



COMMONWEALTH OF PENNSYLVANIA
OFFICE OF ATTORNEY GENERAL

**REVIEW PROTOCOL
FOR FUNDAMENTAL CHANGE TRANSACTIONS
AFFECTING HEALTH CARE NONPROFITS**

Underlying Principle

Whenever a nonprofit, charitable health care entity enters into a transaction effecting a fundamental corporate change which involves a transfer of ownership or control of charitable assets, regardless of the form of the transaction contemplated (*i.e.*, sale, merger, consolidation, lease, option, conveyance, exchange, transfer, joint venture, affiliation, management agreement or collaboration arrangement, or other method of disposition); unless the transaction is in the usual and regular course of the nonprofit's activities; and regardless of whether the other party or parties to the transaction are a nonprofit, mutual benefit or for-profit organization; the Office of Attorney General, as *parens patriae*, must review each transaction to ensure that the public interest in the charitable assets of the nonprofit organization is fully protected. Consequently, to review each transaction, the OAG must be provided relevant financial, corporate, and transactional information, in order to reach a decision on whether or not to object to or withhold objection to the proposed transaction. This decision will determine the Attorney General's position relative to Orphans' Court proceedings required in fundamental change transactions under the Nonprofit Corporations Law.

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Review Protocol

This Protocol was developed to be used as a guide by attorneys and reviewers in the Charitable Trusts & Organizations Section, and its outside experts, in reviewing fundamental transactions affecting nonprofit, charitable health care entities. It provides broad, general guidelines with respect to issues that routinely appear in such transactions and is not intended to be an exhaustive or exclusive list of items to be reviewed and investigated, as these will vary on a case-to-case basis.

1. Notice to the Attorney General

The parties to the transaction shall provide written notice of same to the Attorney General at least 90 days prior to the contemplated date of its consummation. The Attorney General shall be given sufficient time from the receipt of the written notice within which to review and evaluate adequately and fully the proposed transaction. This notice shall include any and/or all of the following documents as the Attorney General may determine to be necessary:

- a) all information, including organic documents such as Articles of Incorporation, bylaws, endowment fund documentation, trust restrictions, expenditure history, and other information necessary to define the trust upon which the charitable assets are held;
- b) all complete transaction documents with attachments, including collateral or ancillary agreements involving officers, directors or employees (i.e., employment contracts, stock option agreements in the acquiring entity, etc.);
- c) all documents signed by the principals or their agents which are necessary to determine the proposed transaction's effect, if any, on related or subsidiary business entities, whether nonprofit or for-profit;
- d) all asset contribution agreements, operating agreements, and management contracts, if any, which comprise part or all of the transaction;
- e) all financial information and organic documents regarding the post-transaction successor or resulting charitable entity (foundation), including the information detailed in Item (a), supra; and including relevant information with respect to officers, directors, and employees (current and post-transaction), in order to determine independence, board composition, charitable purpose, and to review any financial arrangements with officers, directors, or employees which may be affected by the transaction, particularly those which have the potential of affecting an individual's objectivity in supporting or approving the transaction;
- f) all information necessary to evaluate the effects of the transaction on each component of an integrated delivery system, where transactions involve hospitals, including any changes in contracts between the integrated delivery system entities and related physician groups;
- g) all financial documents of the transaction parties and related entities, where applicable, including audited financial statements, any fiduciary accounts whether or not filed with the various Orphans' Courts of the Commonwealth, ownership records, business projection data, current capital asset valuation data (assessed at market value), and any records upon which future earnings, existing asset values and fair market value analysis can be

- based;
- h) all fairness opinions and independent valuation reports of the assets and liabilities of the parties, prepared on their behalf;
 - i) all relevant contracts (assets and liabilities) which may affect value, including, but not limited to, business contracts, employee contracts such as buy-out provisions, profit-sharing agreements, severance packages, etc.;
 - j) all information and/or representations disclosing related party transactions, which are necessary to assess whether or not the transaction is at arms length or involves self-dealing;
 - k) all documents relating to non-cash elements of the transaction, including pertinent valuations of security for loans, stock restrictions, etc.;
 - l) all tax-related information, including the existence of tax-free debt subject to redemption, disqualified person transactions yielding tax liability, etc.;
 - m) a listing of ongoing litigation, including full court captions, involving the transaction parties or their related entities, which may affect the interests of the parties and the valuation of charitable assets;
 - n) all information in the possession of the transaction parties relative to the perspective of the nonprofit's beneficiary class or representatives thereof (e.g., the community);
 - o) all information, including internal and external reports and studies, bearing on the effect of the proposed transaction on the availability or accessibility of health care in the affected community;
 - p) organizational charts of the parties to the transaction, as they exist both pre- and post- consummation of the transaction involved, detailing the relationship between the principal parties and any and all subsidiaries thereof; and
 - q) any and all additional documents that the Office of Attorney General deems necessary for its review purposes.

Any and all confidential information provided in the course of the review will be held in confidence by the Office of Attorney General as a part of its investigative files and, as such, will not be returned to the transaction parties. Only information that is a public record will be privately or publicly disseminated concerning any transaction that is not objected to by the Attorney General, unless such a dissemination is ordered by a court of competent jurisdiction. The Attorney General will notify all transaction parties of any formal or informal request seeking access to the information provided.

2. The Review Process

The Attorney General is entitled to retain outside experts and consultants for the purpose of evaluating information detailed in Item 1, supra. This is more likely to occur in a nonprofit to for-profit transaction. These consultants may be either from state agencies, the private sector, or both. They shall be retained pursuant to written contracts, and the costs for retaining such consultants shall be paid by the parties requesting transaction approval.

The review of the transaction shall include, among other components:

- a) information gathering;
- b) review of fiduciary responsibilities of directors, particularly relative to the exercise of due diligence, the assessment of self-dealing and whether or not the transaction is at arms length;
- c) fair market valuation analysis;
- d) inurement inquiry, including stock options, pension plans and perquisites, performance bonuses, consulting contracts or other post-transaction employment agreements, corporate loans, golden parachute provisions and severance packages, salaries, and related party transactions;
- e) public interest review to evaluate the transaction's effect upon the availability and accessibility of health care in the affected community, to include community involvement and antitrust review; and
- f) appropriate cy pres determination, to ensure that all restricted funds remain segregated and used for their restricted purposes; and that the remaining or successor charitable organization competently and efficiently utilizes the assets for a like charitable purpose benefitting the same class of beneficiaries. The analysis is particularly important when the transaction results in the reallocation of charitable funds from operational use to grant-making use, to ensure that a constancy of charitable purpose is maintained. It is critical to evaluate whether the acquiring entity will maintain control of the charitable assets, post-transaction, through the creation of a newly controlled foundation or through appointments to the existing charity's board.

3. Notice to the Public

The role of the Office of Attorney General in its review of the proposed transaction is to ensure that the actions of nonprofit directors satisfied their fiduciary duties to the public beneficiaries of the health care entity, and to ensure that the charitable assets thereof are

preserved and used for their proper charitable purpose. Further, the Attorney General will consider the broad public policy issue of whether the transaction is in the public interest, specifically whether the proposed transaction will adversely affect the availability or accessibility of health care in the affected community or region.

Implicit in this review is that reasonable public notice of a proposed transaction shall be provided by the parties to the affected community or region, along with reasonable and timely opportunity for such community to contribute to the deliberations of the parties and the Attorney General relative to the health care and charitable trust issues.

In this way, a thorough and complete review of the transaction can be accomplished in a manner that is open to public scrutiny, and the interest of public beneficiaries of nonprofit health care entities may best be protected.

4. Response of Attorney General

Upon completion of its review of the transaction, the Office of Attorney General may: issue a letter indicating that it has no objection to the transaction; bring judicial proceedings to enjoin consummation of any disputed transaction; seek to void any transaction consummated as being in derogation of the law or contrary to public policy; or take any other action it deems appropriate. If, in the opinion of the Office of Attorney General the public interest will be best served thereby, the Office of Attorney General may request that the parties to the transaction seek approval of the Orphans' Court in the county of the nonprofit charitable corporation's registered office. This is more likely to occur in a nonprofit to for-profit transaction.

The procedures set forth in this protocol are in addition to all other powers conferred on the Office of Attorney General by statute or common law.

5. Post-transaction Oversight

The Office of Attorney General will maintain oversight of the transaction after its consummation to ensure that no subsequently executed contracts or arrangements between the parties or their agents effect a denigration of its terms. This oversight may mandate that the resulting entity or surviving charity report on some basis to the OAG to ensure that the terms of the transaction are fulfilled.