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**Discussion Document**  
**Consolidation Review**  
\_\_\_\_\_, 2016

[Student]  
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Stanford Law School  
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# Overview

## **What we cover here**

You asked us to provide high-level information about legal and process aspects of merger and other organizational combination transactions.

We review at a high level:

- the board role in a merger transaction
- questions for consideration as you review potential mergers
- transaction structure alternatives
- transaction execution stages
- alternative approaches for combination and collaboration relationships

Our initial effort at identifying key strategic, operating, and legal questions presented by a combination is reflected in a separate document accompanying this handout.

## **What accompanies this document**

- draft worksheet for combination evaluation as noted above
- draft worksheet for collaboration evaluation and planning
- example of worksheet for summarizing information about each party
- example of time and responsibility schedule for merger transaction
- example of legal due diligence document request

# Key facts

[Org logo]

[Org logo]

[Org logo]

[key programs]

[key programs]

[key programs]

[location]

[location]

[location]

[target clients]

[target clients]

[target clients]

[\$[\_\_\_\_]] in annual  
revenues  
(source: 2014 990)

[\$[\_\_\_\_]] in annual  
revenues  
(source: 2014 990)

[\$[\_\_\_\_]] in annual  
revenues  
(source: 2014 990)

## Other facts

**Sector.** [\_\_\_\_\_].

**Discussions.** [\_\_\_\_\_].

# Board role

## **Fiduciary duties**

Board members have two basic state law duties:

- The duty of care requires that directors be informed about organizational activities, participate in decisions, and do so in good faith, in a manner that the director believes to be in the best interest of the organization, and with such care, including reasonable inquiry, of an ordinarily prudent person in similar circumstances.
- The duty of loyalty requires that directors act in the interest of the organization and not in their own interest or in the interest of another entity.

In carrying out their duties, directors are generally entitled to rely upon information provided by board committees, officers, employees, counsel, accountants, and other experts, so long as they in good faith believe such reliance to be warranted.

## **Specific approvals**

In a merger or other combination situation, the board of the continuing entity must formally approve:

- the merger or asset transfer itself
- any amendments to the articles or bylaws resulting from the merger, including changes in organizational name, board size, board terms, or officer structure
- any changes in board and committee composition and chairs resulting from the merger

In addition, the board would approve:

- any changes in mission or branding
- appointment of senior management of the new organization
- any changes in compensation and benefit arrangements
- facility changes or material IT or capital expenditures resulting from the combination

In general, the board would consider and act upon any material policy changes or expenditures arising from the transaction.

# Key questions

## **Key questions**

The core board role is to determine whether a proposed transaction furthers the mission and is in the best interest of Client. Attached is a worksheet setting out questions we encourage you to consider in reviewing the facts, testing assumptions, and working with management to make that assessment. The questions are grouped in these categories:

- Big picture
- Partner information
- Business case
- Integration
- Execution

The worksheet is intended to help structure go/no go analyses and facilitate detailed transaction and post-transaction planning. In addition, a near-term investment in the diligence and analysis process should provide experiences that will be useful if the sector in fact consolidates and you wish to pursue other combination opportunities.

## **Success factors**

We note also that the extensive literature on nonprofit mergers includes discussions of “success factors” in these transactions. Such factors include:

- shared views on mission enhancement
- strong internal leader driving the transaction
- use of a consultant or intermediary to help drive the transaction
- budgeting for transaction and integration expenses
- strong existing relationship between the senior executives of the combining organizations
- strong board engagement in the transaction
- staff involvement in integration planning
- institutional funder presence and support
- thorough diligence and financial testing/modeling

We encourage you to consider these factors in your review.

# Combination: legal steps

## Exploring and making the deal

### due diligence

Party A closely reviews Party B programs, finances, staff, contracts, intellectual property, and related matters. Party B will engage in similar examination of Party A. Goals include identifying opportunities and risks, building program and financial models, assessing funder, client, and other stakeholder support, and identifying needed third party consents.

### structure choice

Parties determine if transaction carried out through merger or dissolution of Party B followed by distribution of assets to Party A. Relevant factors include liability profile of Party B and relationship dynamics.

### definitive agreement

Parties and counsel negotiate and draft binding contract committing parties to transaction. Contract typically contains representations, conditions to closing, and provisions relating to post-closing matters, including board composition, staffing, and governance documents. Parties usually sign after board approval.

### board approvals

Each board must approve the agreement, the transaction, and other related matters (such as amendments to articles and bylaws, and changes in Party A board, if any).

## Implementing the deal

### third party consents

Parties seek approval from third parties as required under their respective grant agreements and other contracts. In addition, for dissolution, Party B would notify its creditors, who would need to make claim within specified period of time.

### notice to Atty General

Parties provide advance notice of transaction to California Attorney General. Submission includes copy of agreement, board resolutions, financial statements, and various representations about transaction impact. In dissolution, Attorney General must consent to transaction.

### state filings

Merger: parties file agreement of merger and related officers certificates with CA Secretary of State. Merger becomes effective upon filing or date specified in filing.

Dissolution: Party B files certificate of dissolution with CA Secretary of State. Documents are public.

### tax and financials

After closing, Party B files final returns with IRS and Franchise Tax Board. Party A includes appropriate disclosures in Form 990 and financial statements for relevant year.

Note: this discussion assumes that none of the parties has voting members.

# Combination: structure

## merger



### generally

Transaction in which two nonprofit corporations become one through operation of law; all assets and liabilities of “disappearing” corporation automatically become assets and liabilities of “surviving corporation.”

### this transaction

Party B merges into Party A and Party A survives. Some Party B directors may join the board.

### advantages

- Automatic and complete asset and liability transfer
- Symbolic value emphasizing continuation, integration, and collaboration
- Need only provide notice to AG (not obtain consent), so likely less risk of delay

### disadvantages

- Party A automatically takes on all Party B liabilities, known or unknown

## dissolution



Party B winds down operations by notifying creditors, paying off liabilities, and distributing remaining assets to Party A.

Party B adopts plan of dissolution, makes required notice, and enters into agreement with Party A providing for transfer of assets and assumption of related liabilities. Party A may promise to continue Party B programming. Some Party B directors may join the board.

- Party A does not automatically assume all Party B liabilities
- Provides incrementally better vehicle for addressing Party B liabilities

- Possible darker feel to transaction – “death” of Party B (although can be communicated in more positive way)
- Affirmative consent of AG required

### Branding:

Party A can merge with Party B and either maintain Party B as a separate brand and runs it as its own division, or keep and use the Party B brand name in program delivery, marketing, and fundraising but otherwise fully absorb and integrate Party B staff and systems. These approaches provide a way for Party B name, brand, and (to some extent) identity to continue, even if the Party B entity does not.

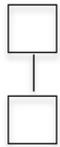
### Key factors affecting decision:

- nature and extent of Party B liabilities
- nature of actions needed to transfer contracts
- relationship dynamics and expectations

**Note:** can do three-way merger in single transaction

# Alternatives: other structural approaches

## Parent-sub subsidiary

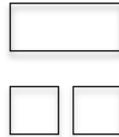


Party A enters into agreement with Party B requiring Party B to amend its bylaws to allow Party A to appoint all Party B directors.

Party B becomes a subsidiary of Party A. It continues to use its current branding and methodology. Party A provides administrative services and leads fundraising activities.

**Comment:** this approach allows for the Party B entity to survive and largely eliminates the need to obtain third party consents. There is meaningful administrative cost associated with maintaining two legal entities and, possibly, employers.

## Holding company

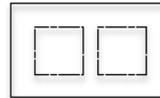


Party A and Party B create a new entity and amend their own bylaws to provide that new entity appoints all of their respective directors.

The parent entity provides administrative services and leads fundraising activities.

**Comment:** this approach, at least initially, has a more “combination of equals” feel. It also allows for both entities to survive, and largely eliminates the need to obtain third party consents. There is meaningful administrative cost associated with creating a new entity, obtaining tax exemption, and maintaining two other legal entities and, possibly, employers.

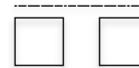
## Consolidation



Party A and Party B create a new entity. Both merge into the new entity.

**Comment:** this approach, at least initially, has a more “combination of equals” feel. There is meaningful administrative cost associated with creating a new entity, obtaining tax exemption, and obtaining needed third party consents.

## Interlocking boards



**Full overlap.** Party A and Party B agree that the same individuals will comprise the boards of both entities.

**Partial overlap.** Party A and Party B agree that some individuals will serve on the boards of both entities.

In each case, Party A provides administrative services to Party B.

**Comment:** this is a way to facilitate a deeper relationship and possibly greater programming and other coordination. It does not of itself result in cost savings, and “loyalty” and similar concerns may affect the dynamics.

**Note: mission and operational considerations should drive choice of structure**

# Alternatives: contractual collaborations

## Program delivery



**Teaming.** Party A and Party B team to offer a single product line to schools, with both organizations providing specific services.

**Subcontract.** Party A subcontracts with Party B to deliver specific services to a Party B client.

**License.** Party A licenses the curriculum and brand name from Party B and provides that service to Party A clients.

**Comment:** these are ways to expand programming and, for Party A, to possibly deepen existing and new immersive partnership relationships. These approaches may enable the parties to increase their respective client bases. Implementation may be challenging because of differences in teaching methodology, contract management approach, and “client ownership” dynamics.

(Attached is a worksheet setting out questions to consider in evaluating and planning such relationships.)

## Administrative



Party A enters into an administrative consolidation agreement with Party B. The agreement may provide for a range of services.

**Comment:** Client is familiar with this model. It could enter into new, and possibly broader, such relationships. We would imagine that Client would change the model to allow Client to make at least a modest profit on the service.

# Next steps

## Next steps

As your discussions progress with potential partners, we encourage you to:

- identify internal Board and management leads on the project
- consider retaining an experienced consultant for advice and analytical and negotiating support
- enter into a non-disclosure agreement with each potential partner
- begin initial diligence work by exchanging basic financial and operating information
- use the worksheets to shape your diligence inquiries and analysis

In addition, we encourage you to review selections from the literature on nonprofit mergers. At your request, we can provide you with links to materials we thought especially useful, and your consultant will be able to make recommendations as well.

\* \* \* \* \*

## Limitations

As contemplated by our engagement letter, the scope of our review was limited. We did not undertake a diligence investigation of Client, [\_\_\_\_], [\_\_\_\_], or any other entity. We examined only the documents and information you provided to us, and information publicly available through organizational websites and the Guidestar website. Our conclusions and recommendations are based entirely on this review.

## Thank you

Thank you very much for the opportunity to represent Client.