

OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF THE SALE OF *
SCREVEN COUNTY HOSPITAL FROM *
SCREVEN COUNTY HOSPITAL AUTHORITY *
AS SELLER, TO COMMUNITY HOSPITAL * AG No. 2010-03
MANAGEMENT COMPANY, LLC, *
OR AN AFFILIATE THEREOF, *
AS PURCHASER *
*

REPORT OF FINDINGS

I.

BACKGROUND

SCREVEN COUNTY HOSPITAL

Screven County Hospital (the "Hospital") is a 25-bed, critical access, general acute care facility located at 215 Mims Avenue in Sylvania, Screven County, Georgia. The Hospital is owned by Screven County Hospital Authority ("the Authority" or "Seller"), a hospital authority organized under the laws of Georgia. The Authority has operated the Hospital since 1951. The Hospital currently has 105 full-time 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 Screven County from which it draws 93% of its patients. The Hospital draws the remainder of its patients from Bulloch, Burke, Candler, Jenkins, Effingham, Chatham and Richmond counties.

THE DISPOSITION PROCESS

The Hospital has struggled over the past several years with increasing costs, loss of medical staff and decreasing reimbursement. Over the past five years, the Seller has evaluated various strategic options for the Hospital including replacing the existing building in its entirety or in part; closing acute inpatient services; entering into a joint operating agreement with another

hospital; merging with Jenkins County Hospital; selling the Hospital; and closing the Hospital. During this process of evaluation, the Hospital's long-term affiliation partner withdrew from the management of the Hospital. The Seller's evaluation process revealed that it had little access to capital. During the same period of consideration of options, the Hospital continued to sustain losses and required ongoing operating support from Screven County.

In mid 2010, the Authority discussed with the Purchaser the operations of the Hospital up to and including the possible sale. After conducting its evaluation of a purchase of the Hospital, Purchaser determined that it was interested in purchasing the Hospital. On July 29, 2010, the Authority voted to enter into the proposed Asset Purchase Agreement with Purchaser.

THE PROPOSED TRANSACTION

The Asset Purchase Agreement ("Agreement") includes the sale of the Hospital together with all clinics and outpatient operations owned or operated by the Seller or any affiliate of the Seller that are related exclusively to the operation of the Hospital, including all developed or undeveloped real property of the Seller associated exclusively with the Hospital and all improvements to the real property. There are certain assets that are defined in the Agreement as "Excluded Assets" which are not part of the sale. Among the Excluded Assets are certain leases, rights to tax refunds, insurance policies and rights of the Seller related to participation in the Georgia Indigent Care Trust Fund.

The Authority proposes to sell the Hospital assets to Community Hospital Management Company, LLC (the "Purchaser"), with its principal place of business located at 210 East De Renn Avenue, Savannah, Georgia 31405. Screven County Hospital, LLC (the "LLC") is a limited liability company owned by Purchaser. Following the closing of the sale transaction, Purchaser intends to contribute the purchased assets to the LLC, which will own and operate the Hospital.

The Purchaser is owned by Community Hospital Holding Company, LLC ("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 \$700,000.00 in cash. The Purchaser will maintain the existing services at the Hospital and staff the emergency room twenty four hours a day, seven days a week. The Authority has retained a right of first refusal

for the Hospital which may be exercised in the event of certain proposed dispositions of assets or controlling ownership interests within three years of the closing. For ten years after closing, the Authority will reimburse the Hospital up to \$600,000 per year for medical services provided to the indigent sick of Screven County. The Authority will utilize the available disposition proceeds to pay for Purchaser's provision of such services to the indigent sick of Screven County.

VALUATION ANALYSIS

Pinnacle Valuation, LLC ("Pinnacle") performed an equity appraisal on behalf of CHHC in order to "provide management with decision making and compliance assistance." For the purpose of the analysis, Pinnacle employed a standard of market value, defined as:

The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.

There are typically three approaches considered in valuation; the market approach, income approach and asset-based approach. Under the market approach, value is derived through a comparison of the transaction prices of similar assets trading in the marketplace. The income approach is based on the concept that value of a business is the present worth of the expected future economic benefits to be derived by the business's owners. In the asset-based approach, value is estimated based on the value of all of the subject business's underlying assets, both tangible and intangible.

Pinnacle considered all three approaches to value, and utilized the market and asset-based approaches to arrive at its determination of the market value of the Hospital's assets. James H. Connors III, Director of Valuation Services at Pinnacle, testified at the public hearing. In its report, Pinnacle stated that it did not apply the income approach, due to the Hospital's history of operating losses. Under the market approach, Pinnacle applied both the guideline public company method and the guideline acquisitions method, whereby it found a value of \$1,753,155 and \$1,120,328, respectively. Using the asset-based approach, Pinnacle found an indicated value of invested capital of \$1,527,000. Pinnacle then correlated the values from the two market approach methods and the asset-based approach by applying a 5 percent weight to the guideline public company method, a 20 percent weight to the guideline acquisitions method, and 75

percent weight to the asset-based approach, which lead to an indicated value of invested capital of \$1,457,000. From that value, Pinnacle deducted \$731,411, the Hospital's debt as of June 30, 2010, which led to a concluded value of the Hospital's equity in the range of \$689,000 to \$761,000.¹

The Attorney General was assisted by the firm of Ketchum Valuation Consulting ("KVC") in the review of Pinnacle's determination of 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 relied on market pricing multiples derived from stock market transactions of shares of publicly-traded "guideline" companies. KVC found that Pinnacle's implied discount of 73 percent to the median price to revenue multiple and their implied discount of 89 percent to the median price per bed multiple had no quantitative support. However, applying the discount was reasonable, given the Hospital's small size and lack of diversification and growth prospects relative to the guideline companies, and the Hospital's poor historical financial performance. Additionally, KVC noted that it was reasonable that Pinnacle put very little weight on the guideline public company method in developing its final conclusion due to the lack of comparability between the Hospital and the guideline companies. Under the guideline acquisitions method, Pinnacle relied on price to revenues and price per bed multiples indicated by six acquisitions of critical access hospitals. Mr. Ketchum noted that Pinnacle's conclusion of value, based on the application of the guideline acquisitions method produced a result at the low end of the range of price to revenues multiples indicated by the guideline transactions. However, it does not appear to be unreasonable given the Hospital's history of financial losses and the age and condition of the facilities.

In its report, KVC stated that when appraising either an asset holding company or an operating company that is in financial distress, the asset-based approach is often considered to be the most appropriate. Pinnacle appraised the Hospital's real estate, equipment, and accounts

¹ The Appraisal Report submitted by Pinnacle states that "it is our opinion that the fair market value as of June 30, 2010 for a 100 percent controlling interest in the net assets of SCH under the stated premise of value (+/- 5% of the midpoint of \$725,000) is: \$689,000 to \$761,000." At the public hearing, Pinnacle's representative testified that "[w]e determined for the equity cash consideration a range of approximately \$690,000 to \$760,000 would be a range for that consideration."

receivable, and added allowances for other current assets based on their respective book values and deducted the amount of the Hospital's current liabilities. Thereafter, the resulting value was reduced by an underutilization factor to reflect the Hospital's low patient census relative to its number of licensed beds.

KVC concluded that Pinnacle utilized valuation methodologies that are consistent with generally accepted industry standards in its appraisal of the Hospital and that Pinnacle's conclusion of value appears to be within a reasonable range.

PUBLIC COMMENT

The public hearing was held on Wednesday, November 3, 2010, at 1:00 p.m. at 320 Millen Road in Sylvania, Georgia. Nine people made comments at the public hearing and all supported the purchase of the Hospital assets by Purchaser.

Following the public hearing, the record was held open until noon on November 5, 2010, for any further public comment but there were no additional comments received. Counsel for Screven County Hospital Authority and for Purchaser were requested to inform this Office in writing on or before noon on November 5, 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 joint letter to the Hearing Officer on November 5, 2010, stating that their clients wished 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 Screven 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). George St. George, the Chief Executive Officer of the Hospital, testified that “over the last five plus years the Screven County Hospital as part of a strategic planning process examined what actions it could take to enhance the long-term viability of the hospital in the community.” Related to the determination to sell the Hospital, Mr. St. George testified:

So then we explored the concept of a sale of the hospital to a hospital company. The hospital engaged an adviser to educate it about the potential for sale. The conclusion of that adviser was that based on our historical financial performance and the county’s socioeconomic characteristics it was highly unlikely that any large investor-owned hospital company would be interested in acquiring or operating the hospital.

That left us to look at the smaller firms, boutique companies, investor companies that target select rural hospitals. They might have had an interest, but again, the financial conditions would pose a significant hurdle for them as well.

So in the early spring of this year, the Authority decided to approach the buyers and let it be known that the Authority was

interested in pursuing discussions about operations of the hospital up to and including the sale.

Mr. St. George further testified that over all of the time that the Authority has evaluated options for the Hospital, it has received no offers or even "earnest explorations" about a purchase of the Hospital and did not receive any real exploration from area hospitals about providing assistance to the Hospital.

David Boddiford, the Chairman of the Authority, testified that he does not think the Authority could have done anything to obtain a different or better purchase offer for the Hospital. He also testified that he did not know of any other offers to purchase the Hospital.

The Authority did not conduct a formal request for proposal process, which would have been ideal. However, Mr. St. George provided testimony regarding the Authority's evaluation of various alternatives for the Hospital over a period of years, including its consultation with an advisor regarding the potential for sale of the Hospital. In addition, the Authority obtained 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 July 29, 2010, the Authority's Board voted unanimously to enter into a letter of intent with Purchaser. In light of the circumstances related to the Hospital's operations, together with the facts that both parties were assisted by experts throughout the process and in negotiating the Agreement, and that the Authority faced ongoing financial losses requiring Screven County's support 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. Purchaser and Seller have entered into a consulting agreement as of October 1, 2010, pursuant to which Seller will pay Purchaser the sum of \$15,000 per month. Purchaser assumes the responsibility for the fee under the terms of the Agreement. In addition, if the transaction does not close, Seller has no liability for the fee. As the Seller has no responsibility for the fee in the event the transaction does not close, and the \$15,000 fee has been disclosed by counsel for the Purchaser to "represent[] costs incurred by Purchaser to provide consultative and operational guidance," the contract is reasonable.

Related to factor number 2, there are no donors who have contributed to Seller in excess of \$100,000.

The disclosure of any conflict of interest involving Screven 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 Screven 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, Screven 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"). James H. Connors, III, the consultant for the Hospital, concluded that the consideration offered is in the range of fair market value. Specifically, Mr. Connors testified that "[w]e determined for the equity cash consideration a range of approximately \$690,000 to \$760,000 would be a range for that consideration. And that would be the cash consideration plus the assumption of any debt." The cash consideration to be received by Seller is \$700,000.

Since Screven 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.

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. Dr. George testified at the public hearing that physician owners of the Hospital

cannot lawfully refer patients to the Hospital. He testified that they may bring in other physician owners for the Hospital who would be capital investors and strategic partners, but would not also be permitted to refer patients to the Hospital. He further testified that patients will be provided with notice regarding any physician ownership. The Purchaser has further confirmed that Dr. George will execute a certification at closing to provide substantially as follows:

Following the closing of the Transaction, for as long as I am a direct or indirect owner of Screven County Hospital, LLC I will not refer patients to the Hospital in violation of any State or Federal laws and I agree to notify my patients of my financial relationship with Screven County Hospital; provided, however, patients shall have the right to obtain medical services from a facility and physician of their own choice unless otherwise restricted by law, including the Hospital.

According to Dr. George's testimony and the above-referenced certification, no physician-owner will refer patients to the Hospital and he will execute the above-quoted certification at closing of the sale. Therefore, any potential conflict of interest will be avoided.

Related to any concern that Dr. George or other physician-owners might refer indigent patients to other hospitals, Purchaser has committed to continue serving indigent patients as indicated below regarding factors number 11 and 12. The commitment by Purchaser to maintain an emergency room that provides emergency care twenty-four hours per day, seven days a week, 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 record demonstrates that the Purchaser has agreed to provide indigent and charity care in accordance with the requirements of applicable state or federal statute or regulation. Purchaser will treat emergency medical patients without regard to their ability to pay and will participate in Medicaid. Therefore, the record supports the conclusion that the charitable and indigent care factors of the Act have been satisfied.

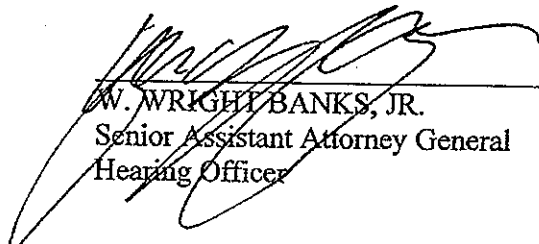
Thus, from the record in this case, it appears that sufficient safeguards exist to assure the community of continued access to affordable care and to the range of services historically provided by Screven County Hospital. The record as a whole demonstrates that the Purchaser has made an enforceable commitment 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 3rd day of December, 2010.



W. WRIGHT BANKS, JR.
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.