FEDERATION AS A REPUTATIONAL MECHANISM:
THE U.S. LAW OF SAME-NAME NONPROFIT ORGANIZATIONS

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Introduction

An NGO’s reputational environment can include membership in a federation of like-named institutions. The law does not dictate any particular mechanism for creating a federation or affiliation. A national or international charity might be the sole member of its associated regional charities, functioning essentially as a parent. Alternatively, the national or international charity might admit regional charity chapters as members, perhaps in combination with individual membership at the local level, or simply establish branches having no legal independence. Autonomous regional charity chapters can be created under the laws of one or more states, with the relationship among these entities established by contract.

Internal disputes can result when a federated group did not clearly anticipate how the relationship supports the overall mission of the organization and whether the group exists chiefly to support the central organization; autonomy of decision-making; and ownership of assets and how revenue will be shared. Ideally, decisions intended to be legally binding about voting and election procedures, ownership, control, revenue, and disaffiliation and dissolution would appear in articles of incorporation or organizational constitution, bylaws, affiliate charters, and policy statements – or in contracts of affiliation – all of which would be internally consistent and updated as necessary. In a

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1 This paper was prepared for the invitational workshop on Reputations and NGOs, convened by the Oxford University Center for Corporate Reputation, Saïd Business School, University of Oxford (July 15-17, 2014, Oxford, U.K.). I am grateful to the participants for the discussion at the workshop.
challenge to the law, though, practices vary widely from the ideal.

The legal tools available depend on the applicable legal regime: corporate law for federations having chapters (with or without voting memberships), agency and partnership law for unincorporated nonprofit associations, and contract law for licensing of the nonprofit’s brand and other intellectual property. Very little law exists on the internal governance structures and practices of federated organizations, however, and a legal analysis would benefit greatly from the results of research in other disciplines.

Legal protection, of course, does not ensure reputational protection. For example, a typical corporate approach to insulating liabilities attributable to one activity from another’s is to use independent corporations affiliated by membership or contract. The public, however, is unlikely to make such fine distinctions, viewing bodies sharing the same umbrella name as the same entity. Thus, external reputational effects depend on how the public perceives the legitimacy of the federation, including the central body’s credibility in “policing” the behavior of its local bodies or chapters.

This paper begins by defining federation, describing the reputational advantages and disadvantages of federation to the participants, and reviewing the legal framework. It then illustrates the themes by focusing on five recent and ongoing examples:

1) **Boy Scouts of America**: In 2000 the U.S. Supreme Court upheld the BSA’s rights, under constitutional provisions for freedom of association, to exclude gays from its leadership and membership. Immediately, however, the organization faced severe public criticism for this policy and continues to suffer significant declines in membership and financial support.

2) **Alzheimer’s Disease and Related Disorders Association**: The federation’s local members (which do not have voting rights) file a “group” Form 990, whose aggregate numbers make transparency of specific operations impossible.

3) **United Way Worldwide**: In order to protect the value of its name from financial scandals involving prominent local bodies and for reasons of good governance, the United Way culled its membership of non-performing locals, shrank its board, and tightened up control of its brand.

4) **Girl Scouts of America**: A federal appeals court, in an alarming (although possibly anomalous) decision, applied Wisconsin franchise law to trump the constitutional associational rights of the GSUSA to structure its organization and operations by combining local councils in that state. Referencing the local council’s main source of revenue, the court declared: “From a commercial
standpoint the Girl Scouts are not readily distinguishable from Dunkin’ Donuts.”

5) **American Cancer Society**: Similar to business corporations that “go private” in order to eliminate the governance and financial costs of having public shareholders, the ACS voted to convert from a membership structure of separately incorporated chapters to governance by a single board. Volunteers continue to serve on local advisory boards.

### I. Models of Same-Name Federation

The law does not dictate any particular mechanism for creating a federation by name. A federation generally consists of a central body (called “the national” here for convenience) and one or more levels of local bodies (such as regional, state, county, city, and even smaller). Legally, as described below, federation occurs either through institutional membership or by license of the name and other marks (or both).

When the law uses the term “member” it means those persons (natural or institutional) having the right to vote in elections of the governing board, to approve amendments to the organizational documents, or to vote on fundamental transactions. Because some nonprofits use the term member more broadly to include affinity membership, the IRS Form 990 asks two separate questions: Does the organization have members, and do members have voting rights? Many federated charities have members with certain voting rights (although not necessarily to vote for the board), but many others do not. Sometimes it can be difficult to ascertain the status of the local bodies.²

² See, for example, the various ways the YMCA of the USA (now branded as the Y-USA) has described itself and its local affiliates. According to its 2013 Form 990, available at [http://www.ymca.net/sites/default/files/pdf/Form%20990%20for%20year%20ended%2012%2031%202013%20-%20Public%20Disclosure.pdf](http://www.ymca.net/sites/default/files/pdf/Form%20990%20for%20year%20ended%2012%2031%202013%20-%20Public%20Disclosure.pdf), the Y-USA has no voting members (Part VI, Lines 6 and 7) or chapters, affiliates or branches (Part VI, Line 10). Its application for federal tax exemption, available at [http://www.ymca.net/sites/default/files/organizational-profile/form_1023.pdf](http://www.ymca.net/sites/default/files/organizational-profile/form_1023.pdf), in Part III, line 10, described the locals as its members, although under its Constitution (appended to the application) the Member Associations do not elect the National Board. (The Y-USA reapplied for exempt status in 1982 because it moved from New York to Illinois.) Separately, Article IX (Names, Mark and Symbols) of the Constitution, available at [http://www.ymca.net/sites/default/files/pdf/Y%20USA%202013%20Audited%20Financial%20Statements.pdf](http://www.ymca.net/sites/default/files/pdf/Y%20USA%202013%20Audited%20Financial%20Statements.pdf), concludes: “It is further recognized and acknowledged that . . . names, marks and symbols may only be used by a Member Association with respect to its own constituency and geographical area and only so long as it is a member in good standing of the National Council.” In describing the group’s income flow, a note to the Y-USA’s 2013 financial statements explains: “Y-USA’s funding comes from various sources, the most significant being
See also the Examples and both Appendices.

In a federation of a central body with separate local entities, the central body can be the sole member of the locals, functioning essentially as a parent that elects the directors of the local governing boards. If separate legal status for the local bodies is not desired, the national charity can simply establish local branches without their own legal status. (In such a case, while the organization looks like a federation, it is really a single entity.) Alternatively, the organization might have grown from the grassroots up – perhaps even without a national body – and the separate local bodies (or those in the next level from the top) could be the members of the national organization. Institutional federation can also be combined with individual membership at the local level.3

Because harm to the reputation of one member of the group can affect the reputation of all, it is common for the group to set standards for and police the members’ or licensees’ or right to use the all-important brand name. While federation can impose limits on self-governance and local control, its benefits to the local organization can extend beyond goodwill and name recognition. Federation might include access to training, fund raising and sharing of resources, sharing or licensing of intellectual property, distribution of merchandise, obtaining and preserving tax-exempt status, centralization of research funding and regional expertise in service delivery, standardization of practices and procedures, aggregating and amplifying voice while harnessing grassroots initiatives and participation, and expanding the nonprofit organization’s mission while preserving a degree of autonomy for local activities and volunteers (board members as well as participants). (See, e.g., Grossman and Rangan (2001), and Widmer and Houchin (1999).) See also Fetgatter (1993), who describes the advantages and disadvantages of the delegate assembly structure, in which each

from YMCA associations throughout the United States. These associations are autonomous corporations, separately incorporated in their respective states, have independent boards and issue separate, individual financial statements . . . .”

3 Widmer and Houchin (1999, p. 11) examine a range of affiliations “from loose associations of autonomous local (and/or regional) members to affiliations in which the national organization exercised almost total control.” Tschirhart (2006, p. 533) describes the complications presented by a “nesting of governance structures”: “[Membership association] may have chapters, affiliates, franchises, or branches, and perhaps even divisions or interest groups within these units and an umbrella or head organization. In addition, associations may have multiple membership categories, each with its own rights and access to decision-making processes. . . .”
constituent member organization has the power to vote on resolutions affecting the association.

Chapters that are not separately incorporated are covered by the entity’s federal tax exemption. Separate corporate entities, by contrast, must obtain recognition of exemption on their own unless they are covered by a group exemption obtained by the parent and listed annually in a group return, which is filed with the IRS separately from the national body’s return. As of tax year 2010, the Internal Revenue Service has recognized more than 2,500 affiliated § 501(c)(3) tax-exempt organizations, which include more than 250,000 subordinate organizations; in addition many mutual-benefit exempt organizations file group returns. See below for discussion of the group Form 990 filing requirements.

For a survey of the different organizational models of 32 large federated nonprofits, see American Cancer Society (2011) (summarized in Appendix B). Tables in that survey indicate whether the particular organization has a national assembly (membership body), and the rights of the members; whether the organization has separately incorporated units (affiliates), and whether those affiliates are included in a group Form 990; data on the governing board, including the number of members, how nominated, and how elected; data on advisory boards, if any; and descriptions of how geographic regions are determined and governed. The footnote to the cover memorandum from ACS’s chief counsel to the members of the organization’s National Assembly explains: “The data contained in the attached schedules was prepared by staff of the Office of Corporation Counsel, with the kind assistance of the general counsels of the peer organizations whose information is referenced herein. There is no publicly available resource containing the data presented in these schedules.” Oster (in 1992 and 1996) found that in a list of the 100 largest nonprofits, substantially more than half use a franchise model, including the YMCA, United Way, Boy Scouts and other scouting organizations, and most of the disease research organizations. (But see discussion in Part IV of the American Cancer Society’s 2012 move to a single-board model.) Other economic studies include Rose-Ackerman (1980); Stone, Hager and Griffin (2001); Young (1989 and 2001) and Young and Faulk (2010).

Compare institutional membership in an independent association – whether
national, regional, or industry-based (such as hospitals, higher education, or museums) – in which the institutional member submits to the groups’ standards and to any disciplinary process for violation, as well as becomes eligible for certain member benefits. This latter type of affiliation, as well as involuntary “peer regulators” known as charity watchdogs, is beyond the scope of this paper. (See generally Brody 2002.)

II. Reputational Aspects of Federation

“What’s In a Nonprofit’s Name?,” the attorneys general of 16 states and the District of Columbia asked in a 1999 preliminary multistate report on nonprofit product marketing subtitled “Public Trust, Profit and the Potential for Public Deception.” They were addressing the emerging, and potentially misleading, fund-raising technique known as cause-related marketing – in which a business pays a fee to license a charity’s name and logo in advertisements or on product packaging – but they could have been referring to name branding in general. Indeed, Attorneys General (1999) begins its description of policy concerns by declaring (at p. 33): “There is little room to question that public trust is the true currency supporting nonprofit organizations. Each and every nonprofit that the Attorneys’ General staff have met with have identified their names and reputations as being their central and greatest asset. Public trust is at the heart of the nonprofit community. Safeguarding the confidence and trust placed in nonprofit organizations necessarily serves as a bedrock objective.”

The term “brand” in this paper embodies the modern shift “in the perception of the role of the brand, away from a fundraising and PR tool to a critical strategic asset focused on mission implementation. Instead of thinking of the brand as a logo and tagline, the new paradigm understands brand as the embodiment of the organization’s mission and values” (Laidler-Kylander and Stenzel 2014, p. 7). Moreover, reputational concerns extend beyond contributions from the public. Notably, government funding can result in an audit of the use of the funds.4

4 See, for example, the Justice Department’s June 2013 decision, available at http://www.justice.gov/oig/reports/2013/g7013006.pdf, to freeze funding to Big Brothers Big Sisters of America: “Overall, we determined that BBBSA was in material non-compliance with the majority of the grant requirements we tested. . . . As a result of these weaknesses, we
Should an organization choose to form affiliate branches or coordinate with independent local chapters, it is essential for all participants to appreciate the benefits and goals of the structure. In “nested governance,” Bradshaw and Toubiana (2014) call for using a systems approach to remedy what they identify as “spatial blindness” (lack of awareness of how the federation’s parts fit together) and “temporal blindness” (lack of appreciation for the organization’s history and current needs): “A systems view calls on board members at all levels to see the whole system and their parts within it, and to work for the good of the system overall. It encourages members at all levels of governance to consider how they fit – in both an historical context and in the broader system, and how they are all accountable to the whole.” See generally Fernandez (2008).

Part III.C, below, considers federal tax law, which exercises significant influence over an exempt organization’s reputation through the public nature of the information return (Form 990). (See generally Brody 2012.)

III. Legal Framework

Two basic types of state-level legal regimes are available to accommodate the different structures described above: organizational law and contract law. Moreover, an association can make use of both. For example, property ownership – not just as to real estate and financial assets, but also including the right to use a name – can be determined either by the organizational documents or by agreement (such as a licensing contract), or some assets can be governed by one mechanism and others by the other.

In any type of affiliation, whether by membership or contract, the desired relationship should be clearly defined and potential conflicts anticipated. (By contrast, when a single legal body’s chapters have no individual legal status, the boards of the local chapters are advisory only.) Ideally, decisions intended to be legally binding about voting and election procedures, ownership, control, the collection and sharing of revenue, and disaffiliation and dissolution should appear in articles of incorporation, bylaws, affiliate charters, and policy statements – or in contracts of affiliation – all of which should be internally consistent and updated as necessary. Separately, franchise law might

questioned $19,462,448 in funding that the grantee has received and recommended the $3,714,838 in funds not yet disbursed be put to better use.”
apply. Finally, the Internal Revenue Service is particularly concerned about the lack of transparency of “group returns.”

A. Organizational Law

A federation can be achieved through membership in nonprofit corporations or through the less accommodating combination of partnership and contract laws that apply to unincorporated nonprofit associations.

As a preliminary matter, a U.S. nonprofit corporation is not required to have members, and most U.S. charities – as distinct from mutual-benefit organizations – lack members in the legal sense. (A memberless charity is an alien concept to many European and other regimes (see Brody 2008).) The memberless option allows the charity to vest control in a self-perpetuating board without having to designate those same persons as the charity’s members. A charity may convert from a membership structure to a memberless structure through an amendment to the appropriate article or bylaw, provided that the affected members approve any such amendment as required by law and the organizational documents.

In a legal system that prohibits a nonprofit corporation from issuing stock (as most state statutes do), membership is the mechanism by which one nonprofit organization maintains formal control over another nonprofit corporation.5 U.S. law permits the nonprofit organization and its stakeholders to determine the tightness of affiliation and locus of control to best further its mission (see Brody 2008): A nonprofit’s members are entitled to voting rights as provided by its organizational documents, and voting rights need not be uniform across classes of members. A few state nonprofit corporation statutes provide detailed language for memberships organized by units.6

“Most state statutes contain few, and sketchy, provisions about associational rights as

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5 See Webster (2013) at § 5.03 (advocating making a nonprofit “parent a member, with full membership rights, of the subsidiary and [i] referencing this in the articles of incorporation. This is a status that guarantees certain rights under State law and cannot be unilateral changed by the subsidiary.”). See also Jacobs (2007, with Supp.), at ___.
6 See 15 Pa. C.S. §§ 5511 (permitting nonprofit corporations to establish and terminate subordinate units), 5754 (permitting nonprofit corporations to group its members into local units, and providing for equal voting power for each unit as a default); Mich. Comp. Laws § 450.2443 (permitting nonstock corporations to group their members into local units and addressing the units’ powers, rights, and privileges in electing representatives or delegates).
such. Provisions as to voting, qualifications, office holding, and the like, of course are part of associational rights. But little is said, usually, about such things as discipline or expulsion of members” (Oleck and Stewart 1994, at § 355). See discussion below.

Using separate corporations for activities conducted in different localities generally permits the group to confine legal liability to a misbehaving member.7 However, placing assets in separate nonprofit corporations can make it difficult for the group to allocate and reallocate resources.8 Moreover, parent-subsidiary membership structures can complicate fiduciary obligations for directors of both corporations, and can raise the possibility that the sole member (“parent”) owes fiduciary duties to the “subsidiary.” Although the law is generally untested, these complications can likely be reduced by formally aligning the purposes of subsidiary bodies with those of the parent or by adopting a single purpose for every member of the group. A desire for certainty in membership structure might dictate where to incorporate, since the law of the state of incorporation generally governs matters of internal affairs.9

Typically, a federation’s organizational documents require the affiliates to abide by the central body’s policies, such as regarding investment practices, accounting methods, conflicts-of-interest, and whistle-blower procedures and protections. The central body might also require the submission of annual financial reports (often including proof of an annual independent audit), as well as such other information required for the central body to file a group Form 990 if the affiliate is included in a group return (discussed below). See generally Glassie (2004), who cites as necessary components of an agreement: rights of approval; tax-exemption stipulations; quality

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7 See Dilgard, Korman and Gerhart (2011) (discussing liability exposure from application of “piercing the corporate veil” under the common law and other theories that collapse insufficiently-independent exempt organizations, as well as “single employer” determinations under labor and employment law).

8 For example, applying a Florida statute prohibiting distributions to members (and others) prior to liquidation, the state attorney general invalidated a charity’s bylaw that provided for operating distributions to a member that was itself a charity. (Op. Fla. Att’y Gen., No. 99-23, 1999 Fla. AG LEXIS 23, April 30, 1999.) The governor then vetoed a bill amending that statute to allow for such distributions. See Veto Message of Gov. Jeb Bush, May 20, 2004, available at www.vote-smart.org/veto_letters/pdf_bush_fl_sb2056.pdf (“Although this bill is well intended, the potential for broad unintended consequences outweighs the narrowly aimed benefits.”)

9 For example, Wisconsin Statutes § 181.1302 authorizes the purchase of memberships, as well as “a distribution or other payment to another domestic or foreign corporation,” if the members are exempt from taxation under Internal Revenue Code § 501.
standards; intellectual property protections; board representation; and various financial issues. The arrangement should also clearly delineate matters of ownership and control. For detailed legal analysis, see Webster (2013, at § 2.12, and §§ 5.01 et seq.), discussing the contractual relationship, governance, trademark issues, tax issues, antitrust issues, territorial and price restrictions, political activity, disaffiliation, and liability of a parent association for a chapter’s conduct, and providing a sample charter.

Members generally have standing to bring suit regarding their status (although courts will not hear disputes over an organization’s doctrine). For example, one court found that a federated group’s organizational “markers of autonomy” gave a local chapter standing as an unincorporated association with “sufficient separate existence” to sue the state body. While nonprofits generally have wide latitude to determine procedures for member discipline and expulsion, members enjoy minimum standards of fair process: some form of notice, opportunity to be heard, and unbiased decision-making. For the text of the various state statutory provisions relating to disciplining nonprofit members, directors, and officers, see Malamut (2009). Because association cannot be compelled,

10 Craine v. NYSARC, Inc, 931 N.Y.S.2d 143, 144-45 (N.Y. App. Div. 2011). The court explained (at p. 147): “Defendant recently reevaluated its corporate structure because of concerns about the potential that defendant or its chapters could be held responsible for liabilities of another chapter. The Chapter objected to defendant’s proposed restructuring and, instead, sought defendant’s approval to incorporate separately while continuing a relationship with defendant on a contractual basis.” But on the merits, compare Resource Center v. NYSARC, Inc., 905 N.Y.S.2d 806 (N.Y. App. Div. 2010) (based on provisions of the bylaws and rules that all property acquired by separately incorporated chapters is held in trust for the state organization, determining that all of the chapter’s assets and programs are owned by the state in the event of disaffiliation).

11 See Lane v. Sierra Club, 183 Misc. 2d 944, 952 (Sup. Ct. 2000) (nullifying suspension of a member of a local chapter where charity failed to provide timely notice and an opportunity to be heard, as the bylaws required); People ex rel. Holmstrom v. Independent Dock Builders’ Benevolent Union, 149 N.Y.S. 771, 774 (N.Y. App. Div. 1914) (summarizing the rule as “has the member received fair play? If so, the court will not substitute its judgment for that of the organization.”); King v. Grand Chapter of Rhode Island Order of the Eastern Star, 919 A.2d 991 (R.I. 2007) (the issue not being whether the organization “had reasonable rules with regard to discipline, but whether [the organization] applied those rules arbitrarily and capriciously”).

12 California Corporations Code § 5341(b) requires that any “expulsion, suspension or termination must be done in good faith and in a fair and reasonable manner,” and sets out minimum procedures. Similarly, the Revised Model Nonprofit Corporation Act § 6.21 (1987) requires “procedure[s] that [are] fair and reasonable and carried out in good faith,” and provides a safe harbor. The Model Nonprofit Corporation Act, Third Edition (2008), though, eliminates both the explicit requirement of fair and reasonable procedures and a safe harbor; its § 6.21(a) allows membership termination or suspension “for the reasons and in the manner provided in the articles of incorporation or bylaws.”
a member may resign at any time, but whether a former member owes contractual obligations and owns property (including the name) are questions separate from status.

These rules apply whether the member is an individual or an entity. Widmer and Houchin (1999, p. 11) found that “[i]n many cases it was difficult to determine the consequences to local affiliates that choose to disaffiliate.” As a formal matter, they noted (at p. 12): “Most of the 48 sets of bylaws that we reviewed contain measures for the national to ‘disaffiliate’ a local, and a few specify that when such action is taken the local must dissolve and assets revert back to national. However, few bylaws describe the procedures a local must follow in choosing disaffiliation, and a third (16) made it clear that disaffiliation was not the choice of the local. The remaining two-thirds (32) apparently permit disaffiliation. In a few cases disaffiliation has raised complex legal questions which are currently being tested in the courts.” That study (at p. 21) also found differences in governing structures and autonomy; in 40 percent of the organizations, dual or shared governance resulted in conflicts. A decade later, Peregrine and Schwartz (2009) noted “the tension emerging in the traditional ‘headquarters/regional chapter’ corporate structure applied by many large national charitable organizations. In recent months, each of the American Lung Association, Make-A-Wish Foundation, and the American Civil Liberties Union have been forced to take action to address (by dissolution or disaffiliation) allegedly ‘rogue’ or other noncompliant action by a regional chapter.”

B. Federal Antitrust Law and State Franchise Law

Antitrust laws, which bar restraints on trade and attempts to monopolize a product in a market, apply not only to such mutual-benefit nonprofits as labor unions, trade associations, amateur athletic associations, professional regulatory associations, but also to commercial charities (notably nonprofit hospitals) and universities. (See Tenenbaum (2002), covering antitrust, negligence (liability to third parties), due process,  

13 In the accreditation context, see, e.g., *Vanderbilt Museum v. American Association of Museums*, 113 Misc.2d 502, 514-15 (N.Y.Sup. 1982) (requiring a museum accrediting association to abide by its own procedures as well as “fair play” in refusing reaccreditation of “evident economic impact” to a member museum). But see *Marjorie Webster Jr. College, Inc. v. Middle States Association of Colleges and Secondary Schools, Inc.*, 432 F.2d 650, 655-57 (D.C. Cir. 1970) (declining to engage in even the limited minimum standards of fairness inquiry and deferring to the accrediting association’s judgment regarding the applicant’s suitability).
defamation, and compliance with the American with Disabilities Act compliance, and Tenenbaum’s similar publications available from the American Society of Association Executives.)

The application of state franchise law to federated nonprofits traces to a single dispute, *Girl Scouts of Manitou Council, Inc. v. Girl Scouts of the United States of America, Inc.*, 646 F.3d 983 (7th Cir. 2011) (discussed further in Part IV.D). Reversing the trial court, the Seventh Circuit applied the Wisconsin Fair Dealership Law to the group’s decision to merge one Wisconsin council into another. The court (at p. 987) observed that the Manitou Council “derives about two-thirds of its income from sale of Girl Scout cookies and merchandise” under a license from the national organization:

> [O]ne doesn’t usually think of nonprofit enterprises as being “commercial” and engaged in “business.” Or didn’t use to . . . Sales of merchandise account for almost a fifth of the national organization’s income, and most of the rest comes from membership fees and thus depends on the success of the local councils in recruiting members; that in turn depends on the councils’ revenues and thus gives the national organization an indirect stake in the cookie sales. The national organization describes its reorganization of the local-council structure as “a key component” of its “Core Business Strategy.” From a commercial standpoint the Girl Scouts are not readily distinguishable from Dunkin’ Donuts.

In ruling against the national body, the appellate court commented (at p. 989): “stripping a dealer of territorial exclusivity granted in the dealership agreement would be an example of such a change [in the competitive circumstances of the dealership].”

Subsequently, Manitou Council’s attorneys wrote (Leydig and Gordon (2012, at p. 190): “Wisconsin’s law is not unique. . . . [W]e identify the many statutes having franchise or dealership laws of general application. Applying the lessons learned from *Girl Scouts* to these statutes reveals that no state’s law excludes nonprofits from their coverage.” They explained (at 190, footnotes omitted):

> [State statutory] protections include the franchisee’s right to be terminated only for good cause; the right to have the franchise renewed unless good cause grounds exist for nonrenewal; the right to receive notice of defaults and the opportunity to cure those defaults to avoid a termination or nonrenewal; and the right to injunctive relief, damages, and attorney fees if the statute has been violated by the franchisor. Typically, any attempts by the franchisor contractually to draft around these or other rights created by the statute are declared void as
against public policy.”

They identified 15 states that imposed a “second layer of regulation, . . . in the form of statutes that require franchisors to make robust disclosures to prospective franchisees in advance of offering the sale of a franchise. . . . All but two of these laws also require franchisors to file and register an offering circular with the relevant state agency in advance of soliciting prospective franchisees.” Finally, they discuss a “third layer of regulation . . . at the federal level via application of the FTC Franchise Rule. . . .”

But compare a dispute involving an international professional tennis association incorporated as a non-stock (nonprofit) membership corporation in Delaware. When ATP Tours’ board voted to change the tour schedule and format, ATP downgraded the Hamburg tournament from the highest to the second-highest tier, and moved it from the spring to the summer season. The unhappy members who owned that tournament sued ATP and six board members in Delaware federal court, alleging both federal antitrust claims and Delaware fiduciary duty claims. Based on an instruction on the “single entity or enterprise defense” – that where entities “are commonly controlled or substantially integrated in their operations, they may be considered a ‘single entity’ or ‘single enterprise’ under the antitrust laws” – the jury found that the plaintiffs failed to prove that ATP “entered into contract(s), combination(s) or conspiracy(ies) with any separate entity or entities.” The Third Circuit Court of Appeals affirmed. *Deutscher Tennis Bund v. ATP Tour, Inc.* 610 F.3d 820 (3d Cir. 2010).

C. Federal Tax Exemption: Group Rulings and Group Returns

As illustrated in the examples below, Line 10a of Part VI (Governance, Management, and Disclosure) of the Form 990 asks: “Did the organization have local chapters, branches, or affiliates?” Line 10b asks: “If ‘Yes,’ did the organization have written policies and procedures governing the activities of such chapters, affiliates, and

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14 At p. 192, these authors asserted: “how, in the face of such plain statutory language, could nonprofit franchisors have been so blind to these laws? A cynic might suggest that they were not blind at all but simply chose to look away. Another answer might lie in the FTC’s interpretation of the FTC Franchise Rule . . . Nonprofit franchisors may have been misled to believe that an absence of enforcement by the FTC under the federal rule meant that they were equally excluded from state laws.”
branches to ensure their operations are consistent with the organization’s exempt purposes?” The instructions\textsuperscript{15} to Line 10a explain: “Answer ‘Yes,’ if the organization had during its tax year any local chapters, local branches, local lodges, or other similar local units or affiliates over which the organization had the legal authority to exercise direct or indirect supervision and control (whether or not in a \textit{group exemption}) and local units that are not separate legal entities under state law over which the organization had such authority. . . .” The instructions provide the following example:

\textbf{Example 1.} X is a national organization dedicated to the reform of K. X has affiliates in 15 states which conduct activities to carry out the purposes of X at the state level. X has the authority to approve the annual budget of each affiliate. X must answer “Yes” to line 10a.

The bolded terms are defined at the end of the instructions. Notably, the instructions define “group exemption” as: “Tax exemption of a group of organizations all exempt under the same Code section, applied for and obtained by a \textit{central organization} on behalf of \textit{subordinate organizations} under the central organization’s general supervision or control. See Rev. Proc. 80-27, 1980-1 C.B. 677, Rev. Proc. 96-40, 1996-2 C.B. 301, and \textit{Appendix E. Group Returns—Reporting Information on Behalf of the Group}, for more information.”

This definition contemplates a hierarchical federation. In 1994, the Exempt Organizations Committee of the American Bar Association’s Section on Taxation recommended that the IRS modify Revenue Procedure 80-27 (at least for churches and religious organizations): Instead of requiring the central organization to have “general supervision or control” of subordinates, the central organization would have sufficient “affiliation bonds” enabling it to provide accurate, timely, and regular information to the IRS about the subordinates covered by the group exemption. Similarly, a high-level analysis of and recommendations on group rulings and group returns (ACT 2011, at p. 27) emphasized the purpose behind the IRS’s control requirement in criticizing it:

It is not “supervision or control,” per se, that is important. What is important is that the central organization has sufficient information about the on-going operations and activities of the subordinate organizations so that it may act to

bring non-compliant subordinates into compliance, and if necessary, remove them from the group. . . . In other words, what is most important is that there are structural mechanisms, reporting processes, or a system of oversight that, on the whole, enables the central organization to sufficiently monitor each subordinate’s activities.16

The ACT (at p. 13) noted the particular concern that “central churches and religious associations should not have to represent that they control or supervise affiliated entities, since such representations are frequently used against the central church or religious association in tort litigation.”17

The ACT urged the IRS to keep allowing group rulings, citing the authority of central organizations “to delete subordinate organizations from the group exemption if they no longer satisfy all the requirements to be in the group. This provides for an ongoing level of oversight by the central organization that can be far greater than what would otherwise exist at the IRS level alone” (ACT 2011, p. 20). For many group exemptions, the ACT members (at p. 21) “believe that the initial and ongoing scrutiny exercised by the central organization – which is often concerned with doctrinal or operational consistency, operational focus and/or reputational risk for the group members – is more probing than that of the IRS.”18

Only about 15 percent of holders of group exemptions file a group return for some

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16 The report suggested possible factors (p. 28): the central organization appoints an observer of the subordinate’s board; the “central organization has ownership rights over the property (including rights to the name or logo) of each subordinate organization or requires that the property of each subordinate organization be transferred to the central organization if the subordinate organization leaves or is removed from the group”; each subordinate has substantially similar articles, bylaws and/or corporate policies, or its articles and bylaws must be approved by the central organization; each subordinate organization report to the central at least annually on basic governance, operations and finances (and financial statements, if prepared); each subordinate not included in a group return must provide a copy of its appropriate Form 990; and the central organization has audit rights over each subordinate and its operations.

17 The ACT report cited Barr v. United Methodist Church, 153 Cal. Rptr. 322 (Cal. App. 1979), “in which the court used, in part, information from a central organization’s group ruling application to hold that the entire denomination could be sued in a dispute involving some retirement homes affiliated with a regional body of the church” (emphasis in the ACT report).

18 However, the ACT (at p. 26) recommended that the IRS provide more guidance to central organizations: “In effect, the IRS has ‘deputized’ central organizations as agents of the IRS, but it has done so without guidance, training, or oversight. In particular, there has been no education or outreach by the IRS to group ruling holders to discuss what constitutes general supervision or control or what are the elements of ‘best practices’ in this area, such as there has been in the past few years regarding governance of exempt organizations.”
or all of their subordinates. (See ACT 2011, p. 9, giving as prominent examples Habitat for Humanity, the NAACP, the International Brotherhood of Teamsters, the Veterans of Foreign Wars, and Rotary International.) These 600 to 700 group returns do not include many affiliated churches; Congress excepts churches from having to file for recognition of exemption, but churches are still subject to the requirements of Code § 501(c)(3).

The ACT (at p. 34) urged the IRS to eliminate group Form 990 returns, which do “not provide the IRS, the states, or the public with adequate transparency about the activities of subordinate organizations covered by a group exemption, or serve as a mechanism to promote adequate accountability by the subordinate organizations on an individual basis.” Alternatively, the ACT recommends requiring group exemption holders to disclose on the Form 990 “information about the composition of the group and how the central organization exercises general supervision or control. . . .” To objections that eliminating group returns would increase filing burdens, the ACT pointed out (at p. 14): “In order to file a complete and accurate group return, the central organization is required to collect the appropriate data from each of the subordinates – in effect, requiring each subordinate to provide the central organization with all of the same information it would need to complete its own Form 990. The central organization is then required to aggregate the data . . . .” See the Alzheimer’s Association example below for a brief illustration of how unhelpful and opaque a group Form 990 can be.

IV. Examples

A. Policy Setting in a Multi-Site Single Entity: Boy Scouts of America

In 2000, by a five-to-four vote, the Supreme Court upheld the constitutional right of the Boy Scouts of America – which was chartered by Congress a century ago – to exclude gay troop leaders. (Boy Scouts of America v. Dale, 530 U.S. 640 (2000).) The BSA’s membership policies constitute expressive activities protected by First Amendment rights of association even though “the organization does not trumpet its views from the housetops, or . . . it tolerates dissent within its ranks” (id. at p. 656).

Epstein (2000, p. 127) explained the BSA’s reluctant expression: “Consistent with the demands of its broad membership base, the Boy Scouts’ general philosophy is a model of diffidence, evasion, and restraint.” He elaborated (at pp. 128-29): “no one should think
for a second that the Scouts’ bland declarations represent a lack of understanding, conviction, or foresight. Rather, they represent the kind of studied compromise that a large and successful organization must make to stave off schism or disintegration.”

To supporters of the Supreme Court’s decision, someone barred from one association can simply join or form another. Of course “switching” is not cost-free, and this approach ignores the high social and emotional (if not economic) costs of both entry and exit. Moreover, some organizations are more desirable to join than others. The bigger the organization, the greater its social legitimacy and the better the network effects. (See Lemley and McGowan 1998, pp. 551-61. Consider, too, the often-overlooked “loyalty” aspect of Albert Hirschman’s trilogy.) Besides a new entity’s “liability of newness,” a start-up scouting group would lack the considerable support from all levels of government enjoyed by the BSA and local troops. On the other hand, as Daniel Farber describes (2001, p. 1506), a tent can be too big: “People may sometimes prefer smaller or more exclusive groups, and find it distasteful to be associated with strangers or individuals with characteristics they regard as undesirable.”

The Supreme Court’s close decision in Dale might have ended the legal battle, but the dispute immediately and loudly shifted to the private and political arenas (see Brody 2002b, pp. 854-56). Within the first year, some parents withdrew their sons from the Boy Scouts; some municipalities sought to terminate the Scouts’ free use public facilities (although the No Child Left Behind Act of 2001 blocked federal money for any state or local agency that discriminates against the Boy Scouts of America in providing equal access to school premises or facilities); reform Jewish leaders recommended ending troop sponsorship; and local United Ways debate terminating support. Troops in Oak Park, Illinois, defied the restriction, and were expelled; but a local council in New Jersey agreed with its United Way funder not to discriminate. Newsweek reported that 30 percent of Scout parents disagreed with the discrimination policy, and a new association

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19 See Hannan and Freeman (1984, p. 157) (“It takes time for an organization to acquire institutional reality to its members and to become valued in its own right”); and at p. 158 (“Old organizations tend to develop dense webs of exchange, to affiliate with centers of power, and to acquire an aura of inevitability.”).

20 See, e.g., Boy Scouts of America v. Till, 136 F. Supp. 2d 1295, 1311 (S.D. Fla. 2001) (enjoining Boy Scouts from using Broward County schools during off hours, because exclusion was not content neutral).
for boys that does not discriminate against gays sprang up. Subsequent years have brought the Boy Scouts continuing challenges, spurring the Boy Scouts to consider a change of policy.

In May 2013, with 61 percent of the vote (757 out of 1,232) the national board of the Boy Scouts of America adopted changes to its membership requirements that distinguish between gay troop members (allowed) and gay adult leaders (not allowed). A year later, the New York Times described the membership change as having “brought the Scouts only more ire from all directions and produced a house divided.” Besides the cumbersome compromise (“with an 18th birthday dividing the two”), the Times identified the following legal and reputational challenges: State judges in California might be barred from involvement with the Boy Scouts under a proposed change to the rules on judicial ethics, which currently exempts “nonprofit youth organizations from its ban on participating with groups practicing ‘invidious discrimination’”; the county attorney in Louisville declared an end to contributions “because the organization violated the city’s antidiscrimination policy”; and “of the dozen or so major corporations and foundations, from Alcoa to Intel, that dropped funding for the Scouts last year under pressure from gay advocacy groups like the Human Rights Campaign, none have reopened wallets under the new policy. . . .”

The BSA’s second largest activity is “[s]upport for local councils, including but not limited to, administration of standards of performance, inspection of council campsites, assistance with long-range planning, conduct of regional training and conferences for professionals and volunteers, administration of an extensive program of local council financial support, and administration and funding of the defense of our

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22 Kirk Johnson, Compromise on Gays Pleases No One, Scouts Are Learning, N.Y. Times, May 9, 2014, at A16.
private membership rights.”23 The BSA’s 2011 Form 990 (Part VI, Lines 7 and 10) states that it has no members in the legal sense, but that it does have local chapters, branches, or affiliates. I cannot ascertain who voted on the policy resolution described above – the governing board has 60 members, not 1,200!24

**B. Group Return Filed by Local Members: The Alzheimer’s Association**

As described on its website, the Alzheimer’s Disease and Related Disorders Association, Inc., “works on a global, national and local level to enhance care and support for all those affected by Alzheimer’s and other dementias,” and it has “local chapters across the nation, providing services within each community.” The Form 990 filed for year-end June 30, 2013 states that of its $144 million in gross receipts (Line G), $13.8 million is “due to chapters” (Schedule D, Part X, Other Liabilities).25 In the governance portion of the return, the Alzheimer’s Association states that it does not have voting members, but that it does have chapters, branches or affiliates (Part VI, Lines 7 and 10). Schedule O explains, in identifying board committees, that the Association has a “chapter relations committee which shall recommend and monitor consistent, predictable and accountable board policy in affiliate relations.”

Separately, the Alzheimer’s Association posts to its website the group return filed by its 39 chapters.26 This group Form 990 reports aggregate gross receipts of $77.4 million (Line G) and a combined 639 governing board members (Part VI, Line 1a). Additional data in the return is similarly opaque.

**C. Independent Entities Federated by Name License: United Way**

In the last two decades, press coverage of the United Way system focused most

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24 A note on operational risk in the Consolidated Financial Statements, available at the end of the 2013 Annual Report (go to [http://www.scouting.org/filestore/annualreport/2013/324-168_WB.pdf](http://www.scouting.org/filestore/annualreport/2013/324-168_WB.pdf)), describes the May 2013 vote and states: “Membership, charitable contributions, litigation, and insurance coverage related to these matters have been adversely impacted. However, management does not consider the impact to be material to the financial statements.”


widely on two scandals, one at the national level and one at a local level. In 1995 William Aramony, chief executive of United Way of America, was convicted on twenty-five counts of fraudulently diverting over $600,000 of UWA dollars to personal use and filing false tax returns, and served several years in prison. The scandal triggered a rebellion in the ranks of the local, independent United Ways. Initially, about 750 of them withheld their voluntary payments to the national. As a governance matter, however, Aramony had his supporters: One long-time United Way executive said, “When Aramony took over, we were a very weak movement and we did not have a common name in the field” (Medillo 1992). A decade later the New York Times and the Washington Post trained a spotlight on the scandal involving the United Way of the National Capital Area, resulting in another criminal case and, at least initially, the reaction by area corporations to cease workplace fundraising for the charity.

In response, the United Way issued “upgraded” accountability and financial standards requiring its then-1,350 local affiliates to, among other things, “provide the national headquarters with annual financial-data-reports.” The United Way’s purpose is now stated as enhancing its reputation in the community and promoting its overall mission through good governance and various volunteer activities at the local level.

But the United Way was not done. The last ten years have seen the overhaul of the entire United Way Worldwide (UWW) organizational structure, and the mission today focuses on three goals: education, income security, and health. Since 2002, the

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27 See United States v. Aramony, 88 F.3d 1369 (4th Cir. 1996) (affirming most of the convictions, but remanding for sentencing).
28 Debra E. Blum, Held to a New Standard, Chronicle of Philanthropy, April 11, 2005.
30 United Way Worldwide Bylaws (as amended and restated April 18, 2013), Article V, provides: “There shall be a single member admitted into membership from each country, except in 1) the case of the U.S. where all UWA members shall remain members until a U.S.A. national member is established (at which time all U.S. members of UWW shall become members of the U.S.A. national organization). . . .”
31 For the consequences to charities falling outside these focus areas, see Elizabeth Schwinn, Charity’s Cutting Edge, Chronicle of Philanthropy, Aug. 21, 2008 (“many organizations that have been longtime beneficiaries of United Way are now scrambling as the organization changes how it distributes aid and slashes or eliminates assistance it once provided”). But see Pablo Eisenberg, United Way’s New Approach Deserves a Try, Chronicle of Philanthropy, August 21, 2008 (“In pushing these plans to transform United Way, [president and CEO Brian] Gallagher and others are acknowledging that United Ways’ old role of raising and distributing money to a wide variety
organization streamlined the number of local United Ways, reducing membership from 1,440 to 1,140. The bulk of the reduction was through expulsion for non-performance; about 40-50 percent of the reduction was through consolidation (most of them voluntary) of overlapping and small bodies into more efficient locals.32 Notably, in 2003, the United Way orchestrated the largest nonprofit merger in U.S. history by combining 52 United Ways in Chicago and suburban Chicago into the United Way of Metropolitan Chicago (of its four members, the Chicago Committee has 45% of the vote and the suburban districts have 55%).33 While the national body facilitated and funded the planning process, the affected locals designed and approved the ultimate plan.34

UWW imposes and enforces its standards on local bodies both through criteria for their membership and through the licensing agreement. Members have the rights to vote for the board and on other issues, including proposed bylaw amendments; to use the UWW’s service and membership marks in accordance with the bylaws; to “receive an established level of services for base membership fee and to purchase additional services for designated fees”; and to receive UWW’s annual audits and financial statements. Because each member is an independent legal entity, a disaffiliated member keeps its property, but cannot thereafter use the brand. The former affiliate also loses access to the corporate and governmental funding that is made to and distributed by the national body.

Article VI of UWW’s bylaws addresses membership requirements, rights, and termination. Members must meet criteria relating to legal compliance, governance, ethics, operations, distribution and use of funds, financial accountability, “global standards” and “system citizenship,” and brand and reputation. These last provisions are stated both positively – “Protects the name and reputation of United Way organizations through responsible and ethical behavior and practices. Follows all trademark requirements and guidelines as set out in any specific license agreements.” – and negatively – “Members shall refrain from taking any actions or conducting activities

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32 Telephone conversation with Brian Gallagher, United Way Worldwide (May 19, 2014).
34 When the parties balked at approving a close-to-finished plan, Brian Gallagher threatened to recommend pulling all of their licenses. (May 19, 2014 telephone conversation with the author.)
likely to damage the welfare, interests, or reputations of the United Way system.” U.S. members must adhere to specific reporting requirements, as well as satisfy state and federal law and filing obligations; “provide financial support to United Way Worldwide in accordance with the agreed-upon membership investment formula”; and “conduct and submit to United Way Worldwide every three years a community-driven self-assessment of their community impact work, financial management, and organizational governance and decision making.”

A four-page United Way Worldwide License Agreement (2013) “confirms in writing the terms of your organization’s rights to use certain registered trademarks of United Way Worldwide (UWW) as a United Way member organization (UWMO) in good standing.” The first term provides: “This License is royalty-free, exclusive and for the geographic area assigned to UWMO . . . .” The fifth term provides: “UWMO shall use the Licensed Marks only in connection with its charitable fundraising, resource allocation to social service organizations concerned with health, welfare, recreation and other human care services, community impact and public education activities and not for any other services, products or purposes not expressly provided for herein.” The seventh term provides: “The Marks shall be used according to the policies, quality and graphics standards set forth in the United Way Brand Identity Guidelines that form a part of the UWW annual membership package, . . . which are subject to revision from time to time. UWW shall have the right to reasonably verify UWMO compliance with the terms of this License.” The license also addresses cause-related marketing (prohibiting product or service endorsements; excluding partnerships with alcohol, tobacco, firearms, adult entertainment, and gambling activities; and requiring the marketing arrangement to “disclose to donors the amount/percentage of purchase or funds to be donated to UWMO”) and Internet use of UWW marks.

UWW’s process for disciplining its U.S. members appears in a separate document.35 The board’s U.S.A. Membership Accountability Committee monitors “U.S. member compliance and makes recommendations to the U.S.A. National Board on issues related to both initial and sustained membership,” expressly including probation or

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35 United Way Worldwide, Membership Status Review Procedures for Current U.S.A. Members, as revised June 13, 2012 (provided by Brian Gallagher to author).
termination. The committee must notify the affected member if it decides to investigate possible noncompliance. “All inquiries and deliberations shall be conducted in confidence and with objectivity. Formal hearings shall not be held and the parties are not expected to be represented by counsel before any reviewing body. Members under review may elect to submit a written statement to the Committee for its consideration.”

The committee then reports to the U.S.A. Board, which “may accept, reject, or modify the Committee’s recommendation . . . .” Probation (with guidance on how to come into compliance) or termination may be imposed “provided the sanction applied is reasonably related to the nature and severity of the non-adherence, taking into account any remedial measures that have been taken by the member.” A terminated member loses membership benefits, including use of the United Way name and logo, “and shall not be entitled to any refund of any membership investment paid to date.” Termination for failure to pay dues or to submit membership certification materials is not appealable (although a two-week grace period applies). A member terminated for any other reason may appeal, in which case the U.S.A. Board would appoint an appellate body of three to five persons (at least one of whom must not be a UWW staffer or volunteer) to review whether the determination “was inappropriate due to (1) material errors of fact or (2) failure of the review committee or Board to conform to published criteria, policies or procedures.”

NYU (2005)’s study of self-regulation and certification by private accrediting associations includes two same-name federated bodies. Writing of the United Way of America (as it was then known), the study (at p. 10) finds: “The UWA certifies local United Ways for membership and can revoke or deny membership to organizations not meeting its Accountability and Financial Standards. This self-regulatory scheme is effective because (1) the sanction of revocation of membership and the right to use the ‘United Way’ name is real and enforceable, (2) membership is important to funders, and (3) 59 local United Ways have lost membership since 2003, creating a genuine threat of enforcement.”36 The NYU study comments: “Sanctions are not publicly disclosed. However, upon termination, a local United Way may no longer use the United Way logo

36 By contrast, the study (at p. 9) writes of the National Council of YMCAs of the USA, that the “effectiveness of this self-regulatory scheme depends on the fact that an unaccredited organization cannot use the YMCA name. Its effectiveness is limited by its lack of robust process.”
or be listed on the UWA website.” Today, a password is required to access much of the material on the United Way’s website relating to the licensing of its brand to affiliates.37

The United Way focuses intently on protecting its “brand,” a term it embraces.38 Its website highlights its appearance on Forbes’ 2010 list of “The World’s Most Valuable Brands,” which found:39

The United Way is the only nonprofit that makes our list, coming in at No. 26 with a brand value of $14.3 billion. The United Way was founded in 1887 and is made up of 1,800 local United Way chapters in 45 countries and territories. . . . [W]ith $4 billion in annual donations, the United Way is twice the size of the next biggest charity, the Salvation Army.

United Way of America CEO Brian Gallagher has transformed the century-old charity since he took over in 2002. At that time 50% of local United Ways defined fundraising as their primary objective, with the rest focused on community impact. Today 90% of United Ways are focused on community impact. In 2008 Gallagher announced a new plan to refocus the organization on three core issues: education, income and health, with specific metrics for measuring success in each area.

D. Application of Franchise Law to Federation: Girl Scouts of the USA

In 2010 a Girl Scouts of the USA press release announced a “national brand initiative,”40 quoting its chief executive officer: “A revitalized and energized brand is absolutely essential for us and our future growth . . . . We have literally revamped our entire organization to appeal to that 90 percent of girls who aren’t benefiting from the

37 Similarly, with respect to the YMCA, the NYU 2005 study found: “These disciplinary actions are listed on a members-only website.”
38 If you go to http://online.unitedway.org/login/?ReturnURL=%2Fsite%2Fuwaservices%2Fbrand%2Fwelcomet obrandmanagement%2Findex%2Fecfm, clicking on “online.unitedway.org/brand” will take you to a password-protected site. However, a 64-page document Live United®: Message Platform Communications Guide (2011) is publicly available at http://online.unitedway.org/site/uwaservices/brand/assets/liveunited/documents/BL-0811-MessagePlatform_lo-res.pdf. Page 7 begins with: “‘Advancing the Common Good’ is a compelling, research-based phrase to communicate the brand position.”
Girl Scout leadership experience. And with our new brand work, we think we have the right message at the right time.” Rebranding was “in the works as part of the organization’s comprehensive transformation that began in 2004,” the press release continued, quoting the GSUSA’s chief marketing officer: “To some degree, our brand had faded and our research revealed that while many girls and parents knew about us, they had a very limited view of us. While we are proud of our $700 million cookie business run by girls, we offer so much more than that, and this new work is designed to let people know about all the new and exciting things girls do every day as Girl Scouts.” In this restructuring, the Girl Scouts “realigned its federated system of 312 councils to 112. Those councils now operate with bigger budgets and are able to draw on economies of scale. . . . Girl Scouting is launching its rebranding from a position of strength because it can draw upon strong name recognition and a long legacy of leadership development.”

In the litigation brought by the squeezed-out Manitou Council, the trial court (reversed by the decision described in Part II.B, above) had held that Wisconsin lacked the compelling state interest needed to impose its franchise law on the constitutional rights of the Girl Scouts. Citing the Supreme Court’s decision in Boy Scouts of America, among other decisions, the lower court declared: “the First Amendment provides expressive associations the right to organize and direct them[elves] in the way that will make them most effective, protecting such groups against a substantial intrusion into the internal structure or affairs of an association.”41 The trial court ruled that preventing the realignment plan from taking effect was a “direct affront to the Girl Scouts’ reasoned efforts to organize and direct itself in a means that it judges most effective in proclaiming its expressive message.”42 As to the local council’s argument “that GSUSA’s realignment plan is a poor means to achieve the Girl Scout’s broad goals and that the empirical data does not support GSUSA’s need to realign, . . . it is not for the courts to mediate the merits of [the] dispute, as the court must afford deference to the expressive organization’s determination as to the best way to organize itself.”43

42 Id. at 1088.
43 Id. at 1090 (internal quotation marks and citation omitted).
Ironically, the Manitou Council had benefited significantly from the Girl Scouts’ last major structuring. As described on its website, beginning in 1957 “Girl Scouts of the USA’s national council voted that a ‘council coverage plan’ should be initiated nation-wide to ensure that no matter where a girl lived, she would be ‘Under the Green Umbrella’ of a Girl Scout council . . . . Due to that initiative, from 1963 to 1966, the many community councils in Sheboygan and Ozaukee Counties voted to join forces with the Manitou Council serving girls in Calumet and Manitowoc Counties.” Compare an unsuccessful New York case brought by an unhappy council merged out of existence in that earlier effort:

The council coverage plan was adopted when local councils were 1,609 in number with 6,794 lone troops without council supervision, and an estimated 12,000 communities in which no Girl Scouting existed and nearly half of all the girls in the country lived in rural areas where few troops were available. Thus it is contended that it became evident that an orderly program of internal reorganization and realignment was indispensable. The merger of existing councils and lone troops into larger units was considered the method to be preferred over a solution by increasing the national budget staff and services to serve the then existing councils and lone troops which varied in size, kind and in need of services.

The “Workbook” prepared for the 1957 annual meeting of the Girl Scouts’ national council explained: “the achievement of the ultimate goal of serving girls only through strong councils will require some change in jurisdiction for nearly half of all presently chartered councils. Among these councils are some that would prefer to remain unchanged. If acceded to, such a preference, while understandable, would make full achievement of the coverage program impossible.” The national council did, though, adopt a resolution granting the right of a hearing by the board, before taking final action, to “any council refusing to participate in an enlarged or changed jurisdiction which had been agreed to by a majority of other councils or communities concerned.” The court ruled that the unhappy local council here was offered and received a “full and proper” hearing, concluding: “In view of these facts, and of the further fact that this was by a

44 [http://www.gsmanitou.org/who-we-are/making-history](http://www.gsmanitou.org/who-we-are/making-history).
46 Id. at 793-94.
stipulation in the effectuation of the over-all national policy, to which no objection has been raised, to direct a further hearing or the taking of any other action would be futile.”

The Seventh Circuit’s decision in 2011 applying franchise law attracted immediate and harsh criticism from the nonprofit bar. One law firm observed: “The general structure used by the GSUSA is a common one for nonprofit organizations creating affiliate networks. It provides liability insulation, assures fidelity to mission, enhances the reputation of the organization, and clarifies governance at the local level. The imposition of state law franchising schemes, each with a particular set of requirements, parts of which are antithetical to the general affiliation structure and which otherwise are designed to address historical commercial over-reaching by some franchisors, is a new and unexpected element in these relationships.” Advising such groups to “re-emphasize mission over margin in the implementation of the structure,” they conclude: “No nonprofit should have to suffer the fate of GSUSA, painted in the decision not as a life-shaping program for so many young women across the United States, but as a money-making organization more intent on promoting cookie sales.”

The attorneys who had represented the victorious Manitou Council (Leydig and Gordon 2012, p. 197) suggested that the GSUSA could have avoided application of the Wisconsin Fair Dealership Law and “ensured its absolute control over local operations” by choosing a different organizational model: “Rather than establishing councils as independent franchisees or dealerships, the councils could have been established as wholly owned subsidiaries of GSUSA or as GSUSA’s branch offices.” They argued:

The benefit to GSUSA in choosing a franchise format was that it was able to

47 Id. at 796.
48 For analysis of this case and recommendations about potential issues regarding the structure and operations of federated nonprofits, see the webinar video and slides available at http://www.venable.com/nonprofit-chapters-and-affiliates-key-legal-issues-pitfalls-and-successful-strategies-07-12-2012/.
49 Michael J. Cooney and Arthur L. Pressman, Nonprofit Organizations Alert (June 8, 2011), at http://www.nixonpeabody.com/118728. “Moreover,” they add, “Manitou raises the question of whether nonprofits such as GSUSA must now comply with the Federal Trade Commission Rule on Franchising and state laws governing pre-sale disclosure and registration. The application of such regulations to nonprofits has the potential to be far more burdensome than the application of the WFDL because of the frequency with which offer and sale issues arise.”
expand its branded services throughout the country without expending its own capital and without assuming the business risks and expenses assumed by each of the independent councils, including the expense of acquiring and maintaining enormous real estate assets, the risk of personal injury claims by campers at the hundreds of independently owned and operated Girl Scout camps, the payroll and insurance costs associated with large staffs, real and personal property lease expenses, and every other risk and expense associated with owning and operating an independent business.

By contrast: “The franchise laws offer a fairly straight-forward trade-off: if the brand owner wants to have another party assume these significant financial obligations and risks, then full disclosures regarding the nature of the business need to be made up front and, in those states with relationship laws, some level of reasonableness or good cause will be required before the investment of the franchisee or dealer can be lost through termination or nonrenewal. It is a trade-off entirely within the control of the brand owner.”

Some observers may be startled by how much nonprofit governance is influenced by business practices (although the complaint is not so new; see Brody 1996). Perhaps the modern terminology, with its emphasis on brand and efficiency, can induce a court to think of nonprofits and just another form of commercial enterprise. But Judge Posner – who wrote the inexplicably awful (from a legal perspective) appellate court decision – is well attuned to the issues of nonprofit association. The GSUSA’s local councils (including the Manitou Council) are its voting members. Even if franchise law properly applies to nonprofits federated only by contract, how can it apply to a membership organization that adopts its own rules for internal organization and reorganization?

E. Roll-Up of Local Bodies into Single National: American Cancer Society

The American Cancer Society, which celebrated its 100th birthday in 2013, has been engaged in a years-long fundamental restructuring. Most significantly, the ACS merged its separately incorporated divisions – which chose delegates to the National Assembly, which in turn elected the ACS’s board – into a single, nationwide legal entity with a self-perpetuating board. In successive consolidations, the ACS also streamlined the number of divisions from 57 down to 11; these local boards are now advisory only.
Finally, the ACS halved the size of its board.50

As described in a lengthy Non-Profit Times article,51 the ACS’s transformation “is expected to improve the charity’s ‘decision velocity.’” “The old model was very unwieldy,” the article quoted one division director. “Each division required an executive, an audit, all the trappings of a corporation. . . . We weren’t terribly different but just different enough that we couldn’t optimize how the organization worked internally. . . . Now as a single operating model, ACS can train staff consistently and offer the same tools and resources throughout the country.” (The Non-Profit Times reported, “ACS is at about 72 percent of funding toward mission, and aims to get to 80 percent after the transformation.”) As the article further explains: “In the previous division model, roles were defined by a 60-40 split of revenues (60 percent stayed locally, 40 percent went to the national office).” It quotes the division executive: “We did what we did very often because we had 60 percent of resources.”

By contrast, the new arrangement allows the organization to organize activities without geographic constraints. The ACS’s 2013 Stewardship Report explains (p. 14) that the central office in Atlanta “is responsible for overall strategic planning; corporate support services such as human resources, financial management, IT, etc.; development and implementation of global and nationwide endeavors such as our groundbreaking research program, our international program, and our 24-hour call center; and provides technical support and materials to Divisions and regional and local offices for local delivery.” The report (at pp. 12-13) describes the transformation process, which began with a subgroup “formed to determine a governance structure that would clarify roles, responsibilities, and accountabilities.” In 2011, the national board’s approval of the subgroup’s recommendation for a single-entity model was followed by a 102 to 19 vote of the National Assembly, “thereby immediately dissolving the Assembly as a governing body of the American Cancer Society. Throughout the spring of 2012, each Division

50 See generally http://www.cancer.org/aboutus/whoweare/governance/governance-landing. See also American Cancer Society, Five New Officers Added to American Cancer Society’s Newly Streamlined National Volunteer Board of Directors (Feb. 10, 2014), at http://pressroom.cancer.org/index.php?s=43&item=466 (“The Society made the decision to reduce the board from 43 members to 21 members after a volunteer task force . . . made recommendations to bring it more in line with industry best practices.).
board of directors voted – also by overwhelming majority – to merge with the American Cancer Society, Inc., and adopt this model. . . . The move was no doubt one of the largest nonprofit restructurings of its kind in history.”

Sheffield Hale, the American Cancer Society’s then-general counsel, described (Hale 2011) how “the legacy federated models” holds back “large mature nationwide organizations attempting to deliver mission results on a national or international level”:52

Federated models with their indirect management by a charter or contract and persuasion while superficially attractive as democratic methods of promoting volunteer engagement and often effective with start up grass roots locally focused charities, become increasingly unworkable and ineffective with larger nationwide organizations that must manage large numbers of employees and volunteers and solve complex issues with limited resources. The forces of compliance, cost containment, mission evolution and mission abandonment confronting larger organizations require the adoption of a more robust centrally managed organization.

Notably, in a fragmented group, the process of disciplining or expelling members or enforcing rights as a licensor can be not only slow and cumbersome, but also inadequate to protect property interests – including reputational. By restructuring as a single legal entity, the ACS sacrificed the liability protections of separate incorporation while empowering its board to respond swiftly and directly to hire and fire executives of the local bodies.

Conclusion

Is federation a reputational tool? If the public views federation as a positive signal, it is hard to tell what criteria the public is valuing. Under U.S. law, federation signifies nothing more than affiliation by name. The law does not require that a federation have a voting membership, nor autonomy for local affiliates. The law does not require the central body to set standards for affiliation, or to police those standards in any particular way.53 Beyond minimum standards of fairness the law does not require the

52 In a telephone conversation with author on May 30, 2014, Hale emphasized the importance to the ACS of being able to speak with one voice, giving, as examples, contentious debates over the efficacy of various cancer screening protocols and therapies.

53 But see the rules for “group exemption” and “group returns” issued by the Internal Revenue Service: The central body is supposed to impose and police standards for members of the group.
group to follow a particular process for disciplining institutional members or for expelling them from the group.

Rather, U.S. law offers broad liberty of contract. We apply contract law to the licensing of name and other brand marks, but courts also view association as a specie of contract – a consent of the governed. In general, contract and organizational laws protect the reasonable expectations of the (private) parties. Often-significant interests of third parties are foreclosed by the group’s constitutional rights of association and the limited liability afforded by corporate law to the fiduciaries.

In historical terms, the striking variation among federated organizations in how they structure legal control and ownership of assets – including their name – often traces to whether the federation arose at the grassroots, by local bodies seeking consistency and strength, or, by contrast, from the top down by a regional, national, or international enterprise seeking to tap local volunteers and financial support. However federation arises, in reputational terms sharing a name is a two-edged sword: While affiliation helps start-up or under-resourced, locally based entities overcome the liability of newness, new or small affiliates might be the weakest members of the group, and thus pose a particular reputational threat to the group. The missteps or misfortunes of nonprofits frequently attract media coverage – including, most recently, in social media – making it unlikely that what happens in Vegas stays in Vegas. (See Brody 2002a.) Over time, one might expect a certain degree of institutional isomorphism in response to these pressures, as described by DiMaggio and Powell (1991). The examples in Part IV suggest that, at least some of the largest and oldest federations have been tightening up control of affiliates, if not eliminating their local bodies’ voting rights or even their separate existence.

But in writing this paper, I discovered how difficult it can be to figure out a federation’s organizational structure; in general, federations typically are not organizationally transparent. The 2008 redesign of the IRS Form 990 helps, but much of the relevant information appears only in the organizational documents, which many nonprofits fail to post on their websites. (See Brody 2012.) This paper, which drew heavily from non-public survey data (NYU 2005 and the unpublished American Cancer Society 2011), is unable to make definitive assessments of federated structures. Without transparency, we cannot know whether similar federated NGOs are converging in their
structures, standards and enforcement efforts – and whether the public rewards one form of affiliation (e.g., local bodies as voting members of the national’s board) over others.

If mere federation provides no assurance of particular worthiness, and if the group’s particular governance structure is not visible to the public, can we say that its choice of how to federate (or instead to operate at multiple sites as a single legal entity) directly affects its reputation? A brand name, alone, can signal value without the federation’s necessarily publicizing its inner processes.54 But then once a brand is tarnished, are there particular (and transparent!) ways the federation should restructure to recover?

References


54 I thank Harvey Dale (lead author of NYU 2005) for the point that federating can enhance reputation even if the group does not disclose its standards and disciplinary measures against wayward local bodies.


Rose-Ackerman, Susan. 1980. United Charities: An Economic Analysis. Public Policy
28: 323-__.


APPENDIX A

Selected Data on "Federated" § 501(c)(3) Nonprofit Organizations, Tax Year 2010 Forms 990

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Corp</th>
<th>Trust</th>
<th>Ass'n</th>
<th>Other</th>
<th>Blank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of returns</td>
<td>186,417</td>
<td>165,758</td>
<td>3,684</td>
<td>3,609</td>
<td>4,391</td>
<td>8,975</td>
</tr>
<tr>
<td>Has members</td>
<td>28,320</td>
<td>26,004</td>
<td>950</td>
<td>438</td>
<td>285</td>
<td>643</td>
</tr>
<tr>
<td>Members elect board</td>
<td>31,445</td>
<td>28,186</td>
<td>659</td>
<td>1,107</td>
<td>589</td>
<td>903</td>
</tr>
<tr>
<td>Members approve governance decisions</td>
<td>20,929</td>
<td>18,830</td>
<td>556</td>
<td>298</td>
<td>509</td>
<td>734</td>
</tr>
<tr>
<td>Has chapters/branches/affiliates</td>
<td>8,118</td>
<td>7,457</td>
<td>295</td>
<td>66</td>
<td>153</td>
<td>146</td>
</tr>
<tr>
<td>Has policies governing chapters</td>
<td>7,636</td>
<td>6,999</td>
<td>298</td>
<td>43</td>
<td>150</td>
<td>146</td>
</tr>
<tr>
<td>Has chapters, but no voting rights</td>
<td>5,487</td>
<td>5,242</td>
<td>41</td>
<td>35</td>
<td>149</td>
<td>20</td>
</tr>
</tbody>
</table>

NOTES: All counts are estimates based on samples. Data are from organizations exempt under IRC Section 501(c)(3) filing Forms 990.

Author’s Note: This table was provided to me by Paul Arnsberger, Statistics of Income Division, Internal Revenue Service, by email on June 23, 2014. Observe that the salient odd result – that the number of organizations whose members elect the board exceeds the number of organizations having members – suggests that some filers might not understand the legal definition of “member.” Let me also add that these data do not include the mutual-benefit organizations exempt under non-(c)(3) subsections of § 501(c) – notably social welfare organizations, labor unions, trade associations, and fraternal organizations – many of which are federated.
# APPENDIX B

## Non-Profit Organizational Structure and Governance Comparison

Analysis of 32 Selected NPOs including 28 from the 2010 Non-Profit Times Top 100 List
Compiled by the Office of Corporation Counsel of the American Cancer Society, Inc.

[Data Below From ACS (2011), Schedules 1 and 2, footnotes omitted]

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>* AARP</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>27 ALSAC/St. Jude Children’s Research Hospital</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>65 Alzheimer's Association</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>5 American Red Cross</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>19 American Cancer Society</td>
<td>Yes &amp; Yes [pre-2012 change] No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>32 American Heart Association</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>70 American Diabetes Association</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>* Arthritis Foundation</td>
<td>No</td>
<td>Yes</td>
<td>Hybrid</td>
<td></td>
</tr>
<tr>
<td>53 Big Brothers Big Sisters of America</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>8 Boys &amp; Girls Clubs of America</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>26 CARE</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>63 Cystic Fibrosis Foundation</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>71 Ducks Unlimited</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>28 Feeding America</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>24 Girl Scouts of the USA</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>9 Habitat for Humanity International</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>89 Juvenile Diabetes Research</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>* Lance Armstrong Foundation</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>50 Leukemia &amp; Lymphoma Society</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>79 Make-A-Wish Foundation</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>67 March of Dimes Foundation</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>* National Wildlife Foundation</td>
<td>Yes</td>
<td>Yes</td>
<td>Hybrid</td>
<td></td>
</tr>
<tr>
<td>33 Save the Children Federation</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>60 Special Olympics</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>43 Susan G. Komen for the Cure</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>51 Teach For America</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>21 The Nature Conservancy</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>82 Trust for Public Land</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>3 United Way of America</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>18 Volunteers of America</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>98 World Wildlife Fund</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>1 YMCA of the USA</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
</tr>
</tbody>
</table>