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DIVISION OF SECURITIES

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September 29, 1997

Mr. Mark E. Rinehart, Esq.
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Re: Utah Valley Physicians Network, L.L.C.
File # B00014664
Request for Interpretive Opinion/No-Action Letter

Dear Mr. Rinehart:

This letter is in response to your letter dated August 18, 1997, in which you requested that the Utah Division of Securities (the "Division") issue a letter of "interpretive response" that membership interests in Utah Valley Physicians Network, L.L.C., (the "Company") are not securities and need not register with the Division before effecting the plan as set forth in your letter. The Division has elected to respond in the form of a no-action letter. The Division understands the relevant facts to be as follows:

- The Company is composed of approximately eighty primary and specialty care physicians from Utah County.
- The Company proposes to foster the independence, and financial viability of physicians in Utah County by offering to these physicians contract negotiation and management services provided by the Company.
- The Company plans to distribute membership interests in the Company to the physicians.
- Membership interests entitle holders to share in the earnings of the Company and receive dividends in proportion to their percentage interests. As the Company's purpose is to pool the resources of individual physicians in order to more efficiently handle administrative duties of each individual physician, the Company will not be operated to generate distributable income.
- Membership interests entitle the physicians to vote on Company issues.
- No Member shall be entitled to transfer, assign, convey, sell, encumber or in any way alienate all or any part of its Membership Interest except with the prior written consent of the Governing Board, in accordance with guidelines set forth by the Governing Board, which consent may be given, withheld, conditioned or delayed.

- Membership interests will only be issued or transferred to licensed physicians or physician organizations who agree to become members of the Company.

On the basis of the foregoing facts, the staff of the Division will recommend that the Division take no enforcement or administrative action against the Company if the transactions proceed as outlined in your letter without registering with the Division. This response does not purport to express any legal conclusions regarding the applicability of statutory or regulatory provisions of federal or state securities laws to the questions presented. It expresses only my recommendation that the Division not take enforcement or other administrative actions.

Inasmuch as this recommendation is based upon the facts noted above, please note that any different facts or conditions of a material nature might require a different conclusion. Furthermore this recommendation relates only to the referenced transactions and shall have no binding effect on the Division with respect to future similar matters.

Very truly yours,

S. Anthony Taggart
Assistant Director

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August 18, 1997

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RE: REQUEST FOR INTERPRETIVE RESPONSE CONCERNING OFFERING OF MEMBERSHIP INTERESTS IN UTAH VALLEY PHYSICIANS NETWORK, L.L.C.

Dear Mr. Taggart:

This letter is a formal request for an interpretive response form the Utah Securities Division (the "Division") to the effect that units of membership interest ("Membership Interests") in Utah Valley Physicians Network, L.L.C., a Utah limited liability company (the "Company"), are not securities, as that term is defined in section 61-1-12(22) of the Utah Uniform Securities Act (the "Act").

I. BACKGROUND

A group of approximately eighty primary and specialty care physicians, represented by a steering committee of approximately eleven physicians and other persons, wishes to organize the Company. It is planned that the Company will be owned by some physicians individually and, in larger part, by clinics and associations of physicians, all of whom practice medicine in Utah County, Utah.[1]

No Membership Interests will be offered to any person or entity who is not an individual physician or a clinic or association engaged in the practice of medicine in Utah County.

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[1] The Company may enter into contractual arrangements (referred to herein as "Affiliation Agreements") with other physicians, clinics or physician associations in Utah or elsewhere. Parties who enter into Affiliation Agreements with the Company will not own Membership Interests in the Company.

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The general purposes of the Company will be to foster the independence, competitiveness, and financial viability of physicians in Utah County, by offering to these physicians contract negotiation and management services provided by the Company. Specifically, the Company plans to negotiate on behalf of members of the Company (and affiliated physicians and clinics) with health insurance companies and large employers who are interested in entering into contracts with health care providers on a fee-for-service or captitated basis. By representing a fairly large number of physicians, the Company hopes to make contracting opportunities available to its members that are more attractive economically than physicians could achieve by negotiating on their own. The Company also hopes to achieve economies of scale in assisting the physicians in administering such contracts, by centralizing bookkeeping, claims processing, purchasing activities, etc. The Company may perform these services using its own personnel, or the Company may elect to contract with one or more third parties, known as medical service organizations, to provide such services.

The Company intends to offer for sale, and to sell, Membership Interests at no initial charge, except that purchasers of the Membership Interests will agree to be assessed a nominal amount, approximately equal to $100 per month per physician, until the Company's own revenues sustain its operational needs for cash. Purchasers of Membership Interests will enter into an Operating Agreement that will provide for governance of the Company. Owners of Membership Interests will elect a seven member governing board that will act like a board of directors in directing the affairs of the Company. Owners of Membership Interests will be assessed "dues" as described above according to an annual budget that will be adopted by the governing board. Owners of Membership Interests will be free to withdraw as members of the Company at any time, subject only to the requirement that assessments must be paid through the end of the budgetary year during with withdrawal occurs. Copies of the Company's proposed Articles of Organization, Operating Agreement and Organizational Minutes are enclosed with this letter for your review.

Thus, the Company will survive as a going concern only if its members perceive that it is adding value to physicians' contract negotiations with health care payors and to the administration of such contracts. The Company will receive revenues as fees for providing negotiation and administration services, but the Company does not expect to generate "profit" for distribution to its members. Instead, it is planned that the Company will manage its affairs to cause its revenues, either from assessments of members or from fees from services provided, to roughly equal the Company's operating expenses. The Company is not, therefore, an investment for its owners in the traditional sense. It is more like a trade organization or cooperative endeavor, formed for the benefit of physicians who practice medicine in Utah County.

Membership Interests will be subject to significant restrictions on their transfer. In general, holders will be prohibited from voluntarily transferring Membership Interests other than as approved by the Company, and in any event only licensed physicians will be allowed, at any time, to own Membership Interests. A restrictive legend to this effect will be placed on the back of all certificates issued to evidence ownership of Membership Interests.

II. DISCUSSION

Section 61-113(22) of the act defines the term "security" as a "...stock; treasury stock; ... transferable share; investment contract, ... or, in general, any interest or instrument commonly known as a 'security,' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guaranty of, or warrant to right to subscribe to or purchase any of the foregoing."

The above definition of a security is not materially different from the one contained in Section 2(1) of the Securities Act of 1933 (the "1933 Act"). Accordingly, the Utah courts have relied on federal case law interpreting Section 2(1) of the 1933 Act in order to interpret the term "security" as contained in Section 61-1-13(22) of the Act. *Payable Accounting Corp. v. Utah Securities Commission ex rel. McKinley*, 667 P.2d 15 (Utah 1983). This position is supported by Section 61-1-27 of the Act which provides that "This chapter may be so construed as to effectuate its general purpose to make uniform the law of those states which enact it and to coordinate the interpretation and administration of this chapter with the related federal regulation."

In *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851 (1975), the U.S. Supreme Court stated:

> We reject at the outset any suggestion that the present transaction, evidenced by the sale of shares called "stock," must be considered a security transaction simply because the statutory definition of a security includes the words "any...stock." Rather we adhere to the basic principle that has guided the Court's decisions in this area:
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> > "[I]n searching for the meaning and scope of the work 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality." *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967). See also *Howes, supra*, 328 U.S. 298 [footnote omitted].

The Company's Membership Interests will not be economically equivalent to "stock." In *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985), the court set forth the following other characteristics as traditionally associated with stock: "...(i) the right to receive dividends contingent upon an apportionment of profits, (ii) negotiability, (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value." (472 U.S. at 686 (*citing United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851 (1975)). Membership Interests that will be offered and sold by the Company will not be equivalent to "stock" for the purposes of applying Section 61-1-13(22)(b) of the Act, or Section 2(1) of the 1933 Act, because they will not possess the characteristics of stock as identified by *Landreth* court, for the following reasons:

First, although holders of Membership Interests will be theoretically entitled to share in the earnings of the Company and eventually may receive distributions of income, such holders will not have the expectation of deriving substantial income in the form of distributions from their purchase of Membership Interests, as a return on the money paid to purchase Membership Interests. The Company will simply not be operated to generate distributable income.

Second, the Membership Interests will not be negotiable or freely transferable. The Operating Agreement of the Company will provide that a holder may not sell, assign or otherwise transfer (by conveyance, operation of law or otherwise) an Membership Interests except on such terms and conditions as the member and the Company shall mutually agree, and in any event only licensed physicians or physician organizations will be allowed to own Membership Interests. Further, the price that the Company must pay for the Membership Interests is fixed at an amount equal to $0.10 or the fair market value of the Membership Interests, depending on the length of time that the Membership Interests has been held.

Third, Membership Interests will not be susceptible of pledge or hypothecation by their owners. The Operating Agreement will so provide. It will be technically impossible for a creditor to foreclose on any interest in the Membership Interests as such foreclosure would result in a prohibited transfer, or for a Membership Interest to pass to descendants or devisees under any testamentary arrangement established by a Membership Interest owner.

Finally, the members will not have any expectation of profit rights. By profits, the courts have meant either capital appreciation resulting from the development of the initial investment or a participation in earnings resulting from the use of investors' funds. Neither is likely to occur.

It is true that owners of Membership Interests will be entitled to vote on certain matters, as provided in the Operating Agreement. This fact alone, however, should not cause the Membership Interests to be considered securities as contemplated in the Act.

In summary, the Membership Interests lack almost all of the characteristics identified by the *Landreth* court as being traditionally associated with stock. A purchasing physician or practice group will not acquire Membership Interests in order to profit from the holding of such Membership Interests, either through distributions or appreciation, but will acquire Membership Interests for the purpose of deriving personal benefits from improved contract negotiation and management, cost containment, and quality improvement services. The Company will be, in effect, a cooperative organization.

Consideration must also be given to whether the Membership Interests would otherwise be deemed "securities" by reason of being "investment contracts" or "instruments commonly known as securities" for purposes of Section 61-1-13(22) of the Act. In *Landreth*, the Court described the test for determining whether a particular instrument, which is not clearly within the definition of "stock" as set forth in Section 2(1) of the 1933 Act or which is otherwise of an unusual nature, is an "investment contract" or an "instrument commonly known as a security." The test, known as the "economic realities" test, is the same as that set forth in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). The test is whether an investment scheme "involves an investment of money with profits to come solely from the efforts of others." *SEC v. W.J. Howey Co.*, 328 U.S. 293 at 301 (1946). *See also Payable Accounting Corp.*, 667 P.2d 15 at 20.

In a number of no-action letters, the staff of the Securities and Exchange Commission has applied the *Howey* test to transactions similar to the one at issue here, and has determined that such transactions do not fall within the definition of a "security." *See, e.g., Arizona Dental IPA, Ltd.* SEC No-Action Letter (available May 1, 1987); *Northwest Practitioners' Associates, Inc.* SEC No-Action Letter (available June 23, 1986); *Central Florida Medical Affiliates*, SEC No-Action Letter (available April 22, 1985). These no-action letters further describe the factors that are to be used in applying the *Howey* test: (1) whether membership is held out as a financial investment; (2) whether members will have the requisite knowledge and expertise to evaluate the risks and merits of memberships; (3) the degree of control members exercise; and (4) whether revenues are based on members' own efforts.

The *Howey* test, as explained by the court in *Forman*, "embodies the essential attributes that run through all of the court's decisions defining a security." 421 U.S. at 852. Federal appellate courts have modified the fourth leg of the *Howey* test to focus on whether "the effort made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *SEC v. Glen W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir. 1973); *Lino v. City Investing Co.*, 487 F.2d 689 (3rd Cir. 1973).

Applying the factors of the *Howey* test to the characteristics of the Membership Interests to be offered and sold by the Company indicates that Membership Interests will not constitute "investment contracts" or any "other instrument commonly known as a security."

Membership Interests in the Company will not be held out as financial investments, in the *Howey* sense. The Company will not provide a financial return to its members through appreciation or dividends. Benefits will come to the owners of the Company as a result of the services that the Company will provide to or for the benefit of its owners.

Purchasers of Membership Interests will clearly have the requisite knowledge and expertise to evaluate the risks and merits of ownership in the Company. Members currently provide for themselves the same services that the Company will provide for them. Membership in the Company will be restricted to physicians and clinics, who are more experienced and expert in marketing their own medical services than anyone else.

Members will exercise control over the Company by electing members of the management committee that will govern the Company. Except in the case of one member of a seven member management committee, all members of the committee will either be themselves members of the Company or physicians who practice at clinics that are members of the Company. Any such physician will be eligible for management committee membership.

Finally, revenues of member physicians or practice groups will not be derived solely or even substantially from the efforts of the Company and its management, but rather from the quality and frequency of the direct provision of medical services by the physicians themselves. The health care service contracts and other arrangements entered into by the Company will all be based economically on the personal professional services provided by member physicians or practice groups, whether those services are paid for on a fee-for-service, captitated, or other basis. The Company will seek to generate revenues that are approximately equal to its expenses, and it is not expected that the Company will provide any revenues in the form of distributions to its members.

In *Forman*, the court explained that when a purchaser is motivated by a desire to use or consume the item purchased by the Company invested in, the securities laws do not apply. *Forman*, 421 U.S. at 582. Member physicians or practice groups of the Company are similar to the cooperative housing common stock purchasers in *Forman*, in that their purchase will be motivated by a desire to use or consume the item purchased. Member physicians or practice groups will use the Company as a means of increasing their own business. The "undeniably significant" effort in producing a member physicians or practice group's "profit" will be the effort of that individual member through the practice of medicine in substantially the same manner as

before joining the Company. Member physicians or practice groups will obtain benefit by virtue of providing services pursuant to agreements negotiated by the Company, not by any economic interest in the Company in the form of a Membership Interests. (It is not expected that the Company will enter directly into any contracts with health care payors; instead payors will contract directly with members of the Company.)

Where an enterprise merely allows a professional person to enhance his or her ability to earn income in the practice of his or her profession, the relationship avoids the fourth leg of the *Howey* test, thus making the interest under consideration not a "security" within the meaning of the securities laws. *IPA of Richmond County, Inc.*, SEC No-Action Letter (available August 18, 1989); *Queens-Long Island Medical Group, P.C.*, SEC No-Action Letter (available November 6, 1990). Accordingly, the Membership Interests are not "securities" under the *Howey* analysis.

The foregoing "common enterprise" analysis is based on the concept of horizontal commonality where multiple investors pool their investments and receive pro rata profits. *See Wals v. Fox Hill Development Corp.*, ¶ 98,085, p. 98,713 (D.C.E.D. Wisc. 1993). Some courts will also allow vertical commonality to satisfy the "common enterprise" prong of the *Howey* test. Vertical commonality exists where the profits and losses of the investor and the promoter are interdependent. (See *Wals*, at p. 98,714.) Although it does not appear that the vertical commonality analysis is recognized in the Utah courts, if such an analysis were used here, again, a common enterprise would not be found. An individual member physician or practice group will realize little if any financial reward from membership in the Company if the member is not individually a successful medical practitioner. The organizers and managers of the Company could be successful in providing an environment in which success could be obtained and yet any one member physicians or practice group could fail due to his or her individual efforts. It is clear, therefore, that profits and losses of the Company and the individual member physicians or practice group are not interdependent.

As a general public policy matter, it is noteworthy that the Commission as well as a number of states now have analyzed the legal and practical circumstances surrounding physicians' organizations and with a relatively uniform approach have determined that their organization and operation are unique and outside the parameters of the commercial areas that the securities laws were intended to regulate. The letters cited above support this generalization.

III. REQUEST

On the basis of the above-stated facts and legal analysis, we request an interpretive response from the Division to the effect that the Membership Interests of the Company do not constitute "securities" under the definition of that term under the Act, and, therefore, that no

registration of Membership Interests with the State of Utah will be required in connection with the offering and sale of Membership Interests to the persons described in this letter.

Very truly yours,

Mark E. Rinehart

Mark E. Rinehart

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