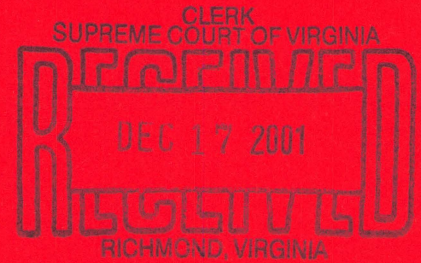


263 Va 520

IN THE
SUPREME COURT OF VIRGINIA
AT RICHMOND



RECORD NO. 011150

LASZLO N. TAUBER, LESLIE L. PETERS, IRWIN S. FREEDMAN, ESTATE OF SAMUEL BURTOFF, MICHAEL A. CORRADO, DAN J. FERIOZI, LESLIE P. GONDOR, REGINALD P. MCMANUS, MAGDOLNA A. IRANYI, ESTATE OF JAMES H. SCULLY, JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE, JEFFERSON MEMORIAL HOSPITAL, INC., JEFFERSON MEMORIAL HOSPITAL ASSOCIATES, JEFFERSON MEMORIAL HOSPITAL CORPORATION, JEFFERSON CORPORATION OF ALEXANDRIA, THE TAUBER FOUNDATION, and THE CHARITABLE REMAINDER UNITRUST,

Appellants-Respondents,

v.

COMMONWEALTH OF VIRGINIA, *ex.rel.*, RANDOLPH A. BEALES, ACTING ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; RANDOLPH A. BEALES, ACTING ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; and THE COMMONWEALTH'S ATTORNEY FOR THE CITY OF ALEXANDRIA,

Appellees-Complainants.

JOINT APPENDIX

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BOARD OF DIRECTORS MEETING
JEFFERSON MEMORIAL HOSPITAL

April 9, 1979

A G E N D A

- I. REDEMPTION OF DR. ALFONSO'S BONDS
- II. A. MOVING OF HOSPITAL ADMINISTRATION TO 6th FLOOR
B. ALTERNATE MOVING PART OF ADMINISTRATION TO DR. GONDOR'S BUILDING
- III. PLANS FOR NEW PARKING
- IV. HOSPITAL RENT TO JOINT VENTURE
- V. DIVISION OF EXPENSES BETWEEN DOCTORS AND HOSPITAL
 - A. UTILITIES
 - B. MAINTENANCE
 - C. INSURANCE
 - D. TAXES
- VI. REPORT OF MEDICAL STAFF PRESIDENT
- VII. REPORT OF HOSPITAL ADMINISTRATOR

TAUBER 01332

EX. 1064

J.APP. 5425

BOARD OF DIRECTORS MEETING
JEFFERSON MEMORIAL HOSPITAL

- I. DATE: Wednesday, April 9, 1979
- II. TIME & PLACE: 7:00 P.M., Conference Room
- III. ATTENDANCE:

A. Present:

Lestie L. Peters, M.D.	Chairman
Laszlo N. Tauber, M.D.	Secretary
Michael Davidov, M.D.	Member
Leslie Gondor, M.D.	Member
Magdolna Iranyi, M.D.	Member
A.A. Coster, D.P.M.	Member
Reginald P. McManus, M.D.	Member
Lucio Luccioli, M.D.	Member
Harold J. Goald, M.D.	Member
Michael Vlahos, M.D.	Member
Richard F. Sappington, M.D.	Member
Carl E. Linton	Hospital Administrator

B. Absent:

Samuel Burtoff, M.D.	Member
----------------------	--------

- IV. CALL TO ORDER: The meeting was called to order by the President at 7:00 P.M.

V. OLD BUSINESS:

I. Dr. Peters announced the only old business for discussion at this time is the hospital's application to the Alexandria Emergency Medical Service whereas the hospital is requesting that Alexandria Rescue Squads bring patients to Jefferson Memorial Hospital. Dr. Peters reported that there has been no correspondence from the EMS Council regarding their decision on our application and in fact, Mr. Linton reported that since the Council Meeting in January he has supplied the EMS with additional information, however, he has not received any minutes of the meeting as promised by the EMS. A lengthy discussion was held on what action the Board should take. A motion was duly made and seconded that the Board of Directors will request the Hospital Attorney to initiate legal action against Alexandria Emergency Medical Service Council, City of Alexandria, and each individual physician member of the council who is also a part of the Alexandria Hospital Emergency Medical Department, because of their unfairness and personal monopolization in the Emergency Medical Service Council. Motion carried unanimously.

II. NEW BUSINESS:

I. Dr. Peters presented Dr. Alfonso's request to redeem his bonds at face value in the amount of \$23,000. Following a brief discussion on the legality of redeeming bonds, a motion was duly made and seconded to redeem Dr. Alfonso's bonds at face value in the amount of \$23,000. Motion carried unanimously.

TAUBER 01333

J.APP. 5426

BOARD OF DIRECTOR'S MINUTES
April 9, 1979
Page Two

2. Dr. Peters asked Dr. Tauber to report on the relocation of Hospital Administration to the 6th floor of the new office building. Dr. Tauber reported that to accommodate Dr. Freedman's practice who is considering moving their practice to Jefferson Memorial Hospital, it would become necessary to relocate the Hospital Administration to the 6th floor of the new office building, thus allowing this group of general practitioners to lease office space on the 2nd floor of the Hospital. Dr. Tauber described the office areas on the 6th floor that would be allocated for administrative offices. In addition to relocating some of the administrative offices to the 6th floor, Mr. Linton said that alternate plans are also being considered to relocate other administrative offices such as Accounting, Comptroller, Billing and Insurance, Purchasing and Supplies to Dr. Gondor's office building on Braddock Road. A lengthy discussion was held on the relocation of the administrative offices and other business that pertained to Dr. Freedman locating his medical offices at Jefferson Memorial Hospital.

3. Dr. Peters announced that he would like to ask Dr. Tauber to present his plans for new parking. Dr. Tauber reported that there are several alternatives to accommodate the required parking for hospital employees and the medical office building employees. First would be to purchase property from the Larchmont Apartment development directly across from the Beauregard Lot. The second alternative would be to purchase the Hopkin's property (shopping center area), and the 3rd alternative would be to rent parking space from Charles E. Smith Company (Newport Village) and run a shuttle bus to and from the Hospital to accommodate the employees. A lengthy discussion was held on the financing and alternatives that Dr. Tauber presented to accommodate future parking problems. Dr. Tauber stated that he felt the Hospital and each office occupant should be assessed a \$1.00 per square feet annually to pay for new parking which would be needed to accommodate all the new anticipated parking requirements. It was pointed out that much more parking would be required than was anticipated by the Architect and Site Plan Engineers. A motion was duly made and seconded that Dr. Tauber be authorized to proceed with getting additional property as may be needed and to study plans for its purchase lease and of course, construction. The motion carried unanimously.

4. Dr. Peters stated he as President of the Hospital wanted to get a better understanding of the Hospital's obligation for rent to the Joint Venture. At present Jefferson Memorial Hospital Corporation has a net-net lease with Jefferson Memorial Hospital Joint Venture for the original hospital land, buildings of 54,000 square feet of floor space and parking spaces identified as lower, 2nd level, 3rd level of King Street, plus the Hospital employee Beauregard Lot. This lease is for a net-net figure of \$112,000 per year. A second lease has been set-up between the Joint Venture and the Hospital. This lease covers only the 3rd floor of the building addition and sets forth a yearly payment of \$11,760. The Board of Directors has agreed to pay for any added cost for the building over time out of the hospital profits and thus not pass any of this cost or expense on to patients or third party agencies. The Joint Venture Trustee said that Dr. Peters was basically correct, but that the Hospital owed the Venture \$80,000 and perhaps this could be paid by the Hospital from profits and thus not pass it along to the 3rd party agents. There was no motion made but general agreement by the Directors that the President should pursue this matter with the Joint Venture trustee so that an exact dollar amount can be arrived at which the hospital has an obligation for and how this amount is to be paid by the Hospital.

TAUBER 01334

J.APP. 5427

5. Dr. Peters addressed the issue of how the Hospital should divide expense with the doctors in the new building. The major expense items will be maintenance, utilities, insurance, taxes, parking and driveways. Several methods of assessing each doctor and the Hospital a percentage of cost for each expense item listed was discussed. A motion was duly made and seconded that the Hospital President, Administrator and Auditor (CPA) study the problem especially in light of 3rd party reimbursements with Blue Cross, Medicare, Medicaid and others, to determine the most fair and acceptable method which can be applied. Then meet with the Joint Venture Trustee to arrive at a position acceptable and then bring the issue to the Board for consideration. The motion was carried.

6. Dr. Peters asked Dr. Davidov, Chief of the Medical Staff, to present the Medical Staff Executive Committee's report. Dr. Davidov presented the application of the following physician with a recommendation from the Executive Committee for delineation of clinical privileges:

Heeshin Kim, M.D.	Nephrology	Provisional
-------------------	------------	-------------

A motion was duly made and seconded and carried to grant this M.D. privileges as delineated on the application form and be appointed to the Medical Staff.

B. Dr. Davidov presented the recommendation of the Executive Committee that the following physicians be promoted to regular staff status from the provisional staff:


Kyung Lee, M.D.	Gynecology	Active
Daniel Jimenez, M.D.	Emergency Room	Active
	Medicine	
Allen Streelman, M.D.	Emergency Room	Active
	Medicine	

A motion was duly made and seconded to promote these physicians as listed above.

7. Dr. Peters asked Mr. Linton to present the Hospital Administrator's Report. Mr. Linton reported that the average daily census for March was 113 patients or 94% occupancy. Year-to-date is 76%. The census compared to March 1978 was 92 patients per day or 77% occupancy. The patient charges for March was \$960,566 and year-to-date is \$6,913,380. The cash collections for March was \$810,744. Mr. Linton said that at the present time, there are 106 patients in-house or 88% occupancy. Following a brief discussion on the census, revenue and expenses. Dr. Peters thanked Mr. Linton for his report.

8. There being no further business for discussion, the meeting was adjourned at 9:15 p.m.

Respectfully submitted:



LASZLO N. TAUBER, M.D.
Secretary

TAUBER 01335

J.APP. 5428

STOCK PURCHASE AGREEMENT

Dated: July 17, 1985

By and Among:

Health Group Inc.

and

Health Group of Virginia, Inc.

and

Fairfax Hospital Association

jem/RML7/FHA

Ex. 1079

J.APP. 5429

STOCK PURCHASE AGREEMENT

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STOCK PURCHASE AGREEMENT

THIS STOCK PURCHASE AGREEMENT is made as of July 17, 1985, by and among Health Group Inc., a Tennessee corporation, (the "Seller"), Health Group of Virginia, Inc., a Tennessee corporation (the "Company"), and Fairfax Hospital Association, a non-stock Virginia corporation (the "Buyer").

WHEREAS, Seller owns all of the issued and outstanding capital stock of the Company;

WHEREAS, Buyer desires to purchase, in accordance with the terms and conditions of this Agreement, from Seller 500 issued and outstanding shares of the Company's capital stock, which shares are all of the issued and outstanding capital stock of the Company, and Seller desires to make such sale.

NOW, THEREFORE, in consideration of the mutual promises, covenants and agreements of the parties contained herein, the parties hereby agree as follows:

1. Closing Date. This transaction shall be closed pursuant to the terms and conditions of this Agreement at 10:00 a.m., on Wednesday, July 31, ¹⁹⁸⁵, at the offices of HGI, Nashville, TN., or if all of the conditions to Closing set forth in Sections 7 and 8 hereof have not then been satisfied or waived, the Closing shall occur on the first business day of the month following the month in which all of such conditions have been satisfied or waived; provided, however, that if all of such conditions have not been satisfied or waived and the transactions contemplated herein have not been

consummated on or prior to August 31, 1985 then either the Seller, on the one hand, or Buyer, on the other, may terminate all of their remaining obligations hereunder, and upon such termination neither Buyer on the one hand nor Seller, on the other, nor their respective shareholders, directors, officers or employees, shall have any further liability or obligation to the other hereunder except as set forth in Section 12.1 hereof. The date of closing of this transaction is herein called the "Closing Date." The actions outlined in Section 3 and Section 9, which are to take place on the Closing Date, are herein called the "Closing."

2. Definitions. Except as otherwise specifically provided herein, as used in this Agreement, the following terms shall have the following meanings:

2.1. "Assets." The term "Assets" means all of the assets, business and property of the Company, of every kind and description, tangible and intangible, real, personal and mixed, and wherever located, whether or not carried and reflected on the books of the Company or on the Company's 1984 Financial Statements (as such term is defined below), whether existing on the date hereof or hereafter acquired on or prior to the Closing Date, and including, without limitation, the following:

2.1.1. Financial Statements Assets. All assets reflected on the Company's 1984 Financial Statements and all assets thereafter acquired by or for the Company, except such assets as are disposed of prior to the Closing Date, either in

the ordinary course of business or in accordance with the terms hereof. .

2.1.2. Know-How and Rights. All know-how and rights of the Company, including, but not limited to, all processes, methods, techniques, inventions, patents, patent rights, trade names, trademarks and all records, documents and data pertaining thereto, except the name "Health Group". Upon the closing, Purchaser shall change the name of Health Group of Virginia, Inc. to a name not confusingly similar thereto.

2.1.3. Leases, Licenses and Contracts. All leases, leasehold estates and any other interests in real property, all licenses for any Rights or Know-How, and all contracts and commitments (and the rights of the Company thereunder) of the Company or as to which the Company has an interest.

2.1.4. Records. All books of account, patient and other records, files, invoices, correspondence and memoranda, customer and supplier lists, engineering, production and other technical drawings, data, specifications and records of the Company relating to the business or Assets of the Company.

2.1.5. Other Rights and Assets. All other rights and assets, tangible or intangible, legal or equitable, contingent or matured, express or implied, owned by the Company or in which the Company may own any right or interest, whether or not shown or reflected on the 1984 Financial Statements, including any rights to tax refunds, tax benefits, and good will. Seller acknowledges that that claim against Harvey Construction

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Company and others, made in the name of Seller is a right of the Company included in this provision, provided that the Company assume the expense of proceeding with this claim.

2.2. "1984 Financial Statements." The term "1984 Financial Statements" means the balance sheet of the Company as at December 31, 1984, and the related Statement of Income for the period of twelve (12) months then ended, together with all notes thereto.

2.3. "Material." The term "material" when used with reference to an amount means an amount of \$10,000 or more, and when used with reference to a course of action or decision-making process shall have a meaning as defined in Rule 405 issued by the Securities and Exchange Commission under the Securities Act of 1933, as amended.

2.4. "Stock". The term "Stock" means all of the issued and outstanding shares of capital stock of the Company owned by Seller and which are to be purchased by Buyer pursuant to this Agreement.

3. Closing. At the Closing, the parties shall take the actions provided for in Sections 3.1 through 3.4 to effectuate the sale of the Stock to Buyer.

3.1. Transfer of Stock. At the Closing, Seller shall sell, transfer, assign, and deliver to Buyer all the Stock (all of which shall be issued and outstanding as of the Closing Date) upon the terms and subject to the conditions set forth in this Agreement. When delivered to Buyer, all certificates representing the Stock shall be duly endorsed in form satisfactory to

Buyer for transfer by delivery or accompanied by appropriate stock powers. Seller and the Company represent and warrant that upon such transfer of the Stock to Buyer at Closing, Buyer shall have complete, absolute, and unencumbered right, title, and interest in and to the Stock, free and clear of all liens, rights, and claims of any other person, corporation or entity.

3.2. Corporate Actions. At the Closing immediately after transfer of the Stock to Buyer pursuant to Section 3.1, Seller and the Company shall deliver to Buyer the written resignations, effective immediately, of such directors and such officers of the Company as Buyer may request. Seller and the Company also shall deliver to Buyer the written resignations, effective immediately, of such Trustees and members of the administrative committee of the Company [Employee Benefit] Plan[s] listed in Exhibit I hereto as Buyer may request.

3.3. Purchase Price for Stock. The entire consideration to be paid by Buyer in exchange for the sale, transfer, assignment and delivery to Buyer of the Stock (the "Purchase Price"), subject to adjustment as provided below, shall be \$5,825,000 plus (or minus in the case of deficit) an amount equal to the Company's Net Working Capital and minus an amount equal to the unamortized portion (including the current portion thereof) of the Company's Capitalized Lease Obligations (as such terms are defined below).

3.4. Payment of Purchase Price.

3.4.1. Method of Payment. That portion of the Purchase Price to be paid by Buyer to Seller at Closing shall be

paid, after transfer of the Stock to Buyer, by bank wire transfer of funds to an account designated in writing by Seller. Any additional payments required to be made pursuant to this Section 3 by Buyer or Seller shall be made by wire transfer of funds to an account designated in writing by the receiving party.

3.4.2. Payment to be Made at Closing. At Closing, Buyer shall pay to Seller the sum of \$5,575,000 (\$5,825,000 less that sum which is to be placed in escrow pursuant to Section 10.5 hereof), plus (or minus in the case of a deficit) ninety percent (90%) of the excess, if any, (or, in the case of a deficit, minus one hundred and ten percent (110%) of such deficit) of the Company's Current Assets over its Current Liabilities (as such terms are defined below), the amounts of the Company's Current Assets and Current Liabilities to be agreed upon by Buyer and Seller and based upon the Company's Updated Financials to be prepared pursuant to Section 3.4.5.6.(f) hereof, and minus an amount equal to the unamortized portion (including the current portion thereof), based upon the Updated Financials and agreed to by the parties hereto, of the Company's lease obligations under the Equipment Lease dated November 1, 1983 by and between the Company and American Medical Leasing Corp. and the Lease dated December 13, 1982 by and between the Company and Citizens Fidelity Leasing Corporation (the "Capitalized Lease Obligations"). In the event that Buyer and Seller cannot agree upon the amounts of the Current Assets or Current Liabilities or the Capitalized Lease Obligations as contemplated by this Section 3.4.2. prior to the Closing Date, either party may terminate this

Agreement by notice to that effect in writing to the other parties at or prior to the Closing. The amounts paid (or deducted, as the case may be) at Closing with respect to Net Working Capital and deducted with respect to the Capitalized Lease Obligations shall be adjusted subsequent to Closing as provided in Section 3.4.3.

3.4.3. Post-Closing Adjustments.

3.4.3.1. First Post-Closing Adjustment.

Not later than thirty (30) days after the Closing Date, Buyer and Seller shall make an initial adjustment to the Purchase Price by (i) determining the excess (or deficit, as the case may be), if any, of Current Assets over Current Liabilities as of midnight on the day immediately preceding the Closing Date, and (ii) making an appropriate payment (the "First Post-Closing Adjustment") (Seller to Buyer, or Buyer to Seller, as the case may be, such payment to be deemed an adjustment in the amount paid or deducted at Closing with respect to Net Working Capital) such that the amount paid (or deducted, as the case may be) at Closing with respect to Net Working Capital and the amount paid, if any, pursuant to the First Post-Closing Adjustment shall together equal ninety percent (90%) of the excess (or one hundred and ten percent (110%) of the deficit, as the case may be) of Current Assets over Current Liabilities as of midnight on the day immediately preceding the Closing Date. Concurrently with the First Post-Closing Adjustment, Buyer and Seller shall determine, as of midnight on the day immediately preceding the Closing Date, the unamortized portion (including the current portion thereof)

of the Capitalized Lease Obligations and, to the extent such amount varies from the amount deducted at Closing with respect to the Capitalized Lease Obligations, Buyer or Seller, as the case may be, shall pay the amount of such variance to the other.

3.4.3.2. Second Post-Closing Adjustment. One hundred and twenty (120) days after the Closing Date, Buyer and Seller shall make a second post-closing adjustment to the Purchase Price (the "Second Post-Closing Adjustment") so that the sum of the amount paid or deducted, as the case may be, with respect to Net Working Capital, at the Closing, the First Post-Closing Adjustment and the Second Post-Closing Adjustment equals the net working capital as of midnight on the day immediately preceding the Closing Date. If Buyer and Seller are unable to agree upon the amounts of the Net Working Capital or have not agreed upon the amount of the Capitalized Lease Obligations, they shall appoint a firm of independent public accountants of recognized national standing to make such determinations, which determinations shall be final and binding on the parties hereto for purposes of this Agreement and they shall share equally the expense of such public accountants.

3.4.4. Intercompany Accounts. Intercompany accounts of Seller and the Company shall be not be included in determination of Current Assets and Current Liabilities and shall be deemed cancelled as of the Closing Date.

3.4.5. Definitions of Current Assets and Current Liabilities. For purposes of Section 3 of this Agreement, the following terms shall have the following meanings:

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3.4.5.1. Receivables. The term "Receivables" means the accounts and notes receivable of the Company as the same exist on the Closing Date, which accounts receivable shall be all the uncollected accounts receivable of the Company on the Closing Date exclusive of any amounts receivable by the Company from Seller. Such accounts receivable shall include charges for services rendered to patients up to the Closing Date but not yet billed. Such accounts receivable shall include all accounts receivable relating to Medicare, Medicaid and other governmental and private insurance and reimbursement programs and any retroactive adjustments thereto resulting from agency actions and court or administrative decisions. Such accounts receivable shall include receivables from employees, physicians and others arising in the ordinary course of business of the Company.

3.4.5.2. Inventories. The term "Inventories" means the inventories of supplies, drugs, food and other disposables and consumables of the Company on the Closing Date.

3.4.5.3. Liquid Assets. The term "Liquid Assets" means and includes, but is not limited to, cash on hand (such as petty cash funds), emergency room funds, cash in banks and bank accounts, certificates of deposit, cash equivalents and money market instruments, funds held by trustees in bond funds (principal and interest) or other debt service funds such as depreciation reserve funds, all as the same exist on the Closing

Date. "Liquid Assets" does not include funds held by trustees for construction.

3.4.5.4. Current Assets. The term

"Current Assets" means:

- (a) Liquid Assets;
- (b) Receivables, net of an allowance for doubtful accounts and contractual allowances determined pursuant to Section 3.4.5.6.;
- (c) Inventories, valued at lower of cost (first in, first out) or market;
- (d) Prepaid assets; and
- (e) Refundable deposits under any lease or contract if the deposit is refundable within five years after the Closing Date.

3.4.5.5. Current Liabilities. The term

"Current Liabilities" means:

- (a) Trade and other accounts payable of the Company, including, but not limited to accrued utilities, amounts accrued under service contracts, liabilities for patient deposits and refunds, trade payables for goods and services delivered or provided, accrued property taxes, accrued interest on long-term debt and capitalized lease obligations, and any other accrued liabilities but excluding accounts payable by the Company to the Seller;
- (b) Liabilities relating to the Company's employees, including, but not limited to, salaries, wages, contractually obligated bonuses, vacation days, sick leave (if the same is

required to be accrued under generally accepted accounting principles), payroll taxes, withholding taxes and other withholdings from employees and employee benefit costs; and

(c) Amounts due to insurance companies, Medicare, Medicaid and other third-party payors for or relating to cost report settlements, rebates, overpayments, set-offs against accounts receivable and similar items.

3.4.5.6. Net Working Capital. The term "Net Working Capital" means Current Assets minus Current Liabilities. With respect to any determination of Current Assets, Current Liabilities and Net Working Capital:

(a) Deductions from the face amount of Receivables for bad debts and contractual allowances shall be determined by mutual agreement of Buyer and the Seller.

(b) Components of Current Assets and Current Liabilities shall be determined in accordance with generally accepted accounting principles applied on a basis consistent with the 1984 Financial Statements, except as otherwise specifically provided, [and except that the parties hereto understand and acknowledge that some amounts including but not limited to certain third-party reimbursement program reserves, have been accounted for in Seller's corporate accounting and that appropriate amounts, to be agreed upon by Buyer and Seller, will be allocated to the Company.]

(c) Current liabilities shall not include any principal due on long term debt or Capitalized Lease Obligations of the Company.

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(d) With respect to Section 3.4.5.5(c) and Receivables relating to insurance companies, Medicare, Medicaid and other third-party payors, Buyer and Seller shall determine such amounts by mutual agreement.

(e) At least seven (7) days prior to the Closing Date, the Company shall deliver to Buyer an unaudited balance sheet and income statement of the Company as of June 30, 1985 or such later date as is available (the "Updated Financials"), such Updated Financials to be prepared consistent with the provisions of Section 3 of this Agreement and in the form of Exhibit A-1. (Schedule 3.3)

4. Representations and Warranties of the Company and Seller. The Company and Seller, jointly and severally, represent and warrant to Buyer that the statements contained in Sections 4.1 through 4.29 are true and correct on the date hereof and will be true and correct on and as of the Closing Date.

4.1. Corporate Standing. Seller and the Company are corporations duly organized, validly existing, and in good standing under the laws of the State of Tennessee, and each has full power and authority to enter into this Agreement and to carry out the transactions contemplated hereby. Seller and the Company each have full power and authority to carry on its business as it is now being conducted and to own or lease its Assets. Seller and the Company are each duly qualified to transact business in each jurisdiction where the nature of its business or its ownership or leasing of property requires it to be so qualified. The execution and delivery of this Agreement by

the Company and Seller do not, and the consummation of the transactions contemplated hereby will not, violate or result in a breach of any provision of Seller's or the Company's Charter or By-Laws, or violate any provision of, constitute a default under, result in the acceleration of any obligation under, or result in the creation or imposition of any security interest, mortgage, lien or other encumbrance upon the Assets of the Company under, any mortgage, lien, lease, agreement, indenture, order, arbitration award, judgment or decree to which the Company or the Seller is a party or by which either of them is bound, and will not violate any other restriction of any kind or character to which the Company or the Seller is subject. The copies of Seller's and the Company's Charter and By-Laws, as heretofore delivered to Buyer, are complete and correct, have not been amended or repealed since delivery to Buyer and are in full force and effect. Except as set forth in Exhibit A attached hereto and made a part hereof, the Company possesses all required licenses, permits, registrations, certificates and accreditations necessary to allow it lawfully to operate Jefferson Memorial Hospital ("JMH"), and to participate in the Medicare and Medicaid reimbursement programs, including, but not limited to state hospital licenses, certificates of need and Section 1122 approvals, waivers or exemptions therefrom, and accreditation by the Joint Commission on Accreditation of Hospitals ("JCAH"). Exhibit A also lists all such licenses, permits, registrations, certificates, accreditations, certificates of need, approvals, waivers or exemptions, and Section 1122 approvals or exemptions.

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Seller has previously delivered to Buyer true and complete copies of the two most recent JCAH accreditation survey reports and deficiency lists, if any, and the most recent state licensing report received with respect to JMH. Exhibit A also describes any notices received by the Company with respect to threatened, pending, or possible revocation, termination, suspension or material limitation of the licenses and permits described herein, or with respect to any challenges, appeals or investigations in respect thereto, except for any such notices which have been cured by appropriate remedial action by Seller or the Company.

4.2. Capital Stock. The authorized capital stock of the Company consists of 1000 shares of capital stock, par value \$.10 per share, 500 of which have been validly issued and are outstanding, fully paid and nonassessable. No shares of the Company's capital stock are held by the Company in treasury. There are no other issued or outstanding equity securities of the Company and there are no other issued or outstanding securities of the Company convertible at any time into equity securities of the Company. The Company is subject to no commitment or obligation which would require the issuance or sale of additional shares of the Company's capital stock at any time under options, subscriptions, warrants, rights, calls, preemptive rights, convertible obligations or any other fixed or contingent obligations.

4.3. Authority. Seller and the Company have full power and authority to enter into this Agreement and have taken all action or will use their best efforts to take all action,

corporate and otherwise, necessary to authorize the execution, delivery and performance of this Agreement, the completion of the transactions contemplated hereby and the execution and delivery on behalf of Seller and the Company of any and all instruments necessary or appropriate in order to effectuate fully the terms and conditions of this Agreement. No consent or approval of any court, governmental agency or other public authority, or of any other person, corporation or entity with any actual or alleged interest in the assets of the Company is required as a condition to (a) the validity or enforceability of this Agreement or any other instruments to be executed by Seller or the Company to effectuate this Agreement, or (b) the completion or validity of any of the transactions contemplated by this Agreement. This Agreement has been properly executed and delivered by the duly authorized officers of Seller and the Company, and constitutes the valid and legally binding joint and several agreement of Seller and the Company and is enforceable against Seller and the Company in accordance with its terms.

4.4. Stock Ownership. Seller is the sole beneficial and record owner of the Stock. All of the Stock is validly issued and outstanding, fully paid and nonassessable. All shares of the Stock are free of any lien, security interest, charge, encumbrance or claim, of any nature whatsoever, and Seller has the right to transfer to Buyer complete and unencumbered legal and equitable title to the Stock.

4.5. Financial Statements. Seller has previously furnished Buyer with true and complete copies of the 1984

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Financial Statements and those financial statements of the Company most recently available as of the date of this Agreement (the "Interim Financials"). The 1984 Financial Statements and the Interim Financials were prepared in accordance with generally accepted accounting principles, consistently applied, and accurately, correctly and fairly reflect and present, the financial condition and position of the Company (a) as at December 31, 1984 and the results of operations of the Company at that date for the twelve (12) month period then ended, and (b) as at the date of the Interim Financials and the results of operations of the Company at that date for the period between December 31, 1984 and the date of the Interim Financials, respectively. There has been no material adverse change in, material loss or destruction of, or material amount of damage to, the Assets taken as a whole or the financial condition or business of the Company since December 31, 1984, whether or not arising from transactions in the ordinary course of business. The regular books of account of the Company fairly and accurately reflect all transactions since December 31, 1984, are true, correct and complete, and are maintained and kept in accordance with generally accepted accounting principles, consistently applied. The Company has no liabilities or obligations, whether accrued, absolute, contingent or otherwise, which would materially and adversely affect the condition (financial or otherwise) of the Company, except as and to the extent reflected or reserved against in the balance sheets included in the 1984 Financial Statements or the Interim Financials. No dividends are due or

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unpaid by the Company. The Company owns no interest, directly or indirectly, in any business entity.

4.6. Lawsuits and Proceedings. Except as disclosed in a schedule heretofore furnished to Buyer and attached hereto as Exhibit B and made a part hereof, to the best of the Seller's knowledge there is no action at law or in equity, arbitration proceeding, governmental proceeding or investigation pending or threatened against the Company or against or with respect to the business or Assets of the Company, and the Company is not in material default with respect to any decree, injunction or other order of any court or governmental authority. The Company is in substantial compliance with all (and has not received any notice of any claimed violation of any) applicable federal, state, county or municipal laws, ordinances and regulations. There is no action at law or in equity, arbitration proceeding, governmental proceeding or investigation pending or threatened against Seller or against or with respect to Seller's assets, and there is no action at law or in equity, arbitration proceeding, governmental proceeding or investigation, or motion or request to any court, pending or threatened, against or with respect to the Seller or the Company with respect to this Agreement or any of the transactions contemplated hereby. No notice from any authority with respect to the suspension, revocation or termination of any permit, license, certificate, certificate of need, accreditation or participation has been issued or given nor is the Company or Seller aware of the proposed or threatened issuance of any such notice. There is no basis known to the

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Company or the Seller for any such action which would have a material adverse effect upon the Assets, liabilities, financial condition, results of operation, business or prospects of the Company or its right to conduct its business as presently conducted.

4.7. Assets - Good Title. Except as may be disclosed in the 1984 Financial Statements, the Interim Financials or a schedule heretofore furnished to Buyer and attached hereto as Exhibit C and made a part hereof, the Company has a valid leasehold interest in the real property and improvements on which JMH is operated and good and marketable title to, and owns outright, all of its other Assets free and clear of all liens, security interests, charges, encumbrances, claims, equities of others and restrictions of any kind or character whatsoever. The Assets are in the possession (subject to such goods as are normally in transit) or control of the Company, except for such Assets as have been disposed of in the ordinary course of business. Except to the extent set forth in Exhibit C or in this Section 4.7, there is no real or personal property in any material way used by the Company in its business in and to which the Company does not have full right, title, and interest. The tangible Assets of the Company (whether owned or held under lease) are in good operating condition and repair, normal wear and tear excepted, free from material defects, and usable in the ordinary course of business and to the date hereof have been, and to the Closing Date, will be, repaired and maintained consistently with the past practices of the Company.

4.8. Zoning. Except as disclosed by written notice to Buyer prior to execution of this Agreement, all structures and equipment owned, leased or used by the Company conform with all applicable ordinances and regulations (including, without limitation, all fire, health, safety and OSHA regulations) and building and zoning laws. No easement, license, grant, zoning or building ordinance or law, administrative regulation or any other impediment of any kind prohibits, interferes with, limits or impairs, or would prohibit, interfere with, limit or impair the use, operation or maintenance of the Assets of the Company or the conduct of the business of the Company as currently conducted.

4.9. Insurance.

4.9.1. The Company has furnished to Buyer a schedule, attached hereto as Exhibit D and made a part hereof, setting forth a description of all policies of fire, casualty, liability (including, without limitation, product liability and medical malpractice), worker's compensation, life and other forms of insurance carried by the Company currently, including with respect to each policy a description of the types and limits of the coverage, the amount of premiums, the name of the carrier, the policy number, the expiration date of the current premium period and the nature and amount of any claims pending thereunder. The Company is not in default with respect to any provision contained in any of such insurance policies which might cause a loss of coverage under any such insurance policy nor has the Company failed to give any notice or present any claim thereunder in due and timely fashion. The Company has currently,

and during each of its two past fiscal years has had, in full force and effect all insurance coverages required by applicable law.

4.9.2. Buyer shall cause Seller to be added as a named insured to all liability insurance policies to be carried by ~~the~~ Company.

Seller shall purchase a
4.9.3. ~~Buyer shall cause the Company to obtain~~ *professional liability insurance coverage with at least the same*
limits of coverage as the policies currently in effect and which
will cover all occurrences since the Effective Date of the
HOOK as a named insured. Buyer shall
pay one-half the premium therefor up to
a payment of \$24,000.
~~Hospital Corporation of Alexandria (formerly Jefferson Memorial~~
~~Hospital Corporation) and Seller.~~

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4.10. Major Agreements. The Company has furnished to Buyer a schedule, attached hereto as Exhibit E and made a part hereof, of the instruments or documents (and a copy of each), if any, embodying or evidencing (or if there are no such instruments or documents, a brief description of) each of the following transactions to which the Company is a party or by which the Company is obligated, and except for such transactions, the Company is not a party to any transaction (whether written or oral) hereinafter listed: (i) contract for the employment of any officer or individual employee; (ii) agreement with any labor union; (iii) any single contract for the purchase or sale of supplies, materials or personal property or for the furnishing or receipt of services, which contract calls for performance over a period of more than 90 days or involves more than the sum of

\$10,000; (iv) distributor or sales agency contracts; (v) lease or letting of real or personal property wherein the Company is lessor or lessee; (vi) option, preferential right of purchase, real estate mortgage, chattel mortgage, deed of trust, security agreement, conditional sales agreement or other encumbrance affecting the title to, or use of, any Assets of the Company; (vii) bond, loan agreement, promissory note or other obligation to pay money, arrangement for the factoring or assignment of accounts receivable, guarantee, indemnification agreement or any obligation with respect to the undertaking of another (except for indorsement of checks in the ordinary course of business); (viii) license agreement wherein the Company is a licensor or licensee; (ix) advertising contract, consulting agreement, and any other agreement that continues in force after the Closing Date with respect to employment or retention of consultants, legal counsel, accountants or anyone else who is not an employee; (x) power of attorney or other similar authorization to do and perform any acts for or on behalf of the Company or with respect to Assets of the Company; (xi) contract for the construction of any plants, equipment, facilities, buildings, structures or other capital improvements involving a sum greater than \$10,000; (xii) government contract which is subject to renegotiation; (xiii) stock purchase, group insurance, bonus, stock option, executive compensation, pension, profit sharing, medical or other employee benefit contract or plan or arrangement, whether established by custom or course of dealing, oral or written agreement; (xiv) contract for the provision of medical or other health-related

services; and (xv) any other material contract or any instrument not made in the ordinary course of business. The Company is not in material default, nor has any event occurred which, with the passage of time or the giving of notice or both, would constitute a default, under any contract, agreement, lease, document or other arrangement to which it is a party, has not waived any material rights under or with respect thereto, and has no knowledge or notice that any party with whom the Company has contractual arrangements, written or oral, is in default in any material respect under any such contractual arrangements. No consent or approval of any party with whom the Company has any such contractual arrangements, written or oral, is required as a condition to (a) the validity or enforceability of this Agreement or any other instruments to be executed by Seller or the Company to consummate the transactions contemplated by this Agreement, or (b) the consummation or validity of any of those transactions.

4.11. Taxes.

4.11.1. The Company has exercised due diligence in the preparation of and has duly and timely filed, or will have filed by the Closing Date, all federal and applicable state and local returns, declarations or statements with respect to all federal, state and local income, property, sales, use, profits, occupancy, employment, excise, withholding, customs duties or other taxes of any nature whatsoever, including, without limitation, penalties and interest thereon, (respectively, "Returns" and "Taxes") required to be filed up to and including the date hereof and thereof. All Taxes shown on the Returns or

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pursuant to any declarations or assessments received by the Company. (including penalties and interest) have been duly and timely paid, or accrued and reserved for and reflected in the 1984 Financial Statements or the Interim Financials or the books of account of the Company. All such Returns are true, correct and complete. No extension of the time for filing a Return is presently in effect except with respect to the Company's 1984 federal income tax return. As of the date of the Interim Financials, there is no tax liability, contingent or otherwise, which is not reflected as a liability thereon or on the 1984 Financial Statements.

4.11.2. There are no waivers of statutes of limitations in effect for any Taxes with respect to the Company.

4.11.3. All federal income tax Returns of the Company have been ^{FILED} ~~audited and finally settled by the Internal Revenue Service or other appropriate taxing authorities~~ for all periods of time through December 31, 1984. ^{AN} ~~no~~ extension of time

is in effect for the assessment of deficiencies by ~~any taxing~~ ^{THE INTERNAL} ~~Revenue Service for tax years 1981, 1982 and~~ ^{REVENUE SERVICE FOR TAX YEARS 1981, 1982 AND} ~~authority against the Company with respect to any Taxes or~~ ^{THE RETURN FOR TAX YEAR 1983 IS} ~~the return for tax year 1983 is~~ ^{CURRENTLY BEING EXAMINED.} ~~Returns for any year.~~ (PSH)
JH

4.12. Banks and Deposits. The Company has heretofore furnished to Buyer a schedule, attached hereto as Exhibit F and made a part hereof, setting forth the name of each bank or other depository in which the Company has an account, the number assigned to each account, and the names of all persons authorized to draw thereon. The Company has no safe deposit box or any other custody arrangement.

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4.13. Claims of Directors, Officers, etc. Except as set forth in Exhibit G attached hereto and made a part hereof, no employee, director or officer (or any current or former family member thereof) of the Company, either individually or in any other capacity, has a claim of any kind whatsoever (including, without limitation, loans to the Company) against the Company, except the right to his current salary or wages, any accrued vacation pay, and any reimbursable expenses arising in the ordinary course of business. Except as noted in the immediately preceding sentence, the Company has no obligation to any such person that has not been fully performed.

4.14. Officer and Director Loans. Except as set forth in Exhibit H attached hereto and made a part hereof, there are no outstanding loans, obligations or open account advances payable to the Company by the Seller or any current or former officer, director or employee (or any current or former family member thereof) of the Company.

4.15 Rights and Know-How - Ownership. The Company owns its Rights and Know-How free of any rights or claims of any officers, directors, stockholders or employees of the Company, or of any other persons, corporations or entities.

4.16 Extraordinary Transactions. Except as set forth in Exhibit E, since December 31, 1984, the Company has not (i) mortgaged, pledged or subjected to lien, charge or any other encumbrance any of its Assets; (ii) cancelled any claim of or debts owed to it, or, except in each case in the ordinary course of business, sold or transferred any of its Assets; (iii) sold,

assigned or transferred any of its Know-How or Rights; (iv) waived any rights; (v) entered into any material transaction other than in the ordinary course of business; (vi) made any management decisions involving any material change in its policies with regard to the provision of services, sales, purchasing or other business, financial, accounting (including reserves and the amounts thereof) or tax policies or practices; or (vii) declared or paid any dividends on or made any distributions in respect of any outstanding shares of capital stock of the Company.

4.17. Accounts Receivable - Inventories.

4.17.1. All information set forth in the 1984 Financial Statements with respect to accounts receivable of the Company is true, accurate and complete as at December 31, 1984, and since that date to the Closing Date there has been no material adverse change with respect to the amount, validity, or collectibility of accounts receivable of the Company, except for decreases in the amount of accounts receivable due to collection in the ordinary course of business since December 31, 1984. Such accounts receivable are, and at the Closing Date, to the extent not theretofore collected, will be, valid and existing and evidence of monies due for services performed or goods sold, and are and will be good and collectible in amounts equal to the aggregate face amounts thereof after giving effect to any deductions from face amounts for bad debts and contractual allowances as determined by mutual agreement of Buyer and Seller under Section 3.4.5.6. hereof.

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4.17.2. The items included in the inventories of the Company as shown on the 1984 Financial Statements (except for any of such items which may have been sold, used or otherwise consumed in the ordinary course of business subsequent to December 31, 1984) are, and any items of inventory acquired thereafter and not sold, used or otherwise consumed in the ordinary course of business to the Closing Date shall be suitable as supplies regularly used in the business of the Company and such items are of a quality and quantity usable or salable in the ordinary course of business. Such items of inventory are valued on the 1984 Financial Statements and the Interim Financials at the lower of cost or market, on a first-in, first-out basis, with an appropriate reserve for obsolescence.

4.18. Broker and Finder Fees. Neither Seller nor the Company has engaged any broker or finder in connection with this transaction, and no action by Seller or the Company will cause or support any claim to be asserted against Buyer by any broker, finder or intermediary in connection with this transaction.

4.19. Adverse Circumstances. To the best of the Seller's knowledge, there are no facts, developments or circumstances, existing or threatened, of a special or unusual nature that may be materially adverse to the Assets, business, financial condition or future prospects of the Company.

4.20. Liabilities. The Company has no material liabilities of any nature, whether accrued, absolute, contingent or otherwise, existing, or which may hereafter arise out of any transaction entered into prior to the Closing Date or out of any

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act or failure to act on the part of the Company or any of its employees or agents prior to the Closing Date, except (i) as and to the extent and in the amounts reflected or reserved against in the 1984 Financial Statements or the Interim Financials, (ii) current liabilities incurred in the ordinary course of business since December 31, 1984, and (iii) as set forth in the Exhibits attached hereto.

4.21. Accounts Payable. All information set forth in the 1984 Financial Statements, the Interim Financials and the books and records of the Company with respect to the accounts payable of the Company for all periods up to and as at the Closing Date are true, accurate and complete, and no supplier of the Company has any right to demand return of any of the Assets of the Company for nonpayment of any account payable. The aggregate amount of all legal and accounting fees and expenses payable by the Company, if any, (including, without limitation, all fees and expenses not yet billed) which are unpaid and outstanding as of the date on which this Agreement is executed by the Company and as of the Closing Date does not and will not exceed \$ _____ in the case of legal fees and expenses and \$ _____ in the case of accounting fees and expenses.

4.22. Employee Benefit Plans.

4.22.1. All "employee benefit plans," as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), sponsored by the Company or to which the Company contributes (the "Plans") are listed in Exhibit I attached hereto and made a part hereof. The Company has

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turned complete copies of each of the Plans to Buyer, and the Company has not previously sponsored or contributed to any employee benefit plans other than the Plans. None of the Plans is a "defined benefit plan" within the meaning of Section 3(35) of ERISA. The financial statements furnished by the Company to Buyer with respect to the Plans (which financial statements are listed in Exhibit I attached hereto and made a part hereof, and which are hereinafter referred to as the "Plan Financial Statements") were prepared in accordance with generally accepted accounting principles, consistently applied, and each accurately, correctly and fairly reflects and presents the financial condition of the Plan to which it relates as of the date of that Financial Statement. All contributions and premiums due and payable by the Company to any of the Plans on or prior to the Closing Date have been paid in full.

4.22.2. Each of the Plans (as in effect on the Closing Date) which constitutes an "employee pension benefit plan" within the meaning of Section 3(2) of ERISA has been determined by the Internal Revenue Service, as to form, to satisfy the requirements of Section 401 or Section 403(a) of the Internal Revenue Code of 1954, as amended (the "Code"), and there are no developments or circumstances, to the best of the Sellers' knowledge, existing or threatened, that may disqualify that Plan under Section 401 or Section 403(a) of the Code. With respect to each of the Plans, all applicable reporting and disclosure requirements under Title I of ERISA have been satisfied on a timely basis and all information reported or disclosed in

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connection with those reporting and disclosure requirements is true, correct and complete. No "fiduciary" (as defined in Section 3(21) of ERISA) of any of the Plans (each such fiduciary being hereinafter referred to as a "Plan Fiduciary"), including the Company, has agreed or undertaken to make any amendment to the Plans. There are no actions, suits, proceedings, investigations or hearings pending, or any claims threatened, against or with respect to any of the Plans, any Plan Fiduciary or the assets of any Plan, and there are no facts which could reasonably give rise to any such actions, suits, proceedings, investigations, hearings or claims.

4.22.3. There are no material liabilities of any of the Plans of any nature, whether accrued, absolute, contingent or otherwise, existing, or which may hereafter arise out of any event occurring on or prior to the Closing Date or out of any act or failure to act on the part of the Company, any Plan Fiduciary or any employee or other agent of either of them on or prior to the Closing Date, except (a) as and to the extent and in the amounts reflected in the Plan Financial Statements and the Actuarial Reports and the notes thereto, and (b) current liabilities for benefits and expenses under the Plans incurred in the normal course of operation and administration of the Plans. There are no developments or circumstances of a special or unusual nature, existing or threatened, that may be materially adverse to the financial condition, operation, administration or actuarial position of any of the Plans. The Plans have been maintained and administered in substantial compliance with all

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(and neither the Company nor any Plan Fiduciary has received notice of any claimed violation of any) applicable federal, state, county and municipal laws, ordinances and regulations.

4.23. Employee Relations. Except as described in Exhibit _____, no complaint or labor grievance has been filed or been threatened to be filed by an employee of the Company or by any other person with any federal, state or local labor relations, equal employment opportunity, civil rights or other authority in regard to employment or hiring practices of the Company or in regard to any other conduct of the Company, and the Company does not know (including the knowledge of any of its current officers and directors) of any state of facts which could lead to such a filing, nor have there been any strikes, pickets, or labor disputes directed against or in regard to the Company or any of its operations. The Company is not a party to or bound by any collective bargaining agreement or other union contracts, and it has not been requested to enter into or be bound by any such agreement or contract. There are not currently any official or unofficial organizing drives or campaigns by any union among all or any part of the employees of the Company, and no petition to organize such a drive or for union election among all or any part of those employees is currently pending before any federal or state labor relations agency. The Company is in substantial compliance with all laws respecting employment and employment practices, terms and conditions of employment and wages and hours, and is not, to its knowledge, engaged in any unfair labor practice.

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4.24. Payment Programs. Except as set forth in Exhibit attached hereto and made a part hereof, JMH is certified for participation in the Medicare and Medicaid programs, and is party to valid participation agreements for payment by the Medicare, Medicaid and Blue Cross programs (the "Programs") and to a valid memorandum of understanding with JMH's peer review organization, a copy of each such agreement and memorandum of understanding having been previously delivered to Buyer. The status of all cost reports for the Programs for the last three fiscal years of JMH is described in Exhibit J, and there are no pending appeals, adjustments, challenges, audits, litigation, notices of intent to reopen or open cost reports with respect to the Programs except as set forth in Exhibit J. JMH has not been subject to or threatened with loss of waiver of liability for utilization review denials with respect to the Programs during the twelve (12) month period terminating on the Closing Date and has not received notice of pending or threatened investigations by or loss of participation in any of the Programs except as set forth in Exhibit J. Seller has previously delivered to Buyer copies of all current participation agreements with health maintenance organizations, insurance programs and preferred provider organizations and the Company is not in material breach of any of such agreements.

4.25. Medical Staff; Hill-Burton Act. Seller has previously delivered or made available to Buyer with respect to JMH a true and complete copy of medical staff privilege and membership application forms, medical staff bylaws, rules and

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regulations, and credentials and appeals procedures not incorporated therein, and of all contracts, oral or written, with physicians or physician groups, and there are no pending or threatened appeals, challenges, or disputes in respect thereto or arising therefrom except as set forth in Exhibit K attached hereto and made a part hereof. There has been neither the receipt of loans, grants or loan guarantees pursuant to the Hill-Burton Act, nor the performance of any experimental or research procedures or studies involving patients in or by JMH except as set forth in Exhibit K.

4.26. Trademarks and Patents. All trademarks, trade names, copyrights and patents and applications therefore owned or used by the Company in its business are listed and described in Exhibit L attached hereto and made a part hereof. No proceedings have been instituted or are pending or, to the knowledge of the Company or Seller, threatened, which challenge the validity of the ownership by the Company of such trademarks, trade names, copyrights, patents and applications. The Company has not licensed anyone to use such trademarks, trade names, copyrights, patents and applications and the Company has no knowledge of the use or the infringement of any of such trademarks, trade names, copyrights, patents and applications by any other person. The Company owns (or possesses adequate and enforceable licenses or other rights to use) all trademarks, trade names, copyrights, patents, inventions and processes now used in the conduct of JMH, and neither such use nor any other practice of the Company conflicts with the rights of others, except that with respect to

trade names only, Seller, merely has no knowledge that such use or other practice conflicts with the rights of others.

4.27. Conflicts of Interest. Except as set forth in Exhibit M attached hereto and made a part hereof, and except for transactions involving less than \$5,000, to the knowledge of the Seller, no director, officer or affiliate of the Company controls or is an affiliate, employee, officer or director of any corporation, firm, association, partnership or other business entity which is a competitor, supplier or customer of the Company in its business.

4.28. Certain Payments. The Company has not, directly or indirectly, paid or delivered or agreed to pay or deliver, any fee, commission, or other sum of money or item of property, however characterized, to any person, government official or other party which is in any manner related to business of JMH or the Company and which the Company knows or has reason to believe to have been illegal under any federal, state or local law.

4.29. No Misleading Statements. The warranties, representations and Exhibits of Seller and the Company contained in or attached to this Agreement do not contain any untrue statements of fact and do not omit the disclosure therein of any fact to Buyer, with the purpose or effect of making any statement contained herein or in the Exhibits misleading, or which might be reasonably expected to affect adversely the Assets, business, financial condition or future prospects of the Company. Copies of all documents referred to in this Agreement or on any exhibit hereto have been delivered or made available to Buyer and

constitute true, correct and complete copies thereof and include all amendments, supplements or modifications thereto or waivers thereunder.

5. Representations and Warranties of Buyer. Buyer represents and warrants to Seller that the statements contained in Sections 5.1 and 5.2 are true and correct in all material respects on the date hereof and will be true and correct on and as of the Closing Date.

5.1. Corporate Authority - Good Standing. Buyer is a non-stock corporation duly organized, validly existing, and in good standing under the laws of the State of Virginia, and has full power and authority to enter into this Agreement and to carry out the transactions contemplated hereby. All requisite corporate and other action has been taken to authorize the execution, delivery and performance of this Agreement, and the completion of the transactions contemplated hereby. This Agreement constitutes the valid and legally binding obligation of Buyer.

5.2. Broker and Finder Fees. No broker, finder or intermediary engaged by Buyer in connection with this transaction will assert any claim or make any demand upon Seller based upon any dealings of such broker, finder or intermediary in connection with this transaction.

6. Covenants and Agreements of Seller and the Company. Seller and the Company, jointly and severally, hereby covenant and agree as follows:

6.1. Corporate Action. Seller and the Company each shall duly take all action, corporate or otherwise, necessary or appropriate to authorize the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby.

6.2. Conduct of Business to Closing. The Company shall conduct its business with diligence and in the normal and regular manner as heretofore conducted from the date hereof to and including the Closing Date and so that, among other things, the representations and warranties contained in Sections 3 and 4 and in the Exhibits hereto will be true and correct at and as of the Closing Date, and the conditions to be satisfied by the Company on or prior to the Closing Date shall have been satisfied. Between the date hereof and the Closing Date, the Company specifically agrees to use its best efforts to act as follows:

(a) Preserve Business. To preserve intact its business organization and goodwill and retain the services, business and goodwill of its officers, employees, suppliers, customers, and representatives and of others with whom it has contractual and commercial relationships, and to keep in effect and undiminished the insurance coverages now in effect upon its business and Assets;

(b) Extraordinary Transactions. Not to encumber any of the Assets, not to dispose of any of the Assets except in the ordinary course of business, and except in the ordinary course of business for the replacement of inventory, not to (1) enter into

any transaction or make any commitment relating to its Assets or business (including, without limitation, any commitment or payment resulting from or related to any investigation or audit of its books and records which may be conducted by any tax or other governmental agency), or (2) commit for any single expenditure in excess of \$10,000, without the prior written consent of Buyer, which shall not be unreasonably withheld;

(c) Major Management Decisions. To consult with Buyer with respect to each management decision of the Company involving any material change in its policies regarding services, sales, purchasing, or other business, financial, accounting (including the amount of reserves) or tax policies and practices, and not to make any such material change of policy without the prior written approval of Buyer, which shall not be unreasonably withheld;

(d) Buyer's Access - Records. To permit employees, accountants, attorneys and other representatives of Buyer to have reasonable access to its facilities, properties, corporate records, books of account, contracts, tax returns and other documents, data and records, and to furnish to Buyer all information with respect to its affairs, and copies of any such records and documents as Buyer may reasonably request;

(e) Impairment - Representations and Warranties. Not to take any action or fail to take any action without the prior written approval of Buyer, which would or might cause any representation or warranty of the Company or Seller made herein not to be true on the Closing Date or impair the Company's ability to carry out its obligations under this Agreement;

(f) Dividends and Redemptions. Not to declare, set aside or pay any dividend or make any other distribution in respect of its capital stock without Buyer's prior written consent, redeem or otherwise acquire any shares of its capital stock, issue any equity securities or options or warrants to acquire any equity securities issue any debt securities or make any other change in its capital structure;

(g) Employment Contracts and Compensation. Not to enter into any employment contract with any present or new employee for a term of more than 30 days; not to hire any new employee except as necessary in connection with its ordinary business operations; not to increase the salary or other compensation of, or make any loans or extend any credit to, any officer, director, employee or stockholder; not to increase the salary or other compensation of any other employee except for reasonable merit increases in accordance with its customary and established compensation practices; not to enter into any consulting agreement; and not to enter into any agreement with any labor union, or any other collective bargaining agreement;

(h) Indebtedness. Not to create, incur, assume, guarantee or otherwise become liable or obligated with respect to any indebtedness for borrowed money, or make any loan or advance to, or any investment in, any person or entity which might result in any lien or other encumbrance upon the Assets;

(i) Compliance with Laws, Contracts, etc. To duly comply in all material respects with all applicable statutes, laws, ordinances and regulations; to keep, hold and maintain all

certificates, certificates of need, accreditations, participations, licenses and other permits necessary for the conduct of its business; to do no act or omit to do an act which would cause a material breach of or violation or default under any contract, agreement or other commitment; to pay all taxes and other assessments upon its Assets and businesses as they may become due (other than those taxes which may be contested in good faith in accordance with all prescribed procedures); to use its best efforts to obtain all consents, approvals and authorizations of third parties, whether governmental or private, to make all filings, and give all notices which may be necessary or desirable on its part under all applicable laws and under its contracts, agreements and commitments in order to consummate the transactions contemplated by this Agreement; and to use its best efforts to consummate the transactions provided for herein as soon as is practicable;

(j) No Merger or Consolidation. Not to merge or consolidate with, or acquire any of the assets of, any other corporation, business or person; through September 1, 1985, not to solicit from any corporation, business or person, nor entertain any inquiries, proposals or offers relating to the disposition of JMH, or the acquisition of shares of its capital stock, or the merger or consolidation of it with any corporation (and to promptly notify Buyer orally, and confirm in writing, of all relevant details relating to inquiries or proposals which it may receive relating to any of the matters referred to in this Section 6.2(j)); and

(k) Medical Staff. To maintain its current relationships with and its policies with respect to the members of its medical staff.

6.3. No Liability. Neither Buyer nor any representative of Buyer shall be liable for any loss or damage arising from the approval or withholding of approval of matters specified in Section 6.2, except for any loss or damage caused by the gross negligence or willful misconduct of Buyer in withholding approval of any such matters when requested by the Company.

6.4. Pre-Closing Audit. Buyer and its employees, accountants, attorneys and other representatives shall have the right to conduct financial, accounting, business and legal audits of the Company prior to Closing, and Seller and the Company, including all of its officers, directors, employees and stockholders, shall cooperate fully with the representatives of Buyer in such audits and furnish promptly all requested documents and information, provided that such audit shall not be conducted in a manner as to unreasonably interfere with the operation of the Company's business. Facilities, information and other material of the Company shall be made available at least during normal business hours. If requested, Seller and the Company shall provide Buyer prior to the Closing with copies of any existing title insurance policies, binders and certificates covering real property owned or leased by the Company, and copies of any existing surveys covering such real property.

6.5. No Encumbrances Upon the Stock. All amounts (if any) payable by Seller to the Company on account of subscriptions

for capital stock of the Company shall be paid in full prior to the transfer of the Stock to Buyer, so that at the time the Stock is transferred to Buyer, it shall be fully paid and nonassessable, free of all escrow arrangements, restrictions, and any claims of the Company of any nature whatsoever. Prior to the transfer of the Stock to Buyer, Seller shall deliver to Buyer all documents and instruments (executed by the Company or otherwise) requested by Buyer to confirm the release of all of the Stock from all escrow arrangements, pledges, liens and restrictions, and the payment in full of all subscription obligations therefor.

6.6. Notice of Change. Seller shall promptly give notice to Buyer of the occurrence of any event or the failure of any event to occur which results in a breach of any representation or warranty of Seller or the Company, or of a failure by it or the Company to comply with any covenant, condition or agreement contained herein.

6.7 Cost Reports. The Company shall file in a timely manner all Medicare and Medicaid cost reports with respect to JMH up to the Closing Date. The Company shall forward to Buyer copies of such cost reports promptly after the filing thereof.

6.8 Management Contracts. Seller covenants and agrees with Buyer that Seller shall cause the Company to cancel and terminate any management or similar agreements between Seller and the Company, which cancellation and termination shall be without penalty to the Company or premium to Seller.

6.9 Retirement of Debt. Prior to the Closing Date, the Company shall have been relieved of liability on all of its

long term debt (and current portions thereof), if any, and interest accrued and unpaid thereon, including, but not limited to, that which is reflected on the 1984 Financial Statements or the Interim Financials, other than the Capitalized Lease Obligations, and shall have terminated (and shall have produced written evidence of such termination satisfactory to Buyer) any and all of its obligations, contingent, fixed or otherwise, under the Guaranty Agreement dated July 7, 1982 by and between the company and Citibank, N.A., as amended August 23, 1982, the Guaranty Agreement dated February 17, 1983 by and between the Company and Citibank, N.A., and the Leasehold Deed of Trust dated February 17, 1983 by and among the Company, Citibank, N.A. and Courtland L. Traver, Trustee.

7. Conditions of Buyer's Obligations to Close. The obligations of Buyer to close this transaction and to perform its other covenants and agreements pursuant to the terms and conditions of this Agreement are subject to the fulfillment as of the Closing Date of each of the following conditions precedent, any or all of which may be waived in writing by Buyer.

7.1. No Material Adverse Condition or Change. There shall exist no state of facts or condition which materially and adversely affects the business, Assets or financial condition of the Company, which is not disclosed in the 1984 Financial Statements, and there shall have occurred no material adverse change in the business, Assets or financial condition of the Company between the date hereof and the Closing Date.

7.2. True Representations and Warranties. Each of the representations and warranties of Seller and the Company contained in this Agreement or the Exhibits hereto shall have been true in all material respects on the date hereof, and shall be true in all material respects as of the Closing Date as though made on and as of the Closing Date.

7.3. No Default - Covenants and Agreements. Neither Seller nor the Company shall be in material default with respect to any obligation under this Agreement, and Seller and the Company shall have performed or complied with all covenants, agreements and conditions to be performed or complied with by either of them prior to or at the Closing.

7.4. Opinion of Counsel for Seller and the Company. Buyer shall have received from Harwell, Barr, Martin & Stegall, P.C., counsel for Seller and the Company, the favorable opinion of that counsel, dated the Closing Date, substantially in the form attached hereto as Exhibit N.

7.5. Stock. Seller shall be ready, willing and able to convey the shares of the Stock to Buyer in accordance with the terms and conditions of this Agreement; provided, however, that this condition precedent shall not be interpreted to permit Seller to refuse to convey the Stock except upon termination of this Agreement pursuant to Section 11.

7.6. Corporate Proceedings of Seller and the Company. All corporate and other proceedings of Seller and the Company in connection with the execution, delivery and performance of this Agreement, the consummation of the transactions contemplated

hereby and the transfer of the Stock, and all documents and instruments incident thereto, shall be satisfactory in form and substance to Buyer, and Buyer shall have received all such documents and instruments, or copies thereof (certified if requested), as may be reasonably requested.

7.7 Execution of New Lease. The Company or Buyer shall have entered into a new lease agreement, satisfactory in form and content to Buyer, with the lessor of the premises at which the Jefferson Memorial Hospital is currently located and in operation.

7.8 Approval of Transaction by Regulatory Authorities. The appropriate regulatory agencies and authorities with respect to Buyer, Seller and the Company shall have been notified of, and shall have approved or irrevocably waived their right to object to, the transactions contemplated by this Agreement; all statutory requirements shall have been met and no legal prohibition or injunction against the transactions contemplated hereby shall be in effect. JMH shall be a party to a standard Blue Cross agreement with the appropriate Blue Cross Plan, and such agreements shall be effective after the Closing Date or the Buyer shall have received assurances reasonably satisfactory to Buyer that such agreements will be entered into with Buyer promptly after the Closing. The Joint Commission on Accreditation of Hospitals shall have determined that the change in control of the Company does not require a new survey.

7.9. Delivery of Stock. Buyer shall have received from Seller duly endorsed certificates, with signatures properly

guaranteed, of all certificates representing the outstanding capital stock of the Company, all in form and substance reasonably satisfactory to Buyer, so as to transfer good and marketable title to the Stock free and clear of all security interests, mortgages, claims, liens, charges or other encumbrances of any nature whatsoever. If any lien exists with respect to any of the Assets of the Company, Buyer at its option and after consultation with Seller may discharge such lien by paying the obligation secured thereby and deducting the amount paid from the Purchase Price.

7.10. No Long Term Debt. At the Closing Date, the Company shall have previously been relieved of all of its long term debt (including the current portion thereof) and all interest accrued thereon, with the exception of the debts represented by the Capitalized Lease Obligations, and shall not be obligated for, or be a guarantor with respect to, the payment of any long term debt (or current portions thereof) or any interest with respect thereto, whether any such amounts are fixed or contingent, currently due or to become due in the future, other than the Capitalized Lease Obligations.

8. Conditions of Seller's Obligation to Close. The obligation of Seller to close this transaction and transfer and deliver to Buyer the Stock and to perform its obligations pursuant to the terms and conditions of this Agreement are subject to the fulfillment as of the Closing Date of each of the following conditions precedent, any or all of which may be waived in writing by the Seller.

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8.1. True Representations and Warranties. Each of the representations and warranties of Buyer contained in Section 5 shall have been true in all material respects on the date hereof, and shall be true in all material respects as of the Closing Date as though made on and as of the Closing Date.

8.2. Payment of Purchase Price. Buyer shall be ready, willing and able at Closing to pay the portion of the Purchase Price due at Closing; provided, however, that this condition precedent shall not be interpreted to permit Buyer to refuse to perform its obligations in accordance with Section 3 except upon termination of this Agreement pursuant to Section 11.

8.3. Approval of Transaction by Regulatory Authorities. The appropriate regulatory agencies and authorities with respect to Buyer, Seller and the Company shall have been notified of, and shall have approved or irrevocably waived their right to object to, the transactions contemplated by this Agreement, all statutory requirements shall have been met and no legal prohibition or injunction against the transactions contemplated hereby shall be in effect.

9. Delivery of Documents. At the Closing, and in addition to all other documents and instruments which Seller or the Company is required to deliver pursuant to this Agreement, Seller and the Company shall deliver to Buyer the following documents duly executed by the Company or, where appropriate, by Seller, the directors, officers, or employees of or counsel to Seller or the Company, or appropriate governmental officials, in form and substance satisfactory to Buyer and its counsel.

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9.1. Good Standing Certificate. Certificates of the Secretary of State of Tennessee, dated not more than 30 days prior to the Closing Date, as to the good standing of Seller and the Company, respectively.

9.2. Compliance Certificates. Certificates, in form and content satisfactory to Buyer, dated the Closing Date, signed by the chief executive officers of Seller and the Company, respectively, certifying to full compliance with the conditions precedent specified in Sections 7.1, 7.2, 7.3 and 7.10.

9.3. Other Documents. Such other documents, certificates and instruments relating to the transactions contemplated by this Agreement as Buyer or its counsel may reasonably request or deem necessary.

10. Indemnification.

10.1. Indemnity. Seller covenants and agrees that it shall reimburse and indemnify and hold Buyer harmless from, against and in respect of any claim, damage, liability, loss, cost, expense or deficiency, including, without limitation, interest expenses and attorneys' fees and expenses (to the extent not paid for by insurance and net of any net tax benefit actually realized by Buyer on account of such claim, damage, liability, loss, cost, expense or deficiency) arising out of:

(a) any misrepresentation, omission or breach of warranty or any nonfulfillment of any covenant or agreement of Seller made under or pursuant to this Agreement or the Exhibits hereto (including, without limitation, any failure of Seller or

the Company to cause the fulfillment of the conditions precedent specified in Sections 7.2 through 7.10.);

(b) any provision by Seller of actual or alleged defective or improper services or products including any alleged negligence or malpractice;

(c) any claim, liability, penalty, interest charge, demand, or set-off whatsoever imposed by a Program, as defined in Section 4.24 hereof, net of any upward adjustments by a Program not previously credited to the Seller in the determination of Net Working Capital, with respect to any cost reporting period or partial period terminating on or before the Closing Date, or with respect to any services rendered on or prior to the Closing Date, including, but not limited to, retroactive settlement of or adjustments to the cost reports filed in connection with such periods or services;

(d) any expense incurred by Buyer with respect to JMH for the purpose of correcting any deficiency which deficiency is (i) in existence at the Closing, and (ii) prior thereto cited in any accreditation report issued by JCAH, or cited in any state licensing survey with respect to JMH which deficiency, if not corrected, would result in a loss of accreditation or licensure, or which under Seller's operation of JMH was not waived, provided that any claim by Buyer under this Section 10.1(d) shall be made by the earlier of the expiration of the Claims Period (as herein-after defined) or 30 days after the receipt by Buyer of the first JCAH report or first state licensing survey report made after the Closing Date with respect to JMH for which indemnification is

J.APP. 5481

claimed; and provided further that no claims by Buyer shall be made under this Section 10.1(d) if the facts providing the basis for such claim were disclosed to Buyer in Exhibit A hereto.

(e) any other commitments, agreements, liabilities or obligations of the Company or Seller (including, without limitation, any federal and state income or other tax liabilities), whether accrued, absolute, contingent or otherwise or whether arising out of the conduct of the business of the Company either before or after the Closing, not expressly assumed by Buyer hereunder; and

(f) any and all actions, suits, claims, proceedings, investigations, audits, demands, assessments, fines, judgments, awards, costs and other expenses (including, without limitation, reasonable accountants' and attorneys' fees and expenses) incident to any of the foregoing.

10.1.1. Seller's indemnification obligations under Section 10.1 shall not apply until any claims, damages, liabilities or losses thereunder aggregate \$25,000, but thereafter shall apply to all claims, damages, liabilities or losses in excess thereof. No claims for indemnification may be made by Buyer hereunder after the day which is 180 days following the Closing (such date being referred to herein as the "Claims Expiration Date"). The indemnification under Section 10.1 shall be the exclusive remedy for Buyer with respect to any matters related to this Agreement and the transactions hereunder and the exclusive method of asserting indemnification claims against Seller is set forth in Section 10.4 hereof. This indemnification

shall not relate to or cover any consequential damages of Buyer. Buyer shall have a duty to mitigate damages. Seller shall have no liability for breach of any representation or warranty hereunder which does not result in damage to Buyer.

10.2 Cooperation With Respect to Indemnification.

Buyer will give prompt written notice to Seller pursuant to the terms of the Escrow Agreement (as such term is defined below) of any claims which it discovers or of which it receives notice after the Closing and which might give rise to a claim by Buyer against Seller under Section 10.1 hereof, stating the nature, basis and amount hereof. In case of any claim or suit by a third party or by any governmental body, or any legal, administrative or arbitration proceeding with respect to which Seller may have liability under its indemnity agreements contained in Section 10.1 hereof, Seller shall be entitled to participate therein, and, to the extent desired by Seller, to assume the defense thereof, and after notice from Seller, of the election so to assume the defense thereof, the Seller will not be liable for any legal or other expenses subsequently incurred by Buyer in connection with the defense thereof, other than reasonable costs of investigation, unless Seller does not actually assume the defense thereof following notice of such election. Each party hereto shall make available to the others and their attorneys and accountants, at all reasonable times, all books and records relating to such suit, claim or proceeding, and each party will render to the others such assistance as may reasonably be required in order to insure proper and adequate defense of any

JAPP. 5483

such suit, claim or proceeding. Buyer will not make any settlement of any claim which might give rise to liability of Seller under the indemnity agreements contained in Section 10.1 hereof without the written consent of Seller, which consent shall not be unreasonably withheld. If Seller shall desire to effect a bona fide compromise or settlement of any such suit, claim, or proceedings and Buyer shall unreasonably refuse to consent to such compromise or settlement, then Seller's liability under Section 10.1 hereof with respect to such suit, claim or proceeding shall be limited to the amounts so offered in compromise or settlement together with all legal and other expenses which may have been accrued prior to the date on which the other has refused to consent to such compromise or settlement.

10.4 Satisfaction of Indemnification Claims. Any amounts which are claimed by Buyer under Section 10.1 hereof ("Claim") may be satisfied against the escrow amount described in Section 10.5 hereof pursuant to the procedures set forth in the Escrow Agreement (as such term is defined below).

10.5. Escrow Account. In order to provide in part for the prompt payment of any sums due Buyer pursuant to this Section 10, Seller agrees that Buyer shall be permitted at the Closing to deliver to Commerce Union Bank, Nashville, Tennessee, a portion of the Purchase Price equal to \$250,000, such funds to be held in escrow for one hundred and eighty-five (185) days following the Closing Date (the "Claims Period") pursuant to the terms of an escrow agreement by and among Buyer, Seller and such escrow agent

J.APP. 5484

(the "Escrow Agreement"). The Escrow Agreement shall be substantially in the form of Exhibit O attached hereto and made a part hereof. Buyer and Seller shall execute and deliver the Escrow Agreement at the Closing.

11. Further Assurances, Assistance & Cooperation; Access.

At or following the Closing, each of the parties hereto will take such further actions and execute and deliver such additional documents and instruments as may be reasonably requested by any other party in order to perfect and complete the transaction as set forth herein. After the Closing, Buyer shall cause the Company to keep and preserve all medical records and other records of JMH existing as of the Closing and which are required to be kept and preserved (i) by any applicable Federal or state law or regulation or (ii) in connection with any claim or controversy still pending involving Seller. After the Closing, upon reasonable written notice by Seller to the Company, Seller or its agents shall be entitled, during regular business hours, to have access to and make copies of all records pertaining to the operation of JMH (other than medical records which shall be governed by the provisions of the following paragraph) or any of the Real Property prior to the Closing as may be necessary for the Seller's use in any such claim or controversy.

12. Termination of Agreement. This Agreement and the transactions contemplated hereby may be terminated by Buyer without liability of any kind of Buyer to Seller or the Company (subject to the obligations of the parties under Section 12.2) by written instrument, signed by Buyer and delivered to Seller at

any time on or prior to the Closing Date, giving notice of termination, if:

(a) There has been a material misrepresentation or material breach of warranty on the part of Seller or the Company in the representations and warranties set forth herein or in any Exhibit hereto or in any certificate delivered pursuant hereto, or Seller or the Company shall have failed to perform or comply with in any material respect any covenant, agreement or condition to be performed or complied with by either of them prior to or at Closing, or Closing shall have failed to occur on or before August 31, 1985;

(b) In the reasonable judgment of Buyer the transactions contemplated by this Agreement have become inadvisable or impracticable by reason of (i) the enactment of new federal, state or local legislation since the date of this Agreement, or (ii) the announcement, written advice or threat of intended institution or the institution by federal, state or local authorities of an investigation of or litigation or proceedings against the Company or Seller which may have a material and adverse effect on the Company or the transactions contemplated hereby, or (iii) the institution since the date of this Agreement by any other person, corporation or entity of litigation or proceedings against or in regard to the Company or Seller which may have a material and adverse effect on the Company, or which may materially and adversely affect the authority or ability of Seller or the Company to consummate the transactions contemplated hereby; or

(c) The business, Assets, results of operations, financial condition or future prospects of the Company have been significantly and adversely affected by reason of changes or developments in operations, otherwise than in the ordinary course of business, since December 31, 1984; or

(d) The Buyer and Seller cannot agree upon the amounts of the Company's Current Assets or Current Liabilities or Capitalized Lease Obligations as contemplated in Section 3.4.2. hereof.

13. Effect of Termination; Confidentiality.

13.1. Scope of Liability. In the event that this Agreement shall be terminated for any reason other than breach or default by any party in accordance with the provisions of this Agreement, then all further obligations of Buyer, Seller and the Company under this Agreement shall terminate without further liability of any one party to the others, except for the obligations of the parties under Section 13.2.

13.2. Confidentiality. In the event of termination of this Agreement, all information received by any party from any other party pursuant to this Agreement shall not thereafter be used by such party for any purpose or disclosed by such party to third persons, and all documents, schedules, writings, work papers or other materials submitted by any party to any other party pursuant to this Agreement and all copies thereof shall be returned to the submitting party within 10 days of such termination; provided, however, the foregoing restrictions on use or disclosure shall not apply to any information which was in any

party's possession prior to the receipt thereof from another party.

14. Expenses. All legal, accounting and other costs and fees incurred by Seller in connection with the transactions contemplated by this Agreement shall be borne and paid for by Seller. All legal, accounting and other costs and fees incurred by Buyer in connection with the transactions contemplated by this Agreement shall be borne and paid for by Buyer.

15. Investment Representation. Buyer is acquiring the Stock for investment, solely for its own account, and not for the account of any other person, and not for distribution, assignment or resale to others. Buyer acknowledges that the securities have not been registered under applicable federal or state securities laws. Buyers agrees that the Stock purchased by it shall not be sold, offered for sale, pledged, assigned, hypothecated or otherwise transferred (with or without consideration), unless pursuant to an effective registration statement, or unless in the opinion of counsel to the Company, the proposed transfer may be made pursuant to a valid exemption from the registration provisions of applicable federal and state securities laws.

16. Miscellaneous Provisions.

16.1. Survival of Representations, Warranties and Covenants. The representations, warranties, covenants and agreements made in this Agreement by Seller, the Company and Buyer, respectively, shall survive for a period of one hundred eighty (180) days from the Closing Date. The respective representations and warranties of each party hereto contained herein

or in any Exhibits hereto or certificates delivered pursuant hereto shall not be deemed to be waived or otherwise affected by any investigation or audit made by any other party hereto or by any action taken by any party at the request of any other party hereto. All statements made by Seller, the Company or Buyer herein, in any of the Exhibits hereto, or in any other document delivered pursuant hereto, shall be deemed representations and warranties.

16.2. Assignment. Neither Buyer, nor Seller, nor the Company may assign this Agreement or any rights or obligations hereunder, in whole or in part, without the prior written consent of the other parties hereto.

16.3. Notices. Any notice, request, instruction or other document or communication required or permitted to be given under this Agreement shall be in writing and shall be deemed given upon delivery in person or upon being deposited in the mail, postage prepaid, for mailing by certified or registered mail, as follows:

If to Buyer, delivered or mailed to:

Fairfax Hospital Association
8001 Braddock Road
Springfield, Virginia 22151
Attention: J. Knox Singleton,
President

with a copy delivered or mailed to:

William C. Bauknight, Esquire
Miles & Stockbridge
114 North West Street
Easton, Maryland 21601

If to the Company or Sellers, delivered or mailed to:

Health Group, Inc.
Ninth Floor
One Commerce Place
Nashville, Tennessee 37239
Attention: J. George Harris,
President

with a copy delivered or mailed to:

[To Be Supplied]

or to such other address or addresses as may be specified in writing from time to time by any party to the other parties.

16.4. Section Headings. Section headings are for convenience only and shall not limit or otherwise affect any of the provisions of this Agreement.

16.5. Entire Agreement. This Agreement and the Exhibits hereto constitute the entire agreement and understanding of the parties hereto with respect to the matters herein set forth, and all prior negotiations, writings and understandings relating to the subject matter of this Agreement are merged herein and are superseded and cancelled by this Agreement.

16.6. Waivers - Amendments. Any of the terms or conditions of this Agreement may be waived but only in writing by the party which is entitled to the benefit thereof, and this Agreement may be amended or modified in whole or in part only by an agreement in writing, executed by all the parties to this Agreement.

16.7. Binding Nature of Agreement. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their successors and permitted assigns. As used herein, any reference to the masculine, feminine or neuter gender

shall include all genders, the plural shall include the singular, and the singular shall include the plural.

16.8. Governing Law. This Agreement shall be construed and enforced in accordance with the laws of the State of Virginia.

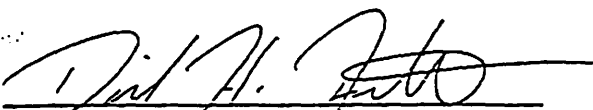
16.9. Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, this Agreement has been executed under seal by the duly authorized officers of Buyer, Seller and the Company as of the date first above written.

ATTEST:

"SELLER":

HEALTH GROUP INC.


ASSISTANT SECRETARY

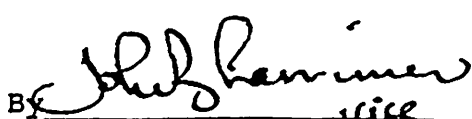
By:  (SEAL)
J. George Harris, President

THE "COMPANY":

HEALTH GROUP OF VIRGINIA, INC.

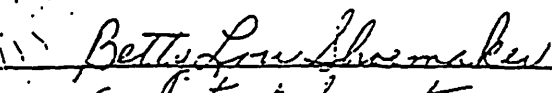
ATTEST:


ASSISTANT SECRETARY

By:  (SEAL)
J. George Harris, Vice President
THE "BUYER" John B. Larrimer

FAIRFAX HOSPITAL ASSOCIATION

ATTEST:


Assistant Secretary

By:  (SEAL)
J. Knox Singleton, President

file

LAW OFFICES OF
ROSS, MARSH & FOSTER

117 SOUTH FAIRFAX STREET
ALEXANDRIA, VIRGINIA 22314

(703) 683-7446

JOHN THORPE RICHARDS
WILLIAM L. BASCOCK, JR.

MALCOLM M. MITCHELL, JR.
JANE S. REESE

May 3, 1982

688 SIXTEENTH STREET
WASHINGTON, D.C. 20006
(202) 822-8088

510 PERPETUAL BUILDING
BETHESDA, MARYLAND 20814
(301) 656-5766

Paul L. Sloan, III, Esquire
Harwell, Barr, Martin & Sloan
P.O. Box 2960
Nashville, Tennessee 37219

Re: Lease between Jefferson
Memorial Hospital Corporation
now known as Jefferson Corpo-
ration of Alexandria and
Health Group of Virginia, Inc.

Dear Paul:

On behalf of Jefferson Corporation of Alexandria, I hereby acknowledge with thanks receipt of \$233,983.83 on Friday afternoon, April 30, 1982. The parties agreed that the following break-down of the calculation of the purchase price based on the Lessor's balance sheet as of March 31, 1982 should be as follows rather than as set forth in my letter to you of April 23, 1982:

1. Eighty percent (80%) of patient accounts receivable	\$2,211,483.72
2. Plus one hundred percent (100%) of the book value of the equipment purchased	265,896.25
3. Plus one hundred percent (100%) of the cost of inventory of usable expendable supplies on hand for hospital operations and purchased by Lessee	264,433.14
4. Plus one hundred percent (100%) of prepaid expenses	96,047.38
5. Less one hundred percent (100%) of trade accounts payable	(875,855.00)
6. Less one hundred percent (100%) of all accrued expenses assumed by Lessee	<u>(85,913.85)</u>
	\$1,876,091.64

MMRW 016681

J.APP. 5492

EX 000

Paul L. Sloan, III, Esquire

Page Two

Re: Lease between Jefferson Memorial
Hospital Corporation, now known
as Jefferson Corporation of
Alexandria and Health Group of
Virginia, Inc.

May 3, 1982

7. Plus fifteen percent (15%) of
the sum of Items 1, 2, 3, 4, 5,
and 6 above

\$ 281,413.75

Adjusted purchase price

\$2,157,505.39

The difference between the aforesaid adjusted purchase price of
\$2,157,505.39 and the purchase price paid as of March 2, 1982 of
\$1,923,521.56 is \$233,983.83.

With kind regards, I am

Very truly yours,

Malcolm M. Mitchell, Jr.

MMW/knw

cc: Laszlo N. Tauber, M.D.
Mr. Dallas Wright

MMRW 016682

J.APP. 5493



extendicare
skilled nursing centers

PORTLAND FEDERAL BUILDING • 200 W. BROADWAY • LOUISVILLE, KY. 40202 • PHONE 502/583-9747

August 28, 1970

Dr. Melvin Small
2946 Sleepy Hollow Road
Falls Church, Virginia 22046

RE: Jefferson Memorial Hospital

Dear Dr. Small:

I enjoyed very much meeting with you and Craig yesterday and I hope that your flight back to Washington was short and pleasant. In accordance with our understanding and agreement, I would like to take this opportunity to outline the offers which Extendicare is willing to make to acquire all of the assets and operation (exclusive of certain land owned by the doctors in their individual capacity) of Jefferson Memorial Hospital. We are most anxious to conclude the transaction on the basis of the first proposal as a result of the working capital situation of the hospital. Our proposals are as follows:

(1) Extendicare will acquire all of the assets of Jefferson Memorial Hospital, Inc. and assume all of its liabilities in exchange for Extendicare common stock in the amount of \$25,000. Extendicare will lease from Jefferson Memorial Hospital Associates the buildings and equipment used at the hospital. The lease agreement shall be for five (5) years and shall be in an amount equal to the present lease payments plus \$25,000 per year. Extendicare will have the option to purchase the buildings and equipment at the end of approximately five (5) years for an amount equal to Two Million One Hundred Sixty Thousand Dollars (\$2,160,000.00) less the then outstanding principal amount of the first mortgages.

As I explained to you in Louisville, the purpose of the lease is to avoid any depreciation recapture problems to

JAPP. 5494

R. ex. A



extendicare
skilled nursing centers

TO

7039984804 P.04

Dr. Melvin Small
August 28, 1970
PAGE TWO

the Associates. The gross purchase price is based upon \$18,000 a bed.

(2) Extendicare will exchange for all of the assets of Jefferson Memorial Hospital, Inc. and Jefferson Memorial Hospital Associates \$700,000 and shares of its common capital stock equal to \$700,000 in value. The number of shares of the common stock shall be determined by averaging the closing price of the Extendicare stock beginning with the date of the signing of this letter of intent until the date of the Closing. The \$700,000 in cash shall be paid, \$100,000 at the Closing with the balance in six (6) equal annual payments bearing interest on the unpaid balance at Six (6) Percent. Extendicare will assume and discharge all of the liabilities of the hospital corporation and the associates.

(3) Extendicare will purchase all of the assets of Jefferson Memorial Hospital, Inc. and Jefferson Memorial Hospital Associates for \$1,100,000 in cash. The cash shall be paid, \$100,000 down at the Closing with the balance over ten (10) years at Six (6) Percent. Extendicare shall assume and discharge all of the liabilities of the corporation and the associates.

All of the above three offers assume that all amounts owed either organization by the physician shall be discharged in accordance with their terms. Extendicare shall discharge all obligations of each of the entities to the owners in accordance with their terms.

I believe that the above three offers correctly state our position in this matter. The stock to be received by the associates will be unregistered and must be taken for investment purposes. The allocation of the purchase price between the associates and the corporation will be agreed upon prior to the time of closing.

In the event the associates and the corporation decide to accept one of our offers, I would appreciate it if you

J.APP. 5495



extendicare
skilled nursing centers

TO

7039984804 P.05

Dr. Melvin Small
August 28, 1970
PAGE THREE

would indicate your acceptance by executing the enclosed copy of this letter at the bottom in the manner indicated. I am sure that you realize that this is merely a letter of intent outlining our proposal and that there is nothing binding on either party until the execution of the definitive agreement.

If you need any further information or if I can be of any further help to you whatsoever, please do not hesitate to contact me. I am enclosing with my letter a copy of a letter written by Dean Grout of the Hospital Division explaining our future plans for Jefferson Memorial and our method of operation. With best personal regards, I remain,

Sincerely,

William C. Ballard, Jr.

WCB:ajp
Enclosure

cc: Mr. Craig Forthman

ACCEPTED THIS _____ DAY OF
_____, 1970

JEFFERSON MEMORIAL HOSPITAL, INC.
and JEFFERSON MEMORIAL HOSPITAL
ASSOCIATES

BY: _____
DR. MELVIN SMALL

J.APP. 5496

TOTAL P.05

JEFFERSON MEMORIAL HOSPITAL

4600 KING STREET, ALEXANDRIA, VIRGINIA 22302
TELEPHONE: 703/931-2600

December 11, 1970

Mr. Ernest Gene Reeves, Esq.
Reeves & Harrison
Suite 500
1701 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

Dear Mr. Reeves:

This letter will acknowledge your recent letter dated November 20, 1970, addressed to the Board of Directors in connection with changing the corporate set-up of Jefferson Memorial Hospital, Inc. At the Board of Directors Meeting on December 9, 1970, it was approved that the Hospital Corporation accepted your offer as Legal Counsel for advice with the understanding that you consult with 2 former attorneys, namely Mr. Bernard Krakow (Me 8-1987), and Mr. Thorpe Richards, (836-2771). I would like to put on record that I personally oppose changing the Charter of Jefferson Memorial Hospital from a non-profit corporation to a profit corporation, however, I am willing to cooperate 100% with the wish of the majority of the Board of Directors. I oppose it principally because I do not agree that any profit-making should be achieved by a hospital. Furthermore, the time for the change is not appropriate. By changing the Charter, we will certainly lose very important benefits which will be an additional burden on the Hospital. Since I have never had the pleasure of talking to you to express my opinion, this statement is just a matter of record rather than a proposal to change future plans.

I have talked to the Administrator of the Hospital, Mr. L. Craig Forthman, who was highly impressed by you and the concept of how to conduct the transfer. I especially welcome your strong suggestions that members of this venture should pay up their current obligations before any change in the Charter is made.



Mr. Ernest Gene Reeves, Esq.
December 11, 1970
Page Two

For being 18 years in real estate investment, without lack of modesty, I can state that these ventures were successful, so I definitely wish to adhere to the method used by me previously, that is to keep my ownership in the building as an individual rather than in corporate form. As you might know, I am trustee for the whole venture, however, I am speaking only for my part, because if any member desires to put his share of the partnership into the future corporation, I will cooperate 100%, and I will release that part of the partnership.

In order to summarize my letter:

1. Your offer is accepted. The retainer fee will be paid by the Hospital Corporation and not by the partnership.
2. Before any change of the Corporation can be made, all obligations of the individual partners must be met; except one note due on December 31, 1970. All the rest are long overdue. I would suggest that these partners put up the money before changing the Corporation or request in writing to adjust their share in the partnership appropriately up to the amount of what they paid for it.
3. The approximate \$150,000. notes obligation of the Hospital Corporation is endorsed only by me at the present time. Therefore, the notes have to be paid in full before any change of the Corporation can be made. However, I am willing to pay or endorse a new note up to my percentage of interest in the new Corporation - 25%. Under no condition would I agree to endorse the full note, and accept notes from other partners. If they feel that due to the high interest rate that banks are now charging they would rather loan that sum of money then naturally I am willing to loan 25% of the amount at the same interest rate and for the same length of time as the rest of the partners are willing to do.

TAG 003360

Mr. Ernest Gene Reeves, Esq.
December 11, 1970
Page Three

4. As far as the land is concerned, I inform you that the land was appraised for \$300,000. The ownership of the land is as follows: Dr. Leslie Gondor and his wife 50%, Tauber Foundation 25%, Jefferson Memorial Hospital 20%, and Dr. Samuel Burtoff 5%. As far as the Tauber Foundation's holdings, I am willing to propose a sale to the new Corporation for \$75,000. if it is desired. In order to clean out the records and make it more simple, I would like to state that this transaction is based on an all cash basis.
5. I recommend that all the Hospital equipment be transferred to the new Corporation.
6. Our appointed Committee, Drs. Vlahos, Corrado, Small and Peters are hereby authorized to work out the details with the cooperation of the Administrator, Mr. L. Craig Forthman, and Attorneys Mr. Krakow and Mr. Richards.
7. Any dilution of the stocks is opposed by each of us. That is, the option to purchase the stocks have to be based on the percentage of ownership of the Hospital building, as agreed on by the Board of Directors unanimously.

With best wishes,

Sincerely yours,

LASZLO N. TAUBER, M.D.
Chairman, Board of Directors

LNT:ata

TAG 003361

J.APP. 5499

June 8, 1979

MEMORANDUM:

TO: LASZLO N. TAUBER, M.D.
TRUSTEE, JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE

RE: CITY OF ALEXANDRIA PROPERTY TAX

The first one-half of 1979 property tax is due the City of Alexandria before June 15, 1979.

The total annual assessment for the land and buildings including the new building and Hopkins property amounts to \$86,954.40 with \$43,477.20 due June 15th. Prorating the tax on the new building by square feet occupied is computed as follows:

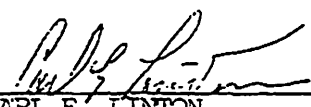
A. Tax on new building prorated:

	<u>Assessed Evaluation</u>	<u>Annual Tax</u>	<u>1/2 year Payment</u>
New Building	2,938,200	\$42,310.08	\$21,155.04
Land Bldg. Occupies	67,265	968.62	484.31
	<u>3,005,465</u>	<u>\$43,278.70</u>	<u>\$21,639.35</u>
Jefferson Memorial Hosp. Occupancy		20.58%	20.58%
Jefferson Memorial Hospital Portion		<u>\$ 8,906.76</u>	<u>\$ 4,453.38</u>
Joint Venture Portion		\$34,371.91	\$17,185.97

B. Allocation of total bill:

	<u>Annual</u>	<u>1/2 Payment due June 15</u>
Amount from Hopkins	3,082.92	1,541.46
Amount owed by Hospital	49,499.54	24,749.77
Amount from Joint Venture	<u>34,371.91</u>	<u>17,185.97</u>
Total Bill	86,954.40	43,477.20

Thank You,


CARL E. LINTON
Administrator

J.APP. 5500

CEL:pc



Communication of Hospital President
August 22, 1979



MEMORANDUM:

TO: LESLIE L. PETERS, M.D.
HOSPITAL PRESIDENT

RE: ALLOCATION AND ACCOUNTING OF EXPENSES BETWEEN THE HOSPITAL AND JOINT VENTURE TENANTS

As you know, the Hospital Auditor, Mr. David Mermelstein, C.P.A., is now conducting the annual audit of the Hospital. He has raised a couple of questions which we must resolve. These are the questions:

1. How does the Hospital intend to treat taxes paid on new building? Expense to hospital?
2. How does the Hospital intend to treat utilities, insurance and other building support service for the new building?

3. Did the Board of Directors have full knowledge of the total cost of the taxes, utilities, insurance and other support services when it approved a fee of \$.50 per square foot to the Hospital as payment for all expenses other than housekeeping, for the 2nd, 4th, 5th and 6th floors? I have explained to Mr. Mermelstein that the Board had agreed to provide all of these services and expenses to the Joint Venture owners of the new building for \$.50 a square foot. His audit reveals that the expenses will be much more than the agreed to \$.50 a square foot. If we charge these expenses in our accounting records as directed, he will have to make mention in his Financial Report. These reports are required documents for audit by Medicare, Medicaid and Blue Cross. Further, they will be reviewed by Internal Revenue when they come for spot checks or full audits. He feels that as soon as IRS discovers this treatment of expenses by the Hospital, they will perform a full audit and go much deeper into everything than they normally would. Further, he is concerned that the Stockholders who are not members of the Joint Venture will have a right to cause investigation or even litigation because Hospital funds are being paid or used to pay

J.APP.5501

expenses of the Hospital Joint Venture.

To avoid all of this as well as any disclosure in the audited statement, the following is recommended:

1. Set up an acceptable procedure for allocating expenses common to the Hospital and the Joint Venture Owners of the non-Hospital portion of the new building.

2. Draw up an agreement between the Hospital and the Joint Venture which provides for the \$.50 per square foot annually and provides for setting up an Accounts Receivable to Joint Venture which will eventually be paid by the Joint Venture. This account receivable could be applied against the sum which has been mentioned as the actual cost incurred by the Joint Venture for the Hospital 3rd floor.

I have worked up the detail on the essential elements which could be used as a basic formula for distributing cost or expense between the Hospital and Joint Venture as discussed above. The essential elements are:

1. Based on City of Alexandria Tax Assessment Survey data which I feel would be reasonable to use, Attachment "A" shows detail of land use. Attachment "B" shows the gross square footage in the old hospital building and the new building. Attachment "C" shows the hours of operation for the Hospital and for the offices in the new building. In summary, the detail recommends:

1. Property Taxes: The Hospital is allocated 87.85% of taxes on the land and the Joint Venture 12.15%. Taxes on the buildings is allocated 100% to hospital on old building and 22% on new building. This is based on percentage of occupancy.

2. Building Insurance. The Hospital pays 100 percent on old building and 22% for insurance on the new building. This is also based on percentage of occupancy.

August 22, 1979

3. Utilities. Hospital is allocated 76.26% and Joint Venture owners are allocated 23.74% of the expense. This is based on percentage of operating hours. Wherein Hospital operates 24 hours a day, 7 days a week and the offices operate 8 hours a day, 5 days a week. Realizing the doctor's offices may operate and use electricity more than 8 hours a day, I feel the higher demand usage by certain hospital departments plus the fact the Hospital occupies 57.34% of total buildings floor space as compared to 42.66% used by the offices of the Joint Venture, serves to offset the assumption that the Hospital is paying more than its share of the cost.

I trust the above information will be helpful for you to make a decision on the appropriate action.

Thank You,

CARL E. LINTON
Administrator

Confidential Draft
Do Not Copy

Jefferson Hospital Options Analysis

for

Inova Hospitals Falls Church, VA

With Assistance From

Cohen, Rutherford, Blum & Schott, PC
Bethesda, MD



National Health Advisors, Ltd.
Vienna, VA

April 2, 1992

Copy Number: 004

Joe Schott

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EXECUTIVE SUMMARY

This study presents Phase I of a two phase comprehensive analysis of the long-term strategic options for Jefferson Hospital (JH). It has been developed by National Health Advisors (NHA) and Cohen, Rutherford, Blum & Schott (CRB&S) in cooperation with Inova Health System (IHS) management. This study has been conducted in part to synthesize the many efforts that have been expended in past years to improve the situation at JH. It is noted that many of these options would require a renegotiation of the existing lease as well as other potential barriers to implementation.

The first section of this report provides an overview of the situation. It is noted that IHS has invested \$18.5M in JH thus far, including \$7.2M, which was the initial cost of entering into the lease. Corporate overhead amounting to \$4.1M has been allocated to the lease through 1991. If IHS had not allocated any corporate overhead costs to JH, the total investment in JH would have been approximately \$14.4M. Thus far, this investment has not resulted in an increase in utilization and financial trends have declined over the six year period since inception of the lease. Part of the declining financial situation was a conscious decision to raise staffing levels to more acceptable targets. The condition of JH's physical plant, its location and lack of convenient access may be among the biggest barriers to success.

There are an estimated 423 excess beds in JH's market area, suggesting that JH may not be a needed hospital. JH could have a projected inpatient average daily census in the future ranging between 39 and 56, as indicated in baseline projections. This would result in annual operating losses ranging between \$3M and \$8M dollars. On a net present value basis, cumulative losses through the term of the lease could range between \$22M and \$47M from 1991 through 2005, assuming JH continues to operate as it has (baseline scenario). If IHS were to close JH and pay off the lease (bail out scenario), the cost is estimated to be approximately \$22M (NPV). Sensitivity analyses are performed on a number of key variables.

Numerous previous studies have been conducted to determine potential options for the future of JH. These have focused on such things as reducing staffing, eliminating programs, dedicating a subunit to different uses, decreasing price, and subleasing space for special uses. A more recent study analyzed the potential of consolidating JH into Fairfax Hospital (FH). Before considering this further, it was determined that a comprehensive strategic options study should first be completed.

Four core options are presented, including maintain the status quo, purchase the beds and move them to a more desirable location, alter the service mix, and joint venture with another group or groups. There are many derivations of each of these options. General advantages and disadvantages are discussed.

An explicit set of critical success factors is identified which are subsequently used to evaluate a representative opportunity within each of these core option categories. Critical success factors are those attributes that must be achieved by any optional approach for JH if it is to represent an improvement to the status quo. Specific criteria are quantified within key categories, including financial, market, political/legal/regulatory, and facility. The application of these criteria to these representative core options result in the identification of two core options that should be further evaluated in Phase II of this study. These options include:

- . Purchase Beds and Move Them. The two related options for further evaluation in Phase II include: purchase the 120-bed JH license and move the beds to a more demographically desirable location (e.g., Franconia, Sterling); and move beds to other IH facilities (e.g., Fair Oaks (15 beds) and Fairfax (45 beds) and de-license the remaining 60 beds).
- . Alter Service Mix. The option for further evaluation related to this core option is to develop a "mixed use" facility at JH. Further analysis will be completed in Phase II to determine the "right" mix of service.

"Next steps" related to the Phase II communication and approval process are outlined. These key steps include:

- . Develop a Steering Committee to participate in the Phase II discussions.
- . Conduct meetings with the Steering Committee on a regular basis throughout Phase II.
- . Conduct individual interviews with physicians from both JH and FH.
- . Meet periodically with the existing JH/FH Integration Task Force throughout the Phase II process.
- . Determine the necessary steps in the approval process.

I. INTRODUCTION

This document presents an analysis of long-run strategic options for Jefferson Hospital (JH). This report has been jointly developed by National Health Advisors (NHA) and Cohen, Rutherford, Blum, & Schott (CRB&S). The strategic options analysis emanates from earlier work that was completed by NHA on behalf of Inova Health System (IHS) regarding the possibility of consolidating the governance, management and medical staffs of Jefferson Hospital (JH) into Fairfax Hospital (FH).

The purpose in conducting this analysis is to provide a clear summary of the performance of JH to date; to establish a baseline projection into the future, assuming no change; and to determine potentially viable future strategic options for JH, based in part on previous attempts to define future opportunities for JH. It was considered important to complete this comprehensive analysis prior to making any decision to significantly alter JH.

In considering certain options, specific criteria were applied, resulting in the elimination of many options as a result of this first phase of the analysis. This technique was used to quickly focus our efforts on a few potentially viable opportunities and then to further examine the viability of this limited set of options in phase II if warranted.

In conducting this study, it is recognized that recommendations arising from this analysis will ultimately need to be communicated and supported, both internally and externally. In view of this requirement, attempts were made to carefully document the analyses in this study.

It has been the express intent of this study to rely, where possible, on previous studies. Previous analyses were conducted by the architectural firm of Cannon and Faulkner (facilities assessment) and the finance and marketing staff of Inova Health

System (IHS). Additional information has been provided by IHS management. Neither NHA nor CRB&S have made any attempt to validate the information found in these previous studies. Projections that are used in this study are based on assumptions as documented. These assumptions are subject to change. These projections are intended for internal use only and should not be used for any other purpose. As with any projection, one cannot attest to the accuracy or impact of unforeseen consequences which may occur and may materially alter the results that are suggested in this report.

It should also be recognized that in considering potential options for JH there are specific limitations due to the fact that the JH property is leased to IHS through a 20-year lease with the Jefferson Hospital Corporation of Alexandria. The terms of the lease have the potential to prohibit specific options that may otherwise be preferable for the future of JH.

Additionally, when IHS entered into this lease in 1985, the healthcare climate differed from today's environment. Given current market trends and the likelihood that these trends will continue through the term of the lease, it is possible that there are really no options that will result in a breakeven or better outcome for JH. Said differently, the options examined in this report may have the potential to limit JH's losses but may not eliminate them. Before proceeding further with this report, it is important to briefly discuss the Hospital Lease Agreement and how this agreement could impact the future options presented in this report.

IHS counsel indicates that under the Hospital Lease Agreement for JH, the bottom three floors of the Hospital must be used primarily as an acute care hospital. Lessee is prohibited from taking any action that would result in the reduction in the number of licensed medical and surgical acute care beds, either directly or indirectly (e.g., increasing the number of beds at another Inova hospital which results by operation of State action in reduction of the number of licensed beds at Jefferson). Without Lessor's prior written consent, any deviation from this requirement, including closing Jefferson, changing Jefferson's service mix by reclassifying beds, or operating a joint venture in a manner effectively constituting a sublease, would constitute a breach of the Hospital Lease Agreement.

The consequences of a breach of the Hospital Lease Agreement could be exceedingly costly. The only way to amend the current agreement without risking great expense is to renegotiate the lease. We have had to assume that the Lessor might be willing to renegotiate any of the options described in this paper. If Lessor is not willing to negotiate, however, a carefully planned termination strategy could reduce the penalties for defaulting to an acceptable level. Such a strategy is not outlined in this

document, but may have to be structured prior to approaching Lessor for consent to proceed with any of the options discussed in this study. It should also be noted that on numerous occasions IHS management has attempted to renegotiate the terms of the lease with the current landlord. These attempts have not been successful.

For ease of review we have divided this document into the following sections:

II. SITUATIONAL ANALYSIS

III. STRATEGIC OPTIONS

IV. PRELIMINARY EVALUATION OF KEY STRATEGIC OPTIONS

V. RECOMMENDED NEXT STEPS

Exhibits appear on the page following the initial underscored reference.

II. SITUATIONAL ANALYSIS

The situational analysis is an overview of utilization and financial trends, key events that have occurred since the commencement of the JH lease, as well as a review of JH's physical plant. The situational analysis also presents a review of two key scenarios:

- . Baseline Scenario -- What will occur through the lease term (2005) if JH continues operating as it has in the past?
- . Bail Out Scenario -- What would it cost to close JH now?

These scenarios provide the basis from which to evaluate all other potential options for Jefferson Hospital.

1. SINCE 1985, WHEN IHS ENTERED INTO THE JH LEASE, IHS HAS INVESTED \$18.5M IN JH.

The investment in JH included an initial acquisition and negotiation of a 20-year lease, as well as additional capital costs.

- (1) Inova Health System's Relationship with JH Began in 1985, When JH was Brought into IHS Under a 20-year Lease.

Exhibit I, on the following page, underscores the key events that have occurred at JH since the inception of the lease in 1985. It is noted that:

- . A number of new technologies and services have been added since 1985, including:
 - mammography,
 - treadmill,
 - cardiac catheterization, and
 - respite center.
- . Other strategies have included a name change (a minor change to include Inova in the name as is being implemented for all IHS facilities), establishing a volunteer/auxiliary program and a gift shop and certain personnel changes.
- . JH has also leased space to both IHS for a Comprehensive Alcohol and Drug Abuse Treatment Services (CATS) program and to IHS for a Drug Studies program. Both of these ventures required renovation of the JH facility and have since been discontinued.

EXHIBIT I
Inova Hospitals

JEFFERSON HOSPITAL MAJOR EVENTS 1985-1991

KEY EVENTS AND CAPITAL INVESTMENTS, 1985 - 1991	
September, 1985	Affiliation with FHS
September, 1985	Telemetry installed in emergency room
October, 1986	Mammography unit purchased
December, 1986	Respite Center opening
October, 1986	Agreement signed with Hazelton Lab to perform post-marketing drug studies
October, 1986	Affiliation with Boston University for research
June, 1987	Name change - Jefferson Hospital (deleted Memorial)
March, 1987	Mount Vernon Hospital assumes management of Physical Medicine and Rehab departments
March, 1987	New anesthesia contract signed
May, 1987	Hospital received Level III Trauma designation
March, 1988	Volunteer/Auxiliary program established
November, 1988	New CFO hired
February, 1989	Fairfax Hospital CATS (Comprehensive Addiction Treatment) opened short stay unit
June, 1989	Opening of Cardiac Catheterization Lab
June, 1989	Opening of Diabetes Management Center
January, 1990	New Radiology Contract with FH based physicians
November, 1990	New Gift Shop opens, \$75,000
December, 1990	Lab Equipment, \$127,450
January, 1991	C-Arm Image Intensifier, \$142,651
January, 1991	Computer Equipment, \$489,627
January, 1991	Ultrasound Scanner, \$107,900
February, 1991	Renovation of East Nursing Unit, \$900,000
June, 1991	CT Scanner System, \$104,780
June, 1991	Whole Body Scanner, \$366,730

Source: JH Hospital Records

- (2) The Initial Cost of Entering Into The Lease was \$7.2M. Since That Time an Additional \$11.3M has been Invested in JH.

Through December 31, 1991, IHS invested approximately \$18.5M in JH. Approximately \$13.2M has been invested in capital expenditures. As of December 31, 1991, JH had outstanding debt of approximately \$2.2M for lease commitments that were used to finance a portion of the capital expenditures.

During the period of the lease, IHS has allocated corporate overhead costs to JH of approximately \$4.1M. If IHS had not allocated any corporate overhead costs to JH, the total investment in JH would have been approximately \$14.4M.

2. THIS INVESTMENT HAS NOT RESULTED IN AN INCREASE IN UTILIZATION AT JH, AND FINANCIAL TRENDS HAVE DECLINED OVER THE SIX-YEAR PERIOD SINCE THE INCEPTION OF THE LEASE.

The decline in utilization is coupled with a loss of physicians in key medical specialties, a decline in productivity, and a decline in financial trends.

- (1) Since 1985, Utilization At JH, in Terms of Admissions and Inpatient Days, Has Declined by 29% And 44%, Respectively, While the Percentage of Medicare and Medicaid Total Days Have Also Declined.

Exhibit II, following this page, highlights utilization trends for JH between 1985 and 1991. Total 1991 admissions were 2,768. From Exhibit II, it can be seen that:

- . JH has 120 licensed beds, of which 100% are in operation. The majority of the beds are Medical/Surgical (112) while the remaining beds (8) are for Intensive Care.
- . Although JH experienced a slight increase in inpatient admissions between 1985 and 1986, and again between 1987 and 1988, there was an overall decrease in admissions between 1985 and 1991 of approximately 29%.
- . As admissions have decreased, the average length of stay has decreased as well. During each year between 1985 and 1991, with the exception of 1989, there was a reduction in length of stay. Overall, Jefferson's average length of stay decreased by 21.2%, during the period to 5.37 days. Adjusted average length of stay, using the Medicare Case Mix Index, declined by 23.7% between 1987 and 1991 (1985 and 1986 case mix not available) from 6.1 to 4.6 days. It should be noted that an increase in managed care in the area, as well as a conscious effort on the part of JH management to provide better case

EXHIBIT II
Inova Hospitals

UTILIZATION TRENDS FOR JH BETWEEN 1985 AND 1991

UTILIZATION TRENDS, 1985 - 1991

	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989	FY 1990	FY 1991	Percent Change 1985-1991
PATIENT ADMISSIONS								
TOTAL	3,877	3,915	3,586	3,672	3,459	3,259	2,768	-28.6%
INPATIENT DAYS								
Med/Surg	25,095	23,832	19,913	18,475	17,581	14,860	12,030	-52.1%
ICU	1,321	993	1,566	1,487	1,558	1,365	1,315	-0.4%
Respite*			895	1,274	1,516	1,294	1,531	71.1%
TOTAL	26,416	24,825	22,374	21,236	20,655	17,519	14,876	-43.7%
AVERAGE LENGTH OF STAY (ALOS)								
TOTAL	6.8	6.3	6.2	5.8	6.0	5.4	5.4	-21.2%
CASE MIX INDEX								
Medicare		N/A	1.02	1.04	1.05	1.07	1.16	12.8%
Overall								
Adj. ALOS			6.1	5.6	5.7	5.0	4.6	-23.7%
AVERAGE DAILY CENSUS								
Med/Surg	69	65	55	51	48	40	33	-52.1%
ICU	4	3	4	4	4	4	4	-0.4%
Respite	0	0	2	3	4	4	4	71.1%
TOTAL	72	68	61	58	57	48	41	-43.7%
OCCUPANCY								
Med/Surg & Respite	61.4%	58.3%	50.9%	48.3%	46.7%	39.5%	33.2%	-45.9%
ICU	45.2%	34.0%	53.6%	50.9%	53.3%	46.7%	45.0%	-0.4%
TOTAL	60.3%	56.7%	51.1%	48.5%	47.2%	40.0%	34.0%	-43.7%
LICENSED/REGISTERED BEDS								
Med/Surg	112	112	112	112	112	112	112	
ICU	8	8	8	8	8	8	8	
TOTAL	120	120	120	120	120	120	120	0.0%
OPERATING BEDS								
Med/Surg	112	112	112	112	112	112	112	
ICU	8	8	8	8	8	8	8	
TOTAL	120	120	120	120	120	120	120	0.0%

* Percent change for only those years shown.

Source: Hospital Revenue and Statistical Reports

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management has contributed to the decline in ALOS at JH.

The decreases in admissions and length of stay have caused both JH's inpatient days and average daily census to decrease by 43.7%, between 1985 and 1991.

Exhibit III, following this page, analyzes JH's utilization trends by payor classification. In reviewing utilization trends by payor there are several important points to note:

Most of the overall 43.7% decline into the JH patient days between 1985 and 1991 was concentrated in three payor categories. These include:

- Blue Cross with a 73.0% decline;
- Medicaid with a 65.1% decline; and
- Medicare with a 46.5% decline.

Medicaid patient days decreased from 2,281 in 1985 to 796 in 1991. Ironically perhaps, this loss of Medicaid volume represents an improvement in JH's payor mix when considering the Medicaid deductions to payments over this period. However, this lost volume also represents a significant loss of contribution to overhead, assuming that Medicaid payments at least covered direct costs of service.

The declining Medicaid inpatient volume combined with an increase in commercial pay patients represents an improved payor mix. However, it also leaves Jefferson more vulnerable to activities by HMOs, PPOs, and other insurance companies that are attempting to secure discounts. This is important to note because managed care (HMOs and PPOs) represents only 1.3% of total JH revenues in 1991, based on available data. This issue of increased vulnerability to discounting by third party payors will be important in reviewing JH's future revenue projections.

Average charges per patient day and per discharge also indicate the successful shift away from Medicare and Medicaid to higher paying patients. However, pricing increases have elevated JH's average charges per patient day and per discharge to the point where they may no longer be competitive. For example, Alexandria Hospital's 1991 budgeted charges per patient day were \$1,276 as reported in "Virginia Health Services Cost Review Commission (VHSCRC) Annual Survey of Charges", dated February, 1991. JH budgeted charges for 1991 as reported in the survey were \$1,376 per patient day. It should be noted that the survey figures are projected and there have been significant differences between

EXHIBIT III
Inova Hospitals

JH'S UTILIZATION TRENDS BY PAYOR CLASSIFICATION

	<u>1985*</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	PERCENT CHANGE <u>1985-91</u>
ADMISSIONS:								
MEDICARE	935	891	804	793	739	739	594	-36.5%
MEDICAID	372	344	275	201	197	177	177	-52.4%
BLUE CROSS	990	922	753	736	686	405	313	-68.4%
COMMERCIAL	1,035	1,100	1,047	1,123	1,075	1,079	979	-5.4%
OTHER	<u>545</u>	<u>658</u>	<u>707</u>	<u>819</u>	<u>762</u>	<u>859</u>	<u>705</u>	29.4%
TOTAL	3,877	3,915	3,586	3,672	3,459	3,259	2,768	-28.6%
PATIENT DAYS								
MEDICARE	9,377	8,674	8,164	7,410	6,920	6,068	5,018	-46.5%
MEDICAID	2,281	2,028	1,590	1,082	1,304	941	796	-65.1%
BLUE CROSS	5,608	5,251	4,135	3,863	3,699	1,922	1,514	-73.0%
COMMERCIAL	5,777	5,771	5,031	4,823	4,633	4,521	4,028	-30.3%
OTHER	<u>3,373</u>	<u>3,101</u>	<u>3,454</u>	<u>4,058</u>	<u>4,099</u>	<u>4,067</u>	<u>3,520</u>	4.4%
TOTAL	26,416	24,825	22,374	21,236	20,655	17,519	14,876	-43.7%
PATIENT DAYS AS % TOTAL DAYS								
MEDICARE	35.5%	34.9%	36.5%	34.9%	33.5%	34.6%	33.7%	-5.0%
MEDICAID	8.6%	8.2%	7.1%	5.1%	6.3%	5.4%	5.4%	-38.0%
BLUE CROSS	21.2%	21.2%	18.5%	18.2%	17.9%	11.0%	10.2%	-52.1%
COMMERCIAL	21.9%	23.2%	22.5%	22.7%	22.4%	25.8%	27.1%	23.8%
OTHER	<u>12.8%</u>	<u>12.5%</u>	<u>15.4%</u>	<u>19.1%</u>	<u>19.8%</u>	<u>23.2%</u>	<u>23.7%</u>	85.3%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	0.0%
AVERAGE LENGTH OF STAY								
MEDICARE	10.03	9.74	10.15	9.34	9.36	8.21	8.45	-15.8%
MEDICAID	6.13	5.90	5.78	5.38	6.62	5.32	4.50	-26.7%
BLUE CROSS	5.66	5.70	5.49	5.25	5.39	4.75	4.84	-14.6%
COMMERCIAL	5.58	5.25	4.81	4.29	4.31	4.19	4.11	-26.3%
OTHER	<u>6.19</u>	<u>4.71</u>	<u>4.89</u>	<u>4.95</u>	<u>5.38</u>	<u>4.73</u>	<u>4.99</u>	-19.3%
TOTAL	6.81	6.34	6.24	5.78	5.97	5.38	5.37	-21.1%

EXHIBIT III (Cont'd)
Inova Hospitals
JH'S UTILIZATION TRENDS BY PAYOR CLASSIFICATION

	<u>1985*</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>PERCENT CHANGE 1985-91</u>
INPATIENT REVENUE (in 000's)								
MEDICARE	\$6,270	\$6,203	\$6,653	\$7,194	\$7,792	\$7,742	\$7,680	22.5%
MEDICAID	1,343	1,319	1,202	1,028	1,714	1,266	1,354	0.8%
BLUE CROSS	3,443	3,538	3,359	3,881	4,287	2,801	3,334	-3.1%
COMMERCIAL	3,704	3,983	4,199	4,763	6,051	7,322	7,324	97.7%
OTHER	1,813	2,066	2,064	2,754	2,954	4,152	3,529	94.7%
TOTAL	\$16,573	\$17,109	\$17,477	\$19,620	\$22,799	\$23,284	\$23,221	40.1%
INPATIENT REVENUE AS % OF TOTAL								
MEDICARE	37.8%	36.3%	38.1%	36.7%	34.2%	33.3%	33.1%	-12.6%
MEDICAID	8.1%	7.7%	6.9%	5.2%	7.5%	5.4%	5.8%	-28.1%
BLUE CROSS	20.8%	20.7%	19.2%	19.8%	18.8%	12.0%	14.4%	-30.9%
COMMERCIAL	22.4%	23.3%	24.0%	24.3%	26.5%	31.4%	31.5%	41.1%
OTHER	10.9%	12.1%	11.8%	14.0%	13.0%	17.8%	15.2%	38.9%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	0.0%
REVENUE PER ADMISSION								
MEDICARE	\$6,706	\$6,962	\$8,275	\$9,072	\$10,544	\$10,476	\$12,930	92.8%
MEDICAID	3,610	3,835	4,371	5,115	8,702	7,154	7,648	111.9%
BLUE CROSS	3,477	3,837	4,461	5,273	6,249	6,917	10,653	206.3%
COMMERCIAL	3,579	3,621	4,011	4,241	5,629	6,786	7,481	109.0%
OTHER	3,326	3,140	2,919	3,363	3,877	4,834	5,005	50.5%
TOTAL	\$4,275	\$4,370	\$4,874	\$5,343	\$6,591	\$7,145	\$8,389	96.2%
REVENUE PER PATIENT DAY								
MEDICARE	\$669	\$715	\$815	\$971	\$1,126	\$1,276	\$1,531	128.9%
MEDICAID	589	650	756	950	1,315	1,346	1,701	188.9%
BLUE CROSS	614	674	812	1,005	1,159	1,458	2,202	258.8%
COMMERCIAL	641	690	835	987	1,306	1,620	1,818	183.6%
OTHER	537	666	597	679	721	1,021	1,002	86.5%
TOTAL	\$627	\$689	\$781	\$924	\$1,104	\$1,329	\$1,561	148.8%

* ACTUAL DATA FOR CALENDAR YEAR 1985 INCLUDING 7 MONTHS OF PREVIOUS OWNER'S DATA.

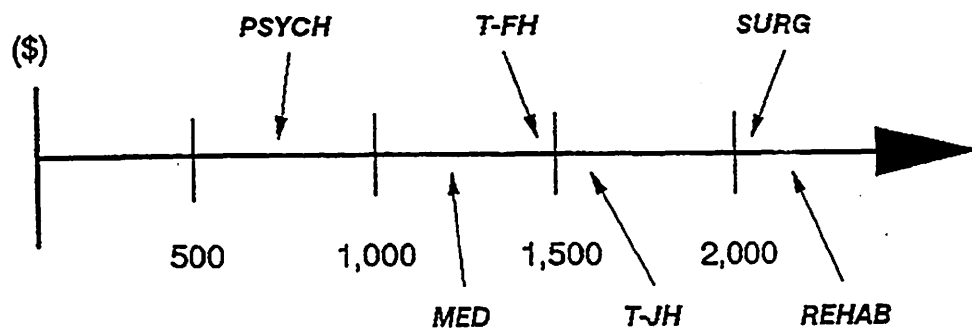
Source: Hospital revenue and statistics reports

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projected and actual values in the past.

Internally produced IHS reports also indicate that JH may not be competitive, from a charges stand point, when compared to FHS. For example, in 1991 JH revenue per patient day was \$1,561. A review of a 1991 analysis developed by IHS marketing shows that FH has an overall average gross revenue per patient day of approximately \$1,495. There may be opportunities to move a select FH service to JH if appropriate incentives could be identified and if the charges for those services were lower at JH. A continuum showing the average revenue per patient day by case type at FH is present below. These values will require further analysis to verify their accuracy and to explore possible options for relocating a service to JH.

Average Gross Revenue Per Patient Day



KEY:

T-JH: Total - Jefferson Hospital

T-FH: Total - Fairfax Hospital

PSYCH: Fairfax Hospital

REHAB: Fairfax Hospital

MED: Fairfax Hospital

SURG: Fairfax Hospital

Source: IHS Marketing

(2) Utilization Trends for Outpatient Surgery and Emergency Room Visits Increased Between 1985 and 1991, While Key Ancillary Services Trends Vary Considerably.

Exhibit IV, following this page, highlights outpatient and key ancillary trends between 1985 and 1991 and shows that:

- . Emergency room visits increased between 1985 and 1989 but declined during 1990 and 1991. Overall, emergency room visits increased by 3.5% between 1985 and 1991 to 10,869. This increase in visits may be attributed to JH's ER advertising campaign.
- . Admissions generated from the emergency room as a percent of total emergency room visits remained relatively constant from 1985 through 1988 (at 10.65% and 11.88%, respectively) but have decreased since 1989, and particularly in 1991 (8.20%).
- . Admissions made through the emergency room as a percent of total admissions increased from 1985 through 1988 (29% to 38%, respectively), however, they decreased from 1989 through 1991, and again particularly in 1991 (32%). It should be noted that JH management has been actively negotiating with the City of Alexandria to allow the Emergency Medical Services ambulance to use JH. The City of Alexandria recently voted against this effort.
- . The reduction in patients admitted through the emergency room in 1991 as opposed to 1990 is 276. This accounts for approximately 56% of JH's total decrease in admissions from 3,259 in 1990 to 2,768 in 1991.
- . The number of inpatient surgeries has decreased by 44.5% between 1985 and 1991 to 935. However, the number of inpatient operating room minutes did not change.

EXHIBIT IV
Inova Hospitals
TRENDS IN OUTPATIENT AND ANCILLARY SERVICES

	1985*	1986	1987	1988	1989	1990	1991	% CHANGE 1985-91
Equivalent Admissions	4,607	4,611	4,312	4,496	4,398	4,376	3,969	-13.8%
Adjusted Patient Days	31,390	29,240	26,906	26,004	26,262	23,524	21,331	-32.0%
Outpatient Visits:								
ER	10,497	11,454	11,799	11,755	12,544	12,073	10,869	3.5%
Other	5,185	5,664	5,991	7,441	8,071	7,569	5,634	8.7%
Total	15,682	17,118	17,790	19,196	20,615	19,642	16,503	5.2%
ER Visits Resulting in Admission	1,118	1,225	1,244	1,396	1,202	1,167	891	-20.3%
% Resulting in Admit.	10.7%	10.7%	10.5%	11.9%	9.6%	9.7%	8.2%	-23.0%
ER admits as % of Total	28.8%	31.3%	34.7%	38.0%	34.7%	35.8%	32.2%	11.6%
Inpatient Surgeries	1,686	1,516	1,234	1,390	1,235	1,053	935	-44.5%
IP Operating Minutes	121,700	140,000	133,300	146,000	152,400	133,300	117,490	-3.5%
Avg. Minutes/Surgery	72	92	108	105	123	127	129	78.1%
Outpatient Surgeries	970	1,018	1,239	1,682	1,770	1,867	1,748	80.2%
OP Operating Minutes	67,100	68,000	83,000	113,000	118,600	130,300	124,610	85.7%
Avg. Minutes/Surgery	69	67	67	67	67	70	70	0.5%
Total Surgeries	2,656	2,534	2,473	3,072	3,005	2,920	2,683	1.0%
Total Oper. Minutes	188,800	208,000	216,300	259,000	271,000	263,600	242,100	28.2%
Avg. Minutes/Surgery	71	82	87	84	90	90	90	26.9%
OP Surgery % of Total	36.5%	40.2%	50.1%	54.8%	58.9%	63.9%	65.2%	78.4%
Ancillary:								
Lab Tests	119,089	128,419	135,360	141,622	160,250	N/A	N/A	34.6%
Radiology Proc.	17,767	16,837	15,839	17,526	17,372	15,585	14,943	-15.9%
Nuclear Med. Proc.	886	844	869	840	709	601	551	-37.8%
Ultra Sound Proc.	0	0	62	94	225	246	1,062	
CAT Scans	0	0	0	0	0	0	1,307	
Endoscopy Proc.	0	0	0	0	0	271	418	
EKGs	5,180	5,196	5,049	5,508	5,120	4,975	4,580	-11.6%
EEGs/Echo	1,007	1,514	1,169	862	772	1,065	937	-7.0%
Cardio-Pul. Proc.	44,712	45,868	44,813	75,699	95,497	77,480	91,376	104.4%
Outpatient Revenue by Payor								
Medicare	\$364,466	\$390,662	\$425,391	\$661,512	\$979,523	\$1,144,274	\$1,121,459	207.7%
Medicaid	304,194	284,701	292,085	296,317	380,424	517,863	676,100	122.3%
Blue Cross	692,856	818,975	783,158	992,733	1,229,983	1,310,572	1,767,330	155.1%
Commercial	904,504	1,064,545	1,326,918	1,822,735	2,544,329	3,868,649	4,659,142	415.1%
Other	687,430	869,949	1,079,169	1,205,428	1,819,933	2,504,149	1,850,969	169.3%
TOTAL	\$2,953,450	\$3,428,832	\$3,906,721	\$4,978,725	\$6,954,192	\$9,345,507	\$10,075,000	241.1%
% Outpatient Revenue by Payor								
Medicare	12.34%	11.39%	10.89%	13.29%	14.09%	12.24%	11.13%	-9.8%
Medicaid	10.30%	8.30%	7.48%	5.95%	5.47%	5.54%	6.71%	-34.8%
Blue Cross	23.46%	23.88%	20.05%	19.94%	17.69%	14.02%	17.54%	-25.2%
Commercial	30.63%	31.05%	33.97%	36.61%	36.59%	41.40%	46.24%	51.0%
Other	23.28%	25.37%	27.62%	24.21%	26.17%	26.80%	18.37%	-21.1%
TOTAL	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	

* Actual data for calendar year 1985 including 7 months of previous owner's data.

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Source: Hospital revenue and statistics reports

appreciably between 1985 and 1991. One possible reason for this may be an increase in complexity of inpatient cases.

- . The number of outpatient surgeries has increased by 80.2% between 1985 and 1991 to 1,748. Total surgical cases remained constant over this same time period.
- . Trends in key ancillary services show a significant decline in all services with the exception of Laboratory, Cardiopulmonary and Ultrasound services. Nuclear Medicine and Radiology services experienced the most significant decline, 37.8% and 15.9%, respectively. While many hospitals in the nation have seen an increased utilization in these services there has been increasing competition in Virginia since regulations requiring medical equipment to be reviewed under certificate of need were lifted during 1989.

Exhibit IV also shows trends in outpatient revenue by payor. The increase in outpatient revenue each year between 1985 and 1991 appears to be primarily the result of price increases and the increased volume of outpatient surgery. The percentage of outpatient revenue related to commercial insurance patients increased significantly between 1985 and 1991 (30.6% to 46.24% respectively). This is yet another area where JH revenue appears to be at risk in the future given the potential discounting by third party payors.

In order to estimate the impact of JH's revenue/cost shifting to commercial patients, the 1991 commercial insurance revenue was compared to the related costs and deductions from revenue. Table 1, below, is a brief analysis of the impact of the commercial insurance patient population on JH's profitability during 1991:

Table 1
Impact of Jefferson Hospital's Revenue/Cost Shifting

Estimated gross revenue	\$11,250,000
Less contractual adjustments at 5%	<u>562,500</u>
Est. Net Patient Revenue	\$10,687,500
Est. expenses based upon commercial revenue to total patient revenue	<u>\$9,300,000</u>
ESTIMATED NET PROFIT	<u>\$1,387,500</u>

Source: CRB&S and JH Records

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If the patients at JH who are presently covered under commercial insurance policies opt for HMO or PPO coverage, or if the commercial insurance companies request discounts to a cost basis (which is still relatively high at JH); much of this profit would disappear, leaving JH with a much larger loss overall than it is presently incurring.

- (3) Staffing Levels at JH have Changed Dramatically Since the Inception of the Lease. Due Primarily to a Conscious Decision by IHS to Raise Staffing to Acceptable Levels.

Exhibit V, following this page, presents an analysis of JH's staffing trends. In reviewing these staffing trends there are several important points to note:

- . JH staffing levels, salaries and other benefits have been increased since 1985 to the levels found at other IHS Hospitals. Implicit in this investment was the belief that by increasing the quality of services at JH the market would favorably respond to the changes.
 - . As declining financial and utilization trends indicate, the investment in staffing has not, to date, yielded any favorable market response.
 - . Hours per patient day on the nursing floors, hours per emergency room visit and per operating room hours, as well as FTEs per equivalent occupied bed have all increased between 1985 and 1991.
 - . The nursing areas in particular have shown an increase in man-hours. There has been an increase from 13 hours (1985) to approximately 24 hours (1991) of nursing time to perform one surgical procedure.
- (4) A Comparison of Physician Inpatient Utilization by Subspecialty Between 1988 and 1990 Shows an Increase in the Number of Active Physicians on Staff for the Primary Care and Surgical Specialties and a Decline in the Number of Active Physicians for the Medical and "Other" Specialties.

EXHIBIT V
Inova Hospitals
ANALYSIS OF JH'S STAFFING TRENDS

	1985*	1986	1987	1988	1989	1990	1991	PERCENT CHANGE (1985-1991)
TOTAL FTEs	269.2	276.6	276.6	295.6	318.6	327.6	310.0	15.2%
FTEs/EQUIVALENT OCCUPIED BED	3.1	3.5	3.8	4.1	4.4	5.1	5.3	69.3%
FTEs/EQUIVALENT AVERAGE DAILY ADMISSIONS	21.3	21.9	23.4	24.0	26.4	27.3	28.5	33.6%
NURSING FTEs	111.0	115.9	112.9	119.3	132.1	133.1	125.7	13.2%
ANCILLARY FTEs	47.7	49.2	48.0	51.6	56.2	58.8	55.2	15.7%
GENERAL SVC. FTEs	47.5	48.4	47.9	53.1	57.4	59.1	56.1	18.1%
ADMIN FTEs	63.0	63.1	67.8	71.6	72.9	76.6	73.0	15.9%
FTEs/EQUIVALENT OCCUPIED BED:								
NURSING	1.29	1.45	1.53	1.67	1.84	2.07	2.15	66.5%
ANCILLARY	0.55	0.61	0.65	0.72	0.78	0.91	0.94	70.2%
GENERAL SVC.	0.55	0.60	0.65	0.75	0.80	0.92	0.96	73.7%
ADMIN	0.73	0.79	0.92	1.00	1.01	1.19	1.25	70.4%
NURSING MANHOURS PER PATIENT DAY:								
MEDICAL/SURGICAL	5.23	5.80	6.10	6.49	7.06	7.64	8.10	55.0%
RESPIRE CARE	N/A	N/A	14.72	12.59	11.12	13.31	12.27	-16.6% **
ICU	22.21	21.01	22.90	23.40	24.53	24.92	26.09	17.5%
OPERATING ROOM AND RECOVERY ROOM MAN- HOURS PER SURGICAL HOUR	10.91	10.50	11.02	11.08	12.11	14.96	15.71	44.0%
OPERATING ROOM AND RECOVERY ROOM MAN- HOURS PER PROCEDURE	12.92	14.36	16.06	15.57	18.20	22.51	23.64	82.9%
NURSING MANHOURS PER EMERGENCY ROOM VISIT	1.47	1.45	1.62	1.79	2.45	2.84	3.17	116.2%

* ACTUAL DATA FOR CALENDAR YEAR 1985 INCLUDING 7 MONTHS OF PREVIOUS OWNER'S DATA.

** PERCENT CHANGE FOR 1987 THROUGH 1991.

NOTE: FTEs REPORTED INCLUDE BENEFIT HOURS.

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Exhibit VI, on the following page, presents a comparison of physician activity in 1984, 1988 and 1990. It can be seen that:

- . Although the total number of physicians increased for all specialty categories between 1984 and 1988, active JH physicians practicing in the Medical specialties declined from 59 in 1988 to 49 in 1990 and the corresponding number of cases declined from 888 to 725. This occurred primarily because of the decrease in the number of physicians practicing in Cardiology, Gastroenterology, Hematology/Oncology and Neurology specialties.
 - . The "Other" specialties experienced a decline from 26 physicians in 1988 to 15 in 1990 and the corresponding number of cases declined from 134 to 52 over the same time period. This decline in the "Other" specialties occurred primarily because of the decline in the number of Podiatrists practicing at JH.
 - . The number of Primary Care and Surgical specialty physicians has grown considerably since 1984 (from 28 to 51 in Primary Care and from 29 to 62 in Surgical specialists), although growth has slowed between 1988 and 1990. Most of this growth was due to increases in Internal Medicine, Family Practice, Orthopedics and ENT.
- (5) Cumulative Operating Losses Since 1985 Total \$5.5M. This Includes a Corporate Overhead Allocation of \$4.1M.

Table 2, shown below, summarizes the cumulative cash contribution of JH between 1985 and December 31, 1991. It can be seen that cumulative losses at JH, net of corporate overhead allocation, have been \$1,351,000. Corporate overhead allocation for that time period was \$4.1M which results in cumulative losses of \$5.5M through December 31, 1991. The actual cost of providing the overhead services is less than the actual allocation to JH. However, to present the best case implications of removing overhead from JH's cumulative losses we deducted all allocated overhead.

Table 2
Cumulative Cash Contribution of JH 1985 - 1991

Cumulative losses through 12/31/91	\$ 5,499,000
Less: Corporate Overhead	(4,148,000)
NET LOSS	<u>\$ 1,351,000</u>

Source: JH Financial Statements

EXHIBIT VI
Inova Hospitals

PHYSICIAN ACTIVITY BY SUBSPECIALTY 1984, 1988, AND 1990

1984					1988					1990				
		MDs		Average			MDs		Average			MDs		Average
		Cases	Revenue	Rev/Case			Cases	Revenue	Rev/Case			Cases	Revenue	Rev/Case
Primary Care:														
FP and GP	15	440	\$1,592,643	\$3,620	20	320	\$1,622,089	\$5,069	25	338	\$2,101,902	\$6,219		
IM	9	159	\$613,321	\$3,857	15	354	\$2,187,381	\$6,179	21	410	\$2,873,805	\$7,009		
GYN	3	17	\$49,938	\$2,938	5	35	\$128,800	\$3,680	4	59	\$417,271	\$7,072		
Pediatrics	1	96	\$176,790	\$1,842	1	138	\$443,773	\$3,216	1	106	\$423,868	\$3,999		
Subtotal	28	712	\$2,432,692	\$3,417	41	847	\$4,382,043	\$5,174	51	913	\$5,816,846	\$6,371		
Medical Specialties:														
Cardiology	10	422	\$1,705,231	\$4,041	18	417	\$2,802,304	\$6,720	14	357	\$2,381,318	\$6,670		
Gastro	6	33	\$117,303	\$3,555	11	78	\$532,416	\$6,826	9	72	\$608,646	\$8,453		
Hema/Onc.	1	22	\$141,888	\$6,449	7	38	\$327,287	\$8,613	5	71	\$646,275	\$9,102		
Inf. Disease	0	0	\$0	\$0	2	7	\$63,845	\$9,121	2	26	\$217,307	\$8,358		
Nephrology	2	24	\$151,867	\$6,328	4	30	\$154,878	\$5,163	5	24	\$156,450	\$6,519		
Neurology	3	159	\$438,122	\$2,755	12	159	\$582,431	\$3,663	9	112	\$516,731	\$4,614		
Pulmonary	4	124	\$1,277,900	\$10,306	4	155	\$1,401,096	\$9,039	4	62	\$868,956	\$14,015		
Rheumatol	1	1	\$21,449	\$21,449	1	4	\$7,769	\$1,942	1	1	\$1,897	\$1,897		
Subtotal	27	785	\$3,853,760	\$4,909	59	888	\$5,872,026	\$6,613	49	725	\$5,397,580	\$7,445		
Surgical Specialties:														
General	7	171	\$649,152	\$3,796	8	307	\$1,762,833	\$5,742	10	293	\$2,319,779	\$7,917		
ENT	4	111	\$196,105	\$1,767	10	210	\$610,724	\$2,908	12	125	\$554,531	\$4,436		
Gen./Vascu	0	0	\$0	\$0	0	0	\$0	\$0	3	44	\$509,241	\$11,574		
Neuro	1	238	\$725,957	\$3,050	4	362	\$1,381,305	\$3,816	3	294	\$1,690,101	\$5,749		
Ophthalmol	2	34	\$118,724	\$3,492	4	10	\$39,368	\$3,937	1	5	\$26,346	\$5,269		
Orthopedic	7	95	\$347,351	\$3,656	10	160	\$974,587	\$6,091	16	369	\$2,995,726	\$8,118		
Plastic	2	25	\$147,438	\$5,898	3	72	\$287,554	\$3,994	4	50	\$227,556	\$4,551		
Thoracic	2	3	\$4,647	\$1,549	4	15	\$174,406	\$11,627	3	15	\$324,290	\$21,619		
Urology	4	57	\$135,943	\$2,385	10	58	\$263,040	\$4,535	10	53	\$394,113	\$7,436		
Subtotal	29	734	\$2,325,317	\$3,168	53	1,194	\$5,493,817	\$4,601	62	1,248	\$9,041,683	\$7,245		
Other Specialties:														
Anesthesia	1	4	\$31,848	\$7,962	3	6	\$34,869	\$5,812	2	5	\$11,981	\$2,396		
Endodontic	1	18	\$89,336	\$4,963	3	24	\$132,273	\$5,511	3	14	\$83,025	\$5,930		
Oral Surger	1	2	\$2,370	\$1,185	3	4	\$10,136	\$2,534	2	2	\$10,841	\$5,421		
PM & R	1	64	\$188,233	\$2,941	3	35	\$103,516	\$2,958	2	7	\$23,843	\$3,406		
Podiatry	7	68	\$230,297	\$3,387	11	31	\$138,005	\$4,452	5	21	\$287,248	\$13,678		
Psychiatry	1	28	\$46,020	\$1,644	1	32	\$86,141	\$2,692	1	3	\$6,507	\$2,169		
Radiology	2	7	\$5,691	\$813	2	2	\$4,898	\$2,449	0	0	\$0	\$0		
Subtotal	14	191	\$593,795	\$3,109	26	134	\$509,838	\$3,805	15	52	\$423,445	\$8,143		
Unknown:														
Subtotal	59	398	\$1,094,945	\$2,751	34	393	\$2,619,368	\$6,665	14	221	\$1,243,451	\$5,626		
TOTAL	157	2,820	\$10,300,509		213	3,456	\$18,877,092	\$5,462	191	3,159	\$21,923,005	\$6,940		

* Note: Cases = Inpatient Admissions

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Source: JH Hospital Records

- (6) Based On Internal Income Statements Prepared by JH for the Period of 1985 Through 1991, JH has Experienced Increasing losses.

Table 3, below, is a summary of JH's financial statements from 1985 through 1991. There are several important points to note:

- . From 1985 through 1991, net revenue increased at an average rate of 8% per year. However, between 1990 and 1991, net revenue decreased by 3% primarily because of the 15% decline in admissions. This was partially offset by rate increases and adjustments to prior year cost report settlements for Medicare.
- . Salary and benefit expenses increased at an average rate of 12.8% per year, largely as a result of upgrading staffing and salary levels to correspond with IHS guidelines.
- . Corporate overhead and other expenses increased at an average rate of 7% per year between 1985 and 1991.
- . In summary, the large annual increases in salary and benefit expenses compared to the lower increase in net revenue is the primary reason for JH's declining profitability. It appears that the improvements in staffing and salary levels at JH have not had a corresponding effect on inpatients utilization.

Table 3

Summary of Historical Income Statements

In 000s						
<u>Period Ending</u>	<u>Net Revenue</u>	<u>Salary & Benefit Expense</u>	<u>Corp. Overhead</u>	<u>Other Expenses</u>	<u>Total Expenses</u>	<u>Net Income (Loss)</u>
12/31/85 (*)	\$ 6,258	\$ 2,511	\$ 215	\$ 3,465	\$ 6,191	\$ 67
12/31/86	16,208	6,447	779	8,817	16,043	165
12/31/87	15,952	7,382	546	9,236	17,164	(1,212)
12/31/88	18,075	9,533	476	9,713	19,720	(1,637)
12/31/89	21,856	11,133	497	10,830	22,460	(604)
12/31/90	24,590	12,205	518	12,025	24,458	(158)
12/31/91	23,768	12,445	1,050	12,393	25,888	(2,120)

*5 months ended (does not include prior owner's data)

Table 4, below, is a summary of JH's cash flow from operations since the inception of the lease. It should be noted that:

- . JH has had a negative cash flow for every year except 1990 and if JH had not increased its debt during 1990 it would have shown a negative cash flow during that period as well.
- . The total cash requirements for JH of approximately \$14.3M over the period since the inception of the lease far exceed the \$5.5M in losses.
- . During the last four years, JH has required an average annual cash subsidy of approximately \$2.8M from IHS. The majority of this subsidy has been used to fund capital expenditures at JH. Given JH's physical condition, it appears that extensive capital expenditures will continue to be required, which will cause JH to show future cash deficits.

Table 4

Summary of JH's Cash Flows From Operations Since 1985

Period Ending	In 000s					
	Net Income (Loss)	Depreciation & Amortization Expense	Capital Expenditures	Increase in Debt	Working Capital Requirements	Increase (Decrease) in Cash
12/31/85 (*)	\$ 67	\$ 253	\$ (1,192)	\$ 546	\$ (742)	\$ (1,068)
12/31/86	165	689	(885)	386	(688)	(333)
12/31/87	(1,212)	704	(1,145)	250	(238)	(1,641)
12/31/88	(1,637)	765	(1,410)	230	(315)	(2,367)
12/31/89	(604)	896	(4,040)	247	(2,176)	(5,677)
12/31/90	(158)	1,261	(2,242)	272	1,127	260
12/31/91	<u>(2,120)</u>	<u>1,541</u>	<u>(2,259)</u>	<u>307</u>	<u>(903)</u>	<u>(3,434)</u>
Total	<u>\$ (5,499)</u>	<u>\$ 6,109</u>	<u>\$ (13,173)</u>	<u>\$ 2,238</u>	<u>\$ (3,935)</u>	<u>\$ (14,260)</u>

* 5 months ended (does not include prior owner's data)

When one evaluates the historical and projected losses for JH, it is important to keep in mind that there are some collateral benefits to other IHS entities related to having JH operate as a part of IHS. It is difficult to quantify the value of the collateral benefits. At this point, it is unclear as to what an appropriate dollar value would be since there is no specific list of the benefits JH provides. Although JH is currently providing collateral benefits to IHS, the net revenue absorbed by other hospitals within IHS if JH were to close would likely exceed the amount of the collateral benefits. This issue may need to be explored further and specific information needs to be reviewed if IHS wishes to estimate the approximate value of JH's collateral benefits to the system.

3. A PRELIMINARY REVIEW OF THE JH FACILITIES AND THE MASTER FACILITY PLAN, COMPLETED BY THE ARCHITECTURAL FIRM OF CANNON AND FAULKNER, INDICATE THAT THE CONDITION OF JH'S PHYSICAL PLANT, ITS LOCATION AND LACK OF CONVENIENT ACCESS (INCLUDING LIMITED PARKING) MAY BE THE BIGGEST BARRIERS TO SUCCESS.

The architectural firm of Cannon and Faulkner (C&F) prepared a JH Master Facility Plan for IHS in July, 1989. A preliminary review of this master plan, as well as a review of the JH site were recently completed by Domenic Pesce, an architect working with NHA.

- (1) A Preliminary Review of JH's Facilities Indicate a Lack of Sufficient Space for Certain Services, Poor Patient Access and Flow and Serious Physical Constraints, which Limit Building and Expansion Opportunities.

Several observations regarding JH's facilities include:

- . The site is small relative to its usage needs and there are serious physical constraints on and adjacent to the site. These constraints limit both site and building expansion possibilities.
- . Access to the facility is difficult, particularly from King Street. It is difficult to find the "front door."
- . There are opportunities to improve functional relationships and access; the appropriate separation of traffic types, both internally (e.g., inpatient versus public) and externally (e.g., emergency vehicle traffic), does not occur.
- . It appears that additional space is needed in a number of areas. This observation is based on a walking tour of the facility and would require further analysis for verification.
- . From a physical standpoint, the existing facilities appear to be limiting due to minimal floor to floor heights and

column bay spacing.

(2) A Review of the Cannon and Faulkner Master Facilities Plan Raises Several Questions Regarding the Proposed Projects, Time Frames for Implementation of Projects and Space Projections Presented in the Plan.

Initial observations regarding the C&F plan include the following:

- . The project Schedule for implementation of the C&F Master Plan indicates a time frame of over 10 years from the establishment of a Master Plan to completion of the final project. Apparently due to construction phasing, a number of proposed projects have lengthy time frames for completion. The most notable include:
 - 6.75 years for Lobby/Outpatient Services
 - 8.0 years for Emergency
 - 8.5 years for Surgery/Anesthesiology
 - 10.5 years for Admitting/Waiting/Consult
 - 10.5 years for Radiology
- . Can IHS afford to wait between 6 and 11 years before addressing the facility needs of these services? These time frames (mentioned above) do not include any potential delays related to the relocation of existing physician offices from Level 4 of the 1978 Building. Currently physicians lease this space.
- . Regarding C&F's proposed "bandaid" schemes, "bandaid" is a misnomer since some of the schemes involve significant expansion and/or total replacement of departments.
- . In some cases, implementing one of the proposed "bandaid" schemes eliminates the opportunity to implement another; hence not all 6 "bandaid" projects can be implemented. For example, the Lobby/Outpatient and ER/Radiology projects hinge on the use of Level 4 of the 1978 Building for different purposes.
- . Based on C&F's phasing plan, significant capital would be invested to relocate departments which are not deemed priorities from a revenue standpoint. This includes the relocation of Hospital Administration and Medical Administration at an estimated cost of \$889,680 and the 4 North Nursing Unit and ICU at an estimated cost of \$1,468,620.
- . Given capital constraints, can IHS afford to spend these dollars on non-revenue generating services? Should IHS investigate a facility option involving new construction

which could minimize the need to relocate existing departments, particularly if the Bolling Brook property were acquired?

- . In addition to the above, the C&F phasing plan requires \$2.36M to relocate functions in order to vacate space for an expansion of Radiology. Is there a less costly and more expeditious solution to expanding Radiology (new construction perhaps)?

- . The C&F plan indicates the reuse of Level 4 of the 1978 Building for Administrative and Medical Administration offices. Given space constraints, should this space be allocated to non-patient care services? Projects that require the use of 4 North hinge on the relocation of physicians who currently hold leases on this space.

- . Regarding C&F's proposed "High Road" scheme, the proposed location of Medical Staff services on the north end of the campus is questionable since it appears that the "High Road" scheme locates the majority of physician offices in the Bolling Brook building on the opposite end of the campus.

- . The proposed location for Endoscopy is questionable; IHS may want to consider a location adjacent to outpatient surgery since this would afford a sharing of prep/recovery staff and space.

- . It appears that the proposed 3,000 SF lobby would have to conform to the existing floor to floor height on the Second Floor (12'-8"). This will limit the aesthetic appeal of this large important space. IHS may want to consider the option of developing the main entrance lobby through new construction, particularly if the Bolling Brook property is acquired.

- . The space projections presented in the C&F Master Plan report appear to have been based on comparisons to other hospitals rather than methodologies incorporating actual JH volume, staff, equipment, and other space generators. Further justification should be provided for JH department space projections, particularly given capital constraints.

- . C&F recommends a square footage per bed ratio of 1,100 for JH. Our experience indicates that this ratio can approach 1,200 to 1,300 SF per bed for hospitals of similar size and scope.

Several additional issues that should be addressed include:

Much of the information in the C&F Master Facility Plan report may be invalid since the report was completed two and one-half years ago; the plan should be updated.

Is the purchase of the Bolling Brook property a viable option given its residential use and large number of individual owners?

Given the current lease arrangement, to what extent is IHS willing to invest in capital improvements to the existing JH site and facilities in order to both rectify current facility deficiencies and accommodate future strategic initiatives?

How sensitive is the JH patient population to site and facility conditions? To what extent will site and facility improvements help to generate increased patient volume and associated revenue? Were these questions/criteria applied to the C&F Master Plan?

C&F recommended that JH urgently needs a solution to its parking situation noting, in particular, that JH has an inadequate number of parking spaces. However, in a meeting with Mr. Venable on January 10, 1992, he stated that a recent parking study indicated that the number of spaces currently provided on the JH site is adequate.

Was the C&F plan tested against Zoning Ordinance requirements? It would appear that a zoning analysis should be performed for the JH site to determine site and facility capacity and the extent to which JH is in variance to the Ordinance. A similar analysis should be performed on the Bolling Brook site if the acquisition of this site is a consideration.

How will the proposed ramp at the North Beauregard and King Street intersection impact access to the JH site?

The C&F construction cost estimate for the proposed "bandaid" schemes is \$9,746,002. The C&F construction cost estimate for the "High Road" scheme is estimated at \$40,537,442 including the purchase and subsequent development of Bolling Brook. This estimate appears to exclude a number of "project" cost items such as professional fees, equipment costs, financing, etc. The actual "project" cost could be 25% to 100% higher than the anticipated construction/renovation cost.

C&F added 10% to their construction cost estimate to account for escalation over a two year period. How do they account for cost escalation related to projects slated for completion in 5 to 10 years as indicated on their Project

Schedule? Hence, given the lengthy time frame for implementation, is the C&F cost estimate realistic?

4. A REVIEW OF KEY MARKET INDICATORS REVEALS THAT THERE IS LIMITED POPULATION GROWTH PROJECTED IN JH'S MARKET AREA AND JH APPEARS TO BE LOSING MARKET SHARE.

Most recent data available were used to conduct this analysis, however, for many statistics (e.g., market share and market use rate) data were not available beyond 1988 estimates. This analysis reviews the results of prior IHS and JH market studies, key market indicators and current demographic trends. Even with limited data, key indicators can be used to estimate market share.

(1) During 1991, JH has Drawn Fewer Inpatients From A Larger Geographic Area Than in 1986.

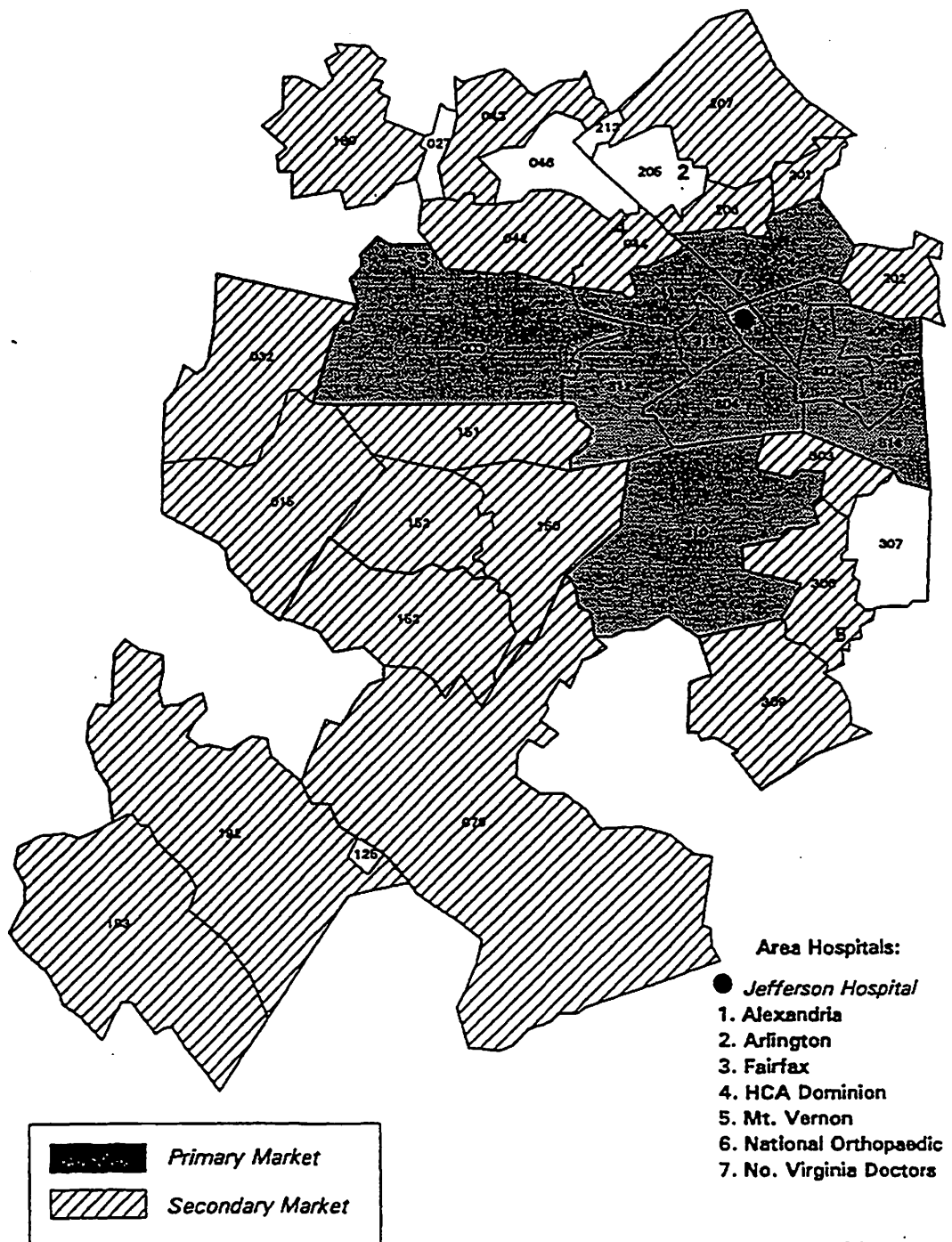
The 1991 market area for JH was defined on the basis of inpatient residence by zip code. Admissions by zip code for the period of January 1, 1991 through December 31, 1991 were supplied by JH. These data were used to delineate JH's primary and secondary market. A total of 2,768 admissions to JH were recorded during 1991. These admissions were divided by zip code into primary, secondary and "other" market areas to identify those generating the most inpatient admissions.

The primary market represents those zip code areas in which JH derives the first 50% of its admissions. The secondary market represents those zip code areas that make up the next 25% of JH's cumulative admissions and the "other" market area represents the remaining zip code areas from which JH generates its admissions.

Exhibit VII, on the following page, presents a map of JH's primary and secondary markets for 1991. It should be noted that:

- . The primary market area consists of 12 zip codes. This area provided 1,399 admissions during 1991.
- . The secondary market area is comprised of 20 zip codes and it provided 607 admissions during 1991.
- . The "other" market area and areas outside of the market consist of zip code areas providing less than 0.7% each of total JH admissions. This area provided 762 admissions during 1991.
- . A comparison between 1991 admissions and actual 1986 admissions suggests a decline in JH's admissions originating from the primary market. During 1991, JH received 798 fewer patients from this primary area than in 1986.

EXHIBIT VII
Inova Hospitals
MAP OF JH PRIMARY AND SECONDARY MARKETS, 1991



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Appendix A, following this report, contains detailed zip code information for JH's 1986 market areas.

- (2) Projected Demographic Trends, Between 1991 and 1996, for JH's Primary and Secondary Service Areas Indicate Little Change in the Distribution of Population Across Age Cohorts, With Slower Population Growth in the Primary Market Area than that for the Northern Virginia Area.

One of the many factors that can influence future changes in demand for services is an underlying population increase or decrease. It is also important to evaluate the projected age profile of the population because an increase in the portion of the elderly population could potentially increase healthcare demand.

Exhibit VIII, on the following page, presents demographic projections for JH's primary and secondary market areas for 1991 and 1996. It can be seen that:

- . Total population in the primary market area is projected to increase from 298,040 in 1991 to 315,623 in 1996 -- an increase of only 5.9% for the period between 1991 to 1996.
- . Total population in the secondary market area is projected to increase by 9.5% over the same time period and is projected to increase from 494,143 in 1991 to 541,184 in 1996. Population increases for the period of 1991-1996 are projected to be 10.1% for the Northern Virginia region -- An area consisting of Alexandria, Arlington and Fairfax counties.
- . The projected age distribution in JH's market areas does not show a major increase or decrease in proportion or distribution of population across age cohorts between 1991 and 1996. This suggests limited changes in the age composition of the population in these areas.
- . The top five zip code areas with the highest percentage population growth in the region between 1980 and 1990 are identified below. None of these areas are located in JH's market area.

- Herndon (22094)	1,465.0 %
- Centreville (22020)	314.2 %
- Occoquan (22125)	309.1 %
- Newington (22122)	264.1 %
- Fairfax (22039)	220.4 %

- (3) Total Market Inpatient Acute Care Demand Projections for JH's Primary and Secondary Market Areas Suggest that Total Primary Market Area Admissions May Show a Modest Increase of 5.9% Between 1991 and 1996.

EXHIBIT VIII
Inova Hospitals

JH MARKET DEMOGRAPHIC PROJECTIONS FOR 1991 AND 1996

	JH Primary	JH Secondary	Northern Virginia
<u>Population</u>			
1991	298,040	494,143	1,153,270
1996	315,623	541,184	1,269,412
% Chg.			
1991-1996	5.9%	9.5%	10.1%
<u>Age Distribution</u>			
1991			
0-14	16.0%	21.9%	20.2%
15-24	12.6%	12.3%	12.6%
25-44	43.5%	41.3%	40.9%
45-64	18.8%	18.3%	19.1%
65+	9.1%	6.2%	7.2%
1996			
0-14	15.4%	21.7%	19.9%
15-24	11.8%	11.7%	11.9%
25-44	43.1%	39.8%	39.7%
45-64	20.3%	20.4%	21.2%
65+	9.3%	6.4%	7.3%
<u>Household Income</u>			
1991			
< \$20,000	10.0%	7.6%	9.0%
\$20,000 - \$39,000	22.4%	17.2%	18.5%
\$40,000 - \$74,999	37.0%	38.2%	35.2%
\$75,000 +	29.9%	37.6%	37.2%

Source: National Planning Data Corporation

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Exhibit IX, on the following page, shows projected inpatient admissions for the JH market in 1991 and 1996. It is always difficult to project admissions for a given market with any certainty. This is even more true when there is only limited information available. This attempt to project total market admissions assumes that total demand is a function of identifiable causal factors. Any given region will have a specific use rate -- one that reflects many variables including not only the health status or general socioeconomic conditions of the population, but also differences in the tendency of physicians to hospitalize patients and the level of managed care penetration.

In this case, total market demand for 1991 through 1996 is based on historical estimates and projected use rates. These use rates are based on the number of admissions per 1000 population observed in the JH market area. Current year acute care use rate information is not available in Virginia. However, estimates of acute care use rates for prior years and projected years were developed by IHS. These use rates were based on population estimates for JH's primary and secondary markets in 1988. This population base is similar to that currently served by JH. These studies were developed using data from the "Washington Area Hospital Discharge Database" and were conducted by IHS in 1988, concluding that:

- . The annual inpatient use rate for the population residing in the 1988 JH market area ranged from 103 to 105 admissions per 1000 population.
- . The 1993 use rate for the population residing in the 1988 JH market area was projected to be 103 admissions per 1,000 population.

For purposes of this study, total market acute care demand was calculated by applying IHS developed use rates to the market population estimates and projections. The 1991 and 1996 acute care admission projections are based on IHS's projected 1993 use rate (103 admissions per 1000 population). The 1996 projections could be considered optimistic since use rates are declining in many parts of the country. The use rates used to project demand in the market were compared to those actually observed in Prince George's and Montgomery counties in Maryland for validation purposes. This review suggests that 103 admissions per 1,000 population was a reasonable estimate. These data suggest:

- . Total primary market area admissions are projected to increase by 5.9%, from 30,698 in 1991 to 32,509 in 1996.
- . Total secondary market area admissions are projected to increase by 9.5%, from 50,897 in 1991 to 55,742 in 1996.

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EXHIBIT IX
Inova Hospitals
PROJECTED TOTAL INPATIENT MARKET ADMISSIONS

JEFFERSON HOSPITAL TOTAL MARKET AREA ADMISSIONS						
		Population		Total Market Admissions		Total Market Admissions
		1991	1996	1991	1996	Percent Change 1991-1996
PRIMARY MARKET	22304 Alexandria	31,180	28,995	3,212	2,986	-7.01%
	22204 Arlington	40,545	40,930	4,176	4,216	0.95%
	22314 Alexandria	22,317	22,905	2,299	2,359	2.63%
	22041 Falls Church	20,102	21,178	2,071	2,181	5.35%
	22311 Alexandria	12,524	12,879	1,290	1,327	2.83%
	22305 Alexandria	13,153	14,314	1,355	1,474	8.83%
	22206 Arlington	17,399	17,855	1,792	1,839	2.62%
	22312 Alexandria	22,414	23,237	2,309	2,393	3.67%
	22301 Alexandria	11,264	11,500	1,160	1,185	2.10%
	22302 Alexandria	14,271	15,776	1,470	1,625	10.55%
	22310 Alexandria	42,416	53,411	4,369	5,501	25.92%
	22003 Annandale	50,455	52,643	5,197	5,422	4.34%
	SUB TOTAL	298,040	315,623	30,698	32,509	5.90%
SECONDARY MARKET	22306 Alexandria	26,247	27,754	2,703	2,859	5.74%
	22309 Alexandria	27,324	29,777	2,814	3,067	8.98%
	22042 Falls Church	28,882	30,472	2,975	3,139	5.51%
	22303 Alexandria	12,562	13,246	1,294	1,364	5.44%
	22202 Arlington	16,459	16,868	1,695	1,737	2.48%
	22015 Burke	39,852	41,779	4,105	4,303	4.84%
	22150 Springfield	18,159	18,803	1,870	1,937	3.55%
	22152 Springfield	27,101	28,523	2,791	2,938	5.25%
	22151 Springfield	16,185	16,542	1,667	1,704	2.21%
	22207 Arlington	30,003	29,916	3,090	3,081	-0.29%
	22079 Lorton	15,393	19,592	1,585	2,018	27.28%
	22203 Arlington	13,804	14,045	1,422	1,447	1.75%
	22043 Falls Church	20,426	23,157	2,104	2,385	13.37%
	22032 Fairfax	29,765	30,999	3,066	3,193	4.15%
	22044 Falls Church	11,277	11,751	1,162	1,210	4.20%
	22193 Dale City	47,397	60,608	4,882	6,243	27.87%
	22192 Woodbridge	35,450	41,745	3,651	4,300	17.76%
	22180 Vienna	21,917	24,277	2,257	2,501	10.77%
	22201 Arlington	21,479	23,751	2,212	2,446	10.58%
	22153 Springfield	34,461	37,579	3,549	3,871	9.05%
	SUB TOTAL	494,143	541,184	50,897	55,742	9.52%
OTHER AREAS	20019 Washington	63,800	61,197	6,571	6,303	-4.08%
	22101 McLean	31,290	34,199	3,223	3,522	9.30%
	22170 Sterling	38,088	41,608	3,923	4,286	9.24%
	20744 Fort Washington	43,623	46,421	4,493	4,781	6.41%
	22046 Falls Church	12,736	12,822	1,312	1,321	0.68%
	22191 Woodbridge	30,428	35,193	3,134	3,625	15.66%
	22554 Stafford	34,649	47,902	3,569	4,934	38.25%
	22110 Manassas	60,151	71,985	6,196	7,414	19.67%
	22020 Centreville	38,246	53,916	3,939	5,553	40.97%
	22031 Fairfax	22,759	23,509	2,344	2,421	3.30%
	22205 Arlington	16,000	15,861	1,648	1,634	-0.87%
	SUB TOTAL	391,770	444,613	40,352	45,795	13.49%

Note: Assumes use rate of 100% - 1990

Although total acute care market demand projections are based on use rate assumptions and not actual rates, these projections can be used as a preliminary means of establishing a "baseline" market scenario. It is important to note that this methodology for projecting demand is based on many significant assumptions concerning the future. Some of these are listed below:

- . Population will grow as projected in Exhibit VIII .
 - . Market use rate remains constant, at 103 admissions per 1000 population between 1991 and 1996.
 - . Average length of stay (ALOS) is projected to remain constant for JH through 1996 while many hospitals with rehabilitation, psychiatry, obstetrics, and other services are experiencing a decrease in LOS.
 - . All other factors that could impact market demand for inpatient care will remain constant.
- (4) Estimates for 1991 Suggest that JH Has Experienced a Significant Decline in Market Share Since 1988.

Exhibit X, on the following page, shows JH's estimated and projected market share for 1991 and 1996, respectively. It can be seen that:

- . 1991 market share for JH is estimated at 4.5% for the total primary market area and 1.2% in the secondary market area.
- . Use rates and market share are assumed to remain constant in the primary, secondary and "other" areas in order to project 1996 JH admissions. By holding the current level of market share constant, these projections show the effect that population growth may have on JH admissions.
- . Admissions to JH from zip code areas outside of the JH market are assumed to continue to decline by approximately 20% between 1991 and 1996. This decline follows past trends and assumes JH will continue to find it increasingly difficult to attract patients from areas outside of the market.

A comparison of JH's 1985 market share and 1988 market share estimates is also presented in Appendix B. This Appendix provides a sharp contrast to Exhibit X and shows that JH has experienced a decline in market share in both the primary and secondary market areas when compared to 1991 results. The same IHS study used to estimate JH's market area use rates in 1988 was also used to estimate JH's historical inpatient market share. These IHS estimates indicated that JH had the following market share results in 1988:

EXHIBIT X
Inova Hospitals

JH TOTAL MARKET SHARE PROJECTIONS 1991 - 1996

BASELINE SCENARIO			Est. 1991	1991	Proj. 1996	Proj. 1996
			market share	admissions	market share	admissions
PRIMARY MARKET	22304	Alexandria	6.2%	198	6.2%	184
	22204	Arlington	4.4%	185	4.4%	187
	22314	Alexandria	7.4%	169	7.4%	173
	22041	Falls Church	7.2%	150	7.2%	158
	22311	Alexandria	9.3%	120	9.3%	124
	22305	Alexandria	7.8%	105	7.8%	114
	22206	Arlington	5.3%	95	5.3%	97
	22312	Alexandria	3.7%	85	3.7%	88
	22301	Alexandria	6.8%	79	6.8%	80
	22302	Alexandria	5.6%	83	5.6%	92
	22310	Alexandria	1.5%	67	1.5%	84
	22003	Annandale	1.2%	63	1.2%	66
SUB TOTAL			4.6%	1,399	4.5%	1,448
SECONDARY MARKET	22306	Alexandria	2.0%	54	2.0%	57
	22309	Alexandria	1.6%	46	1.6%	50
	22042	Falls Church	1.4%	42	1.4%	44
	22303	Alexandria	2.9%	37	2.9%	39
	22202	Arlington	1.7%	29	1.7%	30
	22015	Burke	0.9%	36	0.9%	38
	22150	Springfield	1.6%	30	1.6%	31
	22152	Springfield	1.2%	33	1.2%	35
	22151	Springfield	1.7%	28	1.7%	29
	22207	Arlington	0.9%	27	0.9%	27
	22079	Lorton	1.8%	28	1.8%	36
	22203	Arlington	2.0%	29	2.0%	30
	22043	Falls Church	1.2%	26	1.2%	29
	22032	Fairfax	0.7%	22	0.7%	23
	22044	Falls Church	2.9%	34	2.9%	35
	22193	Dale City	0.5%	22	0.5%	28
	22192	Woodbridge	0.6%	21	0.6%	25
	22180	Vienna	0.9%	20	0.9%	22
	22201	Arlington	1.0%	22	1.0%	24
	22153	Springfield	0.6%	21	0.6%	23
SUB TOTAL			12.2%	607	12.1%	655
"OTHER" MARKET	20019	Washington	0.3%	18	0.3%	17
	22101	McLean	0.6%	18	0.6%	20
	22170	Sterling	0.4%	16	0.4%	17
	20744	Fort Washington	0.4%	16	0.4%	17
	22046	Falls Church	1.3%	17	1.3%	17
	22191	Woodbridge	0.6%	20	0.6%	23
	22554	Stafford	0.4%	14	0.4%	19
	22110	Manassas	0.2%	14	0.2%	17
	22020	Centreville	0.4%	16	0.4%	23
	22031	Fairfax	0.6%	13	0.6%	13
	22205	Arlington	0.7%	12	0.7%	12
SUB TOTAL			0.4%	174	0.4%	196
AREAS OUTSIDE MARKET				588		470.4
TOTALS				2,768		2,769

Note: Assumes 1991 use rate of 103 per 1000 Pop. &
Assumes 1996 use rate of 103 per 1000 Pop.

Source: NPDC, IHS and JH Management

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- . An 8% market share within the primary market area.
 - . A 3% Market Share within the secondary market area.
5. DURING RECENT YEARS, JH HAS FACED INCREASING COMPETITION IN A MARKET WITH EXCESS CAPACITY, SUGGESTING THAT JH IS NOT A NEEDED HOSPITAL

Projected JH inpatient utilization may remain stable if use rates and market share remain constant and population increases as expected as a "baseline" market scenario and sensitivity analyses are discussed below.

- (1) Statistics for 1990. Indicate that JH's Primary and Secondary Services Areas Overlap with Other IHS Hospitals.

Exhibit XI, on the following page, presents a map that shows those few portions of JH's primary and secondary market area which are also not included in other IHS members' service areas. JH faces a significant overlap in the service areas of other IHS hospitals and also competes for a similar patient pool with nearby non-IHS hospitals. In reviewing this 1990 service area overlap there are several important points to note:

- . Only six of ten zip codes in JH's primary market did not overlap with other IHS hospitals' service areas.
- . Only five of 27 zip codes in JH's secondary market did not overlap with other IHS hospitals' service areas.
- . Two of the six JH primary market area zip codes without IHS service area overlap have competing hospitals located within their boundaries.
- . One of the five JH secondary market area zip codes without IHS overlap contains a competing hospital.

These findings all point to a narrow market with multiple competitors.

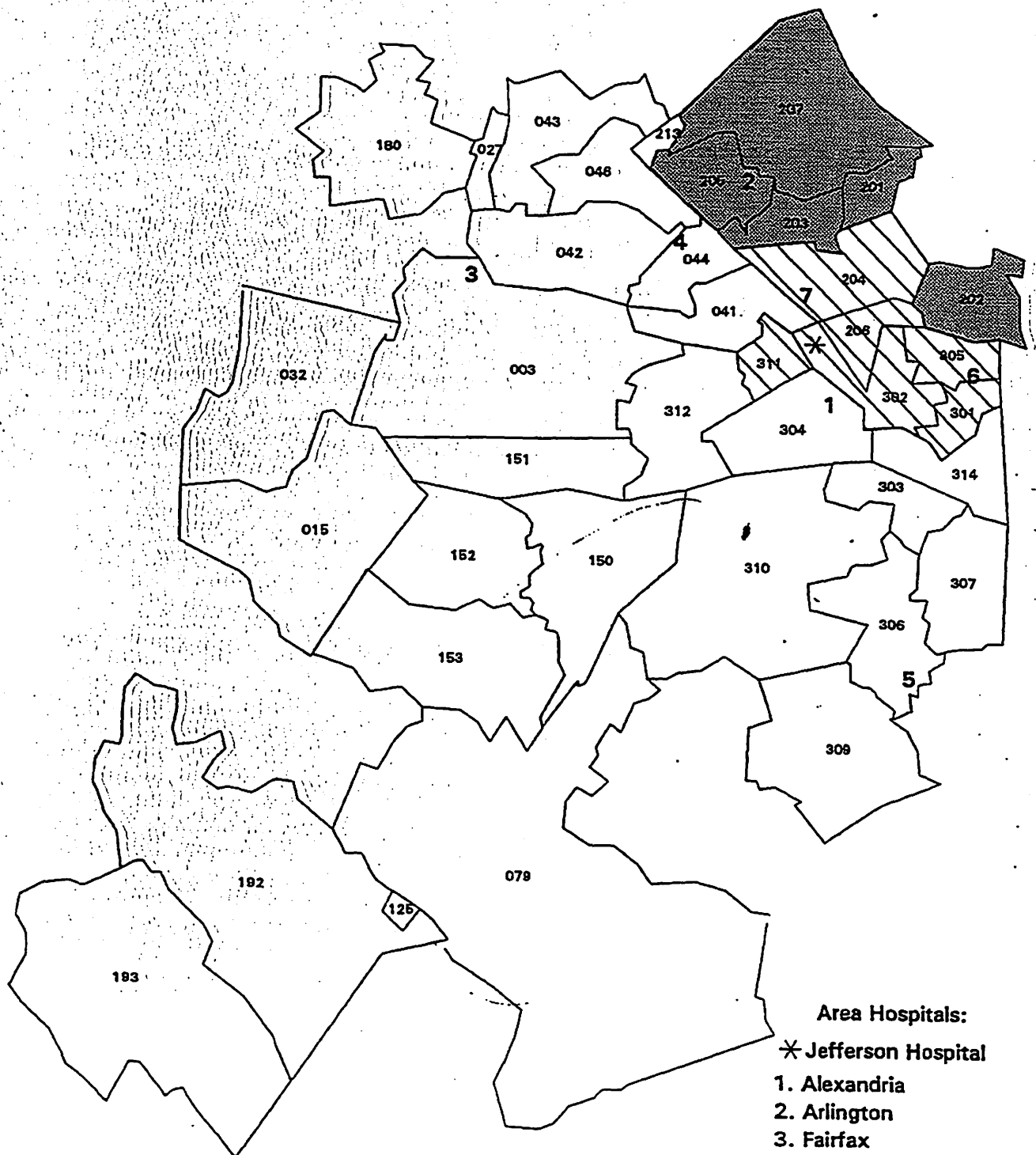
(See Appendix C for a detailed description by zip code of 1990 IHS's market overlap based on JH's primary and secondary markets.)

- (2) JH May Not Be a Needed Hospital in that All Nearby Competitors Have Unused Bed Capacity that Contributes to Increasing Competition for Both Inpatient and Outpatient Services in JH's Market.

When evaluating the competitive intensity of JH's primary and secondary market areas, it is important to consider the number and occupancy levels of competitors. JH's market area contains five acute care hospitals all of which have excess capacity reflected in their

EXHIBIT XI
Inova Hospitals

MARKET AREAS WITHOUT OVERLAP FROM IHS MEMBER'S SERVICE AREAS



Primary Market 1990 without FHS overlap
Secondary Market 1990 without FHS overlap

Area Hospitals:

- * Jefferson Hospital
- 1. Alexandria
- 2. Arlington
- 3. Fairfax
- 4. HCA Dominion
- 5. Mt. Vernon
- 6. National Orthopaedic
- 7. No. Virginia Doctors

to 64%. Although not located in JH's market, Arlington Hospital is located in a zip code area that is surrounded by JH's secondary service area. If total inpatient demand declines in the future, these providers will likely pursue tactics to gain market share and sustain occupancy. There are several strategies currently being employed by these nearby competitor hospitals as described below:

- . Alexandria Hospital has been focusing on competing for General Medical/Surgical services and has specialized in Cancer Care and Behavioral Health. Reportedly, they have plans for expansion.
- . Arlington Hospital has been pursuing arrangements with managed care payors and is reported to have 85 contracts.
- . Mount Vernon Hospital has been providing extensive Rehabilitation services and is attempting to expand general acute inpatient and outpatient care.
- . National Orthopedic and Rehabilitation Hospital has reportedly been attempting to create a unique "differentiated" position for providing Orthopedic services and is also expanding services beyond Orthopedics.
- . Northern Virginia Doctors Hospital had been attempting to aggressively establish a "captive market" through participation in the Kaiser HMO while remaining focused on acute medical/surgical inpatient care and not trying to specialize. Recently their contract with Kaiser was not renewed and it has been suggested that they abandon this strategy.

The data available to calculate 1990 JH market area bed need consists of historical occupancy data supplied by IHS as presented in Exhibit XII, following this page. It can be seen that:

- . There were 423 beds, or (35%) of the 1,210 licensed beds in the market, that could be described as excess. It is interesting to note that 423 excess beds represents approximately 3.5 hospitals the size of JH (120 licensed beds).
- . Given these data, it could be asserted that JH is not a needed hospital and that this market would not be adversely affected if JH were closed.
- (3) A "Baseline" Market Scenario Indicates JH Inpatient Admissions may Remain Flat during the Next Five Years if Both Market Use Rate and JH's Market Share Remain Constant and Population Increases.

A "baseline" scenario was developed to project JH admissions and

EXHIBIT XII
Inova Hospitals
EXCESS BEDS IN JH MARKET

Excess Beds in JH Market						
HOSPITAL NAME	NOVA DOCTORS	ALEXANDRIA	NATIONAL ORTHO.	MOUNT VERNON	JEFFERSON	TOTAL
AVG DAILY CENSUS						
1985	110	255	94	145	72	676
1986	106	263	94	166	68	697
1987	118	259	91	157	61	686
1988	118	274	80	168	59	699
1989	104	257	79	120	63	623
1990*	106	262	64	151	47	630
1989 LICENSED BEDS	267	414	174	235	120	1,210
1989 STAFFED BEDS	211	352	140	211	120	1,034
% OCCUPANCY LICENSED BEDS						
1985	41.2%	61.6%	54.0%	61.7%	60.0%	55.9%
1986	39.7%	63.5%	54.0%	70.6%	56.7%	57.6%
1987	44.2%	62.6%	52.3%	66.8%	50.8%	56.7%
1988	44.2%	66.2%	46.0%	71.5%	49.2%	57.8%
1989	39.0%	62.1%	45.4%	51.1%	52.5%	51.5%
1990	39.7%	63.3%	36.8%	64.3%	39.2%	52.1%
1990 OCCUPIED BEDS	<u>106</u>	<u>262</u>	<u>64</u>	<u>151</u>	<u>47</u>	<u>630</u>
1990 OCC. PLUS SAFETY STACK **	<u>132</u>	<u>327</u>	<u>80</u>	<u>189</u>	<u>59</u>	<u>787</u>
1990 EXCESS BEDS	<u>135</u>	<u>87</u>	<u>94</u>	<u>46</u>	<u>61</u>	<u>423</u>
EXCESS BEDS AS A PERCENT OF LICENSED BEDS	<u>35%</u>					

* 1991 AHA Guide

** Safety stack achieves 80% occupancy at average daily census.

Source: IHS ANALYSIS, NHA

average daily census (ADC) for 1991 through 2005 and is presented in Table 5, below. This analysis shows the potential impact of population growth on JH's utilization. It assumes constant market use rates (103 admissions per 1000 population) and current market share levels (4.6% and 1.2% in the primary and secondary markets, respectively) during future years. Given historical trends one could argue this scenario is somewhat optimistic. This analysis also underscores the limited impact that population growth in JH's market may have on total JH admissions between 1991 and 1996. Furthermore, this projection also assumes that population levels, in the JH market, will remain constant from 1996 through 2005 since no reliable projections are available for this period. The baseline scenario indicates little growth in future annual inpatient admissions or ADC over the next five years.

Table 5
"Baseline" Projected JH Admissions and ADC By Year

<u>Year</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996..2005</u>
Admissions	2,768	2,768	2,768	2,769	2,769	2,769 2,769
ADC	41	41	41	41	41	41 41

Source: NHA

- (4) Based on JH's Current Payor Mix and Expenses, an ADC of Approximately 61 Patients Would Be Required to Breakeven During 1991.

Table 6, on the next page, shows the calculation used to estimate the ADC necessary for JH to breakeven in 1991. It is important to note that:

- . An additional average daily census of 20 patients would have been required for JH to breakeven in 1991.
- . The ADC required to breakeven in the future will likely increase each year due to a potential conversion of commercial patients to managed care coverage. This conversion will cause JH's net revenue per patient day to increase at a slower rate than it has in the past because HMOs will require discount that are not currently being granted to commercial insurance companies. Additionally, payments for Medicare and Medicaid will not increase at the rate of inflation that JH will experience for salaries, supplies, and other expenses. It is estimated that the breakeven point for JH in terms of average daily census will increase at the rate of one to two additional patients each year in the future.

Table 6

Breakeven Analysis (ADC)

JH loss during 1991		\$ 2,120,000
Average net revenue per patient day in 1991	\$ 1,104	
Less marginal expenses per patient day	(810)	
Net profit per additional patient day	\$ 285	285
Additional patient days required to break even during 1991		7,439
		365
Additional average daily census required to break even during 1991		20
Actual average daily census during 1991		41
TOTAL AVERAGE DAILY CENSUS REQUIRED TO BREAK EVEN IN 1991		61

- (5) Sensitivity Analyses Indicate That JH's ADC Could Range From 39 to 56 by 1996, Depending Upon Assumptions Used to Project Changes in JH's Market Use Rates and Market Share.

Sensitivity analyses were developed to demonstrate the impact a decline in use rates may have on total JH admissions and ADC. These analysis uses the same methodology as described in the "baseline scenario" but also factors the following assumptions:

- Sensitivity (A) -- A 2.5% decline in use rate from 103 in 1991 to 100.4 in 1996. This decline is projected to reduce 1996 total JH admissions to 2,711 -- a decline of 57 admissions from baseline projections. Under these conditions, ADC would be 40 in 1996.
- Sensitivity (B) -- A 5.0% decline in use rates is from 103 in 1991 to 97.9 in 1996. This decline is projected to reduce 1996 total JH admissions to 2,654 -- a decline of 114 admissions from baseline projections. Under these conditions, ADC would be 39 in 1996.
- Sensitivity (C) -- JH recaptures one half of the market share it has lost since 1988 by 1996 (recapture 1.75% and 0.9% market share in the primary and secondary markets, respectively, resulting in a 6.2% market share in the primary market and a 2.1% market share in the secondary market), and also experiences a 2.5% decline in market use rates (from 103 to 100.4). These assumptions result in

projected 1996 total admissions of 3,770. This represents an increase of 1,002 admissions from the "baseline" projections. Under these conditions, ADC would be 55 in 1996.

Sensitivity (D) -- JH recaptures one half of the market share it has lost since 1988 (same as Sensitivity C) and experiences a 5.0% decline in use rates (from 103 to 97.9). These assumptions result in projected 1996 total admissions 3,685. This represents an increase of 917 admissions from "baseline" projections. Under these conditions, ADC would be 54 in 1996.

Average daily census (ADC) is a particularly volatile and significant indicator. A change of one day in ADC is equivalent to 365 patient days. At an average of \$ 1,104 in net patient revenue per patient day at JH in 1991, a one day increase in ADC translates into \$402,960 of increased net revenue. Increasing ADC to 56 represents a potential revenue increase of \$6.0M to JH.

Table 7, below, is a summary of the results of the sensitivity analyses that model these various declines in use rates, as well as the effect of JH recapturing market share through 1996. It shows the impact that these changes could have on both admissions and average daily census (ADC).

Table 7

Sensitivity Analysis for JH Projected Admissions and ADC

<u>Year</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996...2005</u>
<u>JH Admissions</u>						
<u>Sensitivity</u>						
A) 2.5% UR Decline	2,768	2,757	2,745	2,734	2,722	2,711 2,711
B) 5.0% UR Decline	2,768	2,745	2,722	2,699	2,676	2,654 2,654
C) 2.5% UR Decline & MSR	2,768	2,944	3,132	3,332	3,544	3,770 3,770
D) 5.0% UR Decline & MSR	2,768	2,931	3,067	3,104	3,286	3,685 3,685
<u>Year</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996...2005</u>
<u>Average Daily Census</u>						
<u>Sensitivity</u>						
A) 2.5% UR Decline	41	41	40	40	40	40 40
B) 5.0% UR Decline	41	40	40	39	39	39 39
C) 2.5% UR Decline & MSR	41	43	46	49	52	56 56
D) 5.0% UR Decline & MSR	41	43	46	48	51	54 54

Key: UR = Use Rate MSR = Market Share Recapture

6. BASELINE PROJECTIONS INDICATE THAT JH'S CUMULATIVE NET LOSSES WILL AMOUNT TO APPROXIMATELY \$47M PV BY THE YEAR 2005.

Several financial pro forma analyses were developed based on utilization trends and other assumptions.

- (1) Baseline Projections Indicate that if Utilization Does Not Increase or If a More Attractive Use of The Facility Cannot be Found, JH Stands to Lose Between \$32M and \$91M Between 1991 and 2005.

Based on JH's current financial performance, taking into account estimated future capital requirements and assuming there is no further deterioration in JH's inpatient market share, "baseline" projections indicate that JH will incur annual operating losses ranging from \$3M in 1992 up to \$8M in 2005, the final year of the lease. Annual cash deficits are projected to also be in this same range. The major reasons for the projected future operating losses and cash deficits are discussed below:

- . . JH's utilization has decreased to the point where there are little or no economies of scale. This will continue to cause JH difficulties competing with other hospitals in the future.
- . JH provides a limited range of services and these will require significant capital expenditures to maintain in the future.

If JH maintains its present operations, the projected losses from 1992 through the end of the lease in 2005 will be approximately \$81M, expressed in absolute (1991) dollars. Even if JH were to cease operations and all corporate overhead allocated to JH were eliminated, and the projected losses were limited to the remaining lease payments, this would be a loss of \$36M ("bail out" option). However, not all of corporate overhead is considered to be variable cost and, realistically, a portion of the amount currently allocated to JH would still be incurred. The amount of corporate overhead that would remain would reduce the gap between the \$81M in projected operating losses as a continuing entity and the \$36M cost incurred to close JH.

In discounted dollars, JH's projected operating losses from 1992 through the end of the lease would be approximately \$47M. The costs to pay off the lease in discounted dollars is approximately \$22M. Absolute dollars were discounted at a rate of 7.5% which approximates IHS' current cost of capital (interest rate on long term debt).

- (2) Sensitivity Analyses on Baseline Utilization Projections Indicate that Total JH losses Could Range from \$32M to \$91M from 1991 through 2005.

Key results from the sensitivity analysis are presented below and describe the range of total losses that JH could experience if conditions vary from baseline projections. The use rate and marketshare assumptions presented in the sensitivity analyses below are the same assumptions used earlier for projecting admissions and ADC.

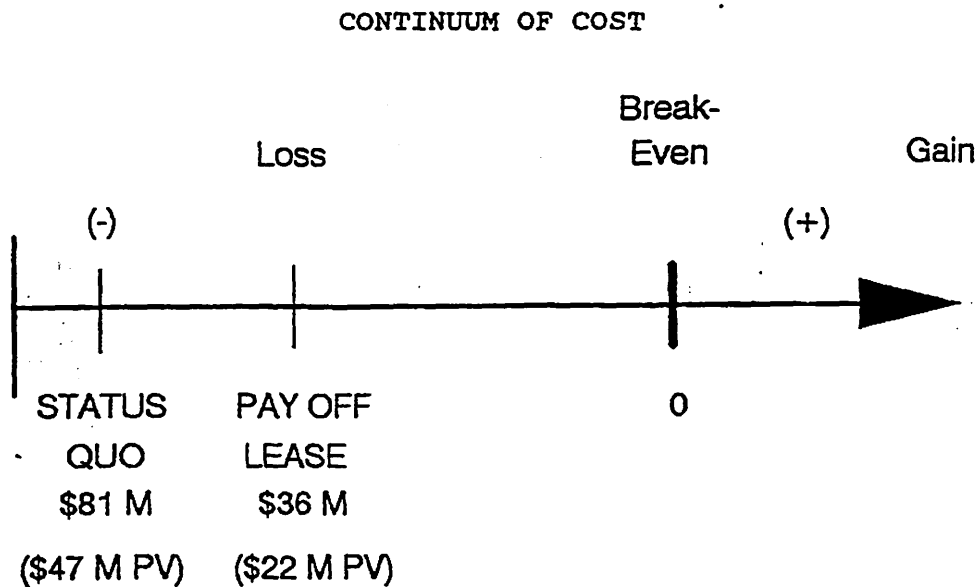
- . If the use rate in JH's market area were to decline by 2.5% over the next five years and then remain constant, the estimated annual operating losses would range from \$3.3M in 1992 to \$8.7M in 2005 and would total approximately \$88M for the remainder of the lease in absolute dollars (\$51M in discounted dollars).
- . If the use rate in JH's market area were to decline by 5% over the next five years and then remain constant, the estimated annual operating losses would range from \$3.3M in 1992 to \$9M in 2005 and would total approximately \$91M in absolute dollars (approximately \$53M in discounted dollars).
- . If the use rate in JH's market area were to decline by 2.5% over the next five years, and then remain constant while JH rapidly improves its market share by one half of the amount lost since 1988, JH's operating losses would range from \$2.8M in 1992 to \$2.5M in 2005. Under this scenario, JH's estimated operating losses through the end of the lease would total approximately \$32M in absolute dollars (approximately \$20.M in discounted dollars).
- . If the use rate in JH's market area were to decline by 5% over the next five years and then remain constant while JH recaptured one half of its market share losses since 1988, JH's estimated operating losses would be approximately \$2.9M in 1992 and in 2005. Under this scenario, JH's estimated operating losses through the end of the lease would total approximately \$36M in absolute dollars (\$22M in discounted dollars).

The "baseline" pro forma analysis, as well as the assumptions used are outlined in Appendix D. No changes in payor mix were assumed, except for the conversion over time of Blue Cross and Commercial patients to HMO and PPO coverage of 10% per year, with a subsequent 20% discount.

In summary, this portion of the report attempts to quantify two scenarios:

- . "Baseline" scenario. The implications if JH continues to operate as it has in the past, and
- . "Bail out" scenario. The cost to pay off the lease.

Sensitivity analyses were performed to underscore how changes in key variables would impact these numbers. As shown below, these can be arrayed along a continuum.



* PV = present value

Source: NHA and Cohen, Rutherford, Blum & Schott

If IHS were to close JH and pay off the lease (bail out scenario), the cost is estimated to be approximately \$36M in absolute dollars (\$22M present value). If JH continues to operate as it has in the past (baseline scenario), the costs through the end of the lease term is approximately \$81M in absolute dollars (\$47M present value). These two scenarios set up a cost continuum against which to evaluate all other options. Those that can improve on these losses will be considered preferred options to the "baseline" and/or "bail out" scenarios. The remainder of this report will therefore focus only on those options that fall to the right on this continuum, i.e. those options where the total costs (present value dollars) are less than \$22M. All options that fall to the left on the continuum, will be eliminated from further consideration. It is the expressed intent of this analysis to narrow the options down to one or two key alternatives and then to complete a comprehensive review of this limited number of options. The next chapter defines more clearly the options that have been considered previously and those that will be considered further in this study.

III. STRATEGIC OPTIONS DEFINED

This section of the study summarizes all options that have been previously considered through internal analyses by both the finance (1991) and marketing (1989) staffs of Inova Health System (IHS). It also presents a summary of a recent study that focused on the potential consolidation of JH with FH. Finally, highlights are presented for four key strategic options that are the primary focus of the remainder of this study.

1. PREVIOUS INTERNAL AND EXTERNAL STUDIES HAVE BEEN CONDUCTED TO DETERMINE POTENTIAL OPTIONS FOR THE FUTURE OF JEFFERSON HOSPITAL.

Reviewing potential options is not a new issue for IH. Numerous studies have been completed both internally and with outside assistance.

(1) An Internal Study Conducted in 1991 by the IHS Finance Staff Analyzed Five Key Strategic Options.

Exhibit XIII, on the following page, is a summary of key options considered by Inova finance staff in 1991. Several important points should be noted. All scenarios analyzed in this internal study were evaluated under the premise that JH must maintain an acute core of business for legal and financial reasons. Legally, the terms of the lease stipulate that the Hospital maintain an acute care base. Financially, the high degree of operating leverage requires that the Hospital generate a high level of revenue per encounter (e.g., admission, O/P surgery, etc.) in order to minimize losses.

The five options studied were:

- Option I, reduce staffing -- This option examined cuts in the Hospital's labor force of 6%, 9%, and 12%. Although each scenario produced results that are better than the status quo, the earliest any of the scenarios suggest a positive net income for JH is 1995. It was estimated that none of these scenarios suggest a positive net present value of cash flows when capital expenditures are included.
- Option II, eliminate programs -- This approach produced only one viable alternative -- move the Cardiac Catheterization Unit out to another INOVA facility. This option would produce an estimated net positive impact of \$130,000 per year.

**JH OPTIONS STUDY, FINANCE
STAFF OF IHS, 1991**

- I. Reduce staffing;
- II. Eliminate programs from Jefferson that are not covering variable costs;
- III. Dedicate a subunit within JH for a skilled nursing facility;
- IV. Decrease outpatient price in order to generate additional volume; and
- V. "Recruit" standalone program for space vacated by the "cats" unit (i.e. psych)

Source: Jefferson Hospital Options Analysis, 1991

JAPP. 5552

- Option III, develop a Skilled Nursing Unit -- This option would not offer sufficient financial return for the risk assumed and capital invested.
- Option IV, decrease outpatient prices -- This option would not produce a positive net financial impact.
- Option V, diversify into the inpatient "Psych" business -
- The results of the analysis indicate break even for net income and cash flow by 1993, with a negative net present value cash flow of \$1.1M through 1996 (this is due to a requirement for an estimated additional \$1.5M in working capital and \$1.5M in capital funds for the renovation of the West unit and the beginning of structural renovation of the North unit.) Although the combined JH/MMB entity begins to show substantial profitability in 1994, the extended elapsed time between investment and return adds an additional element of risk to this option.

The major assumption that underlies every option in this analysis is that the acute care inpatient base will continue to require only 30% of the available capacity at the Hospital. The relatively high level of fixed costs at Jefferson, especially the lease payment and corporate overhead allocation, requires that the inpatient volume be much closer to 40% capacity to cover their costs. A summary of these analyses states that any final plan for JH's future must have, as an integral part, a comprehensive plan to build and maintain the acute care base. Recommended "next steps" were provided at the end of the study. It should be noted that for various reasons, none of the above options have been implemented.

- (2) An Internal Study Conducted by Inova Marketing Services in 1989 Reviewed 10 Long Range Planning Alternatives for the Future of JH.

Exhibit XIV, following this page, presents the ten alternatives evaluated by IHS marketing services in 1989. There are several key points that should be noted:

- The implications of each alternative in this study were divided into three main categories, financial, strategic and political.
- Three alternatives were considered to have more comparative merit than the other seven. These included the following:
 - Relocate licensed beds;
 - Merge with Fairfax Hospital and Specialize; and
 - Extend the Lease and Rebuild for the Future.

**JH OPTIONS STUDY
INOVA MARKETING SERVICES, 1989**

- I. No substantial change;
- II. Buy out the lease;
- III. Down-size/eliminate selected existing services;
- IV. Relocate licensure for beds;
- V. Convert med/surg to other use;
- VI. Merge with Fairfax Hospital;
- VII. Subsidize takeover by another buyer;
- VIII. Convert tax status & write off losses;
- IX. Extend lease at lower rate; and
- X. Renovate/rebuild for future

Source: Jefferson Hospital Options Analysis

Several advantages and disadvantages of these three options were evaluated. These include:

- . Relocate licensed beds (Option IV) -- It was determined that approximately \$15-\$20M (NPV) dollars would be required to pay off the lease. Several opportunities that were determined to be associated with this option include the ability for JH to help physicians build practices in new, growing markets and a better opportunity to avoid regulatory barriers for approval of additional capacity.
 - . Merge with Fairfax Hospital and specialize (Option VI) -- This analysis determined that significant investment of capital in the aging physical plant would still be needed. This option was also seen as a means of leveraging FH's "success" in an increasingly competitive marketplace. It was felt, however, that it would be difficult to convince FH physicians to move their patients to JH.
 - . Extend the lease and rebuild for the future (Option X) -- It was determined that substantial capital investment would be required and, even then it would be difficult to sustain the new investment in the existing market.
 - . Several "next steps" for the three options mentioned above were also outlined in the study. The appendix to the study also provides an analysis of the other seven options mentioned in the report.
- (3) A Recent Study Completed by NHA Focused on Potential Consolidation of JH with FH.

National Health Advisors recently worked with an internal management task force resulting in the development of a specific set of recommendations for consideration by the Medical Staff and Board for the possible consolidation of JH into FH. The following underscores the major components of the suggest option:

- . The initiative to consolidate JH with FH is consistent with the integrated vision for Inova Hospitals (IH) adopted in 1989 to create one hospital with four locations.
- . The reason for the proposed consolidation is to demonstrate that a single standard of quality medical care exists, thus enabling greater utilization of the Jefferson facility by members of the medical staffs of all IH hospitals.

An important factor addressed in this study is the controversial role of the medical staff leadership at JH. Reportedly, the leadership style of the primary owner is highly controversial and may be the single most important barrier to improving the use of JH. It was also reported that unless the medical staff leadership is changed at JH, it will be difficult to successfully implement any long-term strategy.

The specific recommendation of the proposal is to consolidate governance, management and medical staff operations and activities. Specifically, this proposal recommends merging Jefferson into Fairfax which, among other things, would result in a single medical staff, a single management staff and a single Board of Trustees for the two hospitals.

The proposal does not completely answer how the management team could best accomplish this consolidation. It was thought that input from groups that would be directly affected -- trustees, managers and physicians would be necessary before specific recommendations could be made.

The proposal states that the transition to a single medical staff be phased in over a period of 24 months. Eligible physicians at JH who do not currently hold privileges at Fairfax would be given an opportunity to join the FH medical staff during this time.

The management reorganization would begin at Jefferson and the CEO at Jefferson would be added to the Fairfax staff at the level of COO and would report to the CEO at FH.

Consolidation of departments among the two sites would occur over a 12-18 month period. Governance would be consolidated immediately combining 15 members of the two current Hospital operating Boards into a single Board.

It was further recommended that after this consolidation is approved, consideration be given to: a name change for JH; a van transportation system between JH and FH; and the development of a strategic options steering committee to evaluate larger strategic opportunities presented by the consolidation and to determine the ultimate role of the Jefferson asset within Inova.

At the conclusion of this earlier process, the management team felt that this comprehensive options study should be completed before the above mentioned proposal to consolidate JH with FH is further considered. This larger study of strategic options was considered necessary to assure that consolidation in the short run (if recommended) would support longer term alternatives that might be pursued at JH.

2. FOUR CORE OPTIONS WILL PROVIDE THE BASIS TO MORE FULLY EVALUATE POSSIBLE ALTERNATIVES FOR THE FUTURE OF JH.

These four general options, as well as variations to each option, are outlined in Exhibit XV, on the following page. Generic advantages and disadvantages to the four core options are also presented in Exhibit XVI, following Exhibit XV.

- (1) The Option to Maintain the Status Quo is Cost Prohibitive. However, Several Derivatives of this Option Could Help to Reduce These Costs.

The Status Quo and its related options are as follows:

Status Quo. The cumulative costs of continuing to operate JH, as it has operated in the past, is projected to be approximately \$47M (PV). Nearly \$22M (PV) of this amount is the cost of the lease payments through 2005. The other portion is additional required capital expenditures and operating losses. If utilization would decline further than projected, JH could stand to lose even more than the projected \$81M. Therefore, this option presents a high level of risk.

Renegotiate Lease Terms. An alternative approach to the status quo option would be to renegotiate more favorable lease terms in order to reduce costs (e.g. reduce the term of the lease and/or reduce the lease payments). As mentioned earlier in the report, IH management has attempted, on numerous occasions, to renegotiate the terms of the lease with the landlord. To date, these attempts have been unsuccessful. Recently proposed tax legislation, however, could now provide additional incentive for renegotiation on the part of the landlord.

"Bail Out" Scenario. IHS could negotiate to buy out the lease and eliminate all involvement with JH's operation. The cost of the bail out option includes the cost of the lease payments through 2005, projected to be approximately \$36M. In addition to the cost of the lease there would be other costs related to closure. These include:

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OPTIONS FOR JH

I. Status Quo/Renegotiate/"Bail Out"

- Baseline scenario
- Renegotiate the lease
- Bail-out scenario

II. Purchase beds and move them

- Close JH and move beds to a more demographically desirable location
- Close JH and move beds to another FHS facility

III. Alter service mix

- Convert to single specialty or multi-specialty facility (e.g., Psych alone or Psych and Rehab) and consolidate these FHS services at JH
- Joint Venture with local hospital(s) (e.g., Alexandria, Arlington) to develop a 60-80 bed Psych facility at JH
- Develop outpatient and day treatment psychiatric and/or rehabilitation programs
- Acquire Bolling Brook Property and focus on ambulatory services
- Develop a "patient centered care" hospital
- Move an FH service to JH (e.g., Cardiac, Psych, Cancer)
- Conversion to a specialty facility for digestive disorders
- Develop a skilled nursing unit at JH
- Conversion to mixed use facility (e.g., Acute, Subacute, SNF, Outpatient, Adolescent Psych)

IV. Joint venture with group(s)

- Extend teaching programs under joint venture with or without Georgetown and Alexandria Hospitals
- Develop a joint venture corporation with physician(s)
- Joint venture with another third party(s) to buy all or part of lease

EXHIBIT XVI
Inova Hospitals

ADVANTAGES AND DISADVANTAGES OF STRATEGIC OPTIONS FOR JH

OPTION	ADVANTAGES	DISADVANTAGES
Status Quo	<ul style="list-style-type: none"> . Possibility to minimize losses if can renegotiate lease . Minimal political disruption . FHS could maintain greater market coverage in N.V. 	<ul style="list-style-type: none"> . Cumulative losses of approx. \$72 M through lease term (2005) . Risk of even greater losses if utilization declines . Does not address physical plant & access issues . Would owner agree to renegotiate lease?
Purchase Beds & Move Them	<ul style="list-style-type: none"> . Relocation to more demographically desirable market . Opportunity to eliminate a portion of the unused beds in the market . Opportunity to shed outmoded facility . Opportunity to help JH physicians build practices in new, growing market 	<ul style="list-style-type: none"> . May be difficult to get regulatory approval . Cost to purchase and relocate beds . May not be able to generate enough volume to build a new facility . Excess beds in market
Alter Service Mix	<ul style="list-style-type: none"> . Better use of excess capacity . Can focus efforts on one or two services . May be a financially viable option . Opportunity to develop market niche/identity . Consolidation of psych services could produce economies of scale and "free-up" needed beds at Fairfax Hospital 	<ul style="list-style-type: none"> . Difficulty getting FHS physician to move patients to JH . Doesn't address facility issues . Initial capital costs . Difficulty finding service that will cover high fixed costs . Elimination of duplication may not be accepted by other FHS members . Recent decline in inpatient use rates for specialty services (e.g., psych, rehab)
JV with Local Group(s)	<ul style="list-style-type: none"> . Help reduce cost associated with providing a particular program/services . Reduces risk . Profitable cooperation could reduce duplication of services 	<ul style="list-style-type: none"> . Difficulty finding partner(s) . Does not address aging facility issues . Possible antitrust barriers

- Payment to relieve future obligations under the lease;
- Severance pay for displaced employees;
- Operational losses incurred during the phase-down period;
- Results of liquidation of current assets, current liabilities, operating leases, and long-term debt; and
- Potential sale of equipment and Medicare depreciation recapture on leasehold improvements and equipment not sold.

It is estimated that the additional costs related to closing JH, beyond the lease obligations, would be in the range of \$2M to \$4M, depending on how each of the different factors is resolved. If the cost of the lease obligation is included, the resulting cost of closure is approximately \$38M.

Syndicate the "Bail Out" of the Lease with Area Hospitals. An alternative to the "Bail Out" scenario is to develop a joint venture arrangement with area hospitals to assist in the buy out of the lease, including all costs of closure. A major incentive for local hospitals to cooperate in this type of syndication includes the additional utilization these local hospitals could potentially receive if JH closes. A patient origin and market share study will need to be completed to project the number of patients each hospital could potentially receive.

(2) The Option to Purchase Beds and Move Them to a More Desirable Location has Several Advantages and Disadvantages.

There are two variations on this option. These include:

Close Hospital and Move Beds to a More Desirable Location. JH is located in a demographically undesirable market and is surrounded by competing hospitals that are more financially sound and have more modern physical plants. Building a new facility in a more demographically desirable location (e.g., Franconia, Sterling) provides several advantages, particularly, the opportunity to move from the current outmoded physical plant. However, many factors will need to be considered in order to determine if this represents a favorable option for JH. These include:

- An analysis of where patients would come from if a new facility was built in another location in Northern Virginia.
- A determination of the projected cost of closing of

JH (e.g., personnel, capital, and potential avoided costs,).

- A determination of the cost of the land and new construction.
- Regulatory approval to move the beds given that there are currently over 400 excess beds in the market.

Close JH and move beds to another IH facility(s). This option supports the purchase of the 120 bed JH license by IHS. Sixty of these 120 beds would be de-licensed and the remaining 60 would be moved to Fair Oaks (15 beds) and Fairfax (45 beds) Hospitals. Several key advantages to this option include:

- Potential for immediate incremental payoff through the transfer of patients to other IH facilities;
- Less costly due to minimal level of new construction at both FO and FF hospitals; and
- Greater likelihood of regulatory approval because 60 beds in the market would be de-licensed.

(3) Altering Service Mix May Allow JH to Focus its Efforts on One or Two Niche Services and Potentially Reduce Excess Bed Capacity.

There are many variations to this option that might represent an improvement for JH, including:

Convert JH to a single specialty or multi-specialty facility (e.g., Psych alone or Psych and Rehab) and consolidate these IH services at JH. Research has shown that patients are willing to travel distances to receive Psychiatric and Rehabilitation services. Therefore, relocating these IH services to JH poses less of a threat. Several advantages to this approach include:

- The potential to "free-up" needed beds at Fairfax Hospital for other uses (e.g., med/surg).
- The potential to gain economies of scale from the consolidation.

Develop a Joint Venture with a Local Hospital(s). Another derivative of the Psychiatric program approach is to develop a 60 - 80 bed Psychiatric hospital at JH in a joint venture arrangement with area hospitals (e.g., Alexandria, Arlington). Since JH competes with Alexandria and Arlington for Psychiatric services, there may be incentive on the part of these hospitals to enter into a joint venture to minimize their risk and gain economies of scale.

IH management has advised the consultants that it would be highly unlikely that the physicians at FH would agree to move their psychiatric services to JH. Therefore, the consultants have been advised not to pursue these options.

Other variations on altering service mix include:

Develop an Outpatient and Day Treatment Program. A derivation to the inpatient psychiatric or rehabilitation program approach is to develop outpatient and day treatment services at JH. Thereby, focusing on the more economical system for treating patients, especially as managed care begins to play a more prominent role in the market. Payment for these services, however, would not likely be sufficient to cover the relatively high fixed costs at JH.

Acquire the Bolling Brook Property. JH could reduce the number of operating beds and place a greater emphasis on outpatient services. One approach to this alternative is to acquire the Bolling Brook property adjacent to Jefferson hospital and develop it into both medical offices and an ambulatory care facility. While this acquisition may be difficult, given the residential use of this property and the number of individual owners, this alternative could yield many benefits to JH, including:

- increased space allocation for Hospital services and physicians;
- improved traffic flow and access;
- increased parking capacity;
- accommodate revenue-generating ambulatory care services in a convenient setting without the constraints of the current lease;
- "free-up" space in the main hospital building for core department expansion and relocation and minimize the need for costly and time consuming construction/renovation phasing;
- benefits to the existing Hospital site and facilities should be appealing to the Owner of the JH site.

This preliminary suggestion will require further study. In particular, the potential to develop the Bolling Brook site should be clearly determined before acquisition is further considered.

Develop the First "Patient-Centered Care" Approach with IH at JH. The delivery of care at JH offers no "natural" advantages (e.g., the most convenient, the lowest cost, the highest quality). Therefore, in order to remain competitive JH must create advantages for the consumer. One potential alternative is to develop the first truly "patient-centered care" approach within IH at JH. Since "patient-centered care" requires major operational restructuring, it may actually be less difficult to implement this model at a smaller facility such as JH and, if successful, use this as a prototype for other hospitals in IH. This option provides JH with the opportunity to develop a unique service in the healthcare market. This again is a high risk option that may not prove to be financially viable and one that would lose its competitive thrust as soon as others copied it.

Move an FH Service to JH. Another potential alternative is to move a FH service to JH (e.g., Cardiac, Cancer). Again, this option does not address the significant physical plant limitations or the limited access and parking issues. As mentioned earlier, it may be difficult to convince FH physicians to move their patients to JH, as evident by the historical difficulty in getting physicians to use the state-of-the-art Cardiac Catheterization Laboratory at JH. The high political and financial risks of this option may prove to be prohibitive.

Conversion of JH to a specialty facility for digestive disorders. Currently, there is no specialty facility in the market that offers comprehensive services for digestive diseases. JH's endoscopy procedures almost doubled from 1990 to 1991 (from 271 to 418). Based on anecdotal information, Arlington and Alexandria hospitals are currently investing in these services. Financially, this option poses several advantages to both physicians and the Hospital, including its ability to attract a relatively high level of commercially insured patients and low levels of Medicare and Medicaid insured patients. Again, further study will need to be conducted to determine the viability of this option.

Develop a skilled nursing (SN) unit at JH. Developing a SN unit and/or operating certain acute care beds on a "swing bed" basis could also prove to be a financial improvement. This alternative may prove to have several significant barriers including; the current moratorium on the development of Skilled Nursing Beds in the State of Virginia until July 1, 1993 and the ability to modify the current lease agreement to allow the unit to be operated in the Hospital.

- Develop a Mix-Use Facility at JH. A conversion of JH to a mixed use facility to include acute, subacute, outpatient (e.g., ER, ambulatory surgery) and adolescent psychiatric services may prove to be an attractive option. However, there are many factors that will need to be evaluated to determine the viability of this option. These include:

- Estimated Need in the Market
- Physical plant configuration (fit)
- Operating costs (e.g., staffing) and capital costs
- Timing Issues
- Reimbursement
- CoN/Licensure Issues
- Impact on other IH facilities

- (4) Joint Venturing with Another Group May Provide JH with an Opportunity To Develop Synergistic Relationships with Area Providers and Reduce or Minimize its Risk.

Several alternative approaches may be feasible under this option. These include:

- Develop a JV with a local hospital(s) (e.g., Georgetown and Alexandria) to extend teaching programs at JH. This option has the potential to send a signal to the community and medical staff that a single standard of quality exists within IH. This perception will enhance the image of JH and make it more attractive to all users, including managed care contractors. A major incentive for area hospital(s) to become involved is opportunity for additional sites in which to train staff, as well as an opportunity to gain additional access to the market. A disadvantage to this option may be the complexities involved in developing a JV with a major academic center such as Georgetown.
- Joint venture (JV) with local group(s). A joint venture corporation could be developed with physician group(s), with each partner having equal ownership. This new corporation could contract with Kaiser or GHA to establish rates that allow the venture to compete as a low cost provider in the market. Several advantages for JH include the ability to reduce risk and cap any future losses, as well as the opportunity to establish a market niche as the low cost provider. It is important to note that IHS management has attempted to work with Kaiser in developing alternatives for JH, but Kaiser has refused to get into an arrangement with JH.

Several key considerations are probably necessary for these ventures to prove viable. These include:

- . JH would have to be viewed as a unit of FH;
- . JH would need to have house staff coverage;
- . JH would need to be viewed as an additional teaching site for residents from both FH and Georgetown.
- . JH would maintain its core medical/surgical services.

Several "spin-offs" to this option include:

- . JV with other hospital(s). A joint venture arrangement could be developed with area hospital(s), combining facilities so that only one physical plant remains open (e.g., Northern Virginia Doctors Hospital). While this option may provide many of the advantages mentioned above, further evaluation of antitrust limitations, as well as an initiation of discussions with potential partner(s) would be required to determine if this option represents an advantage to IH.
- . JV with a specialty firm to sublease all or some of JH's beds for specialty use. A sublease of all or a portion of JH's beds for specialty use (e.g., subacute) would shift some of the risk to a third party. Such a sublease might result in a lower ADC being required to break even from other acute care services. Integrated Health Services Inc. a specialty healthcare firm out of Hunt Valley, Maryland contacted management at JH regarding several possibilities including the options to sublease all or some of the JH beds. One major limitation to this option is that a portion of the licensed beds would need to be converted to skilled nursing beds and it may be difficult to obtain State CON approval. Further discussions are necessary to explore if this is a favorable option for JH.
- . Prepay the lease and involve the owner in a possible donation of the license and any other tangible property. An incentive to the owners is the potential tax benefits they could receive from the donation. For this option to be viable, however, a value must be established for the license and property.
- . Distribute the cost of closure among the remaining hospitals in the State. An example of this type of arrangement occurred in Maryland when North Charles Hospital closed. It should be noted that a specific Maryland statute requires that all Maryland hospitals help defray the cost of closure. IH could lobby for the State of Virginia to pass a similar statute.

The last section (Chapter IV) focuses on these four core options. Comprehensive analyses will be completed during phase II on only those options that are determined to be the most promising for the future of JH.

IV. EVALUATION OF KEY STRATEGIC OPTIONS

Many factors may be considered when evaluating the strategic options for the future of JH. This section reviews the critical success factors that must be addressed before any alternative strategy can be successfully implemented. This section also presents preliminary criteria to be considered in evaluating the options introduced in Chapter III. Each option is evaluated based on this preliminary set of criteria.

1. PRIOR TO EVALUATING THE OPTIONS PRESENTED IN CHAPTER III, IT IS NECESSARY TO DEFINE CRITICAL SUCCESS FACTORS AND TO IDENTIFY PRELIMINARY CRITERIA WITH WHICH TO EVALUATE THE POTENTIAL OPTIONS.

The concept of critical success factors holds that the strategy of choice must successfully address several key factors.

- (1) Several Critical Success Factors have been Identified for the Future of JH.

The critical success factors that are believed to be important to the future of JH are presented in Exhibit XVII, following this page. These factors are further discussed below.

I. Financial Success Factors:

- Minimize Losses. Any strategy must have the potential to reduce projected losses from the baseline scenario, presented earlier. Projected losses for the baseline scenario range between \$47M (present value) and \$22M (present value).
- Minimize Payback Period. Any strategy chosen must have a projected payback period less than the remaining term of the lease (13 years). The longer the payback period, the greater the risk of the option.
- Minimize Capital Investment. Since the inception of the lease in 1985, IHS has made capital investments of \$13.2M in JH. If IHS continues to invest capital in JH, as it has in the past, this investment will represent approximately \$28M through the remaining term of the lease. Each incremental increase in capital expenditures places an incremental risk on IHS's assets.

EXHIBIT XVII
Inova Hospitals
CRITICAL SUCCESS FACTORS

CRITICAL SUCCESS FACTORS

I. Financial

- . Minimize Losses
- . Minimize Payback Period
- . Minimize Capital Investment

II. Market

- . Respond to Market Need
- . Stabilize or Capture
Additional Market Share
- . Respond to Managed Care
demands in the Market

**III. Political/Legal/
Regulatory**

- . Achieve Medical
Staff Acceptance
- . Minimize Exposure
to Regulatory Barriers
- . Achieve Compliance with
Lease Terms
- . Achieve Strategic Fit with
IHS's vision

IV. Facility

- . Minimize Renovation or
Construction Costs
- . Enhance Access to Facilities

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II. Market Success Factors:

- . Respond to Market Need. For any strategy to be successful, a sufficient market demand must be demonstrated. Projected market demand should be completed through an analysis of market use rates and demographic trends.
- . Stabilize or Capture Additional Market Share. Given the current excess capacity in the market, any strategy must have the potential to capture additional market share.
- . Respond to Managed Care Demands in Market. Managed Care will continue to play a more dominant role in the market. Any option for the future of JH must have the potential to address the managed care demands in the market.

III. Political/Legal/Regulatory Success Factors:

- . Achieve Medical Staff Acceptance.
 - FH Medical Staff Acceptance. There is reportedly a perception among some FH physicians that JH has an inferior standard of care for certain services. As long as this perception is held by physicians practicing at FH, they will continue to be reluctant to care for their patients at JH. Additionally, an argument could be made that there are limited clinical incentives for FHS physicians to care for their patients at JH. It could also be argued that incentives such as lower rates at JH as compared to those at FH will provide the only impetus for FH physicians to care for their patients at JH.
 - JH Medical Staff Acceptance. It can be argued that some physicians may choose to practice at JH because they enjoy the advantages of working in a small environment (e.g., less complexity with scheduling). These factors must be considered when evaluating options from the viewpoint of the JH medical staff.
- . Minimize Exposure to Regulatory Barriers. For any strategy to be successful, it must comply with CON and antitrust regulations, as well as conform with the terms of the lease.

- Compliance with Lease Terms. Given the strict limitations of the Hospital Lease Agreement, any option other than the status quo has the potential to fall outside the terms of the lease. For an option to be viable, it must be in compliance with the lease terms or successful renegotiations must occur with the owner. As mentioned earlier, however, numerous unsuccessful attempts have been made on the part of FHS management to renegotiate the lease agreement with the owner.
- Achieve Strategic Fit with IHS's Vision. Only those options that conform with IHS's long-term strategic vision can be considered for JH. Those options that do not facilitate achievement of this vision will not be considered.

IV. Facility Success Factors:

- Minimize Renovation or Construction Costs. Given the current status of JH's physical plant, any strategy is likely to require renovation or new construction costs. Minimizing both the cost and the time required for new construction will increase the likelihood of a strategy's success.
- Enhance Access to Facilities. The location of and access to the JH facilities is limiting. Only by making it easier for patients to receive care and for physicians to provide that care, will JH be successful.
- (2) Several Key Criteria have been Established to Begin a Preliminary Analysis of the Options Identified in Chapter III.

Exhibit XVIII, on the following page, outlines specific for criteria evaluating the four core options. High, medium and low thresholds have been established to preliminarily evaluate these options. The alternatives will be rated on their overall ability to meet the thresholds established for each individual criterion. Further discussion of these criteria and related thresholds are presented below:

EXHIBIT XVIII
Inova Hospitals
EVALUATION CRITERIA

CRITERIA	THRESHOLDS		
	High	Medium	Low
I. FINANCIAL			
Reduce Losses From Status Quo	Break-even or better	< or = to \$22 M (PV)	> \$22 M (PV)
Payback Period Required on Incremental Investment	5 years or less	> 5 < or = to 7 years	> 7 years
Capital investment Required	\$15 Million or less	> \$15 M < or = to \$20 M	> \$20 M
II. MARKET			
Projected Market Demand	Projected demand to increase by 10% or greater over next five years	Projected demand to remain stable or increase < 10% over next five years	Demand projected to decrease over next five years
Market Share Potential	Low level of competition; potential to capture additional market share	Moderate level of competition; potential to maintain market share	High level of competition; potential to lose market share
Managed Care Potential	10% or greater growth in HMO volume	< 10% > or = to 5% growth HMO volume	< 5% growth HMO volume
III. POLITICAL/LEGAL REGULATORY			
Medical Staff Support (JH/FH)	Supported by majority of medical staff	Supported by less than a majority of medical staff	Supported by only a few members of the medical staff
Antitrust Barriers	Minimal exposure	Moderate exposure	High exposure
CON Regulation	Review not required	Review required; approval likely	Review required; approval unlikely
Lease Compliance	Easily complies with lease terms	May require change to lease terms	Would require difficult negotiation
Strategic Fit with IHS's Vision	High level of Strategic Fit	Moderate level of Strategic Fit	Minimal level of Strategic Fit
IV. FACILITIES			
Facility Access	Significantly improves access	Moderately improves access	Does not improve access

Source: National Health Advisors and Cohen, Rutherford, Blum and Schott

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I. Financial Criteria:

Reduce losses from status quo. Projected losses outlined for the baseline scenario and the various sensitivities, presented earlier, range from between \$22M (PV) and \$47M (PV). Therefore, each alternative should be evaluated on its ability to reduce these losses.

- High: Results in breakeven or better.
- Medium: Results in losses \leq \$22M (PV).
- Low: Results in losses $>$ \$22M (PV).

Payback period required. The shorter the payback period, other things held constant, the greater the liquidity of the project. Additionally, near term cash flows are generally regarded as less risky than cash flows expected in the distant future. Each option should be evaluated on its ability to limit the payback period.

- High: Payback period of five years or less.
- Medium: Payback period $>$ 5 years but \leq 7 years.
- Low: Payback period of $>$ 7 years.

Capital investment required. Any strategy is likely to require capital investment. As presented earlier, IHS has invested \$13.2M in JH since the inception of the lease. Each option should be evaluated on its ability to limit additional capital investment.

- High: Capital Investment of \leq \$15M.
- Medium: Capital investment of $>$ \$15M but \leq \$20M.
- Low: Capital investment of $>$ \$20M.

II. Market Criteria:

Projected Market Demand. Market demand and growth, through an analysis of projected use rates and demographic trends, must be considered when evaluating each option. Any option chosen should have the potential to meet or exceed the baseline scenario (8.1% increase for primary and secondary market between 1991 and 1996).

- High: Demand projected to increase by 10% or greater over the next five years.
- Medium: Demand projected to remain stable or increase $<$ 10% over the next five years ($<$ 10% but $>$ 8.1%).
- Low: Demand projected to decrease over the next five years (\leq 8.1%)

Market Share Potential. The current level of excess capacity in the market requires that, at a minimum, the

option have the potential to maintain JH's current level of market share.

- High: Low level of competition with potential to capture additional market share.
- Medium: Moderate level of competition with potential to maintain market share.
- Low: High level of competition with potential to lose market share.

Managed Care Potential. The recent trends in managed care in the country, as well as in Northern Virginia, require that any option have the potential to address the managed care demand in the area.

- High: $\geq 10\%$ growth in HMO volume.
- Medium: $< 10\%$ but $\geq 5\%$ growth in HMO volume.
- Low: $< 5\%$ growth in HMO volume.

III. Political/Legal/Regulatory Criteria:

Medical Staff Support. Physician perception can be a critical link in facilitating change. The greater the medical staff support for an option the higher the likelihood of success for that option. Since an option may be viewed differently by the JH and FH medical staffs each option must be evaluated based on the support it would achieve from each medical staff.

- High: Option is supported by the majority of the medical staff.
- Medium: Option is supported by less than majority of the medical staff.
- Low: Option is supported by only a few members of the medical staff.

Antitrust Barriers. Evaluating and avoiding the threat of potential antitrust actions is essential for any successful option.

- High: Minimal exposure to antitrust barrier.
- Medium: Moderate exposure to antitrust barriers but manageable.
- Low: High exposure to antitrust barriers.

CON Regulations. State CON regulations could potentially block certain strategies. Each option should be evaluated based on the likelihood for CON review and approval.

- High: CON review not required.
- Medium: CON required but approval likely.

- Low: CON required but approval unlikely.

- Lease Compliance. The current lease agreement for JH is very limiting. Each option must be review for its ability to comply with the terms of the lease.

- High: Easily complies with terms of lease.
- Medium: May require change in terms of lease.
- Low: Will require difficult negotiations.

- Strategic Fit with IHS's Vision. Each option must be evaluated on its ability to enhance IHS's long-term strategic vision. Only those options that fit with this vision can be considered.

- High: High level of strategic fit.
- Medium: Moderate level of strategic fit.
- Low: Minimal level of strategic fit.

IV. Facilities Criteria:

- Facility Access. Given the current physical plant limitations, each option must be evaluated on its ability to improve access and patient flow.

- High: Significantly improves access to facilities.
- Medium: Moderately improves access to facilities.
- Low: Does not improve access to facilities.

Each core option presented in Chapter III has several related alternative strategies. For the purposes of this analysis, one strategy has been chosen to represent each core option. This strategy is thought to best represent all other alternatives considered under that particular core option.

The four core options and their related strategies are described below.

- I. Status Quo. The representative option chosen under this core strategy is best described by the "baseline" analysis presented in Chapter II of this report. This analysis represents what would occur if JH continued to operate as it has in the past through the term of the lease agreement (2005). The status quo option establishes the parameters with which to evaluate all other strategies.

- II. Purchase Beds and Move Them. The strategy chosen in this category proposes to purchase the 120-bed JH license. Sixty of these 120 beds would be de-licensed and the

remaining 60 beds would be relocated to other IH facilities (e.g., 15 beds to Fair Oaks (FO) and 45 beds to Fairfax (FH)). This strategy was chosen because it provides several key advantages over the other alternative strategies in this category. In particular, it has the potential for immediate incremental payoff through the transfer of patients to other Inova Hospitals. Additionally, Fair Oaks is located in a growing market area and is likely to require additional beds in the future. According to information obtained through interviews, FO currently has 15 beds out of service and plans to add an additional floor to the hospital. It is anticipated that this floor will contain a 30-bed unit. The 15 beds from JH, in addition to the 15 out-of-service beds, could be used to complete the 30 bed unit at FO. Since this strategy does not require construction of a new facility, it potentially represents the least costly of all other alternatives considered within this core option.

III. Alter Service Mix. The representative strategy related to this core option proposes the development of a "mixed use" facility at JH. The mix of services would potentially include acute, subacute/skilled nursing, outpatient and adolescent psychiatric services. The conversion to a single specialty facility (e.g., psych) was not chosen because it would require that all Inova Hospitals' psychiatric services be consolidated at JH. IH management felt that it would be difficult, if not impossible, to convince FH physicians to agree to treat their patients at JH. Therefore, the consultants were advised against further analysis of the single specialty option.

IV. Joint Venture with Group(s). The representative strategy related to this core option proposes to develop a joint venture arrangement with local physician group(s). This new corporation would then contract with payors at rates that will allow the venture to establish a niche in the market as the low cost provider. In order for this option to be successful, the lower rates must be offset with volume increases.

The remainder of this chapter describes an exercise completed by the consultants and the IH management team to determine which alternative(s) should be further evaluated in the next phase (Phase II) of this study.

There are two independent steps involved in this exercise. The first step involves the evaluation of the four core options, based on the preliminary criteria outlined earlier in this chapter. This initial evaluation assumes that all criteria are weighted

equally or, said differently, all criteria are of equal importance. Step two, involves assigning weight to each of the criteria, thereby, accounting for those criteria that are assumed to be relatively more important than others. It should be noted that the ratings and weights were established independently to ensure objectivity. In this particular exercise, NHA and CRB&S established the ratings and the IH management team established the weights.

Exhibit XIX, on the following page, is a summary of step one of this exercise. Each criterion was assigned either a high (score of 1), medium (score of .5) or low (score of 0) rating based on its ability to accomplish the particular critical success factor (CSF). An overall score was then assigned to each core option based on the individual ratings assigned to each CSF. It can be seen that:

- . Option I, Maintain the Status Quo. Only four of the 13 CSFs were assigned a high rating. These include the ability of the option to: gain JH medical staff acceptance; minimize exposure to antitrust barriers; minimize regulatory review; and comply with lease restrictions. Two CSF received a medium rating and the remaining seven factors were assigned a low rating. This core option received an total score of 5.0.
- . Option II, purchase beds and move them. Again, only four of the 13 CSF were rated high. These include the ability to: gain FH medical staff acceptance; minimize exposure to antitrust barriers; fit with IHS's strategic vision; and enhance access to facilities. Five success factors were assigned a moderate rating and three were assigned a low rating. This analysis resulted in an overall score of 6.5.

EVALUATION OF CORE OPTIONS FOR FUTURE OF JH

Ability of Option to:	Reduce Losses From Status Quo	Limit Payback Period	Minimize Capital Investment Required	Respond To Market Demand	Enhance Market Share	Respond to Managed Care Demand in Market	Gain Medical Staff Acceptance	Minimize Exposure to Antitrust Barriers	Minimize Regulatory Review (CON)	Comply with Lease Restrictions	Fit with IHS's Strategic Vision	Enhance Access To Facilities
I. Status Quo							JH FH					
II. Purchase Beds & Move Them							JH FH					
III. Alter Service Mix							JH FH					
IV. JV with Another Local Group(s)							JH FH					
	6.5	7.0	6.5	5.0	SCORE							

High = 1
 Medium = 0.5
 Low = 0

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- Option III, Alter Service Mix. Only one CSF, the ability to fit with IHS's strategic vision, was given a high rating. All other factors were assigned a medium rating. This core option received the highest rating of all options presented, with an overall score of 7.0.
- Option IV, JV with Local Group(s). Only one CSF, the ability to gain FH medical staff acceptance, was assigned a high score for this option. Eleven CSFs were assigned a medium rating and only one was assigned a low rating. This analysis resulted in a total score of 6.5.

In summary, core option III, alter service mix received the highest overall rating of 7.0. The second highest overall rating was assigned to core option II, purchase beds and move them and core option IV, JV with other local group(s) -- both received a rating of 6.5. The lowest rating was assigned to core option I, status quo.

Step two of this exercise involves assigning weights to each Critical Success Factor. The weights are then multiplied by the ratings to produce a weighted index for each CSF. The sum total of these weighted indices results in the overall score for the particular core option. Exhibit XIX(b), on the following page, is a summary of step two. It can be seen that:

- Option III, Alter Service Mix, received the highest overall weighted index with a score of 0.57. This ranking is consistent with the ratings assigned to this option in step one.
- Option II, Purchase Beds and Move Them, received a weighted index of 0.54, which resulted in the second highest ranking. This ranking was again consistent with the ratings assigned in step one.
- Option IV, JV with Local Group(s), ranked third with a weighted average of 0.52.
- Option I, Status Quo, received the lowest overall ranking with a weighted average of 0.40.

Given the current lease restrictions, only the status quo option is likely to comply with its terms. This factor has been acknowledged at the outset of the report and a decision was made to explore all options regardless of the potential limitations of the lease. In keeping with that decision, the IH management team felt that an additional analysis, which excludes the criterion related to lease compliance, should be completed.

EXHIBIT XIX(b)
Inova Hospitals
EVALUATION OF CORE OPTIONS

JH OPTIONS ANALYSIS						
OPTION I. Status Quo				OPTION II. Purchase		
SUCCESS FACTORS	Weight-a	Rating-b	Weighted Index-c	SUCCESS FACTORS	Weight-a	Rating-b Index-c
Reduce Losses from Status Quo	16.0%	0.5	0.08	Reduce Losses from Status Quo	16.0%	0.5 0
Limit Payback Period	7.0%	0.0	0.00	Limit Payback Period	7.0%	0.0 0
Min Capital Investment Required	10.0%	0.0	0.00	Min Capital Investment Required	10.0%	0.0 0
Respond to Market Demand	5.0%	0.0	0.00	Respond to Market Demand	5.0%	0.5 0
Enhance Market Share	3.0%	0.0	0.00	Enhance Market Share	3.0%	0.5 0
Respond to Managed Care Dema	5.0%	0.0	0.00	Respond to Managed Care Demand	5.0%	0.5 0
Gain Medical Staff Acceptance			0.00	Gain Medical Staff Acceptance		0
Jefferson Hospital	3.0%	1.0	0.03	Jefferson Hospital	3.0%	0.0 0
Fairfax Hospital	7.0%	0.5	0.04	Fairfax Hospital	7.0%	1.0 0
Min Exposure to Antitrust	12.0%	1.0	0.12	Min Exposure to Antitrust	12.0%	1.0 0
Min Regulatory Review (CON)	3.0%	1.0	0.03	Min Regulatory Review (CON)	3.0%	0.5 0
Comply with Lease Restrictions	10.0%	1.0	0.10	Comply with Lease Restrictions	10.0%	0.0 0
Fit with IHS's Strategic Vision	16.0%	0.0	0.00	Fit with IHS's Strategic Vision	16.0%	1.0 0
Enhance Access to Facilities	3.0%	0.0	0.00	Enhance Access to Facilities	3.0%	1.0 0
Total	100.0%	5	0.40	Total	100.0%	6.5 0

OPTION III. Alter Service Mix				OPTION IV. JV With Another Local Group			
SUCCESS FACTORS	Weight-a	Rating-b	Weighted Index-c	SUCCESS FACTORS	Weight-a	Rating-b	Weighted Index-c
Reduce Losses from Status Quo	16.0%	0.5	0.08	Reduce Losses from Status Quo	16.0%	0.5	0.0
Limit Payback Period	7.0%	0.5	0.04	Limit Payback Period	7.0%	0.5	0.0
Min Capital Investment Required	10.0%	0.5	0.05	Min Capital Investment Required	10.0%	0.5	0.0
Respond to Market Demand	5.0%	0.5	0.03	Respond to Market Demand	5.0%	0.5	0.0
Enhance Market Share	3.0%	0.5	0.02	Enhance Market Share	3.0%	0.5	0.0
Respond to Managed Care Dema	5.0%	0.5	0.03	Respond to Managed Care Demand	5.0%	0.5	0.0
Gain Medical Staff Acceptance				Gain Medical Staff Acceptance			
Jefferson Hospital	3.0%	0.5	0.02	Jefferson Hospital	3.0%	0.5	0.0
Fairfax Hospital	7.0%	0.5	0.04	Fairfax Hospital	7.0%	1.0	0.0
Min Exposure to Antitrust	12.0%	0.5	0.06	Min Exposure to Antitrust	12.0%	0.5	0.0
Min Regulatory Review (CON)	3.0%	0.5	0.02	Min Regulatory Review (CON)	3.0%	0.5	0.0
Comply with Lease Restrictions	10.0%	0.5	0.05	Comply with Lease Restrictions	10.0%	0.5	0.0
Fit with IHS's Strategic Vision	16.0%	1.0	0.16	Fit with IHS's Strategic Vision	16.0%	0.5	0.0
Enhance Access to Facilities	3.0%	0.0	0.00	Enhance Access to Facilities	3.0%	0.0	0.0
Total	100.0%	6.5	0.57	Total	100.0%	6.5	0

* Note: Ratings from WNA and CRBS

a - Total of all weights must equal exactly 100

b - 1=High, .5=Medium, 0=Low

Source: Adapted from:

Strategy Formulation: Analytical Concepts,
Hofer/Schendel, 1978

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Table 8, below, underscores the results of the analysis, after the related lease criterion was excluded. It can be seen that:

- By excluding the lease criterion from the analysis, option II, purchase beds and move them, is ranked the highest with a weighted index of 0.54. In the previous analysis, option II was ranked second among the four core options.
- Option III, alter service mix, is ranked second, overall, with a weighted index of 0.52. Option I, status quo, and option IV, JV with other local group(s), were ranked the lowest with scores of 0.30 and 0.47, respectively.

Table 8
Evaluation of JH Options (Excluding Lease Criterion)

<u>OPTION:</u>	<u>WEIGHTED INDEX:</u>
I. Status Quo	.30
II. Purchase Beds and Move Them	.54
III. Alter Service Mix	.52
IV. JV With Other Local Group(s)	.47

After careful review of the results from the above analyses, several conclusions have been made regarding the particular options to pursue in Phase II. These conclusions set up the framework for the comprehensive evaluation of the remaining options -- Phase II. Several "next steps" have also been outlined. Exhibit XX, on the following page outlines the major conclusions to this phase of the study. These include:

- Examine Option II, purchase beds and move them, in phase II. The two related options for further evaluation include: purchase the 120-bed JH license and move the beds to a more demographically desirable location (e.g., Franconia, Sterling); move beds to other IH facilities (e.g., Fair Oaks (15 beds) and Fairfax (45 beds)) and de-license the remaining 60 beds.
- Examine Option III, alter service mix, in Phase II. The option to develop a "mixed use" facility at JH will be explored. Further analysis will need to be completed in order to determine the "right" mix of services, however, these services could potentially include acute, subacute/skilled nursing, outpatient and adolescent psychiatric services.

CONCLUSIONS

- Evaluate Core Option II, Purchase Beds and Move Them, in Phase II.

Specifically:

- Purchase beds and move them to a more demographically desirable location (e.g., Franconia, Sterling).
- Purchase beds and move 60 beds to other IH facilities, FO (15 beds), FH (45 beds) and de-license 60 beds.

- Evaluate Core Option III, Alter Service Mix, in Phase II.

Specifically:

- Develop mixed use facility at JH to possibly include acute, subacute, SNF, outpatient (ER, Amb. Surg.) and adolescent psychiatric services.

In determining appropriate "next steps" for Phase II, there are really two related components. The first component involves a detailed analysis of each of the remaining options presented above. The second component involves managing the communication and approval process within Inova Hospitals. Communicating the results of this study, as well as managing the approval process, will be as critical to the future of JH as the actual option analyses. Recommended next steps include:

- Develop a Steering Committee to participate in the Phase II discussion. This group should include representative physicians and Board members from FH, JH and IHS.
- Conduct meetings with the Steering Committee on a regular basis throughout Phase II.
- Conduct individual interviews with physicians from both Fairfax and Jefferson Hospitals. (The majority of these interviews have already been conducted.)
- Meet periodically with the existing JH/FH Integration Task Force throughout the Phase II process.
- Determine the necessary steps in the approval process. These steps should include a detailed timetable for seeking the consent of all appropriate groups (e.g., medical staff presidents, Boards etc.).

APPENDIX A
Inova Hospitals
JH ADMISSIONS BY ZIP

JEFFERSON HOSPITAL ADMISSIONS 1986				
		JH admits	Percent of Total	Cum. Percent
PRIMARY MARKET	22314 Alexandria	426	10.8%	10.8%
	22304 Alexandria	280	7.1%	17.9%
	22204 Arlington	267	6.8%	24.7%
	22305 Alexandria	249	6.3%	31.0%
	22301 Alexandria	152	3.9%	34.8%
	22311 Alexandria	92	2.3%	37.1%
	22302 Alexandria	111	2.8%	40.0%
	22306 Alexandria	113	2.9%	42.8%
	22041 Falls Church	162	4.1%	46.9%
	22206 Arlington	153	3.9%	50.8%
SECONDARY MARKET	22312 Alexandria	152	3.9%	54.6%
	22003 Annandale	87	2.2%	56.9%
	22309 Alexandria	74	1.9%	58.7%
	22310 Alexandria	66	1.7%	60.4%
	22303 Alexandria	60	1.5%	61.9%
	22042 Falls Church	52	1.3%	63.2%
	22202 Arlington	25	0.6%	63.9%
	22015 Burke	26	0.7%	64.5%
	22150 Springfield	41	1.0%	65.6%
	22152 Springfield	26	0.7%	66.2%
	22151 Springfield	40	1.0%	67.2%
	22207 Arlington	24	0.6%	67.8%
	22079 Lorton	24	0.6%	68.5%
	22203 Arlington	26	0.7%	69.1%
	22193 Dale City	40	1.0%	70.1%
	22180 Vienna	53	1.3%	71.5%
	22201 Arlington	20	0.5%	72.0%
	22101 McLean	23	0.6%	72.6%
	20744 Fort Washingt	21	0.5%	73.1%
	22046 Falls Church	32	0.8%	73.9%
	22191 Woodbridge	34	0.9%	74.8%
	22031 Fairfax	25	0.6%	75.4%
Other Zip Codes		971	24.6%	100.0%
Totals		3,947		

APPENDIX B
Inova Hospitals
JH HISTORICAL MARKET SHARE 1985 AND 1988

JH Historical Market Share		
	1985	1988
Total JH market area admissions		
primary area	27,043	24,053
secondary area	18,409	18,204
JH admissions from market area		
primary area	1,970	1,892
secondary area	568	514
JH market share results		
primary area	7%	8%
secondary area	3%	3%

Source: IHS Marketing Documents 1989

APPENDIX C
Inova Hospitals
1990 IHS'S MARKET AREA OVERLAP

1990 IHS'S MARKET AREA OVERLAP					
ZIP CODE	JEFF.	FHS	FAIRFAX	FAIR OAKS	MT. VERNON
22041	P	S	P		
22204 *	P				
22206	P				
22301	P				
22302	P				
22304	P	S			S
22305 **	P				
22311	P				
22312	P	S	S		S
22314	P				S
ZIP CODE	JEFF.	FHS	FAIRFAX	FAIR OAKS	MT. VERNON
22003	S	P	P	S	
22015	S	P	P	P	
22020	S	P	P	P	
22032	S	P	P	P	
22042	S	P	P	S	
22043	S	P	P	S	
22044	S	S			
22046	S	S	S		
22079	S	S			S
22101	S	S	P	S	
22110	S	P	P	P	
22150	S	S	P		S
22153	S	P	P	S	S
22170	S	P	P	S	
22180	S	P	P	P	
22191	S	S	S	S	S
22192	S	S	S	S	
22193	S	S	S	S	S
22201	S				
22202	S				
22203	S				
22205 ***	S				
22207	S				
22303	S	S			S
22306	S	P	S		P
22309	S	P	S		P
22310	S	P	S		P

Source: IHS 1991

KEY: P = Primary Service Area (top zip code areas accounting for 50% of total admissions)

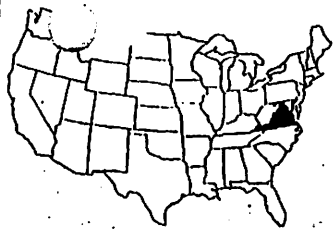
S = Secondary Service Area (zip code areas accounting for 75% of total admissions)

* This zip code contains Northern Virginia Doctors Hospital

** This zip code contains National Orthopedic and Rehabilitation Hospital

*** This zip code contains Arlington Hospital

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Section A provides the legend for this map.

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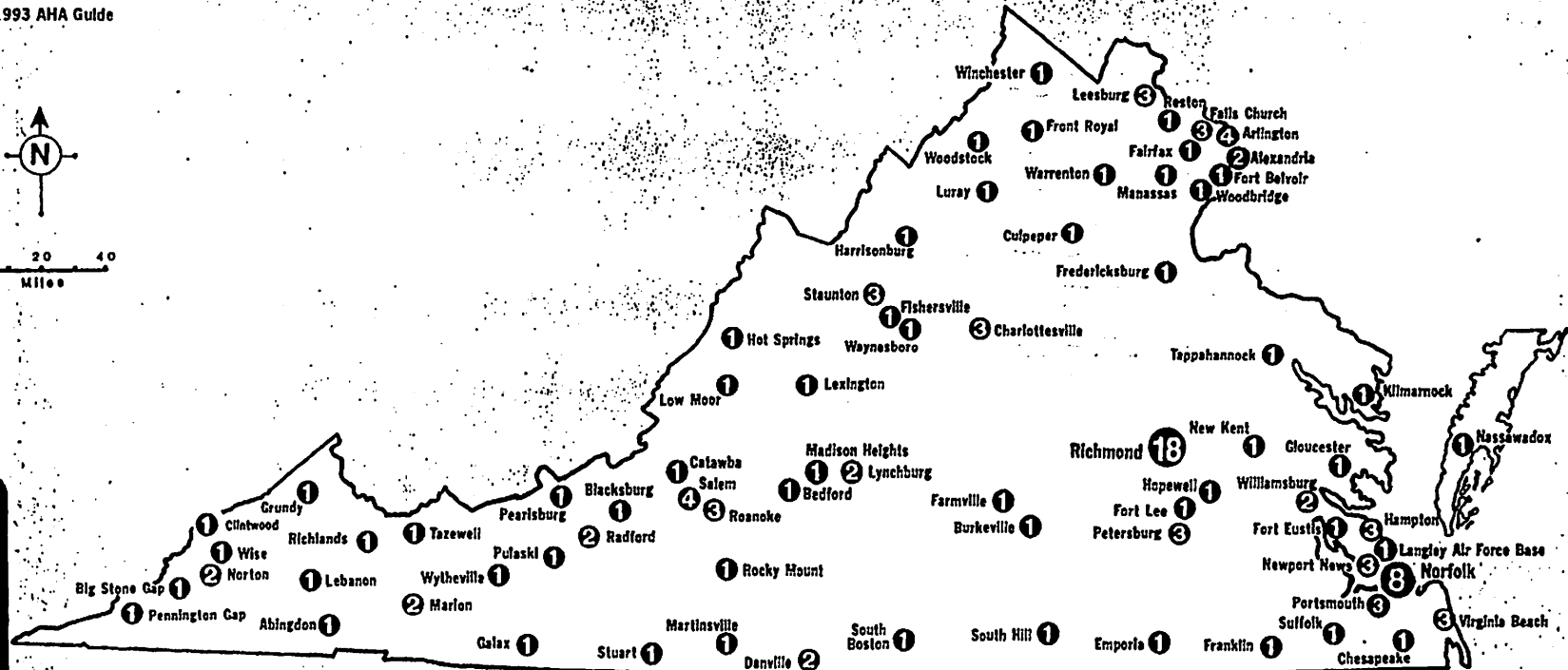
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DEPOSITION
EXHIBIT

J.A.P. 5586



APPENDIX D
Inova Hospitals
BASELINE SCENARIO

Baseline Scenario

Assumptions:

	1972	1973	1974	1975	1976	1977	1978
Legislated reductions	27/68	27/68	27/69	27/69	27/69	27/69	27/69
Organizational volume growth	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
EBTD's	21,460	21,592	21,731	21,868	22,008	22,151	22,296
Basic increases	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
Increases in allowed national/							
national payments	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Percent change conversion of							
BC + contractual to hospital	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%
Discounts granted on patients							
converting to hospital	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%
Average net patient revenues/EBTD A	\$6,003	\$6,278	\$6,560	\$6,850	\$7,146	\$7,448	\$7,754
FTE's 07% reduction in 1972)	310	310	310	310	310	310	310
Salary increases	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Supply and other inflation	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Supply and other expenses vari-							
bly with volume changes	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%
Capital expenditures (in 000's)	\$1,000	\$1,200	\$1,300	\$1,500	\$1,500	\$1,600	\$1,700

Baseline Scenario:

Assumptions:

	1972	1973	1974	1975	1976	1977	1978
EBTD's							
Legislated reductions	27/69	27/69	27/69	27/69	27/69	27/69	27/69
Organizational volume growth	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%
	22,444	22,596	22,739	22,907	23,068	23,232	23,399
Basic increases	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
Increases in allowed national/							
national payments	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%
Percent change conversion of							
BC + contractual to hospital	10.00%	10.00%	10.00%				
Discounts granted on patients							
converting to hospital	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%
Average net patient revenues/EBTD A	\$8,066	\$8,380	\$8,696	\$9,183	\$9,694	\$10,230	\$10,793
FTE's	310	310	310	310	310	310	310
Salary increases	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Supply and other inflation	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Supply and other expenses vari-							
bly with volume changes	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%	75.00%
Capital expenditures (in 000's)	\$1,800	\$1,900	\$2,000	\$2,100	\$2,200	\$2,300	\$2,400

Source: CHSAS

J.A.P.P. 5587

CONFIDENTIAL

Inova Health System

June 8, 1992

Exhibits
w/out 1(A)
1(B)
(w/out 11 also)

TO : Richard C. Magenheimer, Vice President, Financial Operations

FROM : Knox Singleton, President *KS*

SUBJECT : PROPOSAL TO DOCTOR TAUBER ON JEFFERSON HOSPITAL DEAL

What do you think about the following:

Proposal for Doctor Tauber:

1. Keep rent at current level at JH for reminder of term. Reschedule for 15 years, and reduce rent for next 5 years with the savings.
2. Transfer ownership to 1/4 of new building (3 floors) with 15 year master lease @ "x"/feet with 1/2 CPI escalators.
3. Have #1 and #2 added to the PV of the original lease payments at JH unless cannot lease.
4. At end of 15 years, they own the 1/4 of Gatehouse Road.
5. We get the 120 beds and release from any non-vested liabilities under termination of our existing lease and hold harmless on any other breach promises.

A variation that might make more sense would be to set the rate under #2 at say \$17/foot which might be large enough to reduce the current rent level at JH. This would be ideal since I figure we are \$250-500K short of breakeven on a fully costed basis with an ambulatory surgery outpatient services, and 40 bed long-term acute or SNF configuration.



Richard C. Magenheimer
June 8, 1992
Page 2

The benefits I see to us in this deal:

1. Much lower financial operating risk at JH - maximum \$1-1.5 m./year with current rent levels vs \$3-5 m. possible now. If we can get the current rents down, we may even make money.
2. Get a CON one could hardly get otherwise and entering into the Franconia market or expansion of beds at Fairfax Hospital and Fair Oaks Hospital.
3. Below market rent on 3 floors at Gatehouse Road for 3 years.

The benefits to Doctor Tauber:

1. Continuation of some healthcare services of any kind at location next to his MOB.
2. Appreciated value of 1/4 of Gatehouse Road in exchange for his CON (which has little if any value to anyone else).
3. His lease payment stream is secured.

Let's discuss ASAP.

KS:bls

CONFIDENTIAL

INOVA HEALTH SYSTEM

MEMORANDUM

TO: J. Knox Singleton, President, IHS

FROM: Richard C. Magenheimer, Vice President,
Financial Operations, IHS *RCM*

DATE: June 9, 1992

SUBJECT: Jefferson Hospital/Cambridge Court Swap

I have explored several economic scenarios whereby IHS could terminate the lease at Jefferson Hospital. The most feasible approach to termination of the Jefferson lease would be a real estate swap of some portion of the Cambridge Court property in consideration for the Jefferson property and termination of the existing hospital lease. A real estate swap is probably the only feasible approach since an outright buyout of the lease or hospital property would give rise to substantial taxable income to the Tauber partnership. In a straight cash transaction, IHS would have to pay the partnership approximately 160% of the net present value of the lease payments in order for the cash stream on the after-tax proceeds to replace the Jefferson lease payments. A real estate swap would be considered an exchange of like property which would avoid immediate taxation although there are certain complications to my approach since IHS would master lease the Cambridge Court tower at above-market rates. I am having a tax specialist look at the transaction.

The Jefferson lease payments are structured rather strangely. The following table shows the lease payment stream:

Current	\$135,417/mo
July 1992 - June 2002	\$177,083/mo
July 2002 - Sept. 2005 (est)	\$270,000/mo

Although unusual, this stream of lease payments could work to our advantage since the partnership will have to wait until July, 2002 to receive a payment increase. The increased payments in the last three years of the lease would more than be replaced economically by the appreciation on the Cambridge Court property.

IHS would swap one tower of Cambridge Court to the Tauber partnership with IHS immediately leasing back the tower through September, 2005, the term of the existing Jefferson lease. IHS would then either sublease and/or occupy the master leased tower.



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Jefferson Hospital/Cambridge Court Swap

June 9, 1992

Page Two

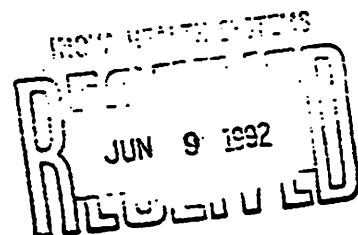
As noted above, the Jefferson monthly lease payment will increase to \$177,083 next month. This would equate to a master lease rate of \$19.14/sq ft plus operating expenses which is well above fair market value. The economics of this transaction are summarized on Schedule A. I have estimated the economic impact to Inova to be a negative \$10.2 million over the thirteen year period. According to Grubb & Ellis' valuation methodology, one tower of Cambridge Court would be worth approximately \$19 million in 2005 if 95% leased up at market rates then in effect. This appreciated asset would more than make up the lower cash stream to the Tauber partnership in the last three years of the lease term.

If the above outlined transaction were to occur, IHS would have to recognize an additional \$7 million in losses on the exchange of the properties assuming Jefferson remains open as some type of healthcare facility. While this is an accounting as opposed to an economic presentation, it nevertheless has an impact on external constituents.

I am not necessarily advocating this scenario as an offer to Tauber, however, the general approach is feasible.

Please review this material and let's discuss at your earliest convenience.

ta



INOV-01480

J.APP. 5591

SCHEDULE A

JEFFERSON HOSPITAL/CAMBRIDGE COURT SWAP

Financial Impact to Inova

**FMV/NPV
\$ 000's**

1.	Jefferson Hospital land and building, exclusive of attached MOB	\$ 3,000 (est)
2.	Hospital license (est @ \$10,000/bed)	1,200
3.	Termination of existing lease (NPV of Jefferson lease payments)	20,061
4.	IHS master lease payments (plus expenses) to Tauber partnership (NPV)	(28,200)
5.	Vacant Cambridge Court property	(6,250)
6.	Enhanced operating surplus at Jefferson	?
Total Financial Impact to Inova 1993 - 2005		<u>\$(10,189)</u>

NOTE: IHS would sublet its master leased tower which is estimated to have a \$13 million NPV. Since IHS could rent out the Cambridge Court property anyway, the impact of this event is not included in the above analysis.

Residual value?

*split lease pymt
between*

Cambridge Ct

*could be
substantially
higher*

STRICTLY CONFIDENTIAL

Inova Health System

July 31, 1992

TO : Members, Inova Health System Board of Trustees
Members, Inova Hospitals Executive Committee

FROM : Knox Singleton, President

SUBJECT : PROPOSAL TO ACQUIRE JEFFERSON HOSPITAL BUILDING AND 120-BED OPERATING LICENSE

BACKGROUND

In 1985 Inova entered into a lease of 18 years to operate Jefferson Hospital with a partnership headed by Doctor Lazlo Tauber. The lease succeeded a period of operation of the hospital by Health Group, Inc. of Nashville, Tennessee and was entered into by the Tauber partnership in lieu of competing offers from George Washington University, Georgetown University, and a number of proprietary hospital management companies to enter into similar arrangements.

The strategic rationale for this action on Inova's part was part defensive and part offensive in character. Defensively, it was felt important to preclude the entry of either of the two major competitors to Fairfax Hospital's magnet referral programs into the Northern Virginia market. Both University Medical Centers indicated to the Tauber partnership their intention of establishing satellite group practices of referral physicians at Jefferson, much as has been done by Childrens Hospital at Woodburn Road and elsewhere.

Offensively, it was believed that Jefferson could operate as a primary care catchment mechanism through its admitting physicians and emergency room to refer patients to Inova's referral programs, especially the magnet clinical programs at Fairfax, Mount Vernon and to the affiliated services such as home care, nursing homes, etc. It was also believed that a primary care base and acute care location inside the beltway would enhance the managed care contracting capabilities of the system overall with the growing customer group of contract purchasers. Finally, it was felt that Inova's influence in the facility could materially improve the quality of patient care being delivered, that the volume of indigent care rendered to the community being served by Jefferson could be increased, and that the facility could contribute financially to the overall system.



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INOVA-0587

Members, Inova Health System Board of Trustees
and Inova Hospitals Executive Committee
July 31, 1992
Page 2

THE CURRENT SITUATION

Over the last seven years, some of the objectives pursued in the leasing of Jefferson Hospital have been achieved and some have not. Perhaps most importantly, the marketplace has shifted to the point where it does not appear to management that short-term acute hospitals of 120-beds or less are viable over the long-term, and that additional investments in the necessary technology and facilities to operate the Jefferson facility as a short-term acute hospital can no longer be justified.

Strategically the control of Jefferson has fulfilled many of the objectives which were identified when the lease was initiated. Perhaps most important, the Northern Virginia market has not been penetrated significantly by the major academic medical centers. It is generally agreed that the quality of care rendered to the community has increased significantly, to some degree driven by the elimination of a number of marginally qualified physicians from the active medical staff. The volume of indigent care has also grown dramatically from a level of approximately \$40,000 prior to our involvement to over \$1.2 million, well over half of which is from Fairfax County. A substantial amount of referral business, representing well over \$1 million per year in incremental contributions to other Inova operating entities is generated annually.

At least in part because of these dynamics, the operating margins have eroded over the last three years. In 1990, Jefferson had a positive cash flow from operations while in 1991 it experienced a loss of approximately \$2 million. In 1992, losses have totalled almost \$1 million in the first five months and, more importantly, have accelerated rapidly in May and June to the point where losses would approximate \$4 to \$5 million on an annualized basis. The need for concerted action to deal with a change in the long-term operating status has become acute.

OPTIONS AVAILABLE

Since January, a task force comprised of board members, medical staff leaders and management have been examining the best uses of Jefferson Hospital over the long-term. An examination of the major options have been conducted with the assistance of National Health Advisors and Cohen, Rutherford and Blum, consultants in health care. Currently, the task force has not concluded its task regarding the best long-term use for the hospital, but has recommended that the license be purchased and flexibility be obtained to convert its service mix to the following:

1. Long-term Acute Care (80-120 beds). This would be accomplished through a sublease or joint venture arrangement with one of the national companies providing this service. Alternatively, this service could be operated by Inova if necessary. The Baltimore/Washington market area does not currently have such a specialty facility and it is felt this service can be profitably provided. At least one company has made a concrete offer to purchase the hospital or lease it for substantial amounts. This would require approximately half of the hospital building to accommodate this use.
2. Ambulatory/Outpatient Care. It appears feasible to continue to operate the outpatient services of the hospital such as laboratory, radiology, etc. The potential for a continuation of outpatient surgery is being studied at the current time. A long-term acute use of the inpatient units would generate significant amounts of ancillary services demand to augment normal ongoing outpatient demand.
3. Emergency/Urgent Care. Continuing to operate the emergency room as either a freestanding ACCESS-type facility or as an Urgent Care Center is also contemplated. This provides a patient capture mechanism for physicians associated with Inova and also generates ancillary services demand.

At its last meeting, the task force recommended to the Inova Board that management proceed to acquire the building/operating license, and that the operations of the hospital be converted to alternative feasible uses as soon as possible.

OTHER FACTORS

Three other factors deserve mention in connection with the present situation at Jefferson. First, the option to simply abandon the hospital does not exist without great risk. In our lease agreement with the Tauber Partnership, there is a positive duty by Inova to not do anything during the term of the lease that would impact negatively on the owner's operating license. Ceasing to operate the facility could create an arguable case of destroying or at least substantially diminishing the value of the operating lease since if it is not used for a 12 month period, it becomes essentially invalid under the Certificate of Public Need Law. While there is a theoretical ability to go to court to obtain a declaratory judgment of our right to abandon the facility, it is clear that that move would be resisted by the current owners and the legal battle could drag on for months or even years. Should we lose, the court could order the hospital to be

Members, Inova Health System Board of Trustees
and Inova Hospitals Executive Committee
July 31, 1992
Page 4

operated AT OUR EXPENSE for the remainder of the lease. The largest costs would be the increasing losses that would be encountered while the litigation drug on. It is reasonable to expect in such circumstances that the census would fall even further below the levels currently being experienced with attendant even larger losses.

The second factor is the potential to utilize the license by relocating it to another area, presumably a strategically important growth area with strong demographics. This is essentially the transaction that took place with Commonwealth Doctors Hospital where a poor building and location were reincarnated in a highly desirable growth area. It is fair to say that Fair Oaks is invaluable to the future prospects of the system, especially as a patient capture device for the magnet clinical programs. It is important to stress that no such opportunities have been concretely identified and that this potential benefit is not at all central in management's view to the advisability of moving forward with the proposed license acquisition.

Finally, it should be noted that a continuing effort is underway to find a way to continue to operate a small inpatient short-term acute unit in conjunction with the long-term acute inpatient program. For technical reimbursement reasons, short-term and long-term acute units cannot normally coexist in the same facility. Additionally, it is unclear that we could obtain the necessary short-term acute volume to make a positive contribution to the bottom line of a reconfigured facility. The continued operation of the short-term component could, however, have considerable value in negotiations with the state planning authorities over any bed relocation strategy, and hence may be indicated on a limited basis for a transitional period of time. Once again, this should not be thought of as central to the revised plan of operation or the rationale for the actions recommended.

FINANCIAL ANALYSIS

CURRENT FORECAST - CONTINUE OPERATIONS UNDER PRESENT LEASE

The current Jefferson lease requires Inova to operate Jefferson as an acute care hospital throughout the lease term which expires in October, 2005. Losses are forecasted at \$150 thousand per month, exclusive of the existing monthly lease payments of \$177 thousand. The present value of this stream of losses for the duration of the hospital lease is \$14.1 million. Given Jefferson's continued drop in census and its exclusion from managed care networks, operating

INOVA-05880

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losses as an acute care hospital could be substantially larger despite aggressive cost reductions. Additionally, short-term acute care operations would be the most capital intensive option Inova could pursue. Continuing acute operations under the present arrangement is simply not financially feasible.

PROPOSED TERMS FOR ACQUISITION OF JEFFERSON HOSPITAL BUILDING AND BED LICENSE

The actual legal transaction is quite complex but can be summarized as Inova receiving the Jefferson Hospital building and license in return for giving the Tauber Partnership the present value of \$20 million to repurchase the Cambridge Court building in 2005. Our price, therefore for the building and license is \$6.9 million.

Specifically, Inova would acquire the Jefferson Hospital building, bed license, and land rights for \$12.7 million. Inova would simultaneously sell Cambridge Court to the Tauber partnership for \$12.7 million and master lease back Cambridge Court from the partnership for twenty years under the following financial terms:

- a. Year 1-13 IHS would pay the existing lease payments on Jefferson Hospital (approximately \$2.1 million/year).
- b. Year 14-20 IHS would pay \$3 million per year.
- c. The master lease of Cambridge Court would be on a "triple-net" basis, i.e. Inova would be responsible for all operating expenses and taxes on the office building.
- d. In October, 2005 IHS may exercise an option to acquire Cambridge Court for the greater of 50% of fair market value or \$20 million, whichever is greater. It is anticipated in this analysis that IHS will exercise this option. The present value of \$20 million is \$6.9 million.

By acquiring Jefferson Hospital and its bed license, Inova would be relieved of the obligation to continue operating the hospital as a short-term acute care facility and could implement alternative services.

Inova has received a proposal from Integrated Health Services, an operator of extended acute care facilities, to lease Jefferson for a five year period. While negotiations are in progress with Integrated, their initial offer is for Inova to receive \$60 thousand

Members, Inova Health System Board of Trustees
and Inova Hospitals Executive Committee
July 31, 1992
Page 6

per month for use of Jefferson and a percentage of Integrated's operating profit. We would also provide certain ancillary services (laboratory, radiology, etc.) to Integrated's patients from the hospital's outpatient operations on campus. This arrangement with Integrated would complement our plan to convert Jefferson to an outpatient facility offering urgent care and diagnostic services. Since the Integrated lease would be five years in duration, Inova would still own the hospital license and have control of the beds at the end of the lease term.

The economics of this plan are shown on the Attached "Exhibit A." All amounts reflect present values of cash flows and residual values. IHS projects the proposed plan will have a \$828 thousand positive contribution. Continuing to operate Jefferson as an acute care hospital has been forecasted to cost Inova over \$14 million.

SUMMARY

It is requested that management be authorized to execute the necessary contractual agreements to implement the plan of action outlined above, subject to satisfactory due diligence review.

KS:bls

INOVA HEALTH SYSTEM
JEFFERSON HOSPITAL ACQUISITION ANALYSIS
PRESENT VALUE ANALYSIS (Note 1)
(Dollars in Thousands)

EXHIBIT A

CURRENT FORCAST - CONTINUE OPERATIONS AT JEFFERSON UNDER PRESENT LEASE

Continued Cash Operating Losses/Capital Investment
from Acute Care Activities (Note 2)

(\$14,173)

PROPOSED PLAN - ACQUISITION OF JEFFERSON HOSPITAL BUILDING AND BED LICENSE

Contribution from five year agreement with Integrated Health Services	\$4,204
Contribution from other Outpatient Services	940
Additional activity at Fairfax Hospital from discontinuation of acute care at Jefferson (Note 3)	1,522
Residual Value of Bed License (Note 4)	3,999
Residual Value of Jefferson Hospital Building and land lease	1,333
Reacquisition of Cambridge Court in 2005 (Note 5)	(6,967)
	<u>\$828</u>

NOTES:

1. Amounts shown are all present values
2. Assumes \$150,000/ month in cash losses exclusive of lease payments, thru Sept, 2005, the termination date of the current Jefferson lease
3. Assumes 5 patients per day will be recaptured at Fairfax Hospital from discontinued acute care services at Jefferson
4. Estimated at \$50 thousand/bed in 1992 discounted for 5 years
5. Assumes IHS exercises its bargain purchase option to acquire Cambridge Court in 2005 for \$20 million

INOVA-05883

JAPP. 5599



EXHIBIT A

411 Braddock Road
Alexandria, Virginia 22301
703-291-1111

Kenneth S. Simpson
President

October 14, 1992

Laszlo N. Tauber, Trustee and
Managing Partner
Jefferson Memorial Hospital Joint Venture
4600 King Street
Suite 2C
Alexandria, Virginia 22302-9988

Re: Binding Letter Agreement on Jefferson Hospital

Dear Dr. Tauber:

We have had recent discussions with you in your capacity as Managing General Partner of Jefferson Memorial Hospital Joint Venture ("JMHJV") concerning the Jefferson Hospital facility as it is currently operated and have engaged in a lengthy course of negotiations as to how JMHJV might permit such a change. As you are aware, a number of issues have arisen which preclude currently closing the discussed transaction which would essentially constitute an exchange of Cambridge Court for Jefferson Hospital.

Problems have arisen which preclude a current consummation of the discussed transaction. Accordingly, if you agree to the terms of this binding letter agreement, Inova will consummate and close the exchange transaction described herein subject to the terms of this letter. The closing of the exchange transaction will occur as soon as you are able to convey the JMHJV Property as described herein to Inova, with good and marketable title, free of liens and insurable. If the premium is more than at regular rates, JMHJV will pay the difference.

As a condition to this agreement, JMHJV agrees to any one of the following four options:

1. Inova in its absolute discretion and without any restriction regarding continuing any use of the facility, may modify the present use of Jefferson Hospital, and in the event such change necessitates any change in the licensure or the Certificate of Public Need, you agree that Inova may take any and all such necessary action to accommodate those requirements

A. Trademark of Inova Health System

INOVA-01450

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Laszlo N. Tauber
October 14, 1992
Page 2

including without limitation a change or termination of either the license or the Certificate, and JMHJV agrees not to oppose those efforts in any way.

2. You consent to allow the operation of the Jefferson Hospital facility immediately to be halted.

3. You consent to a change in use of the Jefferson Hospital facility to any other commercial use consistent with zoning and similar restrictions.

4. You consent to a sublease of Jefferson Hospital to any commercially reasonable subtenant.

Notwithstanding anything else contained in this Agreement, the 1985 Jefferson Hospital Lease and side letters shall continue in full force and effect until the earlier of the expiration of the 1985 Jefferson lease or the consummation of the exchange transaction except those provisions which by their terms survive expiration and except that no provision shall affect or limit in any way the four options set forth above.

For purposes of this letter agreement the properties defined as the "JMHJV Property" and the "Inova Property" are more particularly described in Attachment C.

At such time as JMHJV is able to convey to Inova the JMHJV Property as aforesaid, the following transaction will occur:

A. Inova shall participate in an exchange with JMHJV whereby Inova will take all necessary actions which will result in JMHJV acquiring the Inova Property with good and marketable title, free of liens and insurable (and if the premium is more than at regular rates, Inova will pay the difference) and whereby JMHJV will take all necessary actions which will result in Inova acquiring the JMHJV Property as aforesaid.

B. JMHJV and Inova shall enter into a lease agreement between JMHJV as landlord and Inova as tenant for the Inova Property for the term and rental and containing the options described in Attachment A.

C. JMHJV and Tauber/Trustee will lease to Inova and Inova will lease or sublease from JMHJV and Tauber/Trustee the land constituting Alexandria tax map parcels 3.00-2-1, 3.00-2-3, 3.00-2-4, 3.00-2-5, 3.00-2-6 and 3.00-2-7, excluding the buildings and the land underlying the buildings located thereon, for ninety nine (99) years on a triple net basis with an annual base rent of \$1.00 per year with shared parking with others except that Inova

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Laszlo N. Tauber
October 14, 1992
Page 3

shall pay JMHJV \$750.00 per month to rent certain parking spaces in the Beauregard Building until September 30, 2005. The sublease of 3.00-2-3 shall expire on September 13, 2061.

D. Inova shall lease from JMHJV and/or Tauber/Trustee and JMHJV and Tauber/Trustee shall lease to Inova Suites 2E, 2D, 4J and 6P in the medical office building at 4600 King Street on a triple net basis for \$75,000.00 per year until September 30, 2005.

E. Inova shall lease the third floor of the medical office building from JMHJV on a triple net basis for \$1.00 per year for 99 years and shall purchase it for \$1.00 at such time as it is created as a separate condominium unit.

F. JMHJV shall have the option (exercisable within three months of when Inova exercises its option to purchase the Inova Property) to purchase the JMHJV Property at the price and terms set forth on Attachment B.

If you are in agreement with the terms of the foregoing binding letter agreement and Attachments A through G, we request that you indicate your agreement by signing below. Our signatures hereto will irrevocably bind us to all of the terms and conditions of this letter agreement and attachments. This letter has been delivered to you in duplicate executed originals. Upon execution, please return one completely executed copy to us.

Very truly yours,

Inova Hospitals

Witness: Barant L. Fake
Barant L. Fake

By: C. Michael French
President

Inova Health System

Witness: Barant L. Fake
Barant L. Fake

By: J. Knox Singleton
President

INOVA-0:

J.APP. 5602

Laszlo N. Tauber
October 14, 1992
Page 4

The undersigned accepts and agrees to the terms of the foregoing binding letter agreement.

Jefferson Memorial Hospital Joint
Venture

Witness: He. F. Hall

By: Laszlo N. Tauber

Laszlo N. Tauber, Managing Partner

and

Witness: He. F. Hall

Laszlo N. Tauber/Trustee

INOVA-014

J.APP. 5603

ATTACHMENT A

The lease shall be for a period of twenty (20) years with four (4), five (5) year renewal options, provided Inova gives written notice no later than twelve (12) months prior to the expiration of the initial term of the lease and each subsequent renewal term. The lease shall be a triple net lease with Inova agreeing to pay JMHJV an initial annual base rent of \$2,050,000.00 per annum payable in advance in equal monthly installments of \$170,833.33 (rounded to the nearest cent) without previous demand therefor, on the first day of each calendar month through June 30, 2002. Effective July 1, 2002 through September 30, 2005, the annual base rent payable in monthly installments in advance shall be adjusted annually to (i) \$2,000,000.00 per annum plus (ii) an amount equal to \$2,000,000.00 per annum multiplied by 1/2 of the cumulative percentage increase in the cost of living as measured by the Consumer Price Index, 1982-4 equals 100 of the U.S. Department of Labor CPI (U) (Washington D.C., M.D., V.A.) from July 1985 to March of the year of the adjustment plus \$50,000.00. Effective October 1, 2005 through September 30, 2012, the annual base rent shall be \$3,000,000.00 per annum payable in advance, in equal monthly installments of \$250,000.00 without previous demand therefore, on the first of each calendar month. Effective October 1, 2012, during the balance of the term of the Inova Property Lease and any extension thereof, the annual base rent payable in monthly installments in advance shall be adjusted annually to (i) \$3,000,000 per annum plus (ii) an amount equal to \$3,000,000 per annum multiplied by one-half of the cumulative percentage increase in the cost of living as measured by the same CPI from July 2005 to March of the year of the adjustment. At all times during the term of the Inova Property Lease and any extensions thereof, including the option periods for both the Inova and JMHJV Properties, Inova shall be responsible at its expense (1) for all tenant build-outs, which shall conform to the first class office space standards in the Washington, D.C. metropolitan area and (2) keeping both the JMHJV Property and the Inova Property in good order and shall make all repairs and replacements, structural and nonstructural and shall keep all building systems including mechanical, electrical and plumbing in good working order. In addition, Inova shall have the right to purchase the Inova Property free and clear of all liens and with good and marketable title, insurable at regular rates, for \$20,000,000 or 50% of the fair market value, whichever is greater, on October 1 of the following years: 2005, 2012, 2017, 2022, 2027 or 2032, provided Inova notifies JMHJV in writing at least twelve (12) months prior to such dates specified above. If the parties cannot agree on the fair market value then the fairmarket value shall be determined as follows: Inova and JMHJV shall each hire an MAI appraiser to appraise the Inova Property and if the appraisers are unable to agree between them as to the fair market value and their opinions of the fair market

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INOVA-01454

J.APP. 5604

value vary 10% or less from each other then the average of the two shall be the fair market value. If the two appraisers' opinions of fair market value vary from each other more than 10%, then the two appraisers shall pick a third appraiser whose fees will be split equally by the parties, and the third appraiser will be asked to decide the fair market value which will not be lower than the lowest appraisal nor higher than the highest appraisal. At the request of Inova, for a period of two years immediately following Closing, JMHJV or Tauber/Trustee shall not record any mortgage on the Inova property, and the Inova Property Lease shall not be recorded among the land records of Fairfax County, Virginia. After said two year period, JMHJV has the right to place a deed of trust on the Inova Property in an amount not to exceed \$16,000,000 (interest and principal included).

ATTACHMENT 8.

The option price shall be the greater of the real estate tax assessment value of the JMHJV property or the fair market value of the JMHJV property less the value attributable to any licensed beds therein. If the parties cannot agree on the fair market value then the fair market value shall be determined as follows: Inova and JMHJV shall each hire an MAI appraiser to appraise the JMHJV property and if the appraisers are unable to agree between them as to the fair market value and their opinions vary either 10% or less from each other then the average shall be the fair market value. If the two appraisers opinions vary from each other more than 10% than the two appraisers shall pick a third appraiser whose fee shall be split equally between the parties and the two appraiser shall be asked to decide the fair market value which shall not be lower than the lowest appraisal nor higher than the highest appraisal. The parties agree that if JMHJV exercises its option to purchase the JMHJV Property then in such an event, the land leases and subleases between the parties for the land identified by the tax map numbers described herein shall be terminated.

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J. APP. 5606

ATTACHMENT C

For the purposes of this Agreement, the Hospital Building and the MOB Third Floor, and all appurtenances, beneficial easements relating to the operation and use of the Hospital Building and the MOB Third Floor, including but not limited to, fixtures, equipment and personal property owned by JMHJV and Tauber/Trustee and used in the operation and ownership of the Hospital Building and the MOB Third Floor, and all JMHJV's or Tauber/Trustee's materials stored therein, all warranties, guaranties, licenses, permits and certificate(s) of public need, bonds, claims and rights, if any, running to or assigned to JMHJV and/or Tauber/Trustee in connection with the construction, maintenance or operation of the Hospital Building or any component thereof, all of JMHJV's and/or Tauber/Trustee's rights, title and interest in and to any drawings, plans, specifications, surveys, manuals and contracts, if any, relating to the construction of the Hospital Building, and all certificates of operation, use and occupancy of the Hospital Building and the MOB Third Floor shall be collectively referred to herein as the "JMHJV Property".

Inova is the owner of certain real property located in Fairfax County, Virginia, known as Tax Map No. 49-4-001-28B ("Cambridge Land"), and is the owner of a multi-story office building and parking structure and all other improvements erected thereon known by street address as 8110 Gatehouse Road, Falls Church, Virginia, having Tax Map No. 49-4-001-28B ("Cambridge Building").

For the purpose of this Agreement, the Cambridge Land, the Cambridge Building, all related improvements, appurtenances, beneficial easements and rights of way over the Cambridge Land and the adjacent land, rights in adjacent alleys and streets, fixtures, equipment and personal property used in the operation and ownership of the Cambridge Building and related improvements including without limitation, all Inova's materials stored in the Cambridge Building and in or on the Cambridge Land, all warranties, guaranties, bonds, claims and rights running to or assigned to Inova in connection with the construction, maintenance or operation of the Cambridge Building and any component thereof and any related improvement, all of Inova's rights, title and interest in and to any drawings, plans, specifications, surveys, manuals and contracts relating to the construction of the Cambridge Building and all related improvements, and all certificates of operation, use and occupancy of the Cambridge Building and all related improvements shall be collectively referred to herein as the "Inova Property".

INOVA-014

C-1

J.APP. 5607

ATTACHMENT D

The parties agree that within 30 days following the date of this agreement that Inova shall execute a deed conveying the Inova Property to JMHJV, and JMHJV shall execute a deed conveying the JMHJV Property to Inova, and the parties shall deliver said deeds to Real Title Company to be held in escrow pending the clearing of title to the JMHJV Property.

INOVA-014

D-1

9/11
J.APP. 5608

ATTACHMENT E

Parking on the ground leased by Inova from JMHJV or Tauber/Trustee shall be in accordance with the City of Alexandria zoning laws, and said parking shall be shared or cooperative, that is parking shall not be assigned. Inova shall be entitled to charge for the parking at rates which are normal in the area and Inova shall be entitled to all income arising therefrom except that each tenant or owner in the Medical Office Building or Beauregard Building shall be entitled without charge to use one parking space per owner or tenant. At all times during the ground lease, Inova shall be responsible at its sole expense for all taxes, insurance, repairs and replacements.

ATTACHMENT F

During the term of the ground lease JMRJV and Tauber/Trustee shall cooperate with Inova in obtaining special use permits for the hospital building and third floor of the Medical Office Building as long as the proposed use will not result in the loss of the present commercial zoning on the ground.

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INOVA-0

9/14

JAPP. 5610

ATTACHMENT G

This Agreement may be assigned, in whole or in part, by any party hereto.

All terms, conditions, agreements and obligations hereunder shall be binding upon and inure to the benefit of the parties hereto and their respective legal representatives, successors and assigns.

AMENDED

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INOVA-0146

J.APP. 5611

EXTENSION AGREEMENT

THIS EXTENSION AGREEMENT is made this 13th day of November, 1992 by and between INOVA HOSPITALS and INOVA HEALTH SYSTEM (collectively "hereinafter "Inova"), JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE (hereinafter JMHJV"), and LASZLO N. TAUBER, TRUSTEE as Trustee for JMHJV (hereinafter "Tauber, Trustee").

WHEREAS, the parties entered into a Binding Letter Agreement dated October 14, 1992 and wish to extend the deadline for delivering deeds to escrow and clarify certain provisions of the Agreement among them;

NOW THEREFORE, in consideration of the sum of \$10.00 paid each to the other and other valuable consideration the parties do hereby agree as follows:

1. Attachment D to the Binding Letter Agreement between the parties dated October 14, 1992, is hereby amended in its entirety and replaced with the following language:

ATTACHMENT D

On or before December 18, 1992, JMHJV shall execute a deed conveying the Jefferson Hospital Building portion of the JMHJV Property to Inova, and shall deliver said deed to Real Title Company to be held in escrow pending the clearing of title to the JMHJV Property. Within five (5) business days following delivery of the Jefferson Hospital Building Deed to Real Title Company, Inova shall execute a deed conveying the Inova Property to JMHJV and shall deliver said deed to Real Title Company to be held in escrow pending clearing of the title to the JMHJV Property. Closing shall occur promptly following the date on which the JMHJV Property title is cleared and all other documents contemplated by the Binding Letter Agreement have been executed and delivered to Real Title Company. Closing will not be contingent on or delayed until the third floor of the Medical Office Building becomes a condominium. The parties acknowledge and agree that the Medical Office Building will be made subject to a condominium regime, and the deed to the third floor of the Medical Office Building shall be delivered to Inova by JMHJV promptly after the date on which the condominium regime takes effect pursuant to law. JMHJV agrees to proceed with the creation of the condominium regime in a diligent and expeditious manner.

IN WITNESS WHEREOF the parties have executed this Extension Agreement as of the date first above written in two counterparts each of which shall be considered an original.

WITNESS:

Barry K. Fuku

INOVA HOSPITALS

By: C. Michael French
C. Michael French, President

INOVA-01462

WITNESS:

Robert L. Felt

INOVA HEALTH SYSTEM

By: J. Knox Singleton, President

WITNESS:

Laszlo N. Tauber

JEFFERSON MEMORIAL HOSPITAL JOINT
VENTURE

By: Laszlo N. Tauber, Managing Partner

WITNESS:

Laszlo N. Tauber

Laszlo N. Tauber
LASZLO N. TAUBER, TRUSTEE

INOVA-0146

J.APP. 5613

SECOND
EXTENSION AGREEMENT

THIS SECOND EXTENSION AGREEMENT is made as of this 17th day of December, 1992 by and between INOVA HOSPITALS and INOVA HEALTH SYSTEM (collectively "hereinafter "Inova"), JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE (hereinafter "JMHJV"), and LASZLO N. TAUBER, TRUSTEE as Trustee for JMHJV (hereinafter "Tauber, Trustee").

WHEREAS, the parties entered into a Binding Letter Agreement dated October 14, 1992, and an Extension Agreement dated November 13, 1992 and now wish to extend the deadline again for delivering deeds to escrow;

NOW THEREFORE, in consideration of the sum of \$10.00 paid each to the other and other valuable consideration the parties do hereby agree as follows:

1. Attachment D to the Binding Letter Agreement between the parties dated October 14, 1992, as amended by the Extension Agreement dated November 13, 1992 is hereby amended as follows:

ATTACHMENT D

On or before January 29, 1993, JMHJV shall execute a deed conveying the Jefferson Hospital Building portion of the JMHJV Property to Inova, and shall deliver said deed to Real Title Company to be held in escrow pending the clearing of title to the JMHJV Property. Within five (5) business days following delivery of the Jefferson Hospital Building Deed to Real Title Company, Inova shall execute a deed conveying the Inova Property to JMHJV or its designee and shall deliver said deed to Real Title Company to be held in escrow pending clearing of the title to the JMHJV Property. Closing shall occur promptly following the date on which the JMHJV Property title is cleared and all other documents contemplated by the Binding Letter Agreement have been executed and delivered to Real Title Company. Closing will not be contingent on or delayed until the third floor of the Medical Office Building becomes a condominium. The parties acknowledge and agree that the Medical Office Building will be made subject to a condominium regime, and the deed to the third floor of the Medical Office Building shall be delivered to Inova by JMHJV promptly after the date on which the condominium regime takes effect pursuant to law. JMHJV agrees to proceed with the creation of the condominium regime in a diligent and expeditious manner.

2. The Binding Letter Agreement dated October 14, 1992 as amended by the Extension Agreement dated November 13, 1992 as further amended by this Second Extension Agreement remains in full force and effect and is ratified and confirmed by the parties.

INOVA-01464

J.APP. 5614

IN WITNESS WHEREOF the parties have executed this Second Extension Agreement as of the date first above written in two counterparts each of which shall be considered an original.

WITNESS:

Barrett L. Fabe

INOVA HOSPITALS

By: C. Michael French
C. Michael French, President

WITNESS:

Barrett L. Fabe

INOVA HEALTH SYSTEM

By: J. Knox Singleton
J. Knox Singleton, President

WITNESS:

L. N. Tauber

JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE

By: L. N. Tauber
L. N. Tauber, Managing Partner

WITNESS:

L. N. Tauber

L. N. Tauber
LASZLO N. TAUBER, TRUSTEE

V I R G I N I A:

IN THE CIRCUIT COURT FOR THE CITY OF ALEXANDRIA :

INOVA HEALTH SYSTEM HOSPITALS,
et al.,
Petitioners,

v.

THE JEFFERSON MEMORIAL HOSPITAL
JOINT VENTURE,
et al.,
Defendants.

At Law No. CL 930607

SETTLEMENT AGREEMENT

This Settlement Agreement ("Settlement Agreement") is made on July 11, 1994 by and between INOVA HEALTH SYSTEM FOUNDATION and INOVA HEALTH SYSTEM HOSPITALS (collectively, "Inova") and LASZLO N. TAUBER, TRUSTEE and JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE (collectively, "JMHJV").

WHEREAS, the parties are litigants in a declaratory judgment action pending in the Circuit Court for the City of Alexandria, Virginia styled Inova Health System Hospitals, et al., Petitioners v. Jefferson Memorial Hospital Joint Venture et al., Defendants, Law No. CL930607, and

WHEREAS, the parties have agreed to settle the pending litigation on the terms set forth herein.

NOW THEREFORE, in consideration of the mutual promises and covenants herein contained and other good and valuable consideration, the sufficiency of which is acknowledged and agreed to, the parties agree as follows:

1. On the first day of each month, commencing on August 1, 1994, through June 1, 2002, Inova will pay to JMHJV the sum of One



Hundred Seventy-Seven Thousand Eighty-Three and 33/100 Dollars (\$177,083.33). On the first day of each month, commencing on July 1, 2002, through September 1, 2005, Inova will pay to JMHJV the sum of Two Hundred Thirteen Thousand Five-Hundred Forty-One and 67/100 Dollars (\$213,541.67). The foregoing payments shall be made by Inova without set-off, notice, demand or otherwise and a failure to pay any of the said monthly sums on a timely basis shall constitute a breach sufficient to permit JMHJV, at JMHJV's option, to accelerate all future payments due on account thereof, provided however, that upon any alleged default, JMHJV shall give thirty (30) days' written notice to Inova and the opportunity to cure the alleged default before accelerating payments hereunder. Inova shall be entitled to cure a default by payment of the monthly payment due, plus five percent (5%) penalty, within said thirty (30) day period after receipt of written notice. Acceptance by JMHJV of any of the foregoing payments following the due date shall not constitute a waiver by JMHJV of its right to demand timely payment at any time thereafter. The payments pursuant to this paragraph shall be assignable by JMHJV by written notice to Inova.

2. The payments referred to in Paragraph 1 shall be secured by an irrevocable letter of credit from a commercial bank in the amount set forth below, reasonably acceptable to the parties, which letter of credit shall be renewed annually by the issuing institution through October 31, 2005; provided however, that should the issuing institution be unable to provide renewal through such term, then the letter of credit shall not expire without the issuer having given JMHJV at least thirty (30) days prior written notice and such failure to renew shall constitute a default permitting

JMHJV to present the letter of credit for payment thereunder. In lieu of a letter of credit, at the option of Inova, Inova may place cash or United States Treasury Securities ("Substitute to Letter of Credit") of an equal amount with an independent escrow agent or trustee as security for the payments required by Paragraph 1. During the period of August 1, 1994 through June 30, 2002, the amount of the letter of credit or Substitute to Letter of Credit shall be Two Million One Hundred Twenty-Five Thousand Dollars (\$2,125,000.00) and during the period of July 1, 2002 through October 31, 2005, the amount of the letter of credit or Substitute to Letter of Credit shall be Two Million Five Hundred Sixty-Two Thousand Five Hundred Dollars (\$2,562,500.00). Subject to the notice required in Paragraph 1 hereof, the only condition precedent for presentation of the letter of credit or demand upon the escrow agent or trustee for the Substitute to Letter of Credit by JMHJV and payment thereunder by the issuing institution, escrow agent or trustee shall be a certificate presented by a representative of JMHJV stating that a default shall have occurred under payment hereunder. The calling of the letter of credit or demand for the Substitute to Letter of Credit shall be applied to payments currently due and shall not constitute a default entitling JMHJV to accelerate all future payments provided the letter of credit is replaced for the next succeeding year. Inova shall pay all costs, if any, associated with maintenance of the escrow facility or trustee. The interests of JMHJV in the letter of credit or Substitute to Letter of Credit hereunder shall be assignable by JMHJV by written notice to Inova and the institution issuing the letters of credit or to the trustee or escrow agent (as applicable).

1. On October 1, 2005, Inova will pay to JMHJV the sum of Ten Million Dollars (\$10,000,000.00), without set-off, notice, demand or otherwise. The said Ten Million Dollar (\$10,000,000.00) obligation of Inova to JMHJV shall be secured by a deed of trust and security agreement in a commercially-acceptable form commonly in use in Northern Virginia recorded as a first lien priority among the land and financing records of Inova's improved real property known as "Cambridge Court" having a post office address of 8110 Gatehouse Road, Falls Church, Virginia 22042 ("Cambridge Court").

The Ten Million Dollar (\$10,000,000.00) payment by Inova to JMHJV and JMHJV's interest in the deed of trust and security agreement pursuant to this paragraph shall be assignable by JMHJV by written notice to Inova. Inova shall use its best efforts to obtain from all current tenants at Cambridge Court customarily-acceptable subordination agreements subject to provisions of appropriate non-disturbance agreements by JMHJV to protect rights of tenants under the leases in the event of foreclosure, which agreements shall subordinate any rights of the tenants to the lien of the deed of trust securing the Ten Million Dollar (\$10,000,000.00) obligation. The deed of trust and security agreement shall provide that it shall become immediately due and payable upon transfer of any interest in the Cambridge Court property, whether the same shall be consummated either directly or indirectly, unless Inova shall have provided substitute security as set forth below. Inova shall have the right, at any time upon prior notice to JMHJV, to release the deed of trust and security agreement and, in consideration thereof, Inova shall provide to JMHJV substitute security, reasonably acceptable to JMHJV, in the form of a first lien deed of trust on

real property of reasonable value, cash or cash equivalent or a letter of credit. JMHJV shall have the right to name the trustees under the deed of trust. All costs and fees associated with the recordation of the said deed of trust and security agreement shall be borne by Inova.

4. JMHJV shall make no application for a new license or certificate of public need ("COPN") for the Jefferson Hospital facility until either the earlier of January 1, 1995 or upon such date the Commonwealth of Virginia administrative authorities have ruled on Inova's application to transfer the existing acute care licenses and COPN for Jefferson Hospital. JMHJV shall execute a written acknowledgment, not later than July 15, 1994, addressed to the appropriate State authorities, acknowledging Inova as the owner of the existing Jefferson Hospital license and operator of the Jefferson Hospital facility since July 1985 and that Inova has the right to file an application to relocate or transfer the acute care beds, the operating rooms and any other services and certifications for equipment authorized by the Virginia Certificate of Public Need Program. JMHJV agrees to take no action, either directly or indirectly, to interfere with or oppose these applications.

5. Inova agrees that JMHJV, its successors and assigns, shall have the right on January 1, 1995 or such earlier date as set forth in Paragraph 4, to apply for any COPN or license to operate at Jefferson Hospital any type of medical or surgical facility, including, but not limited to, acute care, extended care, extended acute care, ambulatory, outpatient surgery, nursing home, operating rooms, emergency room services or similar medical or surgical

facilities. Inova agrees to take no action, either directly or indirectly, to interfere with or oppose these applications.

6. The parties agree to dismiss with prejudice all claims, counterclaims and crossclaims actually raised or which could have been raised in the present action, with each party to bear its own costs and attorneys fees and expert witness fees.

7. The parties agree to dismiss with prejudice all claims, counterclaims and crossclaims actually raised or which could have been raised in the case styled The Jefferson Memorial Hospital Joint Venture and Lazzlo N. Tauber, Plaintiffs v. Inova Health System Hospitals and Inova Health System Foundation, Defendants, Civil Action No. 94-811-A, presently pending in the United States District Court for the Eastern District of Virginia with each party to bear its own costs and attorneys fees and expert witness fees.

8. The parties to the present action shall execute mutual and general releases, including but not limited to releasing and discharging each party, their agents and employees, assigns, successors, and affiliates from all claims, suits or liabilities arising in the above captioned ligation or in Civil Action No. 94-811-A (E.D. Va.) or which could have been brought in either case, excepting the obligations and claims arising under this Settlement Agreement and excepting the current lease between The Tauber Foundation, Inc. and Inova and the liabilities of any tenants for operating expenses and utilities incurred by Inova.

9. The lease executed between the parties for the Jefferson Hospital dated July 3, 1985 shall be terminated and the parties shall confirm the same in a lease termination agreement, executed

in recordable form for recordation among the City of Alexandria, Virginia land records.

10. The parties hereby confirm that the lease executed between Jefferson Memorial Hospital Corporation (now known as Jefferson Corporation of Alexandria) and Health Group of Virginia, Inc. dated February 11, 1982 was terminated upon the execution of the July 3, 1985 lease between the parties, which 1985 lease is terminated pursuant to the preceding paragraph; a confirmation of termination shall be executed in recordable form for recordation among the City of Alexandria, Virginia land records.

11. The Binding Letter Agreement executed by the parties on October 14, 1992 shall be terminated.

12. Inova agrees to cooperate with JMHJV in all of JMHJV's efforts to ensure that title is clear to the real property and improvements located at King and Beauregard Streets, Alexandria, Virginia. Such cooperation shall include, but not be limited to, execution of a quitclaim deed, execution of a consent to quiet title and withdrawal of Inova's pending motion to quash service by publication in the equity suit styled The Jefferson Memorial Hospital Joint Venture and Laszlo N. Tauber, Trustee v. Parties Unknown, Circuit Court for the City of Alexandria, Chancery No. CH 940618. Inova also agrees to fully cooperate with JMHJV concerning the inquiry made by the Attorney General of Virginia so that such matter may be resolved quickly and expeditiously. Inova further agrees to cooperate with JMHJV in all of JMHJV's dealings with any and all governmental entities referring or relating to the transfer of interests from Jefferson Memorial Hospital, Inc. to Jefferson Memorial Hospital Corporation. Nothing contained herein shall be

construed to require Inova to engage in litigation to clear title to the real property and improvements.

13. The parties agree that the equipment that is currently at Jefferson Hospital shall remain thereon and shall remain the sole property of JMHJV.

14. Inova agrees to pay upon demand and remain liable for the expenses of Jefferson Hospital including taxes, insurance and utility expenses through and until December 31, 1994.

15. Subject to approval by the Court, the parties agree that the record in this case shall be sealed by the Court and shall be kept confidential and shall not be disclosed to any third parties. The parties also agree that the terms of this Settlement Agreement are, and shall remain, confidential. The parties agree not to disclose the terms of this Settlement Agreement to third parties. In addition, it is agreed that the parties, their respective counsel, and their experts will execute appropriate confidentiality assurances. The parties further agree that this Settlement Agreement shall be filed under seal with the Court and shall be kept confidential and not disclosed to any third parties.

16. The parties agree that the facts developed in this action are, and shall remain, confidential. The parties agree not to disclose any facts developed in this litigation to third parties. The parties further agree that they, their counsel, and their experts will execute appropriate confidentiality assurances. The parties further agree that, immediately upon the execution of this Settlement Agreement, and no later than two (2) days after its execution, Inova will return to JMHJV's counsel all documents produced to Inova in response to discovery requests within the

possession, custody and control of Inova, its counsel, and its experts. Inova agrees that all work product documents within the possession, custody and control of Inova, its counsel (to the extent it pertains to proprietary, confidential and/or financial JMHJV information) and Inova's experts shall be destroyed immediately upon the execution of this Settlement Agreement, and no later than two (2) days after its execution. For purposes of this Paragraph, the word "documents" shall have the broad meaning ascribed to it in Rule 34 of the Federal Rules of Civil Procedure.

17. In the event Inova, its counsel or any of its expert witnesses in this matter receive a document request or any subpoena requesting production of documents or testimony concerning any of the matters that are prohibited from disclosure hereunder, Inova shall promptly notify JMHJV in writing and provide a copy of the request or subpoena. Within the time permitted for Inova, its counsel or its experts to respond to the request or subpoena, JMHJV may take such steps as it deems appropriate to challenge the information or testimony requested. During the pendency of any challenge, Inova, its counsel or its expert witnesses will not produce any documents, information or testimony, unless ordered by the Court to do so. Notwithstanding anything contained herein to the contrary, Inova shall have the right to make necessary and appropriate disclosures in financial statements.

18. The parties agree that this Settlement Agreement may be enforced by specific performance. In the event that either party shall breach any term hereof, the breaching party shall bear all reasonable costs and attorneys' fees of the nonbreaching party in the enforcement of this Settlement Agreement.

19. Any notices to be given hereunder shall be deemed to be given if hand-delivered, sent by certified mail (return receipt requested) or by any reputable next business day courier service as follows:

If to JMHJV, then to: Jefferson Memorial Hospital Joint Venture, Attn: Laszlo N. Tauber, M.D., 4600 King Street, Alexandria, VA 22302 with copies to: Comptroller, Westwood Management Corporation, 5110 Ridgely Road, Bethesda, MD 20816 and Gaspare J. Bono, Esq., Howrey & Simon, 1299 Pennsylvania Ave., N.W., Washington, D.C. 20004.

If to Inova, then to: Inova Health System Foundation and Inova Health System Hospitals, Attn: Chief Financial Officer, 8001 Braddock Road, Springfield, VA 22153 with a copy to Marc Bettius, Esq., Miles & Stockbridge, 11350 Random Hills Road, Suite 500, Fairfax, VA 22030.

Either party may change its address provided above by written notice to the other party.

20. This Settlement Agreement is binding upon, and shall inure to the benefit of the parties, their agents and employees, their heirs, successors, affiliates, assigns, parents, subsidiaries and others.

21. The law of the Commonwealth of Virginia shall govern the construction and interpretation of this Settlement Agreement.

22. Notwithstanding any contrary rule of law, all parties shall be considered to be deemed to be the drafters of this Settlement Agreement and there will be no rules of construction applied against the draftsmen.

23. The parties hereby warrant that they have carefully read this Settlement Agreement and understand all of its terms and have

voluntarily executed this Settlement Agreement with full knowledge of its significance and with advice of counsel.

24. This Settlement Agreement contains the entire understanding and agreement between the parties and there are no oral representations, stipulations, warranties or understandings related thereto which are not fully set forth herein. No amendment, addition to or alteration, modification or waiver of any provision of this Settlement Agreement shall be of any force or effect unless reduced to a writing and signed by duly-authorized representatives of all parties.

25. The undersigned signatories represent and warrant that they have all necessary authority to execute this Settlement Agreement and to bind the affected entities.

26. This Settlement Agreement may be executed in duplicates, the intent of which is to permit distant parties to sign conforming copies of this document just as if all parties had signed the same original document. For purposes of this Settlement Agreement, execution by facsimile shall be treated as an original signature.

In witness whereof, the undersigned parties have executed this Settlement Agreement as of the date hereof, for the purposes therein contained, affixing their seals hereto.

Witness:

INOVA HEALTH SYSTEM
HOSPITALS

Stephen K. Fox 7/12/94

By: C. Michael French
C. Michael French
Chief Operating Officer
A Corporate Representative
with Authority to Bind the
Corporation to this
Settlement Agreement

[SIGNATURES CONTINUED ON FOLLOWING PAGE]

Witness:

B. C. M. Li

INOVA HEALTH SYSTEM
FOUNDATION

By: J. Knox Singleton
J. Knox Singleton
Chief Executive Officer
A Corporate Representative
with Authority to Bind the
Corporation to this
Settlement Agreement

Witness:

JEFFERSON MEMORIAL HOSPITAL
JOINT VENTURE

By: L. N. Tauber
Lazslo N. Tauber, Trustee
with Authority to Bind the
Partnership to this
Settlement Agreement

Witness:

Lazslo N. Tauber, Trustee

Witness:

INOVA HEALTH SYSTEM
FOUNDATION

By:

J. Knox Singleton
Chief Executive Officer
A Corporate Representative
with Authority to Bind the
Corporation to this
Settlement Agreement

Witness:

JEFFERSON MEMORIAL HOSPITAL
JOINT VENTURE

Randy Alan Weiss

By:

Lazlo N. Tauber, Trustee
Lazlo N. Tauber, Trustee
with Authority to Bind the
Partnership to this
Settlement Agreement

Witness:

Randy Alan Weiss

Lazlo N. Tauber, Trustee

Lazlo N. Tauber, Trustee

JEFFERSON MEMORIAL HOSPITAL, INC.
ALEXANDRIA, VIRGINIA

December 21, 1964

Dr. Leslie P. Gondor
3541 West Braddock Road
Alexandria, Virginia

Dear Dr. Gondor:

Confirming our understanding, you have agreed to buy a 50% ownership in the land described as follows:

This land is subject to an original mortgage of \$153,570.00, with a balance due at this time of \$122,856.00. Our ownership of the land is a beneficial one, the legal title being held by Dr. L. N. Tauber, Trustee.

As previously discussed with you, the purchase price for land is \$150,000 less 50% of the present land mortgage of \$122,856.00, your share \$61,428.00 representing a balance due to us in the sum of \$88,572.00. You agree to lease the land back to our corporation for a period of 99 years at a rental of \$9,750.00 per year, but subject to rental increases each 10 years based upon the U. S. Department of Labor "Cost of Living Index". We agree to pay all expenses such as taxes and insurance during the term of the lease, including special assessments.

Please indicate your approval below and return two of the copies of this letter that are enclosed and this will represent our agreement. We will then proceed to draw the necessary documents transferring the land to you and drawing the 99 year lease.

Thank you for your attention,

Yours truly,

JEFFERSON MEMORIAL HOSPITAL, INC

By John William Wore
Vice-president

Accepted and Approved

By Leslie P. Gondor Dr. Leslie P. Gondor
- Dr. Leslie P. Gondor

Witness: Robert B. Gould

Dated: December 22, 1964



JEFFERSON MEMORIAL HOSPITAL, INC.

4600 KING STREET

ALEXANDRIA, VIRGINIA 22302

January 2, 1965

Dr. Leslie P. Gondor
3541 West Braddeck Road
Alexandria, Virginia

Dear Dr. Gondor:

Confirming our understanding, you have agreed to buy a 50% ownership in the land described as follows:

This land is subject to an original mortgage of \$153,570.00, with a balance due at this time of \$122,856.00. Our ownership of the land is a beneficial one, the legal title being held by Dr. L. N. Tauber, Trustee.

As previously discussed with you, the purchase price for land is \$150,000 less 50% of the present land mortgage of \$122,856.00, your share \$61,428.00 representing a balance due to us in the sum of \$88,572.00. You agree to lease the land back to our corporation for a period of 99 years at a rental of \$9,750.00 per year, but subject to rental increases each 10 years based upon the U. S. Department of Labor "Cost of Living Index". We agree to pay all expenses such as taxes and insurance during the term of the lease, including special assessments.

Please indicate your approval below and return two of the copies of this letter that are enclosed and this will represent our agreement. We will then proceed to draw the necessary documents transferring the land to you and drawing the 99 year lease.

Thank you for your attention,

Yours truly,

JEFFERSON MEMORIAL HOSPITAL, INC.

By Leslie N. Tauber, M.D.
Leslie N. Tauber, M.D., President

Accepted and Approved

By Leslie P. Gondor
Dr. Leslie P. Gondor

Witness: Robert H. Tauber

Dated: Jan 2, 1965

TAUBER 02352

Trial Exhibit
No. 274.

J.APP. 5630

JAY ALIX &
ASSOCIATES

J.APP. 5631



VIRGINIA:

IN THE CIRCUIT COURT OF THE CITY OF ALEXANDRIA

COMMONWEALTH OF VIRGINIA, <u>ex. rel.</u>)	
MARK EARLEY, ATTORNEY GENERAL OF)	
VIRGINIA; MARK EARLEY, ATTORNEY)	
GENERAL OF THE COMMONWEALTH OF)	
VIRGINIA; and THE COMMONWEALTH'S)	
ATTORNEY FOR THE CITY OF ALEXANDRIA,)	CHANCERY NO. 961241
)	
Complainants,)	
v.)	
)	
LASZLO N. TAUBER, ET AL.,)	
)	
Respondents.)	
)	

Report of R. Bruce Den Uyl

I. INTRODUCTION

This report contains my opinions in the matter of the Commonwealth of Virginia, et al. v. Tauber, et al. I have been retained by The Jefferson Law Firm, PLC on behalf of the Respondents to analyze and estimate the value as a stand-alone hospital, during the period 1971 through 1992, of the assets that comprised Jefferson Memorial Hospital, Inc. ("JMHI Assets"). In connection with the 1997 trial in this matter, I submitted schedules regarding value as of June 30, 1971, April 18, 1973 and January 31, 1975 to the court and provided deposition and trial testimony.

I am a Principal in the firm of Jay Alix & Associates ("JA&A"). In performing my analysis, I was assisted by JA&A personnel who worked under my direction. All of the opinions presented in this report are based on the available information and my experience, education, and expertise in the areas of valuation, the health care industry and the analysis of financial and economic data.

II. BACKGROUND OF JEFFERSON MEMORIAL HOSPITAL, INC.

Jefferson Memorial Hospital, Inc. ("JMHI") was chartered as a for-profit corporation in Maryland in 1963. In 1964, JMHI amended its charter to become a nonprofit, non-stock charitable entity. JMHI began operations as an acute-care

hospital known as Jefferson Memorial Hospital ("JMHI") on March 15, 1965 in Alexandria, Virginia. The Internal Revenue Service revoked JMHI's tax-exempt status in 1971. In 1971 a Delaware for-profit corporation, Jefferson Memorial Hospital Corporation ("JMHC") was formed and a merger between JMHI and JMHC was planned. Efforts were made to effectuate the merger. JMHC operated the hospital through March 31, 1982. On December 24, 1981 the JMHC board of directors adopted a resolution to change the name of the corporation to Jefferson Corporation of Alexandria ("JCA") effective March 23, 1982.

The property on which JMHI was located, consisted of: 4.86 acres of land at 4600 King Street, the intersection of King Street and Beauregard Street, in the City of Alexandria, Virginia. The buildings included: a 96 bed hospital which was expanded in 1968 to a 120 bed hospital with a fourth floor addition constructed in 1984; a six-story brick medical office building constructed in 1978 with an office/parking addition built in 1982; and several parking lots. The majority of the land and all of the buildings were not owned by JMHI but were leased by the hospital.

JMHC operated JMHI from July of 1971 through March of 1982. JMHC leased certain hospital assets to the Health Group of Virginia, Inc. ("HGV") for a term of ten years and one month commencing on April 1, 1982. The HGV lease was terminated upon the execution of a July 3, 1985 Hospital Lease Agreement between Inova Health Systems, formerly known as Fairfax Hospital Association, ("Inova") and Jefferson Corporation of Alexandria. Pursuant to the July 3, 1985 agreement, Inova was to lease certain assets for a period of twenty years and three months, commencing on July 3, 1985. Inova operated JMHI from July 3, 1985 until 1992. The Hospital Lease Agreement was terminated by the Settlement Agreement entered on July 11, 1994 by and between Inova and Lazlo N. Tauber, Trustee and Jefferson Memorial Hospital Joint Venture ("JMHIJV").

III. THE VALUE OF THE JMHI ASSETS WAS \$0 OR NOMINAL AS OF JUNE 30, 1971, APRIL 18, 1973 AND JANUARY 31, 1975

I previously submitted schedules and testimony to the court regarding the valuation of the JMHI Assets at various dates between June 30, 1971 and January 31, 1975. I have reviewed my prior analysis and determined that my analyses and conclusions regarding the operating value of JMHI as a stand-alone hospital at various dates between June 30, 1971 and January 31, 1975 have not changed since the 1997 trial.

IV. THE VALUE OF THE JMHI ASSETS AS A GOING CONCERN WAS \$0 OR NOMINAL AS OF APRIL 1, 1982

To estimate the value of the JMHI Assets as a going concern as of April 1, 1982, I have analyzed the financial statements of JMHC for the fiscal years 1975 through

1982. Based on my analysis, I have identified that the results presented in the financial statements for the year ended June 30, 1982 do not represent normal operations for JMH. JMHC financial statements for the year ended June 30, 1982 reflect the effects of the transaction with HGV. HGV purchased various assets and assumed certain liabilities of JMHC per the Hospital Lease Agreement entered on February 11, 1982. As of June 30, 1982 JMHC was no longer operating JMH as a going concern. The income statement for the year ended June 30, 1982 and the amounts on the June 30, 1982 balance sheet of JMHC reflect a liquidation of JMHC's assets in JMH via sale to HGV. Consequently my analysis of the going concern value of the hospital as of April 1, 1982 is based on the financial results presented in the financial statements for the year ending June 30, 1981.

During the period prior to April of 1982 when JMH was operated by JMHC, the hospital experienced increasing revenues because this was a period of significant inflation in healthcare costs. Although revenues increased between 1976 and 1981, operating expenses increased even more. (Exhibit 1) Consequently the net income of the hospital, while erratic, deteriorated between 1976 and 1981. As shown in Exhibit 1, net income as a percent of total operating revenue dropped from 2.4% in 1976 to less than 1% in 1981. Similar to net income, the cash flow of JMH was widely variable and had a general downward trend as a percent of revenue in the years prior to April of 1982. Even as revenues increased, cash flow deteriorated. JMHC cash flow was negative or minimal (less than \$8,000) in all years between 1976 and 1980. JMHC's working capital as a percent of operating revenue fell below industry levels by 1981. A shortage of working capital is consistent with a hospital experiencing financial difficulty. If 1981 working capital is adjusted to industry levels JMHC cash flow is negative in 1981. (Exhibit 1)

JMHC's cash flows were not sufficient to provide for capital expenditures to maintain pace with increasingly sophisticated hospital plant and equipment. As a result, JMHJV, not JMHC, funded additions to the hospital in the late 1970's and the early 1980's. JMHJV paid for the construction of the Intensive Care Unit, the Georgetown Lab and the Medical Office Building. In the early to mid-1980's, JMHJV funded more improvements to the hospital. Prior to the lease, HGV requested additions to the facility, including certain improvements to the medical office building. These improvements were funded and made by JMHJV between 1982 and 1984. JMHC did not have the ability to finance these additions and improvements to the hospital.

At the request of counsel for the Respondents, following the trial in 1997, I prepared a valuation of the JMHI Assets as of April 1, 1982. I have reviewed this analysis and made modifications to the capitalization rate, the tax rate and the treatment of working capital. The results of my analysis are consistent with the

analysis I provided following the 1997 trial. My analysis of the going concern value of JMHI as a stand-alone hospital was based on JMHC's financial statements for the year ended June 30, 1981. My analysis uses the capitalization of earnings approach to value the JMHI Assets as of April 1, 1982. The capitalization of earnings approach was based on normalized cash flows for JMHC for the twelve months ended June 30, 1981 and the three year average ended June 30, 1981. I capitalized these cash flows using a capitalization rate of 21%, based on estimated cash flow growth of 5%, (actual cash flow growth was negative between 1976 and 1981) to arrive at the net enterprise value of JMHI. I deducted JMHC liabilities of \$563,664 and the working capital deficit from the net enterprise value to arrive at net equity value ranging from (\$181,400) to (\$503,300). JMHI's deterioration in cash flow in 1981 is evident from the lower value of equity estimated from the 12 month analysis compared to the three year weighted average. Based on this analysis I have concluded that the operating value of JMHI as a stand alone hospital as of April 1, 1982 was less than \$0. (Exhibit 2)

In addition to estimating the value of JMHI Assets under the income approach, I considered the market approach. Under the market approach transactions or publicly available market values are considered. I searched information sources that are used for identifying comparable companies and relevant transactions to find market information that is relevant to the valuation of JMHC as of April 1, 1982. My search did not provide any data that indicated comparable transactions in 1982.

V. THE LIQUIDATION VALUE OF JMHC AS OF APRIL 1, 1982 WAS A MAXIMUM OF \$501,831.

I have analyzed the value of JMHC as of April 1, 1982 based on the adjusted book value approach. For purposes of the adjusted book value approach, I analyzed the assets on the JMHC balance sheets as of June 30, 1982. Based on the adjusted book value approach, JMHC had a liquidation value as of April 1, 1982 that was greater than the value as a going concern.

The June 30, 1982 balance sheet shows a book value of \$763,382. This book value is based on the assets and liabilities of JMHC after the effects of the HGV transaction and the return of certain funds to investors. JMHC redeemed corporate stock for \$909,413 in the fiscal year ending June 30, 1982. Exhibit 3 demonstrates that the \$909,413 represents a return of principal and interest at 15.1%. Investors in JMHC provided the hospital with \$221,260 in 1973 and provided and received various additional amounts over the years through 1981. These cash infusions made by investors were important to the hospital because the cash flow generated by operations was not sufficient to meet JMHI's needs. An unsecured, subordinated investment in JMHC in 1973 would require a return of at least 15.1%. My prior analysis estimated the cost of capital of JMHC to be 19%

in 1973. Further, between 1973 and 1982 interest rates on baa corporate bonds, a less risky investment, reached more than 17%. The \$909,413 return to investors in JMHC in 1982 provided a reasonable return to the investors.

The book value at June 30, 1982 of \$763,382 includes \$261,551 in goodwill. Goodwill does not generate cash in a liquidation scenario. I have assigned \$0 value to the goodwill on the June 30, 1982 balance sheet to arrive at a maximum liquidation value of assets as of June 30, 1982 of \$501,831. The \$501,831 value represents payments related to the HGV transaction which are greater than JMHC could have realized if it liquidated its assets and liabilities. The value does not reflect any reductions to book value for liquidated assets. Liquidation generally results in the sale of assets, including receivables, inventory and equipment, at amounts that are significantly below book value. I have not reflected any of the reductions to the value of assets in the liquidation nor have I considered the costs of liquidation. Therefore, \$501,831 represents the maximum value that the JMHC would generate in liquidation. Further, the liquidation value of JMHI Assets as of April 1, 1982 would be less than the liquidation value of JMHC if any of the assets on the June 30, 1982 JMHC balance sheet were not JMHI Assets.

VI. THE VALUE OF THE JMHI ASSETS WAS LESS THAN \$0 AS OF JULY 31, 1992

Inova is a not-for-profit health care system based in Northern Virginia that consists of hospitals and other health care services including home care, nursing homes, mental health services, physician practices, wellness classes, and freestanding emergency and urgent care centers. Originally founded as the Fairfax Hospital Association in 1956, Inova has grown in Northern Virginia, adding new facilities, services and technological advancements to meet expanding needs. Inova's comprehensive, integrated network of health care facilities and services now covers a broad geographic base throughout the metropolitan Washington area. As of 1997 Inova managed five hospitals in the Washington, D.C. area with over 1,400 licensed hospital beds. With more than 27 health care facilities, Inova is Northern Virginia's most comprehensive health care system.

A. INOVA RETURNS FROM OPERATING JMHI BETWEEN 1985 AND 1992 WERE NEGATIVE

Between 1985 and 1992 Inova operated JMHI (In June of 1987 Inova changed the name of JMHI to Jefferson Hospital). A July 31, 1992 memo by Knox Singleton, President of Inova Health System to the members of the Inova Health System Board of Trustees and the members of the Inova Hospitals Executive Committee ("Singleton Memo") addressed the performance of JMHI between 1985 and 1992 under Inova's management

and the future returns expected to be generated by JMH. The memo discussed the strategic and financial objectives of Inova when it leased the hospital in 1985. The objectives included: precluding entry of competitors into the market, creating a referral program to Inova's other services, and operating a facility that could contribute financially to the overall system.

Despite the perceived strategic benefits enjoyed by Inova as a result of its lease of JMH, the financial objectives of Inova's operation of JMH were not achieved. Singleton concludes that "the marketplace has shifted to the point where it does not appear that short-term acute hospitals of 120-beds or less are viable over the long term." Further, Singleton states that additional investments necessary to operate JMH are no longer justified.

Inova engaged health care consultants, Cohen, Rutherford, Blum & Schott, PC and National Health Advisors, Ltd., to advise on long-term strategic options for JMH. These consultants produced a report to Inova dated April 2, 1992 ("Inova Report") which discussed the historical performance of JMH under the management of Inova and the projected future returns of the hospital to Inova. The Inova Report concluded that despite Inova's \$18.5 million investment in JMH through December 31, 1991, the hospital's financial trends declined between 1985 and 1991. Admissions and inpatient days declined by 29% and 44% respectively between 1985 and 1991. Although the hospital experienced increasing revenues over the period Inova operated it, expenses increased at even higher rates resulting in increasing net losses between 1985 and 1991. Inova's cash flow from operations from the inception of its' management of the hospital through the end of 1991 was a net outflow of more than \$14 million.

B. INOVA EXPECTED NO FUTURE RETURNS FROM OPERATING JMH AS OF JULY 31, 1992

The Inova Report provided pro forma financial projections of performance for JMH for the period 1992 through 2005. The sensitivity analyses on the projections included in the Inova Report indicate that total Inova losses associated with continuing the operations of JMH could range from \$32 million to \$91 million for the period from 1991 through 2005. The Inova Report considered several strategic options of Inova in regards to JMH. None of the options considered provided a positive return to Inova. In 1992 Inova was seeking to minimize its losses from operating JMH with no hope of generating positive value from operating as a going concern.

Based on the Singleton Memo and the Inova Report, I have concluded that the JMHI Assets had no operating value as of July 31, 1992. Inova had suffered operating losses at JMH for the period 1985 through 1991, including a cash

outflow of more than \$14 million for the period. An analysis of Inova's options for continuing operations of JMHI included in the Inova Report demonstrated that JMHI would not have future positive returns as an operating entity. The Inova Report cites JMHI's physical plant, its location and lack of convenient access as certain barriers to success. Further, the Inova Report notes increasing competition and estimates an excess of over 400 beds in the Northern Virginia market suggesting that JMHI may not be a needed hospital in the area.

VII. SUMMARY

In summary, I have previously testified that the JMHI Assets had \$0 or nominal value as a stand-alone hospital as of: June 30, 1971, April 18, 1973 and January 31, 1975. Subsequent to the 1997 trial, I have estimated the going concern value of JMHI Assets to be \$0 as of April 1, 1982 and July 31, 1992. In addition, I have estimated the liquidation value of JMHC as of April 1, 1982 to equal approximately \$500,000.

VIII. DEMONSTRATIVE EXHIBITS

If I am called upon to testify, I may prepare additional demonstrative aids such as graphs, charts, or tables to illustrate the testimony outlined above.

IX. MATERIALS REVIEWED

My opinions are based on documents identified in this report and my general education, training and experience. The principal documents and/or information reviewed generally fall into the following categories:

- Legal filings
- Jefferson Memorial Hospital financial statements for the eight months ended June 30, 1971 and Jefferson Memorial Hospital Corporation financial statements for the year ended June 30, 1973 and the years ended June 30, 1975 through June 30, 1981
- Jefferson Corporation of Alexandria financial statements for the years ended June 30, 1982 through June 30, 1985
- Various Jefferson Memorial Hospital Joint Venture financial statements and tax returns during the period 1975 through 1993
- Evaluation of Jefferson Memorial Hospital's Financial Position and Market Position prepared by Ernst & Whinney and dated June, 1985.

- Various financial and corporate documents and agreements produced by Jefferson Memorial Hospital Corporation, Jefferson Corporation of Alexandria, Jefferson Memorial Hospital Joint Venture
- Memo dated July 31, 1992 from Knox Singleton, President of Inova Health System re: Proposal to acquire Jefferson Hospital Building and 120-Bed Operating License
- Jefferson Hospital Options Analysis for Inova Hospitals developed by National Health Advisors and Cohen, Rutherford, Blum & Schott dated April 2, 1992
- Appraisal of Real Property Leasehold Interests in the Jefferson Memorial Hospital and the 3rd floor of Medical Office Building 4600 King Street, dated October 7, 1992 prepared by Metropolitan Valuation, Inc.
- Accounting of the Assets of Jefferson Memorial Hospital, Inc. submitted by Cobb & Associates, Ltd.

X. QUALIFICATIONS

My curriculum vitae is presented in Exhibit 4.

XI. NEW INFORMATION AND SUPPLEMENTAL REPORT

I reserve the right to offer such other or further opinions and testimony that may result from new information.

Dated: October 29, 1999



R. Bruce Den Uyl
Principal

Jefferson Memorial Hospital
Income Statement & Cash Flow Analysis¹

Exhibit 1

	06/30/76	06/30/77	06/30/78	06/30/79	06/30/80	06/30/81
Revenue From Service to Patients						
Routine Services	\$2,949,900	\$3,019,368	\$3,423,862	\$3,879,627	\$4,454,776	\$5,446,382
Special Services	\$4,001,698	\$4,654,289	\$5,171,012	\$5,704,562	\$6,826,381	\$8,607,711
Total	\$6,951,598	\$7,673,657	\$8,594,874	\$9,584,189	\$11,281,157	\$14,054,093
Deductions From Revenue						
Adjustments & Allowances						
Contracting Agencies	\$486,487	\$472,016	\$676,143	\$858,616	\$912,978	\$1,409,615
Non-contractual Patients	\$16,763	\$16,661	\$24,368	\$23,044	\$37,144	\$52,434
Employees and Professional Accounts	\$8,309	\$12,592	\$9,305	\$12,301	\$21,743	\$27,042
Provision for Uncollectable Accounts						
Net of Recoveries	\$293,093	\$357,191	\$321,296	\$383,771	\$588,011	\$845,544
Total Deductions From Revenue	\$804,652	\$858,460	\$1,031,112	\$1,277,732	\$1,559,876	\$2,334,635
Net Revenue From Service to Patients	\$6,146,946	\$6,815,197	\$7,563,762	\$8,306,457	\$9,721,281	\$11,719,458
Other Operating Income						
Parking Revenue						\$4,273
PSRO Revenue			\$10,121	\$1,209		
Sale of Meals	\$28,855					
Commissions	\$1,987	\$1,150	\$1,343	\$1,669	\$820	\$965
Transcripts	\$3,064	\$4,251	\$5,302	\$6,263	\$6,736	\$6,846
Sale of Supplies	\$1,086	\$413	\$201	\$491	\$1,370	\$1,671
Ancillary Service for Others					\$18,168	
Day Care Center						\$20,245
Total Other Operating Income	\$34,992	\$5,814	\$16,967	\$9,632	\$27,094	\$34,000
Total Operating Revenue	\$6,181,938	\$6,821,011	\$7,580,729	\$8,316,089	\$9,748,375	\$11,753,458
Operating Expense						
Regular Operating Expense	\$5,571,363	\$6,245,457	\$6,893,440	\$7,650,414	\$8,907,099	\$10,809,340
Depreciation	\$59,241	\$64,363	\$65,618	\$73,577	\$84,180	\$93,593
Rent Land & Bldg. And Equip.	\$150,305	\$159,073	\$171,691	\$200,073	\$340,349	\$535,089
Taxes - Other than Payroll and Income	\$70,271	\$71,888	\$72,924	\$80,432	\$104,331	\$136,593
Total Operating Expense	\$5,851,180	\$6,540,781	\$7,203,673	\$8,004,496	\$9,435,959	\$11,574,615
Net Operating Income	\$330,758	\$280,230	\$377,056	\$311,593	\$312,416	\$178,843
Other Income and Expenses¹						
Rents	\$4,100	\$3,600	\$3,900	\$4,724		\$40,333
Medical Educational Income						\$11,511
Interest		\$5,673	\$9,562	\$8,317	\$5,148	
Miscellaneous Income	\$81	\$2,755				
Interest Expense	(\$57,670)	(\$65,345)	(\$63,588)	(\$64,252)	(\$61,500)	(\$61,096)
Amortization of Goodwill	(\$11,377)	(\$11,377)	(\$11,484)	(\$11,377)	(\$11,377)	(\$11,377)
Loss on Disposal of Equipment	(\$13,643)	(\$1,896)	(\$20,532)	(\$10,916)	\$1,090	\$398
Medical Educational Expense						(\$29,148)
Miscellaneous Expense		(\$1,135)				
Total Other Income and Expenses	(\$78,509)	(\$67,925)	(\$82,142)	(\$73,504)	(\$66,639)	(\$49,379)
Net Income Before Income Taxes	\$252,249	\$212,305	\$294,914	\$238,089	\$245,777	\$129,464
Taxes¹	\$110,990	\$97,177	\$129,762	\$104,759	\$108,142	\$33,685
Net Income	\$141,259	\$115,128	\$165,152	\$133,330	\$137,635	\$95,779
% of Revenue	2.3%	1.7%	2.2%	1.6%	1.4%	0.8%
Adjustments To Cash Flow						
Add: Depreciation & Amortization ²	\$70,618	\$75,740	\$77,102	\$84,954	\$95,557	\$104,970
Add: Loss/(Gain) on Disposal of Equipment ²	\$13,643	\$1,896	\$20,532	\$10,916	(\$1,090)	(\$398)
Add: Net Proceeds/(Payments) on Debt ²	\$4,529	(\$89,774)	\$4,873	(\$69,983)	(\$82,085)	(\$32,040)
Less: Capital Expenditures ⁴	\$175,977	\$51,720	\$58,548	\$134,153	\$140,561	\$160,416
Less: Change in Net Working Capital ²	\$135,676	\$43,546	\$215,065	\$46,335	\$71,152	(\$37,140)
Cash Flow	(\$81,604)	\$7,724	(\$5,954)	(\$21,271)	(\$61,696)	\$45,035
Less: Working Capital Adjustment⁵						\$133,199
Adjusted Cash Flow	(\$81,604)	\$7,724	(\$5,954)	(\$21,271)	(\$61,696)	(\$88,164)
% of Revenue	-1.3%	0.1%	-0.1%	-0.3%	-0.6%	-0.8%

Notes:

- 1) Excludes: loss on disposal of building and land and loss from partnership. Taxes estimated at 44% for years in which items were excluded from Net Income
- 2) Actual results of operations.
- 3) Does not include curtailment of mortgage payable. Includes curtailment of notes payable, redemption of bonds payable and curtailment of contract payable. Based on changes as reflected in JMHC balance sheets.
- 4) Does not include building addition and improvements.
- 5) Adjustment based on industry average of 8%.

Jefferson Memorial Hospital
Capitalization of Earnings
Valuation Date: April 1, 1982

Exhibit 2



	Three Year Weighted Average Ended 30-Jun-81 (1)	% of Net Operating Revenue	Twelve Months Ended 30-Jun-81	% of Net Operating Revenue
Revenue				
Routine Services	\$4,854,720		\$5,446,380	
Special Services	7,530,076		8,607,710	
Total Gross Revenue	12,384,796		14,054,090	
Deductions & Allowances	(1,900,232)		(2,334,635)	
Other Operating Revenue	27,637		34,000	
Net Operating Revenue	10,512,201		11,753,455	
Operating Expenses				
Total Salaries & Wages	4,256,863	40.5%	4,747,932	40.4%
Administrative & General	559,783	5.3%	633,250	5.4%
Dietary	255,724	2.4%	270,472	2.3%
Housekeeping, Laundry	343,357	3.3%	365,903	3.1%
Operation of Plant, Maintenance	271,099	2.6%	304,523	2.6%
Other Supplies & Expenses	3,961,946	37.7%	4,487,260	38.2%
Rent of Land, Bldg., Equipment	414,340	3.9%	535,089	4.6%
Taxes (Other than Payroll & Income)	116,479	1.1%	136,593	1.2%
Total Operating Expenses	10,179,591	96.8%	11,481,022	97.7%
Operating Income	332,610	3.2%	272,433	2.3%
Other Income/ (Expenses) (2)				
Interest Income	8,858	0.1%	11,511	0.1%
EBITDA	341,468	3.2%	283,944	2.4%
Depreciation & Amortization	98,496	0.9%	104,970	0.9%
EBIT	242,972	2.3%	178,974	1.5%
Income Taxes @	44.0%	106,908	78,749	
After-Tax Income	136,064	1.3%	100,225	0.9%
Adjustments to Cash Flow:				
Add: Depreciation & Amortization	98,496 (3)	0.9%	104,970 (3)	0.9%
Less: Capital Expenditures	105,122 (3)	1.0%	117,535 (3)	1.0%
Less: Change in Net Working Capital	42,049 (4)	0.4%	47,014 (4)	0.4%
Cash Flow	87,390		40,647	
Capitalization Factor @	21.0%		21.0%	
Net Enterprise Value	416,141		193,557	
Less: Liabilities (5)	563,664		563,664	
Plus: Working Capital Excess / (Deficit) (6)	(33,898)		(133,198)	
Net Equity Value	(181,422)		(503,305)	
Rounded	(\$181,400)		(\$503,300)	

(1) Based on a weighted average of the prior three years' results of operations.

(2) Excluding non-recurring income/expenses including rental income, medical education, gain/loss on disposal of equipment, and loss from partnership.

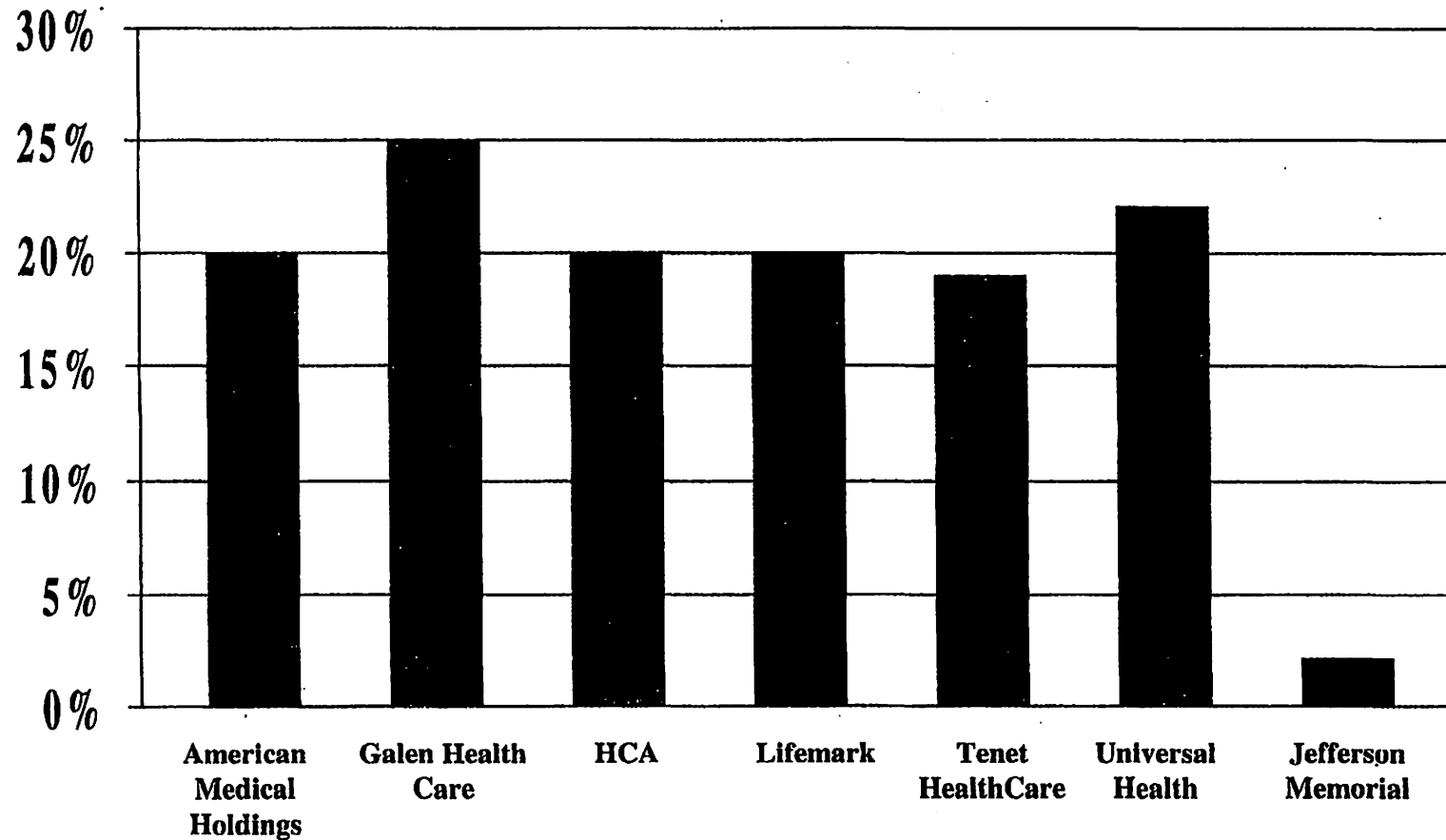
(3) Depreciation & Amortization are actual results of operations and capital expenditures are estimated at 1% of net operating revenue.

(4) Assuming 5% growth in net operating revenue and a change in net working capital of 8% of the change in net operating revenue.

(5) As of June 30, 1981 - Includes Notes Payable and Bond Payable, does not include other liabilities.

(6) Actual working capital balance adjusted to a normalized level of 8% of net operating revenue.

Jefferson Margin is Lower Than Industry

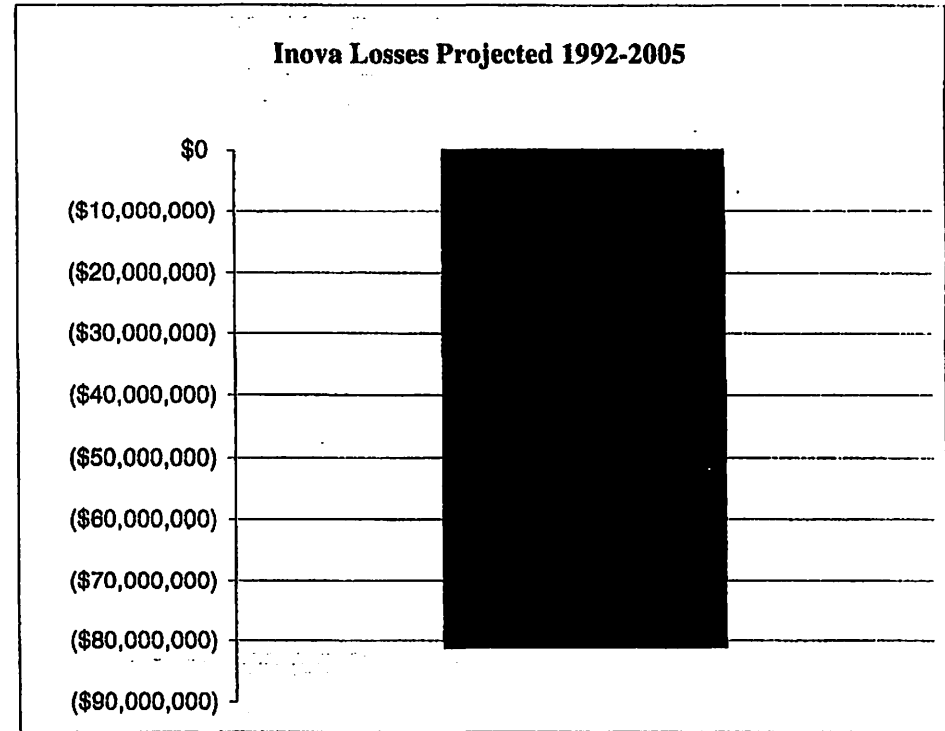
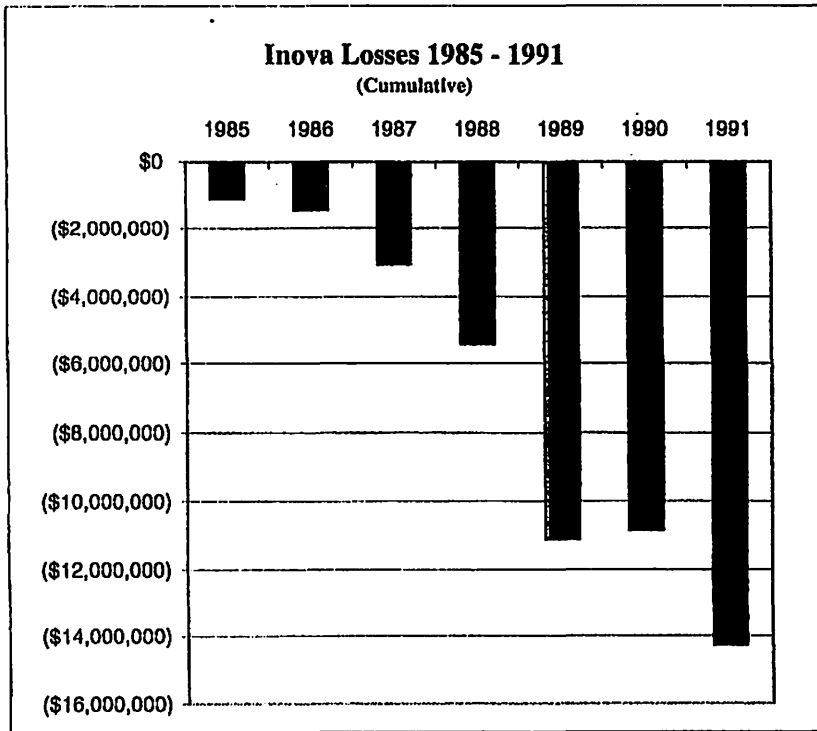


JAPP.5642

1981 EBITDA Margin



Inova Projected Losses From Operations at Jefferson of \$81 million



JAPP. 5643



Jefferson Memorial Hospital
Estimated Return on Investments in JMHC

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Proceeds from sale of Common Stock	177,008	55,662	10,200	15,145	7,008	63,648	9,672	12,900	1,997	-
Dividends	-	-	-	-	-	(30)	-	-	-	-
Purchase of Common Stock	-	(43,908)	(11,738)	(386)	(18,000)	(12,000)	-	(31,998)	-	(909,413)
Net (Purchase)/Sale of Common Stock by JMHC	177,008	11,754	(1,538)	14,759	(10,992)	51,618	9,672	(19,098)	1,997	(909,413)
IRR	17.7%									

Source: Statement of Changes in Financial Position included in Financial Statements of JMHC

JAPP. 5644



Jefferson Memorial Hospital Strategic Rationale for Acquisition by Inova Health Systems

Defensive

- ➡ To preclude the entry of either of the two major competitors to Fairfax Hospitals magnet referral programs into the Northern Virginia Market

Offensive

- ➡ Believed that Jefferson could operate as a primary care catchment mechanism through its admitting physicians and emergency room to refer patients to Inova's referral programs.
- ➡ Believed that a primary care base and acute care location inside the beltway would enhance the managed care contracting capabilities of the system overall with the growing customer group of contract purchasers.
- ➡ Believed that Inova's influence in the facility could materially improve the quality of patient care being delivered, that the volume of indigent care rendered to the community being served by Jefferson could be increased, and that the facility could contribute financially to the overall system.

JAPP. 5645

Notes:

- 1) Source: Information is based on Memorandum from Inova Health Systems President Knox Singleton to the Board and Executive Committee.



Jefferson Memorial Hospital Strategic Rationale for Acquisition by Inova Health Systems

Defensive

- ➡ To preclude the entry of either of the two major competitors to Fairfax Hospitals magnet referral programs into the Northern Virginia Market

Offensive

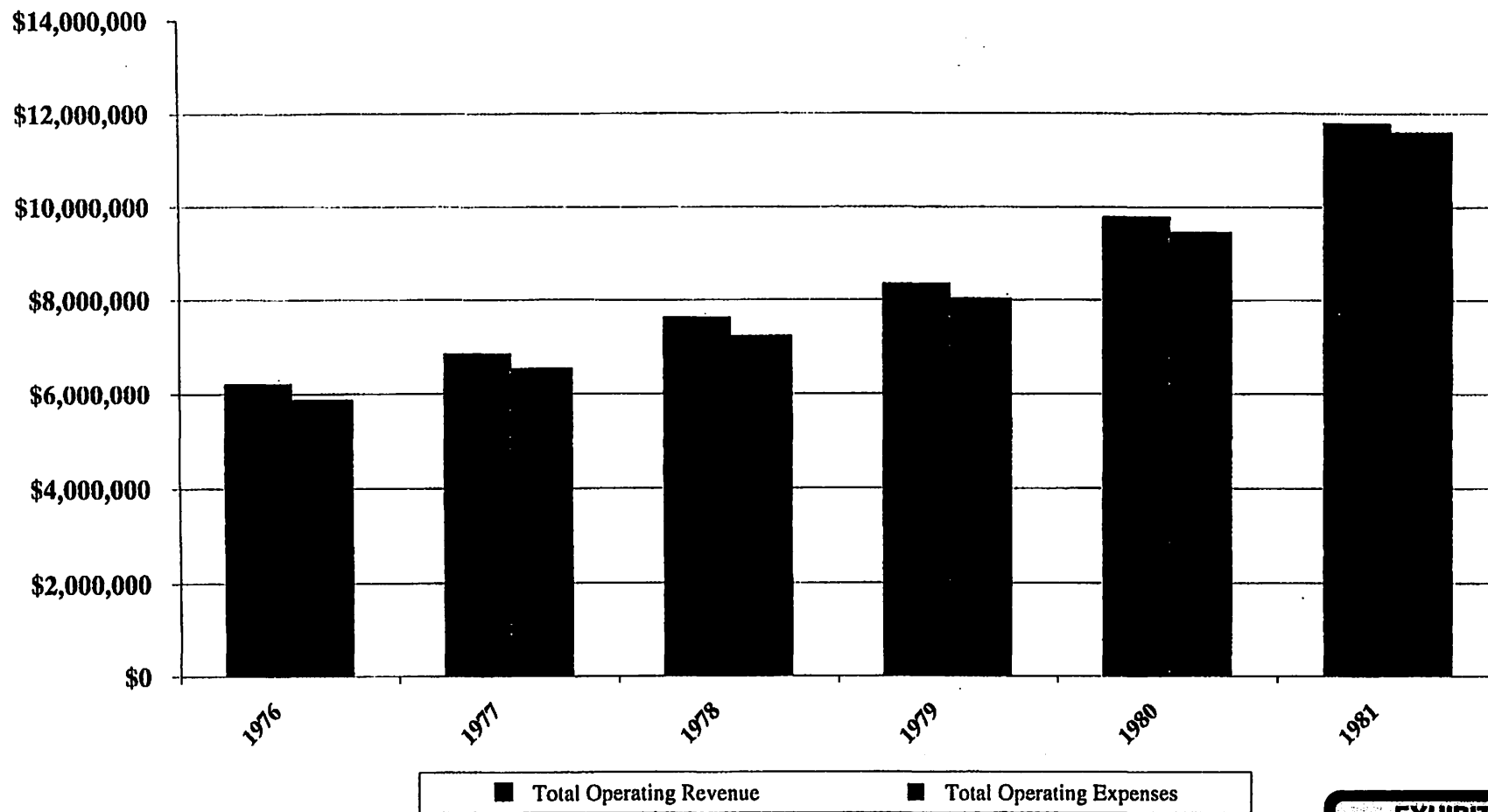
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Notes:

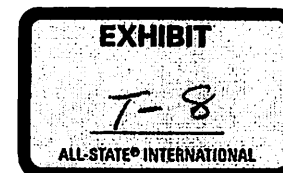
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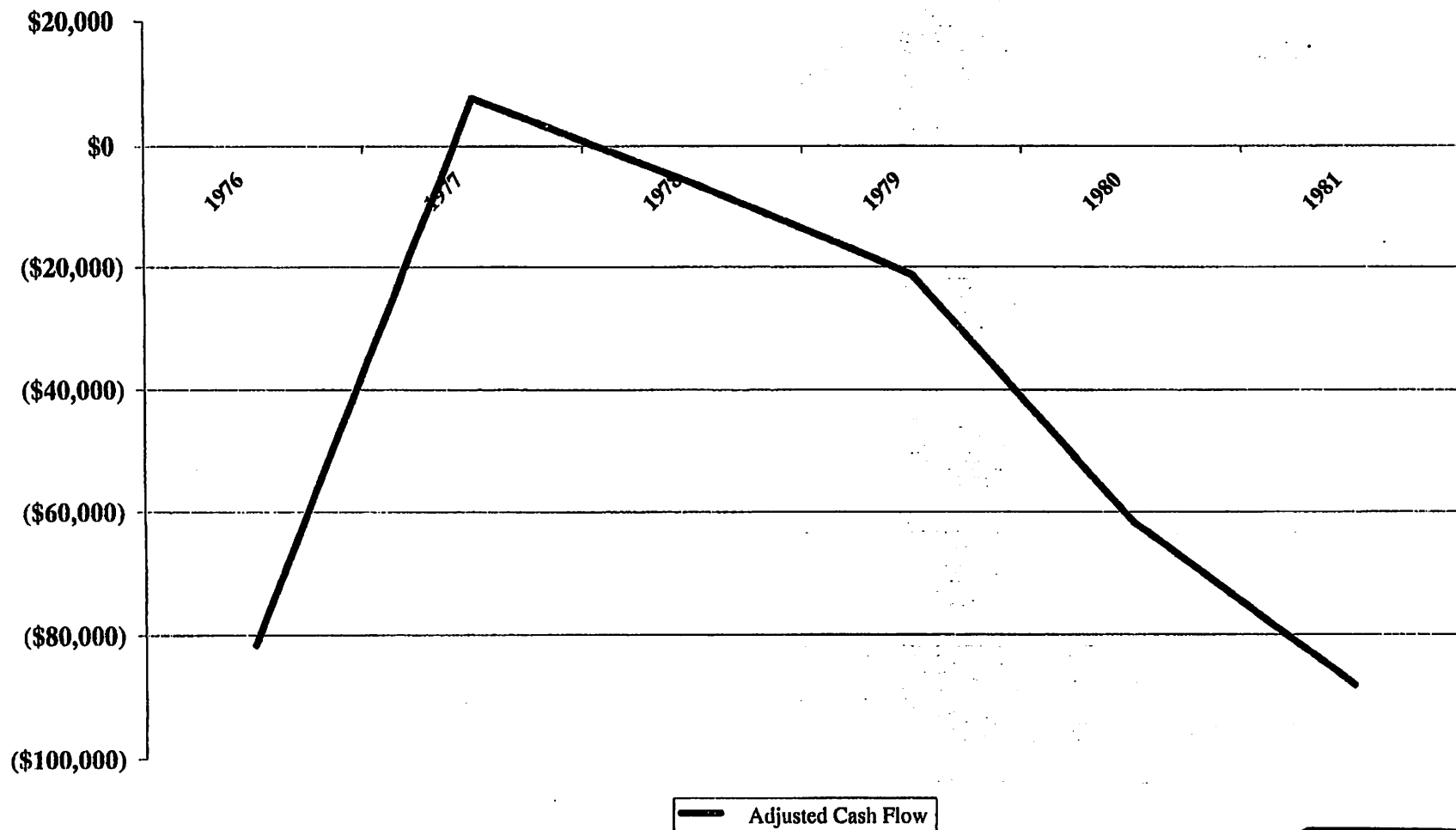
**Jefferson Memorial Hospital
Total Operating Revenue
and Operating Expenses**



J.A.P.P. 5647



Jefferson Memorial Hospital Cash Flow - Adjusted for Working Capital



JAPP. 5648

