



THE UNIVERSITY OF CHICAGO

OFFICE OF LEGAL COUNSEL

MEMORANDUM

DATE: AUGUST 1, 2012

TO: UNIVERSITY PERSONNEL

FROM: OFFICE OF LEGAL COUNSEL

SUBJECT: CONSIDERATIONS FOR CREATING NEW LEGAL ENTITIES

University Financial Policy No. 2711 creates a process that must be followed when a division, school, center, office or other unit of the University seeks to establish a new legal entity, and confirms the University's policy that no new legal entity may be formed without the approval of the Executive Committee of the University's Board of Trustees. This Memorandum outlines the key considerations that should be taken into account by the Vice President for Administration and Chief Financial Officer and the Vice President and General Counsel in deciding whether the formation of a new legal entity is warranted.¹

Review Considerations:

In general, the University presumes that activities that are consistent with the University's or an existing University-related organization's mission and status as a charitable organization should be conducted through the University or an existing related organization, not through a new entity. That presumption can be overcome based on the review considerations set forth below.

In reviewing a proposal for the formation of a new legal entity, the Vice President for Administration and Chief Financial Officer and the Vice President and General Counsel should take into account the following factors:

A. Factors favoring formation of a separate legal entity. Affirmative answers to the following questions support formation of a separate legal entity:

1. Will the activities to be undertaken, if undertaken by the University directly:

¹ It is not within the scope of this Memorandum to address the legal considerations involved in choosing the appropriate form of legal entity (not for profit corporation, LLC, partnership, etc.) once a decision to establish a separate entity has been made.

- subject the University to burdensome, unfamiliar or foreign laws, legal regimes, taxes, or licensing requirements to which the University is not now subject?
 - subject the University to financial losses or liabilities that would be worrisome in nature or magnitude or otherwise best kept off the University's balance sheet?
 - generate substantial unrelated business income (through the regular carrying on of activities that are not substantially related to the University's mission as a tax-exempt charity)?
 - be inconsistent or incompatible with a particular aspect of existing University policies or practices (e.g., University requirements regarding the terms of sponsored research)²?
2. Is there an intention or likelihood that the activities to be undertaken be spun off, to or taken over by, a for-profit business or other organization?
 3. Will the activities utilize personnel whose compensation, benefits or other material terms of employment are significantly different than those of University employees?
 4. Will the activities seek to raise funds in the form of selling interests in the entity to "investors"? Is there an intention that individuals or commercial entities will participate financially in the success of the activity?
 5. Is there an intention that the activity be governed by a separate board that includes representatives from outside the University, having power to make fundamental, binding decisions concerning the activities of the entity (in contrast to an advisory board with the role of providing nonbinding advice)?

B. Factors disfavoring formation of a separate legal entity: Affirmative answers to the following questions disfavor formation of a separate entity:

1. Can the activity be undertaken in a manner that is compatible with the University's broad mission of research and education? If not, can the activity be undertaken in a manner that is compatible with the mission of another existing University-related organization?
2. Will the activity be funded by charitable contributions or grants that can only be received by a 501(c)(3) charitable organization that meets certain requirements (e.g., only to accredited institutions of higher education, only to organizations meeting A-133 audit requirements, etc.)?
3. Will the activity necessarily use the University's name or other trademarks?

² Note that significant inconsistencies with University policies or practices may lead the Vice President for Administration and Chief Financial Officer and the Vice President and General Counsel to determine that the activity is one that should not be undertaken at all.

4. Will the employees engaged in the activity be on the University's payroll and participate in University benefits?
5. Will there be ongoing compliance obligations associated with new entity that have not been adequately provided for in the proposal for the new entity? These include tax compliance (including employment tax withholding and reporting), maintenance of financial books and records, corporate reporting (annual reports), satisfaction of external audit requirements, establishing and maintaining banking relationships, and organizing and holding required periodic meetings of the governing body(ies) of the entity.
6. Will the activity need to rely on the University for administrative support (e.g, tax compliance, financial recordkeeping, procurement office support, etc.)?

C. Other relevant factors: The Vice President for Administration and Chief Financial Officer and the Vice President and General Counsel should consider the following additional factors in assessing whether the formation of a separate legal entity is warranted:

1. Has there been sufficient consultation with relevant offices of the University that would be impacted by the creation and maintenance of a new legal entity?
2. Will the proposed activities compete with other University activities?
3. Is the proposed governance structure of a proposed legal entity appropriate? How will directors be chosen? Who will represent the University's interests? Who within the University is responsible for supervision, management and monitoring of activities?
4. What level of oversight and involvement by University officers or other senior personnel is desirable? Has appropriate oversight and involvement by University officers or other senior personnel been assured?