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ATTORNEYS AT LAW

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VIA FACSIMILE

April 23, 1999

Ms. Alice Villavicencio
Premerger Notification Office
Federal Trade Commission
6th Street and Pennsylvania Avenues
Washington DC 20580

Dear Ms. Villavicencio:

I am writing this letter to confirm our conclusion that the actions to be taken by the non-profit entities described below do not constitute a "merger" or "consolidation" or otherwise require premerger notification filings under the Hart-Scott-Rodino Act. I tried to call you today to discuss the proposed transaction described in this letter, but learned that your office was closed. Since there is some urgency, I am writing in advance of a conversation about it. I will attempt to reach you by telephone on Monday.

Each of the entities involved in the proposal, the "Clinic" and the "Hospital", is a non-profit corporation which is recognized as a charitable health care organization, exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code. The Clinic and the Hospital are both associated with a particular major private university (the "University"). A summary of their affiliations follows:

Operational. The University, the Clinic and the Hospital have cooperated in the operation of a medical center for over five decades.[1] The Clinic, the University and the Hospital

[1] In 1983, the parties organized a new non-profit exempt corporation, the "Medical Center", for the purpose of coordinating their operations and the operations of a nearby Veterans' Administration hospital. The Medical Center's Board of Trustees includes the Dean of the University's Medical School, the Presidents of the Clinic and the Hospital, and the director of the VA facility, all of whom serve *ex officio*. In addition, each of the University, the Clinic, and the Hospital is represented by two individuals, nominated by their respective Boards of Trustees and elected by the Medical Center's Board of Trustees. The Medical Center does not have any formal approval or appointment authority with respect to control or operation of the Clinic, the Hospital or the other members, but does fulfill an informal role of promoting cooperation and coordination among them.

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are separate entities and none of them controls or is under common control with either of the other two. However, to a significant extent they operate in an integrated fashion. The University operates a Medicine School for the education of physicians and the training of resident and fellow physicians following their medical education. The members of the faculty of the Medical School who practice medicine do so through the Clinic, which is the provider of individual physician's services to patients. The Hospital is the principal teaching hospital used by the Medical School, and it operates a large and sophisticated hospital facility.

The Hospital's facility is also used by the Medical School and the Clinic.[2] The Medical School uses the facility for the clinical education of its students, while their classroom instruction occurs in facilities located some miles away on the University's campus

For decades, the Hospital and the Clinic have conducted their affairs concerning the medical center in a financially, managerially and operationally integrated fashion. In 1997, the Clinic and the Hospital entered into a joint operating agreement, which continued the historical relationship and brought their interests closer into alignment. The agreement created a senior leadership group, composed of the senior officers of the Clinic and the Hospital, to be responsible for the development of operating and capital budgets for both organizations and a coordinated process for decisions on the allocation of resources within the medical center. The agreement also provides for an equal sharing between the Clinic and the Hospital of the difference between actual gains or losses and budgeted combined operating gains or losses. This sharing of surpluses and shortfalls applies only to the operating revenue of the organizations and does not apply to the Hospital's non-operating income, which is significant in amount.

The Clinic also operates patient care facilities in several other locations. The operations of these remote facilities are not subject to the joint operating agreement or the sharing of budgetary surpluses and shortfalls between the Clinic and the Hospital.

Organizational. Neither the Clinic nor the Hospital has any authorized or outstanding voting securities. Each of them is governed by a separate Board of Trustees.

Under the Bylaws of the Clinic, new or replacement Trustees are appointed by majority vote of the Trustees then in office. The Clinic currently has 13 Trustees, all of whom

[2] The Medical Center owns the real estate upon which the Hospital's facility is located. The University owns a condominium-based interest in a part of the facility, with the Hospital owning the rest. The Hospital leases space to the Clinic. The Medical Center also operates out of office space in the facility.

have equal voting rights. Four of the Trustees practice medicine through the Clinic, including one who is Dean of the University's School of Medicine. The balance of the Trustees are not otherwise affiliated with the Clinic or the University. Under the Clinic's current bylaws, the Hospital's President is entitled to, and now holds, a position on the Board of the Clinic. Four of the Clinic's Trustees, including the Hospital's President and two of the four Trustees who practice medicine through the Clinic, also are Trustees of the Hospital.

The Hospital has one member, the Alliance, a nonprofit exempt corporation which serves as an umbrella organization for the Hospital and a number of smaller health care providers in the region. The Hospital also has an Assembly of Overseers, a large body of community representatives in Hospital affairs who are successors to the Hospital's original incorporators, and who play an advisory role and a role in the nomination of certain Hospital Trustees.

Under its Bylaws, the Hospital's Board of Trustees currently consists of the following 21 members, all of whom have equal voting rights: (a) thirteen lay trustees who are nominated by the Hospital's Assembly of Overseers and elected by the Alliance; (b) five *ex officio* trustees, the Hospital's President, the Dean of the University's Medical School, the Medical Director of the medical center, an elected trustee of the Alliance, and the President of the Medical Center Auxiliary; and (c) three representatives of the Clinic, the Clinic's President and two physician members of the Clinic's Board of Governors. The Bylaws also provide an *ex officio* seat for an elected Clinic trustee, which is currently vacant.

Four of the Hospital's current trustees (the Hospital's President, the Clinic's President, the Dean of the University's Medical School, and an elected Hospital Trustee) also serve as trustees of the Clinic; while five of the Hospital's current trustees (the Clinic's President, the Medical Director of the medical center, the Dean of the University's Medical School, and the two physician members of the Clinic's Board of Governors) practice medicine through the Clinic.

The current Presidents and Board Chairmen of the Hospital and Clinic are different persons.

The Proposed Course of Action. The Clinic has borrowed a total of approximately $72 million through bonds issued pursuant to a trust indenture. Repayment of this debt is supported by commercial third party insurance. Under the terms of the insurance and indenture, the insurer may trigger a default under the bonds if certain financial ratios are not maintained by the Clinic. The Clinic suffered significant financial losses for its fiscal year ended September 30, 1998, with most of these financial difficulties attributable to the facilities that are

not a part of the existing joint operating agreement with the Hospital. The insurer of the bonds has expressed its intention to declare the bonds in default unless additional credit support or security is provided. The expressed intention is to do so in the very near future.

In light of the historic association of the Clinic and the Hospital with each other and the University and the partial integration of management, operations and finances that already exists, as well as taking into account the impact a declared default under the Clinic's bonds could have on the Hospital's credit and on the community that the Hospital serves, the Hospital and the Clinic have reached an understanding that the Hospital would become an obligor of the Clinic's bonds.

Given the exigency of the situation, no contract or written agreement has been entered into between the Clinic and the Hospital concerning this proposal, and none is contemplated. Under the proposal, the following steps would occur:

1. The Hospital would amend its bylaws to allow the election of 9 additional Trustees, and the Hospital's Board would appoint to the Hospital's Board the nine members of the Clinic's Board of Trustees who are not already on the Hospital's Board. The bylaws of the Hospital would thereby provide for a Board of Trustees composed of 30 members, including, the existing 13 members who are elected by the Alliance, the existing five *ex officio* members, and a total of 12 members from the Clinic.

2. At the same time, the Clinic would amend its bylaws to allow the election of at least 16 new Trustees, and the Clinic's Board would appoint to the Clinic's Board 11 of the 12 elected members of the Hospital's Board of Trustees who are not already on the Clinic's Board in an *ex officio capacity*, and the individuals now on the Hospital's Board who are the Medical Director of the medical center, the Alliance trustee, the Medical Center Auxiliary's President, and the two Clinic physicians not on the Clinic's Board, for a total of 16 new members. Thus, the immediate composition of both Boards would be nearly identical. However, no provision will be made for future institutional control over the election of successor Clinic trustees, other than the one seat already held by the Hospital's President *ex officio*. Rather, the Clinic's Board will follow its existing procedures for the naming of successor Trustees. Further, each entity will retain for the present its separate President and Chairman of its Board of Trustees, although the successors conceivably could be the same persons for both entities.

3. The Hospital and the Clinic will become jointly and severally liable for the bond obligations of each. Except for these bond obligations, each organization will continue to have separate responsibility for its liabilities and obligations to employees and creditors.

Both the Clinic and the Hospital have assets exceeding $100 million.

Analysis. We view a key to the Federal Trade Commission's informal position on when a "merger" or "consolidation" between non-profit entities occurs within the meaning of section 801.2(d) of the Premerger Notification Rules to be whether the transaction results in one "person" having control of the resulting combined operations. If so, that person is seen to have acquired the assets of the other person. If not, so long as a new for-profit corporation is not involved, then at most a non-reportable joint venture would be involved. See interpretation numbers 109 and 115 of the ABA Premerger Notification Practice Manual. This is consistent with the rationale of Formal Interpretation No. 15, regarding limited liability company joint ventures, which only requires reporting if one of the participants ends up controlling the joint venture.

Here, the implementation of this proposal should not be considered to be a "merger" or "consolidation" because the operations of the Hospital and the Clinic are not being joined under the control of any "person."

(1) Each of the Clinic and the Hospital will retain its separate existence and governing body, no assets will be transferred from one entity to the other in the proposed actions and no new entity is being created that, directly or indirectly, would own the assets of, or have responsibility for the operations of, both the Hospital and the Clinic.

(2) No entity now controls the Clinic; no entity will control both the Hospital and the Clinic after the proposal is implemented; and neither the Hospital nor the Clinic will control the other after the proposal is implemented. The new Trustees coming on to the Boards of the Clinic and the Hospital will assume a separate fiduciary duty to the new organization they serve and will not be sitting as a representative of the organization they previously served. With respect to the Hospital, while the Clinic under the amended Hospital bylaws could be seen to have the power to appoint 12 Trustees, that number represents a minority of the Hospital's expanded Board of 30 persons. With respect to the Clinic, its amended bylaws will not give the Hospital the right to designate more than one Trustee of the Clinic, as is true under the current bylaws. No contractual arrangement will

be entered into giving one of the parties the right to designate any members of the Board of the other entity beyond that described above. Thus, the Hospital will not control appointment of 50% or more of the Clinic's Board, and the Clinic will not control appointment of 50% or more of the Hospital's Board.

(3) While we believe the foregoing to be sufficient to conclude that no filings are necessary, the composition of the 16 Trustees to be added to the Clinic's Board of Trustees also indicates that, as a practical matter as well as based on contractual power, the Hospital will not be acquiring control of the Clinic. Of the 16 Trustees being added to the Board of the Clinic, three have existing fiduciary duties to both the Clinic and the Hospital. The first is the Medical Director of the medical center, a member of the Hospital's Board who also practices medicine through the Clinic. The second and third are physicians who are members of the Hospital's Board and who practice medicine through the Clinic. Thus, while 16 persons who are now Trustees of the Hospital will become Trustees of the Clinic, only 13 of them now owe a duty of loyalty only to the Hospital, the Alliance or the Auxiliary. So, even if one views these 13 persons as Hospital representatives, they will not constitute 50 percent or more of the Clinic's Board. The Office of the Attorney General of the affected state has concurred for state law purposes that no control has passed between the two organizations.

I look forward to hearing whether you agree with this analysis. As mentioned, I will call on Monday, but in the meantime, if you need any additional information to evaluate the situation, please call me. The Clinic and the Hospital believe they must act quickly to avoid a significant detriment to themselves and their community, so we would appreciate your early consideration of these questions.

Thank you for your help.

Sincerely yours,

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Called Writer on 4/27/99 Control of respective expanded boards is not taking place R.S. Agrees No HSR filing Required.)
Debbie Villaneueva