

MEMORANDUM

To: mverne@ftc.gov

From: [REDACTED]

Date: July 24, 2007

Re: Hart-Scott-Rodino Filing in Context of Michigan Non-Profit Corporations

This memo addresses whether the acquisition of membership interest in a Michigan non-profit corporation by another Michigan non-profit corporation should be treated as an acquisition of securities rather than an acquisition of assets for purposes of applying the size of transaction test under the Hart-Scott-Rodino pre-merger filing rules, and whether a filing would be necessary under the following circumstances.

My client, "P", a Michigan non-profit corporation, is considering a transaction whereby it would acquire all of the membership interest of a currently unaffiliated Michigan non-profit corporation, "T". Both P and T are members of different "reorganized" health-care systems, with P the parent of its system, and T the main operating entity and parent of its system. It is contemplated that P, in exchange for a \$8,000,000 contribution to the capital of T, would become the sole member of T, while T would own continue to own and operate its businesses out of its pre-existing corporate shell.

T's system has aggregate gross assets of approximately \$120,000,000, but these assets are subject to very substantial debt, and the T system is in a difficult financial position. The aggregate book value of the T system is approximately \$37,000,000.

Non-Profit Corporation Law. Michigan's non-profit corporation act may be unusual in allowing for non-profit corporations to be organized on a non-stock directorship basis, a non-stock membership basis, or a stock basis:

"A corporation shall be organized upon a stock or nonstock basis. A corporation organized upon a nonstock basis shall be organized upon a membership basis or a directorship basis." MCL 450.2302.*

While directorship corporations differ significantly from membership and stock corporations, since the board of directors in a directorship corporation is self-perpetuating, membership and stock corporations are for all meaningful purposes, concerning the rights and powers of members and shareholders, identical. For example, MCL 450.2303, concerning stock corporations, provides as follows:

"(1) A corporation organized upon a stock basis may issue the number of shares authorized in its articles of incorporation. Except as otherwise provided in this act, the articles of incorporation or bylaws may prescribe the qualifications, liquidation rights, preferences, and limitations, and other rights, preferences, and limitations of or upon the shareholders of the corporation.

(2) The articles of incorporation may provide that the shares of a corporation shall be all of 1 class or shall be divided into 2 or more classes. If the shares are divided into 2 or more classes, the shares of each class shall be designated to distinguish them from the shares of the other classes. Except as otherwise provided in this act, each class shall consist of shares of the designation and number stated in the articles of incorporation, and having relative qualifications, liquidation rights, preferences, and limitations, and other rights, preferences, and limitations as may be stated in the articles of incorporation or the bylaws. Each share shall be equal to every other share of the same class.

(3) Each shareholder shall have 1 vote for each share of stock held by that shareholder on each matter submitted to a vote of shareholders, unless the articles or bylaws provide that each shareholder shall have 1 vote regardless of shares held by that shareholder or unless the articles or bylaws deny, limit, or otherwise prescribe the voting rights of shares of any class. The shareholders and each affected class of shareholders, if any, shall adopt, amend, or repeal any bylaw denying, limiting, or otherwise prescribing the voting rights of shareholders or any class of shareholders.”

MCL 450.2304, delineating powers and rights for a membership corporation, is materially identical:

“(1) Except as otherwise provided in this act, the articles of incorporation or bylaws of a corporation organized upon a membership basis may prescribe the number, qualifications, liquidation rights, preferences, and limitations, and other rights, preferences, and limitations of or upon the members of the corporation.

(2) A corporation organized upon a membership basis may have 1 or more classes of members. Except as otherwise provided in this act, any provision for classes of members and the relative number, qualifications, liquidation rights, preferences, and limitations, and other rights, preferences, and limitations of or upon each class shall be set forth in the articles of incorporation or the bylaws. Each member of any class of members shall have equal rights with all members of that class.

(3) Each member of a corporation, regardless of class, shall be entitled to 1 vote on each matter submitted to a vote of members, unless the articles or bylaws deny, limit, or otherwise prescribe the voting rights of any class of members. The members and each affected class of members, if any, shall adopt, amend, or repeal any bylaw denying, limiting, or otherwise prescribing the voting rights of any class of members.”

More to the point, MCL 450.2505(2) treats members and shareholders identically for purposes of electing directors:

“The articles or a bylaw adopted by the shareholders or members of a corporation organized upon a stock or membership basis may specify the term of office and the manner of election or appointment of directors. If the articles of incorporation or bylaws do not so specify the term of office or manner of election or appointment of directors, the

first board of directors shall hold office until the first annual meeting of shareholders or members, and at the first annual meeting of shareholders or members and at each annual meeting thereafter the shareholders or members shall elect directors to hold office until the succeeding annual meeting, except in case of the classification of directors as permitted by this act.”

Accordingly, P, as sole member of T (or as the sole shareholder of T, if T’s articles of incorporation were amended to classify T as a stock corporation) would have the right to elect all of T’s directors.

FTC Rule 801.1(f)(1)(i) provides that “The term voting securities means any securities which at present or upon conversion entitle the owner or holder thereof to vote for the election of directors of the issuer.” As discussed above, under Michigan non-profit corporation law, membership interest and stock possess identical rights which entitle a member or shareholder to elect directors. As such, the acquisition of T’s membership interest by P ought to be considered an acquisition of voting securities, and the value of the membership interest, for purposes of determining the user fee for filing a pre-merger notification, should be the fair market value of the membership interest, rather than the gross value of T’s assets.

Valuation of Membership Interest. The membership interests in T are not publicly traded. FTC’s Worksheet for Valuation of Transactions Reportable under The Hart-Scott-Rodino Act** states that:

“If the stock [i.e., the voting security] is not publicly traded and the Acquisition Price is determined, the value of the transaction is the Acquisition Price. If the Acquisition Price is not determined, the value of the transaction is the Fair Market Value of the stock, determined by the board of directors of the Acquiring Person or its delegee, as described above.”

FTC Rule 801.1(c) explains the valuation process in more depth, and provides the following definitions:

“(2) *Acquisition price.* The acquisition price shall include the value of all consideration for such voting securities or assets to be acquired.

(3) *Fair market value.* The fair market value shall be determined in good faith by the board of directors of the ultimate parent entity included within the acquiring person, or, if unincorporated, by officials exercising similar functions; or by an entity delegated that function by such board or officials. Such determination must be made as of any day within 60 calendar days prior to the filing of the notification required by the act, or, if such notification has not been filed, within 60 calendar days prior to the consummation of the acquisition.”

Here, P would pay to T \$8,000,000 in order for P to become the sole member of T. This would appear to be the “acquisition price.”

If the \$8,000,000 payment were not considered indicative of value for some reason - for example, because non-profit entities may undertake transactions for non-monetary reasons such as the promotion of an organization's charitable purpose - the appropriate value would be the "fair market value", which "shall be determined in good faith by the board of directors of the ultimate parent entity ... or by an entity delegated that function by such board or officials." Here, the board of P has delegated the valuation function to an independent certified public accounting firm which has determined in good faith that the "fair market value" of the T system is not more than \$40,000,000.

Size of Transaction Threshold. Here, the size of person tests established by the Hart-Scott-Rodino Act would be met. As discussed above, the transaction should be considered an acquisition of voting securities, rather than an acquisition of assets. Accordingly, the size of transaction test would be met if P, as a result of the acquisition, were to hold voting securities with a value in excess of \$50,000,000, as adjusted (currently, \$59,800,000). Here, the value of T voting securities held by P as a result of the acquisition would be no more than \$40,000,000, which is below the filing threshold. Therefore, P need not file a pre-merger notification.

If you have any questions, please contact me at [REDACTED]

* Michigan Compiled Laws are available without charge at [http://www.legislature.mi.gov/\(cg11zaaxuounp45sts2euj1\)/mileg.aspx?page=home](http://www.legislature.mi.gov/(cg11zaaxuounp45sts2euj1)/mileg.aspx?page=home)

** <http://www.ftc.gov/bc/hsr/hsrvaluation.shtm>

AGREE THIS IS A VOTING
SECURITIES ACQUISITION THAT
DOES NOT SATISFY THE
SIZE-OF-TRANSACTION TEST.

BM
7/25/07