

OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF THE CHANGE OF
CONTROL OF HOUSTON HEALTHCARE
SYSTEM, INC. TO NAVICENT HEALTH, INC.

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NO. AG 2018-04

REPORT OF FINDINGS

BACKGROUND

Houston Healthcare System, Inc. (“Houston”) is a Georgia nonprofit corporation based in Warner Robins, Georgia. Houston serves as the controlling entity of an integrated hospital system serving the healthcare needs of residents primarily in Houston County, as well as, Dooly, Peach, Taylor and Macon counties. Houston, through its wholly-owned subsidiary Houston Hospitals, Inc., operates two (2) general acute-care hospitals, Houston Medical Center and Perry Hospital. Houston Medical Center is a 237 bed acute-care hospital located in Warner Robins, Georgia and Perry Hospital is a 39 bed acute-care hospital located in Perry, Georgia. Both hospitals provide inpatient, outpatient, urgent care, and emergency services. The Hospital Authority of Houston County (“Hospital Authority”) leases certain real property and improvements to Houston Hospitals, Inc.

In addition to Houston Hospitals, Inc., Houston includes the following wholly-owned subsidiaries: Houston Healthcare EMS, Inc.; Houston Healthcare Properties, Inc.; Houston Health Ventures, Inc.; Houston Primary Care Physicians, LLC; and Houston Physician Specialists, LLC. Houston also has partially owned subsidiaries that include: Velocity Healthcare Collaborative, LLC; HHC Cancer Center of Central Georgia, LLC; PatientSelect, LLC; and Caresouth HHA Holdings of Middle Georgia, LLC. This matter presents a proposed transaction for the transfer of control of Houston to Navicent Health, Inc. (“Navicent”), a Georgia nonprofit corporation.¹

¹ Navicent was the subject of a prior Georgia Hospital Acquisition Act review conducted in 2018. Under that transaction, Navicent continues to exist as a Georgia nonprofit corporation, but AHNH Georgia, Inc., a wholly-owned subsidiary of The Charlotte-Mecklenburg Hospital Authority, will be its sole corporate member.

THE DISPOSITION PROCESS

In the summer of 2017, the Houston Board of Trustees (the “Board”) held a strategic meeting to evaluate the changes occurring within the healthcare industry and their impact on Houston, taking into consideration Houston’s financial and operational outlook. To assist them, the Board engaged Kaufman Hall as its strategic advisor to outline national and statewide healthcare market trends and strategic options to achieve its mission and sustainability. Thus, the Board considered the following options: (1) take no action; (2) stay independent; (3) find an affiliation partner; or (4) sell. Mr. Roy Watson, Chairman of the Board, testified at the Public Hearing that the Board found that taking no action and staying independent would be too challenging and were not viable options in the long run. (Transcript, p.15). The Board unanimously voted to pursue an affiliation partnership. With the assistance of Kaufman Hall, the Board evaluated an array of strategic options, which included: (1) serving as a catalyst to create another system; (2) join a regional not-for-profit system; (3) partner with a non-local-not-for-profit organization; and (4) sell to a for-profit organization. The Board also developed a list of thirteen (13) partnership goals and objectives to evaluate potential partners, which included: (1) alignment of mission, culture, and commitment to the communities served; (2) dedication to quality and safety improvement; (3) medical staff alignment and physicians practice management; (4) strategic positioning, growth, and market synergy; (5) cost effectiveness; (6) financial sustainability; (7) value-based accountable care infrastructure and capabilities; (8) employees; (9) corporate and shared services; (10) branding; (11) information technology; (12) medical education; and (13) governance.

In November 2017, the Board, with the assistance of Kaufman Hall, developed a list of potential partners and evaluated the pros and cons of the various types of partner groupings. The Board determined that the preferred strategic fit for Houston was either to join a regional not-for-profit system or partner with a non-local-not-for-profit organization. The Board assessed each potential partner affiliation against its goals and objectives and ultimately selected Navicent as the leading potential partner. Mr. Watson testified that the Board “realized during the selection process that the leadership of Navicent and Houston share a common vision and interest in proactivity, delivery, excellent community care...and that [a] member substitution is good for the community and good for Houston Healthcare System.” (Transcript, p.16). Thus, the Board began preliminary partnership discussions with Navicent.

THE PROPOSED TRANSACTION

The proposed transaction does not involve a sale or lease of Houston. Rather, Houston proposes to enter into a Member Substitution Agreement (the “Agreement”) with Navicent whereby Houston will amend and restate its articles of incorporation and bylaws to designate Navicent as the sole controlling member. As a result, Houston will continue in existence as a Georgia nonprofit corporation, but it will be controlled by Navicent. Additionally, the lease between Houston Hospitals, Inc. and the Hospital Authority was amended to extend the term of the lease for forty (40) years, and to be reset for another forty (40) years every five (5) years.

Under the terms of the Agreement, Navicent will provide a capital commitment of \$150 million to be spent over ten (10) years towards maintaining and enhancing health care services within the Houston service areas, as described more fully herein. Specifically, \$60 million will be allocated toward routine capital expenditures, and \$90 million toward strategic growth expenditures. The total capital commitment of \$150 million is comprised of \$125 million from Navicent and \$25 million from Houston. Mr. Charles Briscoe, Vice President, Chief Operating Officer, and acting Chief Executive Officer of Houston, testified that the “capital expenditures may include funding items such as new equipment, equipment replacements, facility renovations, new facilities, medical office spaces, the acquisition of physician practices and other related businesses and operating losses associated with the development of new programs or the expansion of existing programs.” (Transcript, p. 25). Specifically, within 120 days of closing, Navicent, in conjunction with Houston, will develop a strategic plan for the capital commitment based on Houston’s IRS-required Community Needs Assessment. This will enable the Board to determine which projects to focus on, as well as, outline future projects. Furthermore, the capital commitment specifically excludes any costs associated with health record conversions or the implementation of new information technology platforms as these costs will be assumed by Navicent and is distinct and separate from Navicent’s capital commitment.

Under the Agreement, Navicent has also made a number of other commitments including: (a) ensuring Houston meets its current bond obligations; (b) ensuring Houston’s cash reserves will only be used in the Houston service area; (c) continuing to operate both hospitals as full service acute-care hospitals with 24-hour emergency departments; (d) continuing current service lines and programs and the same level of care at both hospitals; (e) adopting and maintaining Houston’s current policies on charity and indigent care; (f) maintaining and supporting Houston’s current family practice physician residency training and other clinical

training programs; (g) keeping Houston as the exclusive brand for any Houston facility until December 2021; (h) ensuring all members currently serving on the Board on the day immediately prior to the closing date will remain on the Board; and (i) appointing a then-current member of the Board to serve on the Navicent Board of Directors.

BENEFITS ANALYSIS

Under O.C.G.A. § 31-7-406(6), a transaction involving the acquisition or disposition of the assets of a nonprofit hospital to a nonprofit entity requires the Attorney General to make a determination as to whether the seller “will receive an enforceable commitment for fair and reasonable community benefits for its assets.” Houston retained Stroudwater Associates (“Stroudwater”) to provide assistance in the assessment of the proposed transaction. The scope of Stroudwater’s engagement included a fair market valuation of Houston and an independent assessment of the estimated community benefits to be derived from the proposed transaction, which Stroudwater memorialized in its Fair Market Value Analyses and Community Benefit report (“Report”) to Houston. Opal Greenway, a consultant with Stroudwater, testified at the hearing held on December 3, 2018. (Transcript, p. 63).

In its analysis of the estimated economic benefit the community will receive as a result of the proposed transaction, Stroudwater identified a number of quantitative and qualitative community benefits. Stroudwater focused primarily on two quantifiable benefits, including: (1) the capital commitment of \$150 million over a ten-year period; and (2) the continuation of charity and indigent care along with existing community benefit and graduate medical education programs.

Navicent committed to invest at least \$150 million in capital expenditures for Houston over the first ten years after closing the proposed transaction, as more fully described herein. The capital commitment will be used exclusively for maintaining and enhancing services in the Houston service area, which includes \$60 million for routine capital and \$90 million for strategic expenditures. Stroudwater noted that the \$150 million commitment will be funded as follows: (1) \$70 million from Navicent’s cash reserves; (2) \$25 million from Houston’s cash and reserves; and (3) \$55 million from any increase in the base operating EBITDA generated from improved operations of Houston post-closing or, if the improved EBITDA is not sufficient, from Navicent’s cash reserves or borrowed funds. Stroudwater calculated the present value of \$125 of the capital commitment, reasoning that \$25 million of the \$150 million will be funded by Houston, over a period of ten years using a 3.37% discount rate, which was based on Navicent’s

pre-tax cost of debt. Stroudwater arrived at a present value of \$106.6 million for Navicent's capital commitment. (Report, p. 48).

Stroudwater identified additional financial benefit to the community in Navicent's commitment to maintain charity care, Medicaid, community benefit operations, subsidized health services, cash and in-kind contributions and health professional education. Ultimately, Stroudwater arrived at present values of \$125.5 million for charity and indigent care, \$7.8 million for health professional education, and \$10.4 million for the graduate medical education program, resulting in a combined \$143.7 million. In total, Stroudwater arrived at a combined value of \$250.3 million for the quantifiable community benefits that will result from the proposed transaction. (Report, p. 51).

In addition to the quantitative benefits, Stroudwater recognized significant qualitative considerations that should provide valuable healthcare related benefits and services to the patients and stakeholders of Houston that further enhance the community benefit. For example, Ms. Greenway testified that, because "Houston and its subsidiaries will now be part of Navicent's clinically integrated network," Houston's access to population health initiatives would be substantially expanded. (Transcript, p. 68). In addition, Stroudwater recognized that the community will benefit through the control provisions related to Navicent's commitment to maintain Houston's current Board and to allow Houston to nominate a candidate for potential appointment to Navicent's Board of Directors. (Report, p. 50). Taking the \$250.3 million in quantifiable benefits and the numerous qualitative benefits into consideration, Stroudwater concluded that "the transaction between Houston and Navicent would provide significant community benefit for those patients and communities within the Houston service area." (Report, p. 51).

In the scope of its engagement, Stroudwater also conducted a fair market valuation ("FMV") of Houston. In its FMV analysis, Stroudwater applied the three commonly accepted valuation approaches to estimate the FMV of Houston: the Cost, Income and Market approaches. Stroudwater weighted the values indicated by each approach to estimate a business enterprise value ("BEV") of \$108.5 million. Stroudwater then estimated a range of +/- 5.0% to arrive at a range of \$103.1 to \$113.9 million for the BEV of Houston. Since the BEV range captured only the operating value of Houston, Stroudwater added the value of cash at \$3.9 million and investments limited as to use at \$229.3 million, then subtracted the value of long-term debt of \$100.6 million to arrive at a range of total value of equity of \$235.5 to \$246.4 million. Finally,

Stroudwater applied a 10% discount for lack of control to arrive at a FMV range of equity for Houston of \$212 to \$221.8 million in its Report. (Report, p. 47). However, prior to the December 3, 2018 hearing, Stroudwater conducted further sensitivity analyses and ultimately arrived at a FMV range of \$216.2 to \$225.5 million. The concluded FMV was intended to reflect the value of Houston on a stand-alone basis without an affiliation.

Pursuant to O.C.G.A. § 31-7-405(b), the Attorney General retained Ernst & Young, LLP (“EY”) to act as an independent financial advisor consultant to assist in the review of the proposed transaction. The Attorney General engaged EY to provide valuation advisory services, but not to issue any separate valuation or fairness opinion. As part of its engagement, EY held discussions with representatives of the parties involved and performed independent market research and analyses to review Stroudwater’s conclusions regarding the FMV of Houston and its assessment of the community benefit to be derived from the proposed transaction. Bridget Bourgeois, a healthcare valuation specialist at EY, testified at the hearing. (Transcript, p. 69).

As part of its review, EY performed sensitivity analyses of Stroudwater’s FMV and community benefit analysis to address various methodology and logic issues. In regards to the community benefit, EY noted that Stroudwater’s Report did not provide detailed calculations for its capital commitment analysis. Stroudwater then issued a memo on November 16, 2018, that provided new sensitivity calculations. EY then performed further sensitivity analyses adjusting Stroudwater’s discount periods and application of their methods which resulted in a total community benefit value range of approximately \$225.5 million to \$274.2 million, which was reasonably consistent with Stroudwater’s concluded \$250.3 million determination. Ultimately, EY’s sensitivity analysis resulted in a FMV equity range of approximately \$250 to \$260 million, which EY noted was below, but within a reasonable range, of Stroudwater’s FMV range that resulted from its own sensitivity analyses. While EY did not draw specific conclusions about value based on its analysis, it did conclude that Stroudwater employed relevant valuation approaches and methods in its valuation of Houston and in its analysis of the community benefits.

PUBLIC COMMENT

The public hearing was held on December 3, 2018 at 12:00 p.m. at the Cary W. Martin Conference Center in Warner Robins, Georgia. Notice of the proposed transaction and the

public hearing was provided as required by O.C.G.A. § 31-7-404.² The public hearing location is appropriate in Houston County because that is the location of the “main campus” of Houston’s hospital system within the meaning of O.C.G.A. § 31-7-405. The public comments received during the public hearing were all in favor of the proposed transaction. Following the public hearing, the record was held open until the close of business on Thursday, December 6, 2018 at 5:00 p.m., for any further public comment. This Office received one written comment from a citizen after the hearing in opposition to the proposed transaction. Counsel for the parties 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 Houston and Navicent have written a joint letter stating that their clients wish to proceed with the transaction as proposed.

FINDINGS

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 through 31-7-412; *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(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 to be considered 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 are 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

² The proposed transaction is the subject of two notices published in the *Houston Home Journal* on October, 31, 2018 and November, 7, 2018.

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 transfer of control of Houston is authorized by applicable law as provided in factor number 1. Houston has taken the appropriate steps to provide for the transfer of control to Navicent. O.C.G.A. §§ 14-3-206 and 14-3-302. The proposed transaction is authorized under the Georgia Nonprofit Corporation Code. 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. Each of the members of the Board and its Chief Executive Officer, have executed certifications that the proposed transaction is consistent with the intent of major donors who have contributed in excess of \$100,000.00 to Houston. No concerns have been raised by any donors during the public hearing or the review process. Therefore, the record supports finding that factor number 2 is satisfied.

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). Houston did not conduct a formal process for the solicitation and selection of proposals which is typically the preferred approach. However, as previously discussed, Houston conducted a very robust process of evaluation of potential transaction partners including the engagement of professional services from Kaufman Hall during the process of selecting a potential partner, establishing thirteen (13) partnership goals and objectives, and the use of Stroudwater and the law firm of Arnall, Golden, Gregory, LLP, during the process of negotiating and finalizing a proposed transaction. The record supports a finding that Houston “exercised due diligence 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). The record further supports a finding of adequacy regarding “[t]he procedures used by the nonprofit corporation in making its decision to dispose of its assets” and that “appropriate expert assistance was used.” O.C.G.A. § 31-7-406(4). The deliberative process employed by Houston demonstrates the exercise of due diligence, consistent with factors number 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 exercise of due diligence.

Conflicts of Interest

The disclosure of any conflict of interest involving the Sellers, the Chief Executive Officer of Houston 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 all members of the Board, the Chief Executive Officer of Houston, and Houston's financial consultant.³ Although some exceptions were noted on the certifications, such certifications do not disclose any impermissible or significant 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 System. Therefore, factor number 13 is not applicable.

Valuation of the Hospital Assets

The factors numbered 6, 7 and 10 involve a determination of the value of the hospital assets. Since this transaction involves the transfer of control of a nonprofit corporation which controls hospital assets subject to the Act to a nonprofit corporation, Houston should receive an enforceable commitment for fair and reasonable community benefits for the transfer of control its assets. *See* O.C.G.A. § 31-7-406(6). Based on the record, including the analysis conducted by Stroudwater on behalf of Houston and the review by EY at the request of the Attorney General as described herein, Houston will receive an enforceable commitment for fair and reasonable community benefits in exchange for its assets as required by O.C.G.A. § 31-7-406(6).

Since Houston is not providing any financing for the transaction, factor number 7 is inapplicable. As to factor number 10, under the terms of the Agreement, the Board or its designee retains a right of first refusal to purchase the assets if Navicent proposes to sell or receives an offer regarding the sale of Houston assets. (Agreement, p. 36-38). The right of first refusal includes a general restriction on change of control transactions involving Houston from the closing of the proposed transaction through the date that is at least ten years after closing. After that time, a right of refusal will exist in favor of the Board or its designee. Additionally, the Hospital Authority continues to own the assets used for hospital operations, and thereby serves as a third-party beneficiary under the proposed transaction, which also serves as a

³ Kaufman Hall provided services to both parties with regards to the proposed transaction and could not have provided the fair market valuation of Houston and an independent assessment of the estimate community benefits to be derived from the proposed transaction. As noted above, these services were provided by Stroudwater.

“meaningful right of first refusal.” Therefore, the proposed Agreement is consistent with the purposes of factor number 10.

Charitable Purpose of the Proposed Transaction

With respect to the charitable purpose of the proposed transaction, factor number 9 requires that the disposition proceeds be used for charitable healthcare purposes consistent with the nonprofit’s original purpose. There are no proceeds from sale. Therefore, factor number 9 is not applicable.

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) healthcare to the disadvantaged, the uninsured and the underinsured and (d) benefits to the community to promote improved health care. The notice and the testimony provided at the public hearing indicate that both emergency rooms will remain open 24 hours a day, seven days a week. After completion of the transaction, Houston will continue in existence as part of Navicent, a Georgia nonprofit corporation. Navicent has also committed to maintain and adopt Houston’s policies for the provision of charity care or adopt other policies and procedures that are at least as favorable to the indigent and uninsured as Houston’s existing policies and procedures. 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.

CONCLUSION

Upon review of the public record and in accordance with the Act, the undersigned Hearing Officer finds that the public record in this matter discloses that the proposed transaction is appropriate in light of the factors set forth in the Act.

This 2nd day of January, 2019.



ALKESH B. PATEL
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.