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PG Alert

New Guidance on HSR Reporting Requirements for Not-for-Profit Affiliations

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The Federal Trade Commission's Premerger Notification Office (PNO) recently issued informal guidance on the coverage and reportability of transactions involving not-for-profit entities under the Hart-Scott-Rodino (HSR) Act and Rules.[1] As PNO points out in its accompanying tip sheet,[2] this analysis has big implications for a health care industry trending towards greater collaboration among providers and health systems, including not-for-profit entities. One trend in particular is the concept of "virtual mergers" in which two hospital systems may not formally consolidate structurally through a merger but "affiliate" under a joint operating agreement with varying degrees of continued independence for the affiliating entities. In such cases, it may not be readily clear to the parties and their counsel as to whether an HSR reportable transaction has taken place.

PNO's guidance warns parties and their counsel to no longer focus solely on whether an affiliation results in a change in control of the not-for-profit entity's board of directors to determine whether a reportable acquisition has occurred. The guidance also describes the differing types of transactions the PNO usually sees involving not-for-profits to explain which types of transactions would fall under HSR's not-for-profit exemption to reportability.

Is this affiliation reportable?

The first step in determining whether a transaction between two or more entities is HSR reportable is figuring out if an acquisition has occurred. For not-for-profit entities that question was traditionally answered through the application of the "control" test. Generally speaking, an HSR reportable transaction may have occurred when there is a change in the "beneficial ownership" of an entity as a result of the transaction. Such a change occurs in the not-for-profit context when an "acquiring" party gains the contractual power presently to designate 50% or more of the directors of the not-for-profit.[3] Traditionally, that change in control of the board was considered the exclusive method of obtaining beneficial ownership of a not-for-profit entity, and therefore, the exclusive determination as to whether a transaction involving a not-for-profit was reportable.

PNO's new guidance, however, advises that a change in board control is no longer dispositive as to determining a change in beneficial ownership and reportability. PNO provides other factors that should be considered in determining whether an affiliation has resulted in a passing of beneficial ownership. To do this, the guidance sets up a scenario of affiliating hospitals creating a new not-for-profit entity, Newco. Newco becomes a corporate member of the affiliating hospitals and gains broad governance powers over the respective hospitals. Such powers listed include but are not limited to:

(1) The right to authorize and/or approve governance documents of the affiliates, such as bylaws;
(2) The right to authorize and/or approve the sale or lease of the affiliate's assets;
(3) The right to appoint and/or approve senior officers of the affiliates; and/or
(4) The right to devise and/or approve the strategic plans, capital budgets, and significant contracting of affiliates.

Through these factors, the guidance shows how Newco can gain beneficial ownership of the hospitals, resulting in a potentially reportable acquisition, without necessarily gaining control of either affiliating hospitals' board.

Which transactions enjoy the HSR exemption for not-for-profits?

The HSR rules exempt transactions that are formations of not-for-profit entities.[4] PNO's guidance also reminds readers that Rule 802.40 limits the not-for-profit exemption to formations of joint ventures and does not include consolidations. PNO describes the difference between what it would consider to be a joint venture formation from a consolidation through a description of the three main types of transactions it sees involving not-for-profit entities:

(1) Simple acquisition: This would be considered a pretty straightforward acquisition. One hospital system gains control of the board of another, or gains beneficial ownership of the other system's assets through from some other method of obtaining governance power as previously described. It can be an outright acquisition by the hospital system of the other, or the creation of a not-for-profit holding company, Newco, that the acquiring system in turn controls.

(2) Consolidation into a new entity: In this case neither hospital system is considered to be outright acquiring the other. Instead, they both consolidate under a not-for-profit holding company, Newco, each losing their legacy pre-acquisition identities and becoming wholly-owned subsidiaries of Newco.

(3) Joint venture formation: The systems form a new entity, but still maintain their identities as separate entities. PNO referred to the example of "Hospital A and Hospital B…form[ing] a joint venture entity through which they will own and operate an ambulatory surgery center."[5]

The first and second transaction types exhibit a clear passing of board control or other indications of beneficial ownership of a not-for-profit entity or entities. That is different from the last transaction, the joint venture formation, in which a new entity is created for a specific purpose or even new product, as shown in the example of the formation of a joint venture to operate an ambulatory surgery center. Of the three types, only the last would be exempted from HSR reporting requirements.

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[1] "Control no longer controlling for HSR reporting of not-for-profit combinations", Oct. 26, 2018, Premerger Notification Office, FTC, https://www.ftc.gov/news-events/blogs/competition-matters/2018/10/control-no-longer-controlling-hsr-reporting-not-profit?utm_source=govdelivery.
[2] Tip Sheet: Analysis of Not-for-Profit Combinations under the HSR Act and Rules, https://www.ftc.gov/system/files/attachments/hsr-resources/tipsheet_-_not-profit_combinations_10-5-18.pdf.
[3] *Id*; 16 C.F.R. § 801.1(b)(2).
[4] 16 C.F.R. § 802.40.
[5] Tip Sheet, *supra.*