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Strategic Alliances: **Special Valentine's Day Edition**

Love is in the air, and nothing is more romantic than exploring a new relationship in time for Valentine's Day! Relationships, whether romantic or nonprofit, benefit from a lot of the same wisdom: from the importance of defining the relationship to doing your due diligence. This legal alert reviews steps you should take before you swipe right and enter into *any* alliance. We will also provide brief overviews of the key legal structures for strategic alliances.

Unlike falling in love, we generally advise careful planning before venturing out into the nonprofit partnership market. Keep in mind that along the way you will want to keep your Board informed. You do not want to be asking for a partner's hand only to have family drama the night before the wedding! Before you start looking, it's best to have your organization establish your #relationship goals: Are you looking for a long-term financial partnership? Or someone to help with a discrete project? Clarity about what you are looking for beforehand will prevent both parties from spending time and energy on a bad romance and ensure your goals are clear during courtship.

Now picture this: you are in talks with a potential partner, and you think it's going well. Next, it's time to talk details. Can you both agree on what your goals are? Can you sync up on the nitty-gritty details like charitable purpose, timing, finances, population to be served and shared measures of success? Honest and clear dialogue about expectations at the outset can save a lot of pain and frustration down the road.

You should also do your own research: both parties should conduct due diligence and mutually request and exchange key governance, financial, and operational information to give both parties the best information to make informed decisions.¹ Like in dating, reviewing social media and other public-facing advertising is fair game too. Is your potential partner projecting a wholesome public image that you want to share in? Or is the image indicating you will end up in the next installment of "Can This Marriage Be Saved?"

Regardless of how these considerations are agreed upon and what legal structure is chosen, the most vital step is to define the relationship *in writing*! A 'term sheet' can include the main points in plain English that non-lawyers want to see in the relationship. A more formal written agreement, drafted by lawyers, should document the specifics of the relationship, from its goal and duration to each parties' day-to-day operational responsibilities. Below, we walk through various structuring options for strategic alliances or restructuring, from least- to most-integrated.²

¹ We recommend, at the very least: governance documents (e.g., bylaws, IRS documents, board rolls and resolutions); proposed budget and three years of financial and tax records; licenses; contracts. The broader goal is to determine material risks including, for example, pending or threatened litigation. For a more complete list, please see Appendix A of our previous Legal Alert, *Structuring a Strategic Alliance*, https://lawyersalliance.org/userFiles/uploads/legal_alerts/Structuring_a_Strategic_Alliance_PPE_Legal_Alert.pdf.

² For more detail, we recommend our previous legal alert, mentioned above or our webinar on Building Partnerships, found here: <https://lawyersalliance.org/recorded-webinars>.

Project-Specific Collaboration

- **For:** Organizations who want to collaborate on a specific project, but otherwise remain independent entities.
- **Key Characteristics:** Terms are determined by agreement between the parties. As with any arrangement, the terms should be memorialized in a *written* agreement that may be called a collaboration agreement, a joint venture³ agreement or simply called by the name of the project. There is no joining of assets or liabilities. Collaboration is limited in time and scope. No government approval is needed.
- **Examples:** Two nonprofits jointly apply for a grant opportunity they will implement together or enter into a contract to create a program with joint branding of the two organizations.

Much like planning a date, project-specific collaborations are best suited to achieve specific goals and each parties' role should be defined. For example, administrative services like accounting and bookkeeping may be allocated to one party for a fee paid by the other, memorialized in an Administrative Services Agreement. This kind of agreement ensures that if one party is expected to do some legwork—be it time spent making phone calls (e.g., staff time) or payroll or grant administration—they will be sufficiently compensated for it.

Sole Membership (Parent/Subsidiary) Relationship

- **For:** Organizations that may want to merge eventually, but want an interim step before a full merger (like moving in together before getting married).
- **Key Characteristics:** The subsidiary organization simply amends its bylaws to become a membership corporation, and the parent organization is named as the sole member of the subsidiary, effectively allowing the parent entity control of the subsidiary by appointing the subsidiary's board of directors. No time limitation. No government approval needed.
- **Examples:** A nonprofit wants to merge with another nonprofit, but it has contractual obligations to fulfill, e.g., leases and funding agreements, and wants to complete them before a formal merger. Or the potential parent entity is concerned about the subsidiary entities' outstanding liabilities and debts and wants to maintain corporate separateness until they can be addressed.

Let's say you are interested in merging but right now at your organization, "it's complicated." For one reason or another, organizations may want to merge but are unwilling or unable to go through the formal legalities (like government approval) or bear the legal consequences (such as assuming the debts and liabilities of the other organization). A sole membership or parent/subsidiary relationship allows for both the control of one organization by the other and the maintenance of separate legal entities. Given there is no time duration attached to this structure, it is a great stepping stone towards a complete merger. Nonetheless, while the two organizations maintain separate legal entities, the subsidiary organization should review its grants and contracts to determine whether it is required to notify funders and lenders of its "change of control" to the parent organization. Other than that, the two organizations

³ A joint venture can also involve the creation of a new, third entity that is managed by both of the two existing entities. But such relationships are complex and require ongoing oversight that is beyond the scope of this legal alert. They are often appropriate for substantial income-generating activities.

can continue to operate largely as they did before. Both the parent and subsidiary continue to maintain their own boards and other corporate formalities.

Merger

- **For:** When two nonprofits want to form one, larger nonprofit.⁴
- **Key Characteristics:** One board, set of governance documents, books and records, payroll, and corporate identity. Assets, liabilities, staff, intellectual property and programming are joined.
- **Example:** Two nonprofits with similar programming merge to consolidate resources and improve financial stability.

This is a full-on marriage of two nonprofits! The organizations are completely combined. The Board of Directors for the larger nonprofit often invites Board members from the smaller nonprofit's Board to join the surviving nonprofit's Board.

Why not consolidation? **Consolidation** is when two nonprofits join together and form a new legal entity and identity. A new Board of Directors manages the new entity, and operates under a new corporate name. While consolidation has certain advantages, starting with a clean slate to name one, a major reason why nonprofits might not choose to consolidate is because the new entity must apply for tax-exempt status with the IRS, and obtain new city and state licensing and approval if needed.

Both mergers and consolidations require approval by the Attorney General's Charities Bureau office⁵ or New York State Supreme Court. The approval process is involved and, like getting a good marriage counselor, we recommend retaining legal counsel to navigate through the merger process. In addition to lawyers, there are consultants who can help navigate this process, particularly when an organization might be considering its options at a time of financial distress.

This alert is meant to provide general information only, not legal advice. If you have any questions about this alert please contact Rafi Stern at rstern@lawyersalliance.org or visit our website at www.lawyersalliance.org for further information. To become a client, visit www.lawyersalliance.org/becoming-a-client.

For her assistance in preparing this Legal Alert, Lawyers Alliance would like to thank Celine Zhu, a Staff Attorney and Legal Fellow from New York University Law School's National Center on Philanthropy and the Law.

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⁴ There are a number of possible permutations that a merger can take, but all end in the same general outcome: one entity remains, where two once existed.

⁵ See: <https://ag.ny.gov/sites/default/files/2023-02/mergers-consolidations.pdf>.