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CLIENT ALERT

Not So Fast: New FTC Guidance Means More Hospital Mergers Will Require HSR Filings Before Closing

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The Premerger Notification Office of the Federal Trade Commission (FTC) issued new guidance last week that will require more hospital mergers and acquisitions to be notified under the Hart-Scott-Rodino (HSR) Act. Although billed as a clarification of existing rules, as a practical matter the new guidance means that more hospital mergers will be subject to the HSR Act's prohibition on consummating mergers before notifying the agencies and observing a 30-calendar day waiting period, and it provides the FTC with a powerful tool to collect extensive information before allowing hospital mergers to close.

Background

On October 26, 2018, the Premerger Notification Office (PNO) of the FTC posted an online tip sheet on how practitioners should analyze the combinations of not-for-profit entities under the HSR Act and accompanying rules. The tip sheet is intended to clarify how to analyze a "change of control" in transactions involving not-for-profit entities, especially hospitals. A "change in control" is a key factor in determining whether a change in "beneficial ownership" of a company has occurred and, thus, whether a transaction is reportable under the HSR Act. In addition, the tip sheet reiterates that only certain formations of new not-for-profit entities—and not acquisitions or consolidations of existing not-for-profit entities—may be exempt from reporting requirements.

In the tip sheet, the PNO explained that, in the course of routinely being asked for guidance on how to analyze the HSR reportability of combinations involving not-for-profit entities, practitioners often limited their focus to whether there was a change in control of a not-for-profit entity's board of directors. Now, the PNO has clarified that gaining control of a not-for-profit entity's board is not the only way for a change in beneficial ownership of a not-for-profit entity to occur.

The guidance explains that beneficial ownership of a not-for-profit company changes when another person gains "control" of the entity holding the assets of the not-for-profit company, even if control of the board of directors does not change. In other words, if control—and thus beneficial ownership—of the not-for-profit entity's assets changes, the transaction may be reportable under the HSR Act (if other filing thresholds are met), even if control of the board remains the same. Implicitly, the guidance means that, when the acquired entity's board is eliminated in the transaction and the acquiring entity's board becomes the operative board that controls the assets held by the acquired entity, a change of control has occurred for HSR purposes and the transaction may be reportable.

The PNO explained that its new guidance was particularly important to clarifying HSR Act reportability in the hospital-affiliation context. The PNO said that hospital affiliations often are structured so that two hospitals form a new corporate parent (Newco) for both hospitals. The PNO recognized that, because board control might not change at either hospital under such a structure, practitioners may have assumed that this did not constitute a change of beneficial ownership and, consequently, that no HSR filing was required.

In its new guidance, however, the PNO highlighted the different ways that hospitals affiliate and outlined how it analyzes these combinations by providing a list of examples and factors relevant to analyzing beneficial ownership of hospitals in transactions involving a Newco-parent structure. In particular, the PNO noted that Newco becoming a corporate member of the affiliating hospitals and having the right to approve articles and bylaws, sell assets, appoint senior officers, and approve strategic plans and budgets, were all factors in determining whether there was change in beneficial ownership of a hospital, and likely indicated that a change had occurred. The PNO summarized its guidance by noting that, "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."

The PNO also described three typical types of not-for-profit combinations—simple acquisitions, consolidations, and joint venture formations—to help practitioners accurately identify and distinguish them. The distinctions are important because acquisitions and consolidations, including the consolidation of two hospitals under a Newco parent company, are reportable under the HSR Act if there is a change of beneficial ownership and the other HSR filing thresholds are met. By contrast, the formation of a not-for-profit joint venture entity may be exempt from HSR Act filing requirements under Rule 802.40 (16 C.F.R. § 802.40), which exempts the "formation"—but not "consolidation"—of a not-for-profit entity.

Takeaways

The new PNO guidance indicates that the FTC believed that certain (perhaps many) hospital affiliations were not being properly notified under the HSR Act based upon an overly narrow interpretation of the rules. The FTC guidance rejects that narrow interpretation and expands the scope of the Act to require notification of a broader range of hospital transactions. This has two key implications.

- By requiring HSR filings in more hospital (and other not-for-profit) affiliations, the FTC will have the benefit of the HSR Act rules and process, which prevent merging parties from closing their transaction until the HSR Act waiting period has expired. The HSR Act process ensures FTC staff has at least 30 calendar days (15 days in the case of certain acquisitions out of bankruptcy) to review a merger before it closes. Absent the HSR-filing requirement, the FTC could not prevent merging hospitals from closing their transaction, unless the agency filed a complaint in federal district court and obtained a temporary restraining order or preliminary injunction. The HSR Act process also means that merging parties will have to pay a filing fee.
- By bringing a hospital merger under the HSR Act process, the FTC can issue a Request for Additional Information and Documentary Materials, commonly known as a "Second Request," by the end of the initial 30-day waiting period if the agency staff still has questions or concerns about a transaction. A Second Request is a large and burdensome request for documents, data, and information—often accompanied by a request for depositions of party executives—which results in significant time and resource costs for the merging parties. And again, the merging parties cannot close their transaction until 30 days after they substantially comply with the Second Request. This, too, is a significant timing and leverage benefit to the FTC.

  If a merger is not reportable under the HSR Act, FTC staff can still investigate the transaction and issue Civil Investigative Demands (CIDs) and subpoenas for the same information that they would seek by issuing a Second Request. The key difference, however, is that issuing CIDs and subpoenas does not prevent the parties from closing the transaction. Although FTC staff and merging parties often agree to enter into a "timing agreement," under which the parties agree

not to close their transaction for a certain period of time, the parties have the discretion not to do so, and the FTC's leverage over the parties is arguably less without the benefit of the Second Request process. The PNO's new guidance will change that for certain merging hospitals.

Another key aspect of the guidance is the PNO's indication that an "operating agreement" or "management agreement" does not necessarily constitute an acquisition under the HSR Act, unless there is a change in corporate structure or other indicia of beneficial ownership. This is particularly notable for healthcare providers because they often enter into operating or management agreements, and it has not always been clear whether those would be treated as mergers and acquisitions, or treated as non-merger agreements or "conduct." This guidance suggests that many operating and management agreements will not constitute a merger or acquisition (again, unless beneficial ownership or control changes). If so, that has significant implications. Specifically:

- If a management or operating agreement does not constitute a merger or acquisition, it will be analyzed under Section 1 of the Sherman Act, which prohibits unreasonable restraints of trade, rather than Section 7 of the Clayton Act, which prohibits mergers and acquisitions that may substantially lessen competition.
- While the FTC can investigate and challenge mergers and acquisitions of non-profit healthcare providers under Section 7, it does not have jurisdiction to review non-merger "conduct" and agreements involving non-profit entities. Consequently, this guidance makes it even more likely that operating and management agreements are likely to be reviewed by the DOJ, rather than the FTC.
- Further, agreements analyzed under Section 1 can raise distinct antitrust concerns, which must be evaluated on an ongoing basis, and potentially subject the parties to such agreements to civil (and in some cases criminal) liability. By contrast, the agencies try to resolve concerns raised by a merger or acquisition prior to consummation, there is a lower likelihood of post-merger challenges, and no criminal risk is involved.

Conclusion

In the past, not-for-profit combinations may not have been reportable (or reported) under the HSR Act when board control did not change, even if there were other indicia that control of a not-for-profit entity's governance had changed. That's no longer the case. Instead, the PNO's guidance clarifies that board control is only one of several ways in which an affiliation or other transaction could trigger an HSR notification. The guidance also clarifies that certain consolidations of not-for-profit entities are not exempt from these reporting requirements. As a result, even more not-for-profit entities—particularly hospitals—will now need to be ready to prepare HSR filings, observe the HSR Act waiting period before they close their transactions, and potentially be subject to additional statutory waiting periods under the HSR Act.

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