

MEMORANDUM

803.30  
802.40  
801.40  
801.1(b)

[REDACTED]

CONFIDENTIAL

SUBJECT: Request for Staff Interpretation

This material may be subject to the confidentially provisions of section 7A(4) of The Clayton Act which restricts

Introduction/Conclusion

If it is the belief of counsel (listed above) for each party that a premerger notification

is sufficiently unique and complex that counsel for each party requests a continuing informal interpretation, pursuant to 16 C.F.R. §803.30, by the FTC Premerger Notification Staff.

DESCRIPTION OF TRANSACTION

[REDACTED]

Two (2) (both nonprofit corporations) each operate hospitals and other health care entities, in each case including a nonprofit health care corporation, A Corporation (in which A is the sole corporate member) and B Corporation (in which B is the sole corporate member). Both A and B (and their respective ultimate parents) each have annual net sales or total assets of \$100 million or more. A and B intend to enter into an agreement ("Agreement") to create a Joint Operating Organization ("JOO") known as Newco. Newco will be a non-profit, nonstock, Delaware corporation with A and B as its two members.<sup>1</sup> A (and A Corporation) and B (and B Corporation) will delegate to Newco the responsibilities, subject to certain exceptions, for the management of the operations of the health care activities of A (and A corporation) and the healthcare activities of B (and B corporation) and the entities each controls in a specified service area.

<sup>1</sup> An application for Recognition of Exempt Status will also be filed with the Internal Revenue Service.

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transfer to Newco) which any person contributing to the formation of Newco has agreed to transfer or which agreements have been secured for Newco to obtain at any time, whether or not such person is subject to the requirements of the Hart-Scott-Rodino Act, and (2) any

One hundred percent (100%) of the cash flow (the excess of revenue over expenses, plus depreciation, less debt repayment) of Newco and the combined operations of A and B subject to Newco management will be shared in the following manner. Fifteen

#### NEWCO Authority

Newco will have significant responsibility and authority to manage the health care activities of A and B within a designated geographic service area. Specifically, subject to certain rights and responsibilities reserved to A and B as the corporate members of Newco, Newco shall have the following powers and responsibilities:

<sup>2</sup> "Operating units" refer to programs, facilities, services and other assets wholly owned by A (or A corporation) or B (or B corporation) and all existing and future programs, facilities, services and other assets wholly owned, directly or indirectly, by Newco and Newco affiliates in the service area, whose operations are managed by Newco, whether separately incorporated or not.

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(1) developing and overseeing the implementation of an

(2) developing annual capital expenditures and operating budgets for Newco, its affiliates and the Operating Units;<sup>47</sup>

guarantees, within parameters established by A and B,

affiliations;

power to elect through membership or ownership greater than fifty percent (50%) of the governing body of an entity, or the unilateral power to direct or cause the direction of all significant policies and the overall management of an entity, whether through contracts,

other arrangement; but the term excludes programs, facilities, services and other assets in the service area wholly owned by A, A Corporation or B, B Corporation or an entity for which any one of them has the power to elect through membership, or ownership greater than fifty percent (50%) of the governing body of an entity, or the unilateral power to direct or cause the direction of all significant policies and the overall management of an entity, whether through contracts, membership interests, ownership of voting securities, a lease, a

<sup>47</sup> The initial three year strategic and financial plan together with financial performance targets, each "new" third year of the rolling three-year performance plan, as well as any

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- (5) approving any sale, transfer, or other disposition of any material asset of a Newco affiliate or Operating Unit within parameters established by A and B;<sup>5f</sup>
  - (6) negotiating third-party payor relationships for its affiliates and Operating Units;
  - (7) appointing, through use of the Nominating Committee of
- 
- (8) transferring assets, including cash, among the various Newco affiliates and Operating Units and/or from a Newco affiliate or Operating Unit to Newco within parameters established by A and B;<sup>6f</sup>
  - (9) appointing, evaluating and removing the CEOs of the Newco affiliates;
  - (10) approving and/or determining the creation of new health ~~insurance~~ delivery of health care services, or the discontinuance of any existing health care service, by a Newco affiliate or Operating Unit;
  - (11) developing uniform human resource policies for the Newco affiliates and Operating Units;
  - (12) conducting marketing and promotional activities for the Newco affiliates and Operating Units;

<sup>5f</sup> See, e.g., reserve powers (#10) which requires the approval of both A and B for certain

<sup>6f</sup> See, footnote 5 above.

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(13) conducting or coordinating fundraising activities for the Newco affiliates and Operating Units;

(14) coordinating and planning the Newco management information systems for Newco affiliates and Operating Units; and

(15) \_\_\_\_\_

*may result in changes*

\_\_\_\_\_

as a shareholder or member (in its non-profit setting) of any partner in any wholly owned

The following actions of Newco will require the approval of both A and B:

- (1) changes to the mission and/or philosophy of Newco or any Operating Unit;
- (2) the sale, lease, transfer, encumbrance, or disposition of the tangible property or investments of Newco having a fair market value in excess of three million dollars (\$3,000,000);
- (3) the incurrence, assumption or guaranty by Newco its affiliates, A Corporation, B Corporation or an affiliate of \_\_\_\_\_  
long-term indebtedness outside parameters established by A and B;
- (4) the merger, dissolution, consolidation, or sale of all or substantially all of the assets of Newco or any Operating Unit outside parameters agreed to by A and B;

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- (5) the amendment, repeal, or restatement of the Corporate Documents of Newco;
- (6) the appointment and removal of the jointly appointed *(not absolute control)* members of the board of directors of Newco;
- (7) the approval of capital and operating expenditures that are inconsistent with the three year financial targets, parameters and expectations approved by A and B;
- (8) the approval of major affiliations of Newco, Newco affiliates and the Operating Units;
- (9) the approval of the initial three year strategic and financial plan, as well as the annual update to such plan developed by the parties to create a rolling three-year financial performance plan, and the establishment of the parameters and expectations for the clinical quality, strategic, operating, mission, religious identity and financial performance of Newco;
- (10) the transfer of assets, including cash, among various *Potentially reportable* ~~Newco affiliates and Operating Units and from Newco~~

~~Operating Unit to Newco or Newco affiliates other than~~

~~other than transfers of cash as provided in the Risk Sharing provisions:~~

~~compensation, and termination of the CEO of Newco. However, if A and B are not able to reach a mutual agreement on A's or B's proposal to remove the CEO, the CEO of Newco will be automatically terminated.~~

The following actions of Newco will require the approval of either A (and A Corporation) or B (and B Corporation), as the case may be, before the action may be implemented.

[REDACTED]

- (1) the sale, lease, transfer, encumbrance, or disposition of the tangible property or investment (of an Operating Unit whose assets are owned or controlled by either A or B Corporation) if the property or investment has a fair market value in excess of three million dollars (\$3,000,000);
- (2) the merger, dissolution, consolidation, or sale of all or substantially all of the assets of an Operating Unit whose assets are owned or controlled by either the A or B Corporation; and

*potentially reportable*

documents of an entity controlled by either the A or B Corporation.

*Neither A nor B has to appoint*

*A and B*

with you. A and B each will always be entitled to directly appoint, remove or replace two each (i.e., two by A; two by B) of the eight (8) members of the Board of Newco. After the terms of the initial Board of Directors expires, successors for the four members of the Newco Board, and appointed by the Newco Board upon joint approval of both A and B.

*successors of the*

Proceeds of Asset Sales

Any proceeds from the sale of an asset owned by the respective A or B Corporations, or entities each separately controls, will be retained by A or B Corporation, as the case may be. In the event of a dissolution of Newco, A (or A Corporation) and B (or B Corporation) will each retain the assets to which it holds title. The remaining assets of Newco and Newco affiliates will be distributed one-half to A and one-half to B, after being

*potentially reportable*

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**HART-SCOTT-RODINO ANALYSIS**

**Formation of Newco**

*302.40 does not apply since there are no voting securities. However it is kicked over to 301.4 since there are no voting securities the form is not reportable*

1. As a threshold issue, the joint venture specific HSR rules (i.e., Rule

*we did not seem appropriate since both cores conceptual dependence of voting securities of the contributors. — Ok, as long as no merger or consolidation is taking place which does not seem to be the case here.*

2. The mere acquisitions of "membership interests" in a non-profit tax-

*interests, i.e., as non-reportable events.<sup>21</sup> Not taking pl.*

Nevertheless, there is an issue that by each of A and B having "control", over *Neither f.*

<sup>21</sup> See, American Bar Association, Premerger Notification Practice Manual (2d Ed. 1991)

<sup>22</sup> As used in this memorandum, the term "subsidiary" also refers to a non-stock membership organization for which A (or A Corporation) or B (or B Corporation), or the one may be a corporate member.





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The "Control" Tests

Application of the Rule 801.1(b) "control" alternative definitions would seem to yield the following results: *A or B do not control by this method*

members, subject to the mutual approval of A and B, are deemed to be a "present contractual power" held by both A and B with regard to such directors. Rule 801.1(b)(2)

2. Unless there are disparate "capital contributions" to Newco by A and B, both A and B control Newco under the assets dissolution definition of control. Rule 801.1(b)(1)(i) *yes*

owns, the operations of such entities are subject to management by Newco, Newco could be deemed to "control" such corporations.

of such "control":

- (1) A will acquire beneficial ownership of B's assets (and/or voting securities) contributed to Newco and of assets (and/or

majority of the members of the Boards of Directors of such subsidiaries; and

<sup>(i)(ii)</sup>  
2 Using the "control" tests set forth in Rule 801.1(b), A and B each would appear to become an "ultimate parent entity" of Newco.

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(2) B will acquire beneficial ownership of A's assets (and/or voting securities) contributed to Newco and of assets (and/or voting securities) held by subsidiaries of A or subsidiaries of A Corporation for which the Newco Board has the power, through proxies granted by A or A Corporation, to appoint/remove the majority of the members of the Boards of Directors of such

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a reportable acquisition(s), under the size of transaction test, would seem to exist:

(1) For A as the acquiring person and B as the acquired person -- if A values, in excess of \$15,000,000, the combination of B's assets (and voting securities, if any) contributed to Newco and assets held by subsidiaries of B or B Corporation where the board members of such subsidiaries are subject to appointment/removal by Newco exercising its proxy vote; and

(2) For B as the acquiring person and A as the acquired person -- if B values, in excess of \$15,000,000, the combination of A's assets (and voting securities, if any) contributed to

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See, e.g., American Bar Association, Premerger Notification Practice Manual (2d Ed. 1991), interpretation no. 54, at pages 49-50, wherein FTC staff apparently advised that shareholders who enter into voting agreements or voting trusts or grant or obtain proxies are not regarded as reportable transactions, "even if control of an issuer may be conferred or transferred as a result." Similarly, interpretation no. 74, at pgs. 64-65, reflects advice on whether "a person who controls an issuer by reason of a contractual power to designate fifty percent or more of its directors holds the issuer's voting securities." The FTC staff apparently opined that "A person does not hold voting securities under §801.1(c)(1) unless that person has beneficial ownership of the securities. A contractual power to designate 50 percent or more of the

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*being done in formation of Newco (itself a non-report event).*

entity's board of directors does not necessarily mean that Newco holds beneficial ownership *Correct* of those entities or their assets.

*facto*, create beneficial ownership, the question is whether A acquires beneficial ownership of B's assets and B acquires beneficial ownership of A's assets by virtue of such "control"

and cash flow retained by Newco related to A's and B's assets where title remains in the separate A and B Corporations or their individual subsidiaries. (See description in "Newco Authority" section above).

*A & B will each derive benefit from increase in Va. of their respective assets as well as better decr. in value*

However, there are limits imposed upon Newco by virtue of those reserve powers for actions that require the mutual approval of both A and B, and those reserve powers for actions which require approval of either A or B (See Reserve Powers Section above). On balance, the existence of these reserve powers, as well as A Corporation and B Corporation continuing to hold title to their respective assets and the right of A and B to the

Newco management, has not transferred to either Newco or B and (2) beneficial ownership of B's assets, subject to Newco management, has not transferred to Newco or A -- simply as a result of the management authority granted to Newco by A and B and related cash flow retained by Newco.

**QUESTION PRESENTED**

The question presented is whether, under the facts and circumstances described, -- i.e., the control held by each of A and B over Newco, Newco's "control" over the subsidiaries of A Corporation and B Corporation, and the parameters of Newco's management of A (or A Corporation's) and B's (or B Corporation's) operations -- separately

If there is no acquisition by A of beneficial ownership of B's assets and no acquisition by B of beneficial ownership of A's assets, no Hart-Scott-Rodino filing should be required in connection with the formation of Newco.

*called [redacted] 5/8/98 & 5/11/98 basically concurs with comments noted. (B) -- (B) reviewed and...*