control ~~intra~~ 7(A) — Continuum Theory
801.1(b); 802.30;

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October 11, 1996

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VIA FACSIMILE: (202) 326-2624

John M. Sipple, Jr.
Chief Premerger Notification Office
Federal Trade Commission
Washington, D.C. 20580

Dear Mr. Sipple:

The following letter is a description of the facts and arguments relating to the proposed corporate restructuring transaction which I have discussed with you and Ms. Nancy Ovuka of your office regarding reportability under the Hart-Scott-Rodino Premerger Notification Program.

The questions surrounding this proposed transaction mainly arise from the fact that the corporations involved are non-profit, tax-exempt entities and, as you know, many of the premerger notification rules and guidelines are written for proprietary, for-profit entities. As we have discussed, the facts involving the relevant corporate entities are as follows:

CORPORATION A **non-profit**	**CORPORATION B** **non-profit**
• Internal Revenue Code Section 501(c)(3) corporation	• Internal Revenue Code Section 501(c)(3) corporation
• 509(a)(3) classification; "supporting organization" (as defined by the IRS) to Corporation B	
• No member interest	• No member interest
• 9 member Board of Directors	• 15 member Board of Directors

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• 5 directors must also be directors of Board of Corporation B; 8 directors are currently members of Board of Corporation B	• Power to remove the 5 overlapping directors, with or without cause, serving on the Corporation A Board
• Directors serve 3 year staggered terms; successors to outgoing directors are elected by a majority vote of the remaining 6 directors, however, the 5 designated seats to Corporation B must be preserved	• Directors serve 3 year staggered terms; successors to outgoing directors are elected by a majority vote of the remaining ten directors
• Upon dissolution, all net proceeds paid to Corporation B	• Upon dissolution, net proceeds paid to a separate governmental entity (Corporation B has a lease arrangement with this governmental entity for substantially all of Corporation B's assets)
	• Holds a license to operate and does operate a hospital
	• Charitable mission to provide for the treatment of the ill and disabled
• Over $10,000,000 in assets	• Over $100,000,000 in assets

The corporate restructuring we are proposing is to amend Corporation B's Articles of Incorporation to make Corporation A its Member. Corporation B's Articles and Bylaws will be amended to provide the following reserve powers to Corporation A: approval of directors, approval of CEO and executive officers, approval of Articles of Incorporation and Bylaws, and approval of operating budget and strategic plan.

In support of the "continuum theory" being considered to exempt this restructuring from filing a Premerger Notification Report Form, the purpose for proposing this restructuring transaction is in preparation for an immediate subsequent transaction where a third-party non-profit health care system would acquire Corporation A through an Affiliation Agreement. This Affiliation Agreement provides that the third-party health care system will become the Member of Corporation A. As a pre-requisite to this contemplated transaction, the third-party non-profit health care system is requiring the restructuring of Corporations A and B. The contemplated transaction whereby the third-party non-profit health system "acquires" Corporation A and its subsidiaries, including Corporation B, would be reported to the FTC via a Premerger Notification Report Form. Assuming the issue involving the proposed corporate restructuring is satisfactorily resolved, this filing is scheduled to take place as early as October 15, 1996. The proposed corporate restructuring of Corporations A and B will not occur unless the affiliation transaction with the third-party health care system will be consummated.

Before I discuss more fully the reasoning supporting the proposed corporate restructuring, I think it would be useful to offer additional explanation of Corporations A and B. The corporate structure and relationship of Corporation A and Corporation B were in large part formulated to achieve compliance with the Internal Revenue Code as it pertains to tax exempt organizations. For the past several years the trend among non-profit health care organizations has been to reorganize their corporate structure and establish parent holding companies. These reorganizations allow non-profit health care providers greater operational flexibility to allow charitable organizations to better serve their charitable missions by developing enhanced corporate structures.

For example, this type of reorganization allows a charitable organization such as a hospital to form a parent holding company, which parent may then hold other non-profit and for-profit entities. Holding such diverse entities by a hospital itself could not be accomplished without potentially impacting a variety of issues, including its tax exempt status. These other non-profit or for-profit entities can take the form of fund raising foundations, physician organizations, home health agencies, organized delivery systems, or any number of other health related organizations. Thus, hospitals were able to form integrated health care delivery systems which are vital in meeting the demands of customers and payors (e.g., insurers) who require such a structure to contract with. In reorganizing a tax-exempt hospital corporation so as to provide for a parent holding company, but yet maintain tax-exempt status, a tax-exempt hospital corporation must comply with IRS laws and regulations. To implement the parent holding company structure and obtain and maintain tax-exemption, not only for the parent holding company but also the tax-exempt hospital corporation, the

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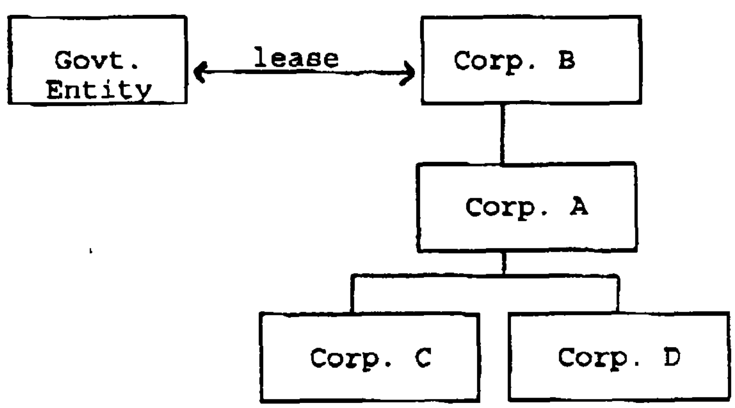
parent holding company must meet the organizational and operational tests of an Internal Revenue Code ("IRC") Section 509(a) support organization.

Corporation A was formed in 1992 as part of such a reorganization and was recognized as an IRC Section 509(a)(3) support organization. One means of meeting the requirements for classification as a supporting organization under Section 509 (a)(3) is for Corporation A's Board of Directors to be controlled by a majority of directors from a public charitable organization (Corporation B); hence, Corporation A was structured so that 5 out of 9 Corporation A directors are controlled by Corporation B as illustrated in the chart above. The resulting control relationship between Corporation A and Corporation B meets the IRS guidelines, and was in fact confirmed in the Private Letter Ruling issued by the IRS which you and Ms. Ovuka have reviewed. However, the level of control stops short of that which is desirable for the contemplated affiliation with the third party non-profit health care system.

The current organizational structure of Corporation A and its controlled subsidiaries is as follows:



As stated, we desire to "flip-flop" Corporations A and B. The following illustrates the organizational structure following the described transactions:

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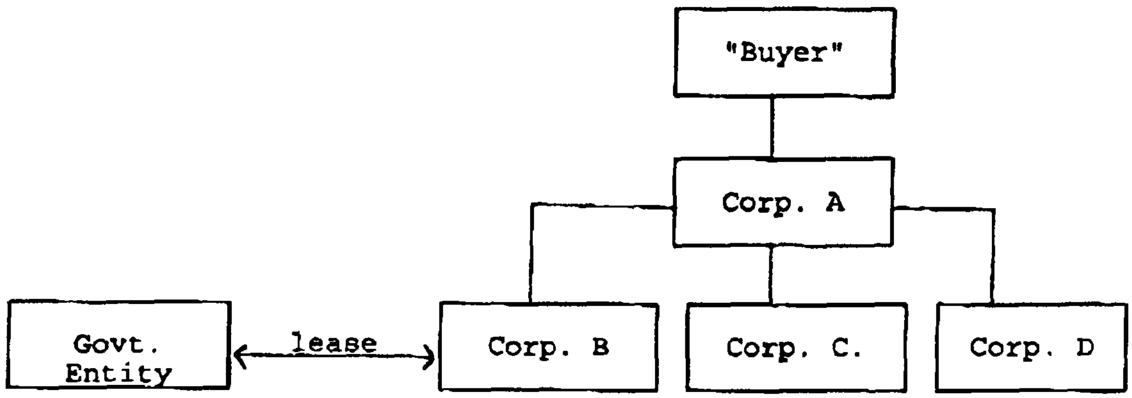

There are numerous reasons why the third-party non-profit health care system requires this organizational restructuring prior to its affiliation with Corporation A. First, the tax exemption implications behind the 1992 corporate restructuring remain relevant. As explained, it is desirable that related health care activities be conducted by separate entities under a common corporate parent. As such, the operations of the related health care entities will not impact or jeopardize the tax exempt status of the public charity hospital entity. Thus, the common corporate parent (Corporation A) should be the entity which is contracted with in an affiliation agreement, not one of the separate entities (e.g., Corporation B).

Second, the corporate structure "acquired" by the third-party "Buyer" must be organized in such a way that it will promote the "Buyer's" business plan and be compatible with its overall system. Specifically, the corporate parent must be able to clearly contractually commit each subsidiary in an integrated fashion to meet the "Buyer's" strategic goals and purposes. If Corporation B remained the corporate parent, then the "Buyer", while it would ultimately have power over other subsidiary corporations through its power over Corporation A, this power is attenuated and not as direct as is desirable. After the proposed corporate restructuring, the "Buyer's" ability to work with a system or organization with Corporation A as the parent is more direct and efficient. In fact, the third-party "Buyer" currently has similar Affiliation Agreements in place with other health care systems. In each case, it is a support organization (like Corporation A) with which the "Buyer" has contracted and which occupies the senior subsidiary (subsidiary to the "Buyer") position as outlined in the proposed restructuring transaction.

Third, in the future there may be circumstances where other entities will want to affiliate with Corporation A's system. Future affiliations or acquisitions can be more efficiently structured with Corporation A as the member of Corporation B and clear lines of control established. By having Corporation A as a parent, board seats may be offered to this potential affiliating entity at the parent level and allow for an efficient manageable transaction.

Finally, the lease which Corporation B has with the governmental entity is a major factor. In view of the strict covenants contained with the lease, it is desirable that the lease not impact the other entities within the corporate system.

In addition to the "continuum theory" which you are considering to exempt the proposed transaction, I would respectfully ask that you considered the following additional arguments:

(1) <u>The proposed transaction is outside the definition of 15 U.S.C. §18a(a)</u>. This section states that ". . . no person shall acquire . . . assets of any other person, unless both persons . . . file notification . . ." "Person" is defined in 16 C.F.R. §801.1(a)(1) as the "ultimate parent entity. . ." and "ultimate parent entity" means "an entity which is not controlled by any other entity" (*Id.* at 801.1(a)(3)). The "ultimate parent entity" in the proposed transaction is Corporation B. Before applying the definition of "person" to the proposed transaction, this section would in essence read: Corporation A may not acquire Corporation B without filing. However, applying the definition of person (the "ultimate parent entity"), this section reads: Corporation B may not acquire Corporation B without filing. Clearly this is not how the section is intended to apply. Indeed, as evidence of the illogical position of requiring the proposed transaction reportable, the two required filings would describe identical data since the ultimate parent entity is the same. To be covered by 15 U.S.C. §18a(a), there should be at least two different ultimate parent entities involved in the transaction; thus, the proposed transaction with only one ultimate parent entity falls outside the §18a(a) definition.

(2) <u>The proposed transaction falls within the 16 C.F.R. §802.30 Intra-Person Transaction Exemption</u>. The proposed transaction is indeed an intra-person transaction,

however, this exemption refers to "voting securities." The applicable term to non-profit corporations relating to voting securities is "board seats." Applying this term to §802.30, Corporation A and Corporation B exhibit sufficient Board overlap such that ". . . the acquiring and acquired persons are the same person, [and should] be exempt from the requirements of the Act." It seems very reasonable to apply analogous terms to non-profit corporations when the rules address only for-profit corporations. Indeed, the IRS quite often applies terms written for for-profit corporations by analogy to non-profit corporations.

(3) The proposed transaction is outside the purpose of the premerger notification program. The FTC guide materials illustrate the lack of connection between the proposed transaction and the intent of the premerger notification program. For example, the Introductory Guides to the Premerger Notification Program Guide I on page 1 states: "The premerger notification program was established to avoid some of the difficulties that antitrust enforcement agencies encounter when they challenge anti-competitive acquisitions after they occur." Corporation A and Corporation B exhibit the exact same competitive effects today as they would after the proposed transaction. Furthermore, if the FTC is concerned about any anti-competitive effects, this transaction is being performed in preparation for a subsequent transaction, as discussed above, which will be reported to the FTC. Therefore, all questions involving competition may be resolved. Finally, the FTC guide materials also state that the ". . . objective of the premerger notification program is to analyze the effects of combining once separate business." (Introductory Guides to the Premerger Notification Program Guide II, pg. 4.) In fact, Corporation A and Corporation B never have been and never will be "separate businesses."

In summary, requiring a premerger notification report to be filed for the proposed corporate restructuring transaction will not serve the purpose of the premerger notification program or the related antitrust laws. The preparation and review of the corresponding filings for the described corporate reorganization would be an inefficient use of charitable organization and enforcement agency resources. Finally, should the FTC conclude that it cannot apply exclusionary or exemption language from the statute or rules as described, I would urge that adherence to sound

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and efficient reporting policy should suggest the proposed transaction would not be reportable.

Thank you for you and your staff's time and consideration involving this matter. I will contact your office to confirm your receipt of this letter and answer any questions. In the meantime, should you have any questions, please call.

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Advised caller that the corporate restructuring resulting in a change of control of entities within the same person occurring in connection with an acquisition of that person was not separately reportable where the primary acquisition of that person is reportable under HSR.