

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

### **PROJECT DESCRIPTION**

Valley Hospital and Medical Center 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. [source: Empire Health Services website]

EHS owns and operates two acute care hospitals in Spokane County: Deaconess Medical Center and Valley Hospital and Medical Center. EHS also operates four urgent care clinics all 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 Valuation]

On January 11, 2008, two separate applications were submitted to the Certificate of Need Program on behalf of Community Health Systems, Inc (CHS). One application proposed the purchase of Deaconess Medical Center and the other to purchase Valley Medical Center (‘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. [source: Deaconess Medical Center Application, p2 and Exhibit 1 and Valley Application, p2 and Exhibit 1; April 18, 2008, supplemental information, pp3-4] This evaluation will focus on the purchase of Valley and will reference Deaconess Medical Center, FirstCare Urgent Care Centers, or Inland Northwest Health Services where necessary.

Valley is a 123 bed acute care hospital located at 12606 East Mission Avenue in Spokane Valley, within Spokane County. Valley is currently a Medicare and Medicaid provider of acute care services to the residents of Spokane Valley and surrounding areas. Valley currently holds a three-year accreditation from the Joint Commission that expires August 2009. As previously stated, Valley is operated through Empire Health Services’ ten-member board of directors. [source: CN historical files]

Services currently provided at Valley include acute care inpatient and outpatient services, a variety of therapies, ambulatory care, and general emergency services. If purchased by CHS, the new owners of Valley 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 Valley Hospital and Medical Center. [source: Application, Exhibit 4; April 18, 2008, supplemental information, Attachments 1 & 2, Exhibit E, and KPMG Valuation]

The estimated capital expenditure for the purchase of both hospitals is \$147,752,920; of that amount, \$34,909,360 is related to the purchase of Valley. [source: 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).<sup>1</sup>

### **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"><li>• 1<sup>st</sup> screening –March 5, 2008; responses received April 18, 2008</li><li>• 2<sup>nd</sup> screening May 12, 2008; responses received May 22, 2008</li></ul>
May 12, 2008	Department Begins Review <ul style="list-style-type: none"><li>• Public hearings conducted June 25 &amp; 26, 2008</li></ul>
June 26, 2008	End of Public Comment
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 Family Hospital—both located in Spokane County—and participates with Empire Health Services in the joint venture known as Inland Northwest Health Services.

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<sup>1</sup> 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).

Those who sought and received interested persons status are listed below.<sup>2</sup>

- 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**

- Community Health Systems’s Certificate of Need Application submitted January 11, 2008
- Community Health Systems’s supplemental information dated April 18, 2008
- Community Health Systems’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 hearing 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 obtained from the Department of Health's Office of Hospital and Patient Data Systems (2004, 2005, and 2006 summaries)
- KPMG Valuation Report received June 23, 2008<sup>3</sup>
- 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](http://www.chs.net))
- Data obtained from the internet regarding Empire Health Services ([www.empirehealth.org](http://www.empirehealth.org))

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<sup>2</sup> 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.

<sup>3</sup> 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 Community Health System, Inc. on behalf of Spokane Valley Washington Hospital Company, LLC proposing to purchase Valley Hospital and 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 \$34,909,360.

## **CONDITIONS**

1. Within 45 days of finalizing the purchase of Valley Hospital and 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 Valley Hospital and 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. Valley Hospital and 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. Valley Hospital and 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. Valley Hospital and 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 Valley Hospital and Medical Center. These services will remain available at the hospital for a minimum of ten years.

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

If Community Health System determines that any of the listed essential services are to be discontinued, Community Health System will submit an application, with all appropriate supporting documentation to modify the issued Certificate of Need.

**A. Need (WAC 246-310-210)**

Based on the source information reviewed, the department determines that the applicant has met the applicable 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.

Valley 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, Valley also currently participates in the Medicare and Medicaid programs. To determine whether all residents of the service area would continue to have access to a hospital'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 Valley. 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 Valley without regard to gender, age, disability, race, ethnicity, religion or source of payment. This policy is consistent with Valley's current policy. [source: May 22, 2008 supplemental information, Attachments 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.

Valley 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 Valley identifies the facility's financial resources as including both Medicare and Medicaid revenues. [source: Application, p2 and 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 Valley. [source: Application, Exhibits 7 & 8]

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

(less King County), Southwest, Central, and Eastern. Located in Spokane County, Valley is one of 21 hospitals in the Eastern Region. According to 2004-2006<sup>4</sup> charity care data obtained from HPDS, Valley has historically provided significantly less than the average charity care provided in the region. Valley's most recent three years (2004-2006) percentages of charity care for gross and adjusted revenues are 0.87% and 1.87%, respectively. The 2004-2006 average for the Eastern Region is 1.36% for gross revenue and 3.35% for adjusted revenue. [source: 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 2.91% of adjusted revenue, which is less than the average charity care provided in the region. [source: Application, Exhibits 11 & 12 and April 18, 2008, supplemental information, p11] RCW 70.38.115(2)(j) requires hospitals to meet or exceed the regional average level of charity care.

A review of the region's demographic information indicates 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. [source: KPMG valuation, pp15 & 16]

Valley 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 Valley Hospital and 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. Valley Hospital and 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. Valley Hospital and 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. Valley Hospital and Medical Center will maintain records documenting the amount of charity care it provides and demonstrating its compliance with its charity care policies.

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<sup>4</sup> 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, \$34,909,360 is related to the purchase of Valley. [source: 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. [source: May 22, 2008, supplemental information, pp6-8; KPMG Valuation, p33]

KPMG reviewed the proposed capital investments CHS committed to provide to Valley as part of the purchase. Table 1 below provides a breakdown of the capital investments proposed for Valley following the first five years of ownership by CHS. [source: Application, p20 and KPMG Valuation, p35]

**Table 1  
Estimated Capital Investment at Valley Hospital and Medical Center**

<b>Year</b>	<b>Information Systems</b>	<b>Equipment</b>	<b>Building</b>	<b>Total</b>
1	\$2,000,000	\$1,510,000	\$1,100,000	\$4,610,000
2	\$0.00	\$1,530,000	\$1,250,000	\$2,780,000
3	\$0.00	\$1,440,000	\$1,500,000	\$2,940,000
4	\$0.00	\$0.00	\$7,500,000	\$7,500,000
5	\$0.00	\$0.00	\$8,500,000	\$8,500,000
<b>Total</b>	<b>\$2,000,000</b>	<b>\$4,480,000</b>	<b>\$19,850,000</b>	<b>\$26,330,000</b>

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

**Table 2**  
**Valley Hospital and Medical Center Debt Service**

	<b>Projected Financials</b>		
	<b>2009</b>	<b>2010</b>	<b>2011</b>
Free Cash Flow	\$35,000	\$3,141,000	\$3,934,000
Beginning Debt	\$30,871,000	\$33,491,000	\$33,097,000
Debt Reduction	\$0.00	\$394,000	\$1,256,000
New Debt	\$2,620,000	\$0.00	\$0.00
Ending Debt	\$33,491,000	\$33,097,000	\$31,841,000
Average Debt	\$32,181,000	\$33,294,000	\$32,469,000
Interest Paid	\$35,000	\$2,747,000	\$2,679,000
Interest Accrued	\$2,620,000	\$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 Valley. Based on Tables 1 and 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. Valley 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 Valuation, p37]

Historical financial statements for Valley reveal that the hospital has struggled in recent years to remain financially viable. Most recently, Valley 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. [source: Application, Appendices 11 & 13; HPDS analysis, p3]

**Table 3**  
**Valley Medical Center's**  
**Projected Revenue and Expenses for Years 2009 through 2011**

	<b>2009</b>	<b>2010</b>	<b>2011</b>
<b># Admissions</b>	4,552	4,668	4,783
<b># Patient Days</b>	17,252	17,690	18,120
<b>Gross Revenue</b>	\$168,990,000	\$187,258,000	\$205,448,000
<b>Deductions From Revenue*</b>	\$104,560,000	\$118,662,000	\$132,705,000
<b>Net Patient Billing</b>	\$64,430,000	\$68,596,000	\$72,743,000
<b>Other Operating Revenue</b>	\$800,000	\$828,000	\$857,000
<b>Net Operating Revenue</b>	\$65,230,000	\$69,424,000	\$73,600,000
<b>Operating Expense</b>	\$65,101,000	\$68,459,000	\$71,927,000
<b>Net Profit or (Loss)</b>	\$129,000	\$965,000	\$1,673,000
<b>Total Revenue per Patient Day</b>	\$3,781	\$3,9224	\$4,060
<b>Total Expenses per Patient Day</b>	\$3,774	\$3,870	\$3,968
<b>Net Profit (Loss) per Patient Day</b>	\$7	\$55	\$92

\*Includes deductions for bad debt and charity care

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

- No change in the scope of services is assumed.
- Volumes are projected to increase at the rate of 2.5% annually (this is slightly higher than the actual rate of 2.1% projected by the Washington State Acute Care Bed Need Projection Methodology for Spokane providers over the period of 2007-2011), but more accurately reflects the history of Valley (the hospital) and the use rates of the Spokane Valley community.
- Capital investments in the amount of \$26,330,182 are planned for the first five years. [shown in Table 1 of this evaluation]
- \$600,000 in investment in new physician recruitment will be made within the first three years
- Deductions from revenue have been assumed at 59-64% of gross charges.
- Charity care has been budgeted at the 2003 – 2005 regional average.
- Operating expenses have been assumed at 89-91% 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). [source: 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 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 projected ratios with the most recent year's financial ratio guidelines for hospital operations. For this project, HPDS uses 2006 data for comparison. The ratio comparisons are shown below.

HPDS also provided analysis to determine the current (2007) financial health of Valley. The results show that Valley's financial health is very poor and well below the state averages. 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 in Table 4 on the following page. [HPDS analysis, p3; HPDS analysis supplemental, p1]

**Table 4  
Current and Projected HPDS Debt Ratios for Valley Hospital and Medical Center**

Category	Trend*	State 2006	Valley 5-Yr Avg	Projected Year 1	Projected Year 2	Projected Year 3
Long Term Debt to Equity	B	0.532	(2.383)	3.692	2.883	2.203
Current Assets/Current Liabilities	A	2.339	0.578	3.874	4.259	4.584
Assets Funded by Liabilities	B	0.420	1.176	0.799	0.756	0.722
Operating Exp. to Operating Rev.	B	0.959	1.005	0.998	0.986	0.977
Debt Service Coverage	A	5.030	2.768	2.166	2.611	3.090

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

Valley has struggled in recent years to remain financially viable. This is demonstrated in the debt service coverage ratio above. After evaluating Valley’s historical and projected ratios above, staff from HPDS provided the following analysis. [source: HPDS analysis, p3]

*“Every ratio in the table above is worse than the state average for community hospitals in Washington State in 2006. ...Valley Hospital with the promised cash infusion from CHS will be able to improve the ratios within a reasonable time. The hospital will be making a profit at the end of the first year.”*

Based on the information above, the department concludes that the immediate and long-range operating costs of the project can be 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 Valley 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 Valley’s market share of patients by expending an additional \$26.3 million related to building and equipment to attract patients. Staff from HPDS compared the proposed costs for services after the purchase of Valley to the costs for services of existing hospitals. HPDS determined the costs and charges are reasonable and comparable. [source: 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, \$34,909,360 is related to the purchase of Valley. [source: 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 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. [source: May 22, 2008, supplemental information, pp6-8; KPMG Valuation, p33]

KPMG, as depicted in Appendix A attached to this evaluation, notes that CHS's 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's 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. [source: KPMG Valuation, p33]

Review of the financial and utilization information shows 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 Valley 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. [source: Application, p39, Exhibit 4]

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

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 Valley 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. [source: Application, p27, Exhibit 15]

The list of existing services contracted by Empire for Valley 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 Valley to the residents of Spokane Valley and surrounding communities. Valley contracts with the Joint Commission to survey and accredit the quality of service provided. The Joint Commission lists Valley in full compliance with all applicable standards following the most recent on-site survey in August 2006.<sup>5</sup>

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*

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<sup>5</sup> <http://www.qualitycheck.org>

*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 (OHCS) has completed four surveys at Valley since 2002.<sup>6</sup> 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 the historical compliance history of CHS and Valley, there is reasonable assurance that the applicant would operate Valley 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 Valley because it allows the facility to continue operating as a hospital in the city of Spokane Valley.

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 Valley 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 Valley for the first ten years following closing of the sale. [source: 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. [source: Application, Exhibit 4, p43]

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<sup>6</sup> Surveys completed September 20, 2002, September 16, 2004, March 8, 2006, & February 21, 2008.

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

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

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

If Community Health System determines that any of the listed essential services are to be discontinued, Community Health System will submit an application, with all appropriate supporting documentation to modify the issued Certificate of Need.

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 and is met.

**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 Medical Center 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 Deaconess Medical Center, on January 11, 2008. [source: Application, pp6-10]

As part of the acquisition review, the department contracted with KPMG, LLP to provide a fair market value of the assets of Empire Health Services 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. [source: KPMG Valuation, 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 approximately \$26 million towards Valley. 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. [source: Application, p20 and Exhibit 4, p43 & KPMG Valuation, p35]

On June 25 and 26, the department conducted two separate public hearings related to CHS's proposed purchase of Deaconess Medical Center 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. [source: 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 Medical Center and Valley, and the valuation provided by KPMG, LLC, the department concludes that the sale of Valley 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)
<b>Credit Statistics</b>											
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
<b>Total Debt/Market Capitalization</b>	<b>0.0%</b>	<b>178.0%</b>	<b>64.4%</b>	<b>204.1%</b>	<b>89.8%</b>	<b>136.6%</b>	<b>24.4%</b>	90%	<b>262.5%</b>	NA	NA
<b>Capital Structure*</b>											
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		
<b>Total Principal Due*</b>	<b>1,011.7</b>	<b>4,861.0</b>	<b>1,172.0</b>	<b>3,764.1</b>	<b>1,517.4</b>	<b>2,054.1</b>	<b>222.6</b>	<b>1,517.4</b>	<b>9,098.1</b>	<b>101.0</b>	<b>32.0</b>
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		
<b>Total Undrawn Credit*</b>	<b>424.9</b>	<b>564.0</b>	<b>213.0</b>	<b>520.0</b>	<b>318.6</b>	<b>303.5</b>	<b>99.0</b>	<b>318.6</b>	<b>714.0</b>	NA	NA

\* Denotes financial data as of latest fiscal year.