

BRIEFING MEMO

Genesis HealthCare of Maine Inc. - Restructuring Project

DATE: December 26, 2008

TO: Brenda M. Harvey, Commissioner, DHHS

THROUGH: Catherine M. Cobb, Director, DLRS

FROM: Phyllis Powell, Manager, CONU
Larry Carbonneau, Health Care Financial Analyst, CONU

SUBJECT: Proposal by Genesis HealthCare of Maine to: Modify corporate structure for six organizational entities from corporation to limited liability corporations.

ISSUE ACTIVATED BY: The subject proposal requires Certificate of Need approval in accordance with 22 M.R.S.A. Section 326 et seq., of "The Maine Certificate of Need Act of 2002."

BACKGROUND:

- On December 5, 2006 a Certificate of Need (CON) was issued that authorized Genesis Healthcare of Maine (GHM) to enter into an option to purchase real estate from Sandy River Health Systems (Sandy River Affiliates). This CON also authorized GHM to purchase certain personal property from SRHS and to form eleven LLCs to operate the eleven nursing facilities owned by SRHS.
- On June 11, 2007, an approved Subsequent Review (SR1) authorized a July 13, 2007 merger between FC-GEN and Genesis HealthCare Corporation (GHC). FC-GEN Acquisition, Inc., headquartered in Alpharetta, GA, became the owner of 100% of the stock of GHC. GHC owns 100% of the stock of Genesis HealthCare Holding Company I, Inc., which is the parent of two other entities organizationally above Genesis HealthCare of Maine, Inc.
- On July 18, 2008 a Subsequent Review SR2 authorized FC-Gen to accomplish the following: (1) Separation of operating entities and real estate entities; (2) acquire leases from sub-landlord companies to whom existing leases are assigned; (3) assume management agreements; and (4) First and Second Amendments to Leases, which had been shared with DHHS in filings dated January 25, 2008 and May 22, 2008.
- This Subsequent Review Briefing Memo SR3 involves actions that will, according to GHM: 1) increase efficiencies and reduce costs by converting six organizational entities (corporations) to LLC status, which will reduce administrative burdens created by multiple tax filings and organizational regulatory filings; 2) satisfy lender requirements; and 3) move closer to satisfying the SR2 approval. SR3 will approve the conversion of the last three corporate entities in the organizational structure to LLCs. The separation of operating entities from real estate entities, acquisition of leases from sub-landlord companies and assumption of management agents, is being deferred for future action.

- The Subsequent Reviews are depicted on the enclosed organization charts (Subsequent Review 1, Subsequent Review 2, Subsequent Review 3) that reflect the changes for each of the subsequent reviews.

HIGHLIGHTS:

Original CON Approved December 5, 2006
Subsequent Review 1 Approved June 11, 2007
Subsequent Review 2 Approved July 18, 2008

CLARIFYING INFORMATION RECEIVED FROM APPLICANT (condensed):

“For your reference, we provide a bullet point summary of the key points, which are discussed further below, of the proposed changes in corporate form:

- The Maine operating LLCs are not changing;
- There will be no change in the ultimate parent entities of the Maine operating LLCs;
- The only change is a change in corporate form of intermediate entities from corporations to LLCs, which will represent cost savings and efficiencies;
- The CONU agency already approved the change in corporate form of the immediate parent of the Maine operating entities, Genesis HealthCare of Maine, Inc., to an LLC;
- The laws by which the intermediate entities are changing confirm that the LLC is a continuation of the corporation and that the LLC cannot avoid any liabilities or responsibilities of the predecessor corporation;
- The change in corporate form does not fall within the scope of the specific considerations found in the statute that require subsequent review;
- There will be no negative impact on the residents, and any cost savings and increased efficiencies would benefit the Maine operating LLCs and therefore the residents;
- Approvals/waivers have been issued in multiple other states;
- Filings with other State Secretaries of State need to be made immediately to permit conversion/mergers to take effect January 1, 2009;
- Delay into the new year would cause significant disruption including need to go back to other states with new timing; and
- Delay would cause bifurcated year for tax reporting purposes with additional expenses and administrative burden.”

“The Second Subsequent Review Approval dated July 17, 2008 (with sub-landlords and management agreement, etc.) has not yet been implemented. The key reason that the Second Subsequent Review Approval could not be implemented was the absence of consent from the lender as discussed at a meeting in December of 2008 with CONU staff. Genesis has until July 17, 2009 to implement this or seek an additional one year extension.”

This is the end of additional comments by applicant (condensed).

CONU COMMENTS:

CONU has determined that this transaction is subject to CON review.

As of December 18, 2008 Genesis has not implemented the organization structural changes approved in the Second Subsequent Review SR2 approved on July 2008 (See table labeled Subsequent Review 2). The applicant now proposes a change in their organizational tax structure from 6 corporations to six LLCs

as a step in the implementation of the SR2. Three of the six conversions were approved as part of the SR2. This Subsequent Review SR3 will allow the applicant to convert the last remaining corporations into LLCs (See table labeled Subsequent Review 3).

According to the applicant, the proposed changes should not have a negative impact on the day-to-day operations of the Maine facilities or on the residents. The day-to-day management functions of the Maine operators will be carried out by Genesis Healthcare of Maine, LLC. CONU has consulted with DLRS Long Term Care and they report no outstanding complaints against the former Sandy River facilities. CONU concludes no adverse impact on patients would result from approval of the SR3.

Upon this restructuring, individuals from Sandy River will continue to be employees of the operating group set up in Maine and continue to work for Genesis from a Portland satellite office. The administrators of the facilities are not expected to change because of this project. The two officers of the operating entities include the Chief Executive Officer, Mr. George Hager and Richard Blinn who was named as the Operating Officer of Genesis HealthCare of Maine. These officers will remain in place with this SR3.

This request eliminates the remaining corporations in the line of ownership for the operating entities. Currently, the top two organizations by hierarchy are LLCs and the intermediate layers are incorporated entities. SR2 approved changes to the 7th through 9th layers of the organization that, when implemented, would change the form of ownership from corporations to LLCs. The applicant has until June 2009 to commence this, pursuant to 22 MRSA section 326. This subsequent review SR3 would allow these entities, as they existed at the time of the second subsequent review, to be transformed into limited liability corporations.

SR3 will authorize the conversion of the remaining three levels of the organizational structure from corporations to LLCs. A future planned step, as approved in SR2, would bifurcate the LLCs at levels 7, 8 and 9 into two LLCs, one of which will manage operations and the other will manage property. This step cannot be implemented without lender approval. According to GHM, the lender has not granted approval due to global market conditions that is impacting rewriting loans and corporate restructuring.

A reasonable consideration for CONU is the ability of the Sandy River Health Services to regain ownership and develop operating strategies for the eleven facilities should Genesis not consummate the lease option approved in the original CON. CONU does not believe that the conversion to LLCs at a higher corporate level would not negatively impact this ability to maintain operations in the short or long term. Several managers of Sandy River are now employees of GHC of Maine (to be converted to LLC) and continue to be involved in operations.

According to the applicant, other states are or have reviewed similar transactions regarding "FC-GEN" entities in their states including Vermont and Massachusetts. The applicant has undergone requisite reviews in other states. It is reported, by the applicant, that all state approvals have been received except the State of Maine CON. The applicant stresses the time urgency of this application to avoid multiple, costly, filings at year's end. All states involved must transact conversions/mergers simultaneously to effectuate the multi-state corporate restructuring.

CONU requested a list of all the operating companies and structures, corporate ID's, etc, from the applicant. This information is included in the material submitted relative to this subsequent review. CONU will forward this information to the Office of Maine Care Services – Audit as well as the long-term care licensing manager.

CONCLUSION:

For all the reasons contained in the record, the Preliminary Review, the initial and second Subsequent Reviews and considering the information provided by the applicant, we now conclude that the review criteria has again been satisfied and recommend the Approval of a modification to the CON.

RECOMMENDATION:

The CONU recommends this proposal be **approved**.