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## Nonprofit mergers gaining velocity

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Competition for scarce dollars, dwindling volunteers and a tough economy have conspired to push more nonprofit groups and industry trade organizations to consolidate, creating a heady array of legal challenges for their lawyers.

Attorneys may require the skills of a psychiatrist to confront culture clashes between groups that otherwise share similar goals, ticklish tax questions and the need for rigorous due diligence investigations to protect governing boards in a post-Sarbanes-Oxley Act (SOX) world. Even the vagaries of antitrust concerns need added vetting.

"In our practice, among the professional societies we are definitely seeing increases in mergers," said Jerald Jacobs, at Pillsbury Winthrop Shaw Pittman's Washington office.

He facilitated last year's merger of the American Bankers Association and America's Community Bankers, and earlier this year when an air-conditioning trade group joined forces with gas appliance makers.

Many mergers are "driven by the leadership of the two organizations that want to reduce dues obligations and commitment of volunteer time," Jacobs said.

They must meld governance, dues and benefits and sometimes get members as well as boards to agree to the deal, he said. The mergers require financial due diligence investigations to avoid board liability, and can include intellectual property and pension issues, he said.

One 2007 merger featured an unsuccessful proxy battle by dissident members who fought the combination of two associations of corporate CEOs, Jacobs said. It was much like a traditional corporate stockholder proxy fight, he said. Eventually, the two groups, the Young Presidents' Organization and the World Presidents' Organization, joined forces.

Although there is no comprehensive tracking of nonprofit mergers, Christine Sorge, with Schulman, Rogers, Gandal, Pordy & Ecker in Rockville, Md., said they have been rising for years. "Some high-profile mergers are getting attention, but most fly under the radar because there are so many and they are small," she said.

### An economic factor

The slow economy has exacerbated the problem for groups competing for the same few donors and volunteers. Consolidation often can increase efficiency and reduce those strains, Sorge said.

She said the combinations raise some of the traditional concerns of for-profit corporate mergers: culture clashes, who will serve on the board, where will the organization be headquartered and what services will change. They also raise issues of merging technology, whether investment portfolios are managed the same way and tax questions. If they provide services that are regulated, such as housing, they may need local government approval to merge.

"It is a good idea to let the IRS know what is going on and even get a private-letter ruling on such things as whether merged assets will be recognized as a [taxable] gain on assets," she said.

**JOINING FORCES**  
*Recent nonprofit mergers*

- AUGUST 2008** Network for Good and ePhilanthropy
- JANUARY 2008** Air-Conditioning and Refrigeration Institute and Gas Appliance Manufacturers Association
- DECEMBER 2007** American Bankers Association and America's Community Bankers
- NOVEMBER 2007** American Association of Ambulatory Surgery Centers and Foundation for Ambulatory Surgery
- JULY 2007** Young Presidents' Organization and World Presidents' Organization
- JANUARY 2007** Community Foundation of Silicon Valley and Peninsula Community Foundation

Not all mergers represent small or midsize charities or associations. Some are substantial.

In January 2007, two Northern California philanthropic foundations, worth \$1.5 billion, attracted attention with the mega-merger of the Community Foundation of Silicon Valley with the Peninsula Community Foundation.

And some recent combinations have presented unique legal challenges and new business models.

The Aug. 12 merger of an online fundraising service, the nonprofit Network for Good, merged with ePhilanthropy Foundation, an educational group for nonprofits, in what looks like an acquisition binge.

Network has acquired three other nonprofits as part of its growth strategy, giving it the looks of a for-profit corporation. Network's other nonprofit acquisitions include Direct Help, WhatGoesAround.org and Groundspring.org.

"Network for Good doesn't fit the mold for a nonprofit — it is run like a corporation and came out of a corporation mold," said Whitney Winston, with Steptoe & Johnson in Washington and one of Network's lawyers.

He said social entrepreneurship "is a new, rising area for nonprofits and a new business model for them." Winston, who practices patent and intellectual property law, and another colleague, who handles Network's intellectual property work, were tapped for the latest merger arrangements.

In the health care industry, where nonprofit hospitals dominate the financial landscape of the nonprofit world, a rash of mergers ran its course a decade ago, although some continue today.

Now that the "crazy boom in health care merger has passed, hospitals and health systems are coming together in new formations," said Donn Herring of Lathrop & Gage in Clayton, Mo.

"What we're seeing on the health care side is major funding groups, such as the National Institutes of Health and the national Center[s] for Disease Control [and Prevention], starting to get uncomfortable with being bombarded with grant requests from different groups that are all treating the same health conditions," he said.

The funders are asking the groups to come together regionally under one umbrella group to accept the grants. Then they will decide among themselves how to allocate it, Herring said.

He worked on the creation of the St. Louis Regional Asthma Consortium six years ago to do just that.

The umbrella group is set up as a nonprofit. That requires legal help, and that all these groups negotiate together, he said.

"You are working with groups to find that commonality and gain trust in each other, when they have traditionally competed," he said. "Suddenly, they are required to work together, and sometimes it is tough to put the old ways behind."

It is similar to the underlying dynamics in for-profit corporate mergers, he said.

### **Antitrust considerations**

Herring noted that some of the mergers may prompt antitrust attention down the road. "There is a strain of antitrust that applies to nonprofits," he said.

"Is there a point at which you cross that line? I have struggled with that question. It may tend to come out of health care because it is such a big group. But I don't know where the line may be drawn," he said.

While funding agencies have encouraged cooperation among groups, Herring wondered whether another part of the government may view the coming together of these groups as a way to assert market power in violation of antitrust principles when they compete for some of the same foundation funds and grants.

In addition, while nonprofits are not mandated to comply with the Sarbanes-Oxley corporate disclosure and ethics rules, parts of the law do come into play, he said.

"The larger nonprofits tend to borrow from Sarbanes-Oxley in the belief that they may one day be required, so why not adapt," he said. They tend to focus on areas of transparency for funders and members as well as ethical rules.

In the wake of the corporate scandals that preceded Sarbanes-Oxley, "many nonprofit organizations have strengthened their governance programs by modeling policies on SOX- inspired corporate measures, ensuring transparency and ethical protections," Jacobs said.

Due diligence investigations, both legal and financial, are critical in merging associations and large nonprofits, Jacobs said. There is a compelling reason for due diligence: Courts have held board members and directors of corporations personally responsible for withholding information in advance of mergers, he said.

"The larger nonprofits tend to borrow from Sarbanes-Oxley," he said.

Despite the wave of nonprofit mergers, Scott Harshbarger, former Massachusetts attorney general and past president of Common Cause, said it is long overdue and should happen even more often.

"Many nonprofits and boards of nonprofits ought to seriously look to see if they can deliver a better product more efficiently with a merger," said Harshbarger, now a senior attorney in Boston with New York-based Proskauer Rose. "I know from my own experience, there is some politics and personal self-interest and the founder's syndrome that prevents mergers."

He added that sometimes the legal instruments that established the original nonprofits impose conditions that make future mergers difficult.

Another problem that should push any major nonprofit and even family foundations to merge is increased efficiency, Harshbarger said.

"The thing I see more and more is thinness in staff, financial infrastructure and, particularly now, more regulatory oversight, depending on the state," he said.

"I do think there is an opportunity for counsel to help boards and leaders to think about what might be a pathway to successful merger," he said.

### **The pitfalls**

Elisabeth Babcock took over as chief executive officer in 2006 of The Crittenton Women's Union, when two of Boston's oldest nonprofits merged — the Women's Union, formed in 1877, and Crittenton, established in 1824. The combined group helps roughly 2,000 low-income people annually with housing, education and training.

Babcock encouraged other nonprofits to consider merging but warned of some pitfalls.

The problem for lawyers is that in the for-profit merger side the merger costs are offset by gains in efficiency and competition, but nonprofits can't be sure of that. If two groups get \$25,000 each from one donor, they need to worry that after a merger they may get only one \$25,000 donation. That happened to her organization.

But she said that the merger allowed the two groups to operate more efficiently as one and provided a stronger base to seek larger government contracts and larger grants.

"Lawyers need to think about the process for merger that is simplified, most cost effective and that makes it possible for the group to deal with the costs," she said.