



STATE OF WISCONSIN  
DEPARTMENT OF JUSTICE

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July 28, 2015

John P. Kosanovich  
Watertown Regional Medical Center  
125 Hospital Drive  
Watertown, WI 53098

Re: Application of Watertown Regional Medical Center for approval  
pursuant to Wis. Stat. § 165.40

Dear Mr. Kosanovich:

Watertown Regional Medical Center, Inc. (WRMC) has submitted an application to the Wisconsin Department of Justice pursuant to Wis. Stat. § 165.40 seeking approval for a proposed contribution of substantially all of its assets used in the operation of its hospital and related facilities to a newly formed for-profit joint venture owned and governed by WRMC and an indirect, wholly-owned subsidiary of LifePoint Health, Inc., a for-profit corporation.

For the reasons explained below, the Department approves the transaction.

## BACKGROUND

WRMC is a Wisconsin not-for-profit corporation. It owns and operates Watertown Regional Medical Center, a 95-bed acute care hospital in Watertown. It also owns and operates various primary care clinics, specialty care clinics, and senior housing campuses in Dodge and Jefferson Counties. LifePoint is a publicly-traded Delaware for-profit corporation that, through subsidiaries, operates 64 hospital campuses in 20 states.

After a lengthy evaluation process, the WRMC board of directors unanimously voted to enter into a joint venture with LifePoint. The terms are set forth in the May 13, 2015, Contribution Agreement by and among Watertown Regional Medical Center, Inc., Watertown Partner, LLC, and Watertown Holding Company, LLC as the Joint Venture. Under the terms of the contribution agreement, WRMC will contribute substantially all of its assets to the joint venture in return for a 20 percent ownership interest in the joint venture.<sup>1</sup> WRMC will receive a

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<sup>1</sup>WRMC will retain certain excluded assets and liabilities that will be used to defease its outstanding bonds and extinguish remaining debts and liabilities.

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\$30 million disbursement from the joint venture and warrants that entitle WRMC to purchase \$2 million of LifePoint's common stock. LifePoint also shall make capital contributions of \$73.7 million during the 10 years following closing.

The joint venture will be governed by an eight-person board. LifePoint, through a subsidiary, will appoint four board members. WRMC will appoint the other four. All actions of the governing board will require approval from a majority of the LifePoint governors and a majority of the WRMC governors. The contribution agreement also provides assurances that the hospital will continue to be operated in furtherance of WRMC's historic charitable purposes and for the benefit of the community.

Following the closing, WRMC has stated an intent to amend its articles of incorporation and bylaws to change its name to "Greater Watertown Community Health Foundation" and revise its purposes to monitor and enforce the covenants of LifePoint and the joint venture, hold the membership interest in the venture and serve as a member of the joint venture, and engage in various activities designed to promote the health of the Watertown community.

## **DEPARTMENT REVIEW PROCESS**

WRMC hand-delivered its application to the Wisconsin Department of Justice on May 29, 2015. As required by Wis. Stat. § 165.40(3)(a), the application included a copy of the contribution agreement and a financial and economic analysis and report by an independent consultant of the effect of the acquisition.

Pursuant to Wis. Stat. § 165.40(3)(c), the Department published a class 2 notice of the proposed transaction in the *Watertown Daily Times*, a newspaper of general circulation in Watertown, and notified by first-class mail all persons who had requested that the Department provide notice of hospital acquisition review applications. The notice set a June 23 deadline for written comments. No written comments were received.

On June 25, the Department held a public meeting at the Watertown City Hall. Presentations were made by John Kosanovich, the president and chief executive officer of Watertown Regional Medical Center; Jeff Baum, the chair of the Watertown Regional Medical Center Board of Directors; and Bill Carpenter, the chairman and chief executive officer of LifePoint Health, Inc. Following the presentations, all attendees had an opportunity to address the meeting and ask questions of the presenters. The meeting was transcribed. A copy of the transcript was mailed to the Watertown Public Library on July 7 and remains available for public inspection.

Following the public meeting, the Department conducted individual interviews with all current members of the WRMC board of directors, a representative of the investment banking

firm WRMC had retained, and staff from the independent entity that provided an opinion letter about the transaction. The Department also reviewed documentation related to the transaction that was made available at the office of WRMC's local counsel.

### **APPLICABLE LAW**

WRMC is a hospital owned by a not-for-profit corporation. The joint venture partner, LifePoint, Inc. is a for-profit corporation. Accordingly, the Department is required to review the application and approve it if all of the following standards are met:

That the acquisition is permitted under ch. 181 or any other statute that governs nonprofit entities.

That the hospital exercised due diligence in deciding to sell or lease, selecting the purchaser or lessee and negotiating the terms and conditions of the sale or lease.

That the procedure used by the seller or lessor in making its decision to sell or lease was adequate, including whether the seller or lessor used appropriate expert assistance.

That conflict of interest was disclosed, including conflicts of interest related to members of the board of directors of, executives of or experts retained by the seller or lessor, the purchaser or lessee or other parties to the acquisition.

That charitable funds are not placed at unreasonable risk, if the acquisition is a sale that is financed in part by the seller.

That any management contract under the acquisition is for reasonably fair value.

That the sale or rental proceeds will be used for appropriate charitable health care purposes, including health promotion, in the community affected by the acquisition and that the proceeds will be controlled as charitable funds independently of the purchaser or parties to the acquisition.

That, if the hospital is sold, a right of first refusal is retained to repurchase the assets by a successor nonprofit corporation, by the city county or state or by the University of Wisconsin Hospitals and Clinics Authority if the hospital is subsequently sold to, acquired by or merged with another entity.

## ANALYSIS

### **1. The acquisition is permitted under Wis. Stat. ch. 181**

If a corporation does not have members, a majority of the directors in office must vote to approve a sale of corporate assets. Wis. Stat. § 181.1202(3). The corporation must provide notice of the meeting that specifically states that the purpose or one of the purposes of the meeting:

is to consider the sale, lease, exchange or other disposition of all, or substantially all, of the property or assets of the corporation and contain or be accompanied by a copy of summary of a description of the transaction.

*Id.* The WRMC Board unanimously voted to select LifePoint as its partner at a meeting on March 25, 2015. The meeting was properly noticed.

Accordingly, the Department finds that the transaction is permitted under Wis. Stat. ch. 181.

- 2. WRMC exercised due diligence in deciding to sell, selecting the purchaser, and negotiating the terms and conditions of the sale or lease.**
- 3. WRMC used an adequate procedure to make the decision to enter into the transaction.**

The minutes of WRMC Board meetings reflect a reasonable and deliberative process at all points in the decision-making process. At each meeting, the Board received and reviewed reports on WRMC's financial condition and progress towards business goals. Periodically, it brought in consultants to apprise it of market trends affecting independent hospitals.

In interviews conducted by the Department, Board members described an increasing concern for the long-term viability of independent hospitals like WRMC. This was reflected by, among other things, significant declines in in-patient market share, outpatient market share, and market share for certain specialty care services. Documentation of these declines and Board discussions of potential responses appear throughout the minutes of Board meetings.

The Board first attempted to address the declines by pursuing a strategic partnership with a larger local non-profit organization. In pursuing this arrangement, the WRMC Board sought to preserve a level of local governance for WRMC, retain services in the Watertown community, and ensure that a significant portion of WRMC assets remained under the Board's control. The two groups entered into discussions that lasted approximately 18 months but were not able to reach an agreement.

After consulting legal counsel, the Board then interviewed two consultants and retained a Chicago-based investment banking firm with extensive experience in the community hospital market. WRMC engaged in a controlled competitive process designed to create a competitive environment. The initial process included:

1. The investment banking firm identified 23 potential strategic healthcare partners and sent instruction letters inviting them to submit non-binding indications of interest.
2. Of the 23 organizations contacted, seven not-for-profit and five for-profit entities executed confidentiality agreements and received a confidential information memorandum.
3. Of the 12 entities that received the confidential information memorandum, seven submitted first-round bids for WRMC. The first-round bids demonstrated a wide range of consideration and potential purchase structures.

After the first-round bids were received, the investment banking firm analyzed and summarized the proposals and presented them to the Board. The Board reviewed the proposals against previously identified criteria and selected four finalists – three not-for-profit entities and one for-profit entity. The investment banking firm then wrote to each finalist, inviting a second proposal specifically addressing the following issues:

- Cultural compatibility
- Creation of a sizeable local charitable foundation
- Recruitment, employment, and retention of physicians
- Governance
- Retention of current employees at the same salary and benefit levels
- Retention of current services
- Charity care
- Prohibition against resale

Representatives from each of the four finalists visited WRMC, met with management, toured the facilities, and made presentations to the Board. WRMC Board members, administrators, and medical staff also visited hospitals operated by each of the four finalists. WRMC continued to negotiate with each of the finalists after the second-round proposals were received.

At a properly noticed Board meeting, the WRMC Board unanimously selected LifePoint's proposal. LifePoint had proposed a whole hospital joint venture, with governance of the former WRMC assets jointly shared between LifePoint and WRMC representatives. Under this structure, WRMC will contribute substantially all of its operating assets to the joint venture.

In consideration, it will receive a 20 percent ownership in the joint venture, \$30 million, and \$2 million in LifePoint stock warrants. In addition, LifePoint has committed to making \$73.2 million in future capital investments and taking specific actions to address issues such as governance, retention of physicians and other staff, continuation of core services, provision of charity care, and resale of the facility.

Based on the review of the first-round and second-round proposals and documentation of subsequent negotiations with LifePoint, the Department finds that the WRMC Board was not unreasonable when it concluded that LifePoint's offer represented the best fit with its articulated goals.

The Department therefore finds that WRMC exercised due diligence in deciding to sell, selecting the purchaser, and negotiating the terms and conditions of the sale. The Department also finds that WRMC used an adequate procedure to make the decision to enter into the transaction.

**4. Any conflicts of interest were disclosed.**

WRMC's bylaws required members of the board of directors to identify and disclose potential and actual conflicts of interest. Two members of the WRMC Board were appointed by a potential acquiring partner. In June 2014, those Board members recused themselves from the vote to retain the investment banking firm and subsequently recused themselves from meetings discussing and votes on any portion of the process leading to the transaction. In March 2015, both resigned from the board of directors.

With the exception of the CEO, LifePoint has agreed to assume the existing employment, severance, and retention arrangements in place with WRMC's current senior management team. The Department makes no finding about whether this arrangement constitutes a conflict of interest for the members of the senior management team. In any case, this agreement was fully disclosed and is expressly set forth in the contribution agreement.

All members of the board of directors (including those appointed by the potential acquiring partner) were interviewed by the Department, as were key members of the WRMC leadership team. Aside from those noted above, none disclosed any conflict of interest, and the Department is aware of none.

The Department therefore finds that any conflicts of interest were disclosed.

**5. The transaction does not place charitable funds at unreasonable risk.**

WRMC is not financing the joint venture. Accordingly, the Department finds that charitable funds are not being placed at unreasonable risk.

**6. Management contracts under the transaction are for reasonably fair value.**

As part of the transaction, WRMC entered into a management agreement with a LifePoint subsidiary for management services on behalf of the joint venture entities. The services to be provided include management services and consulting on a variety of topics. In exchange for the management services, the joint venture entities have agreed to pay a management fee of 3.0 percent of net revenues accrued by the joint venture entities from operation of the business.

According to the independent consultant's report, comparable management fees in the hospital management industry range from 2.0 to 6.0 percent of net revenue. A management services fee of 3 percent is a standard term in LifePoint's joint venture agreements and was originally based on an analysis of its costs to provide management services to its joint ventures.

The Department therefore finds that the management contract under the transaction is for reasonably fair value.

**7. Sale proceeds will be used for appropriate charitable health purposes, and the proceeds will be independently controlled as charitable funds.**

Although the exact amount will not be determined until closing, WRMC will retain substantial financial assets after it defeases its bond debts and satisfies other liabilities. Following the transaction, the WRMC Board has stated its intent to change its name to the Greater Watertown Community Health Foundation and modify its bylaws to, among other things, focus on the broader health needs of the community. To that end, the WRMC Board has created a Foundation Formation Committee that has engaged an outside consultant and is currently developing the structure of the Foundation. The committee includes key WRMC Board members, including the City of Watertown Health Officer. After closing, the Foundation will be administered by a community board of directors that is independent of LifePoint and the joint venture.

The Department therefore finds that proceeds of the sale will be used for appropriate charitable health purposes and the proceeds will be independently controlled by the foundation as charitable funds.

**8. A successor non-profit corporation retains a right of first refusal to re-purchase assets.**

The Amended and Restated LLC Agreement provides:

As required under Section 165.40(4)(h) of the Wisconsin Statutes, WRMC shall have a right of first refusal during the thirty (30) days after receipt of ... notice [of any proposed transfer of the joint venture's interests or the hospital subsidiary's interests to a non-affiliated third party] in which to elect to acquire the Hospital on the same terms and conditions as set forth in such notice. Any sale of the Hospital by [the joint venture] or its subsidiaries in violation of this provision shall be void.

The Department therefore finds that the successor non-profit corporation retains a right of first refusal to re-purchase assets.

**CONCLUSION**

Based on the above findings, the application of Watertown Regional Medical Center filed with the Department on May 29, 2015, is approved.

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