors, County Players, Inc.
From: Lauren Holupko, Esq., *Associate Attorney*
Date: May 13, 2016
Re: Review & Revision of Corporate By-Laws

The New York Council of Nonprofits, Inc. (“NYCON”) appreciates having been afforded the opportunity to review, assess and revise the By-Laws of County Players, Inc. We hope that the updated By-Laws that we have presented will well serve the governance, programmatic and operational needs of your organization in the years to come. This Memorandum is intended to offer a concise overview of the necessity and application of all your governance documents; outline material considerations with respect to our review and suggested revision of your By-Laws, particularly with regard to new mandates imposed by the recently enacted New York Nonprofit Revitalization Act (“the NPRA” or “the Act”); and confirm procedures regarding proper adoption of the amendments to your By-Laws that we have suggested.

NYCON is of the opinion that the By-Laws that we have proposed for your organization comply with all applicable legal requirements, including those contemplated by the NPRA. Nevertheless, be advised that our assistance is based solely on review of those governance documents, related policies and applicable contracts *with which we were provided*, and any opinions and/or observations that have been brought to our attention. Prior to adopting any suggested amendments, or the proposed revised By-Laws in their entirety, your organization should assure that our recommendations were offered upon receipt of all documents and information necessary to offer informed determinations and adequately address the practical needs of your organization.

OVERVIEW: Governance Documents

Certificate of Incorporation & Amendments

With limited exceptions, all Not-for-Profit Corporations are formed upon the filing of a Certificate of Incorporation with the New York Department of State, after any statutorily-required consents and approvals (or the waivers thereof) have been obtained. Provisions found in a nonprofit’s Certificate of Incorporation, as may be amended, ultimately, govern all aspects of its operations. Should there ever be an instance where a particular By-Law contradicts a provision stipulated in the Certificate of Incorporation, any such By-Law would—as a matter of law—be superseded by that provision specified in the Certificate of Incorporation.

By-Laws

A nonprofit’s By-Laws stipulate the rules and procedures by which its corporate decisions are properly authorized. Still, while all nonprofits in the State of New York are lawfully required to adopt and honor to the terms of written By-Laws, the New York Not-for-Profit Corporation Law (“the NPCL”) sets few specific requirements as to their form, content or scope. Therefore questions as to the proper contents of By-Laws are often answered by what is appropriate and needed.

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CONSIDERATIONS: Review, Assessment & Revision of By-Laws

NYS Nonprofit Revitalization Act Considerations

The NPRA was the first major overhaul, in more than 40 years, of statutes applicable to the governance, finances, programs and affairs of nonprofit organizations in the State of New York. Most material NPRA provisions became law on July 1, 2014. While the Office of the Attorney General has offered verbal assurances that it will afford New York's nonprofits a reasonable opportunity to come into compliance with requirements of the Act, there are no guarantees and significant time has already elapsed since NPRA-compliance was lawfully required. As part of our assistance, NYCON paid particular attention to reviewing, assessing and revising your By-Laws, in order to assure that they considered, and appropriately addressed, all applicable NPRA-imposed obligations.

Governance

The NPRA did not change existing law that requires the Board of Governors of a nonprofit to consist of, at least, three individuals. Likewise, there continues to be no limitation on the number of Governors who may serve. However, the Act expressly prohibits any nonprofit employee from serving as the Chair of the organization's Board or holding any other title with similar responsibilities. The Act also expressly permits the use of electronic communication in order to transmit notice of meetings of the Board and committees, waivers of notice and votes on unanimous consent. Lastly, not only may Boards and committees conduct meetings via conference call, they are now expressly authorized to utilize video-conference technology. As you can see, NYCON's proposed revision of your By-Laws addresses a number of these matters.

Electronic Actions and Communications

Member and Board voting electronically by email or fax transmission is still prohibited, except for unanimous written consent or through the use of proxies by members (not by Governors) at a meeting, as explained below. The Act clearly allows notice of member meetings to be given by "facsimile telecommunication" or email. Such notices are deemed to be given when directed to the member's fax number or email as it appears on the membership record or to a fax number or other email address that has been filed with the secretary of the corporation. Notice is considered insufficient if the corporation is unable to deliver two consecutive notices, or if the corporation otherwise becomes aware that electronic notice cannot be delivered to the member.

The Act explicitly permits *members* to submit proxies by email, thereby authorizing another person to act for him/her. However, prior law in less direct wording also permitted transmission of proxies electronically, so this is more of a clarification as to email rather than a substantive change. Further, it should be noted that the Act does not permit member voting directly by electronic ballot and no change was made in this respect, so votes by members are still required to be cast at a meeting of members. However, many corporations use electronic proxy ballots to effectively permit e-voting by members on the election of Officers and Governors, or other actions such as bylaw amendments. As long as a quorum of members submits electronic proxies that are cast at a meeting, voting by members can be conducted electronically.

The Act explicitly permits member actions without a meeting by unanimous written consent transmitted electronically. Similarly, under new § 708, a board of Governors or committee also may take action without a meeting upon unanimous written consent transmitted electronically. This is essentially not a change from reasonable interpretations of current law. Note that the requirement for unanimous written consent for a member vote in most cases will mean that such electronic action without a meeting will not be available.

It is worth noting that the NPRA did not change the requirement that actions taken outside of a meeting of a Board of Governors or corporate committee (using electronic communication or otherwise) must be unanimous to be effective. As such, the Act in no way directly authorizes Boards of Governors, or

committees, to “vote by e-mail”. Rather, Boards and committees may simply rely on e-mail as a means by which they can authorize a particular action by unanimous consent. In order to authorize a given measure on unanimous consent, all Governors or committee members must still unanimously support its adoption based on participation of the “Entire Board” or every member of the committee, as appropriate.

Statutory Definitions

For purposes of this Memorandum, all new definitions established by the NPRA are set forth in quotation marks. Of these new definitions, some relate to governance matters, such as newly-established distinctions between “Committees of the Board/Corporation” (each addressed below) while others confirm long-held understandings of various frequently employed terms such as, “Entire Board” (also, see below). However, most consequential new definitions are applicable to the disclosure, review and authorization of conflicts of interest and responsibilities relative to fiscal oversight and none are more important than that of “Independent Director.”

- *Independent Director.* Of all new definitions, the most relevant for most nonprofits is that of “Independent Director.” In an effort to assure appropriate, uncompromised Director oversight with respect to important governance matters, the NPRA limits approval of certain actions solely to “Independent Directors.” A Governor can only qualify as an “Independent Governor” if he/she, within the last 3-years, was neither employed by, received more than \$10,000 in compensation from, nor has/had a substantial financial interest in any entity that made material payments to, or received payments from, the nonprofit or has/had a “Relative” who did. Our revision of your By-Laws not only addresses the necessity and responsibilities of “Independent Governors” in our proposed Statutory Compliance Article, but stipulates the statutory definition of the term and even offers a quick 6-question test to determine whether an individual qualifies as an “Independent Governor” in Attachments addressing Definitions and Conflicts Disclosure.
- *Entire Board.* In an effort to assure that there is no confusion with respect to the number of Governors that may be required to authorize particular actions, the NPRA adds statutory definition to the term “Entire Board.” According to statute, the term “Entire Board” means “the total number of Directors entitled to vote which the Corporation would have if there were no vacancies.” The Act further provides that when a nonprofit’s By-Laws specify a range between a minimum and maximum number of Governors, the “Entire Board” shall be interpreted to mean “the number of Directors within such range that were elected as of the most recently held election of Directors.”
- *Committee of the Board” & “Committee of the Corporation.* The NPRA provides that nonprofits may now establish and maintain only two types of committees. The first type is a “Committee of the Board,” which must be comprised solely of Governors and, with the consent of the Board, can be afforded authority to bind the nonprofit with respect to certain matters. The second type is a “Committee of the Corporation,” which may include Governors and Non-Governors. As part of our assistance, NYCON has suggested and/or modified committee charges to account for these new distinctions.

Given the extensive number of new statutory definitions, NYCON determined that it would be best to reference the application of all such terms in your By-Laws, but to provide actual definitions in an attachment. Reference to the use of these definitions is found in a proposed new Article termed “Statutory Compliance,” with the definitions, themselves, stipulated in a suggested Appendix.

Conflict of Interest Policies, Procedures & Related Disclosure Obligations

Of all topics addressed by the NPRA, none required more changes to nonprofit governance documents, and related policies and procedures, than those related to conflicts of interest, particularly “Related Party Transactions” (another new statutory definition). The Act takes such a hard stance against Board of Governor-level conflicts that there is now a statutory presumption that any such transaction is invalid and,

as such, unenforceable, unless it is properly determined that the transaction is fair, reasonable and in the best interest of the nonprofit. The term “Related Party,” itself, is broadly-defined, not only including Governors, but also “Key Employees,” “Relatives” and businesses owned by any of the foregoing.

Pursuant to the NPRA, should a Related Party have an interest in a proposed transaction involving the nonprofit, for the transaction to be properly authorized, the Related Party must first, in good-faith, self-disclose all material facts concerning his/her interest and then refrain not only from voting on the transaction, but from participating in deliberations or even attempting to influence outcomes (such obligations are specifically considered to extend to, and cover the review and authorization, of executive compensation). When evaluating any such Related Party Transaction, the Act further expressly requires the nonprofit to consider alternative non-conflicted transactions; approve the transaction by no less than a majority vote; and, contemporaneously document the basis for approval.

The Act expressly authorizes the Office of the Attorney General to bring an action to enjoin, void or rescind any Related Party Transaction (actual or proposed) that violates any provision of the law or that was otherwise unreasonable or not in the best interests of the organization at the time that the transaction was approved. Moreover, the Attorney General’s Office is empowered to seek other relief, including restitution, removal of Governors or Officers, or, in the case of willful and intentional misconduct, payment of an amount up to double the amount of any benefit improperly obtained.

Conflicts of Interest & Related Party Transactions Policy

While it has long been a recognized good governance practice for nonprofits to adopt, and require compliance with, written conflicts of interest policies, the NPRA codified the practice by requiring all nonprofits adopt written conflicts of interest policies, which must adhere to a number of expressly stipulated requirements. In order to assure that your organization has a conflict of interest policy that fully conforms with statutory requirements, particularly those applicable to “Related Party Transactions,” NYCON suggests the adoption of a new “Conflicts of Interest and Related Party Transactions Policy,” which is referenced in our proposed “Statutory Compliance” Article and set forth in an appendix.

Our recommended “Conflicts of Interest and Related Party Transactions Policy” conforms with all applicable NPRA requirements as follows:

- i. identifying procedures for disclosing, addressing, and documenting conflicts;
- ii. restricting the ability of conflicted parties unduly influence decision-making;
- iii. defining circumstances that could constitute a conflict;
- iv. stipulating documentation procedures; and,
- v. establishing protocols for audit-related conflicts disclosure.

Annual Potential Conflicts Disclosure Statements

As mentioned above, as part of their conflicts of interest policies, nonprofits must address proactive disclosure obligations. More specifically, the NPRA requires each Governor, prior to initial election and annually thereafter, to sign and submit a written statement identifying, to the best of his/her knowledge:

- i. any entity of which the Governor is an officer, Governors, member, owner or employee and with which the nonprofit has a relationship; and,
- ii. any transaction in which the nonprofit is a participant and the Governor might have a conflicting interest.

In an effort to comply with this NPRA-disclosure obligation, NYCON has suggested the utilization of a comprehensive “Code of Ethical Conduct & Annual Potential Conflicts Disclosure Statement,” again, referenced in our proposed “Statutory Compliance” Article and provided in an appendix. While Governors

are not statutorily-required to execute a Code of Ethical Conduct, NYCON has long considered reliance on such codes of conduct to be a best practice. By combining this Code with mandated Conflicts Disclosure Statements, a nonprofit can ensure that all Governors are annually reminded of their ethical obligations. We also note that the Conflicts Disclosure Statement, itself, contains a handy two-page questionnaire that can be used to confirm whether a Governor or Officer would properly be considered an “Independent Governor.”

Other Material Considerations

Indemnification & Insurance

The NPCL has long expressly authorized nonprofits indemnify their Governors, Officers, employees and volunteers from liabilities associated with their service to the organization and to purchase insurance coverage necessary to back-up this obligation. By “indemnifying” all such individuals, the nonprofit essentially agrees to assume the financial burden of any damages suffered, and any related legal costs that they may incur, as a consequence of good-faith efforts to advance the interests of the organization. The associated cost of such indemnification is generally guaranteed by advance purchase of appropriate Directors and Officers (“D&O”) liability insurance coverage, which essentially transfers the risk of financial harm from the nonprofit to an insurance carrier.

The indemnification of Governors, Officers, employees and/or volunteers and the authorization and procurement of related D&O liability insurance coverage is amongst the most important of matters to be considered by a Board of Governors in the proper management of a nonprofit’s affairs. In an effort to assure that your organization guarantees appropriate indemnification, secures necessary insurance coverage and, importantly, has comprehensive policies and procedures in place should an event triggering questions as to indemnification ever arise, NYCON suggested a comprehensive “Indemnification and Insurance Policy,” which affords your organization the measure of protection that it deserves.

AMENDMENT OF BY-LAWS: Approval/Notification & Procedure

Approval/Notification

Unless otherwise required by a self-imposed restriction found in its Certificate of Incorporation, as may be amended and/or applicable contractual obligations (all NYS-funded nonprofits should carefully research this potential concern, although it would seem inapplicable, here), no nonprofit is required to obtain any form of external approval in order to amend, modify or repeal its By-Laws. In this regard, the Office of the Attorney General need not approve, or even receive notification of, amendments to a nonprofit’s By-Laws.

While nonprofits are not required to obtain the approval of the Internal Revenue Service in order to amend By-Laws, the IRS must be notified of any amendment that is “structural or operational” in nature. Most nonprofits submit such notification by reporting amendments as part of their annual IRS Form 990 filings. In this regard, Part VI, Line 4 of the Form 990 asks whether a nonprofit has made any “significant” changes to its governance documents. Smaller nonprofits—those only required to submit the Form 990-N postcard filing—are not expressly obligated to notify the IRS of amendments to their By-Laws, but may do so by writing to the Exempt Organizations Determination Office, P.O. Box 2508 Cincinnati, Ohio 45201.

Procedure

NYCON trusts that we have produced a revised set of By-Laws that both fully comply with all applicable legal requirements and account for the specific needs of your organization. Nevertheless, it is essential that your organization be cognizant of the fact that our suggested By-Laws cannot be adopted, in whole, or in part, without specific adherence to mandates imposed by your current By-Laws. In order to properly adopt

our recommendations, your organization must adhere to your existing amendment procedures, not those suggested in our proposed revision that adhere with the Act.

SUMMARY

This concludes our review and assessment of the By-Laws that NYCON has recommended. As indicated, we are of the opinion that the By-Laws serve the governance needs of your organization, as we understand them, and comply with all applicable legal requirements, including those imposed by the New York Nonprofit Revitalization Act. Should you have any questions or concerns with respect to this Memorandum, please do not hesitate to contact me by telephone at 518.434.9194, x109 or by e-mail at lhlopko@nycon.org. Thank you for your interest in, and reliance on, our services.