MERGERS

Signing an LOI and negotiating a final agreement

Experts advise negotiating a letter of intent covering major issues so they are ironed out before exhaustive due diligence starts

By William Ehart

You and the senior team of your association have evaluated the pros and cons and identified a promising merger or acquisition partner. You've had positive initial, informal conversations with the other organization's leadership. The next steps are for leaders of both groups to sign a nondisclosure agreement (NDA) to ensure further talks are confidential, form an M&A steering committee and begin working toward a letter of intent (LOI) to merge.

An LOI ideally spells out what the new association will be — from a brand, governance and tax status perspective — and who will lead it when the merger is finalized.


Tenenbaum

"The LOI can be whatever the parties want it to be," said Jeff Tenenbaum, an attorney specializing in nonprofit law.

"There are some circumstances where the LOI is extremely general and high level and doesn't really say much of anything. Our preference, and we do a lot of these, is to make the letter of intent as specific as we possibly can, because doing so fleshes out the biggest issues, potential challenges and hurdles and forces the parties to address them," he said.

Those issues include the structure of the board that will govern the combined entity, who will be CEO and whether the deal will be a true merger, an asset transfer and dissolution, or a joint venture agreement, Tenenbaum said.

"There may only be a sentence or two on each one of those key points, but it really forces that early negotiation and helps the parties determine whether the deal is workable and doable," he said.

"Once an LOI like that is agreed to and signed, in our experience, all of the steps that follow tend to be a lot easier."

Getting started: NDAs and steering committees

Before entering any formal negotiations on an LOI and other aspects of the merger or acquisition, key association leaders, those privy to the talks, should sign an NDA.

"As soon as you start any really meaningful discussion, there's going to be a sharing of sensitive, comprehensive information," said Jeff Tenenbaum, an attorney specializing in nonprofit law.

"Besides binding confidentiality obligations, the other thing that we sometimes put into these merger-related NDAs is an exclusivity period that both parties agree to not have any discussions and negotiations with other groups about a potential merger for some period, like six months."

After signing the NDA, the parties would form a steering committee to begin more serious negotiations. Such committees are typically composed of top volunteer leaders of both organizations and possibly the CEOs. The steering committee would then begin pre-diligence — the first look at each organization's financial and legal picture — and negotiation toward a letter of intent (LOI) to merge.

Experienced M&A consultants like Eric Curtis, CEO and managing partner at Curtis Strategy and Jay Younger, president of McKinley Advisors, suggest a relatively small steering committee of two to four board officers from each organization, the CEOs and perhaps a senior staffer from each.


Younger

"We like to keep that steering committee reasonably compact," Younger told CEO Update. "We suggest, and have been well served by having, parity — the same number of people from each organization — so there's no perception that one side is outweighing the other."

"You're going to be meeting in person, so the bigger the committee is, the more challenging, schedule-wise, that becomes," Curtis said.

Younger and Curtis facilitate negotiations between the two sides, including talks about the composition of the steering committee.

"The people on that steering committee should be your champions of change," Curtis said. "They should not be the ones you need to prove anything to" about why the transaction makes sense.

The LOI basics

Curtis said he helps negotiate four key items that should be addressed in an LOI:

- Brand (the marketing name of the combined organization)
- Board (the governance structure)
- Leadership (who the CEO of the combined entity will be)
- Surviving entity (the tax ID number that will be used)

Trying to create a new tax ID number with the IRS introduces more costs and delays, he said. It's better to figure out which of the existing tax IDs will be more advantageous.

Negotiating an LOI can take weeks or months. Consider one particularly complex example: It took nearly five months for the Plastics Industry Association (PLASTICS) and the Society of Plastics Engineers to agree on an LOI, said PLASTICS CEO Matt Seaholm. PLASTICS is a 501(c)(6) industry group and SPE is a 501(c)(3) professional society. The two entities began integrating in January but the final documents aren't expected to be signed until October, a full year after the LOI was finalized, Seaholm said.


Seaholm

The parties hired Tenenbaum and Younger to help with the LOI negotiations and later talks toward a licensing agreement, which was reached late last year.

The steering committee, which Seaholm called a task group, consisted of six members from each board of directors. Seaholm and SPE executive director Patrick Farrey were present during talks but didn't have voting power.

While the LOI should cover the major bases, as Tenenbaum recommends, talks toward reaching one should not get bogged down in details like staffing issues. Board members on the steering committee should remain focused on governance, not operations.

"The LOI doesn't have to answer every question, particularly those questions that are operational in nature," Younger said.

For instance, Curtis said, lower-level staffing decisions should be addressed later, by the CEO during the eventual integration of the two associations, not as part of LOI negotiations.

Curtis

"There's so much emotionality around staffing. That can kill a deal," Curtis said. "What is important is to have the CEO and their direct reports identified before the closing of the deal. But below that level, we don't want to get into too much of the integration work because the CEO who will be overseeing both organizations will need to have the time to do a thorough assessment" in the year or two after the merger closes.

After the LOI is signed, the time-consuming and expensive process of due diligence starts. That includes an exhaustive assessment of the financial position of both organizations, including any leases or expected capital expenditures — which may necessitate the use of an outside accounting firm — and of legal risks such as potential liability in any pending litigation against either of the parties, which will run up the legal bills.

That's another reason Tenenbaum recommends a robust LOI.

"You don't want to do all that unless there has been a meeting of the minds between the parties on the core issues," he said.

Communications strategy

After the LOI is signed, the proposed merger should be carefully communicated to stakeholders: the board members who will vote on the definitive merger agreement, members of each organization who may also have a vote and the trade press. Organizations that lack a sophisticated and capable marketing and communications staff may consider hiring an outside firm.

"You have to think about all of the key audiences that need to hear the organization's messaging," Younger said. "It's really helpful to have robust communications strategy, planning and execution, particularly when you need to have a member vote. You want a detailed communication sequence that's been laid out, and town halls, FAQs, one-on-ones with members of the board," he said.

"It would be impossible to over-resource the communications effort when there is a member vote in question, because it really does create a bad look for everybody if the boards bring this kind of decision forward and the membership votes it down."

For board communications, Seaholm had one-on-one meetings with all 31 of his board members ahead of their vote on approving the LOI. (The acquisition did not require a full membership vote.)

"I wanted everybody on the board to feel like they got a chance to hear about it directly from me as well as one of the members of our task group, and had a chance to ask questions," Seaholm said. "Because when you get 31 people around a table and you have a two-hour meeting, people feel like they didn't have enough time to ask questions. That was probably the most important thing we did on the PLASTICS side to get this thing approved unanimously by our board of directors."

On the SPE side, the board vote in favor of the merger was nearly unanimous, Seaholm said.

"With most high-stakes change in associations, there's usually a strong majority of support and a very vocal minority opposition," Younger said. "We've seen 10% or 15% minority perspectives that probably command 80% of the oxygen and you have to deal with that. You have to meet people in the public square and address the questions that are coming forward."

An attorney like Tenenbaum could get involved in the communications plan to review the messaging and make sure it doesn't go beyond what has been agreed to in the letter of intent.

Typically, the organizations will craft a public statement once the LOI is signed, Tenenbaum said. If the LOI is not as comprehensive as he recommends or if major points are yet to be negotiated, "you don't want to put something out that says, 'Yep, we're going to merge,'" he said.

Programs and events

Ahead of a definitive merger agreement, the future of the combined organizations' programs, dues structures and events would need to be hashed out. Fortunately, after the LOI is signed and the merger talks become general knowledge, more board members and staff can be brought together to help harmonize those elements, Younger said.

"Once you can open the aperture to involve other members, we often benefit from expanding that tent of volunteers who can work in support of particular areas of the new construct," Younger said. "We can have a joint education work group; we can have a membership work group. We look at financial models," he said.

"We build, typically, a three-year pro forma for what the consolidated entity is going to look like on both an operating and balance sheet basis. There's good work that happens between the LOI and definitive merger agreement stage so that the organization is ready to go on day one post-closing, with some of those decisions already informed by the voice of the members.

"Members can get passionate about particular programs and services that are offered by their association, and that's where that effort to have the members weigh in on what the future model should look can really provide some benefit."

Except for the confidentiality provision, terms of the LOI are not legally binding, Curtis said. But once associations reach the LOI, the odds are good that the merger will happen, he said.

If the resulting merger agreement is approved by both boards of directors and, if necessary, by the association membership, congratulations, you've got yourself a merger. Then the integration of the two organizations — a potentially years-long process — begins. ■

Coming in October: How to integrate two associations after a merger or acquisition.

Younger, Curtis, Tenenbaum and Seaholm were among panelists at the Sept. 9 CEO Update LIVE: Association M&A Workshop.