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Opinion No. 10-49

Applicability of Notification Provisions of Tenn. Code Ann. § 48-68-203 to Subsidiary Mergers

QUESTIONS

1. Do the notification requirements of Tenn. Code Ann. § 48-68-203 apply to a governmental hospital, which is also a public benefit hospital entity, where: i) the governmental hospital chooses to merge two of its subsidiaries; ii) the governmental hospital is the sole member of each subsidiary; and iii) all related nonprofit assets of both the surviving entity and the merging entity remain under the ownership and control of the governmental hospital?

2. Does such a transaction meet the attorney general and reporter's requirements for a written waiver pursuant to Tenn. Code Ann. § 48-68-203(c)?

3. If not, what types of public benefit hospital entity transactions do warrant a written waiver under Tenn. Code Ann. § 48-68-203(c)?

OPINIONS

1. Yes. Pursuant to Tenn. Code Ann. § 48-68-202(4), a subsidiary of a public benefit hospital entity is also a public benefit hospital entity. Therefore, the merger of two such subsidiaries, whereby the merging subsidiary transfers control of all of its assets to the surviving subsidiary, constitutes a "public benefit hospital conveyance transaction" as defined at Tenn. Code Ann. § 48-68-202(3)(B). Because the merger is not in the "usual and regular course" of the activities of the merging subsidiary, it is subject to the notification requirements of Tenn. Code Ann. § 48-68-203.

2. No. Because the merger does not meet the "usual and regular course" condition for exemption from the notification requirements of Tenn. Code Ann. § 48-68-203, it is not necessary to determine whether the transaction meets the attorney general and reporter's requirements for a written waiver.

3. Whether a particular public benefit hospital conveyance transaction warrants a written waiver from the attorney general and reporter pursuant to Tenn. Code Ann. § 48-68-203(c) will depend on the specific facts and circumstances of the proposed transaction.

ANALYSIS

1. The Public Benefit Hospital Sales and Conveyance Act of 2006, Tenn. Code Ann. §§ 48-68-201, *et seq.* (the "Hospital Act") governs the transfer of assets from one public benefit hospital entity to another entity. Pursuant to § 48-68-203 of the Hospital Act, a public benefit hospital entity must provide written notice to the attorney general and reporter before entering into certain extraordinary asset transfers. The term "public benefit hospital entity" is defined in § 48-68-202(4) of the Hospital Act, as "any public benefit corporation … or any governmental entity that is licensed as a hospital … or considered a hospital …, *including entities affiliated with any of these through ownership, governance, or membership, such as a holding company or subsidiary*." Emphasis added. Under this definition, a subsidiary of a government hospital, which is itself a public benefit hospital entity, would also be considered a public benefit hospital entity.

When two such subsidiaries merge, control of the assets of the merging subsidiary is transferred to the surviving subsidiary. Section 48-68-202(3)(B) of the Hospital Act defines a public benefit hospital conveyance transaction to include "[t]he transfer of control or governance of a material amount of the assets or operations of a public benefit hospital entity to another entity or person." Under this definition, the merger of the two subsidiaries, each of which is a public benefit hospital entity pursuant to § 48-68-202(4) of the Hospital Act, constitutes a public benefit hospital conveyance transaction.

Section 48-68-203(a) of the Hospital Act provides that "any public benefit hospital entity shall be required to provide written notice to the attorney general and reporter, prior to entering into any public benefit hospital conveyance transaction." Therefore, because the merger of two subsidiaries constitutes a public benefit hospital conveyance transaction, the notification requirements of § 48-68-203 apply.

In certain circumstances, however, a public benefit hospital conveyance transaction may be exempt from the notification requirements of the Hospital Act. Section 48-68-203(c) provides that:

> [t]his part shall not apply to a public benefit hospital entity, if the public benefit hospital conveyance transaction is in the usual and regular course of its activities, and if the attorney general and reporter has given the public benefit hospital entity a written waiver of this part as to the public benefit hospital conveyance transaction.

There are two conditions, therefore, for a public benefit hospital conveyance transaction to be exempt from the notification requirements of the Hospital Act: (1) the transaction in question must be in the usual and regular course of public benefit hospital entity's activities, and (2) the attorney general and reporter must provide the public benefit hospital entity with a written waiver of the notice requirements.

If a transaction is not in the usual and regular course of the public benefit hospital entity's activities, then a written waiver from the attorney general and reporter will be insufficient to

avoid the notification requirements of the Hospital Act. The term "usual and regular course" is not defined in the Hospital Act, nor does it appear to be defined elsewhere in Tennessee statutory or case law. Nevertheless, because a merger effectively ends the business of the merging public benefit hospital entity, it is likely not in the "usual and regular course" of activities of the merging entity. For example, under the Tennessee Nonprofit Corporation Act, Tenn. Code Ann. §§ 48-51-101, *et seq.*, there is no "usual and regular course" exception to the notification requirement for mergers by nonprofit corporations. *Cf.* Tenn. Code Ann. § 48-61-102(b). By contrast, the "usual and regular course" exception does apply to sales of assets by nonprofit corporations. *Cf.* Tenn. Code Ann. §§ 48-62-101 and 48-62-102(g). This is likely due to the fact that after selling its assets, a nonprofit corporation may be able to use the sale proceeds to pursue its mission, while after a merger, the nonprofit corporation ceases to exist and can no longer carry out its activities.

Because the merger of two subsidiaries is not in the "usual and regular course" of the activities of the merging subsidiary, the merger will be subject to the notification requirements of § 48-68-203 of the Hospital Act, with or without a written waiver by the attorney general and reporter.

2. Because the merger of two subsidiaries is not in the "usual and regular course" of the activities of the merging subsidiary, the notification requirements of § 48-68-203 of the Hospital Act will apply to the transaction, with or without a written waiver by the attorney general and reporter. Therefore, it is not necessary to address whether or not the proposed merger meets the attorney general and reporter's requirements for a written waiver pursuant to § 48-68-203(c).

3. As noted above, certain public benefit hospital conveyance transactions may be exempt from the notification provisions of the Hospital Act. Such transactions must first be within the "usual and regular course" of activities of the public benefit hospital entity. Tenn. Code Ann. § 48-68-203(c). However, even if the proposed transaction is in the "usual and regular course" of activities, whether or not such a transaction qualifies for a written waiver from the attorney general and reporter will depend on very specific facts and circumstances. For example, § 48-68-206 requires the Attorney General to consider, among other things, whether the public benefit hospital entity will receive full and fair market value for its charitable assets; whether the proposed transaction will result in the any breach of fiduciary duty or private inurement, and whether the public benefit hospital entity's governing board exercised appropriate due diligence. Tenn. Code Ann. § 48-68-207 futher requires the attorney general and reporter to consider "whether the proposed public benefit hospital conveyance transaction may have a significant effect on the availability or accessibility of health care services to the affected community." The determination of these issues will need to be made on a case-by-case basis and will depend on the unique facts and circumstances surrounding the proposed public benefit hospital conveyance transaction.

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