



AFP Information Exchange

Mergers and Acquisitions, Part III ***Legal Considerations for Mergers and Acquisitions***

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Mergers and Acquisitions

Part III – Legal Considerations for Mergers and Acquisitions

Five Important Legal Considerations for Successful Mergers

Once the board of directors of a nonprofit has determined, through due diligence, that it will engage in a merger transaction, the last thing the board wants is for the transaction to go awry for legal reasons. The legal components of a nonprofit merger are complicated and must be completed correctly. Therefore, it's imperative that an entity be aware of the legal aspects of changing its status.

The following are five key legal considerations to take into account when engaging in a non-profit merger:

1. **Get a Lawyer Involved From the Beginning:** Typically, the board will begin exploring the options relating to a merger or acquisition long before a decision to merge or integrate is actually made. A lawyer who specializes in nonprofit organizations will be an invaluable resource in addressing the concerns and legalities of engaging in a merger or acquisition transaction.
2. **Cover Your Assets and Liabilities:** When nonprofit entities merge or acquire one another, they are literally combining their “assets and/or liabilities.” These activities not only have legal connotations, but they also must adhere to generally accepted accounting principles. A good understanding of the nonprofit's assets and liabilities is essential, since a failure to understand these balance sheet items can doom the entire process. To make sure each side understands the merger or acquisition, the agreement must be clear on the type, condition and any other restrictions on the assets that are being transferred. For example, if a merging entity has an asset that is in the form of restricted funds, then this must be disclosed, because the surviving entity will be legally bound to observe such donor restrictions. It is very important that the acquiring entity knows of such restrictions in order to be compliant.
3. **Put Everything In Writing:** While we've heard this famous phrase from the time we were born -- it is vital that all parties memorialize the terms and conditions of

the merger in written words. Here again, the value of a lawyer can shorten the process by making sure both sides are compliant with all regulations and requirements.

Part of putting everything in writing includes memorializing all verbal and other representations made by the parties during the course of the due diligence and negotiation period. For example, if one party makes a representation that it has a fully current donor list of 4,500 names, then the written agreement should reflect this as part of the “deal.” Full disclosure is an absolute necessity in mergers or acquisitions because the parties are making decisions to enter into the transaction based on the representations that have been made.

4. **Identify the Type of Merger that Best Suits Your Need:** At the end of the day, a merger results in an “alliance” of interests that creates unity among the parties. However, there are many kinds of mergers, and how the parties go about achieving this “unity” is a question that has to be answered early on. In the legal world, there are “true mergers,” where entities may merge into one another through legal process to create an absolutely new legal entity. But there also are other ways to merge, which while differing legally, may result in the same or superior results. For example, a charity that desires to merge may be entitled to certain government revenue. However, the case may be that the governmental agency does not agree to the merger. As a result, there may be reasons why a true merger would hurt the parties because the governmental monies would not be accessible. In this case, the parties might choose to keep the original entity “alive,” while creating a controlled structure wherein factors such as staff, operations, etc. are “merged.”
5. **Government Approvals:** It is also important to recognize that, whether the merger is a true merger or some variation thereof, there may be a requirement for state and/or federal approval. Each state is different. For example, in California, not only does the Secretary of State need to review the legal documents of the merger and approve, the Attorney General also must be notified of the merger and give his/her consent. And, in the event that the merging entities have different missions, the IRS may need to be advised and its approval may be required as well.

Do It Right the First Time

Nonprofits provide an invaluable service to the communities they serve, so don't let the good work be diminished by failed due diligence. No matter what type of nonprofit merger or acquisition is involved, there are many legalities and traps for the unwary.

Please, always consult an attorney who specializes in nonprofit law. Nonprofit 501(c) (3) organizations are highly regulated entities and any mistakes could prove costly.

(None of the information contained herein shall constitute legal advice.)



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At Edward Charles Institute for Nonprofit Mergers and Acquisitions (ECI), we bring together charities that need to find partners. We find win-win conditions for both sides of the collaboration, acquisition or merger. In bringing together charities, we create an environment of trust, making the merger process efficient and successful. Founded in late 2008, ECI represents the collaboration of two nonprofit experts, Robert McKim, MA, CISA, CIPP and Kent Seton, Esq. With over forty years of nonprofit and business experience, including his current position as chairman of the board of Meals on Wheels, Robert has a solid understanding of how charities work and what it takes to bring them together. Kent, a seasoned attorney, has represented thousand of charities, both large and small.

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