Memorandum in Opposition

COMMITTEE ON NOT-FOR-PROFIT CORPORATION LAW OF THE BUSINESS LAW SECTION

BLS #4 June 6, 2018

S. 8216	By:	Senator Ranzenhofer
A. 10654	By:	M. of A. Paulin
	Senate Committee:	Corporations, Authorities and Commissions
	Assembly Committee:	Codes
	Effective Date:	immediately

AN ACT to amend the Not-for-Profit Corporation Law, in relation to the regulation of key persons.

LAW & SECTION REFERRED TO: Sections 715-b, 716, 717, 718 and 720-a of the Not-for-Profit Corporation Law.

THE COMMITTEE ON NOT-FOR-PROFIT CORPORATION LAW OF THE BUSINESS LAW SECTION OPPOSES THIS LEGISLATION

The Committee strongly opposes the passage and enactment of this legislation. This bill proposes to expand the application of a number of provisions of the Not-for-Profit Corporation Law (the "NPCL") that currently apply only to directors and officers to also cover "key persons," as defined under the NPCL. The Committee is mindful of a number of fundamental practical difficulties posed by these proposed amendments to the NPCL. One of the fundamental impediments identified by the Committee is the indeterminate nature of "key persons" as defined by the NPCL. Section 102(a)(25) defines "key person" as follows:

> § 102(a)(25) "Key person" means 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.

The bill extends to key persons the application of provisions of Sections 715-b (Whistleblower Policy), 716 (Loans to Directors and Officers), 717 (Duty of Directors and Officers), 718 (List of Directors and Officers) and 720-a (Liability of Directors, Officers and Trustees) of the NPCL. However, as opposed to directors and officers, whose identity at any point in time is fixed and objectively identifiable, the identity of key persons is, by definition, not fixed and objectively identifiable, which brings uncertainty to the application of the provisions that the bill seeks to amend, as well as to the identity of the individuals to whom such provisions would apply.

By way of example, the bill seeks to amend Section 717 of the NPCL (Duty of Directors and Officers) to expand the application of the fiduciary duties of directors and officers set forth in this section to key persons. Such an expansion to a class of individuals that is indeterminate and unfixed is extremely problematic. An examination of the practical difficulties imposed by just two of the three prongs of the definition of key persons, clauses (ii) and (iii) of Section 102(a)(25), is illustrative of the potential consequences that concern the Committee.[1] Clauses (ii) and (iii) provide that a key person is:

> "any person, other than a director or officer, whether or not an employee of the corporation, who . . . (ii) manages the corporation, or a segment of the corporation that represents a <u>substantial portion</u> of the activities, assets, income or expenses of the corporation; or (iii) alone or with others controls or determines a <u>substantial portion</u> of the corporation's capital expenditures or operating budget."
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> (emphasis added)

What constitutes a "<u>substantial portion</u> of the activities, assets, income or expenses of the corporation" is not defined, nor is there a definition of what would constitute "manag[ing] the corporation, or a segment of the corporation." Similarly, what constitutes a "<u>substantial portion</u> of the corporation's capital expenditures or operating budget" is not defined, nor is there a definition of what would constitute "alone or with others control[ing] or determin[ing]." <u>The identity of the persons to whom the very significant fiduciary duties of Section 717 would apply is therefore uncertain, a result that is clearly both unintended and untenable.</u>

The proposed amendments to Sections 715-b (Whistleblower Policy), 716 (Loans to Directors and Officers), 718 (List of Directors and Officers) and 720-a (Liability of Directors, Officers and Trustees) pose similar difficulties.

The application of the very significant fiduciary duties of Section 717 beyond directors and officers to key persons is also problematic because the bill does not extend to key persons the protections offered to directors and officers by the indemnification and advancement of expenses provisions of the NPCL (including, but not limited to, Section 722, Authorization for Indemnification of Directors and Officers, and Section 723, Payment of Indemnification Other Than by Court Award). Practitioners struggle to

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[1] It should be noted that clause (i) of the definition of key persons poses its own difficulties and uncertainties as to the application of the provisions that the bill seeks to amend, as well as the identity of the individuals to whom such provisions would apply.

educate directors and officers, and strive to make them aware of their fiduciary duties under the NPCL. The proposed amendments would create a situation wherein an individual that is not on notice of the applicability of the Section 717 fiduciary duties could be deemed to be <u>subject to these fiduciary duties, and could simultaneously be without the protections afforded to directors and officers by the indemnification and advancement of expenses provisions of the NPCL</u>. A further adverse unintended consequence of the proposed amendments may be found in the fact that, because key persons are, by definition, not directors or officers, key persons may find themselves <u>with the fiduciary duties of directors and officers but without the protections afforded to directors and officers by directors' and officers' liability insurance coverage</u>.

The Committee notes that, to our knowledge, there has not been presented a compelling case as to why the changes implemented by the proposed legislation are necessary, what deficits in the statutory framework the proposed legislation is seeking to remedy, and what alternatives were considered before adopting these proposed changes. In addition to the concerns with, and unintended consequences of, these proposed changes noted above, the Committee is concerned about the capacity of many entities in the nonprofit sector to properly implement the proposed changes. The Committee is also concerned about the implicit costs such changes would impose on entities in the nonprofit sector, where the resources available to dedicate to such costs are more limited than in the for-profit sector, and where there is often a compelling need to utilize nonprofit resources on other priorities.

For the foregoing reasons, the Committee on Not-For-Profit Corporation Law of the Business Law Section **OPPOSES** this legislation.