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OFFICE OF THE ATTORNEY GENERAL

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October 31, 2017

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**Re: Approval of Proposed Acquisition of St. Francis Health Center, Inc. by  
Topeka Health System, LLC**

Dear Counsel:

In May 2017, the University of Kansas Hospital Authority and Ardent Health Partners, LLC, announced the creation of a joint venture company, Topeka Health System, LLC, as a Delaware for-profit entity (“THS” or “Buyer”), to purchase St. Francis Hospital in Topeka. To effectuate that public announcement, on September 29, 2017, the parties presented to this office a proposed Asset Purchase Agreement (“APA”) wherein THS has agreed to purchase from the

Sisters of Charity of Leavenworth Health System, Inc., a Kansas not-for-profit corporation (“SCL” or “Seller”), substantially all of the assets necessary for the operation of (i) the general acute care hospital known as St. Francis Health Center, Inc., Topeka, Kansas (“SFH” or the “Hospital”); (ii) St. Francis Physician Clinics; (iii) St. Francis Accountable Health Network, Inc.; and (iv) an operating division of Med-Care of Kansas, Inc., doing business as Integrated Nuclear Enterprises.

The proposed purchase you have outlined in the APA is a conversion of a not-for-profit charitable organization to a for-profit organization. Unlike some other states, Kansas has no statute specifically governing these sorts of not-for-profit to for-profit hospital conversions,<sup>1</sup> but as you have recognized the Kansas Attorney General long has had authority under the common law and through general statutory provisions, including the Kansas corporation code, to review proposed charitable asset conversions such as this. The Attorney General reviews these sorts of charitable conversions to make certain multiple standards and conditions are met in connection with the proposed sale and transfer of the assets.

Pursuant to that responsibility and authority, my office has made an extensive inquiry and review of your proposed transaction. This letter describes our process of review and sets forth our findings.

#### Attorney General’s Process for Review of Proposed Transaction

In conducting our review of the proposed transaction, the Attorney General’s Office engaged in substantially the same process as it has for similar, prior transactions. Specifically, our review included, but was not limited to, the following:

- Both before and after being provided the final APA, this office requested that the parties allow us to review certain materials and documents that were created incident to the execution of the APA. Your responsiveness to our requests has allowed us to complete our review in an expedited time frame.
- We engaged the services of an outside consultant, David Whelan of Atlanta, Georgia, to review the transaction to ensure it meets accepted standards for the conversion of a not-for-profit to a for-profit hospital. We have attached hereto as Exhibit A a copy of Mr. Whelan’s final report and his credentials.
- We conducted legal analysis related to the proposed transaction and the Attorney General’s role related thereto. We reviewed potentially relevant statutes, looked to the Attorney General’s role in similar prior situations, and reviewed appropriate case law. In light of the importance of this matter to Kansas, and in the absence of a statute

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<sup>1</sup> In connection with the sale of Health Midwest to HCA, the Legislature enacted 2003 Senate Bill 44, later codified at K.S.A. 65-441a, which purported to govern certain aspects of the conversion of a not-for-profit hospital to a for-profit entity. Material aspects of that bill were determined by the Johnson County District Court to be unconstitutional. See *Health Midwest v. Kline*, 2003 WL 328845 (Mem. Order at 20-25). The 2004 Legislature subsequently repealed that statute.

expressly governing this sort of transaction, we also retained independent legal counsel to conduct a separate legal assessment of the Attorney General's authority and role in this matter. A copy of that assessment, which confirms our internal conclusions, is attached hereto as Exhibit B.

- We solicited and accepted public comment to give all persons an opportunity to bring to our attention any concerns or issues related to the proposed transaction. Copies of the public comments received are posted online as Exhibit C but are not attached hereto because they are numerous. Exhibit C is available at <https://ag.ks.gov/docs/default-source/documents/stfrancis-exhibitc-publiccomments-web.pdf>.
- We noted significant public interest in the changed financial condition of SFH in recent years, specifically the disposition of about \$250 million in accounts receivable from SCL that appeared on the SFH financial reports as recently as 2015 but were not present at the time of the proposed transaction. This figure led some observers to compare this situation to prior conversions that resulted in the creation of a charitable foundation to receive assets derived from the net proceeds of the sale of the not-for-profit to a for-profit entity. We conducted the necessary due diligence to address this question that plainly is on the minds of many observers.

We discuss each of these matters below.

#### The Proposed Transaction Meets Accepted Standards for the Conversion of a Not-for-profit to a For-profit Hospital

As addressed in our expert report (Exhibit A), the accepted standards for the conversion of a not-for-profit to a for-profit hospital, as determined in prior transactions of this type, generally include the following six items:

1. The Board of the selling entity has appropriately reviewed the options for continuing operations of the hospital and determined that a sale is the most appropriate strategy for preserving healthcare in the community.

Excerpt from Report Conclusion: **“There was sufficient reason for the Board of SCL to seek to sell the assets of St. Francis Hospital.** The declining performance of SFH and the magnitude of the losses sustained and absorbed by SCL called into question the financial viability and sustainability of SFH. The SCL Board was diligent in reviewing the performance of SFH and alternatives over a 3 year period.”

2. The seller has conducted a fair and unbiased auction process without conflict of interest;

Excerpt from Report Conclusion: “**The Auction Process was comprehensive, open and fair.** Once the Board made the decision to sell or close the hospital, SCL retained a national investment bank, Citigroup World Markets, a credible and knowledgeable advisor with experience in similar transactions, to conduct a national auction to find a buyer for SFH.”

3. The buyer is paying fair market value for the charitable assets;

Excerpt from Report Conclusion: “**While there was not a formal Fair Market Valuation conducted, the Fair Market Value of SFH was determined by a fair and open market auction.** In the case of a distressed hospital, such as SFH, it is often irrelevant to apply common valuation methodologies to determine market value...” The Report also noted that “[t]he initial auction process resulted in no bidders willing to make a proposal for the purchase of SFH. Only when the purchase price was reduced to \$1 by SCL were bidders willing to offer to purchase the hospital.”

4. The consideration paid and any retained assets are transferred to a qualified charitable entity and are used for appropriate charitable purposes;

Excerpt from Report Conclusion: “**The Net Proceeds from the transaction will be transferred to qualified charitable organizations and will be used for appropriate charitable purposes.** The sale of SFH is unlikely to produce significant net proceeds since the purchase price is \$1 plus net working capital. Out of those proceeds any remaining liabilities would need to be paid post-closing. Since SFH is a part of SCL, a not for profit health system, any remaining net proceeds would accrue to SCL to promote its charitable mission.”

5. Certain community benefits consistent with the charitable mission of the hospital are protected, including the continuation of services and charity care;

Excerpt from Report Conclusion: “**Adequate Community Benefits are being received.** In the sale of a hospital, the commitment to provide certain community benefits is often as important as the purchase price. The most important community benefit is to maintain healthcare services in the community. With the stated intention of SCL to close St Francis Hospital due to its continuing losses absent a sale, maintaining hospital services is a key benefit to the community.”

The Report further concluded: “Among the key community benefits to which THS has committed in the Asset Purchase Agreement are:

“1. First and foremost, THS commits to maintain SFH’s general acute care hospital license and continue to operate SFH as a general acute care hospital for a period of three (3) years post-closing. This is perhaps the most important benefit from the sale of SFH, which was slated for closure by SCL if a buyer was not found.

“2. THS commits to invest at least \$50 million in capital in the facility during the first three (3) years post-closing. This capital investment can be in the form of building improvements, equipment, physician recruitment, working capital and funding operating losses.

“3. THS will, subject to customary pre-screening procedures, offer employment to substantially all of the hospital’s active employees in good standing at the time of closing. Those employed will be offered positions and salaries consistent with those currently provided them. In addition, these employees will be covered by THS’ benefit plans with a waiver of pre-existing conditions and recognition of seniority and service status.

“4. THS will maintain one or more local boards to provide local input.

“5. THS will commit to operate the hospital in accordance with the ‘community benefit standards’ set forth in Revenue Ruling 69-545, including, without limitation, “accepting all Medicare and Medicaid patients, accepting of all emergency patients without regard to age, race religion, gender, source of payment or the ability to pay, maintaining an open medical staff, providing and maintaining public health programs of educational benefit to a broad cross section of the communities served by the hospital, and generally promoting the health, wellness and welfare of the community by providing quality health care at a reasonable cost.

“6. THS agrees to maintain the current medical staff bylaws and clinical privileges for physicians and other practitioners, subject to changes in the bylaws with the consent of the medical staff or changes in privileges through normal actions of the medical executive committee and Board.”

And

6. The commitments of the buyer are appropriately enforceable.

The Report identified enforceability of the buyer’s commitments to community benefits from the transaction as a generally accepted standard for the conversion of a not-for-profit to a for-profit hospital. However, the report specifically did not address the enforceability of those commitments. To ensure appropriate enforceability, we insisted on entering into a legally enforceable Memorandum of Understanding (MOU) with the buyer to expressly authorize the Office of the Attorney General to enforce for a specified period of time after closing of the transaction certain community benefits the buyer promises to provide. A copy of that MOU is attached hereto as Exhibit D.

We Identified No Legal Basis or Reason for the Attorney General to Object to the Proposed Transaction, a Conclusion Confirmed By an Independent Legal Assessment

As stated above, Kansas has no statute specifically governing the sale of a not-for-profit hospital to a for-profit entity or setting forth the role of the Attorney General in any such transaction. Nevertheless, several statutes and judicial decisions confirm a role for the Attorney General and provide guidance. We carefully reviewed each of those authorities to ensure this transaction complies with applicable law within the authority of the Attorney General.

The main authority for the Attorney General in a conversion review such as this is to ensure compliance with the corporation code. *See, generally, Kansas East Conference of the United Methodist Church, Inc., v. Bethany Medical Center, Inc.*, 266 Kan. 366 (1998) (corporation code governs such transactions); *see also* K.S.A. 17-6104 (Attorney General has authority to enjoin corporation from transacting unauthorized business). The test is the business judgment rule. *Health Midwest v. Kline*, 2003 WL 328845, at \*17 (Kan. Dist. Ct. Feb. 6, 2003). Here, there is no evidence known to us that the SCL Board acted in violation of that rule.

The Attorney General also has authority to enforce the *cy pres* statute, K.S.A. 59-22a01. The principle of *cy pres* applies to ensure assets of a charitable trust are used to satisfy their intended purpose. Regarding this transaction, the principle of *cy pres* would apply to donations given to the St. Francis Health Center Foundation. However, the foundation's assets are not part of the proposed transaction and, in any event, those assets have been satisfactorily protected by the decision to transfer them in their entirety to the Topeka Community Foundation and the Washburn University Foundation.

The Attorney General also has relevant authority to enforce the Charitable Organizations and Solicitations Act, K.S.A. 17-1759 et seq. As with *cy pres*, however, these statutory provisions apply to donated funds, and the protection of the foundation assets appears to satisfy any concerns that could arise.

Because no statute squarely addresses a not-for-profit to for-profit conversion, in addition to exercising our own legal judgment we also obtained the services of the Hinkle Law Firm to conduct an independent assessment of the Attorney General's role and authority in this matter. The results of that assessment, which is attached hereto as Exhibit B, reached the same conclusions.

There is No Known Legal Basis to Require Creation of a Charitable Foundation to Receive Net Proceeds from this Proposed Transaction

As part of our review of this proposed transaction, we accepted written public comments from October 4, 2017, through October 17, 2017, to ensure any pertinent issues not otherwise known to us could be brought to our attention. We received approximately 340 comments, all of which are available online as Exhibit C as described above. One matter raised frequently in those comments is whether, as a condition of approving this proposed transaction, the Attorney

General's Office will insist on the creation of a new foundation to receive and hold the proceeds of the sale. Those questions generally fall along two lines of reasoning, and because of the public interest in this question we will address it here.

First, it has been noted that in previous not-for-profit to for-profit hospital conversions in Kansas, the Attorney General insisted on creation of a charitable foundation to hold assets from the sale. For example, the sale of Wesley Medical to HCA led to creation of two foundations, the United Methodist Health Ministry Fund and the Wesley Medical Endowment Foundation (now the Kansas Health Foundation). And the sale of Health Midwest to HCA led to creation of two foundations, the REACH Healthcare Foundation in Kansas and the Health Care Foundation of Greater Kansas City in Missouri.

But the proposed transaction in this case is materially different for two principal reasons. First, because of the poor financial condition of SFH, there almost certainly will be no meaningful amount of net proceeds from this sale. HCA, Inc., paid \$1.125 billion for the purchase of the Health Midwest assets. *See Health Midwest v. Kline*, 2003 WL 328845, at \*1 (Kan. Dist. Ct. Feb. 6, 2003). HCA paid \$265 million for Wesley. By sharp contrast, the purchaser in this transaction is paying \$1 (one dollar) plus net working capital for SFH. As noted above in our consultant's report, the proposed transaction "is unlikely to produce significant net proceeds since the purchase price is \$1 plus net working capital."

Second, to the extent any net proceeds are in fact derived from the sale, they would continue to be held by SCL, which is a Kansas not-for-profit corporation. The purpose of the charitable foundations in the previous transactions is to act as a not-for-profit receptacle for the net proceeds of the sale of charitable assets to a for-profit entity. But here, even if there were net proceeds from the sale, those proceeds would continue to be held by the not-for-profit structure of SCL, which continues to provide services consistent with its not-for-profit corporate mission.

Accounting for the 'Accounts Receivable' that Appeared on SFH Financial Reports in Prior Years is Beyond What is Needed to Review the Proposed Transaction But Our Review of Those Funds Has Not To Date Revealed Any Actionable Misuse

Finally, we are aware of a separate but related question that has arisen in community discussion, including comments filed with our office. Some have noted that as recently as 2015, St. Francis' financial statements showed roughly \$250 million in an account receivable from SCL, a fact that has led some to question "What happened to those funds?"

We need not, and do not, definitively answer that question here. However, because of the community interest in this question, we provide the following information that appears to offer an explanation.

First, based upon information available to us at this time, it appears that because of the legal structure of the relationship between SCL and SFH – a structure established by numerous

decisions made years ago – SCL (the parent entity) had authority to use those funds for the broader purposes of the SCL system, not solely for the purposes of SFH. Three of those past decisions are particularly notable. In 1993, the Articles of Incorporation for SFH were amended to eliminate a requirement that SFH exist solely for the operation of a hospital in Topeka. In 1997, SFH and SCL entered into a Restricted Affiliate Agreement that gave extensive control over SFH finances to the parent entity. And in 2004, SFH again amended its Articles of Incorporation to make express that SFH operates to carry out the broader charitable purposes of SCL. Those decisions, which gave SCL almost complete authority over SFH and its finances, were made many years before the proposed transaction and, in any event, are long beyond any statute of limitations. A copy of a timeline explaining the reorganization of SFH is attached hereto at Exhibit E.

Second, despite the legal relationship described above that gave SCL broad latitude to use funds generated by SFH, it nevertheless appears the vast majority of those accounts receivable were in fact used for purposes benefiting SFH. Our inquiry revealed the following: As a result of routine transfers of funds over time from St. Francis Health Center, Inc. (“SFH”) to the Sisters of Charity of Leavenworth Health System, Inc. (“SCL”), as expressly permitted by the Master Trust Indenture and related Restricted Affiliate Agreement, SFH had accumulated an intercompany receivable from SCL in the amount of approximately \$249 million as of December 31, 2015. Following the decision by SCL’s Board of Directors on May 26, 2016, to either sell or close SFH due to the hospital’s continuing losses, SCL opted to use the accumulated assets associated with SFH to effectively “clean up” SFH’s books by defeasing bonds issued for the benefit of SFH and paying off other SFH intercompany obligations. The bond defeasances included a \$163.7 million defeasance in connection with a 2010 Kansas bond, and a \$32.5 million defeasance in connection with three Colorado bonds that had been used in identifiable part for SFH asset purchases (since Colorado is a multi-state issuer). In addition, SCL used \$20.6 million to fund previously unrecognized pension costs associated with SFH employees, \$14.7 million to fund unrecovered costs for information technology assets, \$21 million to fund system-wide interest expenses in excess of interest income, and another \$700,000 to fund other non-profit entities in the SCL network, for a total of \$252.5 million, an amount that accounts for all of the \$249 million in 2015 accounts receivable.

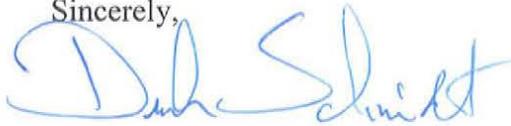
### Conclusions

Based on my review of the materials provided, multiple meetings and conferences with counsel for both the Buyer and Seller, and the opinion of the financial expert engaged by the Office of the Attorney General, approval of this transaction is hereby given and should proceed forthwith, subject to the following conditions that must be complied not later than thirty (30) days post-closing:

1. SCL provides an Affidavit to my office executed by a senior officer of the management team that confirms there are no “Golden Parachutes” being awarded to any member of the management team or members of any Board of Directors.

2. THS is to produce evidence that its application for a license to operate the hospital has been issued by the Kansas Department of Health and Environment, or that the application is pending.
3. Certain costs incurred by my office in connection with the review of this proposed transaction are reimbursed by SCL.
4. The parties to the transaction consent to the public release of the financial evaluation of the transaction prepared by David Whelan, healthcare advisor to the Office of the Attorney General.
5. The Memorandum of Understanding between THS and the Attorney General is incorporated as a condition for this approval.

Sincerely,

A handwritten signature in blue ink that reads "Derek Schmidt". The signature is written in a cursive style with a large initial "D" and "S".

Derek Schmidt  
Kansas Attorney General