

[REDACTED]

(PS)

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Patrick Sharpe, Compliance Specialist
Premerger Notification,
Bureau of Competition
Room 303
Federal Trade Commission
6th Street & Pennsylvania Avenue, N.W.
Washington, D.C. 20580

RE: REQUEST FOR INFORMAL OPINION - APPLICABILITY OF PREMERGER
NOTIFICATION RULES TO AFFILIATION OF NONPROFIT CORPORATIONS

Dear Mr. Sharpe:

This letter shall confirm our telephone conversation today in which we requested an informal opinion concerning applicability of the Hart-Scott-Rodino Antitrust Improvement Act ("Act") to an affiliation between a non-profit hospital and a non-profit health care system.

FACTS

The facts regarding the relationship between the two organizations are as follows:

Background

Three separate corporations are involved in this transaction. [REDACTED] corporation which is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code and State law. [REDACTED] is the parent corporation of other non-profit and proprietary corporations. [REDACTED] total assets are valued at over two hundred and fifty million dollars. One of [REDACTED] subsidiaries is engaged in interstate commerce by operating in five states.

[REDACTED] is the sole member of Corporation A, another tax-exempt, non-profit corporation. As such, [REDACTED] is entitled to elect all of the members of Corporation A's Board of Directors.

How big is A? system is a holding company for A-

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Hospital is also a California non-profit corporation exempt from taxation under federal and state law. Hospital's assets are valued at over thirty five million dollars. Pursuant to the Bylaws of Hospital, the Directors of Corporation A are members of Hospital, and as such are entitled to elect over fifty (50%) percent of the Directors of Hospital.

Affiliation Agreement

The focus of this inquiry is the proposed affiliation between [redacted] and Hospital. These parties plan to execute an affiliation Agreement pursuant to which Hospital would amend its Bylaws to state that [redacted] would be the sole member of Hospital. As a result, [redacted] will have the right to elect the entire Board of Directors of Hospital.

No assets will be transferred between [redacted] and Hospital. Each corporation will maintain its separate corporate identity and separate responsibility for its own liabilities. The Affiliation Agreement does provide for the following oversight of Hospital's corporate operations and/or assets by [redacted]

1. Hospital is required to conform to system wide management policies and procedures;
2. [redacted] must approve future amendments to Hospital Articles of Incorporation and Bylaws;
3. Hospital may be required to join in a Master Bond Indenture with other system facilities upon direction of System;
4. [redacted] will have use of Hospital's non-restricted cash funds over a certain amount for system purposes;
5. Hospital must maintain compliance with specified financial covenants (e.g. debt ratios);
6. [redacted] must approve long term or short term debts over a certain amounts and other budgeting and assets-use decisions.

ISSUES

1. Does the Affiliation Agreement between [redacted] and Hospital constitute an acquisition subject to the Act's notification requirements?

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2. If the Act applies to the Affiliation Agreement, is the transaction exempt from the notification requirements as a result of the pre-existing relationship between Hospital and Corporation A?

ANALYSIS

In determining the applicability of the Act to this Affiliation Agreement, System would be deemed the "acquiring person", and Hospital would be deemed the "acquired person." A "voting security" is defined by the Act as any security which entitles the owner or holder thereof to vote for the election of directors of the issuer.

Membership in a nonprofit corporation does not carry the rights of ownership generally considered when defining the term "voting security." However, the definition of the term "beneficial ownership" under the Act and the Commission Rules appears to be broad enough to include membership in a nonprofit corporation, if such membership entitles the member to vote for directors of the corporation. Thus, it appears that for the purposes of the Act, a voting membership in a non-profit corporation constitutes a "voting security."

Based upon this analysis, execution of the Affiliation Agreement will result in [redacted] acquiring one hundred percent (100%) of the voting securities of Hospital, since [redacted] as sole member of Hospital, will be entitled to elect the entire Board of Directors of Hospital. Thus, under this reasoning, it appears that the notification requirements of the Act will be deemed to apply to [redacted] and Hospital through the Affiliation Agreement.

As I explained, the exemption from filing set forth in subsection (c)(3) of the Act appears to apply to the relationship between [redacted] and Hospital created under the Affiliation Agreement. This exemption states that acquisitions of voting securities of an issuer at least fifty percent (50%) of the voting securities of which are owned by the acquiring person prior to such acquisition is exempt from the filing requirements.

Pursuant to current Hospital Bylaws, the Directors of Corporation A elect the majority of the Directors of Hospital. Thus, according to the voting security definitions above, Corporation A currently holds more than fifty percent (50%) of the voting securities of Hospital. Similarly, [redacted] as the sole member of Corporation A, holds all of the voting securities of Corporation A.

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The definitions stated in Rule 801.1, read together, provide that "a person" holds all assets and voting securities held by entities included within it, such as entities which the person directly or indirectly controls. [REDACTED] directly controls Corporation A as Corporation A's sole member. Since Corporation A controls Hospital, [REDACTED] should, by attribution, be deemed to indirectly control Hospital. Following this line of reasoning, [REDACTED] owns more than fifty percent (50%) of Hospital's voting securities through application of Corporation A's holdings to [REDACTED]. Accordingly, it appears that the [REDACTED] Hospital Affiliation Agreement will be exempt from the premerger notification requirements of the Act.

If you have any further questions or require additional information, please do not hesitate to call. We look forward to hearing from you in the next few days. Thank you for your prompt consideration of this matter.

Very truly yours,

[REDACTED]