

MERGERS, CONSOLIDATIONS & RESTRUCTURING

A PRACTICAL DISCUSSION

I. Introduction

When one or more religious institutions determine that they will merge or consolidate, long term implications of the merger/consolidation need to be considered before determining how the new entity will be structured legally. A careful analysis of the structure of each existing institution, the goals and intentions of the religious institutions and whether the intended restructure will expose assets to certain liabilities is necessary.

The purpose of this outline is to provide a general rubric for making several important decisions with respect to the proposed restructure including whether a new entity is indeed necessary and if so, what model ought to be utilized to structure the new entity.

The process detailed below will:

1. Reveal whether a reallocation of resources is indeed necessary;
2. Result in a bank of information that is centrally located;
3. Give the involved institutions a proper understanding of the assets and liabilities
4. Allow the involved institutions to be better able to identify the risks associated with merging/consolidating/restructuring; and,
5. Determine whether a new legal civil entity is necessary, and if so, which model should be utilized to carry on the affairs of the new institute

II. Step 1: Identify the goals and/or intentions of the religious institutions involved.

III. Step 2: Determine whether the Congregation's intention to restructure will expose assets to certain liabilities.

When Begin this process by Marshalling Information

1. Assess all civil corporations controlled by the involved religious institutions.

Identify the following:

- * The state within which the civil corporation was established;
- * The proper legal name of the civil corporation as it is recorded on a certificate of Incorporation or Charter;
- * Whether the corporation is known by any other name such as a D/B/A;
- * What type of corporation is it, i.e. Not-for-profit vs. for-profit;
- * Provide the initial filing date;
- * Collect copies of the relevant corporate documents such as the certificate of incorporation, and by-laws;
- * Provide the names of the officers, directors and trustees of each corporation along with their respective titles;
- * Provide whether the corporations are in good standing with the Secretary of State's office;
- * Provide whether the corporations maintain bank accounts and/or stock portfolios and if applicable provide the account numbers and amounts

2. Assess real estate properties owned or controlled by the involved religious institutions.

Identify the following:

- * The state in which the property is located;
- * Give a brief description of the property i.e., ABC Grammar school;
- * The legal name of ownership;

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- * The date of acquisition;
- * The original purchase price; and,
- * Whether the involved institution is in any landlord/tenant relationship.

3. Assess development income and expenditures.

Identify the following:

- * Total gifts and donations;
- * Special events i.e. fundraising dinners; and,
- * Expenses

4. Assess lawsuits against the involved institutions or any of its civil corporate entities.

Identify the following

- * The names of the proper parties, both plaintiff and defendant;
- * Status of the litigation;
- * Any reserves set aside to handle a possible judgment; and,
- * Any details with respect to insurance coverage of the lawsuit.

IV. Step 3. Consult a Canon Lawyer.

V. Step 4. Consider Marshaled Information and Determine Whether a New Civil Entity is Necessary

VI. Step 5. Formation of the Not-for-Profit Corporation for the Purpose of Carrying on Temporal Affairs

Forming a not-for-profit corporation involves a great deal more than simply knowing the not-for-profit corporation law of the jurisdiction of incorporation. Careful consideration of the laws and statutes of the jurisdiction of incorporation is also necessary. Laws, statutes and procedural rules governing other ancillary issues within the jurisdiction will become relevant subsequent to incorporation. The organization should carefully consider all of these factors before determining in what jurisdiction it will incorporate. Such laws, statutes and procedural rules vary from jurisdiction to jurisdiction and

may even favor the not-for-profit corporation in certain jurisdictions, making it more beneficial to incorporate in one jurisdiction over another.

1. Ease of Formation.

Considerations:

Does the jurisdiction where the Not-For-Profit will be incorporated encourage more filings in the state?

What does the incorporation process entail?

What are the relevant filing fees?

What documentation is required? Does the state require filing of a certificate of incorporation and by-laws?

What is the timeframe for the process to be complete?

2. Protection Afforded Trustees.

Considerations:

Are members of a NFP corporation personally protected from liability for the debts or obligations of the corporation under the jurisdiction's law and/or statutes?

What is the standard for liability of trustees for third party actions under the jurisdiction's case law and or statutes? Is there "gross negligence" standard on third party actions against trustees/directors of a NFP corporation? Who has the burden of proof on liability issues?

Does the jurisdiction provide for dismissal of suits against a trustee/director absent a showing that there exists a "reasonable probability that the specific conduct... alleged constitutes gross negligence?" (Such protection varies widely from state to state and may depend, in part, upon the provisions set forth in the corporation's Certificate of Incorporation.)

Definition:

Gross Negligence Standard: this statutory protection provides a complete bar to personal liability for trustees/directors except in cases of gross negligence, criminal

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activity or participation in the action that directly resulted in the harm complained of.

Does the jurisdiction uphold “indemnification” agreements between the NFP corporation and trustees/directors in which the NFP corporation promises to pay, under certain conditions, the legal fees, settlement costs, and/or damages assessed against a trustee/director?

Is directors and officer liability insurance available to provide direct coverage and also to fund the NFP corporation’s indemnification obligations to those trustees and officers?

Does the jurisdiction recognize the “Business Judgment Rule” or a similar doctrine? This type of rule typically acts as a tool of judicial review and mandates that a court not second-guess a board’s decision. For example, in certain jurisdictions, if the trustees have acted “on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the not-for-profit corporation,” a court will not second guess that decision.

3. Firm Corporate Veil.

Considerations:

Does the jurisdiction favor recognizing the corporate entity or do the courts routinely pierce the “corporate veil”?

Example: New York courts continue to treat the corporate veil as “nearly impregnable” and continue to adhere to the general rule that courts will not “pierce the corporate veil or disregard the corporate entity by imposing liability on a parent or affiliated corporation.” Provided that the corporation is structured properly and there is no showing of fraud or illegality, New York courts consistently hold that it will not disregard the corporate entity simply because:

1. the parent corporation has the exact board of directors as that of a subsidiary;

2. the subsidiary corporation, in order to survive, depends on cash advances from the parent corporation; and/or;

3. the subsidiary uses a version of the parent’s name.

Does the jurisdiction of incorporation provide similar protection?

Does the jurisdiction of incorporation work to limit liability of separately incorporated entities, reducing exposure to the actions and negligence members of a congregation, employees and other associated parties?

Generally speaking, when debating whether a court will pierce the corporate veil of a corporation, the proper inquiry is not whether the identities of the board of directors and officers of the separate corporations are identical; rather, the proper inquiry is the degree of domination necessary to disregard the separate corporate identity and hold one corporate entity liable for the other’s actions. Domination has to be such that corporate officers and employees of “A” corporation exercise control over daily operations of “B” corporation and act as the prime movers behind it; and that “A” corporation conducts business through the other (“B”) which exists solely to serve “A”.

Courts will pierce the corporate veil and hold that two corporations constitute a single legal unit, where one is so related to, or organized, or controlled by, the other as to be its instrumentality or alter ego. Thus, the fact that a plaintiff may discover that two corporations have identical controlling shareholders, members, officers, and directors does not, by itself, warrant disregarding the corporate entities (see *Berkey v. Third Ave. Ry. Co.*, 244 N.Y. 84, 50 A.L.R. 599, 155 N.E. 58; *Bank v. Rebold*, 69 A.D.2d 481, 419 N.Y.S.2d 135; *Ioviero v. Ciga Hotels, Inc.* 475 N.Y.S.2d 880 (A.D. 2 Dept. 1984)).

However, separate incorporation intended to avoid piercing the corporate veil, may imply some loss of control. A two-

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tiered governance structure (board of trustees and directors) may work to avoid such a loss of control.

4. Statute of Limitations.

Considerations:

Does the incorporating jurisdiction afford a corporation greater protection against certain claims?

Definition: Statute of Limitations - a statute prescribing limitations to the right of action on certain described causes of action or criminal prosecutions; that is to say, declaring that no suit shall be maintained on such causes of action, nor any criminal charge be made, unless brought within a specified period of time after the right has accrued. Statutes of limitation are statutes of repose, and are such legislative enactments as prescribe the period within which actions may be brought upon certain claims or within which certain rights may be enforced. Blacks Law Dictionary.

Has the incorporating jurisdiction adopted a “delayed discovery” rule with respect to claims involving victims of sexual abuse?

Definition: Delayed Discovery Rule – a rule which tolls the relevant statute of limitations until the plaintiff discovers that he or she has been damaged by the action complained of.

When does a cause of action accrue for purposes of determining whether the action is time-barred?

What is the jurisdiction’s statute of limitations for personal injury?

5. Vicarious Liability.

Definition:

Vicarious Liability: Indirect legal responsibility; for example, the liability of an employer for the acts of an employee, or, a principal for torts and contracts of an agent.

Considerations:

Does the jurisdiction of incorporation impose liability on employers for the acts of its employees?

Under what circumstances is an employer responsible for the acts of its employees?

Does the jurisdiction of incorporation require a claimant to first show that an employer had notice of and failed to remedy or remove a dangerous condition/situation created by an employee before imposing liability on an employer?

6. Sarbanes-Oxley Law for Not-for-Profit Corporations.

Consideration:

Does the jurisdiction of incorporation require compliance with Sarbanes-Oxley like regulations, or is there pending legislation in the state assembly to adopt similar regulations?

High profile recent scandals in corporate America that has lead to a heightened awareness of corporate governance has resulted in Federal legislation governing publicly traded corporations such as the Sarbanes-Oxley Law. Such legislation requires publicly traded corporations to adopt new corporate governance practices modeled after certain parts of the Act.

State attorneys general are considering legislative initiatives to adopt similar laws for the not-for-profit corporation. For example, a bill, supported by state attorney general Elliot Spitzer was recently introduced to the state assembly.

The IRS has also solicited comments on a proposal to make changes to the forms filed by not-for-profits.

Some requirements of such legislation may include any of the following:

* Certification with respect to the material accuracy of corporate financial statements by both the chief

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executive officer and chief financial officer.

* Audit Committee

* Internal Controls to provide for whistleblower protection to help identify corporate wrongdoing in the preparation of financial statements.

* Code of Ethics for its senior financial officers and conflict of interest rules.

* Limited indemnification of officers and directors.

* New “interested party” rules

Should you have any questions, please feel free to contact us:

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