OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF THE SALE OF SAINT JOSEPH'S HOSPITAL OF ATLANTA, AS SELLER, TO EMORY/SAINT JOSEPH'S, INC., AS PURCHASER.	* * * * * * *	NO. AG 2011-03

REPORT OF FINDINGS

I.

BACKGROUND

SAINT JOSEPH'S HOSPITAL OF ATLANTA

Saint Joseph's Hospital of Atlanta, Inc. ("SJHA"),[1] a Georgia nonprofit corporation, is the owner of Saint Joseph's Hospital (the "Hospital"), a licensed 410-bed general acute care hospital, located at 5665 Peachtree Dunwoody Road, N.E. in Atlanta, Fulton County, Georgia. Saint Joseph's Health System, Inc. ("SJHS") is the sole member of SJHA. The Hospital has 750 physicians and approximately 2800 employees. The Hospital provides a variety of general acute medical services, including cardiac, vascular, oncology and orthopaedic services. The Hospital primarily serves residents in the North Georgia area.

THE DISPOSITION PROCESS

As a result of the Hospital primarily being a tertiary care center, the Hospital never developed significant primary care or other ambulatory services. Consequently, the Hospital began recognizing a trend of decreasing operating margins. The Board of Directors of SJHS (the "SJHS Board") and the Board of Directors of SJHA (the "Hospital

[1] Saint Joseph's of East Georgia, Inc., Saint Joseph's Mercy Care Services, Inc. and its subsidiaries, and Saint Joseph's Mercy Foundation, Inc., each of which is a direct or indirect subsidiary of SJHS, are not parties to this transaction (the "Non-Contributed Entities").

Board"), determined that the Hospital should affiliate with another healthcare provider to help the Hospital build out its service offerings.

On April 5, 2010, after speaking with a number of third parties, SJHS executed a letter of intent with Piedmont Hospital. The letter of intent with Piedmont, however, was subsequently terminated on July 6, 2010, and the parties ceased discussions. Shortly after terminating the letter of intent with Piedmont, the Hospital (SJHS Board, members of SJHS management and SJHA) began discussions with Emory Healthcare, Inc. ("EHC") regarding a potential transaction. On August 9, 2010, SJHS and EHC executed a letter of intent. The letter of intent with EHC, however, was subsequently terminated on October 6, 2010, and the parties ceased discussions.

On July 27, 2010, the SJHS Board retained Cain Brothers as its financial advisor. The SJHS Board approved a divesture process to be led by the SJHS Board and also approved the creation of a Special Committee on Divestiture (the "SCOD").[2] SCOD, with the help of Cain Brothers, was to manage the divestiture process and make a recommendation to the SJHS Board and the Hospital Board regarding the form of transaction and a strategic partner.

In October 2010, Cain Brothers lead an auction process and contacted eight Catholic systems, nine non-profit systems, and twelve for-profit systems. SJHS received seven proposals to acquire the Hospital, which included proposals from two non-profit entities and five for-profit entities. On December 6, 2010, SCOD selected three "finalist" bidders, which included EHC. SCOD's selections were based on a number of factors, including the form of the transaction, economic consideration offered, continuity of mission, financial stability of the bidder, community benefit track record, commitment to the Ethical and Religious Directives for Catholic Health Care Services, medical staff input, views on cost reduction and improvements in operational efficiency and quality, commitment to efficiently use resources to improve quality and increase the Hospital's service offerings, other transactions that may be a distraction to the bidder, adaptability in the face of healthcare reform, commitment to Saint Joseph's Translational Research Institute, Inc., existing presence in the North Georgia market and cultural compatibility.

[2] SCOD included certain members of the SJHS Board and management team.

After selecting the three finalists, the bidders were asked to submit final proposals. Of the three final proposals, EHC was selected as the successful bidder.

THE PROPOSED TRANSACTION

SJHS proposes to contribute its membership interest in SJHA to Emory/Saint Joseph's, Inc. ("ESJ" or "Purchaser").[3] In exchange for the contribution of its assets, an affiliate of SJHS, SJHS/JOC Holdings, Inc., will receive a 49% interest in ESJ.

EHC is the sole member of EHCA Johns Creek Holdings, LLC ("EHCA Johns Creek Holdings"), which operates Emory Johns Creek Hospital, a general acute care hospital located in Fulton County, Georgia. Concurrently with the contribution by SJHS, EHC will contribute its membership interest in EHCA Johns Creek Holdings to ESJ. In exchange for the contribution of its assets, an affiliate of EHC, EHC/JOC Holdings, LLC, will receive a 51% interest in ESJ.

After closing, ESJ will own and operate both Saint Joseph's Hospital and Emory Johns Creek Hospital. ESJ has committed to maintain the existing medical services at the Hospital and will continue the Hospital's commitment to indigent and charity care, including the operation of an emergency room twenty-four hours per day, seven days a week. The Hospital will remain a Catholic health care organization and will operate according to the Ethical and Religious Directives for Catholic Health Services.

VALUATION ANALYSIS

Cain Brothers was engaged by SJHS to provide a fairness opinion, from a financial point of view, of the consideration to be provided by ESJ ("Total Consideration") in return for SJHS' contribution of the Hospital Assets to ESJ ("Total Contribution"). Cain Brothers utilized a standard of fair market value. There are typically three approaches considered in analyzing the fair market value of a Hospital -- the income approach, the market approach, and the cost approach. The income approach is based on the concept that the value of a business or asset is dependent upon the amount and timing of cash flows. Under the market approach, value is derived through a

[3] ESJ is to be jointly owned by EHC/JOC Holdings, LLC ("EHC/JOC"), a Georgia limited liability company controlled by Emory Healthcare, Inc. ("EHC"), and SJHS/JOC Holdings, Inc. ("SJHS/JOC"), a Georgia nonprofit corporation controlled by SJHS.

comparison of the transaction prices of similar assets trading in the marketplace, typically involving transfers of 100% ownership interests or valuations related to publicly-traded guideline companies. The cost approach, or the net asset value method, relies on the concept that the value of an asset should not exceed the cost to reproduce or replace it, less any physical, functional and economic obsolescence.

Cain Brothers considered all three approaches to value, and utilized the market approach for the valuation analysis of the Total Contribution and the discounted cash flow method under the income approach for the valuation analysis of the Total Consideration. Cain Brothers based its fairness opinion on a comparison of SJHS' Total Contribution, including an estimate of the range of fair market values of the Hospital, with the Total Consideration to be provided by ESJ, including an estimate of the fair market value of SJHS' 49% membership interest in ESJ plus assumed liabilities. Cain Brothers' analysis of the Total Contribution to be made to ESJ by SJHS is comprised of the following components: (1) the Hospital business enterprise value of $200 million to $270 million, which includes SJHS' cash contribution of $30 million; and (2) SJHS' non-operating cash contribution of $45 million.[4] Cain Brothers' analysis of Total consideration comprised of the following components: (1) SJHS' membership interest in ESJ, which is valued at approximately $96.8 to $128.3 million, based on SJHS' rights and benefits;[5] (2) ESJ's assumption of SJHS' debt, which has a book value of approximately $130 million; and (3) SJHS' non-interest bearing liabilities assumed by ESJ, consisting primarily of SJHS' unfunded pension plan obligations, medical malpractice liability and workers' compensation liability, which is valued at approximately $25.5 million. Cain Brothers concluded that the fair market value of the Total Contribution to be made by SJHS to ESJ ranged from $245 million to $315 million and that the fair market value of the Total Consideration ranged from $252 million to $284 million. Through a comparison of the fair market value ranges for the Total Consideration and Total Contribution, Cain Brothers concluded that the Total

[4] SJHS is to contribute a total of $75 million in cash to ESJ.
[5] This value includes the exclusive right of SJHS to sell its membership interest in ESJ to EHC on or after August 31, 2014 ("put option").

Consideration to be received by SJHS as a result of the transaction is fair to SJHS from a financial point of view.

The Attorney General was assisted by the firm of Ernst & Young, LLP ("EY") in the review of Cain Brothers' fairness opinion. Bridget Bourgeois, a Partner at EY, testified at the public hearing. In its report provided to the Attorney General, EY opined that compared to a valuation opinion, "[a] fairness opinion is a much more robust analysis that includes a valuation process and also performs additional analyses to provide a professional opinion as to whether the terms of a transaction are fair from a financial point of view."

With respect to Cain Brothers' analysis of the Total Contribution under the market approach, EY noted that Cain Brothers applied a discount for lack of marketability ("DLOM") of 25% to the business enterprise value inclusive of operating cash ("BEV") calculation. EY observed that a lack of marketability, however, is a characteristic of equity interests and not business value. EY concluded that Cain Brothers' incorrect application of the DLOM to the BEV would lead to a lower indicated value. As to Cain Brothers' analysis of the total consideration, EY noted that although Cain Brothers' fair market valuation of SJHS' membership interest in ESJ did not explicitly value the put option, Cain Brothers' analysis included an assumed liquidity event in during years three and five through the exercise by SJHS of the put option. EY also noted that Cain Brothers' reliance on the book value of SJHS' debt in its analysis assumes that the book value is representative of its fair market value. EY asserted that Cain Brother's assumption would hold true only if the coupon rate[6] on the debt is equal to the required rate of return on the debt. Based on EY's independent research and analysis, the required rate of return on debt was lower than the coupon rate, which is an indication that the fair market value of SJHS' debt is above its book value.

EY performed research and limited analyses to assess the impact on Cain Brothers' values for the Total Contribution and the Total Consideration by changing

[6] A coupon rate is the periodic interest rate paid to bondholders as specified in the bond agreement. The coupon rate is expressed as a percentage of the bond's face value.

certain assumptions in Cain Brothers' analyses.[7] Through EY's sensitivity analysis of the Total Contribution using the guideline company method under the market approach, EY arrived at a range for the Total Contribution of approximately $240 million to $350 million (as compared to Cain Brothers' concluded fair market value of $245 million to $315 million). Under EY's sensitivity analysis of the Total Consideration, EY employed the discounted cash flow method under the income approach and arrived at a range for the Total Consideration of approximately $240 million to $280 million (as compared to Cain Brothers' concluded fair market value of $252 million to $284 million). EY also conducted a sensitivity analysis on the debt and liabilities of the Hospital and Johns Creek Hospital to be assumed by ESJ. Through sensitivity analyses, EY arrived at a range of values for SJHS debt of $129 million to $138.2 million (as compared to Cain Brothers' $130.0 million estimation of SJHS' debt).

EY concluded that the valuation multiples implied by Cain Brothers' valuation of SJHS' Total Contribution is within the range of valuation multiples observed for hospital transactions in the marketplace. Additionally, EY concluded that Cain Brothers used commonly accepted valuation methods in its valuation analysis and it appeared that the value of the Total Consideration under the proposed transaction is similar to, and within the range of the value of the Total Contribution.

PUBLIC COMMENT

The public hearing was held on October 19, 2011, at 5:00 p.m. in the Auditorium at Saint Joseph's Hospital, 5665 Peachtree Dunwoody Road, NE, Atlanta, Georgia 30342. Four 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 Monday, October 24, 2011, at 5:00, for any further public comment. This Office

---

[7] EY's sensitivity analysis of the Total Contribution and Total Consideration examined the analyses provided by Cain Brothers' and the draft valuation report of Emory Johns Creek Hospital performed for EHC by VMG Health ("VMG"). VMG provided EHC with a draft valuation report of Johns Creek Hospital for management planning purposes related to the potential contribution of Johns Creek Hospital to ESJ. Although VMG's report had not been finalized, EY discussed the analysis with VMG and noted that their draft value was consistent with the recent transaction value paid by EHC to acquire Johns Creek Hospital in February 2011.

received one written public comment after the public hearing, which was in favor of the transaction but voiced some concerns that he believed the Attorney General should review. Those concerns have been reviewed and are adequately addressed in this Report of Findings. Counsel for SJHS and EHC were requested to inform this Office in writing before the record closed, as to whether their respective clients intended to proceed with the proposed transaction as structured or modify the proposed transaction in some respect. Counsel for both parties have written a joint letter 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.*; *Sparks v. Hospital Authority of City of Bremen and County of Haralson*, 241 Ga. App. 485 (1999) (physical precedent only). 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.

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 in determining whether the appropriate steps have been taken by the parties. *Id.* The thirteen factors are listed in Appendix A to this report.

The thirteen factors set forth in O.C.G.A. § 31-7-406 can 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) conflicts of interest (factors number 5 and 13), (c) valuation of the hospital assets (factors number 6, 7 and 10), and (d) the charitable purpose of the proposed transaction (factors number 9, 11 and 12).

The Exercise of Due Diligence by the Seller

The disposition of the Hospital is authorized by applicable law as provided in factor number 1, and SJHS has taken the appropriate actions to sell the Hospital. O.C.G.A. §§ 14-3-302, 31-7-400 *et seq.* With regard to factor number 2, it does not appear that the proposed disposition is inconsistent with the directives of any major donors who have contributed over $100,000.00.

The due diligence factors number 3 and 4 necessitate review of the process and procedures employed by the Seller "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). In this instance, SJHS exercised appropriate due diligence in its selection process because the evidence shows that a formal, comprehensive RFP was conducted by the Hospital with the assistance of professional consultants. Offers were solicited from twenty-nine (29) regional and national healthcare providers. Of those twenty-nine (29) potential purchasers, SJHS received seven proposals from potential purchasers. Three finalist bidders were selected and more definitive agreements were negotiated with each. The deliberative process employed by the Board in selecting the proposal of EHC demonstrates the exercise of due diligence, consistent with factors number 3 and 4.

Factor number 8 requires that any management or services contract negotiated in conjunction with the transaction be reasonable. ESJ and EHC will enter into a Management Agreement under which EHC will provide management services to Saint Joseph's Hospital and to Emory John's Creek Hospital. The management services to be provided include, without limitation, certain services related to the employment of personnel, managed care contracting, billing and collection, maintenance and repair, purchasing, information services, public relations, patient support, accounting and quality assurance. EHC will be reimbursed for its costs incurred in connection with management services. Since this is a joint venture between ESJ and EHC, and EHC will only be reimbursed for its costs, the management agreement appears to be reasonable.

Conflicts of Interest

The disclosure of any conflict of interest involving the Sellers, the Chief Executive Officer of the Hospital and its expert consultant is 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 the Hospital, by the Chief Executive Officer of the Hospital, by the board of SJHS, the Chief Executive Officer of SJHS and by the expert consultant retained by SJHS. Such certifications do not disclose any impermissible conflicting financial interest in the proposed transaction. With regard to factor number 13, health care providers will not be offered an opportunity to invest or own an interest in the Hospital. Therefore, factor number 13 is not applicable.

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 factors number 6, 7 and 10. In a sale of hospital assets from one nonprofit corporation to another nonprofit corporation, the nonprofit seller should receive an enforceable commitment for fair and reasonable community benefits for its assets. *See* O.C.G.A. § 31-7-406(6). A determination of the value of the hospital assets to be sold aids in the measurement of the consideration and the community benefits to be received by the nonprofit seller "for its assets." Collectively, the valuation analysis and conclusions developed by Cain Brothers, as reviewed by EY, indicates that the fair market value range of $245 million to $315 million for the total contribution of the Hospital Assets and a fair market value range of $252 million to $284 million for the total consideration, is within the range of valuation multiples observed for hospital transactions in the market place. As it appears that the value of the total consideration under the proposed transaction is within the range of the value of the total contribution, SJHS will receive an enforceable commitment for fair and reasonable community benefits in exchange for its assets as required by the Act.

Since the Seller is not financing any portion of the proposed transaction, factor number 7 is not applicable. The proposed transaction complies with factor number 10 because the Membership Agreement provides SJHS with a right of first refusal to purchase the membership interest held by EHC in the event EHC decides to consider a third-party offer to purchase its membership interest. In addition, the Membership Agreement provides SJHS with a put option, which provides SJHS with an exclusive option to sell its membership interest in ESJ to EHC on or after August 31, 2014, or in the event that ESJ fails to comply with the Ethical and Religious Directives for Catholic

Health Services. Any proceeds from a sale of SJHS' interest in ESJ would be used by SJHS for its charitable healthcare mission.

Charitable Purpose of the Proposed Transaction

With respect to the charitable purpose of the proposed transaction, factor number 9 requires that the disposition of proceeds be used for charitable health care purposes consistent with the nonprofit's original purpose. As consideration for its contribution, an affiliate of SJHS will acquire a 49% interest in ESJ. ESJ will continue to operate the Hospital as a charitable institution and in accordance with the Ethical and Religious Directives for Catholic Health Services. In addition, SJHS will continue its support of indigent and charity care through Saint Joseph's Mercy Care Services, Inc., Saint Joseph's Mercy Foundation, Inc., Mercy Services Downtown, Inc., and Mercy Senior Care, Inc., which are not part of this transaction. The 49% membership interest received by the SJHS affiliate is an additional asset that can provide future funding to support these and other charitable missions of SJHS in Georgia.

The other two charitable purpose factors, factor numbers 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. John Fox, President and Chief Executive Officer of EHC, testified that the emergency room will remain open 24 hours a day, seven days a week. After completion of the transaction, the Hospital will continue in existence as a Georgia nonprofit corporation. In addition, the Hospital will remain a Catholic health care organization and will operate according to Catholic standards and requirements, including the Ethical and Religious Directives for Catholic Health Care Services as published by the United States Conference of Catholic Bishops. The Hospital will continue to serve uninsured, underinsured and indigent patients without regard to ability to pay. The evidence, taken as a whole, demonstrates an enforceable commitment to improve health care in the community and to assure continued access to affordable 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 16TH day of November, 2011.

JULIE ADAMS JACOBS
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;

(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.