

Sheinberg, Samuel I.

From: [REDACTED]
Sent: Wednesday, July 15, 2020 2:25 PM
To: Walsh, Kathryn E.; Berg, Karen E.; Carson, Timothy; Sheinberg, Samuel I.; Six, Anne; Musick, Vesselina
Subject: FW: HSR "Entity"

From: Whitehead, Nora
Sent: Wednesday, July 15, 2020 2:24:41 PM (UTC-05:00) Eastern Time (US & Canada)
To: [REDACTED]
Cc: [REDACTED]
Subject: RE: HSR "Entity"

We disagree. Based on the information you have provided, we conclude that X is subject to HSR filing requirements.

From: [REDACTED]
Sent: Wednesday, July 15, 2020 11:21:08 AM (UTC-05:00) Eastern Time (US & Canada)
To: [REDACTED]
Subject: HSR "Entity"

Hello,

We are seeking your guidance on whether our client (X) qualifies as an "entity" under the HSR rules.

Section 7A(c)(4) of the HSR Act exempts "transfers to or from a Federal agency or a State or political subdivision thereof." We understand that the PNO reads Section 7A(c)(4) in conjunction with 16 C.F.R. Section 801.1(a)(2) which states that an "entity" shall not include "... the United States, any of the States thereof, or any political subdivision or agency of either (other than a corporation or unincorporated entity engaged in commerce)." Thus an acquisition by an acquiring entity that does not qualify as an "entity" is not reportable under the HSR Act. However a corporate or non-corporate entity controlled by a government agency which is itself not a government agency is an "entity" whose acquisitions could be subject to HSR filing obligations. See the ABA Antitrust Section's most recent *Premerger Notification Practice Manual* ("Practice Manual") at #2.

The *Practice Manual* states that the "state enabling legislation will determine whether an organization was created as an agency of the government (and thus is not an entity) or is an entity controlled by the government (which is an entity if not itself a government agency). If the enabling legislation is ambiguous, the PNO will consider a number of factors including, among other things, judicial decisions from the highest state court declaring that an organization is or is not a

state agency and whether the organization holds itself out as a government agency or an independent body.” Other factors that may also be relevant to the analysis include: (1) the position of the State Attorney General on the issue; (2) application to the system of laws generally applied to state agencies; (3) whether the organization’s board is appointed by the state; and (4) whether the government must approve the organization’s annual plans. See Informal Interpretations 9904004, 1608005, and 1402001.

The Transaction

X, a non-stock, not-for-profit corporation, owns and operates hospital facilities affiliated with a state university. In the upcoming transaction X will become the sole member with rights to designate all of the directors of Y, a non-stock, not-for-profit corporation which owns and operates a hospital. X may be required to appoint a small number of Y's directors post-closing from a list of nominees provided by Y's current member. "Any person who acquires control of an existing not-for-profit corporation which has no outstanding voting securities is deemed to be acquiring all of the assets of that corporation." 16 C.F.R. Section 801.2(f)(3). We understand that if X qualifies as a government agency and is not an "entity" under the HSR rules, the transaction will not be HSR reportable.

The Legislation Establishing X

X was created by state legislation which speaks of a public purpose for X. The legislation explains that the purpose of X's hospital facilities "are to facilitate the clinical education and research of the [state] health science schools and to provide patient care, including specialized services not widely available elsewhere in" the state and "[t]hese purposes separately and collectively serve the highest public interest and are essential to the public health and welfare...." Specifically the legislation separated the business and service functions of X from the state university and provided the purposes for which X will operate, including that X will "serve as the primary clinical setting for health science school students to receive educational and research experiences."

The legislation also created a separate non-stock, not-for-profit corporation as the health system affiliated with the state university – X Parent.

Pursuant to the legislation, X has 17 directors and the composition of the board cannot change without a statutory change. The directors include as ex officio members the following: the president of the state university, the vice chancellor for health sciences of a state education policy commission, one designee of X's board, two of the state university's vice presidents, the chief of the medical staff of X's hospital, the dean of the state university's school of medicine, the dean of the state university's school of nursing, and the chief executive officer of X. X's board also includes a representative elected at large by X's employees and seven directors appointed by X Parent. The statute requires the board of X Parent to select appointees in a manner which assures geographic diversity and assures that at least two members are from each congressional district in the state. The statute also requires X to publicly report annually its audited records and to submit them to a state committee.

By statute, a majority of X Parent's board must be comprised of state university representatives. Pursuant to the statute X Parent has 21 voting directors, 11 of whom are state university representatives. The governor, with the advice and consent of the Senate and working from a list of nominees provided by the directors of Parent X, appoints 7 of Parent X's 11 directors. The governor may reject the list of nominees provided by the directors of X Parent and request that the directors of X Parent submit a list of three different nominees for that board position. The other directors are ex officio members with leadership roles in the state university or in one case X Parent. X Parent is prohibited by statute from transferring or divesting its membership in X. X Parent is also prohibited from increasing the size of the board of X Parent unless there are additional state university representatives added in a manner that ensures the state university representatives constitute a majority of the directors on the X Parent board at all times. The statute also requires X Parent to report annually its audited records publicly and to a state legislative committee.

Case law On X's Status

There is a state Supreme Court case that examined the issue of X's status. In that case, the state Supreme Court consolidated two cases involving X. The first case involved the issue of whether an employee of X was owed procedural due process protection under the state constitution in connection with his discharge from X. The relevant provisions in the state constitution protected individuals "from deprivations by the State, but not from actions of private persons." The Court explained that the threshold question was whether X "may be said to be a 'state actor' in this circumstance. It is not necessary to be a political subdivision of the state, a state agency, or a purely public corporation to be found to be a state actor for due process purposes. ... All that is necessary to determine if an entity is a state actor for due process purposes is to evaluate the nature and extent of state involvement so as to determine if its actions are fairly attributable to the state." The Court found that due to the "symbiotic relationship" between X and the state, the actions of X were "fairly attributable to the state for due process purposes" and the Court could "say without hesitation that [X] is a state actor for due process purposes." To support this finding the Court cited a number of facts including the following:

1. X's "vital and crucial role in providing clinical education and research opportunities to the health sciences schools operated by the [state] regents, a traditional prerogative and responsibility of the state, will be continued, by legislative mandate, in the new facility to be constructed by" X.
2. Significantly "only [state] university faculty have staff privileges with" X and "[n]o other doctor or dentist may admit or treat patients at" X's facilit[ies].
3. "[T]he continued provision of tertiary patient care not readily [not widely] available elsewhere in [the state] is also required by the statute because it is essential to the public health and welfare."
4. The structure of X "and the make-up of its Board of Directors were established through legislative enactment, which assured continuing accountability to the public. [X's] board members are appointed directly by the Governor (subject to Senate confirmation), are University personnel, or (in the case of two members) hold office due to their position with the hospital. In addition, X's "board members must file for public disclosure conflict of interest statements like those filed by public employees or officers."
5. X's enabling statute "contains numerous other provisions indicative of state involvement. The annual audits of [X] are reported publicly and are subject to scrutiny by the Legislature."
6. X's facilit[ies] are located on state owned land. (Note that today, years after the state Supreme Court's decision, X's main campus is still located on sate owned land. However, X now has leased land from other entities for off-campus clinics and the like.)
7. X "is prohibited from mortgaging the existing facilities of the medical center."
8. X's assets "revert to the [state] regents upon liquidation."
9. The public believes X to be part of the state university. (Note that this is a perception and not strictly true then or now.)
10. X's board is in "the handbook of state government." (Note that today, years after the state Supreme Court decision, this no longer appears to be true.)

The second case reviewed by the state Supreme Court involved a request by the state attorney general for X's records under the state's FOIA. In that case X refused to comply with the attorney general's request, arguing that X was not a public body subject to the state's FOIA. The Court, however, found that X was obligated to comply with the state AG's FOIA request. The Court explained that FOIA applied to X because X "was created by state authority." The Court noted that "no contention is made that [X] would ever have been incorporated were it not for the enabling statute. The statute laid out very specific requirements that [X] had to meet, ..., and clearly contemplated the formation of a single corporation, ..." Further, the Court explained that its "finding in this matter is consistent with legislative intent and our past cases. The requirements for incorporation are properly viewed as an exercise of the police powers of the state. While the Legislature found it fiscally desirable to separate the business and service functions of the medical center from the regents' educational functions, ..., the Legislature did not relinquish control over the former functions. In fact, a reading of the statute shows that the Legislature intended that [X] remain accountable as a fiduciary to the people of

[REDACTED]

[REDACTED]

[REDACTED]