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NOT-FOR-PROFIT HOSPITALS

Conversion Issues Prompt Increased State Oversight

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The Honorable Pete Stark
Ranking Minority Member
Subcommittee on Health
Committee on Ways and Means
House of Representatives

The Honorable William J. Coyne
Ranking Minority Member
Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Growing competition, spurred by the growth of managed care, and the need for capital investment are driving not-for-profit hospitals to sell to or establish joint ventures with for-profit companies. Between 1990 and 1996, national surveys estimated that 192 of the more than 5,000 not-for-profit hospitals in the United States converted to for-profit status. In 1996 alone, more than 60 not-for-profit hospitals converted to for-profit status. Not-for-profit hospitals have traditionally provided charitable community services, including uncompensated care for the uninsured and underinsured. In exchange for providing these community benefits, most not-for-profit hospitals have received financial benefits, such as exemption from federal, state, and local taxes and access to tax-exempt bond financing. In general, not-for-profit hospitals are viewed as charitable assets that belong to the community. Consistent with this perception, the proceeds from hospital conversions are generally directed to not-for-profit foundations or other charitable entities. Concerns have been raised about the potential loss of community benefits resulting from conversions as well as charitable entities' use of conversion proceeds for nonhealth-related activities. Issues have also been raised regarding public disclosure, including the extent of community involvement in the conversion transactions.

In response to these concerns, you asked that we review the process that some not-for-profit hospitals have used in converting to for-profit status. Specifically, we determined for selected conversions (1) the method used to value assets; (2) the process used to solicit interest and obtain bids; (3) some of the terms negotiated as part of the sales agreement, including provisions for continued charity care; (4) the extent of community involvement in the process; and (5) how the proceeds from some of the

sales were used to fulfill charitable missions. We also determined the role state and federal governments play in regulating and monitoring hospital conversions.

To identify recent conversions, we obtained a list of not-for-profit hospital conversions that occurred after 1990 from three major investor-owned corporations: Columbia/HCA Healthcare Corporation,[1] Quorum Health Group, and Tenet Healthcare Corporation. We selected six states and 14 sites in order to include the following: asset sales and joint venture transactions; states and sites with multiple conversions, conversions involving multiple investor-owned companies, or both; and transactions in which the proceeds were directed to foundations (see table 1). As part of our site visits, we interviewed hospital officials, attorneys who represented the not-for-profit hospitals, not-for-profit hospital board members, foundation presidents and board members, outside consultants hired to advise the not-for-profit hospitals, and attorneys in the state attorneys general offices. We also held discussions with officials of the Internal Revenue Service (IRS), Department of the Treasury, Federal Trade Commission (FTC), and Department of Justice; health care associations; interest groups; and investor-owned companies. In addition, for some of the conversions, we obtained and reviewed documents related to the transaction.

Further, for some of the conversions, we were not provided documentary evidence to support information we received through discussions with officials involved in or knowledgeable about the transactions. For example, although we requested purchase or partnership agreements, valuation estimates, and support for the amount of proceeds that resulted from the conversion, in most cases, neither the not-for-profit nor the for-profit parties involved in the conversion would provide a copy of their complete contractual agreement or documents to support valuation estimates or proceeds. Officials said that they could not provide documentation because of confidentiality agreements. However, we did obtain other documentation, including selected segments of contractual agreements to support terms negotiated, as well as other forms of documentation on purchase price for most of the transactions we reviewed.

In our review of the conversion process, we also determined what processes were used to value hospitals' assets and derive a final selling

[1]In Feb. 1994, Columbia merged with HCA to form Columbia/HCA Healthcare Corporation. The list of not-for-profit conversions we received from Columbia/HCA contains conversions for the merged entity.

price. We did not determine whether the hospitals were sold at fair market value. (See app. I for a detailed description of our objectives, scope, and methodology.) Our work was performed between October 1996 and November 1997 in accordance with generally accepted government auditing standards, except where noted above.

Table 1: Sites Visited

Not-for-profit hospital	For-profit company	Conversion type	Year
Alabama			
Baptist Memorial Hospital	Quorum Health Group	Asset sale	1993
Jacksonville Hospital (city-owned)	Quorum Health Group	Asset sale	1996
Lloyd Noland Hospital	Tenet Healthcare Corporation	Asset sale	1996
California			
Good Samaritan Health System	Columbia/HCA Healthcare Corporation	Asset sale	1996
Louisiana			
Mercy Baptist Medical Center	Tenet Healthcare Corporation	Asset sale	1995
Tulane University Hospital	Columbia/HCA Healthcare Corporation	Joint venture	1995
South Carolina			
Mary Black Memorial Hospital	Quorum Health Group	Asset sale	1996
Carolinas Hospital System	Quorum Health Group	Asset sale	1995
Hilton Head Hospital	Tenet Healthcare Corporation	Joint venture	1994
Tennessee			
Goodlark Regional Medical Center	Columbia/HCA Healthcare Corporation	Asset sale	1995
St. Francis Hospital	Tenet Healthcare Corporation	Asset sale	1994
Virginia			
The Arlington Hospital	Columbia/HCA Healthcare Corporation	Joint venture	1996
John Randolph Medical Center (public)	Columbia/HCA Healthcare Corporation	Asset sale	1995
The Retreat Hospital	Columbia/HCA Healthcare Corporation	Asset sale	1995

Note: Most of the information received from the investor-owned companies reflected conversions that occurred after 1993.

Results in Brief

The process of converting from a not-for-profit hospital to a for-profit hospital was similar among the transactions we reviewed. Most of the transactions were carried out between boards and executives of the selling hospitals and representatives of the for-profit purchasers and not routinely subject to public disclosure. A growing number of states are recognizing the public interest at stake and becoming more involved in overseeing the conversion process and reviewing terms of the conversion transactions.

Standard industry methodologies were used to estimate the value of the 14 not-for-profit hospitals we reviewed. These methodologies for valuing not-for-profit hospitals involve multiplying the hospitals' adjusted earnings by a variable, which in recent years has commonly been six, while also taking into account the value of comparable entities. In addition to obtaining valuation estimates, eight of the hospitals received multiple bids, and six accepted the highest bid. Reported purchase prices that the selling not-for-profit hospitals agreed to ranged from $16 million to $212 million. We did not determine the hospitals' fair market value. In negotiating the terms of the conversion, most hospitals reported including provisions for continued charity care and services in the agreement. The for-profit hospital or joint venture boards that resulted from the conversions are typically responsible for monitoring compliance with these agreements and ensuring that they are enforced. Except for members of the boards of directors, community involvement in conversion decisions was limited, with broader community involvement in only 5 of the 14 transactions.

Net proceeds reported from the conversions we reviewed totaled about $930 million. Of the 14 transactions we reviewed, 12 directed net proceeds to charitable foundations. Most of the foundations had broadly defined missions that primarily focused on health and wellness. At the time of our review, eight foundations had started awarding grants, including awards for disease prevention, cardiopulmonary resuscitation and first aid training, and long-term care. One foundation is not issuing grants but has used the proceeds to support an aerospace program; construction of an arts, education, and technology center; and other projects. The activities of the other two entities that received conversion proceeds, a university and a city, were directed to education, working capital needs, and the construction of facilities. Community input on the use of conversion proceeds was obtained through public forums and needs assessments in 6 of the 14 conversions.

In most states, attorneys general have authority to monitor and oversee hospital conversions through common law and not-for-profit corporation law. For nine of the conversions we reviewed, state attorneys general in five states (Alabama, California, South Carolina, Tennessee, and Virginia) exercised their authority to review the conversion process. Such a review can explore issues of valuation, conflicts of interest, and use of charitable proceeds. In one of these reviews, the attorney general ruled against a proposed use of charitable proceeds that would have benefited the new for-profit hospital. States are beginning to increase the authority of attorneys general through specific conversion legislation. However, at the time of conversion of the hospitals we reviewed, none of the six states had specific conversion legislation. As of August 1997, a total of 24 states (including 3 states in our review—California, Louisiana, and Virginia) and the District of Columbia had enacted legislation to address some conversion concerns, usually including public disclosure and community benefit. Some legislation allows a state official to review the terms of the deal and the direction of the charitable proceeds. In addition, a model act has been developed by two groups, Community Catalyst and Consumers Union, to assist states in formulating specific legislation. The act includes model provisions related to fair market value, conflicts of interest, community involvement, and use of proceeds to meet health care needs.

The federal government's role in monitoring hospital conversions is carried out mostly by the IRS, FTC, and the Department of Justice, which oversee tax and antitrust issues, respectively. The IRS has raised questions about the tax implications of not-for-profit and for-profit joint venture arrangements—for example, whether the not-for-profit partner will retain its tax-exempt status. IRS officials stated that the operation of the joint venture may result in more than incidental benefit to the for-profit partner, thereby creating a basis for denying or revoking the tax status of the charitable entity. The IRS and the Department of the Treasury expect to issue joint venture guidance in December 1997 that may address some of these questions. Another issue related to joint ventures involves the participation of individuals on both not-for-profit and for-profit boards. This participation creates a potential conflict of interest because the not-for-profit has a stake in maintaining the for-profit's interests. Dual board membership occurred in the three joint ventures we reviewed. FTC officials reported that the antitrust issues related to hospital conversions do not differ from those presented by other mergers and acquisitions, and the agency's involvement in hospital conversions has generally been limited to its routine oversight role. Since 1993, FTC has brought three antitrust enforcement actions related to not-for-profit hospital

conversions; one of these actions involved one of the conversions we reviewed.

Background

A not-for-profit hospital conversion is a transaction that results in the shift of all or a substantial portion of the assets of a not-for-profit hospital to for-profit use.[2] Most hospital conversions have been structured as asset sales; however, recently some hospitals have, for example, entered into joint venture arrangements. In an asset sale, a not-for-profit hospital sells its physical assets, name, and accounts to a for-profit purchaser in exchange for cash, stock, notes, or other property. In a joint venture, a not-for-profit hospital contributes its assets to a for-profit partnership in exchange for cash and an ownership interest in the new venture. For example, in an 80/20 joint venture, the not-for-profit entity receives cash equal to 80 percent of the value of the hospital's assets and a 20-percent ownership interest in the for-profit venture. Other methods of conversion include lease arrangements and corporate restructurings. Federal and most state laws require that proceeds from the sale of charitable assets continue to be used for charitable purposes. These proceeds are generally directed to a not-for-profit foundation or other charitable entity.

Market and institutional factors, such as the growth of managed care and the need for capital, are often cited as primary reasons for conversions. To be successful in a managed care environment, not-for-profit hospitals must be in a competitive position. This position can be achieved by building networks that guarantee patient flow and increase bargaining power with managed care plans and physician groups. Access to capital is particularly important in a managed care environment, in which substantial investments may be necessary for information systems, network development, and expanding market share.

Columbia/HCA Healthcare Corporation, Tenet Healthcare Corporation, and Quorum Health Group are major players in the hospital acquisition market. Columbia/HCA is one of the largest health care services companies in the United States. As of February 1996, Columbia operated 343 hospitals, 135 outpatient surgery centers, 200 home health agencies, and extensive outpatient and ancillary services in 38 states, the United Kingdom, and Switzerland. Columbia reported 50 not-for-profit hospital acquisitions, joint ventures, and lease arrangements between 1994 and 1996. Until recently, Tenet, a nationwide provider of health care services,

[2]Not-for-profit hospitals are generally created under state not-for-profit corporation laws. A not-for-profit entity can apply to the IRS for federal tax-exempt status. Throughout the report, the term "not-for-profit" is used to describe entities that qualify for federal tax exemption.

owned and operated 76 general hospitals and related businesses in 13 states. On January 30, 1997, Tenet acquired OrNda HealthCorp, one of the nation's largest investor-owned hospital management companies, with 49 hospitals in 15 states. Through this transaction, Tenet now owns, leases, or operates 130 hospitals in 22 states. Tenet reported nine not-for-profit hospital acquisitions and one joint venture since 1990.[3] Quorum owns and operates acute-care hospitals and local and regional health care systems in 43 states and the District of Columbia. As of June 1996, Quorum owned 14 acute-care hospitals and had management contracts with 253 hospitals and consulting contracts with another 161 hospitals. Quorum reported 12 not-for-profit hospital acquisitions and leases since 1990.

Standard Methods Were Consistently Used to Value Hospitals' Assets, but Other Key Elements of the Conversion Process Varied

The hospitals we reviewed followed the same basic process in converting from not-for-profit to for-profit status: They valued the hospital's assets; sought out a buyer or partner, generally through a competitive process; and negotiated the terms of the final agreement. The methods used to determine the hospitals' value were commonly used approaches, according to industry experts. A key component considered in estimating the value of the hospitals we reviewed was their most recent earnings. The valuation estimate is a benchmark that hospital officials can use in considering bids from potential buyers or partners. The IRS and others suggest that hospitals solicit competing bids through a request for proposals (RFP) in order to increase the likelihood that fair market value is realized. While few hospitals followed such a formal competitive bidding process, officials at most hospitals said that they received multiple bids and accepted the highest bid offered. Once a bid is accepted, the terms of the purchase or partnership agreement are negotiated and formally agreed to by both parties. Participants in the conversion transactions we reviewed told us that items negotiated included the final purchase price and continued charity care and hospital services.

During the conversion process, the communities that the not-for-profit hospitals served generally were not informed about or involved in the various phases of the transaction. However, the not-for-profit hospitals' boards of directors, who viewed themselves as representatives of the community, reported having responsibility for managing the conversion process and having a fiduciary duty to ensure that the conversion was in the best interests of the organization. The for-profit hospital boards of

[3]This does not include hospital acquisitions and joint ventures acquired as part of Tenet's recent merger with OrNda.

directors, which usually included former not-for-profit board members, generally monitor and oversee compliance with the purchase agreement.

Three Standard Approaches Were Primarily Used to Value Hospitals

The IRS and valuation consultants cite the income, market, and cost approaches as generally accepted methods for valuing hospital assets (see table 2). One or more of these approaches were used to arrive at a minimum dollar value. This estimated value of a hospital is not intended to represent its fair market value. Instead, in many cases, it represents a benchmark for the not-for-profit hospital to use in negotiating a purchase price. The income and market approaches, which were the approaches most commonly used in the transactions we reviewed, multiply a hospital's adjusted earnings by a variable—or multiple—to calculate the hospital's value. The multiple depends on the weight given to certain tangible and intangible factors, which can include a hospital's debt and competitive position. For example, lower multiples reflect hospitals that are considered a greater financial risk. Multiples that ranged from 5 to 10 were applied by investment bankers to value six of the not-for-profit hospitals we reviewed. In recent years, investment bankers have commonly applied a multiple of six to value independent not-for-profit hospitals. Experts and representatives from organizations who are knowledgeable about hospital finance, such as the Prospective Payment Assessment Commission (PROPAC), suggest that not-for-profit multiples be carefully monitored to ensure that the not-for-profit hospitals are valued appropriately.

Table 2: Asset Valuation Methods

Methodology	Description
Income	The income method focuses on incorporating the specific operating characteristics of the seller's business into a cash flow analysis. Discounted cash flow and earnings analyses are often used. A discounted cash flow analysis involves making projections and forecasts of future cash flows and discounting them to the present. An earnings analysis involves calculating the hospital's earnings before interest, taxes, depreciation, and amortization (EBITDA) for the past 12 months and multiplying the EBITDA by a factor to calculate the value of the hospital. EBITDA multiples reportedly range from a lower level of four to about seven. Financially riskier hospitals tend to have lower multiples. Factors that determine the multiple used include the hospital's prospects related to managed care, reputation, debt, and future capital needs.
Market	The market method measures value in two ways: comparable companies analysis and precedent transaction analysis. A comparable company analysis relies on EBITDA multiples derived from publicly traded hospital companies. A precedent transaction analysis uses EBITDA multiples derived from prices paid in recent acquisitions of comparable entities. Projections and estimates are developed to determine appropriate adjustments for comparability.
Cost	The cost method measures value by first determining the cost to replace or reproduce an asset, less an allowance for physical deterioration or obsolescence. From this amount, the book value of liabilities is subtracted to arrive at a value for the hospital's assets. This analysis assesses working capital, real estate, and equipment, as well as permits, licenses, and managed care contracts.

Each of the 14 hospitals we reviewed had obtained either an independent valuation (or conducted its own valuation of the hospital) or a fairness opinion, which is a documented analysis and confirmation by a reviewer that the valuation process resulted in a fair estimate from a financial point of view. In obtaining their valuation, 13 hospitals hired outside consultants, whereas 1 relied on in-house expertise. The one hospital that relied on in-house expertise for valuation, Lloyd Noland, hired experts to render a fairness opinion. Five hospitals—Arlington, Goodlark Regional Medical Center, Good Samaritan Health System, Tulane, and St. Francis—obtained both a valuation analysis and a fairness opinion from an outside consultant. For the conversions we reviewed, officials with Columbia/HCA, Quorum, and Tenet told us that they did not retain the same consultants that the not-for-profit hospitals did for valuation purposes. However, a Quorum official reported using Valuation Counselors Group, the consultant retained by the Carolinas Hospital System, for asset allocation purposes related to that hospital following completion of the deal. In addition, all three for-profit companies reported using some of the same consultants for business transactions and services

unrelated to the conversions in our review. (Table 3 lists the hospitals that hired consultants by the type of service rendered.)

Table 3: Valuation Services Provided by Outside Consultants

Consultant	Hospital
Valuation analysis	
American Appraisal	Mercy Baptist Medical Center[a]
Cain Brothers	St. Francis Hospital
Coopers & Lybrand	Jacksonville Hospital
Ernst & Young	Baptist Memorial Hospital[b] Hilton Head Hospital The Retreat Hospital
First Boston	Mercy Baptist Medical Center[a]
Manufacturers' Appraisal Company	Tulane University Hospital
KPMG Peat Marwick	John Randolph Medical Center Mary Black Memorial Hospital
Shattuck Hammond	The Arlington Hospital Good Samaritan Health System
Valuation Counselors Group, Inc.	Baptist Memorial Hospital[b] Carolinas Hospital System
Walsh & Connor	Goodlark Regional Medical Center
Fairness opinion	
J.C. Bradford	Goodlark Regional Medical Center
Cain Brothers	St. Francis Hospital[c] Tulane University Hospital
Coopers & Lybrand	Lloyd Noland Hospital
Shattuck Hammond	The Arlington Hospital Good Samaritan Health System

[a]Mercy Baptist obtained valuation analyses from two independent companies: American Appraisal and First Boston.

[b]Baptist Memorial obtained valuation analyses from two independent companies: Ernst & Young and Valuation Counselors Group, Inc.

[c]As part of the Tennessee attorney general's review, a second fairness opinion was obtained from Mercer Capital.

Eight hospitals disclosed the valuation estimates they received; however, only four provided documentation to support the information. Mary Black and Retreat reported in their IRS revenue rulings that they received valuation estimates of $56 million and $14 million, respectively. Carolinas' valuation report provided an estimated range of $55 million to $60 million, and Good Samaritan's valuation report estimated the hospital's value at $140 million to $160 million. (See table 4.) The remaining six hospitals

would not disclose their valuation estimates. The valuation estimates generally represent a benchmark for the not-for-profit hospital to use in negotiating a purchase price.

Table 4: Hospitals' Valuation Estimates

Hospital	Valuation estimate (in millions)
Carolinas Hospital System	$55-60
Good Samaritan Health System	140-160
Hilton Head Hospital	19-30
John Randolph Medical Center	37
Mary Black Memorial Hospital	56
Mercy Baptist Medical Center	188-267
The Retreat Hospital	14
Tulane University Hospital	120-135

Most Hospitals Received Multiple Bids From Potential Buyers or Partners

According to officials involved in the conversion transactions, most of the not-for-profit hospitals in our review received more than one bid from potential buyers or partners (see table 5). The process used to solicit offers varied among the hospitals. According to the IRS, sellers can more accurately determine the fair market value of their hospitals by soliciting competitive bids through an RFP, which opens bidding to the public. Of the 14 hospitals in our review, 4 used an RFP process; 9 said that they considered several not-for-profit and for-profit entities as potential buyers/partners before focusing on one or more from which to solicit a bid(s); and 1, Jacksonville, only considered one buyer, Quorum, which was selected because of its previous experience—an 8-year management contract with Jacksonville Hospital. Of the 14 hospitals, 7 received more than one bid.

Table 5: Hospitals That Reported Receiving Multiple Bids and Those That Reported Receiving a Single Bid

Hospital	Multiple bids	One bid
The Arlington Hospital		X
Baptist Memorial Hospital		X
Carolinas Hospital System	X	
Goodlark Regional Medical Center	X	
Good Samaritan Health System	X (RFP)	
Hilton Health Hospital	X (RFP)	
Jacksonville Hospital		X
John Randolph Medical Center		X
Lloyd Noland Hospital		X
Mary Black Memorial Hospital	X	
Mercy Baptist Medical Center	X (RFP)	
The Retreat Hospital	X (RFP)	
St. Francis Hospital		X
Tulane University Hospital		X

Although most of the hospitals we reviewed received multiple bids, not all reported accepting the highest offer. Some officials told us that the bid amount is only one of several factors considered by the not-for-profit hospitals in selecting a buyer or partner. The Retreat Hospital, for example, accepted a bid from Columbia/HCA that was $3 million lower than the highest bid it received because the higher bidder did not appear to bring any complementary strengths, such as access to third-party payer contracts and economies of scale in operations, to counter Retreat's weaknesses. Hilton Head accepted a lower bid from Tenet because of the for-profit's financial stability, access to tertiary care, philosophy regarding patient care and employees, and other health care relationships. Hospital officials told us that, in addition to bids, they also considered such factors as the bidding entity's managed care network, presence in the community, corporate culture, reputation for providing quality care, and access to capital, which was reported to be a major factor in the not-for-profit hospitals' decision to accept an offer from a for-profit company.

Hospital Officials Agreed on a Negotiated Purchase Price

Officials from many of the hospitals in our review said that their negotiations with purchasers resulted in a mutually agreed upon purchase price. Officials of some of the hospitals we reviewed stated that they negotiated a purchase price for their hospitals that allowed them to pay off their debts and direct money to communities for charitable purposes. According to hospital officials and for-profit purchasers, purchase prices

for the hospitals we reviewed ranged from about $16 million to $212 million; most were less than $100 million. (See table 6 for hospitals' purchase prices.) The Tulane University and Hilton Head joint ventures resulted in the not-for-profit entities' receiving a percentage of the purchase price in addition to their respective shares of the joint venture. Officials associated with the Arlington joint venture stated that a purchase price was not negotiated because Columbia/HCA contributed three hospitals to the transaction in lieu of cash. Only two of the three purchasers, Quorum and Tenet, provided purchase price information. Purchase prices for the remaining Columbia/HCA transactions were provided by hospital officials. In commenting on a draft of this report, two reviewers raised concerns about conclusions that might be drawn from comparing valuation estimates and purchase prices. Because valuation estimates may or may not reflect a hospital's fair market value, it could be misleading to compare valuation estimates with purchase price for determining whether the purchaser or partner over- or underpaid for the selling hospital.

Table 6: Hospitals' Purchase Prices

Hospital/purchaser (number of beds)	Purchase price (in millions)[a]
The Arlington Hospital/Columbia/HCA (350 beds)	[b]
Baptist Memorial Hospital/Quorum (346 beds)	$56.6 plus $300,000/year for 15 years
Carolinas Hospital System/Quorum (424 beds)	77.5
Goodlark Regional Medical Center/Columbia/HCA (205 beds)	103.0
Good Samaritan Health System/Columbia/HCA (1,155 beds)	176.5
Hilton Head Hospital/Tenet (68 beds)	31.3[c]
Jacksonville Hospital/Quorum (90 beds)	16.3
John Randolph Medical Center/Columbia/HCA (271 beds)	53.0
Lloyd Noland Hospital/Tenet (319 beds)	47.6
Mary Black Memorial Hospital/Quorum (226 beds)	61.4
Mercy Baptist Medical Center/Tenet (798 beds)	212.3
The Retreat Hospital/Columbia/HCA (227 beds)	17.0
St. Francis Hospital/Tenet (697 beds)	103.0
Tulane University Hospital/Columbia/HCA (294 beds)	165.0[d]

[a]Quorum and Tenet provided purchase price information; Columbia/HCA did not, and therefore we relied on information provided by hospital officials.

[b]In the Arlington joint venture arrangement, a purchase price was not negotiated. The parties to the transaction determined the relative value of the four health care facilities contributed to the joint venture. The value of Arlington Hospital was greater than the combined value of the three Columbia/HCA-owned hospitals contributed to the joint venture. As a result, Arlington received an equalization payment of $8 million. Hospital officials would not disclose the value of the three Columbia/HCA hospitals contributed to the joint venture.

[c]Hilton Head Hospital was sold to the joint venture for $31 million, 20 percent of which the not-for-profit entity invested in the joint venture, with the result that the not-for-profit initially received about $25 million.

[d]Tulane University Hospital was sold to the joint venture for $165 million, 20 percent of which the University invested in the joint venture, with the result that the not-for-profit ultimately received $132 million.

Negotiated Terms of the Hospital Sale Often Included Charity Care and Service Provisions

Most of the not-for-profit hospitals that converted to for-profit status that we reviewed negotiated terms in their purchase agreements with the intent of preserving charity care for the community and securing protections for the hospitals and their staffs. All except two of the hospitals (Baptist Memorial and Retreat) negotiated such contract provisions with their buyers/partners. The types of provisions the 12 hospitals negotiated as part of their purchase agreements included continuing a certain level and duration of charity care and hospital services; retaining employees and

certain management positions; and retaining the option to buy back the hospital if the purchaser decided to sell, close, or substantially change the focus of the hospital. Many of the negotiated provisions had time limits—some, a minimum of 3 years; others had no time periods attached. We were provided documentary evidence of the negotiated terms of the agreements for ten of the hospitals.[4] See table 7 for examples of charity care and service provisions that were agreed to.

Table 7: Examples of Charity Care and Hospital Service Terms Hospital Officials Reported Negotiating as Part of Purchase Agreements

Hospital	Terms
Charity care	
Goodlark Regional Medical Center	Columbia/HCA agreed to provide indigent care consistent with policies of the previous not-for-profit hospital.
Good Samaritan Health System	Columbia/HCA agreed to provide indigent care consistent with policies of the previous not-for-profit hospital.
Hilton Head Hospital	Tenet agreed to continue charity care consistent with the policy of the previous not-for-profit hospital.
Jacksonville Hospital	Quorum agreed to the same level of charity care as provided by the previous not-for-profit hospital.
Lloyd Noland Hospital	Tenet agreed to maintain the same level of charity care as provided by the previous not-for-profit hospital.
Mary Black Memorial Hospital	Quorum agreed to maintain charity care levels for 5 years.
Tulane University Hospital	Columbia/HCA agreed to maintain about the same level of uncompensated care as provided by the previous not-for-profit hospital.
Hospital services	
Good Samaritan Health System	Columbia/HCA agreed to maintain graduate medical education programs for 3 years.
Hilton Head Hospital	Tenet agreed to provide for the continuous operation of the hospital as an acute-care facility containing a 24-hour emergency room.
Jacksonville Hospital	Quorum agreed to continue the present level of health care services for at least 5 years.
Lloyd Noland Hospital	Tenet agreed to maintain the same clinical services as the previous not-for-profit hospital for 3 years.
Mary Black Memorial Hospital	Quorum agreed to provide acute-care services for at least 8 years.
St. Francis Hospital	Tenet agreed to maintain the hospital's emergency room.
Tulane University Hospital	Columbia/HCA agreed to maintain graduate medical education programs for as long as Tulane University maintains medical students and residency programs.

[4]As documentary evidence of the negotiated terms, we were provided complete purchase agreements for two of the transactions and selected sections of purchase agreements and other documentary evidence for the remaining eight transactions.

The not-for-profit and for-profit parties to the purchase agreements are relying on the new for-profit hospital boards of directors to monitor compliance and ensure that the terms of the agreements are enforced.[5] Although the for-profit entities and board members are responsible for fulfilling the terms of the agreements, for-profit boards are also responsible for the interests of stockholders and the profitability of the hospital. Therefore, the board might choose to make cost-cutting decisions that, for example, reduce service levels and charity care in the community. Some states are beginning to address the potential for noncompliance by granting third-party oversight and enforcement authority over negotiated terms of not-for-profit conversion transactions to state attorneys general and health insurance commissioners. For example, a Nebraska statute provides that if the Department of Health receives information and can verify that the new for-profit is not fulfilling its commitments to the community, it can revoke the for-profit's license.

Communities Were Generally Not Informed About Conversions

Federal and state laws in most states generally have not required that the community be informed about the conversions through mechanisms such as public hearings and disclosure of transaction documents. For the conversions we reviewed, hospital boards of directors viewed themselves as representing the community through their fiduciary responsibility to protect the not-for-profits' assets. However, the community at large was often unaware of the pending sale and uninformed of the sale price or the structure of the transaction. Nine of the 14 hospitals we reviewed did not involve the public through hearings and open forums before the conversion. While they did not seek community approval of the conversion or the partnership decision, five of the hospitals we reviewed informed the public of the conversion through public meetings and community forums. John Randolph and Lloyd Noland officials reported briefing community and civic organizations about the sale of the hospitals. Arlington officials reported holding 30 to 35 meetings regarding the conversion, including public meetings, briefings for the Arlington County Board, and meetings with civic organizations. Discussions surrounding the sale of the Jacksonville Hospital were open to the public through city council meetings. Hilton Head Hospital officials reported holding public forums to educate the community about the partnership decision and partnership options.

[5]Good Samaritan Charitable Trust officials reported having responsibility for monitoring compliance with the terms of the purchase agreement.

In commenting on a draft of this report, two external reviewers raised concerns about full public disclosure and community involvement in the sales transactions. Specifically, they said public participation in the sales transactions could be detrimental to the value of the selling hospital or result in the disclosure of trade secrets. One of the reviewers stated that oversight by a state attorney general's office, including an independent valuation, is a more effective, realistic, and preferable approach.

Conversion Proceeds Generally Support Health and Wellness as Well as Other Community Activities

Because federal and state laws require that net proceeds from not-for-profit conversions be directed toward a charitable purpose, charitable institutions often receive substantial resources as a result of conversions. In most of the conversions we reviewed, the proceeds were directed to foundations, but a university and a city also received proceeds. Most of the foundations had missions and activities that focused primarily on the broad area of health and wellness. Other foundations focused more directly on such areas as the arts, education, and religion, in some cases also supporting community health programs and activities. Community participation in determining the use of sale proceeds was solicited in about half the cases we reviewed.

Conversions Often Provided Millions to Foundations and Other Entities for Charitable Purposes

IRS guidance and some state statutes generally require that proceeds resulting from the conversion of not-for-profit entities be used for charitable purposes. The charitable entities that receive proceeds from not-for-profit hospital conversions use the funds to support various projects and activities. The use of charitable assets is typically defined by the mission the foundation adopts. The missions of most of the foundations we reviewed focused on health and wellness, which sometimes included a focus on education, public safety, arts, and religion. Some state regulators argue that a foundation's mission and the efforts it supports should be closely related to the original mission of the not-for-profit hospital.[6] However, decisions have been made to use hospital conversion proceeds to fund nonhealth-related projects, such as building a school and financing an arts, education, and technology center.

Conversions of not-for-profit hospitals have resulted in multimillion-dollar endowments to charitable institutions. Although most recipients of these funds are foundations, millions of dollars have also been directed to other entities. For the conversions we reviewed, hospital and foundation

[6]At least one state, Nebraska, has enacted legislation that expressly requires not-for-profit hospital conversion proceeds to be used to provide charitable health care.

officials reported proceeds that ranged from $13 million to $130 million.[7] In addition to the funds transferred from the for-profit entity, these proceeds may also include previous hospital foundation endowments, hospital reserves, and other not-for-profit assets. For example, in addition to the $8 million received from the conversion transaction, the Arlington Health Foundation also received other monies transferred from the hospital and the previous hospital foundation, which resulted in proceeds totaling $130 million. Of the 14 conversions in our review, 12 directed proceeds to foundations.[8] Moreover, in addition to transferring proceeds to a foundation (Baptist Community Ministries), Mercy Baptist Medical Center directed a portion of the proceeds to the other original sponsor of the medical center, the Sisters of Mercy Health System of St. Louis, which reinvested the proceeds in other community hospitals. The proceeds from the remaining two conversions were directed to Tulane University and the City of Jacksonville, Ala. The total amount generated from the conversions we reviewed was $931 million. (See table 8 for the amounts reported as forwarded to individual charitable entities.)

Table 8: Entities to Which Conversion Proceeds Were Directed

Not-for-profit hospital	Resulting entity	Reported proceeds (in millions)[a]
Alabama		
Baptist Memorial Hospital	Etowah Baptist Association	Not reported
Jacksonville Hospital	City of Jacksonville, Ala.	$15
Lloyd Noland Hospital	The Lloyd Noland Foundation	50
California		
Good Samaritan Health System	Good Samaritan Charitable Trust	72
Louisiana		
Mercy Baptist Medical Center[b]	Baptist Community Ministries	112
Mercy Baptist Medical Center[b]	Sisters of Mercy Health System	59
Tulane University Hospital	Tulane University[c]	100
South Carolina		
Carolinas Hospital System	Drs. Bruce and Lee Foundation	90
Hilton Head Hospital	Hilton Head Island Foundation[c]	13
Mary Black Memorial Hospital	Mary Black Foundation	62

(continued)

[7]For 5 of the 14 conversions, supporting documentation was provided for the amount of proceeds directed to a charitable entity: Carolinas, Goodlark, Good Samaritan, Hilton Head, and Mercy Baptist.

[8]The conversion involving The Retreat Hospital did not realize any proceeds after the hospital's debt was paid. The amount transferred to the new foundation was the amount held in the former hospital foundation. One hospital, Baptist Memorial, did not disclose the amount of net proceeds from the conversion.

Not-for-profit hospital	Resulting entity	Reported proceeds (in millions)[a]
Tennessee		
Goodlark Regional Medical Center	The Jackson Foundation	75
St. Francis Hospital	The Assisi Foundation of Memphis, Inc.	103
Virginia		
The Arlington Hospital	Arlington Health Foundation[c]	130
John Randolph Medical Center (public)	John Randolph Foundation	25
The Retreat Hospital	Annabella R. Jenkins Foundation[d]	25
Total		**$931**

Note: For 5 of the 14 conversions, hospital and foundation officials provided supporting documentation for the amount of proceeds available for charitable use.

[a]In some cases, the proceeds may be lower than the purchase prices listed in table 6 because the proceeds represent approximate amounts reported for charitable use after defeasement of debt and payment of other liabilities. In addition to the funds transferred from the for-profit entity, these amounts may also include not-for-profit hospitals' accumulated reserves and working capital, other not-for-profit assets, and previous hospital foundation endowments. As a result, in some cases, the reported proceeds were greater than the purchase prices.

[b]Mercy Baptist Medical Center directed 65 percent of the proceeds to one foundation, Baptist Community Ministries, and 35 percent to the not-for-profit Sisters of Mercy Health System.

[c]For the Tulane and Arlington joint ventures, the total amount that Tulane University and the Arlington Health Foundation receive depends on the ventures' future success. For the Hilton Head Hospital joint venture, as of May 1997, Hilton Head Island Foundation officials reported having divested the Foundation's 20-percent interest in the joint venture arrangement, in part, because the Foundation was unable to obtain a distribution of earned profits.

[d]The Annabella R. Jenkins Foundation did not receive any proceeds from the sale of The Retreat Hospital. The $25 million represents the Foundation's endowment as of Jan. 1997 and includes money transferred from the previous not-for-profit hospital.

The foundations that resulted from the sale of not-for-profit hospitals that we reviewed used conversion proceeds to support a variety of projects, many of them health related. These foundations do not provide direct health care services; instead most issue grants to existing community organizations that support a range of health- and nonhealth-related activities. Grants have been awarded by 8 of the 12 foundations we reviewed. These grants have supported a variety of health-related activities, including disease prevention, purchase of medical equipment, and CPR and first-aid training. Grants have also been awarded to support education programs, such as a tutoring program, an adult caregiver training program, and a summer remediation program. Other grants

supported arts, public safety, and community development. At the time of our review, three foundations (the Arlington Health Foundation, the Good Samaritan Charitable Trust, and the Lloyd Noland Foundation) had not yet awarded grants.[9] One foundation, The Jackson Foundation, is not currently issuing grants but has used the proceeds for projects such as an aerospace program and building an arts, education, and technology center that supports programs in math and science. (See app. II for a summary of each foundation's mission and grant award activity.)

For 2 of the 14 conversions we reviewed, proceeds were not directed to a foundation. The City of Jacksonville and Tulane University received conversion proceeds totaling approximately $115 million. The City of Jacksonville reported using the proceeds to build a new high school and make capital improvements at city facilities. Tulane University reported using the proceeds, in part, for working capital, an addition to its endowment, and capital to fund the development of new programs at the medical school.

Some Communities Were Involved in Determining Use of Charitable Proceeds

As the beneficiary of the proceeds, the community is often more involved in determining the future uses of charitable proceeds than in providing input during the earlier stage of structuring the transaction. Community participation regarding the charitable proceeds can include providing input concerning the structure, purpose, governance, and activities of the entity that receives the proceeds. Eight of the entities in our review that received these proceeds sought no community involvement. The remaining six foundations obtained community input regarding community needs and use of charitable proceeds through community needs assessments; meetings with community groups, organizations, and agencies; or both. Three of these (the Arlington Health Foundation, the Mary Black Foundation, and the John Randolph Foundation) conducted community needs assessments or relied on assessments already conducted.[10] The remaining three foundations (the Good Samaritan Charitable Trust, Baptist Community Ministries, and The Jackson Foundation) sought broad community input through public forums and discussions before determining the foundations' program agenda. Baptist Community Ministries, the Good Samaritan Charitable Trust, and the Mary Black Foundation held public forums or discussions with community

[9]In the case of the Good Samaritan Charitable Trust, the foundation agreed not to distribute any proceeds to new projects or grants until after the attorney general's review was completed. However, it has funded several preexisting community health programs since the sale.

[10]The Mary Black Foundation's community health assessment is not expected to be concluded until the end of 1997.

leaders, as well as relied on community needs assessments. In addition, the Good Samaritan Charitable Trust formed a community task force to study and recommend how the funds could best serve the health needs of the community.

State Oversight Is Increasing in Response to Conversion Activity

Controversy and concerns about the loss of community health services and the transfer of community assets in not-for-profit conversions have prompted some states to take an active oversight role in protecting the community's charitable interests. In most states, the attorney general has the authority to monitor conversions to protect the community's charitable interests but not all attorneys general exercise this authority. Several groups have developed guidance, including a model act, to help attorneys general both develop legislation governing hospital conversions and review proposed not-for-profit conversion transactions. Twenty-four states and the District of Columbia have enacted laws, most in recent years, affecting not-for-profit conversions. These laws contain provisions that include requiring attorney general approval, advance notification, and community involvement. At the time of the conversions of the 14 hospitals in our review, none of the states in which they were located had enacted laws specifically addressing not-for-profit hospital conversions. However, state attorneys general in five of these states did exercise authority granted under state not-for-profit corporation law or common law to review selected conversions.

Some Attorneys General Have Exercised Their Authority to Oversee Conversions

State attorneys general generally have authority to review not-for-profit conversions and, where appropriate, to enforce state requirements that protect charitable benefits. Attorneys general in four states in our review (Alabama, California, South Carolina, and Tennessee) reported that authority to oversee and monitor hospital conversions is granted through state provisions related to not-for-profit corporations. The Virginia attorney general's authority is founded primarily in common law, from which the doctrine of cy pres is derived. (In this context, the cy pres doctrine provides that when the original purpose of a charitable trust becomes impossible to carry out, another approach may be taken if it is judged to be similar in intent to the original purpose.) In Louisiana, until recently, the attorney general had no authority to oversee hospital conversion activity.[11] (See table 9 for a description of state authorities to oversee hospital conversions.)

[11]As of Aug. 1997, Louisiana had enacted specific legislation governing hospital conversions (see app. III).

Table 9: Attorney General Authorities to Oversee Transactions

Authority	Description
Not-for-profit corporation code	Not-for-profit hospitals are generally established under a state's not-for-profit corporation code, which details how not-for-profit corporations are to be established and operated within the state. These laws typically include, for example, restrictions on conflicts of interest and guidance regarding amending corporation bylaws and how to dispose of assets should the corporation be dissolved. The assets of the not-for-profit corporation are often viewed as held in public trust in exchange for the corporation's receiving the benefits of not-for-profit status. That is, the assets of the corporation are considered dedicated in perpetuity to the charitable purposes set out in the corporation's articles of incorporation. In addition, not-for-profit corporations are limited in their ability to engage in profit-making activity. For example, not-for-profit corporations cannot distribute their profits to those who own or control them. Essentially, in most states, not-for-profit corporations and their assets have been viewed as charitable trusts.
Cy pres	The doctrine of cy pres applies to charitable trusts. Under cy pres, should it become impossible to use the assets of a charitable trust as originally provided when the trust was established, a judicial hearing is necessary to determine what should be done with the assets. At the hearing, the trustees must convince the judge that the original purpose is no longer workable and identify another more practical purpose that is as near as possible to what was originally intended. Some interpret this requirement to mean that the trustees of a not-for-profit charitable corporation must obtain court approval for a conversion.
State legislation	State statute can give the attorney general or other state official specific authority to review a conversion transaction. Such a review may include a review of the disposition and use of charitable proceeds. Some statutes require the converting hospital to obtain the consent of the reviewing official before the transfer of assets.

State attorneys general reviewed about half of the conversion transactions in our review through authority granted under state not-for-profit corporation laws. These laws, which require that the not-for-profit entity give notice of its sale to the attorney general's office, were the basis for reviews of the transactions involving the Lloyd Noland Hospital (Ala.), the Good Samaritan Health System (Calif.),[12] Mary Black Memorial Hospital and the Carolinas Hospital System (S.C.), and the St. Francis Hospital and the Goodlark Regional Medical Center (Tenn.). These laws may also give the attorney general authority to review the disposition of assets, which could include determining whether fair market value is obtained,

[12]California's not-for-profit corporation law was amended in 1996 to include specific requirements for the conversion of health care facilities. The law took effect in Jan. 1997.

charitable proceeds are appropriately directed, and conflicts of interest exist. For example, in the Good Samaritan conversion, the attorney general reviewed the entire transaction, including valuation, inurement issues, and consistency of the sale with the purposes of the trust. The attorney general concluded that Good Samaritan's administrators and board acted in good faith, in that the institution's sale price reflected fair market value and all related business decisions had been made with due diligence. The attorney general, in negotiations with Good Samaritan, reached a compromise agreement on how the proceeds would be used. The agreement directs proceeds to fund hospital and medical care for the medically indigent in Santa Clara County and to fund preexisting community health programs historically supported by Good Samaritan. For the Goodlark conversion, the attorney general ruled against a proposed use of the charitable proceeds by The Jackson Foundation. Specifically, the foundation had agreed to purchase a nuclear lab for the new Columbia-owned for-profit hospital. The attorney general prohibited this purchase, ruling that a conflict of interest was present.

The common law doctrine of cy pres allows some attorneys general to bring suit if, in a conversion, the not-for-profit assets are found to be directed inappropriately. The Virginia attorney general has authority to review conversion transactions through common law. Officials in the Virginia attorney general's office reported exercising this authority to review the three Virginia hospital conversions in our study (Arlington, Retreat, and John Randolph).[13] However, these officials would not disclose specifically what was reviewed and the results of their reviews.

Model Provisions for State Oversight of Conversions Have Been Developed

Several organizations have prepared guidance to assist states in oversight of conversion activity. In 1997, the National Association of Attorneys General (NAAG) adopted a resolution containing six specific guidelines for the conversion process. The Community Catalyst and Consumers Union developed a model act with more specific provisions relating to conversions. These sets of guidance are complementary and provide a framework for state attorneys general who will be reviewing conversion transactions. (See table 10 for a comparison of NAAG resolution and model act features.)

[13]As of Aug. 1997, Virginia had enacted specific legislation governing hospital conversions (see app. III).

Table 10: Features of the NAAG Resolution and the Model Act

NAAG resolution	Model act
State attorney general should receive advance written notice of conversions.	State attorney general must receive notice 90 days before the transaction is to take place.
The public should receive advance notice, including the names and addresses of the parties and the terms of the proposed conversion.	The attorney general must provide the public with access to all records related to the transaction at no cost. The attorney general must also hold at least one public meeting no later than 45 days after receiving notice regarding the proposed transaction and publish advance notice of the meeting in local newspapers.
A valuation of the charitable assets should be prepared by an independent expert.	The attorney general must find that the nonprofit corporation used due diligence in arranging the transaction.
Directors and others involved in the transaction should not receive excessive compensation.	The attorney general must find that the transaction will not result in any financial advantage to private people or entities, any nonprofit organizations receiving charitable assets and the for-profit entity involved are totally independent of each other, and the nonprofit corporation receiving the charitable assets has mechanisms in place to avoid conflicts of interest.
The use of proceeds should be consistent with the charitable purpose for which the assets are held by the nonprofit health care entity and not benefit the for-profit purchaser.	The attorney general must find that the transaction is fair and reasonable to affected parties, the transaction is in the public interest, a charitable trust is set aside equal to the fair market value of the nonprofit corporation, and trust distributions are dedicated to existing or new tax-exempt organizations.
The attorney general should be able to recover the costs of reviewing and evaluating the proposed transaction from the parties involved.	The attorney general may charge an entity involved in the conversion for the costs of providing the public with notice and reasonable access to records relating to the conversion.
[a]	The attorney general must find that the transaction will not adversely affect the availability of health care and that the charitable corporation receiving trust assets will be dedicated to serving the state's unmet health care needs.
[a]	The attorney general must find that the charitable corporation receiving the assets will agree to file annual reports, which will be made public, regarding its grant-making and other charitable activities that involve the use of charitable assets received.

(continued)

NAAG resolution	Model act
[a]	The attorney general has the power to subpoena additional information or witnesses to help decide whether to permit the transaction to go forward.
[a]	The nonprofit corporation generally must be notified in writing of the attorney general's decision within 90 days of the attorney general's having received the initial notice regarding the proposed transaction.

[a]The NAAG resolution contained no complementary provision.

In response to the increasing number of not-for-profit hospital conversions and public concern regarding the fairness of the transactions and the potential loss of community benefits, states have enacted legislation affecting conversions. According to the National Council of State Legislatures, 24 states and the District of Columbia have enacted such legislation. These laws often include features similar to those of the NAAG resolution and the model act. Although the features of each state's legislation vary, most legislation contains specific provisions that require advance notice, state official review and approval, and public disclosure/hearing. (See table 11 for a list of states with laws affecting conversions, and key provisions, and see app. III for a brief summary of relevant state law.) Several other states are also considering similar conversion legislation.

Table 11: States With Laws Affecting Conversions, and Key Provisions

	Provisions		
State	Advance notice	State official review and approval	Public disclosure/hearing
Ariz.	X		X
Calif.	X	X	X
Colo.	X	X	X
Conn.	X	X	X
D.C.	X	X	X
Fla.			X
Ga.	X	X	X
Ill.	X		X
Ind.	X		X
Kans.	X	X	X
La.	X	X	X
Maine		X	
Nebr.	X	X	X
N.H.	X	X	X
N.J.	X	X	X
N.C.			X
N. Dak.		X	
Ohio	X	X	X
Oreg.	X	X	X
R.I.	X	X	X
S. Dak.	[a]	[a]	[a]
Tex.		X	
Vt.	X	X	X
Va.	X	X	X
Wash.	X	X	X

Note: For pertinent details regarding the scope and applicability of these laws, see app. III.

[a]The law affecting conversions in South Dakota contains none of these three key provisions.

The American Hospital Association has also adopted guidelines to help hospital officials deal with the wide range of public accountability questions that surround changes of ownership or control. These guidelines are applicable to not-for-profit hospital conversions as well as transactions between not-for-profit hospitals and are intended to be considered before changes of ownership or control. According to the American Hospital

Association, hospital officials should (1) ensure that they have devised a plan for providing charity care and other essential community services, (2) obtain a valuation of charitable assets by an independent party, (3) ensure that the resulting charitable entity continues to serve the appropriate health needs of the community, (4) disclose publicly the terms of the agreement and provide an opportunity for public comment, and (5) inform the appropriate state official of the terms of the conversion.

Federal Agencies Play a Role in Overseeing Hospital Conversions

Three federal agencies, the IRS, FTC, and Department of Justice, play limited but key oversight roles in hospital conversions. The IRS is responsible for enforcing the federal tax laws that apply to the status and operation of tax-exempt organizations, including not-for-profit hospitals and foundations. Hospital conversions involving joint venture arrangements, in which ownership interests and income are shared between not-for-profit and for-profit entities, raise both tax-exempt status and conflict-of-interest questions. The IRS believes it needs to develop specific guidance addressing joint venture arrangements. FTC and the Department of Justice, as part of their broad mission to enforce federal antitrust laws, investigate and challenge potentially anticompetitive hospital mergers and acquisitions, as necessary. FTC and Justice do not view hospital conversions as posing unusual antitrust issues.

IRS Oversees Tax-Exempt Status Issues in Conversions

The IRS Exempt Organizations Division is responsible for reviewing and approving applications for recognition of tax-exempt status; issuing revenue rulings, guidance, and other interpretations of tax-exemption law; and performing audits to ensure that tax-exempt organizations are operated for tax-exempt purposes. Revenue rulings are often used as precedents to ensure uniform handling of a tax issue. Of the 14 not-for-profit hospital conversions we reviewed, at least four hospitals (Retreat, Mercy Baptist, Mary Black, and St. Francis) received private letter rulings from the IRS. According to Division officials, the conversion of not-for-profit hospitals does not appear to pose pressing or widespread tax-related issues that require special attention. The IRS has attempted to position itself to react quickly to any unexpected activities and believes it maintains sufficient information to pinpoint areas warranting attention. Moreover, IRS officials told us that states are generally in the best position to act on hospital conversions that are problematic, unless it appears that federal law has been violated.

Joint Venture Arrangements Raise Tax and Conflict-of-Interest Questions

Joint ventures between not-for-profit hospitals and for-profit entities can raise questions about whether the not-for-profit will retain its tax-exempt status and whether income distributed to the not-for-profit partner will be subject to tax. Because of the shared ownership structure in a not-for-profit and for-profit joint venture, the opportunity exists for charitable assets to be used for private benefit.[14] The IRS' position is that, to maintain its tax-exempt status, a not-for-profit's participation in a joint venture must advance the not-for-profit's charitable purposes and not result in more than incidental private benefit. According to IRS officials, if the not-for-profit does not exercise control over the day-to-day activities of the joint venture, it cannot ensure that the assets contributed by the not-for-profit will not be used for the private benefit of the for-profit organization. If these assets benefit the for-profit organization, the tax-exempt status of the not-for-profit partner may be revoked. According to IRS officials, if the majority of the not-for-profit organization's efforts are directed toward exempt activities, the organization will generally retain exempt status. In such a case, however, the income earned by the not-for-profit organization from the joint venture may be subject to income tax under unrelated business income tax rules. At the time of our review, the IRS had not published a position or issued guidance on joint venture arrangements. IRS and the Department of the Treasury are drafting a revenue ruling to provide guidance on the treatment of joint venture transactions under the federal tax rules. The IRS expects to issue this ruling by the end of 1997. This ruling may significantly affect the tax-exempt status of and income earned by the not-for-profit organization participating in the joint venture.

Another issue surrounding joint ventures involves the potential for conflict of interest when the same people serve on both the not-for-profit foundation board and the for-profit hospital board after a conversion. The potential for conflict of interest is particularly apparent in joint venture arrangements because the foundation board members have a stake in maintaining the for-profit's interests. For all three joint ventures we reviewed, the charitable foundation board members also participated on the for-profit joint venture board. However, foundation officials stated that the foundations had not awarded any grants in support of the new for-profit hospitals, which is one example of maintaining the for-profit's interest.

[14]Charitable hospitals are exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code of 1986. Therefore, they must operate exclusively for charitable purposes and not for the benefit of private interests, such as designated individuals, shareholders of the organization, or third parties.

Joint operating agreements (JOA) raise similar private benefit and conflict-of-interest issues. In a JOA, two or more hospitals or health care entities operate jointly but retain their separate boards, ownership status, and ownership of assets. The profits and losses from JOA activities, however, are shared. Most JOAs have been among not-for-profit entities. However, a JOA can also occur between a not-for-profit hospital and a for-profit entity, an arrangement that is similar to a joint venture. None of the rulings on JOAs has yet involved for-profit participants. Recently, however, a hospital in Jacksonville, Fla., and Columbia/HCA entered into a JOA. The full implementation of the agreement is awaiting an IRS private letter ruling on the tax effects of the operating agreement. While JOAs raise some of the same concerns as joint ventures, the forthcoming IRS and Treasury guidance on joint ventures may not address the specific concerns raised in the context of JOAs.

FTC and Justice Conduct Routine Oversight of Conversion Antitrust Issues

FTC and Justice share responsibility for enforcing the federal antitrust laws; however, according to officials of these agencies, hospital conversions do not raise any special issues under the antitrust laws.[15] In carrying out their oversight roles, FTC and Justice investigate and challenge, where appropriate, potentially anticompetitive hospital mergers and acquisitions. According to FTC officials, antitrust issues presented by not-for-profit conversions do not differ from those presented by mergers and acquisitions between not-for-profit entities, and most hospital mergers do not violate the laws enforced by FTC and Justice. FTC and Justice receive advance notice of many transactions under the premerger notification requirements of Hart-Scott-Rodino.[16] However, according to FTC officials, this filing requirement does not apply to some types of mergers and acquisitions (such as those involving public entities) and to certain joint ventures.

FTC has investigated ten of the many proposed acquisitions of not-for-profit hospitals by for-profit firms and, in three of these cases, blocked a merger or obtained divestiture as a condition for allowing the transaction to proceed. For example, in 1995 FTC alleged that the proposed acquisition by

[15]FTC enforces the Federal Trade Commission Act, sec. 5 of which prohibits unfair methods of competition. Justice has responsibility for enforcing the Sherman Act, sec. 1 of which prohibits all conspiracies or agreements that restrain trade. FTC and Justice both have jurisdiction under the Clayton Act, sec. 7 of which prohibits all mergers and acquisitions of stock or assets that may substantially lessen competition or tend to create a monopoly.

[16]The Hart-Scott-Rodino filing requirement covers agreements in which the acquiring hospital has net sales or total assets of at least $100 million and the hospital being acquired has assets of at least $10 million.

Columbia/HCA of John Randolph Medical Center, one of the conversions we reviewed, would endanger competition for psychiatric hospital care because it would bring under common ownership John Randolph's psychiatric unit and a competing Columbia/HCA psychiatric hospital in nearby Petersburg, Va. In its order, FTC permitted Columbia/HCA to acquire John Randolph Medical Center on the condition that it later divest itself of its psychiatric hospital in Petersburg.

Conclusions

Concerns about the conversion of not-for-profit hospitals and the transfer of millions of dollars in charitable assets still exist, because they are carried out essentially privately between boards of the selling hospitals and management of the purchasing for-profit companies. These conversions are not routinely subject to any disclosure requirements, which leaves little opportunity for community involvement outside of the community members who serve on the not-for-profit hospitals' boards. A growing number of states are recognizing that the public interest is at stake and, as a result, are becoming more involved in overseeing the conversion process and monitoring the terms of such transactions. This increased state oversight may address some questions and concerns related to obtaining fair value for charitable assets, obtaining public disclosure and community input, and ensuring that the proceeds of the transaction are used for appropriate charitable purposes.

Agency and Other Comments

We provided copies of our draft report to the IRS and several experts on hospital conversion issues for review. IRS officials responded that the report generally reflects the agency's position. They noted, however, that they have not fully resolved the issues surrounding joint ventures, and we modified the language in our report accordingly. The expert reviewers suggested that we clarify other issues in our report, and we incorporated revisions where appropriate. We also asked 21 officials, including hospital administrators, foundation executives and board members, and attorneys who represented the not-for-profits in the transactions, to validate the information included in the report. These officials generally agreed with the draft report. Some officials provided technical comments, which we incorporated where appropriate.

Subsequently, we were asked to provide a draft of our report to Volunteer Trustees of Not-for-Profit Hospitals, a public interest group, for review. We also provided a copy to the Federation of American Health Systems, which represents for-profit hospitals and health care facilities. One issue of major

concern to Volunteer Trustees was that we had not obtained documented evidence of sale information. In response to this comment, we revised our draft to indicate those instances where we had documented evidence, including purchase or partnership agreements, IRS revenue rulings, valuation reports, and fairness opinions, to support the testimonial information provided in our report. In those cases where we were not given documentary evidence because of the proprietary nature of the information and confidentiality agreements, we had to rely solely on information provided in interviews. Where appropriate, we clarified the sources used to support information in our report.

We are sending copies of this report to the Secretary of Health and Human Services, the Commissioner of Internal Revenue, state attorneys general, appropriate congressional committees, and other interested parties. We will make copies available to others upon request.

Please contact me at (202) 512-7119 or James O. McClyde, Assistant Director, at (202) 512-7152 if you or your staff have any questions. Other GAO contacts and contributors to this report are listed in appendix IV.

Bernice Steinhardt
Director, Health Services Quality
and Public Health Issues

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Abbreviations

CEO	chief executive officer
EBITDA	earnings before interest, taxes, depreciation, and amortization
FTC	Federal Trade Commission
IRS	Internal Revenue Service
JOA	joint operating agreement
NAAG	National Association of Attorneys General
PROPAC	Prospective Payment Assessment Commission
RFP	request for proposals

Objectives, Scope, and Methodology

In response to concerns surrounding not-for-profit hospital conversions, we were asked to determine for these conversions the methods used to value assets, to what extent funds from the sale of hospital assets are directed to foundations, to what extent the proceeds from hospital conversions are fulfilling their charitable missions, and what role federal and state governments play in the conversion of hospitals from not-for-profit to for-profit status. As part of our review of the conversion process, we also reviewed the processes used for soliciting interest and receiving bids; the terms negotiated as part of the sales agreement, including provisions for charity care; and the extent of community involvement.

To accomplish these objectives, we worked with three major investor-owned hospital corporations—Columbia/HCA Healthcare Corporation, Quorum Health Group, and Tenet Healthcare Corporation—to develop a list of not-for-profit hospital conversions occurring after 1990.[17] We used this list to judgmentally select six states and 14 sites. We chose these states—Alabama, California, Louisiana, South Carolina, Tennessee, and Virginia—and sites because they had one or more of the following characteristics: asset sales and joint venture transactions; multiple conversions, conversions involving multiple investor-owned companies, or both; and transactions in which the proceeds were directed to foundations. Our review focused on reviewing the conversion processes used by the hospitals selected for site visits, and therefore the results cannot be generalized nationally, to a particular state, or to a particular investor-owned company.

To determine the methods used to value assets, the processes used for soliciting interest and receiving bids, the terms negotiated as part of the sales agreement, and the extent of community involvement in the conversion process, we interviewed for-profit hospital chief executive officers (CEO); attorneys who represented the not-for-profit hospitals in the conversion transactions; and other hospital, university, city, and foundation officials with knowledge of the not-for-profit hospital conversion process. We also interviewed officials at accounting firms, consulting firms, and valuation companies to determine their overall involvement in the conversion process and, specifically, the process(es) and method(s) used for valuing the hospital assets. From some hospitals, we collected documentation on the valuation estimate or range, purchase price, and purchase agreement; officials at other hospitals stated that

[17]In Feb. 1994, Columbia merged with HCA to form Columbia/HCA Healthcare Corporation. The list of not-for-profit conversions we received from Columbia/HCA contains conversions for the merged entity.

because of confidentiality agreements they could not provide such documentation. We also reviewed Internal Revenue Service (IRS) guidance governing the valuation of assets and receiving fair market value. Our review did not include an analysis of whether each hospital received fair market value from the sale.

To determine the amount of conversion proceeds directed to a charitable entity and how the proceeds from the sale were used to fulfill a charitable mission, we interviewed officials from the charitable entity that received the conversion proceeds (that is, university officials, foundation board members and presidents, and city officials) and reviewed supportive documentation where available. We also reviewed and analyzed foundation mission and purpose statements, grant award criteria, and board composition. For those foundations that had initiated a grants cycle, we reviewed documentation provided on the grants awarded: recipients, award amounts, and proposed uses.

To determine the role the federal government plays in the conversion process, we held discussions with officials at the IRS, Department of the Treasury, Federal Trade Commission (FTC), and Department of Justice. In addition, we reviewed and analyzed applicable federal laws and regulations governing not-for-profit organizations and use of charitable proceeds. We also reviewed selected IRS revenue rulings, hospital and foundation tax return filings, and FTC Hart-Scott-Rodino antitrust filings. In some cases, hospital officials did not provide documentation of the hospitals' filings with the IRS and FTC.

To determine the role that state governments play in the conversion process, for each state reviewed, we conducted interviews with representatives in the attorney general's office and reviewed and analyzed copies of relevant state legislation. We also coordinated with Consumer Catalyst in Boston and an attorney with The Harrison Institute for Public Law, Georgetown University Law Center, to develop a list and description of enacted and pending state legislation governing hospital conversions.

To verify our information, we asked individuals involved in or knowledgeable about the not-for-profit hospital conversions in our study to review our draft report. We also provided copies of our draft report for review to the IRS, three experts on hospital conversion issues, and both a not-for-profit and a for-profit interest group. We incorporated comments where appropriate

Foundations' Mission Statements and Examples of Grants Issued

Foundation	Mission statement	Year, number of grants, and total amount	Purpose of grant
Annabella R. Jenkins Foundation	"[S]upport quality health care and effective health care programs in the greater Richmond area."	1996 - 29 grants - $706,774	— Provide summer "camperships" for disadvantaged and chronically ill children — Provide adult day care services — Fund a community program that provides medication to those who cannot afford to purchase it — Fund a vision screening project for at-risk children — Purchase medical equipment for children of indigent families — Support a program to increase the new blood donor retention rate
Arlington Health Foundation	"Its mission is to establish, promote and support programs to improve the health and well-being of the people of Arlington and surrounding Northern Virginia communities."	[a]	[a]
The Assisi Foundation of Memphis	"[F]ocuses on support for innovative programs that address the needs of Mid-South residents in the categories of health and human services, education, religion, and community development."	FY 1996 - 83 grants - $5,306,593	— Support research in the area of cell and gene therapy — Support patient care and medical research programs — Assist a university's science and math programs — Increase capacity to provide services in a child care center — Help pay for construction of a new animal hospital and quarantine space
Baptist Community Ministries	"[I]n keeping with our Baptist heritage, Baptist Community Ministries is committed to the development of a healthy community offering a wholesome quality of life to its residents and to improving the physical, mental and spiritual health of the individuals we serve."	Fall 1997 - 40 grants - $7,800,000	— Expand an existing adult caregiver training program and dependent child day care support service in a local housing project — Expand childhood immunization programs in a local housing project — Fund an antiviolence program — Fund a street crime call-in reward system

(continued)

Foundation	Mission statement	Year, number of grants, and total amount	Purpose of grant
Drs. Bruce and Lee Foundation	"[T]o advance the general welfare and quality of all life in the Florence, South Carolina area by providing economic support to qualified programs and non-profit organizations."	1996 - 10 grants - $200,000	— Provide CPR and first-aid training in public schools — Rehabilitate summer camp facilities — Purchase extraction equipment to rescue entrapped victims — Purchase new therapeutic and testing equipment for speech and hearing disorders — Purchase biology lab equipment at a college
Etowah Baptist Association	"[T]he promotion of fellowship among the individual churches, the extension of the Kingdom of our Lord Jesus Christ by evangelism and other means; the encouragement and enlistment of churches in this Association to promote missions, education, and benevolence . . . ."	Fall 1996-97[b]	— Support church and missions development — Fund a Meals on Wheels Program — Provide drug and alcohol education in schools — Purchase a passenger van for transporting youth — Fund scholarships
Good Samaritan Charitable Trust	[M]aximizes the health of the people of the greater Santa Clara Valley by expanding access to health care and promoting education and wellness."	[a]	[c]
Hilton Head Island Foundation	"Our mission is to be a growing community-supported, [not-for-profit] endowment of resources for the betterment of our community."	7/95-6/96 - 53 grants - $946,032	— Support need-based scholarships for community area students — Support the development of the infrastructure for an affordable housing project — Develop a program to assist patients suffering from diabetes — Support development of a youth symphony orchestra — Implement a new program providing educational support for disadvantaged youth
The Jackson Foundation	"[P]romotion and development of educational activities supporting and advancing the quality of life within the communities it serves."	[d]	[d]
John Randolph Foundation	"The foundation is committed to identifying and supporting innovative and creative health and quality of life improvements in our community."	1996 - 18 grants - $250,000	Fund the following agencies: — Hopewell Historic Society — Virginia Blood Services — Crater Community Hospice — American Lung Association

(continued)

Foundation	Mission statement	Year, number of grants, and total amount	Purpose of grant
The Lloyd Noland Foundation	Foundation officials reported their plan is to provide long-term and acute health care services to people in Jefferson County.	[a]	[a]
Mary Black Foundation	"[T]o utilize its resources to benefit and enhance the health status and wellness of citizens of Spartanburg County."	7/96-2/97 - 7 grants - $64,938	Fund the following programs: — Spartanburg County Health Assessment — Healthy Communities Training Program

[a]As of Jan. 1997, this foundation had not yet awarded grants.

[b]Number of grants and total amount were not provided by foundation officials.

[c]This foundation has not yet awarded grants, but it does fund and operate several health-related programs, including nine School Health Centers that provide free primary health care to low-income children.

[d]This foundation is not currently issuing grants but has used the proceeds for an aerospace program; construction of an arts, education, and technology center; and other projects.

State Legislation

Arizona

Not-for-profit health care entities must give detailed written notice, made available to the public, to the attorney general and other state officials 90 days before transferring or entering into a joint venture involving all or substantially all of their assets. Within 30 days of the written notice, the parties must, in agreement with state officials, plan a public hearing. Notice of the hearing must be published in the newspaper, and the hearing must be held within 10 days of the last publication. At the hearing, the parties must submit written summary information addressing various factors very similar to the deciding criteria in the model act. The attorney general may also present information at the public hearing. A public record of the hearing must be produced, and the parties must pay all costs associated with the hearing.

California

Not-for-profit health facilities must give written notice, which must include information specified by the attorney general, and get written consent from the attorney general to transfer, or transfer control of, a material amount of assets. The attorney general has 60 days from receiving the not-for-profit's notice to issue a decision but may extend the period 45 days to obtain additional information. Before reaching a decision, the attorney general must conduct at least one public hearing, which must be publicized in the newspaper at least 14 days before the hearing. The attorney general has discretion in reaching a decision but must consider, at a minimum, various factors very similar to the deciding criteria in the model act. The attorney general may obtain reimbursement for the costs incurred in reviewing, evaluating, and reaching a decision. In addition, not-for-profit board members who negotiate a conversion are prohibited from receiving any renumeration from the for-profit entity.

Colorado

Not-for-profit hospital, medical/surgical, and health service corporations wishing to convert to stock insurance companies must file a detailed conversion plan, which must be available to the public and contain certain assurances, and apply for an amended certificate. The plan must provide, for example, that any officer, director, or staff member of the preconversion corporation is disqualified from serving as an officer, director, or staff member of the postconversion corporation and that no one may own more than 10 percent of the combined voting power of the postconversion corporation for at least 3 years. Within 30 days of filing, the corporation must begin publishing notice of the conversion for 3 consecutive weeks. The commissioner of insurance must hold a hearing before deciding to approve or disapprove the plan and publish the decision

within 60 days after the hearing. The commissioner must approve the plan if it meets all filing requirements; is fair, reasonable, and not contrary to law or the interests of subscribers, contract holders, or the public; and provides that the postconversion corporation will meet the standards for stock insurance companies.

Connecticut

A not-for-profit hospital may not enter into a conversion agreement with a for-profit entity without providing detailed notice, subject to public disclosure, to the attorney general and the commissioner of health care access. The commissioner must publish a summary of the notice in the local newspaper, and hold a joint public hearing with the attorney general. The commissioner may not approve the conversion unless the community is ensured access to affordable health care; the purchaser has committed to providing health care to the uninsured and underinsured; and, if applicable, safeguard procedures are in place to avoid conflicts of interests. The attorney general must conduct a review and approve or disapprove the conversion within 120 days of the original notice. The conversion may not be approved if it is contrary to state law or the hospital failed to exercise due diligence, disclose conflicts of interest, or establish a fair market price. In addition, the conversion cannot be approved if the fair market price has been manipulated to cause the value of the assets to decrease; the financing will place the hospital's assets at unreasonable risk; any management contract contemplated is not for reasonable, fair value; or a sum equal to the fair market value of the hospital's assets is not being transferred for charitable health care purposes, support of health care in the community, or a purpose consistent with the intent of any donors to someone selected by the courts and not affiliated with the hospital.

District of Columbia

A health care entity may not execute a conversion to a for-profit entity without the approval of the corporation counsel. The counsel must publish a request to convert in local papers, may hold a public hearing, and has 60 days to approve or disapprove the conversion. Approval may not be granted unless necessary steps have been taken to safeguard the value of charitable assets, taking into consideration numerous factors similar to those in the model act. Corporation counsel must ensure that assets are placed into an independently controlled charitable trust and may charge the for-profit entity the costs of investigating the conversion. In addition, the converting not-for-profit entity may be assessed a conversion fee equal

to 10 percent of the property tax it would have paid during the past 5 years had it not been tax-exempt.

Florida

Any county, district, or municipal hospital organized under state law may be sold or leased to, or enter into management or operating contracts with, any Florida corporation. The hospital governing board must find that the arrangements are in the best interests of the public and state the basis of such finding. The terms of any such arrangements must be determined by the applicable county, district, or municipal governing board, which must, if it elects to lease or sell the hospital, publicly advertise the meeting where the terms will be considered and an offer to accept proposals from all interested and qualified purchasers. Any sale must be for fair market value, and any sale or lease must comply with all antitrust laws. If the hospital receives more than $100,000 annually from the county, district, or municipality that owns it, the corporation must be accountable to the government entity regarding how the funds are expended. This is done by making the funds subject to annual appropriations or, where there is a contract to provide funds to the hospital for more than 12 months, making it possible to modify the contract with 12 months' notice.

Georgia

To convert, a not-for-profit hospital must provide the attorney general with a detailed notice 90 days in advance, make the notice available to the public, and pay a $50,000 fee. Within 10 days of receiving this notice, the attorney general must publicize the proposal in the newspaper and invite comments. Within 60 days of receiving the notice, the attorney general must hold a public hearing to ensure that the public's interest is protected. Under the law, that interest is not protected unless there has been adequate disclosure that appropriate steps have been taken to ensure that the transaction is authorized, the charitable assets safeguarded, and the proceeds used for charitable purposes. This disclosure must address a long list of factors similar to those in the model act. The attorney general generally must issue his findings regarding compliance with the law's requirements within 30 days of the hearing. In addition, no hospital owned by a hospital authority may be sold, or leased unless a notice is provided and a local public hearing is held 60 days prior to such transaction. If such a hospital is leased, the lease must provide that at least one member of the hospital authority will serve as a full voting member of the lessee's governing body and that the governing body will submit financial statements annually to the governing authority of the county where the hospital is located.

Illinois

Provisions enacted in 1990 authorize county-operated hospitals to be transferred, sold, or leased, by ordinance or resolution, to responsible corporations or other entities. A public hearing must be held first with notice about the hearing published in the newspaper at least 10 days before it is held. If the hospital workforce is unionized and the workforce will remain substantially the same, the hospital must continue to recognize the union for collective bargaining purposes if it timely asserts its representational capacity.

Indiana

After a public hearing (notice of which must appear in the newspaper 10 days in advance) and if the county and hospital governing board agree, county-operated hospitals may be leased. If a county and hospital governing board agree that it would be in the county's best interest, such a hospital may also be sold to a not-for-profit hospital corporation to operate it, but if the corporation ceases operation the hospital reverts back to the county.

Kansas

No conversion of an insurer, including not-for-profit medical and hospital service corporations, may take place unless certain requirements are met. These requirements include filing a detailed statement about the transaction or merger and paying a $1,000 filing fee to the commissioner of insurance. If the commissioner approves, and after a public hearing, the transaction or merger may take place. The commissioner may not approve if the insurer would no longer satisfy licensing requirements, the financial condition of the acquiring party would jeopardize or prejudice the interest of policyholders, the plans are unfair and unreasonable to policyholders and not in the public interest, or the characteristics of the individuals involved are such that the merger would not be in the interest of the policyholders or the public or it is likely to be hazardous or prejudicial to the insurance-buying public.

Louisiana

Health care facilities are expressly authorized to enter into cooperative agreements or merge with other health care facilities. Such facilities may apply (for a fee) to the state Department of Justice for a certificate of public advantage, which is intended to immunize them from antitrust laws. After a hearing, the Department may issue the certificate if the transaction is likely to result in lower health care costs or improved access to health care, or higher quality health care without an undue increase in costs. In addition, at least 30 days before a conversion, a not-for profit hospital

must submit a detailed application to the attorney general, who must publish a notice about it in the newspaper within 5 working days of receiving it and who has 60 days to review it and approve or disapprove it. The attorney general must hold a public hearing and approve the transaction unless he or she finds the transaction is not in the public interest because appropriate steps have not been taken to safeguard the value of charitable assets and ensure that proceeds are used for appropriate health care purposes, taking into account a range of criteria similar to those in the model act. In order to prevent the acquisition from going forward, the attorney general must seek an injunction blocking the action.

Maine

All nonprofit hospital and medical service organizations must file a statement of ownership interests and charitable purposes with the attorney general by the end of 1997, and it must be approved by the courts. All assets of such organizations are expressly held in charitable trusts. To engage in a conversion, a nonprofit hospital and medical service organization generally must submit a charitable trust plan to the attorney general that meets certain requirements (related to, for example, meeting unmet health care needs), and the plan must be approved by the courts.

Nebraska

No one may engage in the acquisition of a not-for-profit hospital without submitting a detailed application, made available to the public, to the Department of Health and the attorney general. Within 5 days of receiving the application, the Department must publish a notice about it in the newspaper. Within 20 days of receiving the application, the attorney general must decide whether to review it. The Department, and the attorney general if that office will conduct a review, must hold a hearing within 30 days of receiving the application. The Department has 60 days from receipt of the application to approve or disapprove the acquisition solely on the basis of specific criteria in the law. On the basis of whether the acquisition is in the public interest, the attorney general also has 60 days to approve or disapprove the acquisition, or it is deemed approved. Acquisitions are not in the public interest unless appropriate steps have been taken to safeguard charitable assets and ensure that proceeds are used to provide charitable health care. In determining if the appropriate steps have been taken, the attorney general must consider criteria similar to deciding criteria under the model act.

New Hampshire

In addition to authorities retained by the attorney general and commissioner of insurance, the director of charitable trusts must approve any conversion involving a health care charitable trust. The governing body of any such trust must submit a detailed notice to the director 120 days before the transaction and provide reasonable public notice. The director may hold a public hearing and must ensure that the governing body of any such trust has acted in good faith, fulfilled its fiduciary duties, and met numerous other requirements similar to those in the model act. The commissioner of insurance may, however, waive these requirements if the transaction is necessary to avoid the future impairment or insolvency of health insurer or health maintenance organizations that are involved.

New Jersey

For a health service corporation to convert to a domestic mutual insurer, the governing board must adopt a resolution to convert that includes a detailed plan for conversions by a two-thirds vote of all directors. The plan must be submitted to the commissioner of insurance, and after 30 days' notice, a public hearing must be held. The commissioner must approve or disapprove the plan within 30 days after the hearing.

North Carolina

Municipalities and hospital authorities may lease, sell, or convey any hospital facility to a for-profit corporation. To do so, they must first adopt a resolution of intent, request proposals, and hold a public hearing. Then they must hold another public hearing on the proposals, which must be made available to the public before the hearing. Finally a proposal may be adopted only if it is determined at another meeting to be in the public interest. The corporation must agree to provide the same or similar medical services and access to them, and a report must be prepared annually to document compliance. The hospital reverts back to the municipality or hospital authority if the corporation fails to comply. A municipality or hospital authority may also lease hospital land to, or enter into a joint venture with, a for-profit corporation, so long as the hospital facility is maintained as the corporation would have been required to maintain it had the corporation bought it. In addition, a public hospital may acquire ownership interest in a not-for-profit or for-profit managed care organization.

North Dakota

Not-for-profit health service corporations may convert to not-for-profit mutual insurance companies, by seeking approval from the commissioner of insurance under the same procedures as required for consolidation, but

are not authorized to convert to for-profit status. The new not-for-profit mutual insurance company may continue to provide health care and related service to members and subscribers and make payments directly to hospitals and others rendering such services. The laws governing other mutual insurance companies generally apply, but not-for-profit corporation laws apply to the operation and control of a nonprofit mutual insurance company that converted from a not-for-profit health service corporation. If any assets of the not-for-profit health service corporation were considered to be in a charitable trust, conversion does not create a breach of that trust nor provide grounds for disapproving the conversion.

Ohio

A not-for-profit health care entity proposing a transaction must provide a detailed notice, made available to the public, to the attorney general. Not more than 7 days after providing the notice, the entity must publicize it in the newspaper. The attorney general has 60 days from the time the notice is submitted to approve or disapprove the transaction but may, for good cause, extend the deadline 90 days. In deciding whether to approve or disapprove the transaction, the attorney general must consider, for example, if it will result in a breach of fiduciary duty, if the entity will receive full and fair market value, if the proceeds will be used for the entity's original purpose, and any other criteria considered appropriate. The attorney general may obtain reasonable reimbursement from the entity for the cost of making the determination. If the attorney general approves the transaction, the entity must hold a public hearing to receive comments on the proposed use of the proceeds not later than 45 days after it receives notice of the approval. The proceeds must be dedicated and transferred to one or more new or existing tax-exempt charitable organizations, which may include a foundation if the attorney general finds that it meets certain conditions.

Oregon

Any public benefit or religious corporation that operates a hospital (unless the hospital is controlled by a political subdivision of the state) must provide a detailed notice to and obtain approval from the attorney general before converting the hospital to a noncharitable entity, unless it has requested and received a waiver, the attorney general has not responded to its request for a waiver within 45 days, or the transaction is of a type the attorney general has by rule excepted. A mailing list must be maintained of members of the public who have requested, and for a fee must be sent, copies of such notices. If requested, however, the attorney general may maintain the confidentiality of submitted information deemed to be "trade

secrets" unless it is necessary to the determination of an issue to be considered at a public hearing on the transaction. Such a hearing is required unless the attorney general waives the requirement. Notice must be sent to the people on the mailing list about the hearing or waiver of the requirement to hold one. If the attorney general has received all the necessary information to make a decision, on the basis of whether the conversion meets criteria similar to those in the model act, the attorney general must approve or disapprove the conversion within 60 days of receiving the original notice about it. Fees may be charged to the costs incurred in reviewing and evaluating the transaction.

Rhode Island

No conversion may take place without the approval of the attorney general and the Department of Health. Detailed applications must be filed and the information in them is generally public. Within 10 days of receiving the application, the attorney general publishes notices about the conversion and a public hearing to consider it in the paper. The attorney general has 120 days after receiving the application to approve or disapprove the conversion and forward it to the Department of Health for review. The attorney general may compel parties to testify, and all costs of reports generated and experts consulted may be charged to the transacting parties. The attorney general must consider a lengthy list of criteria, including criteria similar to those in the model act, in determining whether to approve the conversion. Proceeds from the conversion must be transferred to a charitable foundation, with a judge appointing the initial board of directors. Limits are imposed on the frequency with which a for-profit corporation may acquire greater than a 20 percent interest in a hospital.

South Dakota

Upon the sale, transfer, or merger of at least 30 percent of the assets of a not-for-profit corporation, certain information must be submitted within 60 days after the transaction to the secretary of state on a form provided for that purpose. The required information includes information about the parties involved, the terms of the transaction and dollar amounts involved in it, and an explanation of how the transaction furthers the purpose of the not-for-profit corporation.

Texas

Hospital boards may contract with other facilities to supply services and for the sale or lease of hospital facilities only with the approval of the commissioners' court. Charity care and community benefit requirements

are set for hospitals. A not-for-profit hospital must submit to state officials an annual report that includes its mission statement, information about the charity care and community benefits it provides, and financial data. In addition, state officials must provide the attorney general and comptroller with a list of hospitals that did not meet the charity care and community benefit requirements each year. A mutual insurance company may convert to a stock insurance company, but it must first file copies of documents relating to the conversion plan with the commissioner of insurance, who has 60 days to approve or disapprove the plan but can, on written notice, extend this time by 30 days. The commissioner may hold a public hearing on the plan, and eligible members of the mutual insurance company must have an opportunity to comment on it. If approved by the commissioner, the plan becomes effective only after the affirmative vote of eligible members.

Vermont

No not-for-profit hospital service corporation or medical service corporation may engage in a conversion involving more than 10 percent of its assets without applying to and receiving approval from the commissioner. The commissioner must hold at least one public hearing within 30 days of receiving an application and approve or disapprove it within 30 days of the hearing. In considering an application, the commissioner must consider factors such as whether the transaction will provide cost-effective, high-quality care.

Virginia

Before the disposition of assets, a not-for-profit entity must provide notice to the attorney general in order for the attorney general to exercise common law and statutory authority over the transaction. The notice must be given at least 60 days before the effective date of the proposed transaction in order for the attorney general to exercise his common law and statutory authority over the activities of the entity. Within 10 days of receiving this notice, the attorney general must publish information about the proposed transaction in the newspaper. In addition, with the approval of the State Corporation Commission, a domestic mutual insurer may convert to a domestic stock insurer. After notice and an opportunity to be heard are given to policyholders, the Commission must approve the conversion if, among other things, it is fair and equitable to policyholders.

Washington

A person may not engage in the acquisition of a not-for-profit hospital without first submitting a detailed application, which is considered a

public record, and paying a fee to cover all the costs of considering the application to the Department of Health. The Department must publish a notice regarding the application in the newspaper, conduct one or more public hearings, and forward a copy to the attorney general. Generally within 45 days of the first public hearing, the attorney general must issue an opinion on whether the transaction meets requirements similar to those in the model act. The Department then has 30 days to approve or disapprove the transaction, depending on whether it will detrimentally affect the continued existence of accessible, affordable health care responsive to the community. This is determined on the basis of whether the transaction meets certain minimum standards.

GAO Contacts and Staff Acknowledgments

GAO Contacts

James O. McClyde, Assistant Director, (202) 512-7152
Ann Calvaresi Barr, Project Manager, (202) 512-6986
Janina Johnson, Senior Evaluator, (202) 512-7139

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