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Attorney General

Report on the Proposed Joint Venture between Portage Health and Lifepoint

November 27, 2013

STATE OF MICHIGAN
DEPARTMENT OF ATTORNEY GENERAL

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I have reviewed the proposed joint venture between Portage Health and Lifepoint Holdings 2, LLC, a subsidiary of Lifepoint Hospitals. I approve the transaction.

The Attorney General has a unique responsibility over charitable assets. Recognizing this, the parties conditioned the transaction on my approval. As in past hospital transactions, I convened an internal review team to consider the reasons for the transaction and its fairness, and to ensure the protection of charitable assets and interests. We examined documents and interviewed relevant persons. We accepted comments from the public and from government officials.

I also required Lifepoint to fund a valuation expert to work at my direction. I directed the expert to review the adequacy of the consideration, the fairness of the transaction process, and the fairness of the proceeds to the charitable foundation.

My review is now complete. Portage's board of directors had sound reasons both for the transaction and for choosing Lifepoint. In forming a joint venture with Lifepoint, Portage Health is proactively responding to the changes in the healthcare industry resulting from federal healthcare reform. With this joint venture, local ownership of the hospital will continue as the Portage Foundation will hold a 20% ownership interest; the Foundation will also have 50/50 governance of the hospital with Lifepoint.

In consideration for the hospital's 80% ownership interest, the Portage Foundation will receive roughly $40 million of the cash proceeds to benefit the healthcare needs of the local community. Based on the review of my valuation expert, I conclude that Portage Health received fair market value for its assets. Portage Health also negotiated several other satisfactory terms, including a $60 million capital commitment, and the addition of cardiology and psychiatry services.

To ensure that Lifepoint adheres to its post-closing promises, I am requiring an independent firm—chosen by me—to monitor these promises for the next ten years.

The attached report more fully explains our review process and my reasons for approving the transaction.

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Table of Contents

I. Introduction

Under Michigan law, the Attorney General represents the public in protecting charitable interests, which include the state's nonprofit hospitals. In August 2013, Lifepoint Hospitals and Portage Health agreed to form an 80/20 joint venture to run the hospital and its affiliated facilities. Recognizing the Attorney General's authority in this area, the parties requested the Attorney General's review and approval before closing.[1] This report discusses the general terms of the sale and the review process; it also explains the findings that support the Attorney General's approval.

A. Transaction Overview

The terms of the transaction are detailed in the Contribution Agreement.[2] Significant terms include:

1. Portage Health will contribute its hospital assets and related healthcare assets to the joint venture in exchange for a 20% membership interest in the joint venture;[3] [Contribution Agreement, §§ 2.1 and 2.2]

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[1] For the Attorney General's authority over charitable assets and interests, see Appendix A.

[2] The Attorney General has posted the Contribution Agreement and many other important transaction documents for the public's review at www.michigan.gov/portage.

[3] At closing (or shortly thereafter), Portage Health intends to assign its 20% membership interest in the joint venture to the Portage Foundation. See Assignment Agreement at www.michigan.gov/portage. Thus, the Portage Foundation will be the 20% member of the joint venture with Lifepoint; the Foundation will also share 50/50 governance of the joint venture with Lifepoint.

2. Lifepoint will contribute $40 million[4] in cash consideration to the joint venture in exchange for an 80% membership interest in the joint venture; [Id., §§ 2.1 and 2.2]
3. The joint venture will spend $60 million in capital improvements over ten years; [Id., § 9.10]
4. The joint venture will offer employment to current employees; [Id., § 9.1]
5. The joint venture will continue core services for at least ten years; [Id., § 9.12]
6. The joint venture will establish cardiology and psychiatric services; [Id., §§ 9.17 and 9.18]
7. The joint venture will continue Portage Health's charity care policy; [Id., § 9.9] and
8. Lifepoint will not sell the hospital for at least ten years. [Id., § 9.16]

B. <u>Review Process</u>

In March 2013, the Attorney General assembled a team to review the proposed transaction.[5] The Attorney General also required the parties to pay for a valuation expert to work at the Attorney General's exclusive direction. The

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[4] The $40 million cash contribution will be adjusted at closing based on Portage Health's finances at closing. For details on this adjustment, see Contribution Agreement, ¶ 2.1; see also Exhibit 3, Cain Brothers' Report, pp. 2 and 25. Portage Health intends to transfer the transaction proceeds to the Portage Health Foundation, which will use the proceeds for charitable, healthcare-related purposes.

[5] The Attorney General's team included Chief Deputy Attorney General Carol Isaacs, Consumer and Environmental Protection Bureau Chief Bob Ianni, and members of the Corporate Oversight Division, Consumer Protection Division, and Charitable Trust Section.

Attorney General chose Cain Brothers to value Portage's assets, to examine the transaction process, and to consider the fairness of the consideration.[6]

The Attorney General's team focused on the due diligence of Portage's board of trustees and on the overall fairness of the transaction. More specifically, the review team considered these questions:

1. Why is Portage Health forming a joint venture with Lifepoint?
2. How did Portage Health search for a partner?
3. Was the process fair?
4. Why did Portage select Lifepoint?
5. Did Portage obtain fair market value for its charitable assets?
6. Will the joint venture continue charitable care and core services?
7. What does the public think of the transaction?
8. How will the Foundation change as a result of the transaction?
9. How will the Post-Closing Covenants be monitored?

Section II., below, answers these questions.

[6] The Attorney General requested bids from multiple valuation experts and ultimately chose Cain Brothers—a nationally recognized valuation firm. For a copy of the Cain Brothers expert contract, see www.michigan.gov/portage. For Cain Brothers' valuation report and fairness opinion, see Exhibits 3 and 4.

II. Findings

A. Why is Portage Health forming a joint venture with Lifepoint?

Federal healthcare reform is changing the regulatory environment for hospitals. These changes are impacting the entire healthcare industry—and particularly small, independent hospitals. In short, Portage Health is forming a joint venture with Lifepoint to assist it in meeting the challenges of the evolving healthcare industry so that the hospital can preserve quality medical services—and even expand these services—for the local community.

1. *Brief History*

Portage Health was founded as St. Mary's Hospital in 1896. In 1904, the Sisters of St. Joseph of Carondelet opened a larger hospital, which took the name St. Joseph's Hospital. In the 1970s, the sisters transferred the hospital to the community. The hospital was renamed several times before taking its present name, Portage Health, in 1995. The current facility was completed in 2000.

2. *Reasons Portage began seeking a buyer or other affiliation*

Roughly three years ago, Portage Health's board of directors and senior management foresaw that federal healthcare reform would challenge their hospital in several ways, including:

- downward pressure on reimbursement rates from government payors and commercial insurers;
- increased costs to comply with the new regulations;
- difficulty in recruiting physicians; and

- new capital costs for electronic medical records and information technology.[7]

Rather than wait for these changes to gradually erode their financial stability, Portage began considering an affiliation, merger, or asset sale. From Portage's perspective, exploring a transaction from a position of relative financial strength (Portage has no pension liabilities and has been profitable in recent years) improved its negotiating position. And if the terms of any proposed transaction were unsatisfactory, Portage could continue on its own until it received a better offer.

B. How did Portage Health search for a partner?

In February 2012, Portage sent a letter to Marquette General and three other hospital systems to determine their interest in a possible affiliation with Portage. Portage was dissatisfied with the response. (At the time, and unbeknownst to Portage, Marquette General was already pursuing its own transaction, which it completed in August 2012 with its sale to Duke Lifepoint.) Soon thereafter, Portage hired Juniper Advisory, an independent investment banking firm from Chicago that specializes in hospital mergers and acquisitions. Juniper educated Portage's board of directors on the possibilities. The board instructed Juniper to conduct a competitive, market-clearing process to find a partner.

[7] Over the last year, the Department has reviewed or has been advised of several proposed hospital transactions. With each, the seller hospital has advised the Department that a key factor motivating its transaction was the uncertainty resulting from the changes to the nation's healthcare laws. The Department's discussions with its experts confirm that this is a legitimate concern throughout the industry.

Juniper contacted thirty-one hospitals and hospital systems, including university hospitals, Michigan-based systems, regional and national systems, and both for-profits and nonprofits. Twelve expressed interest. Four submitted bids, with each proposing various transaction structures. The four bidders included for-profit Lifepoint, another for-profit system, a nonprofit system, and a for-profit joint venture between a regional and national system.

Portage's board selected Lifepoint and the for-profit joint venture as the two finalists. Each finalist visited Portage Health. Juniper asked each finalist to revise its bid and to focus on a joint-venture transaction with Portage Health. The finalists revised their bids, clarified terms, and increased consideration. Ultimately, Portage's board unanimously chose Lifepoint to form an 80/20 joint venture.

C. Was the process fair?

A fair market process is the best way to obtain value for a hospital's assets. To test the fairness of Portage's process, the Attorney General:

- interviewed Portage board members and executives;[8]
- requested and examined documents;[9] and
- hired valuation expert Cain Brothers—funded by the parties and ***not*** the taxpayer—to review the process and evaluate the consideration received.

The Attorney General concludes that the transaction process was fair.

[8] For a list of those interviewed, see Appendix B.

[9] See Appendix C.

D. Why did Portage select Lifepoint?

Portage reviewed the final bids to determine which would best achieve its transaction goals of preserving and expanding quality healthcare services, providing access to capital, finding a partner willing to make a long-term commitment to the community and hospital employees, preserving local control through a joint venture, and maximizing consideration for the local foundation.

Several factors weighed in Lifepoint's favor: Lifepoint was the only bidder willing to expand local services; Lifepoint evidenced an expertise in operating rural hospitals and a commitment to quality (through its relationship in all Lifepoint hospitals with Duke University Health System); and Lifepoint already had a relationship with Marquette General (where Portage already sends many of its patients). Lifepoint also offered comparable consideration to the local foundation, a $60 million capital commitment (twice as large as the other bidder), and 50/50 governance in the joint venture. Portage's board unanimously determined that Lifepoint's bid met its transaction goals and was superior to the other bids received.

E. Did Portage obtain fair market value for its charitable assets?

The Attorney General retained valuation expert Cain Brothers to verify that Portage received fair consideration for its charitable assets. Based on a review of

Cain Brothers' report and consultation with Cain Brothers, the Attorney General concludes that Portage received fair consideration.[10]

Cain Brothers used two conventional valuation methods to value Portage's assets: (1) public market valuation, and (2) comparable transactions. Those methods revealed a range of fair market value between $35.8 million and $44.8 million. Cain Brothers calculated the total consideration to be $45.3 million, and thus slightly more than the range of fair market value. Cain Brothers also concluded that Juniper, in guiding Portage through the transaction, completed a comprehensive auction process; such a process is generally recognized as the best way for a seller to obtain fair market value. For these reasons, Cain Brothers concluded that the consideration was fair to Portage.

At closing, Lifepoint will contribute roughly $40 million[11] in cash to the joint venture; in exchange, Lifepoint will receive 80 units of ownership in the joint venture. Shortly following closing, and once certain liabilities have been paid, the joint venture will distribute the remaining cash proceeds to the Portage Foundation.[12] It is expected that cash proceeds to the Portage Foundation will be between $35 and $40 million. The Portage Foundation will also receive 20 units (of

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[10] Cain Brothers' fairness opinion report and letter are available as Exhibits 3 and 4 at www.michigan.gov/portage.

[11] For explanation of how the precise amount is determined, see footnote 3, above.

[12] See Contribution Agreement, ¶ 2.1; see also Assignment Agreement at www.michigan.gov/portage.

the total 100 units) of ownership of the joint venture and 50/50 governance of the joint venture.

Given Cain Brothers' analysis and conclusion regarding the consideration to be received by Portage, the Attorney General concludes that the amount proceeding to the Portage Foundation is fair.

F. Will the joint venture continue charitable care and core services?

Yes. The Contribution Agreement requires the joint venture to maintain Portage's charitable care policy and to continue core services.[13] This provides an important service to the public.

G. What does the public think of the transaction?

The Attorney General hosted a public forum on September 23, 2013 in Houghton to allow the public to comment on the transaction.[14] Ten individuals commented; none opposed the transaction.

The Attorney General also accepted public comment by mail or email. The Attorney General received two emails from individuals expressing concern about the entry of for-profit Lifepoint into the Upper Peninsula healthcare market.

[13] See Section 9.9 of the Contribution Agreement at www.michigan.gov/portage. For Portage's current charitable care policy, see Exhibit 9.9 of the Contribution Agreement at www.michigan.gov/portage. There is no end date to the joint venture's promise to maintain Portage's charitable care policy, though the policy may be changed as necessary to comply with applicable legal requirements. For continuation of core services, see Section 9.12 of the Contribution Agreement.

[14] For a full transcript of the public forum, see www.michigan.gov/portage.

The Attorney General's review team met with Hancock City Manager Glenn Anderson and Mayor Bill Laitila. Both expressed support for the transaction and reiterated that support at the public forum.

H. How will the Foundation change as a result of the transaction?

Because the hospital will be for-profit after the transaction, the Portage Health Foundation can no longer support the hospital with its charitable funds. Thus, the Attorney General also reviewed and approved a modification of the Foundation's articles of incorporation and by-laws and required the Foundation to sign a Protection of Charitable Assets Agreement.[15] This Agreement limits the Foundation's use of the proceeds it received from this transaction to charitable, healthcare-related purposes; and it requires the Foundation to obtain the Attorney General's approval before altering the Foundation's charitable purpose.

I. How will the Post-Closing Covenants be monitored?

In past hospital transactions, the Attorney General has required monitoring and enforcement of the buyer's post-closing covenants. This transaction is no different. As detailed in the Monitoring, Compliance, and Enforcement Agreement,[16] the Attorney General is requiring Lifepoint to annually report to the

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[15] For Portage Health Foundation's articles of incorporation and by-laws, see www.michigan.gov/portage. For restrictions on the use of the Foundation's charitable funds, see Exhibit 2, Protection of Charitable Assets Agreement at www.michigan.gov/portage.

[16] See Exhibit 1, at www.michigan.gov/portage. See also Exhibit 2, Protection of Charitable Assets Agreement.

Attorney General regarding the status of its post-closing covenants. Moreover, the Attorney General is requiring Lifepoint to fund an independent monitor—chosen by the Attorney general—to review annually the performance of the post-closing covenants and verify compliance. If the Monitor finds non-compliance, Lifepoint is required to set aside funds for a potential enforcement action brought by the Attorney General; if Lifepoint cures its non-compliance in a timely manner, the funds revert to Lifepoint. Monitoring will continue for ten years.

III. Conclusion

The Attorney General and his expert, Cain Brothers, have thoroughly reviewed the proposed transaction. In forming a joint venture with Lifepoint, Portage Health is proactively adapting to the changes in the healthcare industry resulting from federal healthcare reform. By affiliating with Lifepoint now, and from a position of relative financial strength, Portage Health has retained a 20% membership interest, has preserved local control through a 50/50 governance arrangement, has generated roughly $40 million for the Portage Foundation, and has obtained a $60 million capital commitment and a commitment to preserve and expand quality healthcare services in the local community.

Because the transaction properly protects the public interest, the Attorney General consents to the proposed charitable asset sale and joint venture.

IV. Appendix

A. The Attorney General's Authority

B. Individuals Interviewed

C. Documents Reviewed

Appendix A

The Attorney General's Authority

Supervision of Trustees for Charitable Purposes Act
The Supervision of Trustees for Charitable Purposes Act[1] empowers the Attorney General to protect charitable interests on behalf of the public.

Charitable Gifts Act
The Charitable Gifts Act[2] authorizes the Attorney General to enforce charitable trusts on behalf of the public and all indefinite and uncertain beneficiaries of charitable gifts. Also, the law liberally protects the intentions of charitable donors.

Revised Judicature Act
The Revised Judicature Act gives the circuit court power over corporate fiduciaries, including the power to remove corporate fiduciaries for abuses of trust.[3] The Attorney General may prosecute actions on behalf of the people.

Nonprofit Corporations Act
The Nonprofit Corporations Act allows the Attorney General to seek dissolution of a nonprofit organization that willfully exceeds its authority or otherwise acts fraudulently or unlawfully.[4] The law also prevents charitable assets from being used for noncharitable purposes.[5]

Common Law
The common law also recognizes the Attorney General's authority to protect charitable assets.[6] This authority is liberally construed.[7] The Attorney General's authority under common law also is derived from the *parens patriae* doctrine.[8]

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[1] MCL 14.251 *et seq.*
[2] MCL 554.351 *et seq.*
[3] MCL 600.3605.
[4] MCL 450.2821.
[5] MCL 450.2301.
[6] *See e.g.*, Restatement of Trusts (Third), § 94.
[7] *Michigan State Chiropractic Ass'n v Kelley*, 79 Mich App 789, 791 (1977) (citations omitted); see *also Attorney General v Michigan Public Service Commission,* 243 Mich App 487, 497 (2000), and *State of Mich ex rel Kelley v C.R. Equipment Sales, Inc,* 898 F Supp 509 (WD Mich, 1995); *Humphrey v Kleinhardt,* 157 FRD 404 (WD Mich, 1994).
[8] *Kelley v Carr*, 442 F Supp 346, 356 (WD Mich, 1977), *aff'd in part, rev'd in part*, 691 F2d 800 (CA 6, 1980).

Appendix B

Individuals Interviewed

James Bogan	Chief Executive Officer
Brian Donahue	Chief Financial Officer
Steve Zutter	Chairman of the Board of Directors
Dr. Wade Liston	Chief of Medical Staff, board member, physician
Dr. Bruce Trusock	Board member, physician
Kevin Store	Foundation Executive Director
Lennon Mattila-Hughes	Chair of Foundation Board of Directors
Glenn Anderson	City Manager of Hancock
Bill Laitila	Mayor of Hancock
William Carpenter	CEO, Lifepoint Hospitals

Appendix C

Documents Reviewed

Transaction Documents

Letter of Intent between Portage Health, Inc. and LifePoint Hospitals dated February 28, 2013
Contribution Agreement by and among Portage Health, Inc., Copper Country Apothecaries, Inc., and Portage Health Home Services, Inc., Portage Health Resources, Inc. as Sellers; LifePoint Holdings 2, LLC as LifePoint Sub and Portage Holding Company, LLC, as the Joint Venture
Contribution Agreement Exhibits (including LLC Agreement of Portage Holding Company, LLC)
Contribution Agreement Schedules

Portage Health, Inc. - Structure, History, and Policies

Articles of Incorporation
Bylaws
Organization Chart
Portage Health Administrative Policy, Conflict of Interest
Portage Health Administrative Policy, Gifts and Gratuities
Portage Health Business Services Policy, Self Pay Discount Policy
Portage Health Business Services Policy, Financial Assistance Services
Portage Health Business Services Policy, Payment Arrangement Policy
Portage Health Business Services Policy, Prompt Pay Discount Policy
Portage Health, Corporate Compliance, Code of Conduct
Portage Health Chronological History

Portage Health, Inc. – Sale Process

Narrative: Whole Hospital Joint Venture for Portage Health Inc., and LifePoint Hospitals; Submitted by Portage Health, Inc., September 5, 2013
Portage Health board meeting minutes, 2012 and 2013
Discussion materials prepared by Juniper Advisory, May 22, 2012 and June 19, 2012
Timelines, various (prepared by Juniper Advisory)
Selected Pages on Financial Situation and Value Estimate, Juniper Advisory, July 31, 2012
Information Memorandum, September 2012, sent to prospective partners
Juniper Advisory Instruction Letters, September 24, 2012
Responses to initial letters, October, 2012
Review of Proposals, Juniper Advisory, October 22, 2012
Juniper Advisory instruction letters to finalists, November 13, 2012
Finalist responses, December, 2012
Review of Finalist Proposals, Juniper Advisory, December 18, 2012
Materials related to Reverse Due Diligence travel, 2012

Portage Health, Inc. and Subsidiaries – Financial Information

Portage Health and Subsidiaries, Consolidated Financial Reports, June 30, 2008 through June 30, 2012
Forms 990: Portage Health, Inc., June 30, 2007 through June 30, 2012 Portage Health Home Services, June 30, 2008 through June 30, 2012 Portage Health Resources, Inc., June 30, 2008 through June 30, 2012

Other Documents

Portage Health Foundation, Article of Incorporation, Bylaws, IRS determination letter, and minutes of board meetings from April, 2012, through April, 2013
Portage Health Foundation proposals related to post-closing operations
Portage Health Home Services, Articles of Incorporation and Bylaws
Portage Health Resources, Articles of Incorporation and Bylaws

V. Exhibits

1. Monitoring, Compliance, and Enforcement Agreement
2. Protection of Charitable Assets Agreement
3. Cain Brothers Fairness Opinion Report
4. Cain Brothers Fairness Opinion Letter

Exhibits are posted at www.michigan.gov/portage.