

September 12, 2006

Dear AESF Members:

Attached you will find a report from a consultant, McCormick Group, specializing in not for profit mergers that was hired by a group of AESF members concerned about the complex Industry Reorganization Agreement and supporting documents. These documents address the proposed reorganization of the three major associations for the surface finishing industries, AESF, NAMF, MFSA. This group of members chose to seek an outside group to review the documents and provide comments related specifically to the documents without regard to special interests.

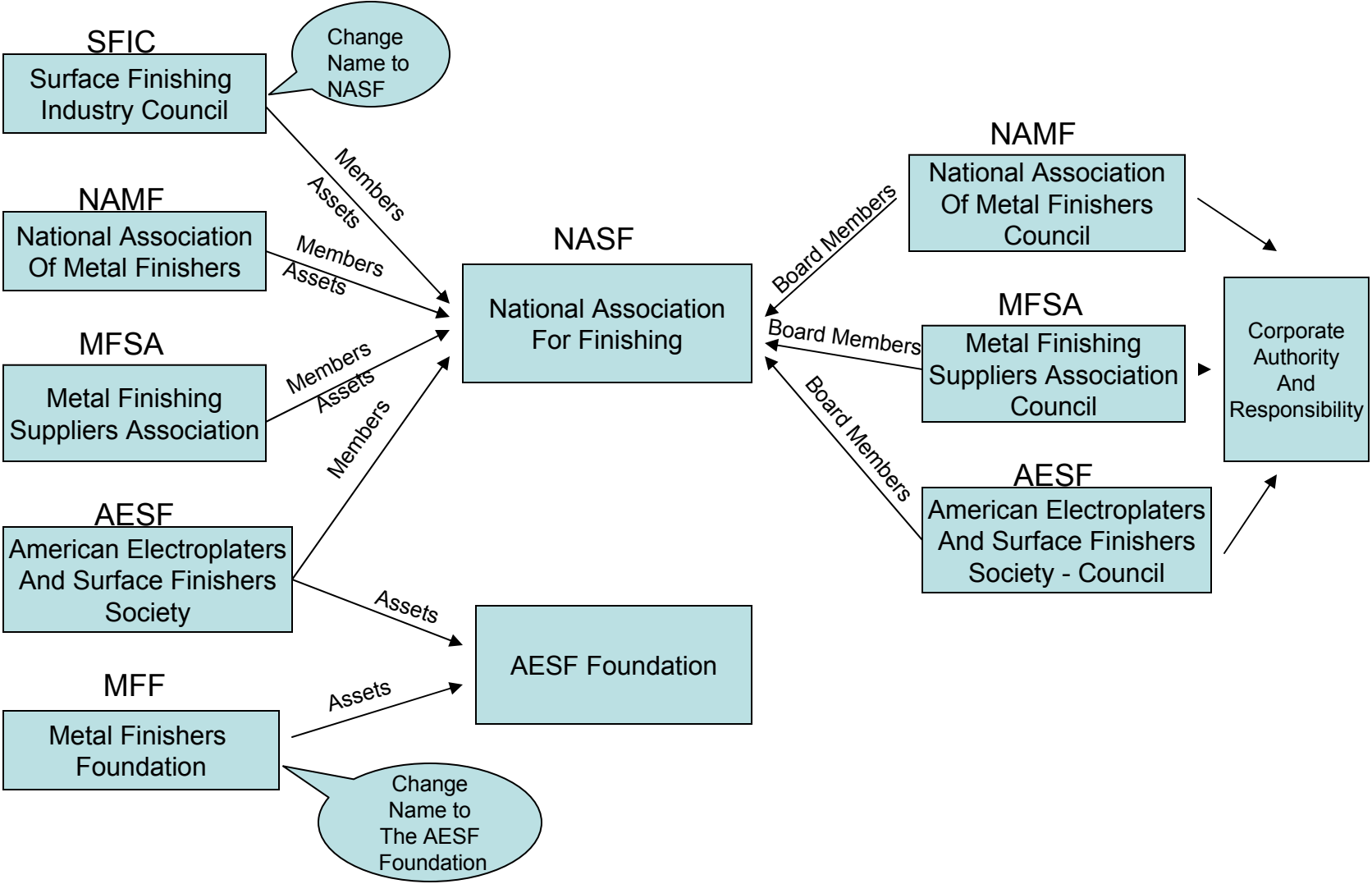
The consultant was not asked to comment on whether or not the proposed consolidation was a good idea or not. In fact, he shared his bias that he feels that most non-profit organizations should be seeking relationships with entities that have similar missions. You will note that the information presented in the review only points out issues and concerns that appear to need to be resolved so that all who are charged with making a decision on the proposal can do so with confidence that their expectations are being met.

His rather broad experience in these matters has shown that volunteers who have been educated about the issues and feel the documents that protect their understandings are clear will typically make the best decision for the organization going forward. When the process being used is fraught with inconsistencies and too many critical questions are left unanswered, volunteers do not feel confident that all participants are honest brokers. That is when problems arise.

Everyone is encouraged to take the time to make sure a critical mass of people are informed and that the documents that they are being asked to approve are clear and represent the negotiated expectations.

To that end, the following comments point out a number of issues that should be more fully explained. We believe that once these issues are addressed, the groups involved in this discussion will be better prepared to make an informed decision.

Industry Reorganization Chart





**A Review of the Consolidation Documents
Between Various Factions of the
Metal Surfacing and Plating Industry
September 2006**

Introduction:

In late August, 2006 Dan McCormick, President and CEO of McCormick Group was asked to review certain documents pertaining to the planned consolidation of the Surface Finishers Industry Council (SFIC), Inc., the National Association of Metal Finishers (NAMF), the Metal Finishing Suppliers Association (MFSA), Inc., the Metal Finishers Foundation (MFF) and the American Electroplaters and Surface Finishers Society (AESF), Inc.

Mr. McCormick is a highly regarded merger and organization development consultant. He is the author of "Nonprofit Mergers – the Power of Partnership" Aspen Publishers, 2001. His clients include: The American Cancer Society, The National Hemophilia Foundation, The Arthritis Foundation, Ford Motor Company, the Humanitarian Aid Foundation, the 5 Girl Scouts Councils of Colorado and many others.

It should be noted that Mr. McCormick is not commenting on the concept of the proposed Industry Reorganization or suggesting whether or not reorganization is a good or bad idea. This report is simply a review of the documents designed, based on his experience, to highlight issues that may impede progress or cause potential problems at a later date.

Mr. McCormick was not present or involved in any of the discussions, negotiations and or decisions leading to the preparation of the documents that are reviewed in this report. The comments in this report are based on reading the documents that have been prepared in support of the consolidation that can be found on the Internet at www.sfic.org. Further, it should be understood that Mr. McCormick is not a lawyer and the comments contained herein are not to be construed as legal advice. Lastly, it should be mentioned that Mr. McCormick has a bias upon which he believes that most not-for-profit organizations that have like-minded related organizations with similar mission would be better served to be consolidated in some format.

Statement of Concept:

It appears that the concept under which the Industry Reorganization is being conducted is as follows:

- 1) There are 5 separate organizations with similar missions representing factions of the plating and surfacing industry that feel some structural and governance shift would be beneficial to all parties.
- 2) The group is making an effort to separate its charitable and educational activities from the direct service activities of a trade organization.
- 3) While the process is being called "Industry Reorganization" the substantial shift in the governance toward the ultimate controlling entity raise questions about the viability of the organizations that are remaining after the consolidation.
- 4) The proposed shift in assets, control and governance suggest something more akin to a merger than a simple collaborative working environment.

General:

It is very difficult to include all contingencies in a document that describes a potential consolidation as complex as the one in question. These types of documents are usually the results of a number of meetings in which much discussion and negotiation has occurred. There are frequently understandings between parties that have been present in those meetings that clarify the language in the documents and bring comfort to the parties that the final desired result is reflected in the agreement and will be carried out according to the written and understood concepts.

In general the documents seem to be in order and consistent with similar merger and consolidation agreements with which I have worked in the past. There are some overriding issues that I think would be helpful to clarify. They are as follows:

Regarding the Industry Reorganization Agreement (IRA):

- 1) This document is the basis upon which the consolidation will occur. It cites the conditions that the various parties have agreed upon prior to being placed before the parties for vote. It is constructed in such a manner as to not allow any of the parties to unilaterally modify the agreement. The parties will either accept or reject the conditions in the agreement. It must be constructed this way so that all parties are voting on the exact same conditions. This fact points to the importance of ensuring that the language in all the documents that are germane to the reorganization are correct, consistent and cover the issues that any party to the agreement wish to be protected.
- 2) When several states are involved or, as in the case of the State of New York, a court of appropriate jurisdiction has some authority in the matter, it is not uncommon to have a flexible effective date. This document allows for that, however, does not contemplate a time in the future upon which date the agreement will become effective. This may cause some parties to question when the change is expected and hamper planning and preparedness.
- 3) The document indicates in the heading that it is an agreement but there is no indication of the period. If it is contemplated to be a perpetual agreement it should be stated. This implied perpetual nature raises a number of issues that do not seem to be present in the agreement. These include:
 - a. Clarity of how a corporate entity that is party to the agreement may exit if a current or future board of that corporation wishes to no longer be part of the agreement. Since the corporate status of the parties to the agreement is apparently still intact, those boards and their members should, where applicable, have certain rights, one of which would be to separate from the agreement.
 - b. Paragraph 18 of the agreement suggest that any party may exit if the agreement has not become effective on or before March 1, 2007, but nothing about what the termination options are after that time.

- 4) Paragraph 13 indicates that the agreement will be terminated in the event that the 4 groups and the AESF Council of Delegates do not approve it. It is not specifically stated whether or not consolidation would occur if some of the parties were to accept the agreement and others do not. Typically, the documents would either allow for consolidation to occur even if all parties to the agreement do not ultimately agree or disallow any sub-set of parties to consolidate under the terms of this agreement. Conceptually, it looks like that the consolidation would not occur if any party pulled out. However, in the case of the AESF shifting members to the NASF and resources to the MFF (now renamed) the issue does not seem clear. Paragraph 13 seems to suggest that if any party does not accept the agreement the whole agreement is voided. It may be helpful to clarify this point. While there is a provision for Severability (Paragraph 22) it does not specifically state that if one or more parties to the agreement do not vote acceptance that the agreement among those that do ratify the agreement will continue. Paragraph 20 regarding “Execution of Counterparts” anticipates this to some degree but usually refers to the fact that all the signatories to the agreement do not have to be on the same page. While this is a small point, clarification might be helpful.
- 5) There is a statement in the preamble of the IRA under sub paragraph (9) that says, “the activities of NAMF, MFSA and AESF were to be reduced accordingly, provided that NAMF Affiliates and AESF Branches would continue to operate (hereinafter sometimes collectively referred to as “the Industry Reorganization”)...”
- a. There does not seem to be any ancillary and supporting documents showing any indication of what the “reduction” really means.
 - b. The documents, while suggesting a “reduction” are not clear on how the participating organizations will address their respective missions going forward.
 - c. Paragraph 4 of the IRA indicates that “upon the Effective Date, the assets of NAMF and MFSA, except such assets as each organization’s Board of Directors or Board of Trustees determines to retain, shall be transferred to NASF to be used solely in the furtherance of the exempt purposes of NAMF and MFSA.....”
 - i. This seems to indicate that there is an expectation that substantially all the assets of MFSA and NAMF will be transferred to NASF yet there is language that the funds will not be aggregated rather reserved for MFSA and NAMF activities and projects. The document indicates that the purposes of NAMF and MFSA will be supported. Later in the NASF Bylaws there is reference to the Councils advising on any restricted funds but clarity regarding who will make the decision that the funds will be spent in the interests of the two named groups should be determined.

- ii. Further on this point, it appears that the current boards of all three organizations may determine what and how much of their current asset base they wish to retain. This loose end could potentially be problematic. For example, if NASF were contemplating receiving the majority of funds from the parties and NAMF and MFSA respective boards elect to “retain” a substantial portion of the funds, one of the primary understandings of the IRA would be in question.
- 6) While paragraph 5 in the IRA indicates that the transition board will serve until the first election of directors takes place there is no indication as to when that may occur. One may assume that it would be the first annual meeting of the newly named entity. Clarity here may be helpful.
- 7) Paragraph 6 in the IRA indicates that the transition officers may not serve as officers on the new board after the initial election. That seems to be an appropriate action however, that will mean that the first elected group of officers may lack experience in helping the new organization get appropriate traction. Reconsidering this point may be worth the time.
- 8) While the document clearly states that the Branches and Affiliates of the remaining parties to the IRA will remain in effect, there is no indication as to the conduct of the business of those entities. To wit:
 - a. How will the Branches and Affiliates be served if substantially all of the assets are now in the purview of NASF?
 - b. How will new Branches and Affiliates become chartered and or charter agreements enforced?
 - c. Will the MFSA and the AESF collect dues?
 - d. Is there an expectation that any dues collected by AESF and MFSA be sent to NASF?
- 9) This ambiguity of relationship carries over into basic membership as well. It is indicated in the IRA that all NAMF, MFSA and AESF members are to become members of NASF. The language describing the powers of councils seems to transfer the powers that would traditionally rest within the membership to the councils. If this is the case, the bylaws and potentially the corporate structure of the named organizations should be modified to reflect the actual change.
- 10) Legal opinion should be sought to determine if by adopting an agreement with multiple parties, the membership of a corporation can delegate the authority to appoint its board and officers to a sub-set of the corporation and continue to be, structurally, a membership corporation. This condition could potentially impact the IRS status of the participants.

- 11) Most states require an annual meeting of a corporation for it to remain viable. The participants should ensure a process that requires parties to the agreement to continue to have an annual meeting and conduct other activities to remain a corporation in good standing with their respective states as well and requirements of the IRS regarding mission, and programmatic support.
- 12) While the documents do not speak the word merger, it is clear that the governance of the respective parties, with the exception of the Foundation, is being consolidated into one organization. It is not clear in the documents whether or not the NAMF, the MFSA and the AESF will retain any organizational identity following the reorganization. While there is mention in the IRA regarding “councils” that represent the respective organizations, there are questions regarding the authorities of the remaining leadership (see section on this in the review of the NASF Bylaws).
- a. Paragraph 8 presents what can only be described as an extremely complex voting structure. The corporate membership has been divided into 6 categories that ultimately relate the number of membership votes to the annual dues of the organization that is further related to the financial size of the participating corporate members.
 - b. There seems to be an effort at trying to achieve some balance by weighting votes. The process is complex and hard to follow at best. The formula being used in which a single corporate member may have a weighted vote worth 40 votes significantly shifts the voting authority in their favor. That means that in a meeting in which the membership was allowed to vote, 40 individual members would have to be present and vote in a block to counter a single Level I Corporate membership vote.
 - c. Couple the observation in sub-paragraph (b) of this section with the language in the NASF Bylaws, Article V – Section 5 – Quorum, where it is stated that only 10% of the members entitled to vote shall constitute a quorum. This means that at any given meeting if members with higher rating votes are present the control of the organization shifts in their favor dramatically. Increasing quorum requirement or revisiting the weighting formula may create more equality in this area.
 - d. Further, there is no indication as to the treatment of non-dues revenues that typically come from conferences, programs and other activities. In addition, there is no discussion regarding donations that may come to NASF through their composite corporate entities. There should be some language regarding these funds in light of the fact that it appears that the parties to the agreement will not have a viable corporate entity to address such issues directly.

Regarding Other Documents:

Proposed Bylaws of the NASF

For the most part the proposed bylaws of the NASF are fairly straightforward and seem to address most internal governance issues. There are some concerns that may provide parties to the agreement more comfort if they were clarified. These include:

- 1) There is reference in Article III – Members sub paragraph 2 that the membership must be members of a Branch of the AESF or an Affiliate of the NAMF to be a member of the NASF. This point once again raises the question that if the entities to which the Branches and Affiliates belong have transferred their assets and delegated their operational components to the NASF, then who is maintaining, supporting and growing membership in Branches and Affiliates. Clarity on this issue is greatly needed.
 - a. To further punctuate the point above, Article IV – Dues, Fees and Assessments indicate “NAMF Affiliates and AESF Branches are authorized to collect Association dues and to forward same to the Association.” This point seems to indicate that NAMF and AESF will need to have some infrastructure in place to manage the Affiliates and Branches and to collect dues and send them forward. Alternatively, NASF may be expecting that they will assume that responsibility. In any case, clarity on how the organization expects to relate to its field members is needed.
- 2) The process for the election of directors of NASF is not inherently wrong. The problem occurs with the appearance that each council has the ability to send forward their representatives for the board while in fact only those names the Board of NASF approve will go forward for consideration. Further, it appears that the members being elected to the board will then be elected by the membership at large rather than directly by the Council members they represent.

- 3) One of the most potentially conflicting issues is in Article VI - Councils. Sections 1, 2 and 3 regarding the MFSA, NAMF and the AESF Councils. In essence it is as follows:
- a. Article VI regarding the powers of the councils indicates that their powers include:
 - i. Nominations to the NASF Board of Directors.
 - ii. Use of restricted funds from their respective organizations.
 - iii. Appointment of the directors and officers to “their” respective corporations, i.e. AESF, MFSA and NAMF.
 - iv. Ensure compliance of their organizations regarding legal obligations.
 - b. This structure seems to indicate that the new “councils” will in fact become the point of authority for their respective corporations. This language says that the Councils will appoint the directors and officers of their corporation thus bringing into question the authorities of existing directors and in some cases the membership of the respective organizations.
 - c. Further review of the proposed bylaws of MFSA, NAMF and AESF does not indicate a structure in which a “council” is elected and then authorized to make the appointments as indicated in the NASF bylaws. Further, the bylaws, mentioned above allows for an election process for directors and officers that is counter to the language in the NASF bylaws regarding council powers. This inconsistency should be resolved.
 - d. This also raises a question about the authority of NASF to “legislate” the powers of another independent corporation unless the intent is to demonstrate that NASF is indeed the controlling organization. In other words this language suggests that somehow, NASF has garnered the authority to instruct councils from the other three entities as to what their powers are in respect to their own corporations. Clearly NASF can “tell” the councils what authorities they may have in regards to NASF but one corporation instructing another “independent” corporation as to what the powers of their own, supposedly elected, council might be seems above their authority.
 - e. Put another way, what the conditions in sub paragraph (a), (b) and (c) describe are: NASF Board of Directors, establishing the councils who have the authority to appoint board members and officers of their respective corporations without any clear authority to do so.

Proposed Bylaws of the AESF Foundation:

- 1) The governance structure of The AESF Foundation as described in the bylaws is one of a closely held relationship. This may be desirable but the potential consequences should be noted.
- 2) The Board of Trustees of the Foundation includes the Vice President and the Immediate Past President of NASF. At least 4 members of the Foundation Board of Trustees, at all times, are members of NASF from the "Professional Members Class." Lastly, the Board of Directors of NASF must "approve" all the other Foundation Trustees.
 - a. In not-for profit code, governance defines ownership of the organization. The entity with the authority to appoint or controls who governs is in effect the "owner" of the corporation. The AESF Foundation bylaws describe a relationship where the NASF Board of Directors in effect "owns" the Foundation because they have 2 NASF officers on the board, direct that 4 members of the Foundation Board of Trustees be from the Professional Members Class of NASF and further that the Board of Directors of NASF approve all the other Foundation Trustees.
- 3) The governance issues could result in other consequences as well. For example, most audit partners will require that the financial statements of the Foundation be included in the financial reporting of the NASF. Care must be taken regarding the potential co-mingling of funds to ensure that the political activities of the NASF regarding their support of the trades, do not conflict with the educational activities of the Foundation.
- 4) It is important to note that the agreement states that all AESF funds and assets will be transferred to The AESF Foundation. The result of this condition is that while The AESF Corporation will apparently be a registered corporation, all the assets will belong to the AESF Foundation, which, according to the current AESF Foundation bylaws, will be controlled by a Board of Trustees that is approved by NASF. This suggests that once the agreement goes into place, it will be difficult for the AESF, Inc. as a corporation, to ever be reconstituted as a viable separate corporation. The suggestion that AESF, Inc. is in essence "dormant" may have IRS consequences on the future viability of its tax-exempt status due to it not being able to demonstrate that the corporation is "directly" conducting any mission related activities. That question should be addressed in some forum.

- 5) Lastly, if all, or substantially all, of the funds that go into the Foundation come from the NASF (see the bylaw provision that 6% of the funds from NASF Member Category VII be donated to the Foundation) then the status of the Foundation may be “tipped” into a private foundation status. This could change the tax treatment of gifts and the amount of taxes and fees charged to the foundation going forward. The question would become “where does the NASF end and the Foundation begin?” When the control of the Board of Trustees is coupled with the % of total income into the Foundation from NASF, there is significant potential for IRS problems for both organizations.
- 6) There is little chance of the Foundation losing its tax-exempt status. The problem may lie in the exempt status being changed in such a way that may potentially impede favorable tax treatment of gifts as well as interest and taxes being charged to the Foundation directly.

Summary:

It appears that the process for industry association reconfiguration is well under way. It seems that much good work has been accomplished and a number of major issues relating to the 5 component organizations streamlining their governance and operations into more efficient patterns have been explored. That being said, there are also a number of significant, and potentially problematic components left under-addressed. These issues include: questions about the support and management of Branches and Affiliates; the work and responsibilities of participating parties to the agreement post approval of the document; period and exit options of parties after the document is approved; ultimate control of the participating governing bodies, and; questions about finance, IRS codes and corporate.

Achieving support of the leadership and membership of all parties in consolidation activities such as this requires a significant amount of negotiations as well as in-depth educational activities to ensure that all participants are knowledgeable and comfortable enough with the issues to cast an informed vote. The questions left unanswered in the documents along with inconsistencies in the consolidation instruments that raise even more issues makes this particular effort more difficult for the voting participants to support.

The consultant recommends the following actions for the group to consider regarding this particular industry reorganization effort:

- 1) Gather a representative group of all participants to address the issues and questions raised in this review and others that have emerged from the field or presented themselves in the course of discussion.
- 2) Consider either modifying the IRA, and or, developing a companion document that will become part of the IRA, that will clarify the concerns and issues raised in this review and or questioned by the field.
- 3) Re-consider the vote weighting formula that is presented in the IRA to one that provides a more equitable structural representation of all participants.
- 4) Modify the language concerning the approval of members of the councils as well as the authorities empowering the councils regarding the boards of directors and officers of their respective organizations.
- 5) If there is not the intent that NASF is to become the “parent” organization and in essence “own” the other participants, restructure the method in which representatives to the board of directors of NAMF and MFSA are determined.

- 6) Consider a rewrite of the NASF bylaws as well as the bylaws of the participating organizations to correct the unresolved and inconsistent issues.
- 7) In that a super-majority of the Board of Directors of NASF (75%) is needed to amend the bylaws once this agreement goes into effect, it would be in the best interest of all parties to ensure that the original language of the NASF bylaws and the Industry Reorganization Agreement were consistent and addressed the concerns of each participant prior to signing.

Respectfully Submitted,

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