Affiliations Between Nonprofit Health Care Providers
October 25, 2012

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Today’s Presenters

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Foley & Lardner

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Owner  
Health Care Futures

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Partner  
Foley & Lardner

David L. Atchison  
President and CEO  
Ponder & Co

Today’s Agenda:  
Affiliations Between Nonprofit Health Care Providers

- M&A Environment: **David L. Atchison**
- Not-for-profit Hospital/Health System “Merger”—Transaction Structure Options: **David Anderson**
- Hospital Affiliations: MTI, Covenant, Tax and Disclosure Considerations: **Heidi H. Jeffery**
- Catholic/non-Catholic Considerations, State Attorney General and Antitrust Issues: **Richard F. Seiden**
- Questions?
Announced Hospital Transactions

Number of Announced Hospital Transactions
January 2007 through Q2 2012

- 2007 - 58
- 2008 - 60
- 2009 - 58
- 2010 - 88
- 2011 - 113

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Willingness to discuss and explore strategic options is up dramatically
- We are aware of over 20 hospitals and systems that are considering options or specific transactions
- In many markets, mentality of “everyone is talking to everyone” about consolidation
- First major market, multi-hospital, NFP deals announced since 2004
  - Detroit Medical Center (6); Caritas Christi (6); Mercy Health Partners (7)
- Percentage of transactions with not-for-profit successors unchanged

Mergers & Acquisitions Update

Drivers of Consolidation

- 1 or Profit M&A
- 1 or Not-for-Profit M&A
- Physician Alignment Wave
- Challenges to Access to Capital
- New Healthcare Delivery Models
- Pressure from Government Payers
- Moderating Managed Care Pricing
- Economic Pressure
- Scale of Volumes (Growth)
Other Trends in M&A

- Joint ventures continue to pick up momentum
  - DLP Ventures – Duke-LifePoint
    - Two systems have had a cardiovascular affiliation in place for four years in Danville, VA
    - Have announced four transactions together
    - Enables Duke to expand its network without the same level of investment if acquired fully these assets; not focused on operating smaller hospitals
    - Enables Duke to counter expansion by Novant and Carolinas
    - LifePoint gets good entrée to acquisition opportunities and leverages Duke name; hospitals fit its operating model

Other Trends in M&A (con’t)

- LHP
  - Built around JV model
  - Three-way transactions recently announced
    - Saint Mary’s Hospital, The Waterbury Hospital (both in Waterbury, CT)
    - Bay Medical Center (Panama City, FL), Sacred Heart Health System (Pensacola, FL)
Other Trends in M&A

- Unsolicited offers more frequent
  - Steward Health Care / Jackson Health
  - RegionalCare Hospital Partners / Cheyenne Regional Medical Center
  - WakeMed / Rex Hospital (UNC Healthcare)

- Increasing number of failed transactions
  - Salinas Valley Memorial (Salinas, CA) – Natividad Medical Center
    - Board ultimately rejected partnership proposal

Other Trends in M&A (con’t)

- St. Luke’s Hospital (Maumee, OH) – ProMedica Health System
  - Transaction blocked by FTC
- Knapp Medical Center (Weslaco, TX) – Universal Health Systems
  - After hospital board approved sale, transaction halted by city’s Hospital Authority
Predictions for 2012 M&A Market

- M&A activity will increase by 8%-10% in 2012 to 120
  - But need FP sector and financing market to remain stable; low public valuations possible negative factor
- FP activity will continue to be at highest levels in 15 years
  - 12+ FP’s or PE-backed groups announced acquisitions in 2010 and 2011; pressure to grow

Predictions for 2012 M&A Market (con’t.)

- Not-for-profits continue to be more selective and consider disposition of under-performing assets
  - Will continue to guard credit rating
  - NFP’s can only handle a few additions to their portfolios
  - NFP’s continue to exit certain markets to concentrate resources
Predictions for 2012 M&A Market (con’t.)

- Joint venture structure will continue to proliferate
  - Duke/LifePont
  - HMA, LHP and others
- State level legislation will trigger additional activity (FL and NC, for example)
- Government scrutiny of deals will continue to increase

Timing of bigger wave still unclear; likely start in 2013 as cuts anticipated to begin in 2014
- “Suspended animation” until more clarity on reform and reimbursement
- Unsure when will see rise in bankruptcies and problem assets; likely 2013-2014
Valuation

- Valuation Methods
  - Three industry-standard methods of valuation are typically used to determine enterprise value. These methods are described below.

  **Public Company Multiples**
  - Market Approach
    - Review valuations of comparable publicly traded hospital companies
    - Determine the multiples of revenue and EBITDA that are implied by the enterprise value of each company (equity market valuation plus any debt outstanding)

  **Comparable Transactions**
  - Market Approach
    - Review of prices paid for healthcare assets in comparable situations
    - Consider both for-profit and not-for-profit buyers
    - Determine the multiples of revenue and EBITDA that are implied by the total consideration paid

  **Discounted Cash Flow**
  - Income Approach
    - Compute PV of projected free cash flow that will be generated by operations in the future
    - Use company provided projections
    - Compute a terminal value at the end of the forecast period
    - Determine the present value of the projected free cash flow and the terminal value

Indicators of Need to Affiliate

- Cannot meet current or long-term capital needs
- Changing physician alignment landscape
- Ongoing financial problems
- Aggressive competitor action; other consolidation in the area
- Major challenges or changes in payer landscape
- Level of preparedness for rise in new healthcare delivery models
- Specific major challenges that can’t be changed
- Ability and willingness to go after opportunities
Strategic Options Assessments

- We have developed the Strategic Options Assessment ("SOA") to provide answers to these questions. The SOA includes the following components:
  - Business analyses
    - Review of organization, facilities and services
    - Analysis of trends in operating statistics
    - Review of medical staff, physician recruitment and employment trends
    - Review of service area and market share
    - Changes in patient services and emphases
    - Review of competitive landscape
  - Interviews with constituents, Directors, physicians and community leaders, if requested by client

Strategic Options Assessments (con’t.)

- Financial analyses
  - Revenue, expense and profitability analysis
  - Capital spending and free cash flow
  - Balance sheet
- Debt capacity and capital access analysis
- Business risk assessment
- Business valuation
- Thorough examination of strategic alternatives
- In-depth review of potential partners
- Conclusions and assistance in decision making
- The SOA typically takes 8 to 10 weeks to complete
# Montgomery General Hospital

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>Profile</td>
<td>Olney, MD</td>
</tr>
<tr>
<td></td>
<td>150 beds</td>
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<tr>
<td></td>
<td>Net revenues, $115 million; total assets, $115 million; long-term debt, $21 million</td>
</tr>
<tr>
<td></td>
<td>Moody’s: A3 (Negative Outlook)</td>
</tr>
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<td></td>
<td>Fitch: BBB (Stable Outlook)</td>
</tr>
<tr>
<td>Situation</td>
<td>Debt capacity constrained relative to requirements of strategic plan</td>
</tr>
<tr>
<td></td>
<td>Very favorable market demographics</td>
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<td></td>
<td>Competitors are financially stronger and affiliated with large healthcare systems</td>
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<tr>
<td></td>
<td>Physician recruitment was a problem</td>
</tr>
<tr>
<td>Outcome</td>
<td>Ponder provided its Strategic Options Assessment</td>
</tr>
<tr>
<td></td>
<td>MGH determined that it should merge with a large healthcare system</td>
</tr>
<tr>
<td></td>
<td>Ponder managed the process to solicit proposals from qualified systems and negotiate terms and conditions of the merger</td>
</tr>
<tr>
<td></td>
<td>MGH selected MedStar Health after receiving proposals from four regional and one national healthcare systems</td>
</tr>
<tr>
<td>Special Features</td>
<td>MGH received a board seat at MedStar</td>
</tr>
<tr>
<td></td>
<td>MedStar agreed to fund the Strategic Plan and other capital projects</td>
</tr>
<tr>
<td></td>
<td>MGH received branding benefits, improved physician recruitment and expense reduction opportunities</td>
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</tbody>
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# Morristown-Hamblen Healthcare System

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<thead>
<tr>
<th>Category</th>
<th>Description</th>
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<tbody>
<tr>
<td>Profile</td>
<td>Morristown, TN</td>
</tr>
<tr>
<td></td>
<td>167 beds</td>
</tr>
<tr>
<td></td>
<td>Net revenue, $90 million; total assets, $82 million; long-term debt, $27.7 million</td>
</tr>
<tr>
<td>Situation</td>
<td>Debt capacity constrained relative to requirements of strategic plan</td>
</tr>
<tr>
<td></td>
<td>Substantial outmigration to Knoxville</td>
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<td></td>
<td>Physician recruitment imperative</td>
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<tr>
<td></td>
<td>For profit competitor hospital next door</td>
</tr>
<tr>
<td>Outcome</td>
<td>Ponder was retained to negotiate a merger with Covenant Health (6 hospitals and $816 million in net patient revenue)</td>
</tr>
<tr>
<td></td>
<td>Achieve MHHS representation on Covenant Board of Directors</td>
</tr>
<tr>
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<td>Commitment to develop MHHS into a regional delivery system</td>
</tr>
<tr>
<td></td>
<td>Commitment to substantially grow physician base</td>
</tr>
<tr>
<td></td>
<td>Capital commitment of $88 million over 6 years (50% increase over Covenant’s original proposal)</td>
</tr>
<tr>
<td>Special Features</td>
<td>Unsolicted offer from for-profit used to enhance outcomes</td>
</tr>
<tr>
<td></td>
<td>A local board of board was put in place in Morristown with enhanced responsibilities, a first for the Covenant Health system</td>
</tr>
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<td>Two permanent MHHS representatives on the Covenant Health parent board</td>
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<td>One of the main identified areas for capital commitment is physician recruitment</td>
</tr>
<tr>
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<td>Covenant Health was chosen, in part, due to its tremendous track record of investing in each of its community hospitals and building and maintaining key service lines at these community hospitals</td>
</tr>
</tbody>
</table>
### Mercy Health Partners, Inc., Tennessee Region

<table>
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<tr>
<th>Category</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Profile</strong></td>
<td>Mercy Health Partners, Inc. (“MHP”), is an affiliate of Catholic Health Partners (“CHP”), one of the largest not-for-profit health systems in the U.S. MHP includes seven acute care hospitals, three of which are leased from certain city and county governments, totaling over 800 licensed beds. In addition, MHP includes a large employed physician group and other ancillary services. MHP has net revenues of approximately $600 million.</td>
</tr>
<tr>
<td><strong>Situation</strong></td>
<td>Significant debt burden due to merger with The Baptist Health System of East Tennessee, Inc. in January 2008. Significant competition from other providers in the market; Covenant Health able to invest much more significantly in its facilities in recent years. Extensive capital needs at certain MHP facilities. Challenging reimbursement environment due to relatively low wage index and TennCare.</td>
</tr>
<tr>
<td><strong>Outcome</strong></td>
<td>Ponder’s M&amp;A Group advised CHP and MHP on the divestiture, managed the controlled auction process and negotiated the terms and conditions of the transaction. CHP received nine high quality proposals. MHP-NEPA selected Health Management Associates, Inc. (“HMA”), one of the largest publicly-traded hospital companies in the United States. Purchase price of $525 million, plus working capital.</td>
</tr>
<tr>
<td><strong>Special Features</strong></td>
<td>Continuation of charity care at levels similar to what has been provided historically. Commitment to continue employment of existing staff for an agreed upon period of time. Commitment to support Catholic programs. Donation by HMA to two foundations.</td>
</tr>
</tbody>
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### Not-for-Profit Hospital/Health System “Merger” — Transaction Structure Options

**David Anderson**  
Owner  
Health Care Futures
ACCESS TO CAPITAL

Best organizational form depends on a mutually compelling business case, mutuality of objectives to be achieved and acceptable internal considerations (constraints)

1. Business Case

2. Compatible?
   - Objectives to be achieved
   - Constraints to organizational form
     - Public/Religious vs. Private
     - Debt documents
     - Regulatory/third party rights/accounting

3. Best organizational form
   - Corporate
   - Governance
   - Management
   - Economics

ACCESS TO CAPITAL

Lessons learned in getting to the best organizational option...

- Decisions are faster and better when moving left to right, not the opposite
- A compelling business case creates clearer objectives, fewer ego-based constraints and better organizational design
- Constraints to organizational form between public/religious vs. private not-for-profit transactions should be understood early
- Debt documents, regulators, third party rights and accounting treatment matter
Characteristics of a compelling Business Case
(and sometimes the regulators disagree with us)

On the right track . . .
1. Administrative costs are lower directly as a result of the “merger”
2. No consideration is given to increasing unit prices as a result of the “merger”
3. Future capital expenditures will be reduced or avoided
4. Clinical services will be combined to improve quality and safety, as well as reduce cost
5. Physicians will have better quality and safer alternatives to locate their patients and be served more conveniently
6. Employers and insurers have better care systems for their enrollees

On the wrong track . . .
1. No commitment is made to administrative cost reduction
2. The business case depends on charging higher unit prices post merger
3. No consideration is given to the impact of future capital expenditures
4. Clinical services will be reduced to eliminate choice
5. Physicians will likely abandon a competitor hospital, causing its closure
6. Employers and insurers have limited choices for their enrollees

What are the big third party rights and accounting treatment considerations?

- Approval rights (or withdrawal rights) of medical groups previously acquired
- Approval rights (or withdrawal rights) by significant independent physician groups in major joint venture relationships
- Triggers in sale/lease-back transactions on change of control
- Change of control provisions in significant managed care contracts
- Property, plant and equipment revaluation of the not-for-profit “seller”
If the business case requires the parties to be able to set fee-for-service prices, allocate clinical services, or access debt together, then:

- The level of corporate alignment between the parties must be high, and;
- The level of governance alignment between the parties must be high, and;
- The level of management alignment (at least from a business perspective) between the parties must be high, and;
- The level of economic alignment between the parties must be high.

There are basically only 4 broad ways to get high alignment around all four dimensions

1. Health System/Hospital A sells to Health System/Hospital B for fair market value compensation
   - Appropriate when Health System/Hospital A desires to exit a market and have no continuing involvement
2. Health System A merges into Health System/Hospital B without receiving fair market value compensation
   - Common in transactions with similar ownership (religious/religious, private not-for-profit/private not-for-profit)
   - Health System A usually has some continuing role in Health System B governance
   - Health System B parent is sometimes re-branded to reduce market perception of “takeover” of Health System A
There are basically only 4 broad ways to get high alignment around all four dimensions

3. Health System A and Health System/Hospital B form new parent Health System C
   - Common in transactions with similar ownership (religious/religious, private not-for-profit/private not-for-profit)
   - Governance and management is negotiated
   - Sometimes Health System A and Health System B become members of Health System C with limited responsibility

4. Health System A and Health System B form a Joint Operating Company, that has substantial governance and management responsibility for Hospital A and Hospital B
   - More typical in transactions with different ownership (religious/private not-for-profit, public not-for-profit/private not-for-profit
   - Must be the functional equivalent of a merger—this is not an option to “try it and see if you like it”
   - Legally complicated to develop, but can be functionally effective

Primary Characteristics of Joint Operating Company Models

- Balance sheets and income statements of System A and Hospital A and System B and Hospital B remain separate
- Financing and debt documents remain separate unless System A and System B agree otherwise
- Economic sharing between System A and System B is based on the combined operating performance of Hospital A plus Hospital B—usually at an operating income or excess margin (adjusted for contributions)
- System A and System B delegate substantially all operating decisions to the Joint Operating Company Board
  - Minimum reserve powers held by Health System A or Health System B
  - Ethical and Religious Directives application to non-Catholic hospital under Joint Operating Company is an important discussion
  - Sunshine laws can be an important discussion topic when public not-for-profit hospitals are involved
  - Helpful if the Board of Joint Operating Company, Hospital A and Hospital B are the same
- The Achilles Heel—how future major capital investments are made, the role of System A and System B play, and the impact on economic sharing on a go-forward basis
Best Examples of Highly Successful Joint Operating Company Models

- TriHealth, Inc, Cincinnati
  - Formed in 1994 between Good Samaritan Hospital of Cincinnati (now a direct affiliate of Catholic Health Initiatives) and Bethesda Hospital Inc
  - 2011-$1.5 billion in total assets, $885 million in net assets, $1 billion in operating revenues, $48 million in operating income, $106 million in operating cash flow

- BayCare Health System, Tampa
  - Formed 1997 among Catholic Health East, Morton Plant Mease Health Care, South Florida Baptist Hospital and BayCare
  - 2011-$4 billion in total assets, $2.4 billion in net assets, $2.4 billion in operating revenues, $165 million in operating income, $352 million in operating cash flow

Hospital Affiliations:
MTI, Covenant, Tax and Disclosure Considerations

Heidi H. Jeffery
Partner
Foley & Lardner LLP
Section Will Concentrate on Five Considerations

Recent acquisitions and consolidations have focused on:

- Treatment of Transactions Under the Master Trust Indenture (MTI)
- MTI, Bank, and Swap Document Covenants Issues
- Bond Indenture Provisions Relating to Security Substitution
- Tax Issues: Refunding and Acquisition Financing
- Disclosure Issues

Practical Considerations: Things to Ask Before Starting Consolidation or Acquisition

- What is this?
  - Is this really an acquisition or a consolidation?
  - What is the “business deal”?
- Do the documents require a redemption or defeasance?
- How will the transaction be effected: membership substitution or a transfer of assets?
- What do your documents say about change in control?
- If creating a new parent, what do your documents say about transferring assets out of the obligated group; how is that new parent going to be supported financially?
- What diligence needs to be undertaken?
**Treatment under Master Indenture**

- Sale of substantially all of the assets
- Change in Control
- Merger
- What to do with the Master Indenture
  - Deceased or continued
  - If separate MTIs continue, what is the practical effect
  - One consideration are separate financial statements

**Practical Consideration**

- Make your financial reporting team a member of the deal team
- Continually wrestling with auditing and financial reporting issues
MTI, Bank, and Swap Document Covenants

- Several provisions to always be on the lookout for
- Look at MTI and each Supplemental Indentures
  - Covenants Running for Benefit of Insurers or Banks
  - Provisions related to Changes in Articles of Incorporation and Bylaws
    - Recent experience suggests that material adverse effect may be difficult to manage
- Mergers and acquisitions
- Transfer of asset provisions
- Change of control provisions
- Approvals and Consents
- Required redemption or defeasance

MTI, Bank, and Swap Covenants Document Covenants (con’t)

- Restrictions on Obligation Substitution
- Restrictions on Admission to Obligated Group
- Upstreaming Restrictions
- Existing Liens and Pledges
Substitution of Security

- Many existing bond indentures have obligation substitution provisions
- Indentures may not be uniform; check each
- Recent market feedback: substitution provisions are becoming scrutinized; facing push back

Substitution of Security (con’t)

- Not as easy as it sounds
- The Bond Trustee will surrender the Obligation to the Master Trustee, upon presentation to the Bond Trustee of the following:
  - (a) original replacement notes or similar obligations (the “Substitute Notes”) issued under and pursuant to and secured by a Master Trust Indenture (the “Replacement Master Indenture”) executed by the new credit group named therein (collectively, the “New Group”) and an independent corporate Master Trustee (the “New Master Trustee”);
  - (b) an opinion or opinions of Independent Counsel addressed to the Bond Trustee and the Issuer (in form and substance acceptable to the Bond Trustee and the Issuer)
  - (c) evidence of compliance with tests for adding a new Member to the Obligated Group, including an officer’s certificate certifying that (a) the New Group could, after giving effect to such Substitute Notes, meet the conditions described in the provisions of the Master Indenture for the incurrence of one dollar of additional Long Term Indebtedness, as demonstrated in such certificate, and (b) the New Group would not be in default under the provisions of the Master Indenture;
  - (d) a Favorable Opinion of Bond Counsel with respect to the surrender of the Obligation and the acceptance by the Bond Trustee of the Substitute Notes; and
  - (e) written confirmation from each Rating Agency then maintaining a rating on the Bonds that such rating will not be reduced or withdrawn as a result of such substitution.
Tax Issues—Practical Considerations

- Complex and varied
- Get your corporate counsel/bond counsel involved early and often
- Best to work with counsel prior to letter of intent phase to the extent LOI will outline board membership

The tax treatment of any financing of the acquisition payments will largely depend upon whether the financing is treated as an “acquisition” new money financing or as a refunding of the existing debt of XXXX.

Regulations under section 150 of the Code provide a detailed definition of “refunding”. The analysis is made somewhat complicated because two sets of “refunding” regulations must be considered: (1) the current final regulations and (2) proposed regulations published on April 10, 2002 that are not currently effective, but that may be applied in whole, but not in part, to any issue that is sold after April 10, 2002.

Three Different Treatments of Refinancings

There are three possible different treatments of refinancings of X System’s outstanding debt by Y:

1. Refunding,
2. Refinancing that is treated as a new money bond issue that is subject to the special rules that apply to “transactions between affiliated persons” under the proposed acquisition financing regulations (referred to as a “hybrid new money financing”), and
3. Refinancing that is treated as a new money bond issue and that is not subject to the special rules that apply to “transactions between affiliated persons” under the proposed acquisition financing regulations (referred to as a “pure new money financing”).

Current Experience

Common for the acquisition of a membership interest of a stand-alone or small system by a large system to be treated as a "pure" acquisition financing, but that affiliations between larger systems have more commonly been treated as "hybrid" acquisition financings.
Transactions between Affiliated Persons

- The benefits of acquisition financing treatment generally are lessened in the case of such a “transaction between affiliated persons.”

A Comparison of Refunding, Hybrid and Pure New Money

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<tr>
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<th>Description</th>
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<tbody>
<tr>
<td>Pre-1986 Bonds</td>
<td>Refunding: Favorable Grandfathering of pre-1986 Bonds (pro refunding)</td>
</tr>
<tr>
<td>CCRCs</td>
<td>Restrictions on financing acquisition of residential rental housing would not apply to a refunding (pro hybrid, pro pure new money)</td>
</tr>
<tr>
<td>Private Use Problems</td>
<td>Under the regulations that apply to refunding bonds, refunding bond treatment will require an analysis of private use during the period the refunded bonds were outstanding (pro hybrid, pro pure new money). With hybrid or pure new money, there is no “look back” at prior private use required. Prior use of the financed assets will not be material to the tax treatment of the refinancing bonds.</td>
</tr>
<tr>
<td>Short Remaining Life</td>
<td>No re-lifting of assets with a refunding (pro hybrid, pro pure new money)</td>
</tr>
</tbody>
</table>
## A Comparison of Refunding, Hybrid, and Pure New Money (con’t)

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
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<tbody>
<tr>
<td>Prior Advance Refundings</td>
<td>- If a refunding treatment applies, any portion of a series that previously has been advance refunded could not be advance refunded with tax-exempt bonds. If the refinancing bonds are treated as new money bonds, advance refunding limitations will not apply and an additional advance refunding of the refinancing bonds would be permitted. (pro hybrid, pro pure new money)</td>
</tr>
<tr>
<td>Non Hospital Bonds</td>
<td>- Nonhospital bond issues avoided. Because the refinancing would be treated as a new money financing of capital expenditures, the refinancing bonds would not be subject to the $150 million limit on nonhospital bonds. (pro hybrid, pro pure new money)</td>
</tr>
<tr>
<td>Appraisals</td>
<td>- Unlike pure new money acquisition financing, it is likely that bond counsel would not require appraisals of assets for a refinancing subject to hybrid new money acquisition financing treatment. An appraisal is not required for a refunding.</td>
</tr>
<tr>
<td>Financed assets can be targeted Taxable debt refinanced with tax-exempt bonds No need to defease to the first call date</td>
<td>- Pure New Money Benefits</td>
</tr>
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## Practical Consideration-Benefit of Acquisition Financing

- One point that has proven to be particularly important in recent years is the benefit of not requiring a private use "look back" or extensive retrospective due diligence (at least to effect a new financing).
- Avoid retroactive tracing
Practical Consideration-Appraisals

- As a practical matter, “acquisition financing” treatment depends upon appraisals of the acquired property.
- The appraisals should be as close to the acquisition date as reasonably possible, and the appraisals should separately state the values of assets eligible for tax-exempt financing (particularly buildings used for exempt purposes).
- Ideally, the appraisals should also state the remaining reasonably expected economic life of the acquired assets.

Disclosure

- SEC Rule 15c2-12: Requires event disclosure if
  - the consummation of a merger, consolidation, or acquisition, or certain asset sales, involving the obligated person, or entry into or termination of a definitive agreement relating to the foregoing, if material
Disclosure (con’t)

- Consider use of audited financials in future offering documents
  - What representations can be made about acquired system/hospital representations
  - Will current management of acquired system/hospital provide needed representations
- What will Appendix A contain
Catholic/non-Catholic Considerations, State Attorney General and Antitrust Issues

Richard F. Seiden  
Partner  
Foley & Lardner LLP

Catholic Hospitals

- Ethical and Religious Directives for Catholic Health Facilities
  - No abortions, euthanasia or direct surgical non-medically indicated sterilization
- Catholic acquiring non-Catholic
- How to implement transaction without violating canonical laws
Catholic Hospitals: Example A

- Catholic acquires non-Catholic: pre-closing funding of family planning services by the non-Catholic hospital party
  - Prior to transaction, non-Catholic sets aside money transferred to a family planning agency
  - Allowable exception to typical “ordinary course” covenant
  - Catholic hospital not deemed to have materially participated

Catholic Hospitals: Example B

- Non-Catholic acquires Catholic
  - Permission of Catholic church
    - Discretion of local Catholic official and Vatican
    - “Indult” – Vatican authorizing document
  - Mostly, health system agrees to maintain Catholicity, observe Directives, maintain Catholic chaplaincy to provide for spiritual needs of patients
Catholic Hospitals: Example C

- A delegated subcommittee of the Board oversees service line, and assures segregation of revenue
- Prohibited procedures under Directives are segregated by billing code

Catholic Hospitals: Example D

- Consolidation with a Catholic hospital not controlled by the Catholic church
  - Hospital funds came from nuns not answerable to the Vatican
  - Structured as consolidation with non-Catholic hospital
  - Nuns okay with sitting on parent board even though other hospital did not observe directives
Medical Office Building

- Catholic hospital owned adjacent M.O.B.
- OB-GYNs wanted to perform prohibited procedures in their offices in the M.O.B.
- Hospital ground leased M.O.B. to independent developer, who in turn leased offices to OB-GYNs – not material participation

The Role of the State Attorney General in Certain Hospital Transactions Involving Nonprofit Hospitals
Attorneys General as Nonprofit Transaction Monitors

- Assets held by nonprofit: “impressed with a charitable trust”
- State laws authorizing AG approval
  - Supervisory authority over assets held in charitable trust
  - Transfer of assets
  - Membership

Attorney General: California

- Approval required for nonprofit + for profit and nonprofit + nonprofit
- Considerations:
  - Fair terms
  - Private inurement
  - Fair market value
  - FMV manipulation
  - Use of proceeds
  - Breach of trust
  - Sufficient info
  - Effect on availability
  - Public interest
Attorney General: California (con’t.)

- Implementing regulations: requests for submission
  - Community needs assessments
  - Description of charity care provided
  - Descriptions of employee staffing and input
  - Guarantees re: job security or continuation
  - Employee wages, benefits, working conditions, protections, etc.

Attorney General: California (con’t.)

- Typical orders to acquiring party of nonprofit hospital: maintain for ≥ 5 years:
  - Number of licensed inpatient beds
  - Charity care delivery levels
  - Contract with Medicaid program
  - Emergency care service levels
  - Critical community services
Recent Hospital Merger Enforcement

- Fighting anticompetitive effects in health care markets remains a top priority of FTC and DOJ – they will continue to pursue health care mergers that they believe threaten competition
OSF Healthcare and Rockford

- 4/5/12 – FTC obtained preliminary injunction stopping a merger
- It would have been a 3 to 2 merger
- Proposed merger – 64.2% share of GAC
- Fear of future price increase
- Parties’ stipulation did not preclude price increases
- Transaction abandoned by the parties

ProMedica/St. Luke’s Hospital

- 3/22/12 FTC ordered Pro-Medica to divest hospital acquired in 2010, since transaction would lessen competition and raise prices through unilateral effects
- Merged entity would control 58% GAC and 80.5 % of inpatient obstetrical services
- Payors testified as to impact of price increases
Hart-Scott-Rodino Premerger Notification

- Prohibits closing of transactions that meet or exceed the HSR thresholds
- Requires filing of premerger notification form with 30 day waiting period for most deals.
- Failure to comply can result in a civil penalty of $11,000 per day
- FTC/DOJ technically could later challenge the deal, but as a practical matter rarely do, exception Evanston Northwestern

Threshold HSR Questions

- Interstate commerce (essentially always met for U.S. deals)
- Size of the transaction test
- Size of the parties test
- Note: All 3 must be met for deals valued at <$200 million
- Note: Deals >$200 million will be reportable regardless of the size of the parties test
Completing the HSR Form

- Typical filing requires 2-3 weeks to prepare
- Filing by acquired person usually less complex
- Parties must supply information including:
  - revenue by SIC Codes
  - a description of the deal documents prepared by officers and directors analyzing the deal with respect to certain topics
  - general corporate information including financials
  - Information regarding overlapping SIC codes with another party to the transaction
  - Information remains confidential

Item 4(c) of the HSR Form

- Instructions broadly call for producing: “all studies, surveys, analyses and reports which were prepared by or for any officer(s) or director(s) (or, in the case of unincorporated entities, individuals exercising similar functions) for the purpose of evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets . . . .”
- High fines, including a fine on an acquiring entity and on the individual who certified the form has raised awareness of this issue
Item 4(c) Classics: Scary but true!

- An officer of “A” prepares an internal presentation recommending the acquisition of “B” and lists as an “opportunity” of the deal – **eliminate a competitor**
- An officer of “C” prepares a financial model of projected sales after a deal is consummated. A written assumption to the model is: “we will have dominated market share of the _____ industry and anticipate after year one taking a _____ [price] increase”

Item 4(c) Classics (con’t.)

- A consultant prepares a market analysis for officers of “D” relating to a proposed transaction with “E” stating that some of “E’s” customers may not like the transaction, but they have no real alternative at least in the short run.
Process After HSR Filing

- Early termination
- Expiration of 30 days with no objection
- Informal inquiry within the 30 day period
- Second request
- Lawsuit/preliminary injunction/consent decree

Informal Inquiries within the Waiting Period

- Typically a telephone call
  - Top 10 customers
  - Principal competitors
  - Phone interview with author of 4(c) documents
  - Contacts to customers
- Note that DOJ lacks the authority to agree to extensions of waiting period without a court order (possible “withdrawal” of filing)
Second Requests

- Onerous and burdensome set of interrogatories and document requests
- Extends the waiting period until 30 days after substantial compliance with Second Request
- Investigation may last months and will likely require retention of economist and meetings with DOJ/FTC in D.C.

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Mark Your Calendar

- 2012–2013 Access to Capital Sessions
  - December 4, 2012: Private Debt Placement for Health Care Providers
  - February 2013: Preparing your Institution for Affiliation