

2009 OPPORTUNITY FINANCE NETWORK CONFERENCE

THE NEW NORMAL

Acquisitions & Joint Ventures

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Program Outline

- » Benefits of acquisitions or joint ventures
- » Overview of Acquisitions
- » Overview of Joint Ventures
- » Choosing a Transaction that's right for you
- » Conclusions

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Introduction

- What is an Acquisition
- What is a Joint Venture

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Benefits of Combining

- **Programming Synergies**
 - Strategic expansion
 - Utilize combined assets to try something new
 - Access complementary programs or assets
 - People and skill sets
 - Bring together complementary skills and build out teams
 - Operational economies of scale
- **Enhance your Profile**
 - Increase visibility
 - Increase market share
 - Develop reputation/influence
- **Economic Economies of Scale**
- **Finances**
 - Access broader and deeper base of support
 - Well-established organizations may have steady funding stream that could benefit the mission of a newer nonprofit
 - Reduce relative overhead costs
- **Personnel**
 - Build out the team
 - Gain a key manager or key expertise
 - Resolve succession issues

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Acquisition Structures

- **The target merges with and into buyer or a subsidiary of buyer**
 - Target may cease to exist
- **Buyer assumes target's assets, rights and liabilities**
- **Control of the board of directors of target company is turned over to buyer's board**
- **Stock purchase**

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Acquisition - Management

- **A transition plan is vital to effective integration**
- **After the acquisition, who will manage day-to-day operations?**
- **How will the leadership structures be integrated?**
- **How will employees be integrated?**
 - Who will be the CEO/Chairperson?
- **Board of Directors - Nonprofit directors bring important experience and relationships to the boardroom**
 - How can the directors be of highest value to the post-merger entity?
 - How will the boards be combined?
 - Avoid the "us versus them" situation
 - Will the merged entity seek new directors? How soon?
 - Who will leave?
 - Who will serve on board committees?

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Due Diligence

- A careful due diligence process will ensure that you know what you are acquiring
- Once discussion gets serious, focus on:
 - Cultural and programmatic fit
 - Key assets and liabilities
 - Key relationships (donors/funders, parties to material contracts)
 - IT and software integration
 - Insurance coverage roles in new organization
 - Financial, legal, accounting, HR and operational matters
 - Conflicts, consent and approvals

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Funding

- How are the organizations funded?
 - Private Donors
 - Philanthropic trusts/foundations
 - Government
 - Corporate partnerships/sponsorships
 - Service contracts
 - Revenues from operations
- How will a transaction affect each organization's legal rights and obligations under funding and other important contracts?
- Will a merger mean that funding from common donors is 2 + 2 < 4?
- Are sources of funds restricted as to how they may be used?
- Is court approval needed?
- Once the parties agree to merge, a coordinated effort must be made to engage the significant donors/funders on whose support the organization depends

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Legal Issues

- nonprofit entities are formed under and governed by the (Nonprofit) Law of the state of their incorporation
- There are also state regulatory considerations, which differ depending on the type of nonprofits involved
 - Example: in Pennsylvania and New York, the Attorney General and the Orphans' Court have jurisdiction over nonprofits
 - The Bureau of Charitable Organizations, the Department of Education, the Department of Health, and the Department of Public Welfare also regulate and/or license nonprofits
- Director and often member approval may be needed
- While many legal requirements with respect to mergers are similar to the for-profit world, there are differences so consult your lawyer

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Tax Issues

- A merger or acquisition may affect tax-exempt status. If both entities are tax-exempt before the combination:
 - Merger of one entity into the other may not require a new 501(c)(3) application or Form 1023
 - Consolidation of both entities into a new third entity would mean the new entity would have to apply for tax-exempt status.
- Regardless of the structure, if the mission or activities of the surviving entity are substantially different from those of the entity on whose exemption the combining entities wish to rely, a new application may be needed
- A nonprofit's Form 990 would advise the IRS of less significant changes to the nonprofit's mission or activities

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Joint Ventures - Overview

- No precise legal meaning
- Commonly called "partnerships," "JVs," "strategic alliances"
- An association of otherwise independent entities that combine resources for a defined commercial purpose to share risks and / or rewards
 - May be complex separate entities with independent management and financing
 - May be purely contractual arrangements, such as strategic licensing, distribution or development agreements

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Joint Ventures - Structure

- Contract
 - No separate entity is formed. Instead, the joint venture parties establish rights and duties set out in an agreement
- New entity
 - Corporation
 - Limited Liability Company
 - Partnership

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Joint Venture – Threshold Considerations

- **Goals**
 - What is the "big picture" being accomplished and what resources (time, money, IP, property, goodwill) are the parties willing to commit? Are there other ways to achieve the goals? How does a JV line up against an outright acquisition or organic growth?
- **Management/flexibility of ownership.**
- **Timing**
 - What is the anticipated duration of the venture?
 - What is the endgame and exit?
- **Liability**
 - What liability/responsibility will the partners have?

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Joint Ventures – Threshold Considerations (continued)

- Do the partners share a compatible vision of the venture and its goals?
- Do both partners share the same culture and values and will the personnel of the partners like and trust one another?
- Can the partners and the alliance live with both partners' policies and regulatory requirements?
- Operation must be consistent with each partner's exempt purposes
 - the operation must not result in any prohibited private benefit
- **With a For-Profit Entity**
 - Whole joint ventures - nonprofit contributes all of its assets and receives a membership interest in the joint venture entity
 - Ancillary joint ventures - nonprofit contributes part of its assets and the joint venture is not its only activity

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Joint Venture – Threshold Considerations (continued)

- **Finance**
 - Are outside investors needed?
 - If outside financing is required, what security does the lender want?
 - Do outside investors want a stake in the venture?
- **Third Party Involvement**
 - May other parties eventually join the joint venture?
- **Regulatory and licensing considerations**
- **Need for separate tax exception**
- **Licensing of JV entity**
 - Antitrust / competition law issues in collaborating with JV partner
- **Fiduciary / Implied Duties**

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Joint Venture - Management

- **Board of Directors**
 - Composition
 - Control of Board
 - Fiduciary duties owed to which partner?
- **Selection of Joint Venture Officers / Senior Managers**
 - How are joint venture officers and senior executives selected?
 - "Secoded" vs. separately employed management
 - Replacement / removal of officers
 - Fiduciary duties of officers

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Joint Venture – Management (continued)

- **Major decisions typically require approval by both partners:**
 - approval of budgets
 - material acquisitions or disposals
 - material capital expenditures or borrowings
 - significant loans
 - change in the scope of the venture's mission or business
 - changes to the constitutional documents of the venture
 - key executive appointments
- **Minority Interests**
 - scope of protection for minority party on fundamental decisions and changes

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Joint Ventures – Dispute Resolution

- **Identify and resolve (or provide a process to resolve) likely areas of dispute in advance**
- **How to resolve partner disagreements**
 - Dispute resolution committee
 - Escalation process
 - Utility of arbitration or mediation?
- **Deadlock on Key Matter?**
 - Certain matters: Deadlocks result in veto of the proposal
 - Other matters: Deadlocks give rise to termination rights

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Joint Venture -Term and Exit Strategies

- **Common Trigger Events to Terminate Joint Venture**
 - fixed date
 - achievement of (or failure to achieve) operational targets
 - management deadlocks
 - default by one of the parties
- **Common exit strategies**
 - Transfer of the venture to a third party
 - Termination and liquidation of the venture
 - Distribution of joint venture assets among the Partners
- **Resolution of a deadlock**
 - Operations of a joint venture can be halted if there is a disagreement among the parties

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Joint Venture – other considerations

- **Intellectual Property**
 - Access / right of partners to use IP of joint venture for non-competitive activities
 - Ownership of IP developed or modified by joint venture
 - Royalties?
- **Ability of Joint venture to use IP and licenses of Partners**
- **Use of Partners' Name**
- **Confidentiality – Protecting Intellectual Property**
 - Impact of a partner's refusal / inability to contribute additional capital (dilution, default remedies, financing by other partner through "deemed loan")
 - Ability of joint venture partners to lend money to venture (mandatory / voluntary)
 - Ability of joint venture partners to seek external financing
 - guarantee of external financing by joint venture partners
- **Due Diligence**
 - Usually required in relation to the contribution of non-cash assets
 - Regulatory or third party consents

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Merger or Joint Venture Which is Right for You?

- **Acquisition benefits**
 - Permanence
 - Independence and flexibility
 - Introduce cost efficiencies
 - Consolidation fixed costs/overhead
 - Other synergies
 - Increase spending on programming vs. administration

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Merger or Joint Venture Which is Right for You?

■ Joint Venture Benefits

- Spreading costs and risks
- Improving access to financial resources
- Accessing new technologies
- Gaining entry into a new market or gaining knowledge in a new area/constituencies
- Knowledge of a local partner
- Economies of scale
- Autonomy - Joint ventures allow the parties to achieve their goals without giving up autonomy
- Timing - Joint ventures can be short, medium or long term and may not be permanent

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Merger or Joint Venture Which is Right for You?

■ Joint Venture risks

- Sharing control / less independence
- Conflicts - the interests of the parties may diverge on certain matters

■ Acquisition Risks

- Liabilities of the target may attach to the acquirer
- Integration issues
- Management from the two older companies may have merger issues
- Permanent

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Other Issues - Use of Charitable Assets

■ Property committed to a charitable purpose generally may not be diverted from that charitable purpose

■ Funding sources often specify how the funds are to be used. If assets are restricted to specific purposes, changes to the charitable mission, purposes or activities should be carefully reviewed to determine whether court or other approval is required.

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Other Issues - Tax

- **Unrelated Business Income Issues**
 - Example: Items sold in a museum gift shop unrelated to the museum would generate taxable income.
- **Nonprofits may lose exempt status if they do not properly structure a for-profit affiliate**
 - I.R.S. may attribute taxable activities and taxable income of for-profit affiliate to nonprofit parent/affiliate
- **Implement internal controls to maintain separate corporate identity**

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Summary

- **Determine whether a merger or joint venture will help you accomplish your mission**
- **Identify a partner or target**
- **Conduct due diligence**
- **Implement public relations plan with key constituencies**
- **Finalize documentation and make corporate and regulatory filings**
- **Execute transition plan and either integrate organizations or manage joint venture**

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