

**EVALUATION OF THE CERTIFICATE OF NEED APPLICATION SUBMITTED ON
BEHALF OF COMMUNITY HEALTH SYSTEMS, INC PROPOSING TO PURCHASE
DEACONESS MEDICAL CENTER LOCATED IN SPOKANE COUNTY**

PROJECT DESCRIPTION

Deaconess Medical Center (“Deaconess”) is currently owned and operated by Empire Health Services (“EHS”), a not-for profit multi-service healthcare system providing inpatient and outpatient services to the Spokane communities and eastern Washington, as well as the neighboring states of Idaho and Montana, and bordering Canadian provinces. [Empire Health Services website]

EHS owns and operates two acute care hospitals - Deaconess and Valley Hospital & Medical Center (“Valley”) - four urgent care clinics known as FirstCare Urgent Care Centers, Empire Health Consolidated services, and Health Providers Northwest. Also, in collaboration with Sacred Heart Medical Center and Holy Family Hospital, EHS participates in the joint venture known as Inland Northwest Health Services. [Websites for Empire Health Services, FirstCare Urgent Care Centers, and Inland Northwest Health Care Services; KPMG Report]

On January 11, 2008, two separate applications were submitted on behalf of Community Health Systems, Inc (CHS). One application proposed the purchase of Deaconess and the other to purchase Valley.

CHS is a for-profit parent corporation of two subsidiaries—CHS/Community Health Systems, Inc. and Community Health Investment Company, LLC. Neither CHS nor the two subsidiaries are incorporated in Washington State. CHS or one of its subsidiaries owns, operates, or leases approximately 118 hospitals in 28 states. In October 2007, CHS created two more subsidiaries—Spokane Washington Hospital Company, LLC and Spokane Valley Washington Hospital Company, LLC. Both are incorporated in Delaware. Spokane Washington Hospital Company, LLC was created for the purpose of purchasing and operating Deaconess Medical Center; and Spokane Valley Washington Hospital Company, LLC was created for the purpose of purchasing and operating Valley. This evaluation will focus on the purchase of Deaconess and will reference Valley, FirstCare Urgent Care Centers, or Inland Northwest Health Services where necessary. [Deaconess Medical Center Application, p2 and Exhibit 1 and Valley Application, p2 and Exhibit 1; April 18, 2008, supplemental information, p3]

Deaconess is a 388-bed acute care hospital located at 800 West Fifth Avenue in Spokane, within Spokane County. Deaconess is currently a Medicare and Medicaid provider of acute care services to the residents of Spokane and surrounding areas. Deaconess currently holds a three-year accreditation from the Joint Commission that expires August 2009 and is designated as a level II trauma center by the Department of Health’s Office of Emergency Medical and Trauma Prevention. As previously stated, Deaconess is operated through EHS’ ten-member board of directors. [CN historical files]

Deaconess provides a variety of healthcare services to residents of eastern Washington, northern Idaho, western Montana, and northern Oregon. Deaconess provides the treatment of heart and vascular diseases, and cancer. Further, Deaconess operates services for mothers and their newborn babies through an intermediate care nursery with level II obstetric services as defined in

Washington Administrative Code 246-310-020(1)(d)(i)(B). If purchased by CHS, the new owners of Deaconess will continue participation in both the Medicare and Medicaid programs, and maintain all essential services currently offered by the hospital. The hospital would continue to operate under the name of Deaconess Medical Center. [Application, Exhibit 4; April 18, 2008, supplemental information, Attachment 1 & 2, Exhibit; KPMG Report]

The estimated capital expenditure for the purchase of both hospitals is \$147,752,920; of that amount, \$112,843,560 is related to the purchase of Deaconess. [April 18, 2008, supplemental information, Attachments 2 & 3]

APPLICABILITY OF CERTIFICATE OF NEED LAW

This project is subject to Certificate of Need (CN) review because it is the purchase of an existing hospital under Revised Code of Washington (RCW) 70.38.105(4)(b) and Washington Administrative Code (WAC) 246-310-020(1)(b).

CRITERIA EVALUATION

To obtain Certificate of Need approval, CHS must demonstrate compliance with the criteria found in WAC 246-310-210 (need); 246-310-220 (financial feasibility); 246-310-230 (structure and process of care); and 246-310-240 (cost containment).¹

APPLICATION CHRONOLOGY

November 9, 2007	Letter of Intent Submitted
January 11, 2008	Application Submitted
January 12, 2008 through May 11, 2008	Department's Pre-Review Activities <ul style="list-style-type: none">• 1st Screening - March 5, 2008; Responses Received – April 18, 2008• 2nd Screening - May 12, 2008; Responses Received – May 22, 2008
May 12, 2008	Department Begins Review of the Application
June 26, 2008	End of Public Comment <ul style="list-style-type: none">• Public hearings conducted June 25 & 26, 2008
July 14, 2008	Rebuttal Documents Submitted to Department
September 10, 2008	Department's Anticipated Decision Date
August 20, 2008	Department's Decision Date

AFFECTED AND INTERESTED PERSONS

Throughout the review of this project, one entity sought and received affected person status under WAC 246-310-010—Providence Health and Services. Providence Health and Services in Spokane and NE Washington is a regional delivery network of organizations offering healthcare through its hospitals, extended care facilities, home health, adult day health, and assisted living facilities. Providence Health and Services operates Sacred Heart Medical Center and Holy

¹ Each criterion contains certain sub-criteria. The following sub-criteria are not discussed in this evaluation because they are not relevant to this project: WAC 246-310-210(1), (3), (4), (5), (6) and WAC 246-310-240(2) and (3).

Family Hospital - both located in Spokane County - and participates with EHS in the joint venture known as Inland Northwest Health Services.

Those who sought and received interested persons status are listed below.²

- Northwest Health Law Advocates—a healthcare advocacy group located in Seattle;
- Rockwood Clinic—a physician-owned, multi-specialty group medical practice in Spokane; and
- The Spokesman Review—a widely read daily newspaper serving Washington’s Spokane County, Idaho’s Kootenai County, and surrounding Washington and Idaho communities.

SOURCE INFORMATION REVIEWED

- CHS’s Certificate of Need Application submitted January 11, 2008
- CHS’s supplemental information dated April 18, 2008
- CHS’s supplemental information dated May 22, 2008
- Comments received at the Certificate of Need Program office until 7:00pm June 26, 2008
- Comments received at the Certificate of Need public hearings conducted in Spokane on June 25, 2008
- Comments received at the Certificate of Need public hearings conducted in Spokane Valley on June 26, 2008
- Comprehensive Hospital Abstract Reporting System (CHARS) data obtained from the Department of Health's Office of Hospital and Patient Data Systems
- Historical charity care data report and supplemental obtained from the Department of Health's program of Hospital and Patient Data Systems (2004, 2005, and 2006 summaries)
- KPMG Valuation Report received June 23, 2008³
- Financial feasibility and cost containment evaluation prepared by the Department of Health's Office of Hospital and Patient Data Systems received June 30, 2008
- Population data obtained from the Office Financial Management based on year 2000 census published November 2007
- Licensing and/or survey data provided by the Department of Health's Office of Health Care Survey
- Quality of care surveys for the healthcare facilities owned and/or operated by CHS throughout the United States
- Data obtained from the internet regarding Community Health Systems (www.chs.net)
- Data obtained from the internet regarding Empire Health Services (www.empirehealth.org)

² A number of persons and entities submitted comments regarding this project; however, only those listed sought and received affected or interested person status under the definition in rule.

³ KPMG LLP, is a United States audit, tax, and advisory services firm that operates from 87 offices with more than 23,000 employees and partners throughout the US. KPMG LLP is a member firm of KPMG International, a Swiss cooperative. The member firms of the KPMG International network have 113,000 professionals, including more than 6,800 partners, in 148 countries. [source: KPMG website] For this project, the department contracted with KPMG, LLP to provide a fair market value of the assets of Empire Health Services as of April 30, 2008.

CONCLUSION

For the reasons stated in this evaluation, the application submitted by CHS / Spokane Washington Hospital Company, LLC proposing to purchase Deaconess Medical Center is consistent with applicable criteria of the Certificate of Need Program, and a Certificate of Need should be issued provided the applicant agrees to the conditions stated below.

The approved capital expenditure for this project is \$112,843,560.

CONDITIONS

1. Within 45 days of finalizing the purchase of Deaconess Medical Center, Community Health System, Inc. will submit to the Certificate of Need Program for review and approval a final, executed Admission Policy. The final Admission Policy will be consistent with the draft policy provided in the application.
2. Within 60 days of finalizing the purchase of Deaconess Medical Center, Community Health System, Inc. will submit to the Certificate of Need Program an executed copy of a Department of Health's Hospital and Patient Data Systems program, approved Charity Care Policy.
3. Deaconess Medical Center will provide charity care in compliance with the charity care policies provided in this Certificate of Need application, or any subsequent policies reviewed and approved by the Department of Health. Deaconess Medical Center will use reasonable efforts to provide charity care in an amount comparable to or exceeding the average amount of charity care provided by hospitals in the Eastern Washington Region. Currently, this amount is 3.35% of adjusted revenue. Deaconess Medical Center will maintain records documenting the amount of charity care it provides and demonstrating its compliance with its charity care policies.
4. Community Health System, Inc. cites the following items as essential services for Deaconess Medical Center. These services will remain available at the hospital for a minimum of ten years.

24-Hour Emergency Care	Labor & Delivery
Cardiac Catheterization	Neonatal Intensive Care
Cardiovascular Surgery & CT Scanning	Mammography
Diagnostic Radiology	MRI Services
General Surgery	Nuclear Medicine
Inpatient Medical & Surgical Services	Outpatient Surgery
Intensive Care	Pharmacy
Lab Services	Therapy Services

If Community Health System determines that any of the listed essential services are to be discontinued, Community Health System will submit an amendment application, with all appropriate supporting documentation to modify this condition as required by (WAC 246-310-570(1)(d)).

A.Need (WAC 246-310-210)

Based on the source information reviewed, the department determines that the applicant has met the need criteria in WAC 246-310-210(2).

- (2) All residents of the service area, including low-income persons, racial and ethnic minorities, women, handicapped persons, and other underserved groups and the elderly are likely to have adequate access to the proposed health service or services.

Deaconess is currently a provider of health care services to residents of Washington State, including low-income, racial and ethnic minorities, handicapped and other underserved groups. As an acute care hospital, Deaconess also currently participates in the Medicare and Medicaid programs. To determine whether all residents of the service area would continue to have access to an applicant's proposed services, the department requires applicants to provide a copy of its current or proposed admission policy. The admission policy provides the overall guiding principles of the facility as to the types of patients that are appropriate candidates to use the facility and any assurances regarding access to treatment.

To demonstrate compliance with this sub-criterion, CHS provided a copy of its current Patient Rights and Responsibilities and its Non-Discrimination Policy that would also be used at Deaconess. The policy outlines the process/criteria that CHS will use to admit patients for treatment or care at the hospital. The policy also states that any patient requiring care will be accepted for treatment at Deaconess without regard to gender, age, disability, ethnicity, race, religion or source of payment. This policy is consistent with Deaconess' current policy [May 22, 2008 Supplemental Information, Attachment 1 & 2]

To determine whether low-income residents would have access to the proposed services, the department uses the facility's Medicaid eligibility or contracting with Medicaid as the measure to make that determination. To determine whether the elderly would have access or continue to have access to the proposed services, the department uses Medicare certification as the measure to make that determination.

Deaconess currently provides services to Medicare and Medicaid eligible patients. Documents provided in the application demonstrate that CHS intends to maintain this status. For this project, a review of the policies and data provided for Deaconess identifies the facility's financial resources as including both Medicare and Medicaid revenues [Application, p2 & Exhibit 11]

A facility's charity care policy should confirm that all residents of the service area including low-income, racial and ethnic minorities, handicapped and other underserved groups have, or would have, access to healthcare services of the applicant. The policy should also include the process one must use to access charity care at the facility.

CHS demonstrated its intent to continue to provide charity care to residents by submitting its proposed charity care policy that outlines the process a patient would use to access this service. Further, CHS included a 'charity care' line item as a deduction from revenue within the pro forma financial documents for Deaconess. [Application, Exhibits 7, 8 & 11]

For charity care reporting purposes, the Department of Health's Hospital and Patient Data Systems program (HPDS), divides Washington State into five regions: King County, Puget

Sound (less King County), Southwest, Central, and Eastern. Deaconess is located in Spokane County and one of 21 hospitals located within the Eastern Region. According to 2004-2006⁴ charity care data obtained from HPDS, Deaconess has historically provided significantly less than the average charity care provided in the region. Deaconess' most recent three years (2004-2006) percentages of charity care for gross and adjusted revenues are 0.83% and 1.97%, respectively. The 2004-2006 average for the Eastern Region is 1.36% for gross revenue and 3.35% for adjusted revenue. [HPDS 2004-2006 charity care summaries]

CHS's pro forma revenue and expense statements and proposed charity care policies indicate that the hospital will provide charity care at approximately 2.97% of adjusted revenue, which is slightly less than the average charity care provided in the region. RCW 70.38.115(2)(j) requires hospitals to meet or exceed the regional average level of charity care. [Application, Exhibit 11]

A review of the regions demographic information indicates that the proportion of adults in Spokane County who were uninsured increased from 10.4% in 1998 to 14.5% in 2006. Adults were 47% more likely to be uninsured in 2006 than in 1998. Further, Adults who were unemployed were 3.7 times more likely to be uninsured in 2006 as compared to 1998. If the proportion of uninsured adults continues to grow at a rate similar to the growth between 1998 and 2006, one could expect this would have a negative impact on the system that currently assists the uninsured in Spokane County. Hospitals, nationally and locally, are under increasing pressure to contain costs while providing high quality care, including Spokane County. In 2004, one out of every nine people was uninsured in Spokane County and medical providers delivered almost \$20 million in uncompensated care to the population. [KPMG report, pages 15 and 16]

Deaconess has historically provided significantly less charity care than the regional average. Because CHS does not propose to meet or exceed the regional average as identified above, a charity care condition for the hospital is necessary to approve the project.

1. Within 60 days of finalizing the purchase of Deaconess Medical Center, Community Health System, Inc. will submit to the Certificate of Need Program an executed copy of a Department of Health's Hospital and Patient Data Systems program, approved Charity Care Policy.
2. Deaconess Medical Center will provide charity care in compliance with the charity care policies provided in this Certificate of Need application, or any subsequent policies reviewed and approved by the Department of Health. Deaconess Medical Center will use reasonable efforts to provide charity care in an amount comparable to or exceeding the average amount of charity care provided by hospitals in the Eastern Washington Region. Currently, this amount is 3.35% of adjusted revenue. Deaconess Medical Center will maintain records documenting the amount of charity care it provides and demonstrating its compliance with its charity care policies.

⁴ Year 2007 charity care data is not available as of the writing of this evaluation.

With the applicant’s agreement to the conditions, the department concludes that all residents, including low income, racial and ethnic minorities, handicapped, and other under-served groups would have access to the services provided by the hospital. This sub-criterion is met.

B. Financial Feasibility (WAC 246-310-220)

Based on the source information reviewed, the department determines that the applicant has met the financial feasibility criteria in WAC 246-310-220(1), (2), and (3).

(1) The immediate and long-range capital and operating costs of the project can be met.

The estimated capital expenditure for the purchase of both hospitals is \$147,752,920; of that amount, \$112,843,560 is related to the purchase of Deaconess. [April 18, 2008, supplemental information, Attachments 2 & 3]

CHS is proposing to finance the acquisition of both hospitals through a combination of cash, internal cash flows, and borrowings under CHS’s existing line of credit with a consortium of lenders. The new debt will be structured as an unsecured inter-company loan to each of the hospitals at an interest rate of 8.25%. The hospitals will not be tied to a fixed loan repayment schedule; rather the interest and principal on the loan will be paid off by the excess cash flows generated by each hospital. [May 22, 2008, supplemental information, pp6-8; KPMG Valuation, p33]

KPMG reviewed the proposed capital investments CHS committed to provide to Deaconess as part of the purchase. Table 1 below provides a breakdown of the capital investments proposed for Deaconess following the first five years of ownership by CHS. [KPMG Report, p35]

**Table 1
Estimated Capital Investment at Deaconess Medical Center**

Year	Information Systems	Equipment	Building	Total
1	\$8, 000,000	\$5, 540,000	\$4,000,000	\$17,540,000
2	\$0.00	\$5,620,000	\$4,500,000	\$10,120,000
3	\$0.00	\$5,690,000	\$5,000,000	\$10,690,000
4	\$0.00	\$4,300,000	\$7,500,000	\$11,800,000
5	\$0.00	\$4,150,000	\$8,500,000	\$12,650,000
Total	\$8,000,000	\$25,300,000	\$29,500,000	\$62,800,000

KPMG also provided a debt service analysis based on CHS’ projected cash flows and beginning debt for the purchase of Deaconess. A summary of the KPMG analysis is shown in Table 2 on the following page. [KPMG Valuation, p37]

**Table 2
Deaconess Medical Center Debt Service**

	Projected Financials		
	2009	2010	2011
Free Cash Flow	\$(2,776,000)	\$10,524,000	\$12,310,000
Beginning Debt	\$98,423,000	\$106,892,000	\$105,113,000
Debt Reduction	\$0.00	\$1,779,000	\$3,794,000
New Debt	\$8,469,000	\$0.00	\$0.00
Ending Debt	\$106,892,000	\$105,113,000	\$101,319,000
Average Debt	\$102,658,000	\$106,003,000	\$103,216,000
Interest Paid	\$0.00	\$8,745,000	\$8,515,000
Interest Accrued	\$8,469,000	\$0.00	\$0.00

Based on CHS' pro forma statements, KPMG reported Free Cash Flows (excess cash flows generated after deducting working capital and capital expenditure requirements) for the Hospitals. Based on Tables 1 & 2 above, KPMG notes debt reduction by principal repayment occurs in year two of CHS ownership. Interest expense is also covered under available/excess cash flows. Deaconess is projected to incur significant amounts of capital expenditures through 2011. However, as the business stabilizes, capital expenditure requirements are expected to moderate after 2011. This results in increased free cash flows to pay down the debt obligation. [KPMG Report, p37]

Historical financial statements for Deaconess reveal that the hospital has struggled in recent years to remain financially viable. Most recently, Deaconess has experienced consecutive net losses in years 2004 through 2007. CHS acknowledges the net losses within the application and provided the projections shown below for the first three years of operation after the purchase. [Application, Appendices 11 & 13; HPDS analysis, p3]

**Table 3
Deaconess Projected Revenue and Expenses for Years 2009 through 2011**

	2009	2010	2011
# Admissions	12,622	12,892	13,165
# Patient Days	67,520	68,978	70,439
Gross Revenue	\$589,815,000	\$650,857,000	\$711,243,000
Deductions From Revenue *	\$356,206,000	\$403,114,000	\$449,416,000
Net Patient Billing	\$233,609,000	\$247,743,000	\$261,827,000
Other Operating Revenue	\$5,003,000	\$5,178,000	\$5,359,000
Net Operating Revenue	\$238,612,000	\$252,921,000	\$267,186,000
Operating Expense	\$237,202,000	\$248,318,000	\$260,327,000
Net Profit or (Loss)	\$1,410,000	\$4,603,000	\$6,859,000
Total Revenue per Patient Day	\$3,533.95	\$3,666.69	\$3,793.15
Total Expenses per Patient Day	\$3,513.06	\$3,599.96	\$3,695.78
Net Profit (Loss) per Patient Day	\$20.88	\$66.73	\$97.38

*Includes deductions for bad debt and charity care

CHS based its projections shown in Table 3 on the assumptions summarized below. [Application, p22]

- No change in the scope of services is assumed.
- Volumes are projected to increase at the rate of 2.1% annually (This is the actual rate projected by the Washington State Acute Care Bed Need Projection Methodology for Spokane providers over the period of 2007-2011).
- Capital investments [shown in Table 1 above] in the amount of \$62,797,011 are planned for the first five years.
- \$3,000,000 in investment in new physician recruitment will be made within the first three years
- Deductions from revenue have been assumed at 59-62% of gross charges.
- Charity care has been budgeted at the 2003-2005 regional average.
- Operating expenses have been assumed at 89-92% of net revenue.

With the assumptions above, CHS expects that the hospital will operate at a net profit beginning in the first full year after the purchase (2009). [HPDS analysis, p3]

To analyze short- and long-term financial feasibility of hospital projects and to assess the financial impact of a project on overall facility operations, the department uses financial ratio analysis. The analysis, provided by the department’s HPDS, assesses the financial position of an applicant, both historically and prospectively. The financial ratios utilized are **1)** long-term debt to equity ratio; **2)** current assets to current liabilities ratio; **3)** assets financed by liabilities ratio; **4)** total operating expense to total operating revenue ratio; and **5)** debt service coverage ratio. If a project’s ratios are within the expected value range, the project can be expected to be financially feasible.

For Certificate of Need applications, HPDS compares the applicant’s projected ratios with the most recent year’s financial ratio guidelines for hospital operations. For this project, HPDS uses 2006 data for comparison.

HPDS also provided analysis to determine the financial health of Deaconess currently. The results show that the financial status is within the average range for community hospitals in Washington State. HPDS was able to use the 2003 through 2007 fiscal year end reports submitted to the Washington State Department of Health/Hospital and Patient Data, though the 2007 statewide ratios are not available. The ratio comparisons are shown below in Table 4. [HPDS analysis, p3; HPDS analysis supplemental, p1]

**Table 4
HPDS Projected Debt Ratios for CHS**

Category	Trend*	State 2006	Deaconess 5 yr Avg.	Projected Year 1	Projected Year 2	Projected Year 3
Long Term Debt to Equity	B	0.532	0.546	3.398	2.658	1.962
Current Assets/Current Liabilities	A	2.339	4.400	1.568	1.636	1.709
Assets Funded by Liabilities	B	0.420	0.425	0.806	0.766	0.711
Operating Exp. to Operating Rev.	B	0.959	0.986	0.994	0.982	0.974
Debt Service Coverage	A	5.030	5.325	2.164	2.688	3.199

*A is better if above the ratio, and B is better if below the ratio.

Deaconess has struggled in recent years to remain financially viable. HPDS notes that the ratios for Deaconess are similar to the 2006 statewide ratios. After evaluating Deaconess' historical and projected ratios above, staff from HPDS provided the following analysis. [HPDS analysis, p3]

“Every ratio in the table above of CHS for fiscal year end 2007 and every ratio for the first three years of Deaconess is worse than the state average for community hospitals in Washington State in 2006. ...Deaconess, with the promised cash infusion from CHS will be able to improve the ratios within a reasonable time.”

Based on the information above, the department concludes that the immediate and long-range operating costs of the project can be met and this sub-criterion is met.

(2) *The costs of the project, including any construction costs, will probably not result in an unreasonable impact on the costs and charges for health services.*

As stated in the project description section of this evaluation, CHS intends to maintain all current services at Deaconess after the purchase. As indicated in the projections in Table 3 and further demonstrated within the application, CHS does not intend to increase charges for health services to make a net profit in year three. CHS proposes to increase Deaconess' market share of patients by expending an additional \$62.7 million related to building and equipment to attract patients. Staff from HPDS compared the proposed costs for services after the purchase of Deaconess to the costs for services of existing hospitals. HPDS determined the costs and charges are reasonable and comparable. [HPDS analysis, p4]

Based on the information provided above, the department concludes that the cost of the project will not result in an unreasonable impact on the costs and charges for health services within the service area. This sub-criterion is met.

(3) *The project can be appropriately financed.*

The estimated capital expenditure for the purchase of both hospitals is \$147,752,920; of that amount, \$112,843,560 is related to the purchase of Deaconess. CHS is proposing to finance the acquisition of both hospitals through a combination of cash, internal cash flows, and borrowings under CHS's existing line of credit with a consortium of lenders. The new debt will be structured as an unsecured inter-company loan to the each of the hospitals at an interest rate of 8.25%. Under this structure, the hospitals will not be tied to a fixed loan repayment schedule. The interest and principal on the loan will be paid off by the excess cash flows generated by each hospital. [April 18, 2008 Supplemental Information, Attachments 2 & 3; May 22, 2008 Supplemental Information, p6-8; KPMG Report, p33]

KPMG, as depicted in Appendix A, notes that CHS' interest coverage ratio (EBITDA/interest expense) of 2.0x is below the industry median of 3.2x. This is mainly due to CHS being highly leveraged when compared to the industry, and a decline in operating EBITDA margins in 2007. CHS had approximately \$9.1 billion of total debt as of December 31, 2007. Reports show that CHS' liquidity as cash and cash equivalents in the amount of \$133 million, and an un-drawn revolving line of credit in the amount of \$714 million, which totals \$847 million as of December 31, 2007. KPMG also notes that the amount un-drawn by CHS on their revolving line of credit is greater than the estimated purchase price for EHS. [KPMG report, p33]

Review of the financial and utilization information show that the immediate and long-range capital expenditure as well as the operating costs can be met. Based on the information reviewed, the department concluded this sub-criterion is met.

C. Structure and Process (Quality) of Care (WAC 246-310-230)

Based on the source information reviewed, the department determines that the applicant has met the structure and process (quality) of care criteria in WAC 246-310-230(1), (2), (3), (4), and (5).

(1) A sufficient supply of qualified staff for the project, including both health personnel and management personnel, are available or can be recruited.

CHS states all Deaconess employees will be offered continued employment, including those on statutory family or medical leave or other short-term leave. Additionally, all privileges for medical staff members will continue. [Application, Exhibit 4, p39]

CHS intends to appoint a Board of Trustees to oversee the governance of the hospital. The 9-member Board of Trustees will be, at a minimum, the hospital's Chief Executive Officer, the Chief of Medical Staff, at least three doctors from the Deaconess medical staff and local community representatives. [Application, p42; Exhibit 4]

Based on documents provided in the application, the department determines this sub-criterion is met.

(2) The proposed service(s) will have an appropriate relationship, including organizational relationship, to ancillary and support services, and ancillary and support services will be sufficient to support any health services included in the proposed project.

CHS states "Empire and Deaconess have long-established and well functioning relationships with health and social service providers in the region. It is only through collaboration with these entities that Empire's goal of enhancing patient care is realized." The applicant continues, "Both CHS and the Applicant have every intention of continuing to work closely with these agencies and providers to the betterment of the community." CHS does not anticipate any new working relationships at this time but will consider additional relationships as opportunities arise. [Application, p27 & Exhibit 15]

The list of existing services contracted by Empire for Deaconess appears to cover all necessary ancillary and support services required for hospital operations. The department concludes that there is reasonable assurance that CHS will continue to maintain the necessary relationships with ancillary and support services to provide healthcare in the communities. Approval of this project would not negatively affect these relationships. This sub-criterion is met.

(3) There is reasonable assurance that the project will be in conformance with applicable state licensing requirements and, if the applicant is or plans to be certified under the Medicaid or Medicare program, with the applicable conditions of participation related to those programs.

CHS will continue to provide Medicare and Medicaid services at Deaconess to the residents of Spokane and surrounding communities. Deaconess contracts with the Joint Commission

to survey and accredit the quality of service provided. The Joint Commission lists Deaconess in full compliance with all applicable standards following the most recent on-site survey in August 2006.⁵

CHS or one of its subsidiaries owns, operates, or leases a total of 118 hospitals in 28 states. All 28 states were surveyed regarding the quality of services for facilities affiliated with CHS. As of July 8, 2008, 23 states (82%) responded covering 110 (93%) of the facilities affiliated with CHS. Of the 22 replies, Arkansas, Georgia, and Nevada did not provide any information on the hospitals in their respective states. The completed responses show that no substantial non-compliance issues were identified.

The department specifically requested CHS to provide detailed information regarding an ongoing investigation of CHS-affiliated facilities located in New Mexico. CHS provided the following excerpt from its Form 10-Q filed with the Securities and Exchange Commission on November 2, 2007.

“On February 10, 2006, we received a letter from the Civil Division of the Department of Justice [DOJ] requesting documents in an investigation they are conducting involving the Company [CHS]. The inquiry relates to the way in which different state Medicaid programs apply to the federal government for matching or supplemental funds that are ultimately used to pay for a small portion of services provided to Medicaid and indigent patients. These programs are referred to by different names, including ‘intergovernmental payments,’ upper payment limit programs,’ and ‘Medicaid disproportionate share hospital payments.’ The February 10 letter focused on our hospitals in 3 states: Arkansas, New Mexico, and South Carolina. On August 31, 2006, we received a follow up letter from the DOJ requiring additional documents relating to the programs in New Mexico and the payments to our three hospitals in that state. We have provided the DOJ with the requested documents. In a letter dated October 4, 2007, the Civil Division notified us that based on its investigation to date, it preliminarily believes that we and three of our New Mexico hospitals have caused the state of New Mexico to submit improper claims for federal funds, in violation of the Civil False Claims Act. The DOJ asserted that these allegedly improper claims and payments began in 2000 and may be ongoing, but provided no information about the amount of any improper claims or the possible damages or penalties it may seek. The DOJ has advised us that before it takes any adverse action, it is providing us with the opportunity to make a presentation demonstrating that no adverse action is warranted. We expect to make such a presentation to the DOJ before the end of this calendar year and will continue to cooperate with the government’s inquiry.”

After considering this DOJ investigation the department determined it focused on billing practices, not quality of care. Monetary sanctions might affect the financial resources of the applicant. The application indicates that CHS would make any DOJ required changes to maintain its Medicare and Medicaid certifications.

The Department of Health’s Office of Health Care Survey investigated two complaints against Deaconess in March, 2008. No deficiencies were identified pertinent to the

⁵ <http://www.qualitycheck.org>

complaint. There were unrelated deficiencies identified during this investigation. Deaconess submitted and implemented acceptable plans of correction. There were unrelated deficiencies identified during this investigation. Deaconess submitted and implemented acceptable plans of correction. The Department of Health's Office of Health Care Survey (OHCS) has completed four surveys at Deaconess since 2002.⁶ There was no adverse licensing action as a result of these surveys. [source: facility survey data provided by the Office of Health Care Survey]

Based on CHS's compliance history, there is reasonable assurance that the applicant would operate Deaconess in conformance with applicable state and federal licensing and certification requirements. This sub-criterion is met.

(4) The proposed project will promote continuity in the provision of health care, not result in an unwarranted fragmentation of services, and have an appropriate relationship to the service area's existing health care system.

The applicant states that continuity in the provision of health care will be accomplished with the purchase of Deaconess because it allows the facility to continue operating as a hospital in the city of Spokane.

Provisions in the Asset Purchase Agreement highlight CHS' intent or requirement to continue providing a sufficient level of healthcare in the community and therefore support continuity. According to the Agreement, for five years following the close of the transaction, CHS is not allowed to sell Deaconess without the consent of the new foundation. This restriction is subject to the following exceptions:

- Sale to an affiliate of CHS is permitted, pursuant to a tax-deferred exchange;
- Pursuant to a merger or acquisition of CHS or a substantial portion of CHS' assets or business; or
- Sale to a financing entity for the purposes of CHS financing.

The new foundation holds a right of first refusal to purchase Deaconess for the first ten years following close of the sale. [Application, Exhibit 4, p44]

With improved funding and upgrades to facilities, the hospitals may be in better position to expand services. CHS is contractually obligated to fund at least \$40 million of routine capital expenditures in both Deaconess and Valley over the five year period following closing. Over this same time period, CHS is obligated to fund \$60 million related to capital improvements within the hospitals. Capital expenditures may include new or replacement equipment, facility renovations, medical office space, development of new services, quality improvement programs, information systems and other capital improvements. [Application, Exhibit 4, p43]

Deaconess is a vital component of health care services in Spokane and the region. CHS has committed to provide the essential services currently available at the hospital. The department concludes the following condition is necessary.

⁶ Surveys completed October 4, 2002, September 30, 2004, March 24, 2006, & March 27, 2008.

Community Health System, Inc. cites the following items as essential services for Deaconess Medical Center. These services will remain available at the hospital for a minimum of ten years.

24-Hour Emergency Care
Cardiac Catheterization
Cardiovascular Surgery & CT
Scanning
Diagnostic Radiology
General Surgery
Inpatient Medical & Surgical
Services
Intensive Care

Lab Services
Labor & Delivery
Neonatal Intensive Care
Mammography
MRI Services
Nuclear Medicine
Outpatient Surgery
Pharmacy
Therapy Services

If Community Health System determines that any of the listed essential services are to be discontinued, Community Health System will submit an amendment application, with all appropriate supporting documentation to modify this condition as required by (WAC 246-310-570(1)(d)).

Provided that CHS agrees to this condition, the department concludes that CHS will continue to promote continuity in the provision of health care services in the community, and this sub-criterion is met

- (5) There is reasonable assurance that the services to be provided through the proposed project will be provided in a manner that ensures safe and adequate care to the public to be served and in accord with applicable federal and state laws, rules, and regulations.

This sub-criterion is addressed in sub-section (3) above.

D. Cost Containment (WAC 246-310-240)

Based on the source information reviewed, the department determines that the applicant has met the cost containment criteria in WAC 246-310-240 (1).

- (1) Superior alternatives, in terms of cost, efficiency, or effectiveness, are not available or practicable.

Within this application, CHS provided the background information related to the purchase of both Deaconess and Valley. EHS has struggled over the past seven years to remain financially viable as a stand-alone health system. In 2006, EHS determined it needed to generate more than \$100 million in cash for capital expenditures over the next five years. EHS was currently generating less cash flow than necessary to meet expenses, and cash balances declined to a point wherein EHS is in technical violation of certain debt covenants. An analysis performed by Cain Brothers in early 2007 demonstrated that EHS will remain below investment grade for the foreseeable future, and that significant additional tax-exempt debt is not an option. After significant analysis, EHS elected to sell to a financially strong organization. The EHS board made 29 direct contacts to potential buyers. This list was pared down to four finalists to participate in a “due diligence” process. At the end of the due diligence process, CHS was selected as the best option. CHS has submitted this certificate of

need application, along with a sister application to purchase Valley Hospital and Medical Center, on January 11, 2008. [Application, p6-10]

As part of the acquisition review, the department contracted with KPMG, LLP to provide a fair market value of the assets of EHS as of April 30, 2008. The KPMG valuation does not specifically reach any conclusions regarding whether this project is the best option for the community. However, it does provide relevant information to substantiate the financial difficulties expressed by EHS. [KPMG Report, p40 & p47]

CHS has committed to spend an additional \$100 million dollars, over five years, for capital investments related to items involving information systems, buildings, and equipment for both Deaconess and Valley. Initial estimates are that CHS will invest \$62.7 million towards Deaconess specifically. After this time frame, if applicable capital improvements total less than the \$100 million, the balance will be paid, upon demand, to the newly formed foundation. [Application, p20 & Exhibit 4, p43; & KPMG Report, p35]

On June 25 and 26, the department conducted two separate public hearings related to CHS's proposed purchase of Deaconess and Valley. Both public hearings were well attended by residents of the Spokane and Spokane Valley communities and surrounding areas. The majority of comments provided by those in attendance recognized the limited options facing EHS if it maintains ownership of both hospitals. [Written and oral comments provided by community members]

After reviewing the process undertaken by EHS to determine 'next steps', taking into consideration comments provided by the residents of the communities currently served by both Deaconess and Valley, and the valuation provided by KPMG, LLC, the department concludes that the sale of Deaconess to CHS is the best available alternative for the community. This sub-criterion is met.

APPENDIX A

Appendix A

Liquidity and debt structure of CHS in comparison to Industry

(In millions, except per share data)

Company Name:	UHS Universal Health Services	THC Tenet Healthcare Corp.	PSYS Psychiatric Solutions, Inc.	HMA Health Managem ent	LPNT Lifepoint Hospitals Inc.	HLS HEALTHS OUTH Corp.	AMSG AmSurg Corp.	Industry Median	CYH Community Health Systems,	DMC (Year 2011)	VHMC (Year 2011)
Credit Statistics											
EBITDA/Interest Expense	11.0x	1.8x	3.2x	2.5x	4.7x	1.4x	20.1x	3.2x	2.0x	3.5x	3.2x
EBITDA-CapEx/Interest Expense	6.3x	-0.2x	2.2x	1.5x	2.9x	1.2x	17.8x	2.2x	0.8x	2.3x	2.1x
Total Debt + Preferred/EBITDA	0.0x	6.4x	5.0x	5.9x	3.5x	7.9x	1.0x	5.0x	8.9x	3.4x	3.7x
Total Debt/Market Capitalization	0.0%	178.0%	64.4%	204.1%	89.8%	136.6%	24.4%	90%	262.5%	NA	NA
Capital Structure*											
Total Commercial Paper	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0x	0.0		
Total Revolving Credit	531.1	0.0	80.0	0.0	0.0	86.4	201.0	80.0x	0.0		
Total Term Loans	0.0	0.0	607.0	2,729.4	706.0	879.8	17.8	607.0x	5,965.0		
Total Senior Bonds and Notes	474.1	4,859.0	476.5	973.7	0.0	949.4	0.0	476.5x	76.6		
Total Subordinated Bonds and Notes	0.0	0.0	0.0	0.0	806.2	30.3	0.0	0.0x	3,021.3		
Total Trust Preferred	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0x	0.0		
Capital Leases (Incl. Current Portion)	6.5	2.0	0.0	61.1	5.2	108.2	3.8	5.2x	35.1		
Other Borrowings	0.0	0.0	8.5	0.0	0.0	0.0	0.0	0.0x	0.0		
Total Principal Due*	1,011.7	4,861.0	1,172.0	3,764.1	1,517.4	2,054.1	222.6	1,517.4	9,098.1	101.0	32.0
Undrawn Revolving Credit	424.9	564.0	213.0	520.0	318.6	303.5	99.0	318.6x	714.0		
Undrawn Commercial Paper	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0x	0.0		
Undrawn Term Loans	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0x	0.0		
Other Available Credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0x	0.0		
Total Undrawn Credit*	424.9	564.0	213.0	520.0	318.6	303.5	99.0	318.6	714.0	NA	NA

* Denotes financial data as of latest fiscal year.