THE ATTORNEY GENERAL OF THE
STATE OF GEORGIA

IN THE MATTER OF THE LEASE OF EARLY MEMORIAL HOSPITAL FROM THE HOSPITAL AUTHORITY OF EARLY COUNTY, AS LESSOR TO PIONEER HEALTH SERVICES OF EARLY COUNTY, LLC, AS LESSEE	* * * * * * *	NO. AG2010 – 01

REPORT OF FINDINGS

I.

BACKGROUND

EARLY MEMORIAL HOSPITAL

Early Memorial Hospital ("Hospital") is licensed as a 25-bed critical access hospital located in Blakely, Early County, Georgia. The Hospital was constructed in 1964, with upgrades and renovations added since that time. The Hospital provides a variety of general acute medical services and emergency medical services. The Hospital's primary service area encompasses Early County.

The Hospital is owned by the Hospital Authority of Early County ("Authority"), a Georgia governmental entity. The Lessee of both the Hospital and Early Memorial Nursing Home is Pioneer Health Services of Early County, LLC ("Pioneer"), whose parent organization, Pioneer Health Services, Inc. serves as Guarantor on the lease.

THE DISPOSITION PROCESS

The Authority has leased Early Memorial Hospital and Nursing Home to John D. Archbold Memorial Hospital, Inc. ("Archbold") since June 1, 1995. In January 2010, Archbold notified the Authority that it was not renewing the lease upon expiration of the current term on September 30, 2010. The Authority contacted 13 health organizations to

determine whether they were interested in entering into a lease with the Authority. Three organizations, Pioneer, Resurgence Management Company, and Rural Healthcare Developers, made presentations to the Authority. Based on these presentations and responses to the Authority's Disclosure Questionnaire, the Authority voted to enter into a lease agreement with Pioneer.

THE PROPOSED TRANSACTION

The proposed Lease and Transfer Agreement dated ("Proposed Lease") provides that on October 1, 2010, the Authority will enter into a lease agreement to lease the Hospital and nursing home to Pioneer, for a term of ten years with the option to renew for an additional ten-year period. The Proposed Lease obligates Pioneer to: (a) make annual lease payments of $720,000 to the Authority; (b) continue to operate the Hospital as an acute care general hospital; (c) assume all operating liabilities; (d) maintain the leased facilities, including improvements and equipment; (e) pay certain taxes, assessments, levies, fees, utilities, and all governmental charges; (f) provide 24-hour-a-day emergency room and emergency ground transportation services; (g) provide indigent care services to the residents of Early County; (h) maintain the Hospital's status as a participating provider in Medicare and Medicaid programs; and (i) operate the nursing home.

Pioneer is required by the Proposed Lease to provide indigent care services in generally the same types and amounts of services as are currently provided, but in no event less than is required by the Authority or by law. Pioneer agrees to fulfill the Authority's responsibilities under the Authority's Indigent Care Contract with Early County in return for the Authority agreeing to pass the funds that it receives from the County under the Contract to Pioneer. The parties may terminate the Proposed Lease by

mutual written agreement or upon the uncured default of the other party. Upon the expiration or termination of the Lease, the leased facilities, including all equipment and improvements, revert to the Authority.

VALUATION ANALYSIS

Marshall & Stevens performed a financial analysis on behalf of Pioneer to determine the market value of the Hospital on a controlling interest basis, under a going-concern premise of value. For the purpose of the analysis, Marshall & Stevens employed a standard of market value, defined as:

> [T]he 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 arms 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 (or cost) 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' owners. In the asset-based approach, value is estimated based on the value of all of the subject business' underlying assets, both tangible and intangible.

Marshall & Stevens considered all three approaches to value, and utilized the income and market approaches to arrive at its determination of the market value of the Hospital's assets. Christopher Louis, Principal of Marshall & Stevens, testified at the public hearing. In its report, Marshall & Stevens stated that it did not apply the cost approach because it was not provided with historic balance sheets for the Hospital, as the

Hospital did not keep separate balance sheets from the nursing home. Additionally, through interviews with Hospital management, Marshall & Stevens learned that the Hospital's only intangible asset was "its Certificate of Need which did not constitute any economic value at the date of the Valuation." Marshall & Stevens gave equal weight to its conclusions regarding the value of the Hospital under the two approaches, resulting in a conclusion of "no value."

The Attorney General was assisted by the firm of Ketchum Valuation Consulting ("KVC") in the review of Marshall & Stevens' determination of market value. Peter Ketchum, President of Ketchum Valuation Consulting, testified at the public hearing. With respect to Marshall & Stevens' analysis under the income approach, KVC noted that Marshall & Stevens relied on market data and data provided by Hospital management to establish a projection of the amount of earnings that the Hospital might reasonably expect to generate going forward. KVC found that Marshall & Stevens' expected revenue growth of five percent per year may have been low, however given the population growth rates in Early County, its finding did not appear unreasonable. Mr. Ketchum testified that while the Hospital's levels of bad debt had experienced large increases in the last few years, it was reasonable to assume that the bad debt levels would diminish over time due to the expected economic recovery and recently enacted health care reform legislation. Mr. Ketchum also noted the advanced age of the Hospital and closely examined the capital expenditure requirements to ensure that the projected investments in equipment and facilities were sufficient to maintain the Hospital. Taking into account the aforementioned factors, KVC concluded that the indication of value

developed by Marshall & Stevens under the income approach does not appear unreasonable.

With respect to Marshall & Stevens' analysis under the market approach, KVC noted that it primarily relied on a review of hospital lease restructurings in Georgia. According to the report, and as evidenced by a discussion of two Georgia lease restructuring transactions, leases of profitable hospitals under the Hospital Authorities Law tend to have nominal lease payments, whereas leases of unprofitable hospitals tend to have larger lease payments in order to provide funding for indigent care. Based on these factors, Marshall & Stevens concluded that the Hospital had no value based on the guideline transaction method. Mr. Ketchum testified that while the approach appeared reasonable, given the specific requirements of the Georgia Hospital Authorities law, he was not in a position to form a legal opinion as to the requirements of the Georgia Hospital Authorities law. However, KVC was able to conclude that the application of the market approach appears reasonable given the circumstances.

KVC concluded that Marshall & Stevens utilized valuation methodologies that are consistent with generally accepted industry standards and that Marshall & Stevens' final analysis is within a reasonable range of fair market value.

PUBLIC COMMENTS

A public hearing was held on August 20, 2010, at City Hall Council Chambers, in Blakely, Early County, Georgia. Five persons made comments at the public hearing and all were in favor of the proposed transaction. Following the public hearing, the record was held open until the close of business on August 25, 2010, for any further public comment. Counsel for the Authority and Pioneer were requested to inform this office in

writing as to whether the parties intended to (a) modify the proposed transaction, (b) terminate the proposed transaction, or (c) proceed with the proposed transaction as presented. On August 25, 2010, counsel for the parties submitted a joint letter stating that the parties wished to proceed with the transaction as proposed.

FINDINGS

The Hospital Acquisition Act ("Act") provides for a public interest determination by the Attorney General in the review of a proposed disposition and acquisition of hospital assets. *See* O.C.G.A. § 31-7-400 *et seq.*; *Sparks v. Hospital Authority of City of Bremen and County of Haralson*, 241 Ga. App. 485 (1999). The Act requires a written notice filing 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. §§ 31-7-401, 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.

In order for the proposed transaction to be in the public interest, the record before the Attorney General must adequately disclose that the parties took appropriate steps to ensure that the transaction is authorized, that the value of charitable assets is safeguarded and 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 which disclosure must address. These thirteen factors, listed in Appendix A to this report, may be grouped into four categories relating to (a) the exercise of due diligence (factor numbers 1, 2, 3, 4 and 8), (b) conflicts of interest (factor numbers 5 and 13), (c) valuation of the hospital

assets (factor numbers 6, 7, and 10), and (d) the charitable purpose of the proposed transaction (factor numbers 9, 11, and 12).

The Exercise of Due Diligence by the Seller

Of the thirteen factors, those factors numbered 1, 2, 3, 4 and 8 relate to the issue of whether due diligence was exercised by the Hospital Authority. With regard to factor 1, the lease of the Hospital by the Authority is permitted under the Hospital Authorities Law, O.C.G.A. § 31-7-70 *et seq.* With regard to factor 2, there have been no contributions to the Hospital over the amount of $100,000.

The due diligence factor numbers 3 and 4 necessitate review of the process and procedures employed by the Authority in deciding to lease the hospital assets, in selecting Pioneer's proposal, and in negotiating the terms and conditions of the transaction. In this instance, the Authority's decision to lease the hospital and related facilities was prompted by the decision of the current lessee, Archbold, not to renew its lease once it expires on September 30, 2010. The Authority hired a consultant to provide consulting services in finding potential lessees. Offers were solicited from thirteen regional, local and national acute care and healthcare providers. Of those thirteen potential lessees, Pioneer, Resurgence Management Company, and Rural Healthcare Developers submitted proposals and made presentations to the Authority. The Authority conducted site visits and prepared a Disclosure Questionnaire for the potential lessees. Mr. Richard Grist, Chairman of the Authority, testified at the public hearing that the Authority Board felt that Pioneer's experience in running critical access hospitals made it a better fit for the Hospital. The Board unanimously voted to enter into negotiations with Pioneer. The

parties were assisted by legal counsel and acted independently of each other in negotiating the terms and conditions of the Proposed Lease.

The deliberative process employed by the Authority in selecting the proposal of Pioneer demonstrates the exercise of due diligence, consistent with factor numbers 3 and 4. Since there is no separate management or services contract negotiated in conjunction with the proposed transaction, factor number 8 is not applicable to the determination of the Authority's exercise of due diligence.

Conflicts of Interest

Factors 5 and 13 relate to the issue of conflicts of interest. Any conflicts of interest of the members of the Hospital Authority, of the chief executive officer of the Hospital and of the expert consultant for the Hospital Authority were disclosed in the certifications filed with the Notice to the Attorney General. These certifications are part of the public record and do not disclose any impermissible conflict of interest. Also, the record shows that Pioneer will be the owner of the hospital assets that will be transferred, with no third-party investors.

Valuation of the Hospital Assets

The value of the hospital and the amount of consideration to be paid in the proposed transaction must be weighed under factor numbers 6, 7 and 10. For the purposes of factor number 6, the lease of the Hospital to Pioneer, a for-profit lessee, implicates a "fair value" determination. Factor number 6 requires consideration of:

> 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.

O.C.G.A. § 31-7-406(6).

The terms of the transaction support a finding that the Authority will receive fair market value for the sale of its assets. The proposed consideration consists of $720,000 in annual rent payments. The valuation analysis rendered by Marshall & Stevens indicates that the fair market value of the lease payment to be made to the Authority is within the range of the consideration to be paid by Pioneer to the Authority for the lease of the Hospital. Mr. Ketchum testified that while Marshall & Stevens did not apply the cost approach, the application of the income and market approaches and their conclusions of reasonableness, appears to be within a reasonable range of fair market value. The conclusion reached by the financial consultants was that the value of the consideration under the Proposed Lease is within a range of fair market value of the Hospital's leased assets.

Since the Authority is not financing any portion of the proposed transaction, factor number 7 is not applicable. For purposes of factor 10, the Authority has retained ownership of the Hospital and there is no indication that the Authority intends to establish a successor non-profit corporation or foundation.

Charitable Purpose of the Proposed Transaction

The charitable purpose of the transaction is addressed by factors 9, 11 and 12. For purposes of factor number 9 which deals with the disposition of proceeds, the Authority will be returning most of the rent payments that it receives from Pioneer back to Pioneer for the specific use in providing indigent care pursuant to O.C.G.A. § 31-7-75.1(a).

With regard to factors 11 and 12, specific provisions of the Proposed Lease agreement require Pioneer to continue to operate the hospital as an acute care general

hospital; operate a 24-hour emergency room and provide emergency ground transportation services; and provide indigent care to the residents of Early County. Pioneer has also agreed to maintain the Hospital's status as a participating provider in Medicare and Medicaid programs. Further, Pioneer has agreed to fulfill the Authority's responsibilities under the Authority's Indigent Care Contract with Early County to be supported by annual funding from Early County.

Collectively, these provisions demonstrate sufficient safeguards to assure the community of continued access to affordable care and to the range of services historically provided by the Authority. Such provisions are an enforceable commitment to provide healthcare to the disadvantaged, the uninsured and the underinsured and to provide benefits to the community to promote improved health care.

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 20th day of September, 2010.

ROBIN J. LEIGH
Assistant Attorney General
Hearing Officer

APPENDIX A

(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 to the hospital;

(3) Whether the governing body of the Seller exercised due diligence in deciding to dispose of hospital assets, selecting the Purchaser, and negotiating the terms and conditions of the transaction;

(4) The procedures used by the Seller 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 Seller 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;

(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 Seller'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 Purchaser subsequently proposes to sell, lease, or transfer the hospital;

(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 Seller;

(12) Whether 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 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 Purchaser or a related party, and whether procedures or safeguards are in place to avoid conflicts of interest in patient referrals.