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After a Criminal Attack and Embezzlement, a Philanthropic Rescue Offers Lessons

By John MacIntosh

The bankruptcy that led to last year's abrupt closure of the Healing Arts Initiative, a 45-year old New York City charity, drew widespread national attention because it had all the elements of a *Law and Order* episode: a heinous criminal attack; a multiyear, $750,000 fraud; an internecine conflict.

Fortunately, the closure wasn't actually the end of the story. The organization I head, SeaChange Capital Partners, came together with others to "take over" Healing Arts in an attempt to preserve its important work of making the arts accessible to all New Yorkers. Our one-year turnaround effort taught us some important lessons about the need for change in the nonprofit world.

Corporate takeovers can be hostile, but ours was friendly. We introduced an executive with experience in restructuring, John Keefe, who assumed the role of interim executive director. Four people, including me, replaced the board. And we bought out a bank that objected to Healing Arts spending any money in its attempt to recover.

Getting Past Plan A

Plan A was simple: Collect the insurance money for the fraud; repay the secured creditors; rehire essential staff members; restart programs; raise fresh money; exit bankruptcy.

By November, Healing Arts had achieved the first three goals and was making progress on the fourth, resuming some programs. We took 500 people with disabilities to the Macy's Thanksgiving Day Parade and ran a holiday party for 150 homeless children at a Hard Rock Cafe.

Despite this progress, government agencies and other potential grant makers could not get over the fact that Healing Arts had "gone bust" and were unwilling to lend support, despite recognizing that we had a new board, a new leader, and a new balance sheet. And we needed contracts or grants to resume a full schedule of programs.

With little prospect of raising fresh money, we moved to Plan B: Conserve cash and find a partner. After initial conversations with several organizations, serendipity connected us with YAI, one of New York State's largest health and human-services nonprofits, which focuses on people with intellectual and developmental disabilities.

YAI proved an ideal partner given its scale, the systems it had in place, and its interest in expanding its arts and arts-education programs. Moreover, its mission and culture were in line with those of Healing Arts, and its senior leadership team quickly developed a good rapport with our program staff. These passionate, hard-working staff members were Healing Art's most important asset and had stood by the organization even as they bore the brunt of a crisis they played no part in creating.

As an incentive for YAI to explore the opportunity seriously, SeaChange provided a letter expressing high confidence that we could raise funds to help support an eventual deal. In the end, YAI decided to hire all four senior staff members from the Healing Arts team and, in a transaction that was just approved by the bankruptcy court, it will incorporate Healing Arts's work under a new department called HAI@YAI.

Think Twice About Bankruptcy

Though most organizations will never face the drama Healing Arts did, we learned (or relearned) some things nonprofits and their boards should keep in mind:

Try not to become insolvent in the first place.

While the fraud at Healing Arts was quite sophisticated, there were plenty of signs that something was wrong, notably that debt was increasing and being used to pay off other debt. The organization had taken a big risk by making a major investment in its headquarters without first raising grant dollars to cover the costs. And it probably didn't help that the second-to-last executive director left for a new job with little notice and before a successor was in place.

While hindsight is always 20/20, I believe the bankruptcy could have been avoided with better management and oversight practices.

Even if an organization is technically bankrupt, think hard before actually declaring it.

The formal bankruptcy process works well for large organizations, but it unleashes a tsunami of legal requirements and associated costs that will overwhelm most nonprofits. It was only because of the heroic efforts of Healing Arts's lawyer, Fred Stevens, and Mr. Keefe, the interim executive director, that our rescue attempt didn't collapse midstream. Both continued to do all they could long after Healing Arts's ability to pay them had been exhausted.

Declaring bankruptcy also creates a "scarlet letter" that scares off donors for longer than most organizations can survive without new funding.

Remember that the board's responsibility is to ensure that an organization's assets are used for charitable purposes.

Squandering those assets on avoidable bankruptcy administration costs is a dereliction of duty. There's no excuse to file bankruptcy because of fatigue or a desire to "get the body off the street."

Of course, there are times when bankruptcy may be necessary to maximize the value of the charitable assets. YAI probably would not have been willing to acquire Healing Arts's assets without the formal blessing of the court. But even then, a prepackaged bankruptcy may be the better option. (In such a case, the organization figures out how to handle its assets and liabilities before going to court.)

Looking for Trouble

We took a big risk in trying to save Healing Arts. It was a lot more work than we expected and it could have ended badly.

But I'm glad we did it, and I hope we can inspire others to consider doing the same. The nonprofit world needs a cadre of people with the skills, experience, and motivation to get involved in troubled situations as donors, board members, volunteers, and pro bono (or at least low bono) consultants.

Trouble is not everyone's cup of tea, but for some people, involvement in troubled nonprofits may offer a better balance of risk and return than involvement in stable ones.

Trouble allows particular skills and experiences to be put to work.

Trouble offers opportunities, like buying a loan at a discount and reinvesting the profits as a grant, that aren't normally available.

Trouble may allow grant makers to build on the assets of existing organizations without the risks associated with starting, or expanding, new ones.

Over the past 10 to 15 years, a vibrant ecosystem of "venture philanthropists" has emerged to play a small but important role by starting, building, and financing emerging nonprofits. Now is the time to develop a parallel ecosystem of "philanthro-restructurists" with the skills, experience, and mind set to rebuild and recapitalize organizations dedicated to the common good. In the current political and financial environment, they will have plenty to do.

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