

Mergers and Acquisitions for churches, charities and para-ministries

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Mergers & Acquisitions - ACC context

- Local Churches merging
- Care arms of different churches merging
- Other charitable entities (e.g. child care centre operators) merging

The terms “merging” and “acquiring” are often interchangeable and effectively mean the same thing.

“Merging” is a kinder term, as it helps the smaller church not feel like it is being taken over.

Even if the word “acquisition” is used, it normally acquisition by way of gift and assumption of liabilities.

To merge or not to merge ...

Advantages:

- Economies of scale – bringing together resources of both entities and the sharing of costs
- Shared knowledge – combining experience of teams to potentially provide a broader, greater diversification of key leaders
- Access gifted leaders – smaller church can access the gifted leadership teams of the larger church
- Larger donor pool
- Increased bargaining power

Disadvantages:

- Loss of unique culture and identity.
- Potential for financial instability – especially if both organisations were financially unstable to begin with.
- Disruptions to merging organisation – particularly if there is a relocation involved.

To merge or not to merge ... Do you have the blessing of the ACC movement?

The ACC State Executive desires that local church leaders speak with State Executive Leaders before merger at a local level is explored.

The reasons for this would, from our perspective, include matters such as:

- Awareness of other church planting / new ministry opportunities or initiatives within the movement that each of the local churches may also want to consider
- Cultural fit issues / or historic challenges that may not be known at a local level
- Safe-guarding the local congregations, their reasonable expectations and so the reputation of the movement as whole
- Movement blessing

Due Diligence

Due Diligence has begun ...

Much of it is informal as you engage with key stakeholders.

Initial merger consents / blessings to be sought ...

- Local Board
- State Executive
- External Lenders (on a preliminary basis to be formalized later)
- Local Leadership Team
- Local Membership

For both ministries that are considering merging.

Merger design ...

- **Asset transfer** - Transfer of assets & agreed liabilities from the target entity and deregister the target entity?

Known liabilities cannot be left with the target entity.

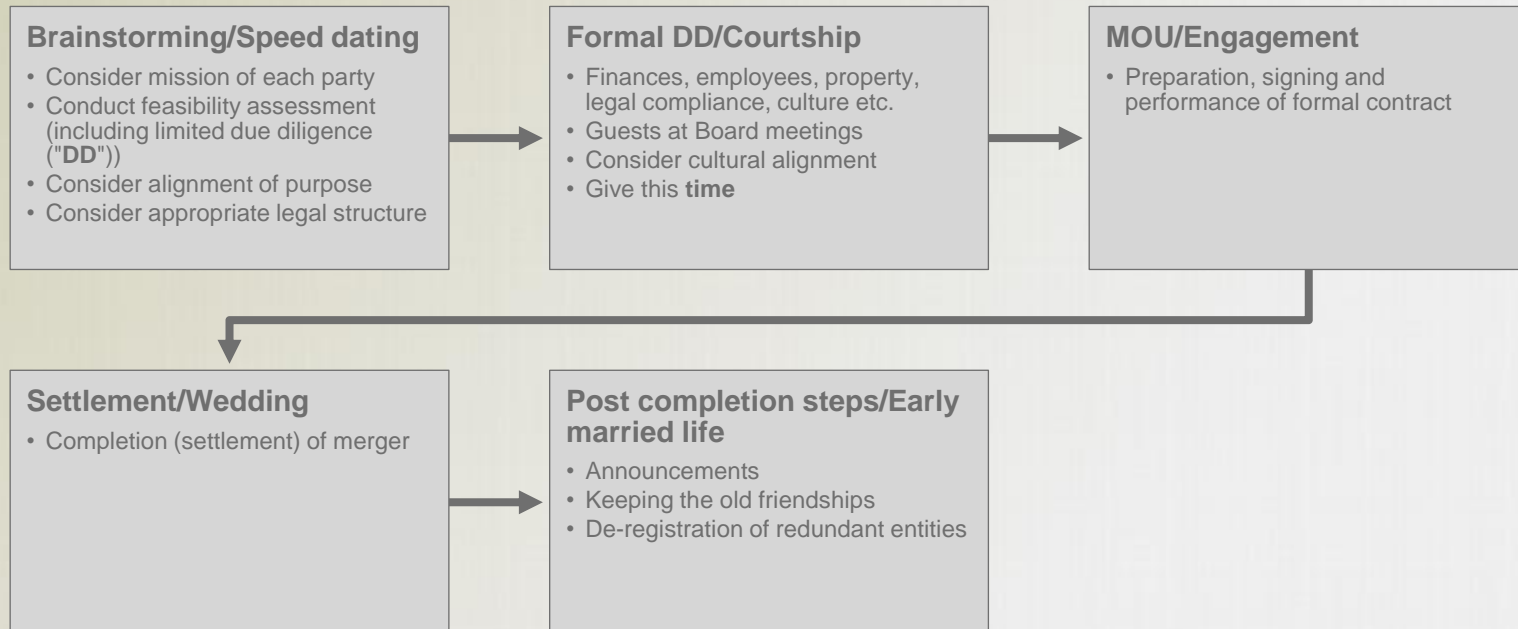
If target entity knows of Will bequests in their favour best practice is keep the target entity going.

OR

- **Entity transfer** - For more complex enterprises consider a transfer of control of the target entity. **Downside** – all the liabilities come with the entity

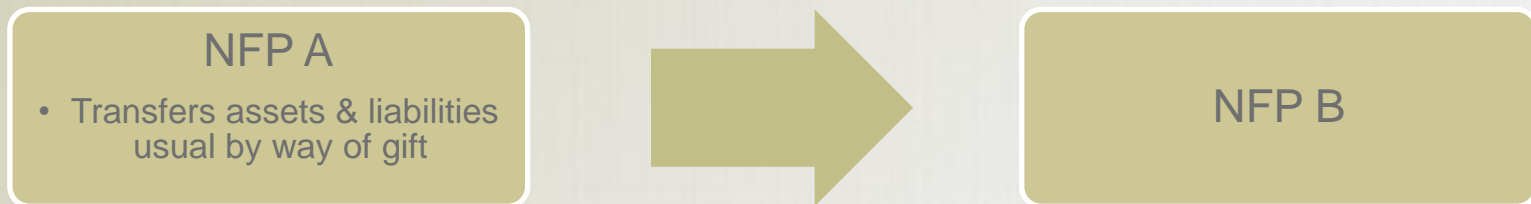
Take some professional advice at this point. Develop a Budget and a time line.

The merger process



Legal structures

Asset Transfer



Feels like:

A takeover ❌

One less entity:

NFP A wound up or deregistered ✓

Control:

Representative/s of NFP A can become members/directors of NFP B ❌

Cash:

All funds of NFP A transferred to NFP B at completion 😐

Identity:

Various options but some loss 😐

Material contracts:

Need to be assigned and novated to NFP B ❌

Roadblocks:

Possible different charitable purposes ❌

Contingent liabilities in NFP A ❌

Legal structures

Membership Transfer

Sole member

NFP B
(parent)

NFP A
(subsidiary)

Feels like:

A takeover ❌

Both entities remain:

NFP B becomes the sole member of NFP A 😐

Control:

Control in hands of the members → ultimately NFP B in control 😐

Cash:

Each entity retains own funds following completion 😐

Identity:

Each entity retains its identity / branding / reputation / charitable purpose ✓

Material contracts:

Stay with each entity BUT check deemed assignment clauses
caused by change in control ✓

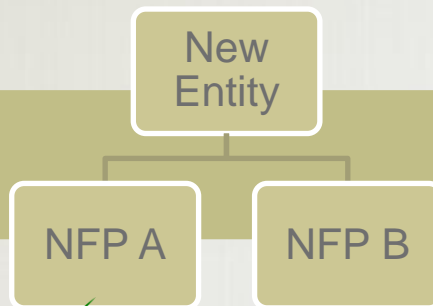
Roadblocks:

Most roadblocks removed (if NFP A and NFP B have different charitable purposes,
great care must be taken in inter-entity arrangements) ✓

Legal structures

New Parent Entity

Sole member



Feels like:

A merger with an exit path ✓

New entity:

New parent entity created → sole member of NFP A and NFP B 😐

Control:

Various options 😐

Cash:

Each entity retains own funds following completion 😐

Identity:

Each entity retains its identity / branding / reputation ✓

Material contracts:

Stay with each entity BUT check deemed assignment clauses caused by change in control ✓

Roadblocks:

Most roadblocks removed (If NFP A and NFP B have different charitable purposes, great care must be taken in inter-entity arrangements). ✓

Legal structures

New Single Entity



Feels like:

A merger with **no** exit path ✓

New entity:

New entity created → NFP A and NFP B transfer assets / liabilities to new entity.
NFP A and NFP B generally wound up / deregistered 😊

Control:

Members / directors of new entity comprised of individuals from NFP A and NFP B ✓

Cash:

NFP A and NFP B transfer all funds to new entity ✓

Identity:

Both identities subsumed by new entity. Can be managed well 😊

Material contracts:

All material contracts assigned and novated to new entity ✗

Roadblocks:

Possible different charitable purposes ✗

Contingent liabilities in NFP A or NFP B ✗

Legal structures – consider all entities

Remember a local ACC church normally has:

- Company Limited by guarantee (carrying on the enterprise of the church)
- A property trust for each piece of real property they own with a property trust company. Could be multiple trusts if multiple pieces of real property

All entities need to be considered

Information needed – mutual disclosure

- Up to date Financials (including Balance Sheet)
- Board Minutes for the last 12 months (longer if entity transfer)

Assets

- Real property details – address, real property description (Lot # on SP #), money owed to who on the property
- List of material contracts of the target entity (e.g. leases)
- List of employees / key contractors of the target entity

Liabilities

- Any material (or reasonably probable) liabilities (including those not on balance sheet), including complaints of abuse
- Any commitments that gifted money or property be applied for particular more limited purposes than the objects of the entity
- Insurance claims over the last 24 months

Information needed – why *mutual* disclosure?

- Mutual trust
- Target entity has confidence in the robustness of the other party and that target entity assets are not needed to prop it up

Assets on charitable trust – the terms of the trusts must be strictly followed

- Most ACC land is held on charitable trust and the terms of those trusts need to be examined to determine what *assembly* is entitled to pass resolutions to give the trustee directions about how to deal with the land
- Beware of *informal charitable trusts* – gifts made and accepted on the condition that they be applied in a particular manner
- Beware of *DGR fund monies* – these are impressed with narrow charitable trust purposes

Alignment of charitable purpose & tax concessions

- Both parties to the merger need to have an alignment of charitable purpose
- For example – both – *advancement of religion*
- If misalignment (even partial) specific advice needs to be taken as Governors (and probably members) of a charity owe duties to ensure that the assets of the charity are only applied in a manner consistent with the purposes of the charity
- Consider tax concession alignment (and GST registration for going concern treatment)
- Consider use of a single new Church Enterprise Trust or Land Holding Charitable Trust

Alignment of membership structures

- Some ACC entities have:
 - *Narrow membership* – such that the Directors are the Company members
 - *Broader membership* – Company / Church membership more board than the Directors
- For broader membership target body, asset transfer often more attractive. Special Resolution of those members may either be required or prudent – check the Constitutions carefully.

Treatment of assets and liabilities

Asset transfer (gift)

- Only the agreed assets & liabilities are transferred
- Can't leave the target entity with no assets and liabilities – personal liability of directors
- Target entity usually deregistered (simpler than full windup) after transfer. But only if confident are no sleeping liabilities.

Entity transfer (gift)

- Comes with all the assets liabilities whether known or not
- Company limited by guarantee – change of Member and Directors
- Consider deemed assignment provisions in Leases for example (when change in control)

Emerging Issue:

Contingent Liabilities

Contingent liabilities from lifting of limitation periods for child sexual abuse is one example.

Rather than the expense of a formal winding up, entities that have no further purpose are sometimes just de-registered as an administrative step under s 601AA of the *Corporations Act 2001* (Cth) (see next slide).

Emerging Issue:

Contingent Liabilities

A 601AA - Deregistration--voluntary

Who may apply for deregistration

- (1) *An application to deregister a company may be lodged with ASIC by:*
- (a) *the company; or*
 - (b) *a director or member of the company; or*
 - (c) *a liquidator of the company.*

If the company lodges the application, it must nominate a person to be given notice of the deregistration.

Circumstances in which application can be made

- (2) *A person may apply only if:*
- (a) **all** *the members of the company agree to the deregistration; and*
 - (b) *the company is not carrying on business; and*
 - (c) *the company's assets are worth less than \$1,000; and*
 - (d) *the company has paid all fees and penalties payable under this Act; and*
 - (e) *the company has **no outstanding liabilities**; and*
 - (f) *the company is not a party to any legal proceedings.*

Emerging Issue:

Contingent Liabilities

Section 601AH allows an “aggrieved person”, which has been interpreted broadly and has been extended to contingent creditors, to make an application to court for re-instatement of registration of the company on the basis that it is “just” to do so effective from the time of deregistration (s601AH(5)).

Emerging Issue:

Contingent Liabilities

Section 601AA was considered in the NSW Supreme court in, *Vero Insurance Ltd v Nicejade Pty Ltd* [2010] NSWSC 556 (1 June 2010), with the following cautionary comments from Barrett J:

I should add that the facility under s 601AA to obtain “voluntary” deregistration is one that is properly resorted to only in clear and uncontentious cases where a company has come to the end of its useful life and has been reduced to a mere worthless shell without any continuing legacy. It is not a means of circumventing winding up in case where there is any estate to be administered or any background from which claims for the benefit of creditors may emerge. The court will take these matters into account in deciding what is “just” for s 601AH(2) purposes [i.e the reinstatement section]. That has been done in this case in light of the fact that the controllers of Nicejade were aware of the facts grounding Vero’s claim which they chose to subject Nicejade to a s 601AA application.

Staff, ministry leaders & people

- People are down on what they are not up on
- Design where we are pre merger and what it might look like post merger
- Regular information sessions with many opportunities to ask questions
- Formal meetings passing resolutions to merge (post MOU)

MOU

- Written binding agreement to transfer (usually by way of gift) what is happening and when
- Normally subject to:
 - Formal approval of the MOU by special resolution of both parties
 - Formal consent of banks (who would have been spoken to before this point)
 - Formal consent of Landlords
- Needs to be lodged with the OSR with a well considered application for exemption from transfer (stamp) duty which will otherwise be assessed on market value

Merger settlement date

Merger announcements

- Settlement date – the agreed date in the MOU when the transfer takes place
- Announcement Date – could be different to the settlement date, but conservatively only if the MOU is unconditional

Post merger tidy up

- There is normally a long list of items to be tidied up administratively post merger and staff allocation for these tasks cannot be under-estimated

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Questions