

Kaplan

May 15, 1986

Premerger Notification Office
Room 303
Federal Trade Commission
Washington, D.C. 20580

Re: Request for Informal Interpretation of
Requirements of the Hart-Scott-Rodino Antitrust
Improvements Act of 1976
and
Alternative Request for Waiver of Notification
Requirements as to Transaction

Gentlemen:

Pursuant to 16 C.F.R. §803.30, 15 U.S.C. §18A(d)(2)(B), and 16 C.F.R. §803.11(c), we hereby request an informal interpretation by the Commission staff and a confirmation that the transactions described herein are not subject to the reporting and waiting requirements of §7A of the Clayton Act as added by the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "Act") or, alternatively, a waiver of the reporting and waiting requirements for the transactions described herein.

Material Facts

Our client, _____, Inc. ("SYSTEM") is a non-profit corporation formed in part to cause its trustees to serve as the membership of health care institutions (hospitals, nursing homes and other health-related facilities), as designated by the membership of the corporation. We are enclosing as Exhibits A and B to this document the SYSTEM organizational papers, as amended. Exhibit C is an organizational chart of SYSTEM and its affiliates, and Exhibit D describes generally the relationship between SYSTEM and any "sponsored" institutions. Presently, the individual trustees of SYSTEM constitute the sole members of the following non-profit corporations shown on Exhibit C:

(hereinafter, the "Sponsored Institutions"). SYSTEM and the Sponsored Institutions are all 501(c)(3) organizations. SYSTEM is also a member of certain other non-profit corporations and holds the shares of one newly-formed for-profit corporation, but none of those other operations, individually or in the aggregate, represents more than \$10 million in annual revenues or in assets. We enclose as Exhibit E a copy of the consolidated financial statements for SYSTEM and the Sponsored Institutions, including in the final section information on the assets and revenues of each.

For a variety of corporate governance and business reasons, including a desire to simplify the approval process for renovating and equipping existing health care facilities; acquiring, constructing and/or equipping new health care facilities; participating in new health ventures; and financing the foregoing activities, SYSTEM has formed a non-profit corporation named _____

_____, Inc. ("NEWCO"). It is proposed that NEWCO be substituted as the sole member of each of the Sponsored Institutions except No. 1, which is in the process of organizing a holding company of which NEWCO would become the sole member. The net effect of this transaction for competitive purposes will be nil, because both before and after the reorganization the Sponsored Institutions will ultimately be reporting to the SYSTEM Trustees.

Coverage Under the Act

The Act applies to the acquisition of "voting securities" or "assets." §18A(a). The first question, then, is whether there are any assets or voting securities being acquired. Neither of these terms is defined in the Act or the Regulations. In fact, a definition of "security" was deliberately deleted from the Regulations. Statement of Basis and Purpose, 43 F.R. 33,462.

The law views the acquisition of an "asset" as the acquisition of something tangible from a prior owner. In this particular reorganization, all of the assets of the Sponsored Institutions will continue to be owned by the corporations that presently hold title to them; nothing will be transferred to NEWCO or to SYSTEM. Thus, there is no acquisition of an asset.

Similarly, no voting securities will be acquired in this transaction. As non-profit corporations, the Sponsored Institutions

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do not issue voting securities. As the Commission stated, "the term 'security' has a commonly understood meaning which poses no difficulty in the vast majority of transactions." 43 F.R. 33,462. Membership in a charitable corporation is not commonly understood to be the same as owning stock. Even the pre-promulgation drafts of the Regulations including a definition of the term "security" did not at any time list membership in charitable non-profit corporations as securities. This is most likely because an indispensable element of holding a "security" under the "commonly understood meaning" is that there would be "a reasonable expectation of profits" for the investors. United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 851-858 (1975). The member(s) of the Sponsored Institutions do not have an expectation of profits, and in fact non-profit corporations are prevented by law from using their assets for the benefits of any member. See, for example, Model Non-Profit Corporation Act, §26:

No dividend shall be paid and no part of the income or profit of a corporation shall be distributed to its members, directors, or officers.

Where members in a non-profit corporation have no reasonable expectation of profit, the courts have regularly held that they were not purchasing a security. E.g., Dunwoody County Club of Atlanta, Inc. v. Fortson, 253 S.E.2d 700 (Ga. 1979). Thus, membership in a non-profit corporation may include voting rights, but it does not constitute a security, and there are no voting securities to be acquired. *not met case*

Coverage Under the Regulations

Ordinarily, we would end our discussion of coverage under the Act at this point, because neither of the prerequisites to statutory coverage are present. However, a question has been raised as to the impact of this statement in the Regulations: "Mergers and consolidations are transactions subject to the act." 16 C.F.R. §801.2(d)(1)(i). In connection with another non-profit corporation transaction discussed between our office and the Commission staff, the staff took the position that substitution of members of a non-profit corporation might be a "merger or consolidation." We believe closer examination demonstrates that this is an untenable interpretation. *was we*

In the first instance, the Commission does not have the authority to add to the types of transactions covered by the Act. The Commission has only the authority to promulgate forms and to exempt certain classes of transactions. 15 U.S.C. §18A(d). We

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question the Commission's authority to broaden the statutory terms to include mergers. In any event, the vote of the members of a corporation to amend its articles of incorporation to substitute in their place a different member is not a merger or consolidation. Mergers and consolidations are formal transactions that require precise compliance with specific statutory requirements in order to be effective. 1983 Statement of Basis and Purpose for Amendments, 48 F.R. 34,430. The substitution of members of a charitable corporation does not require any such compliance, does not combine the business of two corporations, does not result in any change in the corporate existence of the corporation, and does not affect the ownership of any of the assets of that corporation. In the context of for-profit corporations with which the Commission more frequently deals, this transfer is perhaps closest to the transfer of voting rights on securities from one owner to another, without the transfer of the security. It is not a merger or consolidation.

In informal discussions of another transaction, the Commission staff indicated that, even if a transaction were not formally a merger or consolidation, it should be treated as such because "it looks most like that." Whatever the merits generally of the staff's ignoring the language of the Regulations, in this instance, the Commission has by formal action in compliance with law eliminate that argument. The original version of §801.2(d) provided:

A merger, consolidation or other transaction combining all or any part of the business of two or more persons shall be an acquisition subject to the act.

The "or other transaction" language was deleted in the amendments of July 29, 1983. 48 F.R. 34,431. Therefore, the "it looks like a merger or consolidation" argument is not available, and no transaction within the coverage of the Regulation is present.

Size-of-Person Test

Even if there were a transaction subject to the Act and Regulations, this transaction would not involve parties that meet the size-of-transaction or size-of-parties tests. NEWCO is paying nothing and receiving none of the assets or voting securities of the Sponsored Institutions. As you can see from the attached audited financial statement of SYSTEM, its assets are less than \$2 million and its revenues in its most recent fiscal year were less than \$4 million. NEWCO is newly-formed and has no assets or voting securities. Further, it does not "control" (within the meaning of the Act and Regulations) any of the Sponsored Institutions, and thus

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its size is not determined by reference to the assets or revenues of any of the Sponsored Institutions.

The term "control" for all purposes under the Act is defined in §801.1(b) as

- (1) holding 50% or more of the outstanding voting securities of an issuer; or (2) having the contractual power presently to designate a majority of the directors of a corporation.

As demonstrated above, neither NEWCO nor any of the Sponsored Institutions has voting securities that could be held by SYSTEM. Further, there exists no contract granting SYSTEM or any of the other corporations the power to designate a majority of the trustees. That power flows strictly from the appropriate State's non-profit corporation law and from the filing of the Articles of Incorporation with the appropriate Secretary of State designating the members. } WLDH

The Question to be Resolved

We ask that the Commission staff render an informal interpretation of the Act and the Regulations confirming that the proposed reorganization of SYSTEM is not covered by the Act.

Alternative Request for Waiver of Filing and Waiting Requirement

Based on our previous discussion of these issues in a different context, we understand that certain members of the staff either do not agree with the above interpretation or will not respond to a request for an interpretation in this regard. Such a stance would present unreasonable burdens for SYSTEM. SYSTEM and the Sponsored Institutions have proceeded for more than a year in planning the reorganization on the reasonable assumption that its internal realignment did not raise any competitive or premerger notification issues. It clearly has no competitive implications. If for any reason an interpretation as requested above will not be issued promptly, we request that the Commission treat this submission as sufficient compliance with 16 C.F.R. Part 803 and immediately terminate any applicable waiting period. Such termination is necessary in order for the Sponsored Institutions to complete in the near future the amendment of their Articles of Incorporation substituting NEWCO as the sole member of each. } 2

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if further information is required, we would be happy to attempt to provide it.

Sincerely yours,

on 5/29/86 I informed [redacted] that the transaction was not required to be filed since (1) if it involves voting securities it is exempt under § 807.30 as an intraperson transaction and if it is not voting securities it is not an acquisition of control over an outside business.

Wayne E Kaplan