ATTORNEY GENERAL
STATE OF MONTANA

Tim Fox
Attorney General

Office of Consumer Protection
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January 12, 2015

Mr. Gary Chumrau
Garlington Lohn Robinson
350 Ryman Street
P.O. Box 7909
Missoula, MT 59807-7909

RE: Approval of the Sale of Assets of Community Medical Center, Inc., a Montana Public Benefit Corporation

Dear Mr. Chumrau:

I. OVERVIEW

a. Applicable law

On September 9, 2014, you submitted a Notice of Sale of the Assets of Community Medical Center, Inc. ("CMC" or "Seller") to the Montana Attorney General's Office for review, pursuant to Mont. Code Ann. 35-2-617(7)(a). This letter approves the sale of substantially all of CMC's assets to RCHP Billings-Missoula LLC, a Joint Venture between Billings Clinic and RegionalCare (collectively "Buyer", or individually "Billings Clinic" and "RegionalCare"). Seller and Buyer collectively are referred to as the Parties.

As noted below, this letter does not address, and therefore does not approve, CMC's proposed distribution of charitable assets. The Montana Attorney General's Office sought and received additional time for public input and review of the proposed distribution.

The Attorney General's Office reviewed the transaction pursuant to *parens patriae* authority, as well as authority granted by statutes governing nonprofit corporations and charitable trusts. Thus, the office focused on whether the Board of CMC satisfied its fiduciary obligations when deciding to sell, selecting a buyer, and negotiating a fair market value purchase price. The office further examined whether CMC's officers and directors acted in the best interests of CMC, whether any of them had conflicts of interest, and whether they acted in good faith. Additionally, the Attorney General conducted an antitrust review of the proposed transaction under authority granted by the Montana Unfair Trade Practices and Consumer Protection Act.

b. Process

The Attorney General conducted a thorough review of the proposed transaction. This office made over 55 separate inquiries and requests for follow up information throughout our investigation. This office received and reviewed roughly 2,000 pages of documents produced by both the Seller and Buyer in response to our inquiries. We interviewed several key employees and Board members of CMC, and frequently met with representatives from CMC's Board of Directors. Additionally, this office interviewed three doctors who participated in the Physician Advisory Council that was established by the CMC Board to assist in reviewing those hospitals that bid to acquire CMC. Staff members from the Attorney General's Office toured CMC's facilities in order to facilitate our evaluation of CMC's business, its programs and service lines as well as its clients. Finally, to ensure the purchase price for CMC's charitable assets represented fair market value, this office retained an independent expert valuation firm to assess the value of the assets.

c. Commitment to Transparency and Public Involvement

Public interest in the proposed transaction was significant. Therefore, though not required by law, the Attorney General endeavored to ensure that its review would be transparent and to encourage public awareness and participation. We posted a voluminous number of documents related to the transaction on our website, including the Asset Purchase Agreement, correspondence, an expert valuation report, CMC Board meeting minutes, financial statements, agreements between the Parties and Attorney General, and all the Attorney General's requests for production and responses from the parties.

Further, the Attorney General held a public forum in Missoula on November 19, 2014. Over 200 people attended, some of whom provided public comment. The public forum was an opportunity for representatives of CMC and the Buyer to listen to and address questions and community concerns, and to more fully describe the proposed transaction. It was also an opportunity for this office to engage the community by listening to questions, concerns, and comments regarding the proposed transaction. The public forum was video recorded and the video was posted on the Attorney General's website and on YouTube for viewing by the general public.

Additionally, this office encouraged the public to comment in writing through the mail or online regarding the proposed transaction. The public responded by producing over 150 written comments. The comments reflected a public discourse that shared insights and raised questions. Several members of the community voiced their support or opposition for the sale. This office considered each of the public comments received.

II. FAIR MARKET VALUE OF PURCHASE PRICE

The Attorney General retained an independent valuation firm, CBIZ Valuation Group, LLC ("CBIZ"), to provide an opinion of the fair market value of CMC's assets. Although the valuation firm was paid by the Parties, the firm worked at the direction of the Attorney General's Office and remained independent of CMC and Buyers in reaching its valuation conclusion. CBIZ considered the state of the economy and the healthcare industry as a whole in reaching its opinion. Further, CBIZ studied the specifics of the proposed sale, reviewed CMC's current and historic financial performance, and conducted an on-site investigation, including interviews with key employees and board members. CBIZ applied the information it gathered to analyze the transaction under the Market Approach and Income Approach of valuation. As a result of its analysis, CBIZ determined that the fair market value of Community Medical Center, as of September 30, 2014, was between $67,000,000 and $75,000,000. The CBIZ report estimated that the sale price of CMC under the provisions of the Asset Purchase Agreement is $74,790,000. This office understands that the ultimate sale price may be slightly more or less depending on adjustments made at closing. However, the parties have represented that any deviation from the purchase price will not result in the ultimate sale price being less than the concluded range of fair market value. Therefore, we conclude that the purchase price of Community Medical Center represents a fair market value for its charitable assets.

III. FIDUCIARY DUTIES OF CMC'S BOARD IN DECIDING TO SELL AND SELECTING THE SUCCESSFUL BIDDER

a. Decision to seek a partner

In the mid-2000's, CMC was experiencing financial hardship -- it had experienced turnovers in its executive leadership, its cash on hand was severely depleted, and its financial viability was in question. CMC hired consultants to identify efficiencies in its operation and opportunities to bring the hospital back to profitability. However, the consultants noted that CMC's long term viability as an independent community-based hospital was uncertain because it would be increasingly difficult to generate the capital necessary for improvements, physician recruitment, technology, and quality care from thin margins. Therefore, as early as 2007 and throughout the next five years, CMC occasionally debated and considered partnership or affiliation with another healthcare system, while at the same time improving its profit margin to a healthy level by 2012.

Based on our independent research, across the nation there is a trend toward mergers and consolidations in smaller, once-independent hospitals, like CMC. Factors driving this trend include the migration from in-patient care to out-patient services, changes in the way healthcare is reimbursed by government payors and insurance companies, and expensive technology updates mandated by the federal Affordable Care Act.

CMC advanced several reasons justifying its deciding to seek a partner or to sell the hospital. Its rationale included that the partnership:

- will reduce costs through service coordination and support service consolidation;
- improve quality of health care by collaborating on the identification and adoption of best practices;
- prepare CMC for the challenges introduced by the Affordable Care Act by acquiring the experience and competencies needed to manage capitation and population management; and
- secure access to capital for needed improvements to the hospital, including service expansion, information systems development, and physician recruitment.

It is our opinion that CMC's rationale for seeking a partner is consistent with national trends and with the challenges that CMC has faced, as identified by its Board and consultants, since as early as 2004.

b. Retention of Counsel and Consultants to Assist

In 2009, CMC retained an independent consultant who compared the status quo, namely remaining a community-based hospital, with other alternatives, including the sale to a for-profit system and the affiliation with a partner. Given the nature of CMC's fee arrangement with the consultant, there was no incentive for that consultant to reach any particular recommendation or conclusion. The consultant concluded that remaining a community-based hospital was not a viable option.

In 2011, CMC retained a different independent consultant who explored the option of affiliating with a partner. This consultant noted the benefits of an affiliation and identified a number of issues that would have to be resolved if the affiliation were to be pursued successfully. Like the first consultant, there was no financial incentive for the consultant to reach any particular recommendation or conclusion.

By 2013, CMC had concluded that the status quo was clearly not a viable option. Therefore, in June 2013, CMC retained a third consultant, Cain Brothers, to assist CMC as its financial advisor in connection with any transaction to which CMC might be acquired by, or combined with, another entity. Cain Brothers assisted in the solicitation and evaluation of proposals. In addition to a monthly fee, Cain Brothers received a fee when a definitive agreement was executed, and Cain Brothers will receive a transaction fee upon the consummation of this transaction. Had Cain Brothers been retained to advise on the desirability of remaining a community-based hospital, these fee arrangements would have resulted in a conflict of interest. However, there was no conflict in light of the scope of Cain Brothers employment, which was limited to assisting CMC with a transaction after other independent consultants had concluded that CMC needed to explore an acquisition or merger.

CMC retained competent consultants to assist them in their decision making to seek a partner and in selecting the successful bidder. Each of these consultants provided analysis of the strengths and weaknesses of CMC. The first two independent consultants presented the favorable and unfavorable aspects of affiliating with a partner. The third consultant, Cain Brothers, provided analysis to the CMC Board of the strengths and weaknesses of each potential bidder. Therefore, the CMC Board of Directors appropriately relied on the analysis and counsel of the consultants it hired to assist them.

c. Physician Advisory Council

In addition to seeking the counsel of qualified consultants, CMC assembled a Physician Advisory Committee ("PAC"). The PAC was comprised of seven Missoula area physicians who practice under different specialties and who were either employed by Community Physicians Group or who operate independent practices with admitting privileges at CMC. According to CMC's Board and administration, the PAC was created to help the CMC Board analyze and review the need for partnership and provide input, from the physicians' perspectives, on the varying bids from potential partners.

This office interviewed three PAC members who practice medicine in Missoula. The PAC member physicians we interviewed expressed genuine concern about the effective delivery of healthcare to the community of Missoula and the western Montana region. These physician interviews revealed that a majority of the PAC members believed that there was a need to associate with a financially stronger entity under existing market conditions and that based on commitments made in the content of its bid to the Board, the Buyer was the best candidate for the Missoula community. This office also concluded that the PAC members were given adequate opportunity to participate meaningfully by engaging in fact finding and voicing their opinion in decision-level discussions with the CMC Board.

d. Bidding process, selection of a bidder, and negotiation of the Asset Purchase Agreement

Cain Brothers identified potential bidders, both nonprofit and for-profit entities, sent packets of information, and asked interested parties to submit proposals. Three bids resulting from this initial process were of interest to the CMC Board. With Cain Brothers' assistance, the CMC Board compared these proposals and visited the facilities of each of the bidders along with members of the PAC. In evaluating these bids, CMC determined that it should seek a proposal from a fourth bidder. The CMC Board narrowed the field of potential partners to the Buyer and one other bidder. The CMC Board actively engaged in negotiations with the entities.

CMC contends that it was able to secure favorable terms in the Asset Purchase Agreement because of its position of financial strength during the negotiation of the sale. In particular, CMC negotiated that the Buyer must:

- contribute a minimum of three percent annually of the hospital's net patient revenue for routine capital expenditures;
- spend an additional $60 million over the next ten years on strategic initiatives;

- spend $40 million over the next ten years on physician and healthcare provider recruitment;
- maintain essential services currently offered at CMC; and
- continue providing charity care to the indigent and uninsured pursuant to the present charity care policy of CMC or one substantially similar.

The Attorney General conducted multiple independent interviews of representatives of both CMC and Buyer, as well as a focused review into CMC's past and present financial condition, and the negotiations leading up to finalization of the Asset Purchase Agreement. This office confirmed that the $40 million commitment to professional recruitment and the $60 million for strategic initiatives represents a substantial increase over the amounts CMC had historically spent in these areas and that they had reasonably expected to be able to spend over the next ten years. We conclude that CMC's strong financial condition was a controlling factor in the Buyer's ultimate commitment to invest $100 million in additional financial resources for capital improvements, physician recruitment and the continuation of essential services, including charity care.

Additionally, comments at the public forum and the written comments we received appear to reflect a preference within the community for hospital choice – even among commenters and interviewees who questioned the Buyer that the CMC Board selected. Based on the comments we received and reviewed, this office concludes that there is a significant number of people who believe that their community is best served by preserving a choice in healthcare providers in Missoula and the surrounding service area. This office concludes that the public preference weighed heavily in the CMC Board's decision to select the Buyer over other bidders.

In public comments, some cited CMC's strong financial position as a reason why the sale of CMC may not be necessary or prudent. The Attorney General thoughtfully considered these comments. However, after multiple, independent interviews of CMC Board members and the hospital's executive staff, this office concludes that the CMC Board's decision was based on a bona fide belief that an affiliation was necessary for the long-term survival of this hospital. The CMC Board's belief was in part based on years of financial struggle in the recent past. Furthermore, while it is not this office's role or responsibility to specifically endorse the CMC Board's decision, it concludes that the CMC Board's reasonable business judgment in choosing the Buyer did not violate applicable fiduciary obligations.

We reviewed documents and interviewed CMC Board members, doctors, and staff to confirm that the process was thorough and fair. Documents that we reviewed include minutes of CMC Board and committee meetings, CMC Board resolutions, materials prepared by CMC's consultants, materials distributed to potential partners, and bids received. The CMC Board engaged in a deliberative and thorough process, including consideration of the advice of qualified consultants and the PAC, in making its decision to sell and in selecting the Buyer as the successful bidder.

e. Other issues raised in the course of the Attorney General's investigation

One concern raised was whether the Buyer's CEO, Mr. Martin Rash, had demonstrated a pattern of buying and selling hospitals similar to the flipping of houses before the Great Recession. In response, we learned that Mr. Rash has been associated with RegionalCare for the past five years. During that time, RegionalCare has not sold any of the eight hospitals it acquired. Prior to his employment with RegionalCare, Mr. Rash was associated with another corporation which acquired 25 hospitals. During Mr. Rash's nine-year employment with that other corporation, only one of those 25 hospitals was sold. Additionally, we note that the Asset Purchase Agreement contains a right of first refusal provision that allows CMC, Inc. (the corporate entity that will continue to wind-down the affairs of the business and monitor the post-closing covenants) to purchase any assets that would be sold or be subject to a change of control on the same terms as the offer made to acquire them.

Another concern was whether a non-profit corporation, like CMC, could sell its assets to a for-profit entity because donors to CMC intended to benefit a charity, not a for-profit entity. As noted, CBIZ concluded that the purchase price of the hospital represents a fair market value of its charitable assets. In our future review of the disposition of charitable assets, our office will examine the proposed disposition to ensure that the assets will be transferred to one or more charitable organizations that will use the assets as nearly as possible in accordance with the charitable mission of CMC in the same geographic region or service area.

A third concern was raised concerning the CMC's Board failure to establish a public Advisory Council as required by Article 21 of CMC's Bylaws. We view this concern as part of an overall criticism that CMC was not transparent in undertaking this proposed transaction. Although we understand the necessity of confidentiality when negotiating with potential buyers, the CMC Board's proposed disposition of charitable assets should not be subject to that same confidentiality. Had the CMC Board established a public Advisory Council, we believe that the public's concern about a lack of transparency would be lessened. Certainly, we expect an open process that will ensure that the charitable assets, namely the proceeds of the sale, will be used in a manner as near as possible to the charitable mission of CMC.

An additional concern was raised about the legality of the transfer of CMC's land to a for-profit hospital. In a memorandum to the Missoula Board of County Commissioners dated September 15, 2014, entitled "Community Hospital Sale," the Missoula County Attorney's office concluded, "There is nothing in the above transaction that would limit or restrict the sale of the property to a for-profit entity…." That conclusion is consistent with a Title Insurance Commitment by First American Title Insurance Company issued on October 8, 2014, which was provided by the Buyer at the request of this office.

Also, a question was raised about CMC's 2014 modification of its Articles of Incorporation, which eliminated Missoula County as the recipient of corporate assets upon dissolution. Our investigation revealed that Missoula County held title to CMC's real property in order to satisfy an Internal Revenue Service requirement concerning the issuance of tax-exempt bonds. Bonds subject to that requirement were retired in 2007 and the County conveyed title back to CMC in 2008. At that time, CMC could have amended its Articles of Incorporation removing Missoula County as the recipient of corporate assets upon dissolution. However, CMC neglected to do so and did not focus on the matter until 2014 when the Parties were undertaking their review in anticipation of this transaction.

IV. POST-CLOSING MONITORING

As noted above, the CMC Board was able to negotiate some important post-closing covenants to ensure the future stability of the variety and quality of health care offered at CMC. These important provisions of the Asset Purchase Agreement include promises to: continue essential services; continue to provide charity care and community-based health programs consistent with CMC's prior practice and policies; commit $40 million to recruit physicians and other health care providers over the next ten years; and, commit $60 million over the next ten years in needed capital for improvements and other strategic initiatives.

The Attorney General has a keen interest in ensuring these promises to the public are kept. The Buyer has cited post-closing CMC facility operations and operations from other RegionalCare operations as the sources of needed capital. However, the Attorney General has learned that RegionalCare has had less than investment-grade credit ratings. Therefore this office required that CMC, Inc., the entity that will monitor the new for-profit hospital after the closing of the transaction, has adequate resources to enforce the provisions of the Asset Purchase Agreement, should the need arise. The Attorney General will also appoint an individual to attend meetings of CMC, Inc., in order to oversee the continued monitoring of these promises in the future. Additionally, the Attorney General has retained an independent right to enforce these provisions if the covenants are violated.

V. CONFLICTS OF INTEREST

The Attorney General requested and received a copy of CMC's conflict of interest policy and disclosure statements executed by CMC Board members, officers, and key employees.

This office further inquired whether conflicts of interest were identified among CMC's Board members, officers, and key employees. No conflicts of interest were disclosed as to the decision to sell Community Medical Center to the Buyer. However, CMC disclosed three conflicts of interest among Board members that were identified with respect to a Board vote to transfer charitable assets to the University of Montana Foundation. Thus, we intend to address possible conflicts of interest involving the University of Montana and its Foundation when we consider CMC's proposed transfer of charitable assets. Additionally, CMC confirmed that no CMC Board member, officer, or key employee was offered or received stock options in Regional Care, nor has any been offered or received any other financial incentive to approve this transaction.

Finally, this office asked whether any special benefits would accrue as a result of the transaction to any CMC Board member, officer, or key employee. The Parties responded that, "no director, officer or key employee will be paid a retention payment or success fee as a result of this transaction." In addition, the Parties disclosed that Buyer had offered to extend Mr. Steve Carlson's severance benefit to three years, an increase from the 18-24 month severance benefit which Mr. Carlson's current contract contains for termination other than for cause.

In response to this disclosure, the Attorney General's Office interviewed representatives of the Buyer, members of CMC's Board, representatives of Cain Brothers, and Mr. Carlson about the extension of the severance benefit. Through our additional inquiries, the Parties explained that the CMC Board was concerned that a benefit offered by one bidder could disadvantage the other bidder under consideration. The CMC Board instructed Cain Brothers to seek parity in the offers. The other bidder was willing to increase Mr. Carlson's severance by an equal amount, thus ensuring that Mr. Carlson's advice to the CMC Board would not be motivated by personal financial considerations.

Additionally, the Buyer disclosed that it had compelling and independent reasons for offering the increased severance. First, Buyer cited the increased severance as an incentive to ensure Mr. Carlson would not resign prior to closing. Next, the Buyer's agreement with Mr. Carlson requires him to be available to consult with the Buyer for three years after the closing to assist Buyer with making the change in ownership a smooth transition. Also, in exchange for the additional severance, the Buyer bound Mr. Carlson to abide by restrictive covenants, including a non-disparagement agreement and a non-competition clause. Finally, representatives from RegionalCare confirmed that Mr. Carlson will not be offered employment at any of its facilities in other states.

With respect to the decision to sell CMC to the Buyer, this office is satisfied that no inappropriate conflicts of interest existed, nor did the offer to extend Mr. Carlson's severance benefit unduly influence the CMC Board in its selection of the Buyer over other bidders.

VI. ANTITRUST REVIEW

The Attorney General reviewed the scope of primary, secondary and tertiary care services provided by hospitals in western Montana, with a focus on those services offered by Community Medical Center. Additionally, this office reviewed Billings Clinic's current presence in western Montana. After conducting this review, we determined that the proposed transaction would not substantially lessen competition in the CMC primary and secondary service areas, as well as the western Montana region as a whole.

VII. RESERVATION OF THE ISSUE OF DISPOSITION OF CHARITABLE ASSETS FOR FURTHER REVIEW BY THIS OFFICE

The Attorney General's approval of the proposed transaction, as outlined in this letter, reflects only an approval for the underlying sale of CMC's assets. However, it expressly excludes approval for CMC's proposed disposition of charitable assets to one or more qualifying nonprofit entities or charitable trusts. The Attorney General received CMC's formal proposal regarding the disposition of its charitable assets on December 15, 2014. The Attorney General has not had adequate time to review this proposal nor to receive requested information from CMC to address questions and concerns raised by this office. Additionally, the public has not been afforded adequate time to review the proposal and provide public comment. Therefore, by agreement between the Attorney General and CMC, the Attorney General's review of the proposed disposition of CMC's charitable assets, including the sale proceeds, will continue for a period of time to ensure that CMC's charitable assets will be transferred to one or more charitable organizations that will use the assets consistent with the charitable mission of Community Medical Center and in the same geographic region or service area.

Sincerely,

TIMOTHY C. FOX
Attorney General of the State of Montana

c: Joel L. Kaleva