

# MERGER CASE STUDY

The Minnesota Office of Economic  
Opportunity Encourages Mergers

*This case study is based on CAPLAW's interview with several staff members at the Minnesota Office of Economic Opportunity. This case study explores what state CSBG offices can do to facilitate merger explorations among Community Action Agencies in their respective states.*



The Minnesota Office of Economic Opportunity (OEO) is the state office responsible for administering the Community Services Block Grant (CSBG) program in the state of Minnesota. OEO took the time to speak to CAPLAW about how CSBG state offices can facilitate mergers and the obstacles that arise. In the conversation three major topics arise: encouraging merger talks, government grants, and merger costs.

## ENCOURAGING MERGER TALKS

According to OEO, “we bring the [merger] discussion up regularly.” OEO believes that state CSBG offices are well positioned to encourage merger talks. State CSBG offices have relationships with CAA executive directors and are aware of the strengths and weaknesses of their CAAs. This information can help a state office identify a CAA that could benefit from a merger. For instance, OEO encourages merger talks when it learns of an executive director’s plans to retire, or when it believes that the services provided by a CAA can be improved or made more sustainable by merging. In other instances, where a CAA is actively looking for a merger partner, the state office can be a good resource for suggesting partners.

If merger discussions have been initiated, OEO has suggested that it can be a good idea to keep merger talks confidential until the board has had the opportunity to vote on whether to proceed with merger negotiations. “There is a reason that in corporate America they don’t start talking about mergers two years before they are ready to pull the trigger,” OEO staff commented. Although keeping merger discussions private during the initial stages can be controversial “because there is this balance between bringing people in on the process,” disclosing too early can allow for unnecessary opposition from individuals or groups that do not understand the benefit of the merger. Disclosing to staff, funders, and other parties after the board has decided to proceed with merger negotiations rather than before allows for input on the merger process yet keeps opposition from interfering with the board’s ability to make a reasoned decision on whether the merger is in the best interests of the organization.

Lastly, OEO emphasized that it is always better to initiate merger talks when a CAA is financially strong rather than when it is facing financial difficulties and an uncertain future.

# GOVERNMENT GRANTS

**HEAD START** According to OEO staff, a significant obstacle to a merger of two CAAs with Head Start programs is the potential for competition of the non-surviving CAA's Head Start program. The Administration for Children and Families (ACF) (the agency within the U.S. Department of Health and Human Services that administers the Head Start program) takes the position that mergers of Head Start grantees usually require ACF to offer an open competition in the service area of the grantee being absorbed. Unfortunately, after one recent merger of two Minnesota CAAs with Head Start programs, the surviving entity was not successful in competing for the Head Start funding relinquished by the non-surviving CAA.

A possible solution to this problem may be for one of the merging CAAs to become a corporate subsidiary of the other; the subsidiary corporation would thus retain its corporate existence and should be able to continue operating its Head Start program. An ACF official has indicated informally that this structure should not require competition; however, ACF has not issued any formal guidance on the matter. Therefore, CAAs facing this situation should discuss with ACF whether such a parent-subsidary relationship would avoid the need for competition and, if so, work with an attorney to structure the merger accordingly.

**CSBG** When two CAAs merge there may be a concern that some CSBG funding could be lost due to state formulas for allocating funds. Although the level of CSBG funding is usually tied to the size of the low-income population served by the CAA, many states set a base level of funding that every CAA can expect to receive regardless of its service area size. Therefore, when CAAs merge, it is possible that the level of funding that will be allocated to the resulting CAA will fall short of the level of funding that both CAAs had received as separate entities. The drop in funding can be a disincentive to merging. To eliminate this disincentive, OEO provided CSBG discretionary funding to one merged entity to make up the difference. OEO also worked to change the state statute on the CSBG funding formula. In 2014, due in large part to OEO's



efforts, the Minnesota legislature amended this statute to specify that generally, when two Community Action Agencies (CAAs) merge, the merged entity will receive a base funding amount equal to the sum of the base funding amounts each of the merging CAAs had received before the merger.<sup>1</sup>

OEO staff also noted that the fact that Minnesota's Community Action regulations detail the process for CAAs to follow in obtaining OEO approval of a proposed merger clarifies and streamlines the merger process.<sup>2</sup>

## MERGER COSTS

The costs associated with merging can be high and a roadblock to success. Merger costs are often more expensive than anticipated. Hiring lawyers to review and draft corporate documents (such as articles of merger and bylaws), accountants for due diligence and tax filings, consultants, and costs for website re-designs, new logos, signs, and marketing are but some of the expenses that can be incurred during a merger. The ability of the state CSBG office to contribute to these costs – for example, through grants of state CSBG discretionary funds – can play an important role in making a merger possible. OEO also encourages state offices to reach out to the local philanthropic community to help raise funds for the expensive costs associated with merging.

## LESSONS LEARNED

- Mergers can help keep small or struggling CAAs improve their viability and sustainability. State CSBG offices can play an important role in encouraging and facilitating mergers by: encouraging CAA executive directors to reflect on their organizations' strengths and weaknesses; bringing CAA executive directors together to discuss mergers; and helping to pay for some of the costs related to CAA mergers.
- News of a CAA executive director's plans to retire can provide a great opportunity for a state CSBG office to initiate a discussion on merging. The imminent gap in leadership can provide the impetus needed to encourage a merger exploration.
- Initial merger discussions should be kept private until each CAA's board has had an opportunity decide whether to pursue the merger.
- Mergers of two CAAs with Head Start programs are likely to require competition for the non-surviving CAA's program. However, it may be possible to avoid competition by structuring the merger as a parent-subsidiary relationship. CAAs facing this situation should discuss with ACF whether such a parent-subsidiary relationship would avoid the need for competition and, if so, work with an attorney to structure the merger accordingly.
- State CSBG offices should be proactive in adopting regulations (and, if necessary, advocating for changes to state law) that: (1) provide a clear process for CAAs to obtain the state CSBG office's approval to merge; and (2) ensure that the merged entity will not receive less CSBG funding than the combined amount of CSBG funding received by each CAA before the merger.

## FOOTNOTES:

1. See Minnesota Statutes § 256E.30.
2. Minnesota Administrative Code § 9571.0040.

*This publication is part of the National T/TA Strategy for Promoting Exemplary Practices and Risk Mitigation for the Community Services Block Grant (CSBG) program and is presented free of charge to CSBG grantees. It was created by Community Action Program Legal Services, Inc. (CAPLAW) in the performance of the U.S. Department of Health and Human Services, Administration for Children and Families, Office of Community Services Cooperative Agreement – Grant Award Number 90ETO433. Any opinion, findings, and conclusions, or recommendations expressed in this material are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Health and Human Services, Administration for Children and Families.*