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

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Models of Federation

• The law does not dictate any particular mechanism for creating a federation or affiliation.

• A national or international charity might be the sole member (“parent”) of associated regional charities.

• Alternatively, the central body might admit regional charity chapters as members, or simply establish branches having no legal independence.

• Autonomous regional charity chapters can be created under the laws of one or more states, with their relationship established by contract.
How Disputes Arise

• 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.
  – The central and local bodies disagree about autonomy of decision-making.
  – They disagree over ownership of assets and how revenue will be shared.
Paucity of Law

• The legal tools vary by applicable legal regime:
  – corporate law for federations having chapters (as voting members or not);
  – agency and partnership law for unincorporated nonprofit associations; and
  – contract law for licensing of the nonprofit’s brand and other intellectual property.

• The results of research in other disciplines could greatly help the law develop.
Extra-Legal Forces

• Legal protection is not the same as reputational protection.

• For example, independent same-name corporations federated by membership or contract to isolate liability are likely to be viewed by the public 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.
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.
The federation’s local members (which do not have voting rights) file a “group” Form 990. As is common, though, the group return’s aggregate numbers make transparency of specific operations impossible.
United Way Worldwide

• In order to protect the value of its name after 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.
Girl Scouts of the United States of American

- A federal appeals court, in an alarming (hopefully anomalous) decision, applied Wisconsin *franchise law* to trump the GSUSA’s constitutional associational rights to restructure 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.”
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.
  – Now volunteers serve on local advisory boards.
Analogy of Members to SHs

Shareholders of a business corporation have:
(1) financial ownership (stock) and
(2) control via limited oversight (voting for the board, on amendments to org docs, and on fundamental transactions).

In a non-stock (nonprofit) corporation, who performs the second function—
- if the NP has members?
- if the NP does not have members?
Legal Definition of “Member”

• A “member” for legal purposes is anyone (natural or institutional) having the right to vote for the governing board, to approve amendments to the organizational documents, or to vote on fundamental transactions.

• Some NPs use the term member more broadly to include affinity membership, so the IRS Form 990 asks separately: Does the organization have members, and do members have voting rights?

• Top down: membership to create Parent/Sub.
## Selected Data on "Federated" § 501(c)(3)’s, Tax Year 2010 Forms 990

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Corp</th>
<th>Trust</th>
<th>Ass’n</th>
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<tbody>
<tr>
<td>Number of returns</td>
<td>186,417</td>
<td>165,758</td>
<td>3,684</td>
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<tr>
<td>Has members</td>
<td>28,320</td>
<td>26,004</td>
<td>950</td>
<td>438</td>
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<tr>
<td>Members elect board</td>
<td>31,445</td>
<td>28,186</td>
<td>659</td>
<td>1,107</td>
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<tr>
<td>Members approve governance decisions</td>
<td>20,929</td>
<td>18,830</td>
<td>556</td>
<td>298</td>
</tr>
<tr>
<td>Has chapters/branches/affiliates</td>
<td>8,118</td>
<td>7,457</td>
<td>295</td>
<td>66</td>
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<tr>
<td>Has policies governing chapters</td>
<td>7,636</td>
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<td>298</td>
<td>43</td>
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<tr>
<td>Has chapters, but no voting rights</td>
<td>5,487</td>
<td>5,242</td>
<td>41</td>
<td>35</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.
Federating by Contract

• Nonprofits can also federal by contract.
• An association can use both membership and licensing.
  – 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 a licensing agreement, or some assets can be governed by one mechanism and others by the other.
Defining the Relationship

• Ideally, decisions intended to be binding about
  – voting and election procedures,
  – ownership, control, and 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.
Conclusion*

• If the public views federation as a positive signal, it is hard to tell what criteria the public is valuing.
• Federation signifies nothing more than affiliation. The law does not require that a federation have a voting membership, nor autonomy for local affiliates or local ownership of assets.
• The law does not require the central body to set standards for affiliation, or dictate how to police those standards. Only minimum standards of fairness apply in judging a group’s process for disciplining or expelling members.
**Caveat**

- This paper, which draws heavily from non-public survey data (NYU 2005 and the unpublished American Cancer Society 2011), is unable to definitively assess 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.