

OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF THE SALE OF
JENKINS COUNTY HOSPITAL FROM
JENKINS COUNTY HOSPITAL AUTHORITY
AS SELLER, TO COMMUNITY HOSPITAL
MANAGEMENT COMPANY, LP,
OR AN AFFILIATE THEREOF,
AS PURCHASER

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AG No. 2010-02

REPORT OF FINDINGS

I.

BACKGROUND

JENKINS COUNTY HOSPITAL

Jenkins County Hospital (the "Hospital") is a 25-bed, critical access, general acute care facility located at 931 East Winthrop Avenue in Millen, Jenkins County, Georgia 30442. The Hospital is owned by Jenkins County Hospital Authority ("the Authority"), a hospital authority organized under the laws of Georgia. The Authority has operated the Hospital since 1968. The current Hospital was built in 1975 and has 85 employees. It provides general acute care services, including inpatient and outpatient services, general surgery provided by rotational surgeons, diagnostic radiology, laboratory services, outpatient psychiatric services and emergency medical services. The Hospital's primary service area encompasses Jenkins County and Emanuel, Burke and Screven Counties.

THE DISPOSITION PROCESS

The Hospital has struggled over the past several years with increasing costs, loss of medical staff and decreasing reimbursement. The Hospital has also experienced a lack of cash flow stemming from a low patient census. The minutes of the meetings of the Authority reflect that, on March 15, 2010, Mr. Jeff Brantley, the Secretary-Treasurer of the Authority, reported that the finance committee concluded that there was "not enough cash flow," to keep the

Hospital operating and that “there [was] around \$40,000 available on the line of credit.” Mr. Pete Mills, the Chief Executive Officer of the Hospital, said that it took “approximately \$13,000 a day to run the hospital.” The Notice filing reflects that the Hospital’s daily revenue was insufficient to fund the Hospital’s daily operations.

The Hospital experienced net operating losses from the end of fiscal year 2007 and extending through the latest twelve months as of March 31, 2010. As counsel for the Authority described it, the Hospital was in “dire straits.” The County Commission and the Authority agreed that they must sell the Hospital or close it.

The Hospital was approached by HMC/CAH Consolidated, Inc., (“HMC”) a company which provides consulting, development, and management services for hospitals. It engages in developing critical access hospital networks. HMC was formerly known as Hospital Management Consulting and changed its name in April 2007. HMC was founded in 2000 and is based in Kansas City, Missouri. On March 22, 2010, HMC wrote a non-binding letter of intent to purchase Jenkins County Hospital.

Then, in May of 2010, the Authority met to discuss the interest by another entity, Community Hospital Holding Company, Inc. (“CHHC”) in purchasing the Hospital. After conducting its due diligence process, CHHC determined that it was interested in purchasing the Hospital. On July 12, 2010, counsel for the Authority wrote HMC to advise it that the Authority had voted to sell the Hospital to another entity. On May 27, 2010, the Authority voted to enter into the proposed Asset Purchase agreement with CHHC.

THE PROPOSED TRANSACTION

The Asset Purchase Agreement (“Agreement”) includes the sale of the Hospital, two medical office buildings, a modular building used for meetings and a vacant lot (collectively “Hospital assets”). There are certain assets as listed in the Agreement, such as capitalized leases, insurance policies covering the hospital and deferred tax assets or right to tax refunds which are not included in the sale.

The Authority proposes to sell the Hospital assets to Community Hospital Management Company, L.P., a for-profit Georgia corporation, with its principal place of business located at 210 East De Renn Avenue, Savannah, Georgia 31405. Purchaser is owned in part by CHHC.

Jenkins County Hospital, LLC (the "LLC"), is a limited liability company owned by Purchaser. At or prior to the closing of the sale transaction, Purchaser intends to assign its rights and obligations under the Agreement in the Hospital to Jenkins County Hospital, LLC which will own and operate the Hospital.

The Purchaser is owned by CHHC and George Kleinpeter II, Inc. CHHC is wholly owned by Johnny George, M.D. George Kleinpeter II, Inc. is owned equally by Michael Kleinpeter and Johnny George, M.D.

The Purchaser will assume the Hospital's debt and pay the Hospital \$500,000.00 in cash. Purchaser will maintain services at the Hospital and staff the emergency room 24/7. The Authority has retained a right of first refusal for the Hospital which may be exercised in the event that, within three years after the closing, Purchaser proposes to dispose of over fifty percent (50%) of the voting interest of or the stock of Purchaser, or substantially all of the assets of the Hospital to a purchaser that is not an affiliate.¹ For the first five (5) years after closing, the Authority will reimburse the Hospital up to \$300,000 per year for medical services provided to the indigent sick of Jenkins County to be paid semi-annually. For years 6 through 10 following the closing, the Authority will reimburse the Hospital twenty-five percent (25%) of fees charged by the Hospital for medical services provided to the indigent sick up to \$150,000, provided that the total fees charged for such patients exceeds Four Hundred Thousand Dollars (\$400,000.00) during the respective year.

VALUATION ANALYSIS

Pinnacle Valuation, LLC ("Pinnacle") performed a financial analysis to determine the market value of the owners' equity in the Hospital. Pinnacle used a premise of value of a controlling interest with the value in place, but not currently producing income. There are typically three approaches considered in analyzing the fair market value of a Hospital: the income approach, market approach and cost or asset-based approach. The income approach is based on the concept that the value of a business is the present worth of the expected future economic benefits to be derived by the business' owners. The market approach involves a

¹ The term "affiliate" used in this Report is as defined in the Asset Purchase Agreement.

comparison and correlation of the subject to observed transactions in the marketplace. Under the cost approach, value is estimated based on the value of all of the underlying assets, both tangible and intangible of the subject businesses. Pinnacle considered all three approaches and applied the market and cost approach to arrive at its determination of the market value of the Hospital's equity. Pinnacle did not rely on the income approach due to the Hospital's history of operating losses and its expected operating losses going forward. Jim Connors, Director of Valuation Services at Pinnacle, testified at the public hearing.

Pinnacle gave roughly equal weight to its conclusions regarding the value of the Hospital under both the asset-based approach and the market approach; but, in applying the market approach, Pinnacle gave more consideration to the guideline transactions method (as opposed to the guideline companies method²), resulting in a calculation of the Hospital's business enterprise value as of June 30, 2010, at between \$632,000 and \$698,000, excluding the medical practices affiliated with the Hospital. After deducting the Hospital's debt from the business enterprise value, Pinnacle determined that the value of the equity in the Hospital was within a range of \$37,000 to \$41,000. Ultimately, Pinnacle concluded that Purchaser's offer price exceeded the fair market value for the Hospital.

The Attorney General was assisted by the firm of Ketchum Valuation Consulting ("KVC") in the review of Pinnacle's determination of fair market value. Peter Ketchum, President of Ketchum Valuation Consulting, testified at the public hearing. With respect to Pinnacle's analysis under the market approach, KVC noted that Pinnacle developed price-to-revenues and price-per-bed multiples based on an analysis of four publicly traded guideline companies. The market pricing multiples for the guideline public companies were based on the market value of each company's invested capital as of the valuation date, and each company's revenues and number of beds for the latest twelve months. Pinnacle elected not to adjust the market equity value of each of the guideline companies to reflect the fact that their stock prices

² The guideline companies' method relies on data derived from transactions in the stock of publicly-traded companies, whereas the guideline transactions method relies on data derived from transactions of companies that have recently been acquired, either by a tender offer or in a private transaction.

generally reflect the values of minority interests, whereas Pinnacle's appraisal of the Hospital was on a controlling interest basis. The selected market multiples were .30 times revenues and \$50,000 per bed, after adjustment for factors such as the guideline companies' greater size, geographic diversity and higher profit margins as compared to the Hospital. Pinnacle's selected multiples reflected a discount of 73 % to the median price-to-revenue multiple, and a discount of 92 % to the median price-per-bed multiple. Pinnacle stated in its report that the multiples exhibited by the guideline companies were discounted based on the Hospital's very small size and lack of diversification relative to the guideline companies, as well as its poor historical financial performance and lack of growth prospects relative to the guideline companies. There is no quantitative support for the discount presented in the appraisal report suggesting that the discount was based largely on qualitative factors. KVC observed, however, that due to the lack of comparability between the Hospital and the guideline companies, Pinnacle did not place a great deal of reliance on this method.

With respect to Pinnacle's analysis under the cost or asset-based approach, KVC noted that Pinnacle appraised the Hospital's real estate, equipment and accounts receivable, and then added allowances for other current assets based on their respective book values and deductions of the amount of the Hospital's stated current liabilities. The resulting indicated value of the business enterprise was then reduced by an underutilization factor to reflect the Hospital's low patient census relative to its number of licensed beds.

As part of its review, KVC performed additional research and analysis concerning the four acquired hospitals evaluated by Pinnacle in its application of the guideline transactions methodology under the market approach. Among other things, KVC compared and evaluated factors such as county population sizes and anticipated capital expenditures. KVC noted, for example, that a replacement facility is currently under construction for the acquired guideline hospital that indicated the lowest price to revenue multiple. From that, KVC deduced that the buyer was anticipating a large capital outlay which would tend to reduce the purchase price of a hospital, all other things being equal. KVC also noted that the guideline hospital generating the second lowest price-to-revenue multiple is much more profitable than the subject Hospital, but, like the Hospital, is also located in a county with a declining population. KVC observed that when a price-to-revenue multiple between the lowest and second lowest indicated by the guideline transactions was applied to the subject Hospital's revenues for the latest 12 months, the

resulting indication of value was higher than that concluded by Pinnacle, but still consistent with the consideration being offered by the Purchaser. KVC concluded from this additional analysis that the value concluded by Pinnacle, while conservative, was not unreasonable.

KVC also performed additional analysis of Pinnacle's application of the asset-based approach. Among other things, KVC adjusted certain of the assumptions made by Pinnacle concerning patient census. While Pinnacle had applied an underutilization discount based in part on a capacity of five beds, KVC calculated an underutilization factor based on a capacity of 10 beds. The result was an indicated value that is higher than that concluded by Pinnacle but still consistent with the terms of the current offer.

KVC concluded that Pinnacle utilized valuation methodologies that are consistent with generally accepted industry standards and that Pinnacle's final analysis is at the low end of a reasonable range of fair market value.

PUBLIC COMMENT

The public hearing was held on Wednesday, September 1, 2010, at 2:00 p.m. at Jenkins County Hospital meeting room located at 931 E. Winthrope Avenue, Millen, Georgia 30442-1839. Five people made comments at the public hearing and all supported the purchase of the Hospital assets by Purchaser. Mr. Mills, the Hospital CEO, had testified prior to the public comment that in order to "keep the doors" of the Hospital open, they would have to sell. The Chairman of the Jenkins County Board of Commissioners, James Henry, commented that the commission is "solidly behind this effort to try to make this transition of ownership" and would help handle the indigent care and that the new owner would provide medical services to the community.

Following the public hearing, the record was held open until the close of business on September 3, 2010, for any further public comment but there were no additional comments received. Counsel for Jenkins County Hospital Authority and for Purchaser were requested to inform this Office in writing on or before noon on September 7, 2010, as to whether their respective clients would proceed with the proposed transaction as structured or modify the proposed transaction in some respect in light of the oral and written public comments, or make any other disposition of the transaction. Counsel for Purchaser and counsel for the Authority

sent a letter to the Hearing Officer on September 3, 2010, stating that their clients wish to proceed with the transaction as proposed.

II. FINDINGS

The Hospital Acquisition Act (the "Act") involves a public interest determination in the Attorney General's review of a proposed disposition and acquisition of hospital assets. See O.C.G.A. § 31-7-400 *et seq.* and *Sparks v. Hospital Authority of City of Bremen and County of Haralson*, 241 Ga. App. 485 (1999) (physical precedent only). The Act requires both a written notice filing (O.C.G.A. § 31-7-401) and a public hearing "regarding the proposed transaction in the county in which the main campus of the hospital is located." O.C.G.A. § 31-7-405(a). The purpose of the public hearing is "to ensure that the public's interest is protected when the assets of a nonprofit hospital are acquired by an acquiring entity by requiring full disclosure of the purpose and terms of the transaction and providing an opportunity for local public input." O.C.G.A. § 31-7-406.

Under the Act, disclosure is linked to whether "appropriate steps have been taken to ensure that the transaction is authorized, to safeguard the value of charitable assets, and to ensure that any proceeds of the transaction are used for appropriate charitable health care purposes." O.C.G.A. § 31-7-406. The Act identifies thirteen factors that are key considerations or guidelines in determining whether the appropriate steps have been taken by the parties. The thirteen factors are listed in Appendix A to this report.

The thirteen factors set forth in O.C.G.A. § 31-7-406 may be grouped into four categories relating to (a) the exercise of due diligence by the seller (factors number 1, 2, 3, 4 and 8), (b) valuation of the hospital assets (factors number 6, 7 and 10), (c) conflicts of interest (factors number 5 and 13) and (d) the charitable purpose of the proposed transaction (factors number 9, 11 and 12).

The due diligence factors number 3 and 4 require review of the process employed by Jenkins County Hospital Authority "in deciding to dispose of hospital assets, selecting the acquiring entity, and negotiating the terms and conditions of the disposition." O.C.G.A.

§ 31-7-406(3). Mr. Mills testified at the hearing that, over the two years prior to the decision to sell, the Authority discussed ways to attempt to keep the Hospital open. Mr. Mills said that potential management possibilities and bringing in new doctors were discussed. Ultimately, he said they reached a point where the choice was either selling the Hospital or closing it. At that point, without funds or sources of funds to continue operating the Hospital, the Authority's knowledge of, and proximity of a potential purchaser, a sale to the potential purchaser seemed to be "a win-win" situation. A company had purchased and was operating The Doctors Hospital of Tattnall in Reidsville, Georgia, located about 50 miles from the Hospital. The same company had purchased an orthopedic clinic near the Hospital. Mr. Mills testified that the company turned Doctors Hospital into a thriving hospital for the community.

Mr. Mills asked that company to consider acquiring or managing the Hospital. In the period prior to receiving a response, the Authority attempted to contact several other parties to buy the Hospital. Mr. Mills initially received a letter of interest to transfer the ownership or management of the Hospital to HMC. The Authority had concerns about whether HMC could manage the Hospital because of its location in Kansas, its lack of knowledge about the community and its perceived difficulty in recruiting physicians.

The Authority did not conduct a formal request for proposal process, which would have been ideal. However, the Authority did support obtaining a valuation to ensure that the consideration offered to purchase the Hospital was fair and that a proposed purchaser would support the Authority's objectives of protecting the assets of the community. The parties reached an arms length proposed agreement and on April 19, 2010, when the Authority's Board voted unanimously enter into a letter of intent with Purchaser. In light of the exigencies dictating the Authority to either "sell or close," together with the facts that both parties were assisted by experts throughout the process and in negotiating the Agreement, and that the Authority faced a financial crisis in its attempt to continue operating the Hospital, it appears that the Authority took appropriate actions to sell the Hospital. O.C.G.A. §§ 14-3-302, 31-7-400 *et seq.*

With respect to factor number 1, the disposition of the Hospital is authorized by applicable law. Factor number 8 requires that any management or services contract negotiated in conjunction with the transaction must be reasonable. Since the Consultant Agreement no longer requires payment by the Hospital for Executive Management Consultations, the contract appears to be reasonable. There are no donors who have contributed the amount required under factor 2.

The disclosure of any conflict of interest involving Jenkins County Hospital, the chief executive officer of the Hospital and the expert consultant are required to be considered under factor number 5. Conflict of interest certifications as required by the Act and the Notice filing requirements of the Attorney General have been filed by members of the governing board of Jenkins County Hospital, by the chief executive officer of the Hospital, by the governing board of the Authority and by the expert consultant.

The value of the Hospital and the amount of consideration to be paid in the proposed transaction must be weighed under factors number 6, 7 and 10. Since Purchaser is a for-profit corporation, Jenkins County Hospital is required to receive "fair value" for the sale of the Hospital. *See* O.C.G.A. § 31-7-406(6). In this context, the term "fair value" means "fair market value." *Compare* O.C.G.A. § 31-7-403(b) (board members and the chief executive officer of the seller must provide a certification "stating that the nonprofit corporation has received fair market value for its assets"). The consultant for the Hospital concluded that the consideration offered exceeds fair market value. The consultant for the Attorney General concluded that, while certain of the assumptions utilized by the consultant for the Hospital may be considered conservative, applying more aggressive assumptions would have yielded an indication of value that is not inconsistent with the consideration offered for the Hospital.

Since Jenkins County Hospital Authority is not financing any portion of the proposed transaction, factor number 7 is not applicable. As required under factor number 10, the Agreement provides that the Authority will have a right of first refusal which may be exercised in the event that, within three years after the closing date, Purchaser proposes to sell more than fifty percent (50%) of the assets or the voting interest or stock of Purchaser to a purchaser that is not an affiliate. In the event Purchaser exercises its right of first refusal, the Authority will use the \$500,000.00 in cash as from the sale to buy back the Hospital.

The ownership interest of a physician in the Purchaser requires that the Attorney General consider under factor number 13 -- "[w]hether health care providers will be offered the opportunity to invest or own an interest in the acquiring entity or a related party, and whether procedures or safeguards are in place to avoid conflict of interest in patient referrals." O.C.G.A. § 31-7-406 (13). Dr. George is the physician who will become an owner of the Hospital under the Agreement. He and Mr. Kleinpeter testified at the public hearing that they may bring in other physician owners for the Hospital who would be capital investors and strategic partners.

Dr. George testified that it was necessary to exercise care where physician ownership exists because it was “against the law” for a physician owner to refer patients to a facility in which he or she has an ownership interest.

“Conflict of interest” is defined as “a clash between public interest and the private pecuniary interest of the individual concerned . . . [or a] situation in which regard for one duty tends to lead to disregard of another.” BLACK’S LAW DICTIONARY, 299 (6th ed. 1990).

According to his testimony, Dr. George will not refer patients to the Hospital and he agreed to execute a certification to that effect at the closing of the sale.

The federal health care program’s Anti-Kickback Statute³ prohibits “conflicts of interest in patient referrals,” as when a physician tends to refer paying patients to a hospital in which she or he owns a financial interest, while referring indigent patients to other hospitals. Pertinent literature indicates a second category of conflicts of interest resulting from referral by a physician for hospital admission where hospital care is not warranted.

Under the first conflicts-of-interest category, the likelihood of a conflict arising from physician referral of indigent patients to other hospitals is lessened to a large extent where the healthcare facility in which the referring physician has an interest is an acute care hospital with an emergency department.⁴ Here, the Hospital currently operates an emergency room, and Purchaser has committed to continue operating its emergency room. The Emergency Medical Treatment and Active Labor Act (EMTALA)⁵ protects individuals from being denied emergency medical services from hospitals that participate in Medicare by requiring that every person who comes to the emergency room “seeking care must be given an appropriate medical screening examination reasonably calculated to determine whether an emergency medical condition exists, regardless of the patient’s ability to pay.” AMERICAN HEALTH LAWYERS ASSOCIATION, JOURNAL OF HEALTH LAW, Vol. 38, No. 1, Pg. 77 (Winter 2005). Failure to comply may result in certain

³ Exclusion of certain individuals and entities from participation in Medicare and State health care programs - 42 U. S. C. § 1320a – 7b.

⁴ Some comments and information provided regarding the physician syndication actually applies to physicians’ interest in Limited-Services hospitals.

⁵ Emergency Medical Treatment and Active Labor Act, 42 U.S.C. § 1395dd (a); Pub. L. No. 99-272, 100 Stat. 164 (1986).

civil penalties against the hospital and responsible physicians, as well as civil actions for damages against the hospital. *See*, 42 U.S.C. §§ 1395dd(d)(1) and (2). Purchaser has committed to continue serving indigent patients as indicated under factors number 11 and 12. The commitment by Purchaser to maintain an emergency room and to continue to provide indigent care is itself a safeguard against conflicts of interest in physician referral of indigent patients to other hospitals.

The remaining two charitable purpose factors, factors number 11 and 12, concern the purchaser's commitment to provide (a) continued access to affordable care, (b) the range of services historically provided by the seller, (c) health care to the disadvantaged, the uninsured and the underinsured and (d) benefits to the community to promote improved health care. The Notice filing documents and testimony at the hearing demonstrates that the charitable and indigent care factors of the Act have been satisfied.

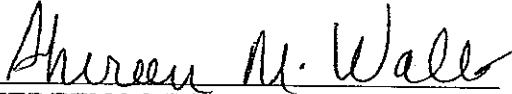
Thus, from the decided weight of the evidence, it appears that sufficient safeguards exist to assure the community of continued access to affordable care and to the range of services historically provided by Jenkins County Hospital. The evidence taken as a whole demonstrates that the Purchaser has made an enforceable commitment to provide health care to the disadvantaged, the uninsured and the underinsured and to provide benefits to the community to promote improved health care.

III.

CONCLUSION

Upon review of the public record and in accordance with the Hospital Acquisition Act, the Hearing Officer finds that the public record in this matter discloses that the parties have taken appropriate steps to ensure (a) that the transaction is authorized, (b) that the value of the charitable assets is safeguarded and (c) that any proceeds of the transaction are used for appropriate charitable health purposes.

This 28th day of September, 2010.


SHEREEN M. WALLS
Senior Assistant Attorney General
Hearing Officer

APPENDIX A

FACTORS TO BE ADDRESSED UNDER O.C.G.A. § 31-7-406

- (1) Whether the disposition is permitted under Chapter 3 of Title 14, the 'Georgia Nonprofit Corporation Code,' and other laws of Georgia governing nonprofit entities, trusts, or charities;
- (2) Whether the disposition is consistent with the directives of major donors who have contributed over \$100,000.00;
- (3) Whether the governing body of the nonprofit corporation exercised due diligence in deciding to dispose of hospital assets, selecting the acquiring entity, and negotiating the terms and conditions of the disposition;
- (4) The procedures used by the nonprofit corporation in making its decision to dispose of its assets, including whether appropriate expert assistance was used;
- (5) Whether any conflict of interest was disclosed, including, but not limited to, conflicts of interest related to directors or officers of the nonprofit corporation and experts retained by the parties to the transaction;
- (6) Whether the seller or lessor will receive fair value for its assets, including an appropriate control premium for any relinquishment of control or, in the case of a proposed disposition to a not-for-profit entity, will receive an enforceable commitment for fair and reasonable community benefits for its assets;
- (7) Whether charitable assets are placed at unreasonable risk if the transaction is financed in part by the seller or lessor;
- (8) Whether the terms of any management or services contract negotiated in conjunction with the transaction are reasonable;
- (9) Whether any disposition proceeds will be used for appropriate charitable health care purposes consistent with the nonprofit corporation's original purpose or for the support and promotion of health care in the affected community;
- (10) Whether a meaningful right of first refusal to repurchase the assets by a successor nonprofit corporation or foundation has been retained if the acquiring entity subsequently proposes to sell, lease, or transfer the hospital to yet another entity;
- (11) Whether sufficient safeguards are included to assure the affected community continued access to affordable care and to the range of services historically provided by the nonprofit corporation;
- (12) Whether the acquiring entity has made an enforceable commitment to provide health care to the disadvantaged, the uninsured, and the underinsured and to provide benefits to the affected community to promote improved health care; and
- (13) Whether health care providers will be offered the opportunity to invest or own an interest in the acquiring entity or a related party, and whether procedures or safeguards are in place to avoid conflicts of interest in patient referrals.