

Strategic Alliances in the Voluntary Sector in Canada*

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A. Introduction

What is a strategic alliance?

Many will have heard of the term “strategic alliance” being used in a wide variety of contexts. In this review, we will focus on strategic alliances in the voluntary sector that involve two or more organizations collaborating to achieve a result that can be achieved more effectively or more efficiently than if done independently. This arrangement can range from something as informal as a collaboration to complete integration in the form of a merger.

Some examples are useful to start. One of the best known Canadian examples is the success story that was created when Big Sisters in Edmonton merged with their male counterpart, Big Brothers. Before the merger, the two organizations shared funders and ran similar campaigns to raise money. Big Brothers rented office space and Big Sisters owned a building and, most importantly, the two organizations serviced a distinct client base of only 856 families. Big Brothers and Big Sisters have been one body nationally in the United States for many years and in Canada most smaller centres have a single organization. Logic seemed to dictate a merger and by all accounts the merger has been a great success. Most feel that the new organization created by the merger has allowed the two groups to tap many unexpected synergies in their program delivery.¹

Not long ago, the Manitoba Interfaith Immigrant Council and the Citizenship Council of Manitoba entered into an alliance which permitted both organizations to survive at a time when a windup seemed inevitable. Both organizations offered reception services to immigrants and refugees in Winnipeg and with a 60 per cent drop in the number of newcomers to Winnipeg the agencies were told that the federal government would only fund one reception centre. The easy solution would have been for one of the agencies to close. The two groups decided that since they both offered such other “non-core” services as a student residence, a language bank and a co-operative farm, they should form a

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strategic alliance. They retained separate boards and administrative autonomy but they decided to work out of the same office and to integrate their program delivery into a “one-stop” shopping approach.²

Another alliance in the health care field in British Columbia between two organizations which collaborated collectively to deliver nursing, homemaking and therapeutic services to individuals in their homes was achieved through a relatively simple agreement. While both organizations retained separate corporate autonomy, they formed a joint advisory committee to govern the joint provision of services. The opportunity allowed both organizations to enter a field which had previously not been available to them independently and, through the sharing of personnel and other resources, the joint programs were carried out with a high degree of operational efficiency.

In Ontario, the Fred Victor Mission and Keith Whitney Homes in Toronto had been working together for some time before they decided to merge their operations into the new Fred Victor Centre. In that case, the Fred Victor Mission had been providing social services to the clientele served by Keith Whitney Homes.³ Many other charities have followed suit in the forming of strategic alliances, either through an informal collaboration or a more structured merger.

The Current Environment

It is fair to say that the charitable and not-for-profit landscape is in a process of change in Canada, forcing many organizations to re-examine the ways in which they are managing and financing their programs. Changing economic and social realities in Canada combined with reduced public funding and increased competition for resources have created a stressful environment for voluntary organizations. At the same time, the role of government has changed, resulting in the voluntary sector delivering more services that were previously carried out by government.

In this climate of change, organizations are looking at different ways to increase their efficiency and some are working collaboratively with other charitable, nonprofit or even business corporations. In the case of alliances with businesses, there have been some prime examples of successful “partnerships” which have evolved, resulting in win-win situations for both charity and business. Several years ago, Chapters bookstore and Frontier College, a literacy organization, launched *Bringing Literacy to Canadian Communities* to spread literacy outward from Canadian university campuses to the community at large. In this program, student volunteers ran reading circles for children, tutored and mentored teens at homework clubs, coached special needs groups and tutored adults. Chapters provided an annual grant of \$100,000, donated books for the program and encouraged its staff to volunteer. Another \$100,000 was raised for local programs through in-store promotions. The gains to

Frontier College are clear and Chapters benefited from the goodwill it generated from giving back to the community.⁴

A little further away from home, CARE U.S. and Starbucks Corporation became involved in an alliance in 1991 when Starbucks was a young \$20-million coffee retailer and CARE was a well-known international relief and development institution with annual revenues of about \$300 million. The first main fundraiser was the creation by Starbucks of a coffee sampler containing coffees from three countries in which CARE operated. It was sold by Starbucks with \$2 from each sale going to CARE. This generated \$62,000 for CARE in 1992. By 1998, Starbucks had become a global company with sales of almost \$1 billion and was CARE's largest corporate donor with donations totaling \$1.2 million in 1998. In this example, Starbucks's and CARE had a strategic fit which generated huge gains for both parties.⁵

We have also seen a marked increase in the number of charities carrying on business activities and even forming separate business entities to act as funders of the charitable programs being carried out by the "parent" charity. Organizations are also looking to for-profit companies for ideas ranging from governance strategies to joint ventures and entrepreneurship to cause-related marketing strategies. For example, a few years ago, both the Toronto Stock Exchange and Montreal Stock Exchange adopted sets of governance guidelines for publicly listed companies which many in the voluntary sector adopted within their own organizations.

But the kind of "partnering" which takes place through a strategic alliance or a merger of charities, and sometimes of nonprofit organizations, while gaining in popularity in the United States, has not taken off on the same scale in Canada. In this country, there has been relatively little attention paid to the subject by professional advisors, consultants and even funding bodies to the voluntary sector. It is interesting to note that in the United States, government grants are made available to fund collaborative projects among nonprofits.⁶ In addition, several private programs exist to encourage collaboration in the voluntary sector. For example, the Strategic Alliance Fund was founded in New York in 1995 to encourage social service providers to pool resources, cut costs and save programs through alliances.⁷ Since it was founded, 21 corporate and private funders and United Way of New York City have committed over \$3 million to supporting the collaborative efforts of about 250 organizations. In Canada, few private programs exist to encourage this type of collaboration, although the Muttart Foundation in Edmonton advertises one of its funding programs as offering funding for mergers and alliances "where social services organizations can demonstrate that they are likely to lead to a more effective charitable sector".⁸

In this context, it is interesting to consider some of the most common roadblocks to strategic restructuring. Although most organizations are facing increas-

ing economic pressures, relatively few consider strategic alliances as a possible solution; instead, most organizations reduce services and salaries, deplete reserves and keep hanging on in expectation of the next grant. Strategic alliances are generally viewed with some suspicion and most fear the inevitable change that would result through such a process. Research suggests that this type of resistance usually stems from one of the following three factors:

- (a) *Autonomy.* Mergers and other forms of strategic alliances are often perceived as a threat to organizational and individual autonomy, rooted in the fact that not-for-profit organizations are often founded by or motivated by a small group of dedicated leaders. In this environment, the prospect of a strategic alliance can raise heartfelt emotional responses from the key players involved. The study suggests that appropriate attention must be given to the “hidden” emotional angle of any potential partnership.
- (b) *Self-Interest.* Self-interest is a factor in almost all potential nonprofit alliances since, by definition, those involved in this sector have a strong attachment to the organizations they work for. This can be the case with a board member who has devoted a significant amount of time to the organization or in the case of a staff person, fearing loss of status or even loss of employment in the event of an alliance. Often the self-interest of one of both of the executive directors ends up being a major stumbling block. Some mergers have dealt with this concern by establishing at the outset that each executive director will continue to have employment for a defined period of time after the alliance.
- (c) *Culture Clash.* Most organizations have a strong organizational culture which shows itself in everything from the small day-to-day operational details to the more potentially problem-plagued relationship between management and the board. When a potential marriage in the form of a strategic alliance is being contemplated, the cultures of the organizations can clash as expectations shift and the organizations engage in a process of mutual scrutiny.⁹

Experience has shown that not-for-profit organizations that pursue strategic alliances generally have leaders with a sophisticated understanding of the environment in which their organizations operate. In looking at success factors following an alliance, many have reported the leadership role played by the executive directors or boards of the merging organizations as the single most important factor leading to a successful merger. However, a successful strategic alliance also requires the strong support of staff at all levels within the partnering organizations. The involvement of the whole organization in the process and open dialogue and communication are key elements of a successful alliance. Cross-organization committees can help facilitate this process.

This article will review some of the strategies that are available to charities and nonprofit organizations that wish to either work collaboratively with other organizations or that wish to merge. It will also consider the legal implications and in some cases, the restructuring which is required.

B. Types of Alliances

Alliances among not-for-profit groups and charities operate on a continuum from models which allow significant organizational autonomy to models in which the organizations actually merge or amalgamate in the legal sense, with many variations in between. The choice of which model to use depends to a significant degree on the corporate identity, motivation, programs and opportunities for joint operational efficiencies of the participants.

A recent study on strategic restructuring of nonprofits in the United States describes all of these alliances as falling under the rubric of “strategic restructuring”. The study defines this type of restructuring as follows:

Strategic restructuring occurs when two or more independent organizations establish an ongoing relationship to increase the administrative efficiency and/or further the programmatic mission of one or more of the participating organizations through shared, transferred or combined resources or programs. Strategic restructuring ranges from jointly managed programs and consolidated administrative functions to full-scale mergers.¹⁰

It is probably fair to say that the most successful strategic alliances are likely to be those which have not be dictated or “pressured” by external forces, most commonly withdrawal of government funding or other serious external pressures. This is because one of the most important exercises to undertake before even considering an alliance is for an organization to engage in a critical evaluation of its own strengths and weaknesses and, in so doing, to consider what opportunities may be available through an alliance and what the organization wants to achieve through the process. It should also be said that a strategic alliance should not be a goal in and of itself but rather a means to achieving a well thought out objective.

While there are various models of strategic alliance (and various labels that have been attached to each), this review will focus on the following types of strategic alliances and the legal considerations which apply to each:

(1) Administrative Alliance

An administrative alliance generally involves one organization entering into an agreement with another for the provision of administrative services, space or products. The main purpose of entering into an administrative alliance is to share administrative functions and to increase operational efficiency.

(2) *Service Organization Model*

In this model, two or more organizations collaborate to establish a third organization to provide shared services to the founding participants and others who may wish to join in the collaboration.

(3) *Joint Programming Alliance*

Organizations enter into programming alliances or joint ventures for the purpose of delivering a joint program, each organization possessing a different skill set which, when they are brought together, delivers improved results. In this type of alliance, programs are launched by the participating organizations and are generally managed pursuant to the terms of an agreement. In some cases, a separate corporation is established to deliver the program.

(4) *Merger*

A merger or amalgamation is a union between two or more organizations that usually share similar programs or objectives. A merger always involves a change in corporate structure and may result in the dissolution of one or both participating organizations, depending on the provisions of the relevant corporate statute.

It should be noted that this review will be limited in scope to strategic alliances among incorporated not-for-profit corporations and charities and will not consider alliances among unincorporated associations or trusts.

C. General Legal Considerations Applying To All Models

Getting Started

Every strategic alliance involves some form of legal transaction or agreement and, as such, legal advice is critical. It is important to remember that the executive directors and boards of directors who are involved in an alliance today may not be the same five to 10 years down the road and therefore it is important to ensure that the agreement that is reached at the time of the alliance is well documented and establishes the terms of the relationship that is going forward.

In many cases, the parties will have engaged a consultant to assist them in establishing a framework for the alliance before going to a lawyer. Using a consultant with experience both in the organizations' service areas and in strategic alliances is a process to be encouraged, especially in the early stages. In the pre-alliance stage, a consultant should be assisting the organization in engaging in a process of self-evaluation to determine whether a strategic alliance will enable the organization to achieve its objectives. A consultant is also useful to use as a facilitator during the first several alliance meetings.

Strategic alliances will often touch on several branches of the law (including tax law, corporate law, trust law, employment law and real property law). It is therefore important to ensure that the law firm that is being used has the skill set, either in the firm itself or available to it, in order to address the potential

issues in the alliance. However, it is just as important to be well prepared in advance of going to a lawyer and to try and anticipate the information that needs to be conveyed to the lawyer. From the perspective of a lawyer acting for a client in a strategic alliance, it is important to ensure that the client understands the implications of the type of alliance being contemplated (e.g., assumption of liabilities or loss of corporate identity, in some cases) and that all of the key documentation has been provided by the client (such as letters patent and bylaws of the organizations, core program agreements, intellectual property information and the terms of any restricted funds (where applicable)). While the same lawyer can provide general advice regarding the possible parameters of a strategic alliance, it goes without saying that each party to a strategic alliance should obtain independent legal advice.

Due Diligence

A due diligence investigation of the operations and finances of the parties to a strategic alliance should be carried out, particularly where the type of strategic alliance involves more than an administrative relationship and is further down the continuum of permanency. Obviously the type of relationship being considered will dictate the depth of investigations to be carried out. For example, in the case of an amalgamation, under general principles of corporate law the surviving organization “inherits” all the assets and is subject to all of the liabilities of the merging entities and an in-depth due diligence investigation should be carried out. In the case of an administrative alliance, the parties may only be concerned with sharing of some limited financial information. Depending on the type of alliance being formed, items that should be reviewed include:

- Corporate – Letters patent and bylaws
Minutes of meetings
Corporate filings
- Financial – Financial statements
Current budget and status
Tax filings (T3010) and other
Accounts receivable and payable
Encumbrances on equipment or other interest
Status on government remittances (Income Tax, GST, etc)
- Employees – Compliance with laws
Litigation, pending or potential
Employment agreements
Personnel policies
Job Descriptions
Union considerations
Employee benefits plans and filings
Pending and potential claims and history
Wages

Insurance –	Comprehensive General Liability insurance policy Directors’ and officers’ liability insurance Other insurance Claims history
Registrations –	Notification of charitable registration Provincial fundraising legislation registrations Lobbyist registrations Extra-provincial registrations
Restricted Funds –	Any restricted or special-purpose trust funds Fund balances and conditions Investment policies Review of restricted funds to ensure compliance with terms
Intellectual Property –	Trademarks or official marks Patents Copyright Licence Agreements
Real Property –	Deed/Transfer of Land Mortgages Survey, appraisal, compliance with zoning Leases Licences Other records
Personal Property –	Office equipment Leases Security interests Software licences
Contract review –	Fundraising contracts Loan agreements Pledges Joint ventures Agency agreements

Any Legal Impediments or Approvals Required?

An initial analysis should be undertaken to ensure that there are no outright legal impediments to the alliance, such as for example, the relevant corporate statute not providing for an amalgamation (if the parties wish to amalgamate) or a relationship between a charity and a non-charity which could put the charitable registration of the charity at risk. It should be noted that a charity may not amalgamate or merge with a non-charity unless the corporate entity of the charity is the one that survives with the objects unchanged, no liabilities are being assumed by the charity and none of the charity’s resources are applied for non-charitable purposes. Even if those conditions are satisfied, it would be prudent to obtain the prior approval of the Canada Customs and Revenue

Agency (Charities Directorate). Finally, there may be trust law issues in the event that restricted trust funds are held by a charity partner to a merger which may require a court order to move into the newly merged organization.

Other Issues

Other important legal issues that should be considered in most strategic alliances are the following:

- (a) *Employees.* Consideration should be given to how the employees involved in an alliance are going to be treated, particularly where there is to be a sharing of human resources or a merger. Questions that need to be examined include the following: Are there collective bargaining agreements, existing personnel policies or employment agreements that need to be considered? Does the nature of the strategic alliance result in a fundamental change to the terms and duties of employment of any of the employees? Could employees raise any severance obligations? Will the alliance have any effect on existing benefits and pension obligations? In the case of a merger, will there need to be a termination and rehiring of employees? Where an employee is being shared by two organizations, which organization should be the employer and are there any employment law implications to “sharing” an existing employee with another agency?
- (b) *Contracts.* An organization should evaluate how the arrangement will affect existing contractual relationships. Many contracts require consent of the contracting party in the event of a merger or amalgamation. Also, funders, particularly government funders, may have an outright prohibition on merging or amalgamating which could jeopardize the organization’s government funding in the future. Organizations should also identify any potential problems with software licences and any type of licence or registration held by the organization.
- (c) *Corporate Governing Documents.* A review should be conducted of the organization’s letters patent to ensure that any new programming contemplated by the alliance is permitted under the organization’s objects and if necessary the objects should be amended.
- (d) *Organizational Approval.* Approval of the strategic alliance should be obtained in most cases from the board of directors of the organization and in the case of a merger, in accordance with the governing corporate statutes which virtually all require membership approval. The board of directors should be kept closely involved in the whole process and due diligence findings should be communicated to the directors to allow them to consider whether the alliance is still in the best interests of the organization.

- (e) *Letter of Intent/Confidentiality Agreement.* Before the strategic alliance is actually formalized into an agreement, a letter of intent and confidentiality agreements are usually good practice.

D. Specific Legal Considerations

Administrative Alliance

The most common administrative alliances that we have encountered involve organizations sharing office space, office equipment and personnel and, as such, are usually brought about for reasons of financial expediency. Some organizations have found that they can significantly cut their overhead by jointly leasing or purchasing equipment and other office requirements as well as “sharing” the burden of a lease by becoming co-lessors. In some cases there is also a sharing, exchange or “purchase” of personnel. Others have shared a capital campaign or become co-owners of a facility.

An administrative alliance is generally governed by a management or services agreement and does not involve any change to the corporate structures of the participating organizations. While some organizations still prefer to have a joint advisory committee of some kind, in which both organizations are represented and which oversees the alliance and acts in a “trouble-shooting” capacity, most simple strategic alliances of this nature do not require such a formalized structure.

The key elements of a typical agreement that would govern an administrative alliance are as follows:

- (a) there should be a clear formula or provision regarding shared expenses;
- (b) where personnel are to be shared or contracted out, the agreement should specify whether one of the organizations will hire the employee and charge the employee’s services back to the other, whether each organization will hire the employee on a part-time basis or other details of the arrangement such as an exchange of personnel for a particular period;
- (c) where there is a sharing of leased space, ideally both parties would contract directly with the lessor or in the alternative one party may sublease space to the other;
- (d) where fundraising will be conducted jointly, the rules regarding the fundraising campaign should be clearly spelled out;
- (e) there should be a clear statement that neither party is the agent of the other nor can bind the other to any contractual commitment;
- (f) consideration should be given to including some method of resolving disputes; and

- (g) the agreement should state that books and records will be maintained separately.

In the United States, some have found that an initial arrangement such as an administrative alliance has resulted in further collaborations and even restructuring with the same partner.¹¹ It can be a good “stepping-stone” for an organization to enter into an administrative alliance first, before attempting something more permanent such as a merger. This has been our experience in at least a couple of cases.

It should also be noted that in the vast majority of cases, the parties to an administrative alliance tend to be organizations serving the same client base or in a similar program delivery area.

Most administrative alliances are straightforward and as long as they are well documented by a properly drafted agreement, they are usually problem-free. However, it should be noted that where a charity and a non-charity enter into an administrative alliance, great care must be taken to ensure that the charity is not subsidizing the non-charity by providing goods or services to the non-charity at less than market value, that the arrangements are clearly documented and that the terms of the agreement are closely followed. In our experience, the Charities Directorate of Canada Customs and Revenue Agency scrutinizes these types of arrangements very closely.

The following practical observations should be made with regard to the establishment of an administrative alliance:

- it is easier to work out details of an alliance when only a small number of partners is involved;
- information sharing and sometimes referrals among parties to an alliance can create new opportunities for the organizations involved;
- an administrative alliance requires little infrastructure or expense since it does not involve the creation of a new entity nor involve programming considerations;
- an alliance can serve to enhance the impact of a smaller not-for-profit organization;
- it can often be difficult to “share” or combine information systems either because the systems are not compatible or because of end-user licence restrictions.

Service Organization Model

Organizations typically establish a separate service organization to consolidate administrative services to be delivered to two or more organizations. This type of organization is distinct from an organization established as a separate entity in a joint programming alliance in that its sole function is to provide services to participating charities or not-for-profit organizations.

Services provided by such an organization typically include fundraising, contracts management, accounting and bookkeeping, event planning, personnel services, facilities management and equipment outsourcing or procurement. By way of example, a few years ago we established a service organization on behalf of a national charitable organization with regional charities across the country to develop and procure cutting edge fundraising software for use by the national organization and its member charities. In that case, the service organization was set up as a nonshare corporation and registered as a charity; its objects were to improve charitable efficiency among the organizations forming part of the particular national organization. Each member charity contributed a certain amount of funds to the service organization (the amount of the contribution being determined according to a particular formula and based on the size of the organization) and funds were also generated from outside sources including some foundation money. The service organization entered into a major development agreement with a software developer and the software was completed and delivered to the member agencies who also received training from the software developer. The service organization in that case was retained for future projects of a national nature which may serve to benefit the organizations down the road.

A few comments are in order about service organizations. First, and the most obvious point to make is that setting up a separate service organization insulates the charities or not-for-profit organizations who will be benefiting from the services, from liability. In the above example, the service organization entered into a million-dollar-plus contract with a software developer and the existence of this separate entity provided a much needed “buffer” between the operating charities and the software developer, both from a liability perspective and an operational perspective. Second, in most cases a service organization would likely not be registered as a charity since it is generally very difficult to attract foundation or individual donations to what is perceived by most as an administrative rather than a program need (regardless of whether CCRA considers improving charitable efficiency as charitable). Third, one of the most important considerations when setting up a separate service organization is control by the participating organizations. We generally recommend the following:

- (a) the parties that are setting up the service organization have equal representation on the board and membership levels (so that the service organization essentially operates as a subsidiary of the parties);
- (b) consideration be given to entering into a membership agreement (similar to a shareholder agreement) pursuant to which the parties agree on certain key issues (such as board appointees, officers, dead-lock provisions etc.);
- (c) the parties also enter into an agreement with the service organization, pursuant to which, the scope of the services to be provided to the parties is clearly spelled out.

A separate service organization clearly involves another layer of administration and will not always be the right model for those attempting to streamline their administrations. In our experience, the most successful service organizations have been set up by a relatively small group of organizations and with quite a narrow mandate.

Another well-known type of service organization is the foundation established by two or three or more charities to carry out fundraising for the benefit of all of the founding charities. While usually referred to as a parallel foundation when established by a single charity, typically such an organization fits the model of a service organization when used as a vehicle to provide fundraising services for a number of organizations. Generally speaking, such an arrangement works best when the charities operate in the same field. It perhaps goes without saying that the foundation should be registered as a charity.

The following practical observations should be made with regard to the establishment of a service organization:

- forming a new, jointly controlled corporation can enable the organizations to share the risk of certain administrative requirements, while leaving more time for program delivery;
- a separate service organization allows for efficient contracts administration in providing a single point of contact to meet administrative needs;
- full-time staff should generally be hired by the service organization since experience has shown that executive directors of the participating organizations are generally too taxed to move the separate organization forward in an effective manner;
- where the organizations forming the new service organization are charities and the service organization is a non-charity, care must be taken to ensure that the practical arrangements are in compliance with the *Income Tax Act*.

Joint Programming Alliance

A joint programming alliance usually involves an arrangement in which both parties agree to carry out a specific program for a limited period of time (such as in the case of one client of ours that carried out a one year contract with a “partner charity” to deliver a joint literacy program) or an actual combining of programs by two or more organizations that share a common programming goal. It should be noted that in some cases, a joint programming alliance can be preferable to an actual merger of the parties in that it can achieve the same program result without the loss of corporate identity on the part of those participating. It can also operate as a first step in the direction of a merger.

A joint programming alliance may be carried out by way of agreement or through the creation of a new corporation to deliver the program. In either case,

the parties to the alliance typically share the risk of the new program and retain their corporate identities. However, the formation of such an alliance can open up doors and create opportunities previously unavailable to the parties acting independently. For example, core funding may be available to fund a particular program which each organization acting independently could not run. Acting in concert, the agencies are able to attract the funding.

By its very nature a joint programming alliance incorporates many of the elements of an administrative alliance since there is almost always a sharing of resources to achieve a common program goal.

The following issues should be addressed in an agreement providing for a joint programming alliance:

- (a) the respective contributions of the parties to the alliance. For example, will there be a joint purchase of materials or equipment, a sharing of human resources or a dedication of personnel from each agency etc.;
- (b) where a new corporation is established, the objects or corporate purposes of the new entity, the composition of the board (usually with representatives from participating organizations) as well as the identity of the members (we often recommend that the membership be comprised of the boards of the participating organizations - though care must be taken where this would result in uneven representation and control);
- (c) where no new entity is being formed, consideration should be given to providing for the formation of a Joint Advisory Council, the members of which are appointed by the participating agencies to the alliance (in that event, provisions regarding meetings of the Joint Advisory Council, e.g., quorum, notice etc.. should be included);
- (d) insurance and indemnification;
- (e) a clear statement that neither party is the agent of the other nor can it bind the other to any contractual commitment;
- (f) termination provisions should be consistent with any funding grant;
- (g) a method for resolving disputes should be included;
- (h) where intellectual property owned by one or both parties independently will be used by the new entity or by the parties to the alliance jointly, the necessary licence terms should be added to the agreement.

Where the parties to an alliance are registered charities and they wish to form a new corporate entity to carry out a joint program, consideration should be given as to whether the new entity should be a registered charity or a not-for-profit organization. While the formation of a new registered charity can be time consuming and expensive, the organizations are less likely to run into obstacles

with the Charities Directorate of Canada Customs and Revenue Agency in carrying out the programs since any issues regarding the movement of resources from the charities to the new organization would be eliminated. However, it should be noted that there is no technical difficulty with the formation of a not-for-profit corporation to act as agent for one or more charities in carrying out a charitable program on their behalf. In that event, care should be taken to enter into an agency agreement with the organization and the organization must carry out the programs strictly in accordance with the requirements of the agreement.

The following practical observations should be made with regard to the establishment of a joint programming alliance:

- although not technically a merger, a thorough due diligence investigation should be carried out since both parties will be integrating their programs;
- consider the formation of a joint venture committee prior to actually entering into the alliance in order to address issues affecting the delivery of the joint programs;
- consider hiring a consultant with expertise in nonprofit strategic alliances;
- consider asking for financial help from funders that are interested in enhancing program delivery in the voluntary sector;
- a positive relationship between the boards of the parties to the alliance is important for enabling an effective alliance;
- forming a new corporate entity to carry out a joint program creates a single point of contact for funders and government bodies that are contracting out services, but before setting up the corporation ensure that the relevant third parties will deal with a new corporation rather than the participating organizations directly (since they are the ones which have built confidence and good will over the years).

Merger

A merger or amalgamation may be appropriate where two or more organizations with similar or compatible programs, perhaps already working in tandem, wish to continue as one entity. A merger necessarily involves the complete integration of all programs and administrative functions of the parties. The objective in any nonprofit merger is to increase program quality and administrative efficiencies.

As a matter of corporate law, a merger can take place in any of the following ways:

- (a) if the relevant corporation law statute permits it, a formal amalgamation of the parties may take place;

- (b) one corporation may absorb the other through the dissolution of one of the corporate entities which winds up its affairs into the other corporation;
- (c) both corporations may dissolve and establish a completely new corporation;
- (d) the corporations may keep their separate charters, set up a new entity and “abandon” the existing ones since the amalgamation appears to be a success.

Mergers by amalgamation and mergers by dissolution will be reviewed separately.

Amalgamation

In the last few years in Ontario, we have seen a number of amalgamations among hospital foundations as a result of hospital restructuring. However, it should be said that while mergers in general are relatively rare in Canada, true amalgamations are even more unusual with more corporations electing to dissolve or abandon their charters to start a new organization. There may be circumstances, however, in which amalgamation is preferable, such as where substantial amounts of goodwill are involved or where certain key contracts or gifts are not assignable.

Where a formal amalgamation is permitted under the corporate statute, an amalgamation agreement is generally required as part of the amalgamation process. In general and subject to the specific requirements of the applicable corporate statute, most organizations will follow the legal procedure described below in bringing an amalgamation (as opposed to another type of merger) into effect:

- (1) the parties will carry out an in-depth due diligence investigation;
- (2) an application for letters patent of amalgamation and an amalgamation agreement are prepared;
- (3) in the event that the bylaws of either amalgamating corporation are not suitable to be adopted, a new general bylaw of the amalgamated corporation is prepared;
- (4) in the event that charities are involved, the approval of the Office of the Public Guardian and Trustee is required;
- (5) in the event that charities are involved, the approval of the Charities Directorate of Canada Customs and Revenue Agency is obtained;
- (6) meetings of the boards of directors of each amalgamating corporation are held to approve the amalgamation agreement and the application for letters patent (or articles) of amalgamation and, if applicable, the bylaws to be adopted by the new corporation;

- (7) meetings of the members of each amalgamating corporation are held to approve the amalgamation agreement and the application for letters patent (or articles) of amalgamation and, if applicable, confirmation of the bylaws to be adopted by the new corporation;
- (8) a solvency certificate of each amalgamating corporation is usually required; and
- (9) a certificate from the secretary of each amalgamation corporation, certifying the adoption of the amalgamation agreement is required to be prepared and submitted to the Companies Branch in Ontario together with the other amalgamating documents.

Under Ontario's *Corporations Act*, corporations with the same or similar objects may amalgamate by entering into an amalgamation agreement prescribing:

The terms and conditions of amalgamation, the mode of carrying the amalgamation into effect and stating the name of the amalgamated company, the names, callings and places of residence of the first directors thereof and how and when the subsequent directors are to be elected with such other details as may be necessary to perfect the amalgamation and to provide for the subsequent management and working of the amalgamated company.¹²

As such, the amalgamation agreement generally sets out the following basic details:

- (a) the name of the amalgamated corporation;
- (b) the names, addresses and occupations of the first directors;
- (c) the rules under which subsequent directors are to be elected;
- (d) the adoption of a bylaw of one of the amalgamating corporations, or the creation of a new bylaw;
- (e) the objects of the amalgamated corporation;
- (f) the classes of membership in the new corporation and the rules for converting existing memberships into the new membership scheme; and
- (g) any other details that are necessary to perfect the amalgamation and to provide for the subsequent management and working of the amalgamated corporation.

In prescribing the rules for membership and conversion of existing memberships in the amalgamation agreement, special attention should be paid to the issue of effective voting control by the members of the amalgamated entity. This issue arises where one amalgamating corporation has more voting members than the other. In that situation, it is necessary to consider whether one of the corporations should really have effective voting control or whether special provisions that balance the control should be inserted. Where the amalgamating

corporations have different classes of membership, more complications can exist unless it is clearly provided which classes “survive” the amalgamation and whether new classes are created. Some amalgamation agreements may also contain a mechanism whereby certain classes “convert” into new classes of the amalgamated corporation. Another possibility is that the membership classes of one or both of the amalgamating corporations remain intact but the criteria attaching to the classes change.

Due to the fundamental change resulting from an amalgamation, the *Corporations Act* requires that the amalgamation agreement be submitted to the members at a general meeting called for the purpose of considering it and that the agreement be approved by two-thirds of the votes cast by the members at that meeting.¹³ If the agreement is adopted by the members, the amalgamating corporations may apply to the Lieutenant Governor for letters patent confirming the agreement and amalgamating the corporations. If one or both corporations are charities it is important to note that the pre-approval of both the Public Guardian and Trustee and the Charities Directorate of the Canada Customs and Revenue Agency will be necessary. The amalgamated corporation thereafter possesses all of the property, rights and privileges and is subject to all of the liabilities, contracts and disabilities of the amalgamating corporation.¹⁴ The effective date of amalgamation is the date set forth in the letters patent of amalgamation.¹⁵

Most of the other provinces permit amalgamations with the notable exceptions of Nova Scotia¹⁶ and Prince Edward Island.¹⁷ Federally, it is not possible to amalgamate non-share capital corporations under the *Canada Corporations Act*,¹⁸ which can cause some frustration when amalgamation as opposed to another type of merger is the alliance of choice. Under these circumstances, it is common to surrender the charter of one or more of the corporations while leaving the other intact and amending its objects so that it can carry on the activities of the former corporations. It should be mentioned that the approval of the Charities Directorate at the Canada Customs and Revenue Agency should be sought before any formal attempt to change the objects of the “surviving” organization, if it is a charity.

Merger by Dissolution

As noted above, a merger can take place when one corporation dissolves and winds up its affairs into the other corporation. In the alternative, both corporations may dissolve and establish a completely new corporation or the corporations may keep their separate charters, set up a new entity and “abandon” the existing ones once the amalgamation appears to be a success.

As we have noted earlier in this review, the decision to merge is generally made after considerable deliberation. While the question of “how to” merge is largely technical, it can be the cause of the greatest amount of anxiety for participants

to the merger. Where a merger takes place by dissolution, the question of which organization survives the dissolution can cause considerable turmoil.

The question of which model of merger by dissolution to adopt is generally driven by practical considerations such as the relative financial situations of the participants, the goodwill associated with the names or programs of the participants and the sometimes unfathomable question of whether membership approval to a proposed dissolution will be given by the membership. Where the extenuating circumstances suggest that one of the parties should dissolve and one should continue, there are two options. One is to voluntarily dissolve one of the corporations as if it were simply ceasing its operations. This would require the satisfaction of its liabilities and the transfer of any remaining assets in accordance with its dissolution clause (which may permit a transfer to the merger partner). The other option which some organizations decide upon is to effectively dissolve one corporation into the other so that one merger partner inherits not only the assets but the liabilities of the other. This option is usually only attractive where there is, for example, intellectual property and goodwill which the surviving corporation will need to carry out the merged programming.

However, a positive answer to most of the following questions should guide the parties in deciding which model to follow:

- (a) Does one corporation have significant debt?
- (b) If so, are the creditors unwilling to forgive all or a portion of the debt?
- (c) If the creditors are unwilling to forgive all or a portion of the debt are they willing to transfer the obligation to a new entity?
- (d) Does one corporation have a funding source that is unwilling to transfer the funding to a new entity?
- (e) Does one corporation have a licence or other certification which cannot be readily transferred?
- (f) Was one corporation created by special act and is therefore difficult to dissolve?
- (g) Is it unlikely that the membership will approve a dissolution of either corporation?
- (h) Does one corporation have restricted trust funds which may require court approval for transfer to a new entity?
- (i) Does one corporation have significant intellectual property?

The most cautious approach (and the one favoured by Big Sisters and Big Brothers in Edmonton) is to establish a new organization, wait a while and then dissolve the predecessors. That way, the organizations continue to exist for an agreed upon period of time in a kind of “watchdog” function in order to ensure that program and other expectations are met. In the Big Sisters/Big Brothers

case, it was agreed that both groups would continue to have dedicated boards for the first two years, with eight directors from Big Sisters and six directors from Big Brothers sitting on the new entity's board. Both executive directors were guaranteed employment for 18 months following the merger and it was agreed that Big Sisters would continue to own the real property for up to five years before transferring it to the new corporation. In reality, the new board worked so well together that they agreed to abandon the separate boards and to dissolve and the building was transferred after one year instead of five.

The following are legal procedures required to dissolve a not-for-profit corporation a) in the province of Ontario and b) federally.

Ontario

A not-for-profit corporation incorporated under Ontario's *Corporations Act*¹⁹ may be dissolved either by voting to voluntarily surrender its charter pursuant to Section 319 of the *Act* or, less commonly, by voting to wind up the corporation and appoint a liquidator under the winding up provisions contained in Part VI of the *Act*.

Generally speaking, a voluntary surrender of the charter is the procedure of choice unless the corporation's affairs are exceedingly complex and the process of liquidating the assets and dealing with creditors requires the intervention of a liquidator. Where this is the case, a voluntary wind up may be authorized by a majority vote of members at a general meeting called for that purpose. Where a wind up is authorized, the appointment of a liquidator is mandatory. It is also mandatory to file a notice of the resolution with the Companies Branch and to publish the notice in the *Ontario Gazette* within 14 days after the resolution has been passed. Failure to follow these requirements could subject the corporation and its directors to a fine.²⁰ Note that a wind up can also be achieved by court order made on application of the corporation, a member or a creditor.²¹ Once a liquidator is appointed, the corporation will cease to carry on its undertaking and the directors' powers cease unless otherwise required by the liquidator.²²

An Ontario not-for-profit corporation may surrender its charter if it proves to the satisfaction of the Lieutenant Governor that:

- (1) the surrender of charter has been authorized by a majority of the votes cast by the members at a meeting duly called for that purpose or by such other votes as may be provided in the letters patent, or that all of the members have consented in writing;
- (2) the corporation has distributed its remaining property in accordance with its distribution clause or, if there is no distribution clause (and if the organization is not a charity), rateably among its members;

- (3) the corporation has no debts, obligations or liabilities, or that they have been duly provided for, or that the creditors or other persons having an interest therein consent; and
- (4) there are no proceedings pending in any court against the corporation.²³

Where the corporation is a charity, the Companies Branch requires that the provisions of the *Charities Accounting Act*²⁴ be complied with and the Public Guardian and Trustee must signify its consent to the dissolution. When reviewing an application for surrender of a charter, the Public Guardian and Trustee generally requires that the following be included with the application for review:

- (1) a copy of the letters patent and of any supplementary letters patent;
- (2) written confirmation that the charity has requested voluntary revocation of its registration and business identification numbers assigned to the charity by Canada Customs and Revenue Agency;
- (3) a written explanation as to why the charity is surrendering its charter;
- (4) information regarding to whom on dissolution the charity is proposing to disburse its remaining assets and property pursuant to its dissolution clause;
- (5) copies of the charity's audited financial statements for the last three financial years;
- (6) street and mailing address of the charity;
- (7) the residential street addresses of the charity's current board of directors; and
- (8) confirmation that the corporation does not hold any trust, special purpose or restricted purpose funds. Alternatively, if the corporation does hold such funds, a confirmation is required that transfer of such funds to other charities is contingent upon such charities agreeing to carry out the conditions attached to such trust funds.

It should be noted that in some cases, a court order may be necessary in order to transfer the funds to a successor trustee. Depending on the circumstances, it may be possible to obtain such an order using the summary procedure provided for under Section 13 of the *Charities Accounting Act*.

In addition, where the organization is a registered charity, it is important to request a voluntary revocation of the organization's charitable registration with the Charities Directorate of the Canada Customs and Revenue Agency. This will cause Canada Customs and Revenue Agency to issue a *Notice of Intention to Revoke (Voluntary)* and to publish the intended revocation in the *Canada Gazette*. The organization will be required to file a Form T2046 within one year of the date of revocation.

An application for surrender of charter must be accompanied by the original letters patent or supplementary letters patent, if any of the corporation. If the letters patent or supplementary letters patent are lost or cannot be located, an affidavit by a director or officer to that effect and an undertaking to return them to the minister if they are found in the future must be provided.²⁵ If the Lieutenant Governor is satisfied, he or she may make an order accepting the surrender of charter and declare the corporation to be dissolved on the date set out in the order.²⁶

It is important to be aware of recent amendments to the *Corporations Act* which provide that notwithstanding the dissolution of a corporation under the *Act*, a civil, criminal or administrative proceeding commenced by or against a corporation before it is dissolved may be continued as if the corporation had not been dissolved. Further, a civil, criminal or administrative proceeding may be brought against a corporation as if the corporation had not been dissolved. Any property that would have been available to satisfy any judgement or order if the corporation had not been dissolved remains available for execution and land belonging to the corporation before dissolution may still be sold under power of sale. The section also provides a scheme for service and notice of action and notice of power of sale proceedings under these circumstances.²⁷

Federal

There are two ways to effect a dissolution of a federal not-for-profit corporation. One is a formal liquidation under the *Winding-up and Restructuring Act* and the other is a voluntary surrender of charter pursuant to Section 32 of the *Canada Corporations Act*.²⁸ However, just as in the case of an Ontario dissolution, one is unlikely to use the procedure under the *Winding-up and Restructuring Act*²⁹ unless the affairs of the organization are especially complex and warrant the services of a liquidator. The process described in the Ontario legislation is similar to a federal windup and as such, we will not review the procedure to effect a windup under the federal *Winding-up and Restructuring Act*.

A federal corporation may surrender its charter under the *Canada Corporations Act* provided that it satisfies the minister that:

- (1) it has no assets or, if it had assets prior to the application, they have been rateably divided among the members; and either,
- (2) that it has no debts, liabilities or other obligations; or
- (3) that the debts, liabilities or other obligations of the corporation have been provided for or protected, or that the creditors or other persons having interests in such debts consent; and
- (4) that the corporation has given notice of the application for leave to surrender its charter by publishing same in the *Canada Gazette* and once in a newspaper published at or near the corporation's head office.³⁰

An application for surrender of charter must be approved by a vote of a majority of the members (unless the charter or bylaws otherwise provide) which is shown by a bylaw or resolution to that effect. The *Canada Corporations Act* provides very little guidance in the dissolution procedure, however, Industry Canada has published its requirements for a surrender of charter in Annex 10 of its *Non-Profit Policy Summary* (available on the Strategis Website at *strategis.ic.gc.ca*). The documents that are required for a voluntary surrender of charter are as follows:

- (1) a form of application to surrender the charter (while not prescribed by the regulations, there is a recommended form);
- (2) a certified copy of the bylaw or resolution authorizing the surrender of the charter, including the date that it was passed by the members;
- (3) an affidavit attesting to the truth of the facts set out in the application;
- (4) an affidavit of an officer certifying that the facts recited in the application are true;
- (5) an officer's statement certifying that:
 - (i) the corporation has no assets
 - (ii) if the corporation had assets they have been (A) rateably divided among the members or (B) distributed among other corporations in Canada having the same or similar objects or among other registered charities in Canada;
 - (iii) the corporation has no debts, liabilities or other obligations.
- (6) the original letters patent (and supplementary letters patent, if any) or, if they are missing or lost, an affidavit to that effect.

Unless the application is pursuant to subsection 32(2), i.e., the corporation has not gone into operation or has been inoperative for three or more consecutive years, evidence of publication of the required notices in the *Canada Gazette* and in a local newspaper must be provided.

Provided that a complete application has been filed, the minister will issue a "Directive of Dissolution and Cancellation of Charter": pursuant to subsection 32(3) of the *Act*. The directive will bear an effective date of one year from the date on which the intent to dissolve was published in the *Canada Gazette* or some later date. The directive will become effective on the date specified unless it is revoked as a result of an objection to the dissolution or a withdrawal by the corporation intending to be dissolved. It should be noted that, where there are valid reasons for requesting an earlier effective date, the directive will be amended accordingly provided that the minister is so satisfied.

While it is not necessary to obtain the approval of the Public Guardian and Trustee's office to a federal surrender of charter, if the organization is a registered charity it is still necessary to require a voluntary revocation of the

organization's charitable status. As noted earlier, this will cause Canada Customs and Revenue Agency to issue a *Notice of Intention to Revoke (Voluntary)* and to publish the intended revocation in the *Canada Gazette*. The organization will be required to file a Form T2046 within one year of the date of revocation. Since this form is often prepared by the organization's accountants, it is usually advisable to place funds in trust with the accounting firm in order to cover these final expenses.

Practical Implications of Any Merger

The primary concern in any dissolution is dealing with creditors. Quite often, creditors will be co-operative, particularly where it is clear that the organization is impecunious and must "settle" with its creditors in order to wind up its affairs. In that type of situation, organizations may be able to come to an informal agreement with creditors and while it is important to comply with the rules regarding preferential treatment of creditors, reasonable arrangements can often be made. Similarly, lessors of property and equipment will often allow not-for-profit organizations to buy out the lease at a preferred rate.

It is important to be aware that any ongoing litigation against a corporation will prevent the dissolution from occurring until it has been disposed of.

It should be noted that if the only reason for preferring one corporation over another is because the corporation name of one organization is desired for the "merged" entity, the merged entity can always change its name to the name of the dissolving corporation. In the past we have submitted an application for surrender of the charter of the dissolving organization and for supplementary letters patent changing the name of the surviving organization, together with the required name consent and cross-referenced the two applications, with no objections from the relevant government department.

The following practical considerations should obtain with regard to any merger:

- carry out a thorough due diligence investigation, especially in the case of an amalgamation or where one corporation will be assuming the liabilities of another;
- consider the formation of a merger committee with equal representation from each organization to address relevant issues in the merger;
- consider hiring a consultant with expertise in the program areas of the merging partners and in nonprofit strategic alliances;
- consider asking for financial help from funders interested in enhancing program delivery in the voluntary sector;
- where a new corporate entity is being set up, ensure that key third party players will deal with the new entity rather than the predecessor organi-

zations (since they are the ones which have built confidence and good will over the years);

- don't expect to realize immediate benefits following the implementation of the merger since program enhancement and the attainment of operational efficiencies can take some time to accomplish.

E. Summary

Whether a given organization should consider a strategic alliance is a question which can only be answered with considerable inward scrutiny on the part of the board of directors and management of the organization. Both program and economic considerations may drive an organization towards a merger but in the end, it has been argued, the organization's mission will steer its board and management towards clarity on the question of a strategic alliance. An excerpt from a recent article on mergers puts it this way:

The most reliable guidepost in considering the appropriateness of merger is always mission. Why do our charitable groups exist? Many organizations would say it is to provide the best possible service to those who we assist, or to be of some benefit to our clients or community. If a non-profit's ability to fulfill this mission would ultimately be strengthened by combining with another group, then it is the organization's responsibility to seriously examine the merger option. A clear focus on mission will virtually always shepherd groups towards the best decision.³¹

If an organization's mission or other considerations point in the direction of a strategic alliance, the importance of sound planning, open communication, flexibility, a good sense of humour and of course, good legal advice cannot be underestimated for ensuring success. Forming a strategic alliance can be hard work and costly and take a long time to implement, but the rewards of a good "fit" with an alliance partner can produce a synergy that makes the process not only worthwhile, but essential for a bright future.

FOOTNOTES

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4. *Charity Village Newsweek*, "Winning Partnerships That Prove Working Together Gets Things Done", May 11, 1998.
5. Austin, James E., *The Collaboration Challenge*, The Drucker Foundation, Jossey-Bass Publishers, 2000.

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11. D. Vinokur-Kaplan and B. McBeath, *Getting Help Down the Hall: Non-Profit Collaborations under one Roof*, 1999.
12. *Corporations Act*, R.S.O. 1990, c. C.38, subsection 113(2).
13. *Ibid.*, subsection 113(3).
14. *Ibid.*, subsection 113(4). It should be noted that section 314 preserves the rights of creditors against the property, rights and assets of the amalgamated company.
15. *Ibid.*, subsection 12(2).
16. R.S.N.S. 1989, c. 435.
17. R.S.P.E.I. 1988, c. C-14, sections 77 and 91.
18. R.S.C. 1970, c. C-32.
19. *Supra*, footnote 12, c.C.38.
20. *Ibid.*, Section 231.
21. *Ibid.*, Section 244.
22. *Ibid.*, Section 236.
23. *Ibid.*, subsection 319(1).
24. *Charities Accounting Act*, R.S.O. 1990, C.C. 10.
25. R.R.O. 1990, Regulation 181, paragraph 23(2)(a).
26. *Ibid.*, subsection 319(2).
27. *Ibid.*, Section 318.
28. R.S.C. 1970, c.C-32.
29. *Winding-up and Restructuring Act*. R.S., 1985, c. W-11, s. 1; 1996, c. 6, s. 134.
30. *Ibid.*, subsection 32(1).
31. Sherry Ferronato, "Non-Profit Mergers: Perils and Possibilities," *Front & Centre*, January 1999, Vol. 6, No. 1.