

Need to know:

ABOUT MERGERS



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Post-pandemic – and now with the cost-of-living crisis – many organisations are looking at new ways of working and are exploring the possibility of merger. In this guide we set out the main legal issues you should think about when merging. We hope this guide will answer some of your questions, but do get in touch if you'd like to talk anything through.

Here are some of the main legal issues you should be thinking about:

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Is it in our organisation's interests to merge?

Your board should assess whether merger is appropriate, weighing up the reasons for merging and other benefits, but also considering the costs, barriers, risks and other options (e.g. collaborative working or transfer of a service or asset). Although preserving the heritage, brand and culture of your organisation may feature in this weighing exercise, the organisation's ability to fulfil its purposes/meet the needs of your beneficiaries effectively should be your first consideration.

For charities, the Charity Commission has produced a **guide** to trustee decision making, which is particularly helpful as a resource when trustees make significant decisions such as these.

The board of other organisation you are considering merging with will have an equivalent duty to further their organisation's purposes and so similar considerations will apply.



Do we have the power to merge?

Both organisations will need to have legal authority to merge. The first place to check is the governing document, which may have an express power. Often, a merger can be achieved under a very generally expressed power in the governing document. If there is no such power, it should be possible to add one through an amendment. In some cases it may be necessary to seek authorisation from the Charity Commission if your organisation is a charity.

Who can we merge with?

It is possible that your organisation will already be familiar with, and may even have previously worked with, potential merger partners. But that on its own is not enough.

Check whether the merger partner has compatible objects (as set out in the governing document). If the objects are not aligned but the receiving organisation in the merger has wider objects, it is possible for the transferring organisation to transfer its assets to be held by the receiving one on a restricted basis so that the assets can only be used to further the original purposes of the transferring organisation. An alternative option to explore is whether the objects of one of the organisations can be changed (which, for charities usually requires the Charity Commission to exercise its powers) so that the transfer can take place on an unrestricted basis.

Non-legal considerations include whether the organisations make a good match in terms of vision, values, culture, governance arrangements, funding sources and activities. Compatibility can be explored through both formal and informal means – open dialogue, due diligence or even through a trial collaboration. Discussions which are facilitated (often by a non-lawyer) can

often help to smooth the path, or identify blockers early in the process. Being clear about the brand of the new organisation is also important to explore at an early stage – will it be one of the party’s brands, some combination of both or a new one?

How can we get our stakeholders on board?

Whilst the ultimate responsibility for the decision to take a merger forward generally lies with the board, consultation can help the board take an informed view and retain the goodwill and engagement of supporters, staff, members, funders and other stakeholders. If the organisation transferring its assets is a membership organisation, the approval of its members should be formally obtained during the merger process and early consultation can help to pre-empt and address any potential opposition.



How will we structure this merger?

There are a number of ways to merge – three common ways of doing so are illustrated below:

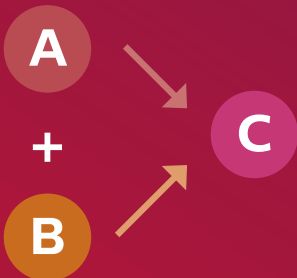
- **An asset transfer** where A transfers its assets and liabilities to B, with B continuing as the operational entity and A wound up or kept as a shell.



- **A change of control merger** where B becomes a subsidiary of A by A becoming the sole member or trustee of B.



- **A “merger of equals”** where A and B transfer their assets to a newly established C with C continuing as the operational entity.



The 'change of control' structure involves one organisation taking control of the other, rather than merging all the assets and liabilities into a single organisation. It may be used as an interim step, giving the 'parent' the opportunity to find out more about the subsidiary before taking the more significant step of an asset transfer, and is often a quicker process. Alternatively, there may be reasons why it is desirable to retain the subsidiary as a separate entity on a permanent basis (for example, to ring-fence valuable assets from risk, to protect potential legacies that might otherwise be lost in the future, or to avoid disturbing gift aid arrangements and direct debit payments that are being paid to the transferring organisation). Often though, it is not desirable to maintain two distinct legal structures each with their own separate boards, finances and employees.

As well as the legal structure, you should agree what the governance structure of the merged organisation will be – will the board comprise an equal number of members from each organisation? What will be the process for determining who is on that board? Who will be the chair? Who will be the CEO? If one organisation will be retained as a subsidiary, who will be on the board of that organisation? We recommend that discussions on these points are started at an early stage.



What other common obstacles should we look out for?

Things to look out for which can complicate and delay mergers include permanent endowment, property arrangements, secured borrowing, contract issues, gift aid, VAT, specialist regulatory approval (either for the merger itself, change of control of subsidiaries or change of control of regulated establishments such as care homes, schools etc), ongoing legal disputes, pension schemes and staff restructuring. In relation to mergers between non-profit organisations that are not charities, the tax issues (particularly corporation tax or capital gains tax and stamp duty land tax) can be particularly complex. These matters are made considerably less complex in a merger by change of control, which is why that type of merger is usually much quicker.

A due diligence exercise will assist with assessing these matters (see further below). A significant part of the due diligence exercise will be trying to establish whether the merger makes financial sense – are the current and future liabilities of one organisation much greater than the value of its assets, to the extent that the assets of the other organisation will be at risk as a result of the merger?



So, what are the key legal steps to merger?

A number of processes – including HR, finance and legal – will be set in motion by the initial decision to merge, and to keep on top of them we'd recommend forming a project steering group comprised of trustees and senior managers with relevant skills who will oversee the day to day business associated with the merger.

The typical legal steps involved in a merger depend on the merger structure and the size and complexity of the merger partners, but often involve the following (note that some of these may overlap and are not necessarily undertaken in this sequence):

- Entering into a confidentiality agreement at the outset to protect the early discussions that are taking place.
- Deciding on the merger structure and reviewing the governing documents of the parties and considering if any changes need to be made to enable the merger to proceed (e.g. to align the objects, include a power to merge or expand the membership provisions of the organisation that will continue following the merger)
- Preparing heads of terms setting out the parties' intentions – this may flush out fundamental problems at an early stage.
- Obtaining any regulatory approvals that may be required. For example, depending on the status and functions of the organisations, Charity Commission, Office of the Scottish Charity Regulator, Financial Conduct Authority, Ofsted, Care Quality Commission
- Undertaking a mutual legal and financial due diligence exercise so that each party can assess the viability of their merger partner, reviewing their assets and liabilities and identifying the steps to merger and any obstacles to overcome

- Taking steps to address any issues identified in the due diligence process
- Seeking consent from funders and contracting parties for the transfer of significant grants and contracts (including leases)
- Drafting the transfer agreement and other transfer documentation (e.g. to assign leases and novate contracts) using the information gathered in the due diligence exercise
- Obtaining members' approval to the merger if the transferring organisation has a membership.
- Informing and consulting staff in compliance with employment legislation
- Boards of both organisations passing resolutions to approve merger and transfer documentation
- Completing the transfer agreement
- Notifying third parties about the merger where necessary
- If the transferring organisation is not being kept in existence, preparing final accounts and winding it up, and, if it is a charity, registering it on the Charity Commission's register of mergers
- If the transferring organisation is being kept in existence (for example to protect potential legacies), amending its constitution and making arrangements for it to be governed, in a light-touch way, as a shell charity.



How we can help

You can find further guidance on merging in The Institute for Voluntary Action Research (IVAR) has a section of its website devoted to mergers, which was updated in light of the COVID-19 pandemic, [here](#), and a new edition of its downloadable guide [Thinking about...merger, during Covid-19](#). The Charity Commission publications [Collaboration and Mergers](#) and [Making Mergers Work](#). You can also find newly updated guidance pages on mergers on the NCVO website [here](#).

If you are thinking about merging, we'd be delighted to have an initial chat with you about it.

Get in touch



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This information is necessarily of a general nature and doesn't constitute legal advice.

This is not a substitute for formal legal advice, given in the context of full information under an engagement with Bates Wells.

All content in this document is correct as of February 2023.





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