OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF THE SALE OF WEST GEORGIA MEDICAL CENTER, INC., AS SELLER, TO WELLSTAR HEALTH SYSTEM, INC., AS PURCHASER.	* * * * * * *	NO. AG 2015-06

REPORT OF FINDINGS

I.

BACKGROUND

WEST GEORGIA MEDICAL CENTER

West Georgia Medical Center, Inc. (the "Seller" or "WGMC"), a Georgia nonprofit corporation, operates West Georgia Medical Center (the "Hospital"), under a long-term lease agreement with the LaGrange-Troup County Hospital Authority (the "Hospital Authority"). The real estate, buildings and fixtures that constitute the Hospital are owned by the Hospital Authority. The Hospital is licensed for two hundred seventy-six (276) beds and is located in Troup County, Georgia. The Hospital provides a variety of general acute medical services including intensive care, emergency services, cardiovascular services, diagnostic imaging neurosciences, oncology services, orthopedic services, rehabilitation services, surgery, wound care, home health and hospice services. The Hospital primarily serves residents in the West Georgia area, including Troup, Harris, Heard and Meriwether Counties. The Hospital also serves residents in the East Alabama area.

THE DISPOSITION PROCESS

West Georgia Health Services, Inc. ("WGHS"), the parent corporation of the Seller, made the decision to seek out an affiliation partner in anticipation of changing national and state healthcare trends, its local geography, and its current capabilities to serve its population. The Hospital is large enough to effectively serve as a regional community hospital for most services, but does not have the full range of tertiary services needed for its served population. The decision to seek out a partner was primarily motivated by its desire to ensure the long-term provision of high-quality healthcare for patients in its service area.

In April 2014, the Board of the Hospital Authority voted unanimously to pursue a formal comprehensive approach to strategic planning for the local healthcare system, recognizing that while the local health care system was doing well from a quality and overall performance standpoint, the system needed to plan for broader viability given the significant changes occurring in the healthcare industry. A Strategic Planning Committee ("SPC") was established by the WGHS and Hospital Authority Boards to commence this process. J.P. Morgan Securities, LLC ("JP Morgan") was retained to assist in reviewing the current healthcare landscape and to advise the SPC on the possible challenges and opportunities for the Hospital and other WGHS assets. Recognizing the significant challenges of remaining independent, the SPC determined that partnering with another health system was an appropriate step.

The SPC worked with JP Morgan[1] to create a search process to identify potential partners that would meet the SPC's preferences for a partner. WGHS sought a partner that possessed (a) culture and values consistent with WGHS; (b) a demonstrated commitment to healthcare delivery and payment innovation; (c) a commitment to invest in a transformational strategic vision for WGHS and it community; and (d) deep clinical, organizational and financial resources.

JP Morgan identified 26 healthcare organizations, consisting of local, regional and national healthcare systems, which were sent a request for an expression of interest, together with a brief introductory description of the WGHS System. Twelve of the 26 organizations that were contacted expressed interest, and in September 2014, were sent a confidential information memorandum and a request for proposal. JP Morgan received eight formal proposals from a mixture of local not-for-profit, regional not-for-profit, and national for-profit entities.

JP Morgan assessed the proposals it received and reported its assessment to the SPC. The SPC selected four of the respondents based on how well their initial responses

[1] WGHS also engaged McDermott Will & Emery, LLP as transaction counsel to assist with the implementation of the search process and with the ultimate transaction.

matched the SPC's partnership evaluation criteria. All four respondents were invited to WGHS to introduce their organizations and leadership teams to SPC. The SPC then narrowed the search to two non-profit organizations. The SPC conducted site visits with the two nonprofit organizations and then asked the two non-profit organizations, along with one for-profit entity, to submit Letters of Intent ("LOI") with their best offer.

The SPC received LOIs from all three entities which they reviewed with the full boards of the Seller, WGHS, and the Hospital Authority. WellStar Health System, Inc. ("WellStar"), a Georgia nonprofit corporation, was ultimately selected as the winning bidder on May 18, 2015, at a joint meeting of the boards of the Hospital Authority, WGMC and WGHS. During the ensuing four months, the parties conducted due diligence, negotiated a set of transaction documents, and secured final approval from their respective boards.

THE PROPOSED TRANSACTION

WGHS proposes to enter into a member substitution agreement with WellStar, in which WellStar will become the sole corporate member of WGHS. Under the transaction, WellStar will control the governance, management and operations of WGHS and the Hospital, subject to local board control over certain operational matters, including accreditation and medical staff matters. The Hospital will continue to be leased from the Authority. After completion of the transaction, WGHS will continue in existence as a Georgia nonprofit corporation with the purpose of providing medical care to residents in the West Georgia area but it will be controlled by WellStar.

WellStar has made a number of commitments related to the transaction including continuing to provide indigent and charity care services and participating in Medicare and Medicaid. Additional commitments by WellStar include providing $84 million in capital investments, of which $30 million will be utilized within twenty-four (24) months after the transaction closing date. WellStar will also guarantee Troup County's payment obligations related to the Hospital Authority's 2008 revenue bonds. Furthermore, WellStar has committed to the timely payment of the Seller's ongoing obligations and, when financially advantageous, to refinance the Seller's debt obligations.

The Hospital will continue to operate as a licensed acute care hospital. The Hospital Authority, which will remain independent of WellStar, will have the authority to enforce certain obligations of WellStar under the Member Substitution Agreement.

VALUATION ANALYSIS

WGHS identified an opportunity to add value to its community by developing a partnership with WellStar (the "Affiliation" or the "Transaction"). The proposed Affiliation would create opportunities for improvements in access to care, quality of care, and cost efficiencies, all of which would create benefits to the community. To that end, on or about September 23, 2015, WGHS retained Pershing Yoakley & Associates, P.C., ("PYA"), an independent third-party, to provide consulting services to WGHS including performing various qualitative and quantitative analyses to assess the community benefit derived from the Affiliation with WellStar. The scope of PYA's engagement was to provide an analysis of the community benefit, and testimony at the public hearing.

On or about November 19, 2015, PYA presented WGHS with a report that provided a calculation of value ("COV")[2] for WGHS, assessed the community benefit, and calculated a range of estimated incremental value related to the proposed Transaction with WellStar. PYA reviewed relevant documents provided by WGHS and WellStar, conducted on-site interviews with key constituents to the Transaction, made calculations using hypothetical conditions assumed to result from the Affiliation of WGHS with WellStar, researched certain industry and market information and trends that were applicable to the assessment, and prepared a written report to WGHS.

There are three generally accepted approaches commonly used to value any asset. Those being: (1) the Asset (Cost) Approach, (2) the Income Approach, and (3) the Market Approach. The Asset (Cost) Approach is based on the anticipated cost to recreate, replace, or replicate the asset. The Market Approach is based on a comparison of the transaction prices of similar assets and services trading in the marketplace. And, finally, the Income Approach is based on the concept that the value of a business is the

[2] PYA performed its analyses under the standard of "fair market value," which is defined in IRS Revenue Ruling 59-60 as *"the price at which the property would change hands between a willing buyer and a willing seller, neither being under compulsion to buy or sell and both having reasonable knowledge of all relevant facts."* PYA's analyses did not represent a fairness opinion or a fair market value analysis of the Hospital or the community benefits from an affiliation.

present worth of the expected future economic benefits to be derived by the owners of the business. PYA considered all three approaches, but ultimately relied solely upon the Discounted Cash Flow ("DCF") Method, a form of the Income Approach, to calculate the value of the Affiliation between WGHS and WellStar because it was based on the economic benefits generated by WGHS for the community. The DCF Method provides an indication of value based on the entity's ability to generate net cash flow. The projected net cash flow is discounted to present value using an appropriate risk-adjusted discount rate.

As a starting point, PYA developed a baseline calculation of value for WGHS for assessing whether the community would receive fair and reasonable community benefit from the Affiliation with WellStar. The calculation assumed that WGHS would continue to operate as is, without an affiliation. PYA's DCF Method under the Income Approach indicated a calculated value range for the business enterprise of WGHS without an affiliation of $70.3 million to $77.7 million. Recognizing that there is value in a hospital to an interested buyer and that an affiliation can add value, PYA continued its analysis and conducted a comparative analysis for the community benefit from the proposed Transaction. Based on its analysis, PYA concluded that the Transaction with an affiliation would yield enforceable quantifiable direct benefits to the community in the areas of cost savings and incremental capital expenditures.

Regarding cost savings, PYA applied present value techniques to quantify the value, in today's dollars, of the cost benefits attributable to the Affiliation with WSH. PYA again utilized the DCF Method to calculate a value range for the business enterprise of WGHS but this time *with* an affiliation resulting in a value range of $86.9 million to $96.1 million. PYA subtracted the baseline calculated value without affiliation ranging from $70.3 million to $77.7 million from the calculated value with affiliation resulting in a net benefit to the community ranging from $16.6 million to $18.4 million. In its calculation, PYA assumed that absent the Transaction, the cost benefits would not be realized.

Regarding incremental capital expenditures, WellStar committed to invest $84.0 million in capital expenditures for WGHS over a seven (7) year period after the closing of the Transaction. The capital commitments will include expenditures of $30.0 million in the first two (2) years. During this time period, WellStar will make reasonable and appropriate investments in WGHS's property, plant and equipment, and technology to support continued operations and growth. After deducting the normal level of capital expenditures that would be made by WGHS without the affiliation, PYA valued the incremental capital commitment by WellStar at $22.0 million.

PYA ultimately concluded that the total benefit resulting from the cost savings and the capital expenditures due to the proposed Affiliation to be in the range of $38.6 million to $40.4 million.

In addition to the quantifiable community benefits explained above that are anticipated, qualitative benefits to the community are projected to result as well. Access to care should improve through continued access to full community hospital services in the WGHS service area, improved ability to recruit and retain physicians, continued commitment to charity care for WGHS service area residents, increased local access to specialists and specialty services, and improved coordination of care resulting in more convenient access. Quality of care should improve through additional resources and expertise to attain quality outcomes and increase patient satisfaction, improved opportunity to continue to develop a regional coordination of care to focus on population health strategies, and commitment to share and develop best practices to reduce variation in care. Other improvements are anticipated such as, commitment to retain current local boards with the addition of two WellStar representatives, to continue medical staff, financial, and strategic planning in the best interest of the community, community retention of leased assets which will revert to the Hospital Authority upon termination of the lease, and representation on the WellStar Board to participate in system-wide "reserved power" decisions impacting WGHS.

In accordance with O.C.G.A. § 31-7-405(b), the Attorney General retained Ernst & Young, LLP ("EY") as an independent financial advisory consultant by the Attorney General to assist in the review of the proposed Affiliation between WGHS and WellStar. The Attorney General engaged EY to provide valuation advisory services, but not to provide a separate valuation or a fairness opinion. Bridget Bourgeois, a partner at EY, specializing in health care valuations, testified at the hearing. As part of its engagement, EY held discussions with representatives of all the parties involved in the proposed Transaction and performed independent research and analyses to review the conclusions contained in PYA's report.

In the course of its engagement, EY analyzed PYA's underlying valuation methodologies and assumptions, and performed a number of sensitivity analyses of PYA's assessment of community benefit by changing certain assumptions employed by PYA in its analysis. In its review, EY confirmed that the Income, Market, and Cost Approaches to value considered by PYA were consistent with generally accepted industry standards for valuation analyses, and found PYA's decision to rely solely upon methodologies under the Income Approach corroborated by the Market Approach to be reasonable. EY's sensitivity analyses yielded a calculated enterprise value range with the "affiliation scenario" of $77.4 million to $101.9 million as compared to PYA's range of $86.9 million to $96.1 million. In addition, PYA did tax effect their incremental capital expenditures which was an unnecessary step in the valuation. Once the application of the tax rate was removed from PYA's incremental cash flows, the present value of incremental capital commitment would be greater than $22.0 million, thereby increasing the benefit to the community by approximately $10 million higher than PYA's conclusion.

EY also conducted independent research and performed sensitivity calculations related to PYA's calculation of value and community benefit assessment. EY's sensitivity analysis of PYA's valuation of the community benefits yielded slightly higher results. EY's market research of hospital transactions and analysis of the bids that came in indicated that the valuation multiples implied by PYA's calculated value for WGHS were within the range of multiples observed for hospital transactions in the market place. Ultimately, EY concluded that PYA used reasonable valuation methods and techniques in its analysis to quantify the direct community benefits expected from the proposed Affiliation with WellStar.

PUBLIC COMMENT

The public hearing was held on January 20, 2016, at 5:00 p.m. in the Enoch Callaway Cancer Clinic Auditorium at the Hospital. 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 January 22, 2016, at 5:00, for any further public comment. This Office did not receive any public comments after the public hearing. Counsel for WGMC and WellStar 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 WGMC 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, the Seller exercised appropriate due diligence in its selection process because the evidence shows that a formal, comprehensive Request for Proposals ("RFP") was conducted by the Seller with the assistance of professional consultants. Offers were solicited from twenty-six (26) local and regional healthcare organizations. Of those twenty-six (26) potential purchasers, twelve (12) expressed interest and eight (8) submitted formal proposals. The Seller considered LOIs from three (3) potential affiliates. The deliberative process employed by the Board in selecting the proposal of WellStar 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 Seller's exercise of due diligence.

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 Directors of WGMC, by the Chief Executive Officer of WGMC and by the expert consultant retained by WGMC. 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. 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 PYA, as reviewed by EY, calculated a value range for quantifiable direct benefits to the community of $38.6 million to $40.4 million, are 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, the Seller 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 Substitution Agreement provides the Hospital Authority with a right of first refusal to purchase the membership interest held by WellStar in the event WellStar decides to consider a third-party offer to purchase its membership interest on substantially the same terms and conditions as are proposed in such sale, lease or other transfer.

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. The testimony and documents filed disclose that WellStar will provide $84 million in capital investments and will guarantee the payment obligations of Troup County's indebtedness and certain other commitments. It does not appear, however, that there will be any monetary proceeds generated by the proposed affiliation.

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. Candice Saunders, President and CEO of WellStar, 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. 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 19TH day of February, 2016.

Julie Adams Jacobs

JULIE ADAMS JACOBS
Senior 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.