# Mergers and Acquisitions Between Nonprofit Organizations

*by Stephanie A. Mattoon*

If you practice in the nonprofit arena, you are likely to be asked at some point to guide a nonprofit organization through the process of combining with another nonprofit organization. In some cases, nonprofits utilize mergers and acquisitions as a strategy to advance their mission by increasing geographic reach, broadening services, or otherwise expanding through inorganic growth. On the other hand, many nonprofits are facing a challenging environment with reduced funding sources and choose to combine resources to enhance operational efficiencies and avoid financial distress. Whatever the rationale, the process and documentation necessary to combine two nonprofit organization will look similar to that involved in a "conventional" business combination in the for-profit sector; lawyers for both parties may be engaged to prepare a letter of intent, conduct due diligence, negotiate definitive agreements, and close the deal. However, there are additional and distinct issues, both legal and nonlegal, that must be considered when the transaction involves a nonprofit organization.


### Stephanie A. Mattoon

**Stephanie A. Mattoon** is a partner at Baird Holm LLP. She represents nonprofit and for-profit organizations at all stages of their life cycle with respect to corporate formation, mergers and acquisitions, and corporate governance matters. She regularly assists new organizations in obtaining 501(c)(3) or other tax-exempt status and advises existing public charities regarding compliance with federal tax law, including private benefit issues, unrelated business income tax, lobbying and political activity restrictions, fiscal sponsorship arrangements, and public charity support determinations. Stephanie received her Juris Doctor, with high distinction, from the University of Nebraska College of Law in 2005.


As in the for-profit sector, business combinations between nonprofit corporations may come in a variety of flavors. This article focuses on mergers and asset transfers as basic alternatives available to a nonprofit organization, discussing the mechanics and legal considerations associated with a decision to combine. Procedurally, business combinations are governed by state law; in Nebraska, mergers and asset purchases between nonprofit corporations are governed by the Nebraska Nonprofit Corporation Act (Neb. Rev. Stat. Ann. § 21-1901, *et. seq.*) (for purposes of this article, the "Nebraska Act"). Many of the considerations facing a nonprofit board of directors evaluating a business combination decision in the state of Nebraska flow from this Nebraska Act. In addition, the Federal tax-exempt status of one or both parties to the business combination may result in added complexity at the federal level.

It should be noted that nonprofits are frequently parties to joint ventures, collaborations, affiliations, and other arrangements involving the sharing of goals and resources in a manner that allows each organization to maintain some degree of separateness and autonomy. While beyond the scope this article, such collaborations also involve important legal issues and should be carefully considered and documented. In addition, this article primarily focuses on combinations between nonprofit organizations classified as public charities, and does not generally address transactions involving a private foundation or between a nonprofit and a for-profit entity (which can trigger significant additional legal and tax issues).

## Mergers Between Nonprofit Corporations

In a simple two-party merger, one organization (typically, a smaller entity) will merge into a second organization (typically, a larger entity), such that the first organization is merged out of existence and the second organization emerges as the sole surviving entity. There are numerous variants on this basic merger structure, although this section of the article will focus only on the simple two-party case.

A merger may be a desirable form of business combination between two nonprofit corporations because of its relative simplicity and efficiency, particularly from the perspective of the merged-out corporation. Merger procedures are governed by state law and, if complied with, have numerous effects by operation of law. Most significantly, the assets and liabilities of the merged-out corporation automatically transfer to the surviving corporation and no dissolution procedures are required for the corporation that is merged-out of existence. The correlating disadvantage of course is that the surviving corporation assumes all liabilities of the merged-out entity, known and unknown, so it is essential for the board of directors of the survivor to conduct thorough due diligence.

### State law merger procedures

Mergers involving nonprofit corporations in the state of Nebraska are governed by Subchapter (j) of the Nebraska Act.[1] Procedurally, the first step in a merger between one or more nonprofit corporations is the adoption of a plan of merger, which must be approved by the board of directors of the participating entities, as well as their members (if any).[2] (For this purpose, a "member" is defined under the Nebraska Act as a person with the right to vote for the election of directors.[3] Many nonprofits may refer to supporters or other interested persons as members for a variety of other purposes, but those persons do not have the right to vote for directors and thus their approval would not be required.) Prior court approval may be required for mergers involving a public benefit or religious corporation in some circumstances.[4] Among other requirements, the plan of merger must explicate the identity of the surviving corporation and the manner and basis for converting memberships of each merging corporation into memberships of the surviving corporation.[5] After approval, the articles of merger must be delivered by the surviving corporation to the Secretary of State.[6]

The merger between two nonprofit corporations has the following legal consequences: 1) the separate existence of the corporation that is not the surviving corporation ceases; 2) all assets and liabilities of the merged entities are transferred to the surviving corporation; and, 3) the articles of incorporation and bylaws of the surviving corporation are amended to the extent provided in the plan of merger.[7] Notwithstanding the foregoing, a proceeding already pending against any party to the merger may be continued as if the merger did not occur, with the surviving corporation substituted in the proceeding for the corporation that no longer exists.[8] Any bequest or gift contained in a will or other instrument made to a party to the merger, that takes effect after the merger, inures to the surviving corporation unless the instrument specifies otherwise.[9]

### Additional legal requirements

Various state law and Federal law requirements may be triggered depending on the status of each of the participating organizations under both the Nebraska Act and Federal tax law. Most frequently, both organizations will have the same status; usually, each organization constitutes a "public benefit" corporation under the Nebraska Act and a 501(c)(3) public charity under Federal tax law. In that scenario, the Nebraska Act does not require specific notice to or approval of the Nebraska Attorney General and the Federal tax exempt status of the surviving corporation will typically survive. The merged-out corporation would need to file a final Form 990 to notify the Internal Revenue Service of the merger.

Occasionally the merging organizations fall under different categories of tax exemption. For example, an organization classified as a "mutual benefit corporation" under the Nebraska Act and tax exempt as a "social welfare organization" under Section 501(c)(4) of the Internal Revenue Code could potentially merge with a 501(c)(3) public benefit corporation. In that scenario, the surviving corporation may need to file a new application with the IRS for federal tax exemption. In addition, the Nebraska Act imposes specific requirements as a condition to effectuating the merger of a charitable organization with a mutual benefit or for-profit corporation, including prior notice to the Attorney General (and potentially prior court approval), to ensure the fair market value of the charitable assets continue to be used for charitable purposes following the merger.[10]

### Special Considerations

The unique nature of nonprofit mergers also triggers special considerations at the board of directors and staff level. The directors of a nonprofit corporation owe fiduciary duties similar to for-profit directors when making decisions related to a combination. However, a nonprofit director's duty is not to maximum shareholder value (since the nonprofit has no owners) but rather to further the organization's mission. Regardless of which entity survives the merger, both parties to a merger will seek some degree of alignment of charitable purpose from the outset to ensure that the combination is a beneficial strategy for achieving each respective mission (and is likely to obtain the requisite approvals to move forward). Because strategic mergers generally have a greater likelihood of success than an expedient merger driven solely by financial rescue, nonprofits considering a merger often look to organizations with which they have a preexisting relationship.[11]

In addition to ensuring that its mission will be carried on by the surviving organization, the board of directors of the merged-out organization should be cognizant of how it frames the transaction to members, donors, or other constituents. The board may frame the merger as a "strategic alliance" or "merger of equals" (despite that the entity will cease to exist) to cast the transaction in a positive and cooperative light. Recent studies have found that the language of merger between nonprofit corporations can potentially damage the merger's prospects of success.[12] In certain circumstances, the merging organization may propose that its mission and services (and perhaps even its brand or logo) maintain some degree of formal recognition within the surviving corporation via a separate "division" with a distinct subset of interests, management, and finances. While this model adds complexity, it can be accomplished with clear expectations and proper documentation.

## Asset Transfers Between Nonprofit Corporations

In a simple two-party asset transfer, one organization (typically, a smaller entity) will sell or otherwise transfer all or substantially all of its assets to the second organization (typically, a larger entity). In contrast to a merger, each party to an asset transfer remains in existence after the transaction is complete. However, in connection with the transfer of substantially all of its assets, the transferring organization will frequently commence dissolution proceedings.

As with mergers, there are many potential variants on the basic asset purchase structure, although this article will focus only on the simple, two-party case. Like mergers, the approval procedure for transferring a nonprofit corporation's assets are governed by state law. Unlike mergers, however, the consequences of asset transfers do not automatically take effect by operation of law. Rather, the terms of the transaction are governed by an asset transfer agreement, which may produce various legal consequences depending on the nature of the assets and liabilities subject to transfer.

An asset transfer may be a desirable form of business combination because of its flexibility. Unlike a merger, not *all* of the assets and liabilities of the acquired organization are necessarily transferred through the combination. Rather, the asset transfer agreement will specify the assets (and potentially liabilities) subject to transfer. Therefore, this structure may be particularly desirable from the perspective of the acquiring organization. If the transferring organization has significant liabilities (including contingent liabilities), those liabilities may be carved out from the transaction by a contractual provision stating that the acquirer is assuming only expressly identified liabilities. (Even so, the acquirer should evaluate any risks of successor liability, under a potential theory that the acquirer is a mere continuation of the transferor or the transfer constituted a de facto merger or fraudulent transfer.) Not only does an asset transfer allow the acquirer to limit its liability exposure, but it also imposes on the acquirer less onerous approval and filing requirements. Namely, the acquirer need not seek *member* approval (unless required by its bylaws) and its receipt of the assets will not typically impact its Federal tax-exempt status. In addition, because the acquirer is merely absorbing assets (and not liabilities unless specifically agreed), the due diligence required of the board of directors is typically less rigorous.

However, this enhanced flexibility comes at the cost of greater complexity. An asset transfer agreement between two nonprofit corporations is likely to resemble an asset purchase agreement in the for-profit context, but may also include special provisions unique to nonprofits. Because the assets do not automatically transfer by operation of law, they must be specifically identified in the purchase agreement and conveyed by appropriate transfer instrument. Similarly, any liabilities to be assumed by the acquirer (such as obligations under assigned contracts) must be specifically documented, and the closing is usually contingent upon obtaining consents from all required third parties. In addition, the asset transfer structure may be less desirable than a merger to the transferring organization due to the additional procedure required to dissolve the corporation and the difficulty framing the transaction as one between organizations on "equal footing."

## State law asset transfer procedures

A nonprofit business combination structured as an asset transfer is governed by Subchapter (k) of the Nebraska Nonprofit Corporation Act.[13] Just like a for-profit entity, a nonprofit corporation may sell or otherwise transfer substantially all of its assets (or purchase substantially all of the assets of another nonprofit corporation) as a step precedent to the dissolution of the transferring corporation and as an alternative to business combination through merger. Procedurally, the transferring organization must obtain the approval of its board and its members (if any), by a specified vote.[14] A nonprofit corporation classified as a public benefit or religious corporation under the Nebraska Act must give written notice to the Nebraska Attorney General at least 20 days before it transfers substantially all of its property outside the regular course of activities.[15] (A sale of an organization's assets preceding its dissolution will not be considered in the regular course of activities.) The board of the acquiring organization must approve the transaction, but the approval of the acquiring corporation's members is not required.

## Special considerations

As with mergers, asset transfers may involve unique considerations arising from the status of one or both of the parties as a nonprofit organization. Although the form of an asset transfer agreement will often include representations and warranties and indemnification provisions similar to those in a for-profit asset purchase agreement, the acquiring organization will typically have limited or no redress for a breach of those provisions, since the transferring organization will often have no remaining assets (and may dissolve shortly after the transfer). Whereas the principle shareholders of a selling for-profit corporation would often sign the purchase agreement and assume some liability for the seller's indemnification obligations, the transferring nonprofit corporation has no shareholders (and its volunteer directors are unlikely to agree to assume any personal liability). If the transferring organization has members that will be integrated into the acquiring organization, the details of that integration will need to be set forth in the purchase agreement or restated bylaws. The asset purchase agreement must also stipulate whether bequests, restricted funds, gifts and donations, and donor information, will be included in the transfer. Restrictions on the transfer of these items must also be considered, as well as the process for transferring donor information (if applicable).

The transfer agreement involving the assets of a nonprofit corporation may also significantly differ from a for-profit asset purchase agreement as it relates to the purchase price. When the transfer is between two nonprofit corporations with the same status (for example two 501(c)(3) charitable organizations), the parties may consider structuring the asset purchase as a gift of assets, rather than a transaction for fair market value. This may be desirable if the acquiring organization is in a position to continue carrying on the mission and operations of the transferring organization and would be permissible so long as the transferor's creditors are paid in full. Even if the transaction is structured as a gift of assets, however, a formal written agreement is recommended for the legal protection of both parties. In that scenario, the acquirer should be aware that it is unlikely to receive full disclosure with respect to the assets transferred. Indeed, the gifting organization may propose to transfer the assets "as is" and thus the parties may agree to disregard traditional representations and warranties regarding the condition of assets. The board of the acquirer must still engage in due diligence in an effort to fully understand the extent and conditions of the assets subject to the gift (and any potential accompanying obligations).[16]

The transfer of substantially all of an organization's assets is usually a step precedent to dissolution; however, in contrast to a merger, the transferring organization does not automatically cease to exist. Rather, the transferring organization will continue to exist as a legal entity unless it takes the additional affirmative steps required to dissolve. Dissolution of a Nebraska nonprofit corporation requires compliance with the applicable sections of Subchapter (m) of the Nebraska Act.[17] In short, the board of directors of the dissolving corporation must approve a plan of dissolution, obtain member approval (if applicable), provide certain notices to the Nebraska Attorney General (if a public benefit or religious corporation), file articles of dissolution with the Secretary of State, publish notice of dissolution, provide notice to known and unknown creditors (if desired to dispose of claims), make provision for payment of remaining liabilities, and distribute remaining assets pursuant to the approved plan. When the transferring organization is a charitable organization (tax exempt under Section 501(c)(3) and a public benefit corporation under the Nebraska Act), its assets must be distributed exclusively to one or more other charitable organizations.[18]

## Conclusion

Although mergers and asset purchases between nonprofit corporations largely mirror those between for-profit companies, there are myriad legal considerations unique to the nonprofit sector. In evaluating a potential combination, the board of directors of a nonprofit corporation must consider not only whether the proposed transaction will further its nonprofit mission but also how to structure the transaction in a manner that most efficiently and effectively achieves its objectives. With proper planning and strategic vision, business combinations between nonprofit corporations may present a promising opportunity for mission advancement and heightened impact.

## Endnotes

1 Neb. Rev. Stat. Ann. § 21-19,118 *et. seq*.

2 Neb. Rev. Stat. Ann. § 21-19,118; Neb. Rev. Stat. Ann. § § 21-19,120.

3 Neb. Rev. Stat. Ann. § 21-1914(20).

4 Neb. Rev. Stat. Ann. § 21-19,119.

5 Neb. Rev. Stat. Ann. § 21-19,118.

6 Neb. Rev. Stat. Ann. § 21-19,121.

7 Neb. Rev. Stat. Ann. § 21-19,122.

8 *Id*.

9 Neb. Rev. Stat. Ann. § 21-19,124.

10 *See* Neb. Rev. Stat. Ann. § 21-19,119.

11 *See* Haider, *Nonprofit Mergers that Work*, Stan. Soc. Innovation. Rev. (Mar. 2, 2017); Haider, *Nonprofit Mergers: New Study*, Stan. Soc. Innovation Rev (Jan. 11, 2017).

12 Haider, Nonprofit Mergers: New Study, supra note 11.

13 Neb. Rev. Stat. Ann. § 21-19,125 - § 21-19,126.

14 Neb. Rev. Stat. Ann. § 21-19,126(b).

15 Neb. Rev. Stat. Ann. § 21-19,126(g).

16 *See generally Major Asset Transfers Between Charities: Corporate Law Considerations*, Miller Thomson (Apr. 2011), http://www.millerthomson.com/en/publications/communiques-and-updates/social-impact-newsletter-formerly-the/april-2011/major-asset-transfers-between-charities/.

17 Neb. Rev. Stat. Ann. § 21-19,129 *et. seq*.

18 Treas. Reg. § 1.501(c)(3)-1(b)(4); Neb. Rev. Stat. Ann. § 21-19,134(a)(6)