

NON PROFIT BORROWERS & THE CREDIT CRISIS

Is this the End of Easy Access to Inexpensive Capital?



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INTRODUCTION – THE AVAILABILITY OF TAX-EXEMPT FINANCING

Charitable corporations and other entities holding 501(c)(3) status under the Internal Revenue Code of 1986, as amended (“Code”) generally have had access to tax-exempt financing to pay for their capital projects.¹ Although this access has been available in most states since the late 1960s or early 1970s, it was not until the early 1980s that large numbers of these entities (often referred to as charitable corporations) began accessing the tax-exempt bond and note market through state or local agencies empowered to issue tax-exempt debt on their behalf.

As their name suggests, tax-exempt bonds and notes do not result in taxable income to the purchasers of such debt. Consequently, the interest rates on tax-exempt debt are lower than conventional, taxable debt, with the concomitant result that the borrower’s debt service obligations are decreased. The availability of tax-exempt debt reflects a legislative policy determination that entities that perform charitable functions should have certain tax advantages. While the primary advantage is tax-exempt status, requiring no payment of federal income taxes and exemptions at the state level from certain taxes, less expensive borrowing for capital projects is

a significant benefit to most charitable corporations.

Before passage of the Tax Equity and Fiscal Responsibility Act of 1986 (“TEFRA”), banks and other financial institutions were the primary purchasers of tax-exempt debt issued by smaller charitable corporations; more substantial 501(c)(3) borrowers issued bonds through public offerings. Because of a general concern at the federal level about the loss of revenue due to the growth in tax-exempt debt, TEFRA included provisions to make access to tax-exempt debt more difficult.² The results were mixed: although the new restrictions limited the purposes and uses of proceeds of each individual issue of tax-exempt bonds or notes, the growing popularity of such debt led to a substantial expansion of the total number of debt issues and the overall amount of tax-exempt debt.³

ISSUING TAX-EXEMPT DEBT IN NEW HAMPSHIRE

In New Hampshire, virtually all tax-exempt debt for 501(c)(3) borrowers is issued through either the Business Finance Authority (“BFA”) or the New Hampshire Health and Education Facilities Authority (“HEFA”). In essence, any tax-exempt borrower can issue bonds or notes through BFA or HEFA for virtually any capital purpose. Hospitals, ambulatory care facilities, retirement and nursing homes, colleges and universities, private schools, cultural institutions and social service agencies, among others, can access the tax-exempt market through BFA and HEFA to acquire land and existing buildings, to construct new or expanded facilities, to renovate existing facilities and to pay for associated furnishings and equipment as well as related soft costs such as architectural and engineering expenses and legal fees.

TAX-EXEMPT STRUCTURES: THE GROWTH OF NEW PRODUCTS

As the use of tax-exempt debt as a financing vehicle became more widespread, so did the number of ways to issue it. Investment bankers, known for their creativity in developing corporate financing structures such as leveraged buyouts and initial public offerings, realized that the expansion of tax-exempt borrowing could be further fueled by new structures as well. While tax-exempt debt issued through the late 1970s

generally was based on a borrower's own creditworthiness, in the 1980s the concept of "credit enhancement" — the use of bond insurance provided by monoline bond insurers or letters of credit issued by banks — was introduced to the municipal marketplace.⁴ The use of credit enhancement was perceived to offer significant benefits for many borrowers. For less creditworthy institutions, bond insurance or a letter of credit allowed access to the public market, where interest rates were markedly lower than in the private placement marketplace; for more creditworthy borrowers, credit enhancement could lower the cost of obtaining capital.

In a credit-enhanced transaction, the ultimate risk of repayment to the bondholders shifts from the underlying borrower to the credit enhancer, which charges what it considers an appropriate upfront premium or annual fee for assuming the risk that it may not be repaid by the borrower. In addition to the creditworthiness of the entity seeking credit enhancement, bond insurers and letter of credit banks also base their fees on the cost of meeting their regulatory requirements for providing credit enhancement, such as capital set asides or reserves.

When credit enhancement was first gaining acceptance, the few bond insurers sought, and obtained, "Aaa/AAA" ratings from Moody's Investors Service ("Moody's") and Standard and Poor's Ratings Group ("S&P"). Although initially most letters of credit were issued by United States banks rated in the single or double "A" category by Moody's and S&P, Japanese and European banks soon entered the market, providing competition and often driving down the rates charged to borrowers for letters of credit-backed issuances. As a general matter, investors, particularly mutual fund investors, often prefer tax-exempt debt backed by a highly-rated credit enhancer because of the perceived security provided by such an entity despite the somewhat lower yield on the enhanced debt. The primary advantages for borrowers are the lower cost of capital and the ability to deal with any problematic issues with one institution rather than hundreds or thousands of bondholders.⁵

As the use of credit enhancement spread, more bond insurers entered the marketplace, with some having ratings in the "AA" category and at least one rated "A". The lower-rated insurers tended to take on less creditworthy borrowers for higher premiums, and required that their borrowers meet more strenuous economic and operating covenants. Although these insurers were less well-capitalized than their "AAA" rated counterparts, the obligations they supported were nevertheless rated at least "A", and the yield was higher.⁶ By the time these non-"AAA" rated insurers began enhancing transactions, the municipal market had become comfortable with letter of credit banks with "A" category ratings.

Transactions employing bond insurance as enhancement originally only used for long-term, fixed rate bond issues because bond insurance covers the bonds for the life of the issue. Because letters of credit do not cover the related debt for its life, but typically provide enhancement for between three and five years, letters of credit have tended to be used most often in variable rate bond issues where the interest rate is reset frequently. The majority of such issues have had weekly interest rate resets. While the bond-insured issues generally have had an up to 10 year "no call" period, in which the bonds cannot be prepaid by the borrower, variable rate issues allow the borrower to repay on 30 days' notice to the bondholders, who have the right to "tender" their bonds, i.e., have them repurchased, on seven days' notice, resulting in these bonds being referred

to as variable rate demand obligations or "VRDOs". Because these bonds often change hands, they require a remarketing agent whose function is to find new bondholders when existing bondholders tender their bonds.⁷ The remarketing agent also sets the weekly (or other variable) rate, based on its judgment as to what rate will allow the bonds to be resold at par. As might be expected, variable rate bonds generally carry considerably lower interest rates than fixed rate bonds because of the difference in the period for which the interest rate is set. Variable rate bonds by their nature also are more volatile and correlate much more closely to current, short-term market interest rates.

As variable rate bond issues became more accepted and provided lower costs of capital, and the use of bond insurance for fixed-rate transactions declined, the investment banking community created another opportunity for the use of bond insurance: auction-rate securities ("ARS"). These securities combined what was perceived to be the best feature of traditional insured fixed rate bonds — a guarantee that the bonds would be highly rated through the use of bond insurance for the life of the bond issue and thus would continue to trade until their final maturity without the risk that a letter of credit would not be renewed or could not be replaced — with the lower interest rate benefits and purchaser liquidity associated with VRDOs.

Auction-rate securities take their name from the frequent (7-, 28- or 35-day) auctions in which the interest rate is reset and the holders have an opportunity to have their bonds purchased. Buyers and sellers participate in a so-called "Dutch auction" process in which orders to sell ARS are matched with orders to purchase ARS, with purchasers willing to accept the prevailing auction rate (the lowest rate at which all bonds to be sold can be sold). However, unlike a letter of credit backed bond issue, there is no third-party financial institution guaranteeing that the ARS will be purchased. Rather, the process of selling ARS assumes that there will always be sufficient buyers so long as the highest potential rate at which the bonds can bear interest, the so-called "Maximum Rate", is high enough to produce purchasers looking for higher yielding short-term obligations. Like the VRDO market, where remarketing agents can purchase for their own account to ensure that there is not a failed remarketing, the ARS market has broker-dealers who similarly may purchase and hold ARS in inventory in order to avoid a failed auction.

PAIRING INTEREST RATE SWAPS WITH BOND ISSUES

There is an additional Wall Street creation — the "synthetic fixed-rate bond issue" -- designed to provide the stability of a long-term fixed rate bond issue by combining the short-term variable rates of the VRDO and ARS, with interest rate swaps. Interest rate swaps are agreements entered into by the borrower with a third party, referred to as the "counterparty". Under the swap structure, which is a separate agreement from the documents relating to the bond or note issue, the borrower agrees to pay the counterparty a fixed rate in return for the counterparty paying the borrower a variable rate.⁸ The most common swap for VRDOs and ARS has been one in which the counterparty pays the borrower an amount equal to 67 percent of one-month LIBOR. That amount historically has served as a proxy for the weekly tax-exempt interest rate paid on the bonds, a rate based on what initially was the Bond Market Association ("BMA")

rate, and now is the Securities Industry and Financial Markets Association (“SIFMA”) rate.⁹ Although borrowers can also choose swaps based on BMA or SIFMA, they typically pay a greater fixed rate to the counterparty, in return for a swap which carries less risk that the payment back from the counterparty will vary significantly from the related bond interest rate.¹⁰¹¹

Interest rate swaps carry other risks as well. The first risk is counterparty risk. Since many swaps reflect the up to 30-year maturity of the related bonds or notes, and the swap agreement is a separate contract between the borrower and the counterparty, the borrower will only be paid if the counterparty continues to remain solvent and honor its payment obligations to the borrower. As discussed below, the September 2008 bankruptcy of Lehman Brothers, a major swap counterparty, demonstrated the reality of that risk.

A second risk is referred to as “pricing risk”. Unlike the stock market, there is no readily available, transparent market for interest rate swaps. As a consequence, a borrower wanting to assure itself that it is receiving appropriate pricing and terms for the swap either has to engage in a competitive process, in which the potential swap is bid out to numerous providers, or retain a swap advisor to provide the equivalent of a fairness opinion relating to the specific terms of the swap negotiated with the one counterparty (often the letter of credit bank) with whom the borrower enters into the swap agreement. Without either protection, a borrower will enter into a swap without any assurance that it is “on market”, i.e., not at a higher rate than it should be or on terms stricter than are appropriate in light of the borrower’s creditworthiness.

A third risk is referred to as “termination risk.” Although the swap agreement may be for as long as 30 years, there are circumstances under which it may be terminated early. Termination events range from typical defaults to declines in the borrower’s credit rating from Moody’s or its S&P rating being downgraded, or the borrower’s failure to meet specific economic covenants (e.g., a debt service coverage ratio, a liquidity ratio, or a similar measure). Early termination may present significant issues to a borrower because the termination payment associated with an interest rate swap will be determined based on how the fixed rate paid by the borrower on the swap relates to what the borrower would pay as a fixed rate if the swap were entered into on the date of termination. If interest rates have fallen, the borrower will owe the counterparty a termination payment, which may be substantial.¹²

A fourth risk relates to the potential need by the borrower to post collateral to assure the borrower’s performance under the swap. To the extent that the mark to market value of the swap is negative as to the borrower beyond a certain defined threshold, the borrower will be required to post liquid collateral to reflect that negative value. This may require the borrower to liquidate certain of its existing investments to provide cash or cash-equivalent investments which will yield less than the liquidated investments. A related risk is that the posting of collateral may cause the borrower to be out of compliance with certain of its economic covenants, most typically a liquidity or days cash on hand covenant.¹³ A breach of those covenants can have harm the borrower’s bond issue and, in some cases, can put the borrower in default.

Finally, LIBOR-based swaps carry two risks: basis risk and tax risk, which reflect the difference between the taxable nature of the index

used to determine the counterparty payment to the borrower and the tax-exempt index used to set interest rates on the bonds.¹⁴

RISKS IN VARIABLE RATE AND AUCTION STRUCTURES

In addition to the risks presented by interest rate swaps, VRDOs and ARS carry their own risks. Most VRDOs are marketed to so-called “2a-7” funds, which are money market funds permitted to purchase “First Tier Securities” as that term is defined under Rule 2a-7 of the Investment Company Act of 1940, as amended.¹⁵ A First Tier Security is one with a short-term rating in the highest rating category from one of the nationally recognized rating agencies, which include Moody’s and S&P. Typically, as a matter of practice, tax-exempt money market funds will limit their purchases to VRDOs with short term ratings of “VMIG 1” from Moody’s and “A-1” or “A-1+” from S&P. Because the bond rating is usually the rating of the letter of credit bank, a VRDO carries a risk that is analogous to the counterparty risk in swap transactions. If the letter of credit bank’s short term rating(s) is downgraded below these levels, the universe of purchasers for the VRDOs will change and shrink, with a related rise in interest rates paid by the borrower. In the worst case scenario, there will be no third party buyers and the bonds will be held by the letter of credit bank at a higher rate of interest until they are remarketed.

A second risk in VRDO transactions is renewal risk. Most bond issues have a long term maturity – typically 20-30 years, but at times up to 40 years – but letters of credit are short term commitments of between one and 10 years. If a letter of credit is not renewed, or an appropriate substitute is not found at the end of its term, the borrower must either convert the bond issue to a fixed-rate issue based on the borrower’s credit, or repay the letter of credit bank over a brief period. Even if the letter of credit is renewed, or an appropriate substitute found, there is no guarantee that the terms of the renewal will be as favorable as the original letter of credit.

The primary risk with ARS is auction failure. Unlike VRDOs, where a third-party bank provides liquidity, ARS depend on auction participants for their liquidity. The theory behind ARS is that that self-generated liquidity always will be there, thereby eliminating the renewal risk associated with VRDOs.

Despite all of these risks, the VRDO and ARS structures (and the related interest rate swaps) worked well until the subprime mortgage crisis hit the financial markets. Although there might seem to be no clear relationship between that market and the municipal tax-exempt market, there were two common threads. Many monoline bond insurers had enhanced collateralized mortgage obligations (“CMOs”) and were beginning to experience substantial and dramatic losses as the underlying mortgage obligations failed in numbers far beyond those anticipated.¹⁶ Similarly, banks issuing letters of credit that held significant amounts of CMOs as investments (or the underlying subprime loans) began to experience those losses. The result was a substantial tightening of the credit markets, including the tax-exempt market, beginning in late 2007.

THE SUBPRIME CRISIS' EFFECTS ON THE TAX-EXEMPT MARKET

The ripple effects of what began as problems in the housing markets that affected the financial institutions holding substantial amounts of subprime mortgages and CMOs was first felt in the tax-exempt market in November and December of 2007. For the first time since their inception, ARS issues became difficult to sell.¹⁷ In the preceding years, letter of credit banks had been supplying longer term and lower priced letters of credit but in late 2007 and early 2008, increasing demand led to tighter terms, and greater economic and operating covenants for those borrowers who could receive commitments.

Beginning on February 13, 2008, the major investment banks/broker-dealers stopped supporting auctions and the ARS market experienced a widespread failure for the first time in its history. Most auction rate bond documents anticipated the possibility of a failed auction, but no one was prepared to have the entire ARS market stop functioning all at once. Essentially what occurred was that the major investment banks no longer believed they should continue to support the market by purchasing ARS issues that otherwise would not have been purchased. This change in position, which involved all of the major broker-dealers, completely undermined the ARS market.

When the ARS market had first started tightening in December, 2007, many investment bankers counseled their clients to amend their documents on a temporary basis to allow increased interest rates. The concept was that this would create sufficient liquidity in the ARS market to keep it functioning. Implicit in the request was a *quid pro quo*: the increased rates would provide greater numbers of buyers, and the investment banks would continue to support the market to the extent buyers otherwise could not be found.¹⁸ Between the pre-existing clauses which set forth maximum rates and amended documents which raised them, starting on February 13, 2008 borrowers suddenly found themselves paying up to 20 percent on tax-exempt obligations, a 500 percent increase above prior market levels.

In addition to the systemic issues in the ARS market, and because of the increased exposure of major financial institutions to the subprime housing market, Moody's and S&P began a series of downgrades of the monoline insurers whose policies were supporting many CMOs and ARS. As defaults rose on mortgage obligations, their value fell as securities dropped. It became clear that the monoline insurers, also highly involved in the ARS market, were exposed to substantial and continuing losses. In addition, many of the major, highly rated, banks that had issued letters of credit to support VRDOS had invested in the CMOs (initially rated in the "AAA" category) in order to obtain the yield presented by the portfolios underlying the CMOs.¹⁹

As a result, although the VRDO market was still attractive to investors, the availability of letters of credit became scarce at the same time that the costs rose, the conditions tightened and the length dropped.²⁰ Banks were increasingly forced not just to choose their existing customers over requests for new credit support, but also to choose among their existing customers.

Over the course of the spring and summer of 2008, borrowers saw a variety of other major changes, with a number of major Wall Street and national banking companies acquired by others during this period. The

concept driving many of these acquisitions and mergers was that certain key financial institutions were "too big to fail". In the initial stages, the investment banker Bear Stearns was merged into J.P. Morgan Chase while the commercial bank Wachovia was merged into Wells Fargo.

The credit crisis hit a new level in the week of September 15, 2008, when Merrill Lynch was taken over by Bank of America, Lehman Brothers filed for bankruptcy protection²¹, and the federal government began a massive bailout of AIG.²² Merrill Lynch and AIG, major players in the municipal marketplace, appeared to have met the "too big to fail" criteria and were shored up. Merrill Lynch, through a merger (with subsequent bailout money, to Bank of America) and, in AIG's case, through an infusion of many billions of dollars of federal assistance.

The filing by Lehman Brothers Holdings, Inc. ("Holdings"), the "A"-rated parent of numerous Lehman entities, ran counter to the "too big to fail" theory as certain of its subsidiaries, primarily Lehman Brothers Special Financing, Inc. ("Special Financing") were deeply involved globally in derivatives in the hundreds of billions of dollars, including many interest rate swaps entered into between municipal borrowers and Special Financing. Special Financing was a favorite swap counterparty for many less creditworthy tax-exempt borrowers because of Special Financing's relatively lenient credit terms.²³

Many borrowers who had Special Financing swaps already were experiencing problems with their VRDOs because of letter of credit bank downgrades, with the uncertainty over the future of the swap tied into the uncertainty of the continuing credit quality of the bank. For those borrowers who had entered into synthetic fixed rate bond issues in the expectation that they had a vehicle which was subject to few risks and would provide a significant measure of interest rate protection, the Lehman Brothers bankruptcy created a whole new set of realities. Borrowers learned quickly that, unlike most executory contracts, interest rate swaps are *not* subject to the automatic stay under the federal Bankruptcy Code.²⁴

Because there is very little case law about what happens to a derivative contract in bankruptcy, borrowers became subject to conflicting advice about how to proceed with their swap and to what extent they, or Special Financing, could withhold payments or terminate the swap as a result of the bankruptcy. Leaving aside the legal issues, many borrowers who had swaps maturing up to 30 years out realized that Special Financing not only had lost its credit support partner (Holdings), and thus its "A" rating, but also the certainty that a swap counterparty would be available to make any required payments.²⁵

One further, and shocking consequence of the mid-September developments was that the SIFMA index began to rise rapidly as investors pulled their money from the 2a-7 funds in order to create liquidity. On September 24, 2008, SIFMA jumped to 7.96 percent, an almost 500 percent increase from its 1.63 percent level just three weeks earlier on September 3, 2008.²⁶ By the end of 2008, SIFMA had dropped below 1.00 percent, and has remained at very low levels since then. But as bond insurers²⁷ and banks continued to be downgraded, even the very low interest rate environment did not solve the problems faced by many borrowers.

WASHINGTON'S EFFORTS TO SHORE UP THE TAX-EXEMPT MARKET

The Bush Administration and the Congress recognized these problems, and took one ameliorating step in the summer of 2008 by passing the Housing and Economic Recovery Act of 2008 ("HERA").²⁸ Although the Code has expressly prohibited any federal guarantee of tax-exempt bonds, HERA created an exception to this rule by permitting Federal Home Loan Banks to guarantee tax-exempt bonds under certain circumstances during the period July 30, 2008 through December 31, 2010 without violating the Code's prohibition on federal guarantees. That initial step was followed by the enactment of the American Recovery and Reinvestment Act of 2009 ("ARRA") in early 2009.²⁹

ARRA contains a number of provisions seeking to provide some relief to tax-exempt borrowers, primarily through making it possible for banks and a broad range of 501(c)(3) institutions to make direct purchases at levels up to \$30 million of tax-exempt bonds in each of 2009 and 2010.³⁰ These changes free borrowers from the concerns about downgraded banks, as a purchase by a bank is in no way dependent on its credit rating. The changes thus permit smaller local and regional banks, as well as the banks that had been issuing letters of credit based on their ratings, to purchase tax-exempt bonds or notes.³¹

While HERA and ARRA create opportunities for tax-exempt borrowers, they only can be used through the end of 2010. Nevertheless, they have reopened the municipal market to a significant degree, allowing an increased flow of transactions for charitable corporations that have critical projects to complete and for which tax-exempt financing will help defray the costs of those projects. Institutions needing to borrow more than \$30 million in tax-exempt bonds or notes in a year are, however, left to the more traditional marketplace.

Although the concept is not new, another tool available to certain 501(c)(3) borrowers is so-called "FHA 242" financing. In an FHA 242 financing, the borrower applies for mortgage insurance to enhance its long-term, fixed-rate bonds. If insurance is granted, the bonds will be rated in the "AA" category. Traditionally this type of financing has been available only when it included a significant new construction/major renovation component. However, in July, 2008, the FHA 242 program was extended to institutions otherwise qualifying that simply wish to refinance existing bonds. For qualifying borrowers who have issued VRDOs or ARS that carry numerous risks, this enhanced program may permit them to return to long-term, fixed-rate debt.³²

CONCLUSION

Tax-exempt financing for 501(c)(3) borrowers experienced much the same easy access to credit and unparalleled growth as the housing and stock markets did in the two decades leading up to 2008. While it is not possible to predict the extent to which the tax-exempt marketplace may expand to meet its borrowers' increasing needs for capital over the next decade, the present market likely is in transition to a new reality for charitable corporations. It seems clear, however, that so long as there are borrowers with capital needs and banking institutions designed to meet them, structures will emerge which will allow the borrowers to obtain funds, albeit perhaps not as readily as they have been able to in the most recent period of economic growth.

ENDNOTES

1 The Code permits each state to determine through legislation what types of 501(c)(3) entities (sometimes referred to as charitable corporations) may have access to tax-exempt financing, often referred to as "municipal bonds". In order to qualify as tax-exempt debt, the bonds (or notes) must be issued by an entity which is a subdivision of the state. In New Hampshire, there are two primary entities, both of which are state agencies, through which tax-exempt debt can be issued by charitable corporations: the Business Finance Authority, established under NH RSA 162-A, with authority to issue bonds under NH RSA 162-I) and the New Hampshire Health and Education Facilities Authority, established under NH RSA 195-D, with authority to issue bonds under that statute and, for student loan corporations, under NH RSA 195-E. Charitable corporations issuing tax-exempt debt through such an entity are referred to as "conduit borrowers" as the agency is the conduit through which the tax-exempt debt is issued.

2 As examples, these provisions included new restriction on the extent to which, and the amount of: (a) positive arbitrage that could be earned by investing the proceeds of tax-exempt debt in higher yielding, taxable investments; (b) tax-exempt proceeds that could be used to pay for costs of issuing the debt and other expenses not directly related to the borrower's charitable purposes (so-called "bad money"); (c) moneys that could be used to finance so-called "blind pools", where bonds were issued based on possible need for access to moneys by a range of tax-exempt borrowers, without a commitment on the part of any of the potential borrowers to actually use the moneys; and (d) the deduction banks and other financial institutions could take on the tax-exempt moneys loaned directly to charitable borrowers (effectively raising the rates for such loans).

3 One period of substantial activity was the last three months of 1985. Although TEFRA was not enacted until August 1986, Congress made clear in 1985 its intent to pass such legislation and suggested that its provisions could be retroactively effective to January 1, 1986.

4 A bond insurance policy issued in connection with a tax-exempt debt issuance guarantees the timely payment of principal and interest on the bonds or notes. If the underlying borrower defaults on its payment obligations, the bond insurer may either make principal and interest payments as they come due or accelerate the debt issue and pay all outstanding principal and accrued interest at one time. The decision whether to continue payments or make one payment typically is driven by the difference between the interest rates on the bonds or notes and prevailing interest rates at the time of default by the underlying borrower. Unlike a bond insurance policy, in which the full premium is paid upfront and the insurance covers the bonds or notes until they mature or are prepaid, a letter of credit has a limited period of coverage for the related debt, most typically from one to five years, although in the period from 2003-2007, some banks issued letters of credit with up to 10 year terms. A letter of credit provides for the payment of principal and interest as they come due and, upon its expiration, if it is not replaced, pays all outstanding principal and accrued interest at that time.

5 Most amendments to bond documents or waivers of covenants breaches or defaults require at least majority bondholder consent. In a credit enhanced issue, however, so long as the credit enhancer is not in default of its obligations and has not repudiated them, it is treated as the sole bondholder for most purposes.

6 For the most part since the mid-1980s, there have been appreciable differences in the interest costs between bonds or notes in different rating categories. Thus, an "A" rated obligation will frequently provide up to 50 more basis points in yield than a "AAA" rated obligation and up to 100 less basis points than a "BBB" rated obligation. Those differences assume a normal yield curve, in which short term rates are markedly lower than long term rates and differences between ratings categories are distinct. There have been times, however, when the yield curve flattens or inverts and the ratings differences are much less significant. That tends to happen when there is a lack of highly rated debt available to purchasers and significant demand for tax-exempt debt.

7 In the event that the remarketing agent cannot find purchasers for bonds which have been tendered, the letter of credit bank will become the owner of the bonds, at least for some period of time. If the bonds can never be remarketed, the letter of credit bank converts the bond issue into a taxable loan with the borrower. For the period from the first use of variable rate bonds issues backed by a letter of credit in the 1980s until September, 2008, there were very few failed remarketings, even during the week of September 11, 2001. As set forth in this article, the credit crisis ultimately led to many failed remarketings. There were several factors which led to the failed remarketings, but one critical factor was the remarketing agents' decreased use of their own capital to purchase bonds for their own account to ensure that there were no failed remarketings.

8 Interest rate swaps and other derivatives (so named because they derive their value from a separate transaction) are by no means limited to floating-to-fixed rate or fixed-to-floating rate transactions. The widespread growth of derivative products, which have been generally unsupervised, played a critical role in the global economic crisis. The so-called "credit default swap", which received considerable publicity in connection with the crisis, is an example of a product that produced substantial revenue, but whose risks far outweighed its benefits and was a substantial contributor to the problems faced by AIG. Credit default swaps reflect the market's view of the likelihood that a swap counterparty (e.g., Lehman Brothers, which filed for bankruptcy protection in September, 2008) will default on its swaps. If it does, as Lehman Brothers did, payments become due under the swaps.

9 The SIFMA rate (like its predecessor, the BMA rate) is set weekly, reflecting a cross section of tax-exempt interest rates, and serves as the reference for where weekly tax-exempt bonds

trade.

10 Historical studies demonstrated that, despite the variation from BMA or SIFMA, 67% of one month LIBOR produced slightly greater payments back from the counterparty over a 10 or 20 year period. Since most swaps were for periods between 10 and 30 years, and LIBOR-based swaps typically required the borrower to pay a fixed rate that was 50-75 basis points less than what a BMA or SIFMA-based swap would require the borrower to pay and 70-100 basis points less than a traditional fixed rate bond issue. The specific risk associated with a LIBOR-based swap is referred to as "basis risk", which refers to the fact that a taxable rate (LIBOR) is being used as a proxy for the tax-exempt rate (BMA/SIFMA) paid on the related bonds. Although historically 67% of one month LIBOR have averaged out to an amount slightly greater than BMA/SIFMA, there have always been variations on a month-to-month basis, some significant. In addition to basis risk, LIBOR-based swaps carry tax risk. Substantial variations in marginal tax rates will affect the tax-exempt bond interest rate. The lower the marginal rate, the greater the tax-exempt BMA/SIFMA based payment will need to be to provide the intended benefits of the tax-exempt bond or note. If marginal tax rates were to be lowered, the correlation between a 67% of LIBOR payment and the current 33% marginal rate which most tax-exempt bondholders pay, would diminish as BMA/SIFMA based rates would most likely increase while the 67% of LIBOR payment would not.

11 The safest swap, rarely employed in the tax-exempt marketplace, and considerably more expensive to the borrower is what is referred to as a "cost of funds" swap. In that swap, the counterparty pays whatever the borrower's interest rate on its bonds is on a monthly basis. Since bonds do not always trade at BMA/SIFMA, for a variety of reasons, a cost of funds swap provides a perfect, if expensive, hedge in which the borrower always pays the agreed to fixed rate. Since September, 2008, cost of funds swaps have generally not been available.

12 The changing value of an interest rate swap, known as the "mark to market" ("MTM") of the swap, is reflected in the borrower's audited financial statements. Most simply stated, the MTM is similar to an unrealized gain or loss on a security based on changing market conditions.

13 An interest rate swap agreement generally provides that the counterparty will have to post collateral upon the occurrence of certain events, such as a downgrade in its Moody's or S&P credit rating or if the MTM value is greater than some percentage of its shareholders' equity. Generally these thresholds are so high (because swap counterparties are typically rated at least in the "A" category) that posting is almost never required. Although Lehman Brothers was required under certain of its swap agreements to post collateral under these circumstances, its drop from an "A" rated institution to a bankrupt institution overnight precluded any collateral posting.

14 See notes 10 and 11, *supra*.

15 17 CFR 270.2a-7

16 Many of the CMOs that were at the heart of the subprime crisis carried ratings in the "AAA" category, often based on the bond insurance provided for the CMOs. However, the CMOs contained several tranches of mortgages, from those that were traditional, highly secured mortgages with borrowers capable of repaying them to subprime loans that were based on limited documentation and made to borrowers who might be able to afford the initial interest rate, but did not have the means to pay when those rates reset to market rates. Whether the rating agencies rating the CMOs properly analyzed the portfolios has been a source of contention since the subprime crisis began.

17 Although not directly relevant to this article, many investment bankers who marketed ARS on behalf of borrowers, whether tax-exempt or for-profit, sold the securities to their retail and institutional customers as the equivalent of cash or a cash equivalent investment, and (incorrectly) claimed that the ARS had the same liquidity. The reality of ARS illiquidity became clear on February 13, 2008, when the investment banks and broker-dealers that had marketed the ARS on behalf of their borrowers stopped supporting the ARS market, leading to widespread failures in the market, and in turn to actions brought on behalf of retail and institutional purchasers by several states (most notably Massachusetts, New York and Texas) as well as the Securities and Exchange Commission.

18 Although not the focus of this article, many of the same investment banks that served as broker-dealers for the ARS market also sold them to their retail clients. In many cases, the ARS were represented to be "cash equivalents", and were shown on retail and institutional brokerage accounts in that manner. As became clear when the ARS market stopped functioning, ARS were by no means cash equivalents as they depended on a willing purchaser for liquidation (unlike VRDOs, where bond holders had the liquidity of an "A" or better rated bank ensuring their ability to liquidate their securities on short notice). The practices of many of the major broker-dealers in the

ARS market led to a series of state and federal proceedings referenced in footnote 17, *supra*.

19 Most CMOs were issued in "tranches", or tiers of indebtedness. While the CMOs included many conforming and secure mortgages, lower tranches included much more risky mortgages which failed at significant rates.

20 In the first part of 2008, one major provider of letters of credit, JPMorgan Chase Bank, N.A. (Chase) reported requests for letters of credit at a ratio of 4 to 1 to the amount it could provide based on its capital requirements.

21 Lehman Brothers Holdings, Inc. (Holdings) was the initial bankruptcy filer. Holdings carried ratings in the "A" category from Moody's and S&P prior to its filing and was the credit support provider for Lehman Brothers Special Financing, Inc. (Special Financing), which was the Lehman Brother counterparty involved in the vast majority of swaps entered into by Lehman Brothers. Special Financing followed Holdings into bankruptcy in early October, 2008.

22 AIG's presence in the municipal marketplace was primarily in the form of investment contracts. Guaranteed Investment Contracts, or "GICs", are a vehicle frequently used for the investment of bond or note proceeds which have been borrowed, but which will be spent over time. AIG's "AAA/Aaa" ratings made it a major player in municipal GICs, which generally are limited to investments in entities rated in the two highest rating categories by Moody's and S&P.

23 As a major example, Special Financing frequently entered into interest rate swaps where there was one-way collateralization running from Special Financing to the borrower, but no required collateralization back from the borrower even if the borrower was not highly creditworthy.

24 See 11 U.S.C. § 560, which provides in part: "The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title [the insolvency of a debtor or filing of a bankruptcy petition by the debtor or the financial condition of the debtor] or to offset or net out any termination values or payment amounts arising under or in connection with the termination, liquidation, or acceleration of one or more swap agreements shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title."

25 Special Financing has not been making any periodic payments since the bankruptcy filing. For parties who were "in the money", i.e., the mark to market value of the swap was an asset, a termination of their swap at the outset of the bankruptcy would have resulted in their becoming an unsecured creditor of Special Financing with a possible payment of some reduced amount at the end of the bankruptcy. In this sense, and although it is somewhat counterintuitive, it was better to be "out of the money" at the time of the filing.

26 SIFMA Research - "Municipal Bond Credit Report", September, 2008 (Securities Industry and Financial Markets Association).

27 As examples, FGIC, one of the first highly-rated bond insurers, fell from "Aaa" to "A3" on February 14, 2008, from that level to "Baa3" on March 31, 2008, and to "B1" on June 20, 2008. Ambac, also traditionally one of the premier bond insurers, lost its "Aaa" from Moody's on September 18, 2008, when it was downgraded to "Aa3" and fell further to "Baa1" on November 5, 2008. (Bear Stearns - Municipal Market Update)

28 Public Law 110-289, adopted on July 30, 2008.

29 Public Law 111-5, adopted on February 17, 2009.

30 Prior to ARRA, so-called "small issues" were limited to \$10 million per year and to the issuer of the obligations. Thus, a conduit entity like BFA and HEFA, as the actual issuer of bonds for its conduit borrowers, would be limited to \$10 million of bonds in the aggregate in any year, which made use of these provisions of limited application. ARRA not only changed the amount that could be issued in any year to \$30 million, but also determined the applicability of the issuance at the conduit borrower (i.e., charitable corporation) level rather than the issuer (i.e., BFA or HEFA) level.

31 ARRA also contains favorable conditions with respect to interest deductions for banks purchasing these obligations, making them as attractive as they were prior to TEFRA.

32 Issuing bonds through the FHA 242 program is a complex, expensive and often tedious process. Not all institutions that wish to issue bonds through this process will qualify. Nevertheless, it is another example of attempts at the federal level to make more tax-exempt financing available.



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MANAGING MERGERS & DISSOLUTIONS

Options for Faltering Nonprofits— A Practical Mission-Based Approach

By Attorney Todd C. Fahey¹

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 organizations³, 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 options⁵:

- 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 corporations⁸. 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 organization’s 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 ethically¹⁶ 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 latent¹⁸) 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 Hampshire¹⁹ 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 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 competence²⁸ 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 estate³⁰ 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 suspend 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 Report³⁹ 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 Trusts 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 transactions⁴² 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 ... (II) 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).



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CASE STUDY: SALE OF A NONPROFIT— *The Sale of Daniel Webster College to ITT Educational Services, Inc.*¹

By Attorneys Ovide M. Lamontagne
and Ryan M. Williams

Editor's note: This article was reviewed by an editorial board member but not by the Issue Editor.

INTRODUCTION

After nearly five years of substantial economic growth, the engine of American prosperity started to sputter in 2006. During that fateful year, as housing values leveled² and interest rates rose from their historic lows,³ defaults on adjustable-rate mortgages by subprime borrowers began to escalate at a feverish pace. By 2008, the disastrous marriage of these subprime loans to mortgage-backed securities was threatening even the most established financial firms. As the year progressed, with the collapse of such institutional giants as Lehman Brothers and the failure of Fannie Mae and Freddie Mac, the seemingly unceasing string of bad news only appeared to be escalating. Indeed, the speed and severity with which things appeared to be falling apart led legendary investor Warren Buffet to describe the turmoil as “an economic Pearl Harbor.”⁴

For countless small, non-profit educational institutions, however, troubled times began well before the subprime mortgage crisis took its grip. Confronted with an increasingly competitive market, these unfortunate trendsetters have been toiling under distressed fiscal circumstances for more than a decade. As a result, for many of these organizations, the credit crunch that has attended the current market turmoil has been not the first, but rather the final, fatal blow in a long, hard-fought battle for solvency. With little hope of survival, these institutions are left with little choice but to dissolve, merge with another non-profit entity, or be acquired by a for-profit company.

To an increasing extent, the latter of these three alternatives has proven to be the only feasible option. To be sure, from the acquisition of Franciscan University in Iowa by the for-profit company Bridgepoint Education in 2005,⁵ to the more recent purchase of Myers University in Ohio by the for-profit investment firm Significant Partners in 2008,⁶ these for-profit acquisitions are gradually becoming a staple of modern business in the education realm. But despite their increased prevalence, these transactions continue to raise interesting, and often unsettled legal questions as they result in an uncommon interaction between the non-profit and for-profit worlds.

In an effort to illuminate some of these considerations, this article explores the recently completed sale of substantially all of the assets of Daniel Webster College (“DWC”) to the for-profit corporation DWC Acquisition Corp., a wholly-owned subsidiary of ITT Educational Services, Inc. (collectively, “ITT”).⁷ Although not exhaustive in its discussion, the article will highlight for practitioners some of the larger issues that can arise when representing a non-profit seeking rescue from financial distress through a transaction of this nature.

DANIEL WEBSTER COLLEGE'S DEEPENING WOES

With a full-time enrollment of less than one thousand students,⁸ DWC is a small college located on a fifty-acre campus to the south of Boire Field municipal airport in Nashua, New Hampshire.⁹ Founded in 1965 as the “New England Aeronautical Institute,” DWC was initially established as a non-profit technical school devoted to workforce training in the fields “of aeronautics and aerospace.”¹⁰ However, by an act of the Legislature in 1973, DWC was granted the authority to offer programs outside the field of aeronautics in the areas of arts and sciences.¹¹ Since adopting the name “Daniel Webster College” in 1978,¹² DWC has further expanded its curriculum to include degree programs at the bachelors’ and masters’ level, and offering courses in business, social science, computer science, and engineering.

Like many of its contemporaries, DWC had been struggling financially well before the global economic collapse in 2008. Indeed, with crushing debt and unstable enrollment, DWC had been suffering from operating losses since at least the turn of this century.¹³ In the 2004 fiscal year, for example, it received \$12,864,442 in net tuition and fees, but had operating expenses totaling \$18,634,484. Even taking into account other sources of revenue, including contributions and gains on long-term investments, DWC incurred a year-over-year decrease in net assets of over \$150,000. This budgetary shortfall was not only jeopardizing DWC’s viability, but was also stymieing the Board’s ability to engage in the type of innovation and enrichment of programs and amenities that might bring in additional revenue through increased enrollment.

This was the financial predicament that Robert E. Myers inherited on July 1, 2005, when he was hired by the Board of Directors (the “Board”) to serve as DWC’s new president. Despite these fiscal obstacles, President Myers assumed his position determined to return the institution to solvency. To that end, within months of starting

his tenure, President Myers set forth a proposed course of action for revitalizing DWC in a letter to the Board entitled "A Vision for 2015 and Beyond" ("Vision 2015"). While conceding in that letter that DWC was "financially fragile" and suffered from a "culture of poverty," President Myers expressed his belief that DWC could become one of "the top ten small colleges in the nation that have mastered the balance of developing today's workforce and preparing tomorrow's workforce for careers in aviation, business, engineering, and information technology."¹⁴ To achieve this transformational change, he noted DWC would need, among other things, to add new programs to its academic inventory, review and retool existing programs, and bolster DWC's modest endowment.¹⁵ On October 22, 2005, the Board adopted President Myers' Vision 2015 plan.

FUNDAMENTAL CHANGE IS NEEDED

DWC's management struggled mightily to achieve the goals set forth in Vision 2015, but progress was hobbled by the lack of financial resources. To be sure, following the Board's adoption of Vision 2015, DWC incurred operating losses in both 2005 and 2006.

This ongoing fiscal predicament became a cause for concern for the United States Department of Education (the "USDOE"). On April 10, 2006, DWC received written notice from the USDOE that it was at risk of losing its ability to participate in the federal student financial assistance programs (the "Federal Aid Programs")¹⁶ offered under Title IV of the Higher Education Act of 1965 (the "HEA").¹⁷ Under the HEA, an educational institution must demonstrate that it can "meet all of its financial obligations" in order to participate in any Federal Aid Program.¹⁸ In its letter, the USDOE explained that DWC failed to meet this criteria and, as a result, would only be permitted to continue to participate in the Federal Aid Programs on a provisional basis if, among other things, it maintained a letter of credit in excess of \$700,000.¹⁹ However, apart from the fact that this provisional form of participation could be revoked at any time if the USDOE determined that DWC could not "meet its responsibilities under its program participation agreement,"²⁰ it would also automatically lapse on June 30, 2009,²¹ with no guarantees that DWC would be re-approved. Given that DWC received approximately 35 percent of its gross annual revenue (or approximately 51 percent of net annual revenue) through federal aid, loss of this funding would be fatal.

To make matters worse, DWC's financial frailty also caused the college's accrediting body, the New England Association of Schools and Colleges ("NEASC"), to issue a formal "Notice of Concern" in the spring of 2006. NEASC issues such notices when it "determines that an institution is in danger of being found not to meet one or more Standards of Accreditation if current circumstances or trends continue."²² In DWC's case, NEASC explained that the college was in danger of failing to meet the NEASC "standards on Financial Resources" because of DWC's: (1) heavy dependence on tuition; (2) mixed financial results, especially with regard to unrestricted assets; (3) thin or weak operating margin; (4) high level of debt; and (5) low cash reserves. Accordingly, NEASC required DWC to undergo a "focused evaluation" - which is a form of assessment involving

a team of academics visiting a college's campus and assessing its progress towards addressing the issues raised in a Notice of Concern²³ - by the end of 2008. When that focused evaluation was completed in 2008, the visiting team of academics reported that DWC had experienced "no significant improvement in financial stability" and was now operating "on a year-to-year or perhaps semester-to-semester basis."²⁴ As a result, they concluded that "a dark cloud of uncertain financial viability continues to hover over the [c]ollege: a challenge which must be resolved."²⁵ In light of the fact that accreditation is necessary for an institution to grant degrees,²⁶ if DWC had failed to resolve this challenge and its accreditation was lost, it would have been forced to close.

Though hobbled by the potential loss of its accreditation and its ability to participate in federal aid programs, DWC managed to struggle through 2008. However, it suffered a year-over-year decrease in its net assets of \$316,235, and was projecting an operating loss in excess of \$700,000 for the upcoming fiscal year. Faced with the stark reality that DWC was teetering on the brink of insolvency, the Board came to the unanimous conclusion that a fundamental change would be necessary in order to insure the survival of the institution.

SELECTION OF ITT

Unlike the directors of a for-profit corporation, the Board could not focus merely on economic factors when exploring the alternatives available for resolving the College's precarious financial situation. Since its inception, DWC had operated as a voluntary, non-profit corporation²⁷ that was exempt from federal taxation under Section 501(c)(3) of the Federal Tax Code (the "Code").²⁸ As such, pursuant to both common and statutory law, the College was deemed a "charitable trust"²⁹ and its assets were held for the public benefit.³⁰ To the maximum extent possible, therefore, all of the Board's decisions needed to be guided by an awareness of, and fidelity to both DWC's charitable mission and the interests of its beneficiaries (i.e., the college's students and the local community).³¹

With these principles in mind, President Myers and several members of the Board began exploring external alternatives for preserving DWC's charitable assets, including merger discussions with two other non-profit colleges and negotiations with a venture capital firm about potential investment. However, none of these options could meet DWC's needs in a manner that would allow it to remain sufficiently aligned with its charitable mission. It was not until the end of 2008, when President Myers and the Board members began a conversation with representatives from ITT that their search for a financially viable solution bore fruit.

Unlike DWC, ITT is a for-profit, publicly-traded corporation. Despite this difference, ITT was an attractive potential partner because it possesses nearly 40 years of experience in higher education and operates 29 nationally-accredited institutions across the United States. Moreover, in contrast to the other scenarios explored, the discussions with ITT produced a template for a transaction that would allow the institution "Daniel Webster College"³² to continue to provide educational opportunities to the community in accord

with the general charitable intent of DWC's founders, permit DWC to extinguish in excess of \$22,300,000 in debt, and enable the corporate entity that held title to the DWC's assets to create an independent source of charitable giving for New Hampshire residents.

Ultimately, DWC and ITT concluded that several unique factors common to both organizations would enable a synergy between the two institutions with minimal disruption to the student body, including the fact that both organizations share: (i) a close symmetry of mission; (ii) a congruence of program offerings that emphasize practical education and professional advancement; (iii) a common history as technical schools that train students for entry directly into the workforce; and (iv) a similar vision for the future. After carefully considering all available options, the Board determined that partnering with ITT presented the best option for resolving DWC's long-standing financial problems. and provide "Daniel Webster College" with the resources to continue. The Board and ITT also determined that structuring the deal in the form of an asset sale would provide both parties with the flexibility needed to achieve this dual objective.

EXECUTION OF THE LETTER OF INTENT

On January 14, 2009, DWC and ITT signed a Letter of Intent ("LOI"), in which they agreed to begin the arduous process of preparing the final asset purchase agreement (the "Purchase Agreement") that would govern the sale of substantially all of the assets of DWC to ITT's subsidiary, DWC Acquisition Corp. (the "Transaction"). As is customary in acquisition transactions, the LOI set forth the parties' general understanding as to the assets to be acquired, the purchase price, the structure of the deal, the scope and extent of the parties' due diligence, the seller's obligations to preserve the business during such due diligence, and each parties' obligations as to confidentiality. It was not until after this LOI had been executed that the Board sought assistance from outside legal counsel.

Ideally, in transactions of this nature, legal counsel would be involved in the negotiations well before the LOI is executed. While an LOI has obvious utility in guiding the relationship between the parties when a deal will involve lengthy and costly preliminary negotiations, "in the hands of many entrepreneurs and corporate officers, . . . [LOI's] have led to much misunderstanding, litigation and commercial chaos."³³ The confusion and problems tend to arise from the fact that, unbeknownst to many in the business world, an LOI can become binding even though the document expressly contemplates the execution of a subsequent writing.³⁴ As more fully explained by Judge Leval in his oft-cited opinion, *Teachers Ins. and Annuity Assoc. of America v. Tribune Co.*,³⁵ there are at least two distinct types of preliminary agreements with such binding force: The first binds the parties "to their ultimate contractual objective" and "occurs when the parties have reached complete agreement (including the agreement to be bound) on all the issues perceived to require negotiation," but express an intention to adopt a more formal writing.³⁶ The second occurs when the agreement, on its face, "expresses mutual commitment to a contract on agreed major terms, while recognizing the existence of open terms that remain

to be negotiated."³⁷ Unlike the first, this latter form of binding preliminary agreement imposes upon each party a duty to negotiate in good faith and bars each from "renouncing the deal, abandoning the negotiations, or insisting on conditions that do not conform to the preliminary agreement."³⁸

Given that many LOI's are prepared by persons who are unaware of their potential ramifications, to the extent possible, practitioners should advise their clients against executing such documents without first obtaining the advice of legal counsel, even if counsel is not retained to negotiate the terms of the document. This need for counsel becomes arguably more pronounced when the transaction is between a charitable organization, which will likely have little experience with such matters, and a sophisticated for-profit entity. Fortunately, in this case, DWC's Board consisted of a group of sophisticated business persons cognizant of both charitable trust principles and the implications of executing an LOI. Not surprisingly, therefore, the LOI expressly disavowed the enforceability of the majority of its provisions.

Of those few provisions that were purportedly enforceable, only one warrants further discussion. In particular, the LOI prohibited DWC and its representatives from directly or indirectly engaging in, essentially, any activity that could have resulted in DWC's receipt of a competing offer.³⁹ While such exclusivity (or "no-shop") provisions are not uncommon, and indeed are often necessary to protect a contracting party's investment in a potential deal, they should not be accepted without due consideration. This is so because, beginning with the seminal case *Revlon, Inc. v. MacAndrews & Forces Holdings, Inc.*, courts have increasingly held that a for-profit corporate board that has determined to partake in a transaction to sell the company must focus on "the maximization of the company's value at a sale for the stockholders' benefit."⁴⁰ As a direct corollary to this rule, *Revlon* and its progeny have concluded that such for-profit boards must obtain "a body of reliable evidence with which to evaluate the fairness of the transaction."⁴¹ In application, this means that, when a "board is considering a single offer and has no reliable grounds upon which to judge its adequacy, [it must engage in] a canvas of the market to determine if higher bids may be elicited."⁴² Thus, in certain cases, acceptance of a "no-shop" provision can be problematic because it blocks a board's ability to engage in such a canvas of the market and hinders its ability to obtain a "reliable grounds upon which to judge [the deal's] adequacy."⁴³

To be sure, it does not appear that any court has yet had the opportunity to consider whether the so-called *Revlon* duties would apply to the sale of a non-profit corporation. Nevertheless, it should be noted that the *Revlon* duties are not the product of some abstract judicial artifice, but rather derive from a board's general duty of "care and loyalty to the corporation and its shareholders."⁴⁴ While they do not possess shareholders, charitable corporations owe a similar, if not more stringent duty of care and loyalty to their beneficial community as fiduciaries. In recognition of these owed loyalties, the majority of states now employ general corporate law principles in defining a non-profit corporate board's fiduciary duties.⁴⁵ Indeed, the Director of Charitable Trusts of the New Hampshire General's Office

(the “Director”) has gone even further and stated that the managers of a charitable trust must “be judged by a stricter standard of duty and care than the managers of ordinary for-profit corporations.”⁴⁶ Accordingly, given the legal landscape in New Hampshire, if the issue were to come before a New Hampshire court, the authors believe that there would be a compelling argument for the application of Revlon standards in the non-profit realm.

Nevertheless, even if *Revlon* were deemed applicable, it was apparent that its standards would have been met in this case. Somewhat auspiciously, the Board had done precisely what *Revlon* commands by entering the market and considering the reasonably available options prior to entering into any form of definitive agreement. Moreover, as stated in the LOI, the purchase price in the deal the Board ultimately chose was based upon an independent appraisal of the fair market value of the assets to be sold. With this information on hand, it was clear that the Board had reliable grounds upon which to judge the deal’s adequacy.⁴⁷

After deciding that the transaction with ITT was in the best interests of DWC and the community at large, the Board still faced several hurdles in order to accomplish the sale. As discussed below, both the Charitable Trusts Unit of the New Hampshire Attorney General’s Office and the Hillsborough County Probate Court, as well as certain college accrediting bodies, would play significant roles in achieving DWC’s objectives.

REVIEW BY THE NEW HAMPSHIRE CHARITABLE TRUSTS UNIT

On January 29, 2009, representatives of DWC and ITT met informally with the Director of the Charitable Trusts Unit to discuss the proposed transaction. By statute and common law, the Director represents the public interest in matters involving charitable trusts.⁴⁸ Pursuant to RSA 7:20, he is empowered to exercise “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” operating within the State of New Hampshire.⁴⁹

For over a decade, the Director has interpreted this statutory and common law power as granting to his office oversight authority in transactions involving the merger or acquisition of charitable trusts, under the theory that such transactions invariably result in some alteration to the trust’s charitable purpose. Perhaps the most famous exercise of this oversight authority occurred in 1998 when the Director investigated the merger of Elliot Hospital and Catholic Medical Center into Optima Health. In that matter, the Director concluded that the affiliation had violated charitable trust law because it had resulted in a change to the charitable purpose of both entities and neither party had provided notice to the New Hampshire Charitable Trusts Unit or sought approval from the Probate Court.⁵⁰ Accordingly, even though the union of these two organizations had been consummated over four years prior, Optima Health was ultimately dissolved and its constituent parts (the two independent hospitals) reconstituted.⁵¹

The Optima Health matter reaffirmed for DWC’s counsel, as it should for all practitioners, the critical importance of involving the

New Hampshire Charitable Trusts Unit in merger and acquisition transactions of this nature from the outset.⁵² To this end, the parties deemed it prudent to open a dialogue with the Director on a confidential basis as soon as practicable after the LOI had been executed and, thus, submitted several important documents (including the LOI and certain financial statements) for the Director’s confidential review prior to their January meeting. The parties also kept the Director apprised of any major developments that arose during negotiations, provided the Director with a copy of the draft Purchase Agreement once completed, and, on March 26, 2009, made a presentation to the Director and his forensic accountant⁵³ regarding the financial aspects of the Transaction. All of these disclosures were made prior to the execution of the Purchase Agreement.

For his part, because the statutes were of little help, the Director indicated that he would look to the standards articulated in RSA 7:19-b for guidance in conducting his review of the merits of the proposed sale. Enacted in 1997 to address a rising trend of hospital mergers and healthcare acquisitions, RSA 7:19-b provides a regulatory framework governing “acquisition transactions”⁵⁴ involving “health care charitable trusts” (a “HCCT”).⁵⁵ In pertinent part, the statute requires the Director to review such acquisitions to determine if certain “minimum standards” are met,⁵⁶ including whether: (1) the proposed transaction is permitted by applicable law; (2) due diligence has been exercised in selecting the acquirer, negotiating the terms of the proposed transaction, and in determining that the transaction is in the best interest of the HCCT and the community which it serves; (3) all conflicts of interest and pecuniary benefits have been disclosed; (4) the proceeds to be received pursuant to the transaction constitute fair value; (5) any proceeds from the transaction will continue to be devoted to purposes consistent with both the HCCT’s charitable purpose and the needs of the community; and (6) if the acquirer is other than another New Hampshire-based HCCT, control of the proceeds will be independent from the acquirer.

Though recognizing that RSA 7:19-b was inapplicable to the transaction, counsel had no quarrels with the utilization of these criteria as a theoretical framework in which to structure the review of the proposed transaction. However, in addition to the aforementioned factors, RSA 7:19-b also requires an HCCT to provide reasonable “public notice” of the proposed transaction to the community, “along with reasonable and timely opportunity for such community, through public hearing or other similar methods, to inform the deliberations of the governing body of the [HCCT] regarding the proposed transaction.”⁵⁷

Typically, this element is fulfilled through a series of public forums, conducted in advance of the execution of a binding contractual agreement.⁵⁸ The application of this particular process to an educational institution proved problematic - unlike a hospital (whose patrons tend to focus on immediate needs), a college must have an appearance of stability and permanency in order to attract prospective students. If disclosure prior to the execution of a definitive Purchase Agreement had been required, DWC’s precarious financial condition would have become a matter of public knowledge. As a result, if the deal ultimately fell through it would have more

than likely resulted in a precipitous decline in enrollment, which would have exacerbated the problems faced by DWC and further jeopardized its charitable assets. Perhaps in recognition of these facts, the Director determined that it was in the public's interest to postpone receiving public comment until after the Purchase Agreement had been executed and DWC had submitted its application to the Probate Court for *cy pres* relief. As it turned out, the Probate Court proved to be an ideal forum for eliciting public comment.

THE PROBATE COURT AND *CY PRES* RELIEF

Apart from clarifying the scope of the Director's authority in non-profit mergers and acquisitions, the Optima Health matter also underscored the critical importance of obtaining Probate Court approval for such transactions through the doctrine of *cy pres*. Derived from the olden French phrase "*cy pres comme possible*," meaning "as near as possible," the common law doctrine of *cy pres* permits a charitable trust to alter its purpose when such purpose has become "obsolete, impossible, or impractical to enforce due to changes in social, economic, or other conditions."⁵⁹ As the New Hampshire Supreme Court further explained in 1889, the doctrine is a rule of construction "by which a charity may be enforced in favor of the general intent, even where the particular mode or means provided by the donor fails by reason of its inadequacy."⁶⁰ Now codified in the revised statutes, the doctrine now dictates that:

[i]f property is or has been given in trust to be applied to a charitable purpose, and said purpose or its application is or becomes impossible or impracticable or illegal or obsolete or ineffective or prejudicial to the public interest to carry out, the trust shall not fail. Upon petition by the trustee or trustees or the attorney general, the [P]robate [C]ourt may direct the application of the property to some charitable purpose which is useful to the community, and which charitable purpose fulfills as nearly as possible the general charitable intent of the settlor or testator. In applying the doctrine of *cy pres*, the court may order the distribution of the trust assets to another charitable trust or to a charitable corporation to be held and administered by it in accordance with the terms of the governing instrument as said terms may be modified by the application of *cy pres* under this section and RSA 547:3-e.⁶¹

For this transaction, there were multiple charitable trusts for which *cy pres* relief would be required. As noted previously, DWC was itself a charitable trust, the purpose of which was to operate the non-profit educational institution "Daniel Webster College."⁶² In effect, the corpus of this "trust" consisted of all of the operational assets of DWC, including its real property, personal property, accounts receivable and intellectual property. ITT would acquire substantially all of these operational "charitable assets" and continue to operate "Daniel Webster College," but as a for-profit entity. As a result, the legal entity that held title to the college's assets would no longer be capable of pursuing its stated charitable purpose and, thus, *cy pres* relief would be required in order to permit it to adopt a new charitable purpose. At the same time, as part of its endowment, DWC also had custody and control over approximately 25 academic scholarships.

Each of these scholarships qualified as separate charitable trusts because each had been established by a donor with the express intent that the funds would be utilized to provide financial assistance to students attending the college.⁶³ However, ITT would not acquire the scholarship funds. Instead, those funds and any remaining proceeds from the transaction would be retained by the legal entity that previously held title to DWC's assets, with the intent that they would be utilized in furtherance of that entity's new charitable purpose.

This layering of multiple charitable trusts presented certain logistical hurdles.⁶⁴ For one thing, the arguments for *cy pres* relief to change the charitable purpose of the legal entity that held title to the college's assets and the scholarship funds were distinct, with the former premised upon the financial impracticability of continuing to operate the DWC on a non-profit basis and the latter contingent upon the fundamental change that would occur at "Daniel Webster College" as a result of the acquisition. Moreover, because of the potential revocation of its accreditation and its participation in federal aid Programs, DWC needed to complete the sale as soon as practicable. With such an expedited schedule, DWC's counsel questioned whether it was feasible to both track down the various donors to the scholarship funds and provide the same with adequate notice of the Probate Court proceedings.⁶⁵ Even more to the point, because the purchase price for the sale was dependent in part upon DWC's net working capital at the time of closing, it would not be clear until after the closing had occurred whether the legal entity that would retain custody of the scholarship funds would have the financial wherewithal to continue to operate as an independent charitable foundation.

In light of these considerations, DWC's counsel determined that the Probate Court approval process should be bifurcated into two discrete stages: In the first stage, the Board filed an initial Petition for *cy pres* relief with the Probate Court, requesting approval for the transaction and permission for the legal entity that previously held title to the college's assets to continue to retain in trust both the scholarship funds and any remaining assets until completion of the second stage. Moreover, as that legal entity would no longer be able to pursue its charitable purpose of operating a college by the name "Daniel Webster College" following the transaction, the Board also requested the authority to adopt amended Articles of Agreement and By-Laws contemporaneously with the consummation of the transaction.⁶⁶ As amended, those documents dictated that the legal entity that held title to the college's assets would adopt the name "STEAM Fund," and would continue to operate for the following charitable purpose:

to . . . foster the accessibility of higher education in New Hampshire by providing scholarships and other financial assistance to New Hampshire residents who desire to attend a secondary or post-secondary school, preferably located in Southern New Hampshire, that focuses on degree programs in a technical field, said schools including, but not being limited to Daniel Webster College, and which individuals have demonstrated sufficient merit and/or financial need based upon criteria adopted by the Trustees of the Corporation, in their sole and absolute discretion, and to do

any and all things in furtherance of these objects and purposes.

The second stage is still ongoing at the time of this writing and was initiated following the completion of the transaction. In this stage, the focus is on the proper disposition of the scholarship funds and other residual operational assets which were not acquired by ITT and which STEAM Fund holds in trust for the public benefit. Segregating these particular issues allowed the Board and its counsel to focus their energy at the outset on consummating the transaction and preserving the charitable assets of DWC. Moreover, the Board could both provide proper notice to the various donors of the scholarship funds and more adequately marshal the assets of STEAM Fund in order to assess the practical reality of its continued existence as a separate charitable entity after the closing. Ultimately, adoption of this bifurcated approach provided a workable solution to what could have been a much more complicated Probate Court process.

ADDITIONAL APPROVALS FROM VARIOUS EDUCATIONAL BODIES

In addition to the approvals and challenges discussed above, consummation of the proposed Transaction also required sanction from NEASC, the USDOE and the New Hampshire Postsecondary Education Commission (“NHPEC”). To alleviate the risk that tardy receipt of any of these consents would jeopardize the transaction, the parties agreed to begin the process for obtaining these approvals before the formal Purchase Agreement had been executed. Accordingly, on February 5, 2009, DWC submitted a “Substantive Change Report” with NEASC’s Commission on Institutions of Higher Education, in which it set forth the facts and circumstances that justified the proposed change in ownership of “Daniel Webster College.”⁶⁷ At around the same time, DWC also filed a change of ownership application with the NHPEC⁶⁸ and requested that the USDOE conduct a pre-acquisition review of the Transaction.⁶⁹ In the end, each of these agencies granted DWC the authority to proceed with the Transaction.⁷⁰

THE PURCHASE AGREEMENT

Unlike its counterpart in the for-profit realm, a non-profit board of directors cannot rely on mere business judgment in determining that the sale of a non-profit corporation is necessary to protect that entity’s charitable assets. Instead, as a direct consequence of the cypres doctrine’s application in this arena, the non-profit board must wait until the non-profit corporation’s charitable mission has become “impracticable”⁷¹ or “ineffective”⁷² before it will be permitted to sell. By the time that the facts support such a claim, however, it is often the case that the non-profit corporation is in dire financial straits.⁷³ As a result, it is also often the case that non-profit corporations will have to suffer under a gross disparity in bargaining power once a prospective acquirer comes along.

The present matter was no exception to this general observation. As discussed at length above, by the time the parties had reached the point of executing the LOI, DWC was operating on the edge of a

financial precipice. Its accreditation and eligibility for federal aid in jeopardy, DWC was suffering yearly operating losses and had no ability to borrow the funds necessary to change its blighted course. If the transaction failed to go through, both parties were well aware that DWC would soon close. The other party to transaction was on a firm footing: ITT had a net cash position in excess of \$225 million as of December 31, 2008. Clearly, DWC and ITT were not on equal footing.

Despite this disparity in bargaining power, DWC managed to maintain a modicum of leverage by continually advertizing to the impending review of the acquisition by regulatory and administrative bodies. The parties had no choice but to work towards an agreement that was fair and consistent with charitable trust principles. In this sense, the very thing that could have prevented the DWC board from achieving its objective of protecting the college’s remaining charitable assets through the transaction ultimately gave it the bargaining strength to adhere to its fiduciary duties to the public in structuring the deal. In the end, due in no small part to the possibility that the Director would not approve the transaction and the energy and resources the parties had invested would have been for naught, the negotiations resulted in a Purchase Agreement that contained terms that protected the value of DWC’s charitable assets to the maximum extent possible.

More particularly, as suggested above, in the Purchase Agreement the parties agreed that ITT would acquire essentially all of the assets necessary to operate “Daniel Webster College” (e.g., DWC’s real estate, tangible and personal property, and the trade name “Daniel Webster College”). In return for these assets, ITT agreed to pay in full all of DWC’s outstanding indebtedness, including three issues of tax-exempt bonds,⁷⁴ and assume all of the contracts that DWC had with its faculty. In addition, ITT agreed to pay DWC an amount equal to the fair market value of the assets acquired (as determined by two independent appraisal reports), plus \$2,500,000, minus certain other adjustments to be determined at the closing, including the final amounts expended by ITT in paying off all of DWC’s outstanding debt. Finally, ITT agreed to assume, pay, perform and/or discharge: (i) DWC’s accrued current liabilities and accounts payable; (ii) all liabilities and obligations arising under the contracts assigned to ITT under the Purchaser Agreement; and (iii) all of the New Hampshire transfer tax owed in connection with the sale of DWC’s real property.

Beyond the financial provisions, the Purchase Agreement contained numerous other terms that are standard for an acquisition transaction of this nature. Just by way of example, DWC was required to carry on its business in substantially the same manner throughout the pendency of the Purchase Agreement and to provide reasonable access to all of its contracts and other documentation for ITT’s review. As the critical asset being acquired by ITT was the right to operate “Daniel Webster College,” the Purchase Agreement also made consummation of the sale conditional upon the approval of the Director, the Probate Court, the Federal Aviation Authority and the educational agencies discussed above (e.g., NEASC, the USDOE and NHPEC). Finally, because asset purchase agreements can be

interpreted as only governing the parties' rights and obligations during the pendency of the underlying transaction, the Purchase Agreement contained a term extending the representations and warranties of DWC for two years post-closing.

On or about March 28, 2009, the Board held a special meeting in order to consider the terms of the Purchase Agreement and the general propriety of the transaction. Recognizing that the financial outlook for DWC was bleak, the Board determined that the proposed sale was the best option for ensuring that "Daniel Webster College" continued to provide educational opportunities to the community in a manner that is the functional equivalent of DWC's original charitable purpose. At the same time, the Board was pleased with the fact that the transaction would free DWC to continue to serve the public interest by applying its remaining assets to a modified charitable purpose of providing financial assistance to individuals who desire to attend a secondary or post-secondary technical education institution in New Hampshire. Accordingly, the Board voted unanimously to allow DWC to engage in the Transaction. Accordingly, on April 1, 2009, DWC and ITT executed the Purchase Agreement.

OBTAINING CY PRES APPROVAL AND CLOSING THE DEAL

On April 23, 2009, representatives for DWC and the Director had an informal meeting with the Administrative Judge of the Probate Court in order to explain the transaction and file DWC's initial Petition for cy pres relief. The Petition described in detail: (i) the history of DWC; (ii) the persistent and ongoing financial troubles of the college; (iii) the circumstances causing DWC to select ITT as an acquirer; (iv) the pertinent terms of the Transaction; and (v) the prima facie justification under the doctrine of cy pres for both DWC's adoption of a modified charitable purpose and its participation in the Transaction. As an attachment to its Petition, DWC also submitted over 800 pages of exhibits.

The intent of providing such an exhaustive submission was to permit the Probate Court to review the matter without the necessity of a time-consuming request for additional documentation. In order to further expedite the process, DWC also submitted a proposed Procedural Order at the initial conference, in which it recommended that the Probate Court adopt the bifurcated approach to the proceedings and schedule a hearing for May 26, 2009, in order to consider and rule upon the merits of the Petition. In addition, DWC attached to the Order a proposed Notice by Publication which it intended to publish in the Union Leader twice before the final hearing.⁷⁵ That notice informed the public of the nature of the transaction and required all persons having a direct, legal relationship with DWC to submit a written statement to the Probate Court by May 12th or else be foreclosed from asserting any future interests or rights in the outcome of the matter.

Although the Director is the duly authorized representative of the public in matters such as those presented in the petition,⁷⁶ and thus the legal necessity for the notice was not entirely clear, DWC determined that there were numerous benefits to providing such public notice. For one thing, it provided an avenue through which

unknown parties with a potential legal interest in the matter could come forward and, thereby, significantly decreased the likelihood of a challenge being raised to the validity of the Probate Court approval. But even more importantly, because transparency is an underlying tenet of charitable trust principles,⁷⁷ DWC desired to inform the public of the transaction and afford the community an opportunity to voice any potential concerns to the Director and/or the Probate Court. For this reason, DWC also published the Petition and all of its exhibits on DWC's website for the public's review. Perhaps recognizing the benefits of such disclosures, the Probate Court adopted the proposed Procedural Order and ordered DWC to publish the Notice by Publication in the manner described.

On or about May 18, 2009, the Director submitted his answer approving the transaction.

With the Director approving the transaction and no members of the public coming forward to voice an objection to the sale, the May 26th hearing proved to be straightforward. In order to grant the relief requested in the Petition, the Probate Court needed to determine that: (i) it had become impossible, impracticable, illegal, obsolete, ineffective or prejudicial to the public interest for DWC to continue to fulfill its charitable mission as a non-profit educational institution; and (ii) the proposed charitable purpose for the entity that previously held title to the college's assets fulfilled as nearly as possible the general charitable intent of the college's original creators.⁷⁸ Based on the evidence, counsel for the Board argued that it had become, at minimum, financially impractical for DWC to continue to operate as a non-profit. On the second required finding, counsel asserted that providing scholarship funds to individuals who desire to attend a secondary or post-secondary educational institution in New Hampshire that focuses on technical programs fulfilled as nearly as possible the general charitable intent of DWC's settlors and donors. Moreover, counsel explained that the proposed transaction furthered both DWC's current purpose, in that it ensured that "Daniel Webster College" would continue to exist for the foreseeable future, and that the proceeds from the sale would advance the proposed charitable purpose for STEAM Fund. The Probate Court agreed and, on that same day, issued an Order granting DWC's Petition for cy pres relief in its entirety.

Having obtained all requisite approvals and completed all necessary due diligence, the parties closed the sale on June 10, 2009. As of the time of this writing in early September 2009, the Probate Court, the Director and representatives of STEAM Fund have embarked upon the second stage of the probate court process discussed above.

CONCLUSION

From execution of the LOI to consummation of the deal at closing, it took a little more than six months for DWC to obtain all approvals required to finalize the transaction. Although it may appear unnecessarily cumbersome to those accustomed to practicing in the for-profit realm, this elaborate review process serves a critically important function - to protect the charitable assets that the non-profits operating throughout this state hold for our collective benefit. While certainly not perfect, when respected and followed, the process

can actually benefit the charitable entity seeking to engage in an acquisition transaction, as it provides both a means for assessing the propriety of an offer and a workable framework in which to structure a deal. In the end, if both parties make a conscientious effort to conduct their negotiations with absolute transparency and fidelity to the process, the involvement of the reviewing bodies is more of an asset than a hurdle.

The authors would also like to acknowledge attorneys Jon B. Sparkman, Karen S. McGinley, Daniel E. Will, Sandra K. Mann, James F. Merrill and Harper R. Marshall.

ENDNOTES

- 1 Although the legal entity that acquired DWC's assets was DWC Acquisition Corp., for ease of reference both DWC Acquisition Corp. and ITT Educational Services, Inc. will be referred to collectively as "ITT."
- 2 The decrease in home equity was a vital contributing factor to the current economic crisis as extraction of home equity more than doubled from \$626.9 billion in 2001 to \$1.428 trillion in 2005. A. Greenspan and J. Kennedy, *Sources and Uses of Equity Extracted from Homes*, Table 2 (2007), available at <http://www.federalreserve.gov/pubs/feds/2007/200720/200720pap.pdf> (last accessed July 13, 2009).
- 3 Beginning in 2000, the Federal Reserve engaged in a prolonged series of cuts to the federal funds rate which resulted in the rate being reduced from 6.5% at its peak on May 16, 2000 to 1.00% on June 25, 2003. Thereafter, the Federal Reserve began increasing the rate until it hit 5.25% on June 29, 2006. See Federal Reserve Board, *Chart: Intended Federal Funds Rate: Change and Level, 1990 to Present*, available at <http://www.federalreserve.gov/fomc/fundsrate.htm> (last accessed July 14, 2009).
- 4 L. Shen and A. Frye, *Buffet Calls Crisis an 'Economic Pearl Harbor,' Backs Paulson*, dated September 24, 2009, available at <http://www.bloomberg.com/apps/news?sid=a8B.QQmw5A8M&pid=20601087> (last accessed July 9, 2009).
- 5 D. Lederman, *Inside Higher Ed: Rescuing a College in Cleveland*, dated June 12, 2008, available at http://www.insidehighered.com/news/2005/03/02/forprofit3_2 (last accessed July 16, 2009).
- 6 S. Jaschik, *Inside Higher Ed: A For-Profit Buys a Catholic College*, dated March 2, 2005, available at <http://www.insidehighered.com/news/2008/06/12/myers> (last accessed July 16, 2009).
- 7 It is the authors understanding that all of the facts presented in this article can be found in the documents submitted to the Hillsborough County Probate Court in connection with DWC's Petition for *Cy Pres* Relief and, thus, are matters of public record. To the extent that the reader has an interest, the petition and all of its exhibits are available for review at the Hillsborough County Probate Court, located at 30 Spring Street, Nashua, New Hampshire, under the case caption *In re: Daniel Webster College*, probate court docket number 316-2009-EQ-866 (Hillsborough 2009).
- 8 As of the 2007-2008 academic year, the College had a full-time enrollment of approximately 940 students. See Daniel Webster College, *Factbook 2008-2009* 8, <http://www.dwc.edu/about/factbook/> (last accessed July 9, 2009).
- 9 Daniel Webster College, *Factbook 2008-2009* 8, <http://www.dwc.edu/about/factbook/> (last accessed July 9, 2009).
- 10 See New England Aeronautical Institute, *Articles of Agreement*, Article 2. A copy of the New England Aeronautical Institute Articles of Agreement can be obtained by searching for the legal entity on the New Hampshire Secretary of State's corporate database, which is located at the following web address: <https://www.sos.nh.gov/corporate/soskb/csearch.asp>.
- 11 See N.H. Laws 1973, c. 73; see also RSA 292:22 (providing, among other things, that the legislature may "alter, amend or repeal the charter of any voluntary corporation"); RSA 292:8-h (forbidding educational institutions from granting degrees unless permitted to do so by legislative act).
- 12 See N.H. Laws 1970, c. 68; N.H. Laws 1978, c. 18.
- 13 When required because of a direct quote, citations will be provided to documents that were submitted to the Hillsborough County Probate Court in connection with the DWC's Petition for *Cy Pres* Relief. Citation to these documents will list the exhibit number and be formatted in the following manner: [Description of Document], Exhibit [#] at [pinpoint cite]. Subsequent citations will be shortcited as merely the Exhibit number and page.
- 14 Robert E. Myers, *A Vision for 2015 and Beyond*, Exhibit 13 at p. 1, 2-6.
- 15 *Id.* at pp. 1, 2-6.
- 16 These federal student assistance programs include the federal: (1) Pell Grant Program, 20 U.S.C. § 1070a, *et seq.*; (2) Family Education Loan Program, 20 U.S.C. § 1071, *et seq.*; (3) Direct Student Loan Program, 20 U.S.C. § 1087a, *et seq.*; (4) Perkins Loan Program, 20 U.S.C. § 1087aa, *et seq.*; (5) Supplemental Educational Opportunity Grant Program, 20 U.S.C. § 1070b, *et seq.*; and (6) Work-Study Program, 20 U.S.C. § 2751, *et seq.*
- 17 USDOE, *Letter Concerning Title IV of the Higher Education Act - dated April 10, 2006*, Exhibit 45 at p. 1.
- 18 See 34 C.F.R. § 668.171(a).
- 19 The amount of the letter of credit is determined by the Secretary of Education, with the caveat that it must be for an amount "not less than one-half of the title IV, HEA program funds received by the institution during its recently completed fiscal year." 34 C.F.R. § 668.175(c).
- 20 See 34 C.F.R. § 668.13 (explaining that "[i]f, before the expiration of a provisionally certified institution's period of participation in a Title IV, HEA program, the Secretary determines that the institution is unable to meet its responsibilities under its program participation agreement, the Secretary may revoke the institution's provisional certification for participation in that program.>").
- 21 See U.S. Department of Education, *Program Participation Agreement*, dated September 12, 2006, Exhibit 15 at p. 1.
- 22 NEASC, *Letter Re: Notice of Concern*, dated March 17, 2006, Exhibit 12 at p.1. It should be noted that DWC received a similar Notice of Concern in 2003. See New England Association of Schools and Colleges, *Focused Evaluation Team Report*, Exhibit 18 at p. 17.
- 23 As more fully described in NEASC materials, a "focused evaluation":
provides a means of monitoring specific developments or concerns within an institution between comprehensive evaluations. When [NEASC] requires a focused evaluation, the institution submits a report on specified areas, and a small team visits the institution to validate the information provided in the report, evaluate the areas of focus, and report its findings and its recommendation and the chief executive officer's response and takes action, if appropriate, on the institution's accreditation status.
NEASC, *Procedures for the Focused Evaluation Visit*, February 2009, copy available online at http://cihe.neasc.org/downloads/POLICIES/Pp52_Procedures_for_Focused_Evaluation_Visit.pdf (last accessed July 15, 2009), Exhibit 30 at p. 1.
- 24 Exhibit 18 at p. 20.
- 25 Exhibit 18 at p. 22.
- 26 See RSA 292:8-h, II, III (forbidding an educational institution from granting degrees unless authorized to do so by an act of legislature and, through its specification of permitted degrees, the Postsecondary Education Commission); see, e.g., N.H. Admin. R. Pos 1005.02 (h), (i) (requiring an institution under the jurisdiction of the Postsecondary Education Commission to "be in good standing with a U.S. Department of Education institution accrediting agency," such as NEASC).
- 27 RSA 292:1, II (permitting the creation of voluntary corporations for the "promotion of education and the arts and sciences").
- 28 26 U.S.C. § 501(c)(3) (excluding from federal business income taxes corporations which, among other things, are "organized and operated exclusively for . . . educational purposes . . .").
- 29 "Charitable trust" is statutorily defined 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.
RSA 7:21, II(a).
- 30 RSA 7:21, II (defining "charitable trust" as including entities, such as DWC, that are determined by the IRS to be tax-exempt under section 501(c)(3) of the Code); see, e.g., *Society of Cincinnati v. Exeter*, 92 N.H. 348, 349 (1943) ("It is of the essence of a privately organized public charity, termed in the law as a charitable trust, that it hold property in trust for the public benefit . . . in the case of a charitable trust property is devoted to purposes beneficial to the community." (internal citations omitted)).
- 31 See H. Oleck and M. Stewart, *Nonprofit Corporations, Organizations, & Associations*, § 455 (Prentice Hall, Supp. 1999).

32 Because the educational institution “Daniel Webster College” is still in existence and is operating separate from the corporate entity that previously held title to all of DWC’s assets, in an effort to avoid confusion the DWC will be referred to as “Daniel Webster College” whenever reference is being made to its existence post-transaction.

33 1 J. Perrillo, *Corbin on Contracts* § 1.16, at 46 (Rev. ed. 1993).

34 See, e.g., *Burbach Broad. Co. of Del. v. Elkins Radio*, 278 F. 3d 401, 405, (4th Cir. 2002) (remanding to the district court to consider evidence on the intention of the parties where the LOI expressly stated that it would “expire by its own terms if an asset purchase agreement was not executed” by a certain date). Although it has not explored the matter in as much detail as other courts, the New Hampshire Supreme Court has likewise acknowledged that a preliminary agreement can become a binding contract, despite the absence of certain terms, “if it demonstrates that the parties have manifested their intent to be bound to the essential terms of a more detailed forthcoming agreement.” *Lower Village Hydroelectric Assoc., L.P. v. City of Claremont*, 147 N.H. 73, 75 (2001) (citing *Estate of Younge v. Huysmans*, 127 N.H. 461, 466 (1985)).

35 *Teachers Ins. and Annuity Assoc. of Am. v. Tribune Co.*, 670 F. Supp. 491 (S.D.N.Y. 1987).

36 *Id.* at 498.

37 *Id.*

38 *Burbach Broad. Co.*, 278 F. 3d at 407.

39 Once executed, the Purchase Agreement contained a similar provision granting to ITT certain exclusivity rights while the parties conducted their due diligence. See *Asset Purchase Agreement*, § 5.7, at 46, Exhibit 8 at pp. 46-47.

40 *Revlon, Inc. v. MacAndrews & Forces Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

41 *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1287 (Del. 1989); see also *In re Netsmart Techs., Inc. S’holders Litig.*, 924 A.2d 171, 195 n. 76 (Del. Ch. 2007) (“The corollary to this is clear: when [a board does] not possess reliable evidence of the market value of the entity as a whole, the lack of an active sales effort is strongly suggestive of a Revlon breach.”).

42 *Barkan*, 567 A.2d at 1286.

43 *Id.*

44 *Revlon, Inc.*, 506 A.2d at 179.

45 *Stern v. Lucy Webb Hayes Nat’l Training Sch.*, 381 F. Supp. 1003, 1013 (D.D.C. 1974) (holding that the directors of a nonprofit board breached their duty to supervise management of hospital’s funds); see also *Mile-O-Mo Fishing Club, Inc.*, 210 N.E.2d 12, 15 (Ill. 1965) (“The officers and directors of a not for profit corporation should . . . be charged with the same degree of fidelity to the interests of the corporation as are the officers and directors of a business corporation.”); Memorandum of the Attorney General at 26-2, *Burson v. Nashville Mem’l Hosp., Inc.* (Tenn. Ch. Ct. filed Mar. 17, 1994) (No. 94-744-1) (stating that, under Tennessee law, the “current accepted standard for nonprofit corporate directors is the same as that of their for profit counterparts”); *Developments in the Law - Nonprofit Corporations*, 105 Harv. L. Rev. 1579, 1593 (1992) (noting that most courts now define nonprofit duties of care by reference to corporate law); Colin T. Moran, *Why Revlon Applies to Nonprofit Corporations*, 53 Bus. Law. 373 (1998) (collecting cases).

46 Director of Charitable Trusts, *New Hampshire Attorney General’s Report on Optima Health*, dated March 10, 1998, available at <http://doj.nh.gov/publications/optima1.html> (last accessed July 17, 2009) (“Optima Report”).

47 See, e.g., *Barkan*, 567 A.2d at 1286 (stating that “there is no single blueprint a board must follow to fulfill its duties.”).

48 See, e.g., *Attorney General v. Rochester Trust Co.*, 115 N.H. 74, 76 (1975).

49 RSA 7:20.

50 See Optima Report; Cf. 11 C. DeGrandpre and W. Treat, *New Hampshire Practice: Probate Law and Procedure*, § 65-6(c), at 233 (3d ed. 2001).

51 See *In re Optima HealthCare Corp. et al*, probate court docket number 1999-0339 (1999).

52 See generally O. Lamontagne and W. Maroney, *The Charitable Trusts Aspects of a Hospital Merger: The Merger of Franklin Regional Hospital and Lakes Region General Hospital*, N.H.B.J. at pp. 28-29 (March 2003) (“FRH Article”).

53 The Director is imbued with the authority in transactions involving assets in excess of \$5,000,000 to retain “expert assistance” after consultation with the parties. See RSA 7:19-b, IV.

54 Under the statute, an acquisition transaction is defined as:

[the] 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).

55 The statute further defines “health care charitable trust” as:

a charitable trust organized to provide health care services including, but not limited to, hospitals, community health care services, and medical-surgical or other diagnostic or therapeutic facilities or services, or a charitable trust operating as a health insurer or health maintenance organization . . . [but] include[ing] any testamentary or inter vivos trust which is not organized to provide health care services.

RSA 7:19-b, I(d).

56 RSA 7:19-b, II.

57 See RSA 7:19-b, II(a)-(g).

58 See generally FRH Article at pp. 31-32 (March 2003).

59 11 C. DeGrandpre and W. Treat, *New Hampshire Practice: Probate Law and Procedure*, § 68-4, at 278 (3d ed. 2001).

60 *Trustees of Adams Female Acad. v. Adams*, 65 N.H. 225, 227 (1889). Note that the *cy pres* doctrine is distinguishable from the doctrine of deviation, as the latter is invoked where compliance with the terms of the trust instrument causes the impediment and the primary charitable objective can be achieved by simply changing “the machinery, management and methods of administering the trust.” *Town of Exeter v. Robinson’s Heirs*, 94 N.H. 463, 466 (1947); see also *Citizens’ Nat. Bank v. Morgan*, 94 N.H. 284, 288 (1947) (applying the doctrine of deviation where “the results of the provisions of a trust are so interfered with and the gifts so diminished by an unanticipated change of circumstances that it is equitable to permit a deviation from the terms.”). The Probate Court is also invested with the power to invoke the charitable doctrine of deviation pursuant to RSA 547:3-c.

61 RSA 547:3-d, I.

62 See New England Aeronautical Institute, *Articles of Agreement*, Article 2.

63 RSA 7:21, II(a).

64 To be sure, this was not the first instance in which the sale of a non-profit entity to a for-profit entity had required consideration of multiple charitable trusts. For example, in *Portsmouth Hospital v. Attorney General of New Hampshire*, Portsmouth Hospital had filed one petition with the Probate Court requesting *cy pres* relief in order to sell its principal assets and transfer its remaining assets, including several trusts and the proceeds from the sale, to a charitable foundation. *Portsmouth Hospital v. Attorney General of New Hampshire*, superior court docket number E-426-84 (Rockingham 1984). However, as discussed, other considerations militated against adopting this approach.

65 In a tentative draft, the American Law Institute has explained that, even without a retained property interest, the settlor of a charitable trust has standing to enforce the trust, subject to three qualifications:

First, if a nonprofit organization receives a restricted gift or devise that is treated as a charitable trust . . . , special-interest standing ordinarily enables the settlor to maintain a suit against the trustee-organization only to enforce the restriction - that is, to restrain the trustee from diverting funds from the specified charitable purpose or to compel restitution for any such breach of trust Second, when numerous donors contribute to the funding of a trust, only a settlor who is a major contributor relative to the trust’s total funding has the required special interest Finally, absent contrary provision or agreement, settlor standing is “personal,” although exercisable by an incapacitated settlor’s personal fiduciary . . . or by a deceased settlor’s personal representative during a reasonable period of estate administration.

Restatement (Third) of Trusts, § 94, comment (g) (T.D. No. 5, 2009); but see *Restatement (Third) of Trusts*, § 67, comment (d), at 516 (2003) (indicating that, in framing a new purpose for a charitable trust through *cy pres*, “it would be especially appropriate to consult the donor if available”). Therefore, in an abundance of caution, notice should typically be provided to those charitable trust donors that are reasonably available.

66 See RSA 292:7 (granting a voluntary corporation the right to “change its name . . . or amend its articles of agreement”).

67 Additional information concerning the process involved in obtaining NEASC’s approval can be found at: http://cihe.neasc.org/accreditation_processes_resources/accreditation_processes/proposal_for_substantive_change/ (last accessed July 13, 2009).

68 See, e.g., N.H. Admin. R. Pos 100, *et seq.*

69 See 34 C.F.R. § 600, *et seq.* (concerning the process for maintaining participation in the Federal Aid Programs after a change in ownership of a participating institution has occurred).

70 At its May 14, 2009 meeting, NHPEC voted to approve ITT’s acquisition of the

College, with the requirement that a site visit take place in March 2010 to examine the transition, developments in governance, future plans, and a general assessment of progress (successes, issues, etc.). Previously, on March 23, 2009, the College had also received a favorable response from the USDOE to its request for pre-acquisition review. However, after the closing, Daniel Webster College will be required to file various applications with the Federal Aviation Administration and the United States Department of Veterans Affairs.

71 RSA 547:3-d, I; see also *Webster's Third New International Dictionary* 1136 (unabridged ed. 2002) (defining "impracticable" as "incapable of being performed or accomplished by the means employed or at command.").

72 *Id.* at 1136 (defining "ineffective" as "not producing or incapable of producing an intended effect.").

73 For an example, Myers University was hemorrhaging money and, indeed, was in receivership when it finally obtained a purchaser. See D. Russ, *WKYC.com: \$11 Million Takeover Offer for Myers University*, dated April 9, 2008, available at http://www.wkyc.com/news/news_article.aspx?storyid=86867 (last accessed July 18, 2009).

74 The majority of transactions involving non-profit colleges will require the payment

(or defeasance) of tax-exempt bonds. Although beyond the scope of this article, most bonds have very specific payment provisions and will often permit early payment (referred to as a redemption) only on and after specific dates and only upon payment of a premium (usually a percentage of the amount of principal being paid). Because this area of law is complicated, the authors recommend that experienced bond counsel is obtained when such matters arise. In this transaction, the parties relied upon the expertise of Attorney Karen S. McGinley, a shareholder in the law firm of Devine, Millimet & Branch, Professional Association, to handle the various bond issues that arose.

75 See RSA 550:10 (requiring the register of probate, when notice by publication is required under RSA 550, to publish said notice in a similar manner "unless otherwise ordered by the judge.").

76 See *Concord Nat. Bank v. Haverhill*, 101 N.H. 416, 419 (1958) (explaining that the Director "represents the public in the enforcement and supervision of charitable trusts").

77 See, e.g., RSA 7:19-b, II(a)-(g).

78 RSA 547:3-d, I.

Author



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