MANAGING MERGERS & DISSOLUTIONS
Options for Faltering Nonprofits–
A Practical Mission-Based Approach

By Attorney Todd C. Fahey[1]

I. INTRODUCTION

This article is intended as a practical guide for counsel called upon to assist a faltering New Hampshire nonprofit organization that is considering some type of restructuring, including a reorganization, merger or dissolution.[2] While there are many types of nonprofit organizations[3], this article will focus on mission-driven charitable organizations qualified as tax exempt under Section 501(c)(3) of the Internal Revenue Code.[4] Despite such focus, the proposed analytical framework applies equally to other troubled New Hampshire voluntary corporations.

Charitable organizations are different from business organizations. At their best, they are born of altruism and exist to perpetuate a charitable mission. When they die, the best of them leave a void for their clients like the loss of a cherished friend. The unexpected closure of a nonprofit makes headlines. Such stories are a testament to the force of nonprofits and the energy they bring to bear on the lives of those who depend on them. This "charitable energy" is not found in a reorganization, merger/acquisition or closure of a for-profit entity. Consequently, nonprofit governing boards and their counsel must (in addition to addressing the obvious and usual concerns) mindfully manage this energy in the context of the organization's mission and in the midst of economic turmoil.

When a charitable organization lacks the means (financial or otherwise) to fulfill its mission, the organization has essentially three options[5]:

i. It can reorganize.
ii. It can merge.
iii. It can dissolve.

In evaluating these options, care must be taken to protect the energy of the organization expended in the fulfillment of its charitable mission. New Hampshire's legal framework provides basic guidance, but it does not sufficiently address the unique needs and expectations of those who have come to depend upon a charity that has grown infirm.[6] New Hampshire's voluntary corporation statute, RSA 292 (all 35 pages of it), stands in stark contrast to the 137 pages of New Hampshire's Business Corporation Act, RSA 293-A.[7] This difference is highlighted not to suggest that RSA 293-A is entirely sufficient, but it certainly provides more tools for practitioners to use. This article will propose a framework suitable for troubled nonprofits based upon existing law and will conclude with some suggestions for change and improvements to RSA 292.

II. THE CALL OF DUTY

New Hampshire nonprofit organizations can take many forms, including charitable trusts, testamentary trusts, or voluntary corporations[8]. Most will have as their purpose one of the purposes set forth in RSA 292, even if not incorporated under that section. Ultimately, the organization needs to function in a manner that fulfills its mission. Commonly, it will be prevented from fulfilling its purposes/mission for financial reasons. At other times, an organization may be prevented from fulfilling its mission for non-economic reasons like impracticability, obsolescence and the like. Regardless of the reason, an unfulfilled mission is a crisis for a mission-driven charitable organization.

Those who govern nonprofit organizations are bound by fiduciary duties to act in the best interests of the organization. This is a basic concept, but what does it really mean and what does it require of a governing board? Does it mean preserving the organizations assets? Definitely. Does it mean managing the organization's liabilities? Yes. Does it mean preserving the organization's mission to the full extent possible, even in the wake of a transformative event like a reorganization, merger, or dissolution? Certainly.[9] As discussed below, a reorganization or a merger can occur without terminating an organization's charitable mission. By contrast, the decision to dissolve is an extreme measure that must be seriously examined. Governing boards are, after all, expected to perpetuate a charitable organization's mission, not to extinguish it. The decision to dissolve should be undertaken only after much careful thought and documented deliberation about the organization's prospects, with the board's deliberations and final decision ideally informed by an expert specifically retained for the purpose.[10]

In the case of charitable organizations, there will likely be a small, yet perceptible, "charitable void" left unfilled upon the organization's dissolution which should be considered. Metaphorically speaking, the creation of this void upon dissolution is but one of the reasons behind the various fiduciary duties incumbent upon those who govern nonprofit organizations. While the human needs met by any particular faltering nonprofit may be modest, needs met are needs met. In a survey of the sector, the NH Center for Nonprofits ("the Center") estimates that the nonprofit sector comprises about fourteen and one-half percent (14.5%) of New Hampshire's economy.[11] Contributing most heavily to the sector and to this statistic are health care organizations, like hospitals and community mental health organizations, and human service agencies that address housing, and needs of children youth and families.[12] Based

upon the Center's data, roughly half of the sector is comprised of smaller nonprofits, many with missions endeavoring to make a meaningful micro-impact that meet human needs on a daily basis. Without someone, or some organization to meet these needs, the needs will go unmet and those who have come to depend upon the organization to meet them will be left un-served, and likely somewhat worse off because of it.

There are clearly times when the nonprofit sector in general is better served, if not strengthened, by the dissolution of certain nonprofits.[13] However, the realization of such a macro benefit must begin at the micro level. The governing body of the nonprofit must first engage in a sober assessment of the organization's chances for survival in the short term and for true viability in the long term. To do this, at least three distinct options for addressing the organization's unfulfilled mission -- reorganization, merger, or dissolution -- must be considered, with each viewed through the prism of the organization's mission. Dissolution is only one available option. It is not the only option, nor should it be considered prematurely to the exclusion of other options.

III. THE BASIC TRIAD OF OPTIONS FOR FALTERING NONPROFITS

a. Reorganization

A faltering organization must initially consider a reorganization. A reorganization may, but need not, entail a bankruptcy filing under Chapter 11 of the Bankruptcy Code.[14] Instead, it could simply mean an overhaul of the organization's staffing, operations, funding, fundraising and governance along with a rededication to its core purposes or mission. Many nonprofits, like many business organizations, suffer from lack of leadership, ineffective board oversight, lack of vision, insufficient funding or too much debt.[15] In many situations, nonprofits suffer as a result of any number of these things. Whether accompanied by a bankruptcy filing or not, a reorganization must be considered in the first instance. If funding permits, an expert consultant would be a wise investment to identify organizational weaknesses and potential corrective measures at the first sign or trouble in the organization and/or in the segment of the sector that the organization serves.

If the organization's board is ineffective, then a new board should be installed. If its executive officer lacks initiative or leadership, then other executives should be considered. If programs can't be sustained, then some should be jettisoned for the benefit of others that remain true to the organization's core mission. While most of these ideas are intuitive to the types of thoughtful, smart, and caring people that devote countless volunteer hours to nonprofit boards, implementation and execution of these ideas can be painful on many levels. Most people don't want to hurt others, particularly in times like these, but some casualties are an unhappy fact of life. At the very least, a governing board must examine these options in the exercise of its fiduciary duties. To do otherwise would be to elevate one's personal preferences and feeling over the good of the organization, a situation that is both contrary to one's legal duties and unwise as a matter of both business and common sense.

There are certainly ways for fiduciaries to act kindly and ethically[16] toward others in the discharge of their duties, but fiduciaries (trustees, board members, etc.) must remain faithful to the organization and to its mission in the first instance. If, in the exercise of proper deliberation, an organization's governing board determines that a reorganization is unlikely to succeed in both the short and long terms, then the next inquiry should be whether a suitable merger partner exists.[17]

b. Merger

Merger is like marriage. Merger partners need to be both compatible and committed. While those choosing to marry usually do so to build a life together, nonprofits opting to merge should do so to perpetuate and strengthen their ability to fulfill their mission and purposes. Selection of a partner is therefore critical.

In the usual case, a governing board will need expert assistance to identify a suitable merger partner. One need not look hard in New Hampshire to find instances where an attractive partner appeared, and the governing boards – pleased with the prospect of perpetuating the mission – agreed to a merge with a partner that was plagued by the same problems (although latent[18]) that caused the need for a merger in the first place. The ideal nonprofit merger partner is an entity with a similar mission, that has a different or better way of doing it, or that fulfills its mission from a position of strength (by way of resources, "market share", or other unique qualities). If assets alone are to merge and most staff is to be jettisoned, then "cultural" differences aren't critical. However, if the organization is personnel-intensive, then a governing board should consider the various shades of compatibility in view of cultural differences within the organization. A failed merger won't likely help either entity. Consideration of a merger or a loose affiliation beforehand, *at the first sign of trouble ahead*, will do more good for the organization than any expert or lawyer will do when the storm hits and the only thing scarcer than resources is morale.

The challenge of a merger in a small state like New Hampshire[19] is that the challenges facing one nonprofit likely face them all. While not always the case, more frequently than not, funding sources are similar, the population served is similar, and the regulatory climate is likely substantially the same for one as for all. There are, however, always community leaders and organizations that serve as the vanguard of a certain segment of the sector. Perhaps because of an historical accident, good fortune, wise management or myriad other possible constellations of circumstances, there is always the favored dance partner. Sometimes, the dance partners come from out of state. While it might be desirable to look within New Hampshire's borders first, some organizations with a regional or national presence and with a desire (or a mandate) to fulfill their mission in New Hampshire should be considered. With planning and vision, an inclusive search can be conducted to the end of identifying a suitable partner with which to consummate an effective merger.

In the nonprofit realm mission is, or should be, paramount. Assets, once devoted to a particular organization's charitable mission ought – to the extent thereafter possible – to continue to be devoted to the mission in perpetuity.[20] In the usual case, the organization's "dissolution clause" will speak directly to this issue. But, like the granite cairns that purport to mark the way for hikers navigating New Hampshire's backcountry, dissolution clauses – while conspicuous – do not always provide direction with the clarity one might like.[21] Until released from their charitable obligations, the trustees and directors of New Hampshire nonprofits organizations are duty-bound to act as prudent stewards of the assets

entrusted to their care. To that end, the selection of a merger partner that will elevate, rather than extinguish, an organization's mission is the duty of a board contemplating a merger. To do otherwise, an organization's governing board is essentially opting for a *de facto* dissolution by orchestrating a failed merger.[22] There are many ways to perpetuate an organization's mission in the context of a merger. Restrictions on assets, court orders, or amendments to organizational documents are but a few tools available. In any event, the organization's mission should be honored to the full extent possible, even if it will ultimately be carried on by another organization.

c. Dissolution

If the only true option is to close the doors because there are no alternatives and/or energy left, then dissolution is the option. Unfortunately, New Hampshire law provides little guidance about how to properly dissolve a voluntary corporation and the guidance provided is conflicting. Although nothing is mentioned of mission, charitable corporations are treated differently throughout RSA 292, a clear testament to the special and important place they occupy within the sector.

Under RSA 292:9, *any [voluntary charitable] corporation, or 1/4 of the members thereof* (emphasis added) may apply to either the superior court or the probate court for a decree of dissolution, *subject to such limitations and conditions as justice may require.* In this case, the attorney general must be notified. By contrast, RSA 292:10-a permits dissolution by vote of either (a) 2/3 of the membership, (b) 2/3 of the voting stock., or (c) 2/3 of both. Upon filing with the Secretary of State a sworn statement verifying the 2/3 vote along with a "[p]lan for distribution of the corporation's assets and satisfaction of its obligations" a voluntary corporation will be automatically dissolved. The statute provides no direct guidance about what the dissolution plan should look like. The law is insufficient and much more guidance is needed.

Beneath the backdrop of advancing and perpetuating an organization's charitable mission, the primary elements to consider in any dissolution are the organization's resources, both financial and human.[23] Of secondary legal importance, but surely worthy of concern in the realm of ethics, is the proper management of those persons or entities who may have come to depend upon the organization's charity. Most board members are astute and caring people who give their time, talents (and sometimes their treasure as well) because they believe in the organization's mission and objectives. There is presently no statutory roadmap to guide those seeking to properly dissolve a New Hampshire voluntary corporation. Like death itself, it can take many forms and come as a result of many causes. The board's task is to make it orderly, just and permanent.

IV. ELEMENTS OF AN ORDERLY, JUST AND PERMANENT DISSOLUTION

a. Thoughts on Order

In an ideal situation, the process of dissolution would follow weeks, months or perhaps even years of deliberation and careful board discussion. Employee issues would have been managed by natural attrition, loose affiliations with potential merger partners would have brought the organization to the brink of a successful merger and the delivery of programs would have been reduced substantially in anticipation of the organization's end. Unfortunately, that's not usually how it works, particularly with small nonprofits that don't have the resources to retain competent consultants or to attract a large, talented and diversified board with sufficient expertise to manage the windup of the corporation's affairs. In those situations, the board (or if the board has been removed, a receiver) will need to swiftly bring order to what is sometimes veiled -- and at other times naked --chaos in the organization. Because no individual "owns" the organization's assets, the only thing connecting the directors to the organization's assets is their good will, fiduciary duty, and/or or fear. Unlike situations where one is protecting his or her property (and might be likely to be more aggressive to fight for what is his), there *appears* to be no chance for personal loss, unless the Attorney General's Office becomes involved and decides to bring action.[24]

The board is responsible for the organization's actions and destiny until dissolution. Commonly, the board will have delegated its duties to an executive officer to run the organization under its direction. If that person is effective, efforts should be made to retain that individual by a retention bonus or other incentives to retain her services throughout the wind-up process.[25] Without someone competent at the helm who knows the employees and the vendors, is there to execute the board's directives, then various board members will either need to find someone else to serve in this capacity (very challenging without the means to pay such a person) or will be doing these tasks themselves. If there was ever an apt analogy to a low-budget horror film, this is it. No one will hear the screams. Even if they did, they probably wouldn't help. If the ship is sinking on one's watch as a director, one is duty-bound to stay on until the band stops playing. If the organization lacks financial resources to retain an executive officer, or to hire a short-term replacement to wind up the organization's affairs, the task will legally fall to the board.[26] If more boards truly thought this through and appreciated the scope and duration of their duties, many nonprofits would likely merge, reorganize or dissolve long before they usually do.

The above makes the point that stewards of a nonprofit need to understand the organization's mission and insist that it be capable of fulfillment from the moment one agrees to serve on a board.[27] Failing such vigilance, the organization may quickly find itself in a dizzying downward spiral from which no escape seems likely. Some practical tips for nonprofits to follow to avoid these are as follows:

1. If you are asked to serve as counsel for one of these organizations, first decide whether you or your firm have the competence[28] to lead your client through the complexities and nuances of a nonprofit dissolution, merger, or reorganization. To use another New Hampshire metaphor, endeavoring to provide representation under these circumstances can be like driving in a blizzard. With little visibility, a slight misjudgment of steering, braking or acceleration can quickly lead to a crash.
2. Immediately contact creditors and explain the organization's situation; ideally, strive for forbearance agreements, unless bankruptcy is the decided option.
3. Control and understand expenses.

4. Manage personnel costs and potential labor claims. If possible and appropriate, consider severance packages for employees, conditioned upon a term of service to the organization through a date certain and in exchange for releases from claims. If that is not possible, then employees should be released and treated as well as prudently possible.[29]
5. Prevent waste of the organization's assets. Resist the urge to mortgage the organization's real estate[30] or to borrow from its endowment unless absolutely necessary and entirely defensible.
6. Assemble committees (from within the board or from the community at large) to manage the various tasks and draw from strengths to manage various tasks, particularly if resources are scarce.
7. Expect and encourage transparency, keep careful notes and minutes, and ensure that everyone executes on assigned tasks.
8. Develop a timeline and an action plan.
9. Remain aware of applicable annual filing deadlines for property tax exemption, if applicable, and endeavor to keep the organization eligible for such exemptions, particularly if a merger or reorganization is contemplated.
10. Contact regulators.[31] Bear in mind that, if inclined, regulators *will* uncover the true state of the organization and how it got there. If the organization is in trouble, deal with the problem openly and honestly lest you make matters worse by obfuscation.

The above is not an exhaustive list by any means, but threshold issues that should be considered.

b. Thoughts on Justice

You pay tithes of mint and dill and cumin, and have neglected the weightier things of the law: judgment and mercy and fidelity. [But] these you should have done, without neglecting others. Matthew 22:23

A thoughtful board will consider elements of justice in dissolution, as should its counsel. The theme of justice will echo during the board's attempt to find order and achieve completeness. Indeed, thoughts of "doing right" by the employees, the organization, the organization's stakeholders and the community at large should be considered. While the dissolution of a for-profit, privately held company is essentially a private matter, the dissolution of a nonprofits is "public" and implicates many different concerns. There is a need, perhaps even a moral imperative, to do "right" to the full extent possible. How to do right in the context of mission is highly fact-specific and judgment-intensive and there is no substitute for experience in this area.

Beyond doing right, the board must do what the law requires and should comply fully with RSA 292 to terminate the organization's legal existence. If acting under court supervision, orders should be sought requesting a discharge from all fiduciary obligations upon the conclusion of the winding up process.

c. Thoughts on Permanence and Completeness

The solution, once chosen, should be permanent and complete. As to completeness, measures should be taken to ensure that there are no lingering issues after the closure occurs. To that end, all liabilities *should* be managed and dealt with in the closure, whether by payment in full, compromise, discharge in bankruptcy or assumption by the successor/acquirer. Of course, with scarce assets and limited liability for the board (if any), the board may need to make hard choices to prioritize payments of liabilities given potential issues of managing payroll and retiring both secured and unsecured debt. In the case of a voluntary dissolution, a charitable corporation must present a plan for the distribution of its assets *and* satisfaction of its obligations.[32] This statute does not leave the board with much (if any) discretion to avoid paying organizational debt.

New Hampshire law provides fair, but not extraordinary, guidance on how to wind up the corporation's existence.[33] As a matter of completeness, permanence and simple good housekeeping, articles of dissolution should be filed. With an intact board, the endeavor is relatively simple. With a board in shambles, or in the case of an absent board with the assets of the organization being managed by a court-appointed receiver, or the like, the process for filing articles of dissolution becomes more difficult because of the inability to convene a meeting to obtain authority to file them. In such case, New Hampshire's voluntary corporation law provides a mechanism for obtaining an order from the court permit the filing of such articles with the Secretary of State to conclude the corporation's affairs.[34] Formal dissolution puts the public and regulators on notice that the organization no longer exists. This is particularly important in the case of organizations that have been qualified as tax-exempt so that would-be donors don't inadvertently contribute to a non-existent entity with the expectation of receiving a tax deduction for their charity.

As to taxes, the organization should file a "final" return with the Internal Revenue Service, thereby indicating to the IRS that its corporate existence has ended. In the unlikely event that the organization was not exempt from paying various taxes to the State of New Hampshire, it should also notify the New Hampshire Department of Revenue Administration that its existence has ended as a matter of completeness. Finally, it would be good practice to file final paperwork with the Director of Charitable Trusts (notably, copies of the documents and forms filed with the New Hampshire Secretary of State and its plan of dissolution) so that the record is clear and so that the Charitable Trusts Unit can properly list the organization's status as closed.

Various regulated organizations like hospitals, nursing homes and some schools may also need to provide notice of their closure to agencies with jurisdiction over them. In some cases, organizations granted licenses by licensing authorities will need to physically surrender their licenses. The full extent of such reporting is beyond the scope of this article, but counsel should be mindful of this issue while counseling organizations to conclude their affairs.

V. THE SPECIAL CASE OF CHARITABLE TRUSTS

The Charitable Trusts Unit of the New Hampshire Attorney General's office has jurisdiction over charitable trusts.[35] Charitable trusts are, by their nature, subject to different requirements and the Charitable Trusts Unit, acting by and through the Director of Charitable Trusts, is a necessary party to any action involving such an organization. Charitable Trusts

are broadly defined under New Hampshire law.[36] Given the Director's broad regulatory authority over charitable trusts, it is good practice to involve the Director in matters involving charitable trusts. As the voice of the public (the intended beneficiary) of charitable trusts, the Director has broad authority to regulate the operation of such trusts. [37]

The Director has, pursuant to RSA 7:19, broad regulatory authority over charitable trusts. Beyond the specific regulatory authority granted by RSA 7:19, the Director also has certain common law powers pursuant to which the Director has the authority file petitions to remove governing boards, to suspended the authority of governing boards, and/or to see the appointment of a receiver to act in the board's stead once removed or suspended, or if it is not functioning. The Director has similar authority in the case of charitable trusts to seek the appointment of a special trustee if circumstances so warrant.[38] Trustee, board members, and their counsel should be aware of the Director's broad authority, particularly when contemplating a merger or dissolution. In the usual case, the Director will learn of mishaps with charitable trusts upon (i) a public complaint; (ii) review of annual filings, or; (iii) from whistleblowers or press inquiries and will always be in a position to conduct a complete investigation. Hence, there is little to be gained by not contacting the Director's office at the first sign of trouble. One way or another, the Director will become involved if trouble comes. Moreover, beyond its regulatory role, the Charitable Trusts Units can be a very good source of information and assistance for a faltering charitable organization.

As to annual reporting, a charity's failure to file its Annual Report[39] is not only a failure of the organization to fulfill its reporting requirements, but is also a clear signal to the Charitable Trusts Unit that something may be amiss. Similarly, the Annual Report, usually accompanied by the new and revised Form 990, contains much information that will alert the Charitable Trust's Unit of potential problems with the charity. Again, those who may think the stakes are not high should review the penalty sections set forth in RSA 7:28-f, II(d)[40] Bearing in mind that the Charitable Trusts Unit is the guardian of the public's interest in charitable assets, and because governing boards are the stewards of such assets, those counseling charitable organizations would be wise to understand and respect the relationship and to approach the Director's office cooperatively, if for no other reason than out of respect for the mission that both the Director and the organization ought to be working to protect and to perpetuate. Given the breadth of the Director's authority, it is clear that the legislature expected such cooperation.

VI. THE SPECIAL CASE OF HEALTH CARE CHARITABLE TRUSTS

Health Care Charitable Trusts are a subset of charitable trusts that operate under different pressures and serve unique needs.[41] Given the broad community needs met by health care charitable trusts, acquisition transactions[42] involving such trusts are subject to a different statutory scheme set forth in RSA 7:19-b. That statute establishes certain minimum standards applicable to the governing board. In broad terms, the statute requires, as a prerequisite to entering into an "acquisition transaction", that a health care charitable trust's governing body: (i) act in good faith; (ii) in a manner consistent with its fiduciary duties to the health care charitable trust, and (iii) while meeting seven enumerated minimum standards. Items (i) and (ii) impose a statutory obligation on such an entity's governing board to act in accordance with established common law principles.[43] These trusts include nonprofit hospitals, community health centers, visiting nurses organizations and other entities that provide direct healthcare services to patients.

VII. RECOMMENDATIONS FOR CHANGE

The standards applicable to health care charitable trusts are different, and more stringent, than those applicable to charitable trusts, partially because of their unique position in the sector. While the standards set forth in RSA 7:19-b are not applicable to ordinary charitable organizations, those standards are helpful to those having to navigate the waters of an acquisition transaction. Some thought should be given to adopting a similar statute to guide governing boards of charitable corporations in transactions involving reorganizations, mergers and/or dissolutions. Minimum standards would help bring more order to these processes and could, if made readily available to the governing boards of charitable organizations, help them avoid costly errors that could hurt the organization's charitable mission.

Another thought would be to revisit RSA 292. While familiar to many and beloved by some, its brevity makes it a bit of an anachronism. A Revised Model Nonprofit Corporation Act (1987) (the "Model Act") does exist which is much more comprehensive than RSA 292. It provides guidance in many areas for which no guidance now exists under RSA 292. For instance, it sets forth specific standards of conduct for directors and imposes liability for a breach of those standards.[44] The Model Act speaks to mergers and contains provisions relevant to governance that are presently left to those drafting bylaws.

If New Hampshire were to consider adopting this model act, bar members and others would need to convene a study committee (as was done fairly recently with the Uniform Trust Act) to be certain that adoption of the Model Act would be an advancement for the sector. The fact that fiduciary standards are not readily ascertainable on a reading of RSA 292 suggests that the time is near (or has come) to revise RSA 292 in a way that makes it current and comprehensive while retaining the best of RSA 292. Such a revision should be considered now, given the many changes that have befallen the sector over the last two decades and that have originated from both Congress and our State House. The task would be burdensome, but the sector -- and its public beneficiaries -- would be well served if the law were brought current and made complete.

A thoughtful and comprehensive revision to RSA 292 would make reorganizations, mergers, and dissolutions more orderly and, ideally, less common. The people of New Hampshire who rely daily on the sector's charitable energy deserve no less.

ENDNOTES

1 Attorney Fahey is a director and shareholder at Orr & Reno, P.A. in Concord, New Hampshire where he focuses on the representation of nonprofit and tax exempt entities. He has a particular interest, and unique experience, counseling New Hampshire nonprofits in distress and in transition.

2 The author wishes to gratefully thank and acknowledge Attorney Michael S. DeLucia, Director of New Hampshire's Charitable Trusts Unit for his comments, my law partner, Attorney Connie B. Lane for her comments, and my colleague, John L. Arnold, for his thoughtful edits.

3 For a list of purposes for which a New Hampshire "voluntary corporation" (i.e., a nonprofit) may be formed, *see* RSA 292:1 (1999). The first, and most common of these is "[t]he promotion

of the cause of temperance and of any charitable or religious cause." RSA 292:1, I.

4 A voluntary corporation, organized under RSA 292, is not necessarily tax exempt. An organization must qualify for tax exempt status under some section of the Internal Revenue Code. Qualifications under sections 501(c)(3) and 501(a) are the most common.

5 These are the basic options without judicial oversight. When the courts are involved, subsets and variations of these three options may include (i) petitions for deviation brought pursuant to RSA 547:3-c; *cy pres* relief sought pursuant to RSA 547:3-d; (iii) general equitable relief pursuant to RSA 547:3-b and common law, and tax relief available under RSA 547:3-e in certain circumstances. In some cases, it is prudent to seek more than one remedy depending upon the legal standards to be met since the foregoing relief is not available in all circumstances.

6 The references to life and death are deliberate. In this author's view, an organization's fulfillment of its charitable mission is an organic concept that grows and begets growth, a "charitable growth" not easily measured.

7 New Hampshire nonprofit case law provides little guidance. There are very few published cases construing RSA 292, and even fewer dealing directly with pressing contemporary issues facing New Hampshire nonprofits.

8 Prior to the enactment of RSA 292, many charitable organizations were created by act of the legislature. *See, e.g.*, RSA 292:24 (acknowledging existence of voluntary corporations created by legislative act) and RSA 292:22 (permitting legislature to alter, amend or repeal charter of voluntary corporations).

9 Standard dissolution clauses echo this sentiment. Most such clauses anticipate the redirection of a failed organization's assets to a successor with a similar mission.

10 In most cases, board members will lack the specialized knowledge needed to identify a merger partner and to assess issues of compatibility, fiscal health, long-term viability, market trends, etc. A carefully selected expert consultant should lend assistance in this regard. In the event the matter should proceed to court (for any reason), or if any regulator(s) should question the board's actions, a board would stand in good stead with independent, specialized, and objective data to present to support its decisions lest it be criticized for failing to act in the organization's best interests. Experts can be expensive and sometimes hard to locate. A thoughtful board will not wait to retain one until the organization is insolvent or on the brink of insolvency to seek help. At that point, it is too late, and one could argue (if so inclined) that the board has already breached its stewardship duties by failing to avert disaster through proper planning and vision.

11 *See, Essential, A portrait of the nonprofit sector in New Hampshire*, published by the NH Center for Nonprofits, page 3.

12 The Center also reports that (based upon 2004 reporting data) human service organizations comprised 35% of the New Hampshire's charitable nonprofits with health care/mental health making up another 13%. Not surprisingly, these two subsectors accounted for nearly 50% of the sector in 2004. The Center also reports that "4,799 charitable nonprofits (not including foundations) are registered as tax exempt under 501(c)(3), but only 2,451 (51%) are required to file an annual report with the IRS because they meet the filing requirement of over $25,000 in gross receipts." *See generally, The New Hampshire Nonprofit Sector,* published by the NH Center for Nonprofits.

13 Nonprofits that provide redundant services and/or that inefficiently deliver services compete for resources in the sector, notably grant funding. These scarce financial resources might be better directed to stronger organizations that provide the same (or similar) services more efficiently.

14 A lengthy description of a Chapter 7 or Chapter 11 bankruptcy proceeding is beyond the scope of this article. A Chapter 7 proceeding would generally not be favored because a liquidation would almost certainly extinguish a charitable organization's mission and would therefore be inconsistent with the approach suggested in this article. By contrast, a Chapter 11 filing is a very useful tool and has been recently used with success to preserve the mission of at least one well established and well known New Hampshire nonprofit that, without having filed for such relief, would likely have passed into obscurity. On account of the filing, the entity was able to reorganize and emerge from bankruptcy stronger and prepared to perpetuate its mission.

15 A good example of this is real estate. Real estate is expensive to own, to properly maintain and to insure. While it may be desirable, in the long-term, for an organization to own its own quarters, care should be taken not to invest the organization's assets of real estate ownership is not integrally related to the organization's fulfillment of its mission. In some cases, a municipality's revocation (or challenge) of a charitable organization's property tax exemption can have devastating financial consequences. Leaving aside the many benefits that real property ownership confers upon property owners, a contemplative governing board should ask whether ***on balance*** the organization has any business owning real estate and, if so, whether it can truly afford it. Can it afford to fund reserves for maintenance? Can it afford the debt service? Is the mission advanced by property ownership? Will it qualify for exemption from local property tax as a religious, educational or charitable organization? Real estate is a great builder of wealth, but it is not appropriate for every nonprofit. By contrast, nonprofits can make attractive tenants for landlords who might be willing to trade some economic upside for a stable nonprofit and cost savings could be used to build endowment or cash reserves in furtherance of the organization's mission.

16 For purposes of this article, the term "ethics" is used to define moral obligations, as opposed to legal ones.

17 For purposes of this article, the author assumes that the faltering entity is without sufficient resources and capital to acquire another entity to augment itself. Hence, this is written from the perspective of the troubled entity being the target of an acquisition that is merged into a compatible and viable entity.

18 A careful governing board can (and should) avoid latent merger issues by retaining competent counsel and qualified experts and then carefully considering their advice before deciding to merge.

19 While it may be desirable, and required in some situations (*see* RSA 7:19-b), merger partners need not be New Hampshire based entities. They should, however, have a strong presence in New Hampshire and a commitment to fulfilling a mission within the State's borders, unless geography is of no concern.

20 Fortunately, there are various means of escape from the bondage of a faltering or a failed mission. *See* Endnote 5, *supra*. Any of these remedies can be sought to save, in a very tangible way, the charitable energy that an organization has developed over the course of its existence. This "charitable energy" is the product of the entity's fulfillment of its mission. For hospitals and similar entities, it is generally referred to as community benefit; for individuals, it may be as simple as providing scholarship funding.

21 Every nonprofit organization formed in New Hampshire under RSA 292 must include a dissolution clause. See RSA 292:2 which states, in relevant part "The Articles of Agreement shall contain … (III) The provisions for disposition of the corporate assets in the event of a dissolution."

22 There are many ways for a concerned board to perpetuate its organization's mission through a merger. The most obvious way is to select a compatible partner. Less obvious, but equally effective under the proper circumstances, would be to require the acquiring entity to amend its organizational documents to reflect the merger and to honor the mission of the target. In other circumstances, seeking some representation on the acquiring entity's board to preserve some "institutional memory" might be sensible. In other cases, neither option would be viable, but both should be explored.

23 Debts should also be satisfied, compromised, or discharged as circumstances permit.

24 This would be a dangerous view to hold. Violations of RSA 7:19-32-a, inclusive, are unlawful and carry civil penalties of up to $10,000.00 for each violation. *See* RSA 7:28-f, II (d)(2003). Worse yet, no indemnification of the officers, employees or directors of a charitable trust (which includes charitable corporations) may be indemnified by the charitable corporation (or its insurer(s)) unless a court determines that the individual acted in good faith and for the benefit of the organization. *See* RSA 7:28-f(II)(f). In other words, inaction will not suffice and ignorance will not prove an effective insulator from enforcement action by the Director of Charitable Trusts.

25 Ironically, payment of such incentives in the midst of economic turmoil is necessary to keep talented individuals engaged and motivated. The recent AIG debacle highlighted the payment of such bonuses in the private sector. Regardless of the propriety of particular payments made in the AIG case (as to amounts or recipients), the AIG case is illustrative. It is very difficult to convince employees to stay on a sinking ship without providing them with incentives to do so. Without such incentives, employees would naturally leave to find gainful employment and to secure their futures. With proper incentives, they can feel that they have some security and order in their personal lives and thus be comfortable staying on to assist with an orderly closure. The corollary to this is, of course, that the governing board needs to time its payment of these incentives to ensure that it receives full value from the employee(s) in return.

26 Resignation, while an option, is not the answer. In this author's view, a director's resignation in times of turmoil that harms the organization is a clear breach of duty. One would be wiser not to join a suspect board, or to resign at the first sign of trouble, than to jump ship at the last moment. Prospective board members should thoroughly examine an organization (its most recent Form 990 is a good place to begin) before agreeing to serve.

27 The author would also encourage practitioners who may be new to this area to elevate their discussions about viability with their clients. One way to start an interview with a client, or group of them, seeking to organize a new nonprofit would be to hand them Form 1023 or Form 1024, let them study it, and then decide whether their organization will be likely to succeed in the long-term. This is not to suggest that any lawyer should squelch another's dreams, but lawyers should counsel their clients about risks and rewards. *See* N.H. Rules of Prof. Conduct, R. 2.1(2008)(lawyers shall exercise independent professional judgment and render candid advice).

28 *See* N.H. Rules of Prof. Conduct, R.1.1 on competence, etc.

29 Beyond the public at large, there are usually two distinct classes victimized by the closure of an effective and productive nonprofit: its employees and the beneficiaries of its mission. In the usual case, neither class will have had much (if anything) to do with the nonprofit's

collapse, but the interests of both should be managed appropriately for at least two reasons. First, because the governing board has an obligation to these two classes on account of the organization's mission. Second, because failure to properly manage these classes will likely expose the organization to potential legal claims, particularly from its employees. Employees who are not treated well are more inclined to sue and/or retaliate, particularly if they have no options or if they perceive that they have no options. This again makes the point that foresight is critical and that boards need to act at the first sign of trouble. It is very difficult to manage either class without sufficient financial resources, particularly in the midst of chaos.

30 In the current economic climate, lenders are unlikely to lend to an insolvent organization or one with less than bright prospects, without some additional guaranties. It is not beyond the realm of possibility for a lender to ask the board for joint and several personal guaranties before extending credit, a situation that would need to be avoided for many reasons, particularly for 501(c)(3) tax exempt organizations.

31 While there may be varying views on an open approach with regulators, the author's experience with New Hampshire regulators has been overwhelmingly positive. In few, if any, instances will counsel – however skilled – be able to resist the inquiries of regulators determined to ferret out the cause of a nonprofit's demise and to shine the bright light of inquiry on the actions of the board. Clever legal maneuvers to delay or obscure should be carefully considered and, ideally, avoided.

32 *See* RSA 292:10-a, I.

33 *See* RSA 292:9 and RSA 292:10-a.

34 *See* RSA 292:10.

35 *See* RSA 7:19, I:

> RSA 7:19 through 32-a inclusive shall apply to all trustees holding property for charitable purposes and to all persons soliciting for charitable purposes or engaging in charitable sales promotions; and the attorney general shall have and exercise, in addition to all the common law and statutory rights, duties and powers of the attorney general in connection with the supervision, administration and enforcement of charitable trusts, charitable solicitations, and charitable sales promotions, the rights, duties and powers set forth in RSA 7:19 through 32-a inclusive. The attorney general shall also have the authority to prepare and maintain a register of all charitable trusts heretofore or hereafter established or active in this state. However, this subdivision does not apply to the United States; any state, territory or possession of the United States; the District of Columbia; the Commonwealth of Puerto Rico or to any of their agencies or governmental subdivisions or to any religious organization which holds property for charitable or religious purposes or their integrated auxiliaries or to conventions or associations of churches.

36 RSA 7:21, II(a) defines a charitable trust as:

> any fiduciary relationship with respect to property arising under the law of this state or of another jurisdiction as a result of a manifestation of intention to create it, and subjecting the person by whom the property is held to fiduciary duties to deal with the property within this state for any charitable, nonprofit, educational, or community purpose. Charitable trust includes, but is not limited to charitable organization, as that term is defined in subparagraph (b). The fact that any person or entity sought to be charged with fiduciary duties is a corporation, association, foundation, or any other type of organization that, under judicial decisions or other statutes, has not been recognized as, or has been distinguished from, a charitable trust does not provide a presumption against its being a charitable trust as defined in this paragraph.

37 While beyond the scope of this article, the question of legal standing deserves some attention, if for no other reason than to understand and to appreciate why the Director's authority is so broad. In the case of a faltering charitable trust, one who is not directly interested as a beneficiary, director, or "member" (in the case of a membership organization), may have difficulty maintaining an action on behalf of a charitable trust. This leaves open the question as to who will (or who can) speak on behalf of those the charitable trust is intended to benefit. Questions of standing aside, the Director speaks on behalf of the public's interest in the charitable trust. Without such a voice, certain elements of the sector would be left defenseless in some circumstances. While views may differ on regulation in general, the regulators and the regulated both have roles to play and duties to discharge. In this author's experience, all parties and the courts can, if inclined, work together to achieve efficient and effective outcomes for the good of the sector. This author has been involved in several such matters where the product of such collaboration has been the preservation of both missions and charitable assets – in perpetuity – to the clear benefit of the people of New Hampshire.

38 *See generally* New Hampshire's Uniform Trust Code, RSA 564-B.

39 *See generally* RSA 7:28. In some cases, extensions may also be granted. *See* RSA 7:28, III.

40 Penalties can include injunctions, restitution, an award of attorney's fees and costs, and civil damages of up to $10,000 for each violation.

41 See generally, Fahey, Todd C., *Transforming a Nonprofit Healthcare Entity: New Hampshire's Cy Pres Doctrine and RSA 7:19-b*, New Hampshire Bar Journal, March, 2003.

42 An "acquisition transaction" is defined in part as a "transfer of control, direct or indirect, of a health care charitable trust, or of 25 percent or more of the assets thereof, including, but not limited to, purchases, mergers, leases, gifts, consolidations, exchanges, joint ventures, or other transactions involving transfer of control or of 25 percent or more of assets." RSA 7:19-b, I(a).

43 For instance, in accordance with its fiduciary duties and consistent with the charitable trust's organizational documents, etc.

44 *See* Revised Model Nonprofit Corp. Act Ch. 8 (1987).

Todd C. Fahey

Author

***Toddy C. Fahey**, a partner at the Orr & Reno law firm, has worked extensively with nonprofit organizations and businesses on business and real estate issues.*