Working Better Together, Part Two:
Mergers as a Strategy for Success

CAPLAW Training Webinar
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Agenda

- Why merge?
- Issues to consider before moving forward
- Overview of merger process
- Who are the players and what are their roles?
- Lessons learned from other CAAs
Polling Question #1

1. Has your CAA ever (select all that apply):
   a. Merged with another CAA?
   b. Merged with another non-CAA organization?
   c. Started the merger process but ultimately decide not to complete the merger?
   d. None of the above

Merger Case Study

Agency A
- Non-profit CAA; $15M annual revenue
- 24 board members; 92 employees
- Serves 3 counties (mix urban/rural)
- Programs:
  - CSBG
  - Head Start
  - Energy assistance
  - Weatherization

Agency B
- Non-profit CAA; $5M annual revenue
- 18 board members; 65 employees
- Serves 2 counties, adjacent to Agency A’s 3 counties (urban)
- Facing financial difficulty (significant loans that CAA cannot repay; built a number of homes as part of a housing development that could not be sold).
- Programs:
  - CSBG
  - Head Start
  - Energy assistance
  - Weatherization
Why Merge?

- Cuts in government funding and intensified competition for funding
- Be better equipped to meet increased funding source expectation for effectiveness, efficiency and oversight
- Strengthen financial position
- Increase exposure within community
- Expand service programmatic offerings
- Executive/leadership transitions

Working Definition of Merger

- Working Definition
  - General term used to describe a partnership in which two or more organizations become one
    - Legally, governed by state nonprofit corporate law and generally describes a transaction where one organization is the successor to all of the assets and liabilities of the other organization
- Many different ways of structuring a merger
  - First, discuss goals of partnership
  - Form (choice of partner and structure) will follow function (what we hope to achieve)
  - Language matters in framing partnership
Issues to Consider
Before Moving Forward

- When to start thinking about a merger?
- Choosing merger partners
- Choosing a merger structure
- Funding source rules
- Overview of merger process
When Should We Start?

- **Before it is necessary** (i.e., before there is a crisis/before programs have been damaged)
- **Often leadership transitions** can be a good time to initiate conversations internally and externally

Choosing Merger Partners

- **What are some ways of identifying potential partners?**
  - Existing alliances and collaborations
  - Board or ED contacts/relationships
  - Working with a consultant
    - E.g., state CSBG office or CAA state/regional association
Choosing Merger Partners

- **What should we look for in a partner?**
  - May, but need not necessarily be, another CAA or Head Start grantee
  - Both organizations bring strengths (e.g., resources, relationships, experience, skills) to the table
  - Compatible missions, services, organizational cultures
  - Strategic service fit
  - Geographic fit

Choosing a Merger Structure
Changes in Corporate Structure
Acquisition Merger

Surviving corporation assumes assets and liabilities of one or more corporations, which then cease to exist (non-surviving corporations)

BEFORE

CAA #1

AFTER

CAA #2

Changes in Corporate Structure
Acquisition Merger

MERGER CASE STUDY

Merger between Peoples’ Regional Opportunity Program, Inc. and Youth Alternatives Ingraham to form the Opportunity Alliance

This case study is based on CAPLAW’s interview with Mike Toperoks, Chief Executive Officer of the Opportunity Alliance in Portland, Maine, about the merger of a Community Action Agency, Peoples’ Regional Opportunity Program, Inc., with Youth Alternatives Ingraham to form the Opportunity Alliance.

PEOPLES’ REGIONAL OPPORTUNITY PROGRAM, INC.
People’s Regional Opportunity Program, Inc. (PRDP) was a 501(c)3 Community Action Agency (CAA) with annual revenue of approximately $17 Million and about 215 employees. PRDP provided the following services to low-income people in Maine, particularly in the Portland area:

- Head Start, Early Head Start and child care services

YOUTH ALTERNATIVES INGRAHAM
Youth Alternatives Ingraham (VAI) was a 501(c)3 organization with annual revenue of approximately $19 million and about 266 employees. VAI, based in South Portland, Maine, served children, youth, adults, seniors, families, and communities throughout Maine. VAI provided the following:

- Crisis prevention and intervention services
**Changes in Corporate Structure**

**Consolidation**

A new corporation is created, which assumes assets and liabilities of two or more other corporations, which cease to exist.

**Before**

- CAA #1
- CAA #2

**After**

- CAA #3

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**Changes in Corporate Structure**

**Asset Acquisition/Transfer**

One corporation transfers all or a portion of its assets (but usually not liabilities) to another and then dissolves.

**Before**

- CAA #1

**After**

- CAA #2
  - CAA #1 Assets
Changes in Corporate Structure
Asset Acquisition/Transfer

**MERGER CASE STUDY**

This case study is based on CAPLAW’s interview with Dr. Leah Piggott, executive director of Mahube-Owaa Community Action Partnership (Mahube-Owaa) in Minnesota, as well as a review of Mahube-Owaa’s website. This case study presents an example of the combination of a CAA experiencing financial difficulties with a larger and healthier CAA.

**Before**

- **Mahube Community Council**: A $10-15 million agency with 90 employees.
- **Otter Tail-Wadena Community Action Council**: A $9-15 million agency with 85 employees.

**After**

- Both organizations have the same (or largely overlapping) board members.

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Changes in Control
Interlocking boards

One organization controls both boards

**Before**

- CAA #1
- CAA #2

**After**

- Both orgs have same (or largely overlapping) board members

- CAA #1
- CAA #2
Changes in Control
Parent-Subsidiary

One corporation becomes a subsidiary of another corporation (parent)

BEFORE

CAA #1 → CAA #2

AFTER

CAA #2

Sole member

CAA #1

Changes in Control
Parent-Subsidiary

MERGER CASE STUDY

Mesa Community Action Network

At the time of the merger, MesaCANA was a 501(c)(3) non-profit community action agency (CAA) that provided a variety of anti-poverty services in Mesa, AZ, including homelessness prevention and emergency housing assistance, low-income home energy assistance (LIHEAP), a men’s homeless shelter, emergency food assistance and referrals, individual development accounts (IDA), income tax preparation, and financial literacy classes. MesaCANA had an annual operating budget of approximately $2 million and around 25 employees.

A New Leaf

At the time of the merger, A New Leaf was a 501(c)(3) non-profit organization that provided a broad array of social services in Mesa, AZ, including affordable housing units, domestic violence shelters and services, a family homeless shelter and services, and youth and behavioral health services. A New Leaf had an annual operating budget of approximately $20 million and around 250 employees.
Funding Source Rules

- **CSBG**
  - Get state CSBG office on board
  - Will new designation be required?
    - For all mergers, maintain tripartite board composition

- **Head Start**
  - If Head Start grantee’s “legal status” changes, HHS will require recompetition (*45 C.F.R. § 1304.5(a)(2)(ii)*)
    - Recompetition not required if Head Start grantee survives the merger
  - Need to notify OHS of name change
  - Need OHS approval of change in (1) Head Start Director and (2) Executive Director/Chief Financial Officer (if >50% salary paid out of Head Start funds or listed in grant application as key personnel) (*45 C.F.R. § 75.308(c)(ii)*)
Other Issues . . .

- Ability to transfer other government grants/contracts
- Merger costs likely to be unallowable charges to federal grants, except with prior approval
  - See Uniform Guidance, 2 C.F.R. § 200.455
- Keep your funding sources informed!
- Accreditation/licensing
- Union issues

Polling Question #2

2. What do you see as the biggest obstacle to your CAA merging with another organization? (select one)
   a. Loss of identity and goodwill in the community
   b. Amount of money, time, and effort required to merge
   c. Staff concerns about employment post-merger
   d. Need to recompete Head Start grant
   e. Not enough information about the merger process
Overview of Merger Process

- Start with an organizational self-assessment
  - Motivations
  - Desired goals
  - Critical issues
  - Organizational obstacles and red flags
  - Financial position
Overview of Merger Process

- Initially, have a discussion between organizations’ leaders
  - Identify potential merger partners
  - Engage in discussions with leaders of various organizations to assess interest
- Once parties are committed to moving forward
  - Often sign a “Letter of Intent” (also known as a “Term Sheet” or a “Memorandum of Understanding”)
    - Outlines objectives and key terms that have been discussed, including payment of fees and costs
  - Enter into a Confidentiality Agreement

Overview of Merger Process

- Consider forming a joint merger committee
  - Comprised of senior management and board members of both organizations
  - Streamlines merger process
  - Ensures both organizations have an active voice in process
- Consider engaging a merger consultant
- Draft a merger agreement
  - Each organization should have outside counsel’s assistance
Overview of Merger Process

- **Conduct due diligence**
  - Each organization conducts a thorough investigation to ensure it understands the **operations, assets, and liabilities (actual and potential)** of the other organization.
  - Satisfies the directors’ **fiduciary duties** to their respective organizations.
  - Categories of information to inspect:
    - Corporate structure and records
    - Intellectual property
    - Contracts
    - Employment matters
    - Finances/debts
    - Compensation arrangements
    - Existing or threatened lawsuits

- **Obtain necessary approvals**
  - Funding sources
  - Board of directors
  - State/government officials (e.g., Attorney General)
  - Third parties to transfer contracts (e.g., landlord)

- **Merger filings**
  - Secretary of State
  - Notify IRS via final Form 990 filing
Who Are the Players and What Roles Do They Play?

Board Members
Role

- Analyzes pros and cons of merging, whether and how it will fulfill mission

- Board committee
  - Explores options and partners, including (especially for mergers) meeting with potential partners and overseeing negotiations
  - Oversees due diligence (in case of merger or setting up new entity)
  - Keeps full board informed
  - Makes recommendations to full board
Board Members
Votes

- **Full board votes on:**
  - Creating committee and scope of its authority
  - Whether to merge
  - Merger Agreement
  - Corporate documents (if a merger, plan of merger and articles of merger, etc.)

Board Members
Documenting the Decisions

- **Important to document board and committee discussions and votes in minutes**
  - Include the basis for board/committee decision(s)
  - Attach reports, other documents on which board/committee relied
### Board Members

**Fiduciary Duties**

- **Duty of Care:** In overseeing the organization, nonprofit board members must act with “the care an ordinarily prudent person in a like position would exercise under similar circumstances”
  - Possible personal liability if board members don’t carefully examine potential merger partner

### Board Members

**Business Judgment Rule**

- **Under the “business judgment rule,”** nonprofit board members who exercise good faith judgment will usually be protected from liability to the corporation
  - Even if the corporate action turns out to be unwise or unsuccessful
Board Members
Duty of Care

- Board members must make informed decisions
  - Board should obtain and consider written reports and professional advice before making important decisions
  - Board should ensure that a full, deliberative process is conducted and that directors are able to ask hard questions and get answers

Sample Merger Decision Matrix

<table>
<thead>
<tr>
<th>Variable</th>
<th>Value</th>
<th>Priority</th>
<th>Scores Based on 100 Total Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decisionmakers</td>
<td>Board leadership, Sr. Staff</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Timeframe</td>
<td>3-6 months</td>
<td>M</td>
<td></td>
</tr>
<tr>
<td>Program/Mission Fit</td>
<td>X100</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Operations Fit</td>
<td>X75</td>
<td>M</td>
<td></td>
</tr>
<tr>
<td>Culture</td>
<td>X75</td>
<td>M</td>
<td></td>
</tr>
<tr>
<td>Relative fit of Board</td>
<td>X55</td>
<td>M</td>
<td></td>
</tr>
<tr>
<td>Systems</td>
<td>X35</td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Public Relations/Fundraising</td>
<td>X95</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Is there a need?</td>
<td>X55</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Economically Feasible?</td>
<td>X100</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Impact on other programs?</td>
<td>X55</td>
<td>M</td>
<td></td>
</tr>
<tr>
<td>Can we provide a quality service?</td>
<td>X100</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Assets</td>
<td>X90</td>
<td>M-H</td>
<td></td>
</tr>
<tr>
<td>Current Assets/Liabilities</td>
<td>X100</td>
<td>M-H</td>
<td></td>
</tr>
<tr>
<td>Leases Obligations</td>
<td>X50</td>
<td>L</td>
<td></td>
</tr>
<tr>
<td>Pending Litigation Issues</td>
<td>X100</td>
<td>H</td>
<td></td>
</tr>
<tr>
<td>Other benefits the merger brings?</td>
<td></td>
<td>H</td>
<td></td>
</tr>
</tbody>
</table>
Management
Role

- The executive director or interim executive director, chief financial officer, chief operating officer (program or operations directors), other staff
- Due diligence
  - Programs and activities
  - Financial strength and viability
  - Sustainability
  - Staff culture and roles
- Plan for integration

Advisors
Role of an Outside Attorney

- Involve attorney early on
- Work with attorney(s) in your state with relevant expertise
- CAPLAW is available to consult with CAAs on CSBG-, Head Start- and other government-grant specific issues
- Each partner should work with its own attorney
  - Until, in the case of a formal merger/consolidation, both organizations’ boards vote to merge
Advisors
Role of an Outside Attorney

- Evaluate organization’s current legal situation
- Guide choice of restructuring options
  - Form follows function, legal rules
- Advise the board on its role and responsibilities
- Advise board and management during negotiations
- Conduct legal due diligence
- Draft legal documents
- Handle filings with state (Articles of Merger, etc.)

Merger Agreements

- Typical provisions
  - Merger structure
    - If asset acquisition, list of specific assets and liabilities being acquired
  - Name of surviving organization
  - Amending governing documents
  - Makeup of the board of the surviving organization
  - Senior leadership positions
  - Retention of employees
  - Continuation of key programs
  - Representations and warranties of each organization
  - Conditions for closing (e.g., obtaining needed approvals)
Advisors
Role of Other Outside Professionals

- **Consultants** – help identify partners and facilitate merging or other partnership
- **Accountants** (especially for mergers) – tax filings, impact on financial statements, due diligence
- **Funding sources/state association/local municipality** – understand landscape of organizations with shared missions, providing similar services

Lessons Learned from Other CAAs
Lessons Learned

- Build trust and familiarity with the other organization
  - Good relationship prior to merger is essential
- Ensure merger furthers each organization’s mission
- Be clear about how a merger will enable each organization to achieve its overall goals
- Conduct thorough due diligence
  - Be honest about each organization’s assets, liabilities, strengths, and weaknesses

Lessons Learned

- Have a strong advocate for the merger
  - CEO, board/board chair
- Keep your funding sources informed
  - Involve major funding sources (government/private) early in the process
- Communicate with and involve staff members
  - Communicate early and often to get staff buy-in
  - Work to align organizational and staff interests
  - Clarify new roles
Lessons Learned

- Don’t overlook organizational culture issues
  - Address integration issues from the outset
  - Anticipate future issues and concerns (size, reputation, financial strength, etc.)
- Engage outside experts
  - 3rd parties offer outside perspective
  - Rely on experts who are familiar with the merger process

Polling Question #3

3. What additional resources do you think would help your CAA be in a better position to consider a merger? (*select all that apply*)
   a. Additional case studies on CAA mergers
   b. Sample documents (merger agreement, confidentiality agreement, etc.)
   c. Resources/trainings on the due diligence process
   d. Resources/trainings for board members on their role in the merger process
   e. Other (please type into the chat panel)
Additional CAPLAW Resource

Working Better Together: CAPLAW's Guide to Shared Services and Mergers

http://www.caplaw.org/resources/PublicationDocuments/mergersandsharedservices/Introduction.html

Questions
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