

Tip Sheet: Analysis of Not-for-Profit Combinations under the HSR Act and Rules

Background

the board of directors of one or more of the combining entities. This was because those seeking guidance described hospital combinations primarily in terms of formal board governance.

Recently, however, when asked to analyze combinations of non-for-profit entities, the PNO began to appreciate the limitations of relying solely on the concept of control to determine reportability. In particular, as potential filers described combinations of not-for-profit hospitals, it became clear that a potentially reportable acquisition could occur even when there is no change in control of the board of directors of one of the combining entities. Typically, this is because one party obtains the indicia of beneficial ownership over the assets of another party – the fundamental basis for concluding that a potentially reportable acquisition occurs under any HSR analysis.

A hospital "affiliation" is one of the most common examples the PNO analyzes. This can take the form of one hospital becoming the corporate member of, and obtaining broad governance powers over, the other hospital. Alternatively, the affiliating hospitals may create a new not-for-profit entity (e.g., a "Newco") that will become the corporate member of, and have broad

As with any transaction, we start with whether the transaction is potentially reportable, and then determine whether the HSR Act and Rules apply. Such analysis requires

Question 1: Is an acquisition of control by one indication that "beneficial

We start all HSR analyses at the beginning. The HSR rules were promulgated in 1976. The first step in analyzing whether a transaction involving securities is to determine the indicia of control, which assets or voting securities

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- x Newco has the right to authorize and/or approve the sale or lease of the affiliating hospital assets
- x Newco has the right to appoint and/or approve the senior officers of the affiliating hospital entities
- x Newco has the right to devise and/or approve the strategic plans, capital budgets and expenditures, and significant contracting of the affiliating hospitals

In short, where the Newco parent becomes the corporate member of the affiliating hospitals and obtains governance power over the existing hospitals to such an extent that the indicia of beneficial ownership of the hospitals passes, an acquisition has occurred. (Note that this transaction, in which a change in corporate structure occurs and beneficial ownership passes, is distinct from a scenario where two parties enter an "operating agreement" or "management agreement" without an accompanying change in corporate structure or other indicia of beneficial ownership).

Question 2: What type of acquisition is occurring? Accurately0 Td(JD.001hffu-1 hax)10 nt acfca(18 14 1)10

Rule 802.40, which exempts the formation of entities that will be not-for-profit within the meaning of certain sections of the Internal Revenue Code (e.g., a "501(c)(3) entity"). Rule 802.40, however, exempts "formations," not "consolidations," under the plain language of the rule. As explained above, the HSR rules clearly distinguish between formations and consolidations. Therefore, while Rule 802.40 may exempt certain joint venture formations between not-for-profit hospitals, it will not exempt a consolidation, such as two not-for-profit health care systems affiliating under a Newco.

The Bottom Line

In the context of not-for-profit combinations, focus on board control alone has led to some informal determinations of non-reportability when the PNO was not fully informed about the extent to which the indicia of beneficial ownership would pass. But the rules are clear: board control is not the sole determinant of whether an acquisition has occurred; affiliations (whether simple acquisitions or consolidations) are potentially reportable transactions; and 802.40 exempts certain formations, not simple acquisitions and consolidations.