



Office Of Health Care Access Certificate of Need Application

Final Decision

Applicants: HealthSouth Corporation & Select Medical Corporation

Docket Number: 07-30953-CON

Project Title: Termination of HealthSouth's Connecticut Outpatient Rehabilitation Division with Acquisition and Continued Operation of 32 Connecticut Outpatient Rehabilitation Centers by Select Medical Corporation

Statutory Reference: Sections 19a-638 and 19a-639 of the C. G. S.

Filing Date: August 3, 2007

Decision Date: October 31, 2007

Default Date: November 1, 2007

Staff Assigned: Jack A. Huber

Project Description: HealthSouth Corporation proposes to terminate its Connecticut Outpatient Rehabilitation Division by selling its 32 Connecticut outpatient rehabilitation centers to Select Medical Corporation at a total capital cost of \$14,459,087.

Nature of Proceedings: On August 3, 2007, the Office of Health Care Access received a completed Certificate of Need ("CON") application from HealthSouth Corporation seeking to terminate its Outpatient Rehabilitation Division by selling 32 Connecticut outpatient rehabilitation centers to Select Medical Corporation, at a total capital cost of \$14,459,087. HealthSouth Corporation is a health care facility or institution as defined by Section 19a-630 of the Connecticut General Statutes ("C.G.S.").

Notices to the public regarding OHCA's receipt of HealthSouth Corporation's and Select Medical's ("Applicants") Letter of Intent to file a CON Application were published on May 8, 2007, in the *New Haven Register* and the *Hartford Courant*. OHCA received no responses from the public concerning the Applicants' proposal.

Pursuant to Sections 19a-638 and 19a-639, three individuals or an individual representing an entity with five or more people had until August 24, 2007, the twenty-first calendar day following the filing of the Applicants' CON application, to request that OHCA hold a public hearing on the Applicants' proposal. OHCA received no hearing requests from the public.

OHCA's authority to review and approve, modify or deny the CON application is established by Sections 19a-638 and 19a-639, C.G.S. The provisions of these sections, as well as the principles and guidelines set forth in Section 19a-637, C.G.S., were fully considered by OHCA in its review.

Findings of Fact

Clear Public Need

Impact of the Proposal on the Applicants' Current Utilization Statistics Proposal's Contribution to the Quality of Health Care Delivery in the Region Proposal's Contribution to the Accessibility of Health Care Delivery in the Region

1. HealthSouth Corporation ("HealthSouth") is a for-profit Delaware corporation, headquartered in Birmingham, Alabama. Through the subsidiaries of its Outpatient Rehabilitation Division, HealthSouth owns and operates approximately 600 outpatient rehabilitation centers nationwide. (*August 3, 2007, Initial CON Application, page 2*)
2. HealthSouth is proposing to terminate ownership of its Outpatient Rehabilitation Division, including its 32 Connecticut outpatient rehabilitation centers ("Connecticut Facilities"), through the sale of certain assets of its Outpatient Rehabilitation Division to Select Medical Corporation ("Select Medical"). HealthSouth and Select Medical are identified collectively as the "Applicants" with respect to this proposal. (*August 3, 2007, Initial CON Application, page 2*)
3. Select Medical is a Delaware corporation headquartered in Mechanicsburg, PA. It has been a leading operator of outpatient rehabilitation centers in the United States since 1997. (*August 3, 2007, Initial CON Application, page 5*)
4. Select Medical also operates long-term acute care hospitals, acute medical rehabilitation hospitals and provides medical rehabilitation services on a contract basis at nursing homes, hospitals, assisted living and senior care centers, schools and work sites. (*August 3, 2007, Initial CON Application, page 5*)
5. As of March 31, 2007, Select Medical owned and operated 545 outpatient rehabilitation centers in 19 states and the District of Columbia. With acquisition of the HealthSouth Outpatient Rehabilitation Division, Select Medical will own and operate more than 1,100 facilities nationwide. (*August 3, 2007, Initial CON Application, page 5*)

6. The sale of Outpatient Rehabilitation Division is consistent with HealthSouth's strategy decision in August of 2006, to concentrate its corporate activities as a post-acute care provider, with a focus on its core business of inpatient rehabilitation services. *(August 3, 2007, Initial CON Application, page 5)*
7. HealthSouth currently owns 100% of the interest in the Connecticut Facilities, either directly or through wholly owned subsidiaries. Upon receipt of CON approval and the closing of the transaction, Select Medical, through its wholly owned subsidiaries, will own 100% of the interests in the Connecticut Facilities. *(August 3, 2007, Initial CON Application, page 21)*
8. The Connecticut Facilities offer comprehensive outpatient rehabilitative care for general orthopedic and sports injuries and conditions, as well as work-related injuries. *(August 3, 2007, Initial CON Application, page 2)*
9. The Connecticut Facilities are located throughout the state and are not required to be licensed by the Connecticut Department of Public Health. *(August 3, 2007, Initial CON Application, page 3)*
10. Select Medical will continue to operate the 32 Connecticut Facilities and will continue to offer all of the same services presently offered without any interruption of service. *(August 3, 2007, Initial CON Application, page 2)*
11. HealthSouth terminated services at the Norwalk outpatient rehabilitation center at 40 Cross Street in Norwalk. *(August 3, 2007, Initial CON Application, page 34 and 124)*
12. The primary referral source for the Norwalk center (approximately 65% of all referrals for FY 2006) has been Coastal Orthopaedics, PC ("Coastal"), a private practice located at 40 Cross Street Medical Building. After lengthy negotiations between the parties concerned, HealthSouth, Coastal and the medical building's landlord ("Landlord"), the following events occurred:
 - a. On June 5, 2007, a lease termination was executed between HealthSouth and the Landlord, with closure of the Norwalk center slated for June 30, 2007;
 - b. On June 6, 2007, OHCA issued a determination that CON approval was necessary for transfer of ownership and/or closure of any of the HealthSouth outpatient rehabilitation centers;
 - c. On June 30, 2007, Coastal acquired HealthSouth's equipment and continued to provide outpatient rehabilitation services at the 40 Cross Street center without interruption under the name Coastal Orthopedics Physical Therapy.
 - d. With approval of this request, Select Medical will not establish operations at the Norwalk center as it owns and operates clinics as close as Fairfield and Trumbull. Should patients of the Norwalk center not wish to be treated by Coastal Orthopedics Physical Therapy, they will be referred to the Fairfield and Trumbull centers. *(August 3, 2007, Initial CON Application, pages 3 and 4)*

13. **Attachment 1** provides the following information for each of the Connecticut outpatient rehabilitation centers:
 - a. Town and street address;
 - b. Primary and secondary service areas;
 - c. Age range of patient population served;
 - d. Hours of operation;
 - e. Actual annual visits for fiscal years ('FYs') 2004 through 2006;
 - f. Projected annual visits for FYs 2007 through 2009; and
 - g. Listing of outpatient rehabilitation services provided.
(August 3, 2007, Initial CON Application, page 2 and Exhibit A)

14. The Applicants based the need for the change of ownership on the following:
 - a. The strategic decision by HealthSouth to sell its Outpatient Rehabilitation, Diagnostic Imaging, and Ambulatory Surgery Divisions in order to concentrate on the provision of inpatient rehabilitation services and to deleverage the company;
 - b. The strategic decision by Select Medical to expand its own Outpatient Rehabilitation Division;
 - c. The ability of Select Medical to acquire the Outpatient Rehabilitation Division of HealthSouth, integrate same into its existing business and, in doing so, ensure continued access to quality outpatient rehabilitative care for Connecticut residents; and
 - d. The ongoing need for each Connecticut Facility and the Applicants' desire to engage in a transaction that will guarantee that each outpatient rehabilitation center continues to exist as a vital healthcare resource in its community.
(August 3, 2007, Initial CON Application, page 6)

15. HealthSouth undertook a number of measures to restore its integrity and financial health after experiencing significant financial problems in 2003. The measures are as follows:
 - a. The Board of Directors and senior management team were replaced;
 - b. Corporate governance policies and practices were improved;
 - c. Accounting transactions were reconstructed;
 - d. Amended financial reports were filed with the SEC;
 - e. Settlements were reached on lawsuits; and
 - f. All existing prior indebtedness was prepaid through recapitalization transactions.
(August 3, 2007, Initial CON Application, page 7)

16. HealthSouth's new management decided that the company would focus on being a provider of post-acute healthcare services, with an initial focus on rehabilitative health care. The decision was based on the following factors:
 - a. HealthSouth's existing divisions compete in market segments with substantial growth potential;
 - b. HealthSouth's significant debt burden, including settlement obligations to be paid to government agencies, limited its ability to pursue many growth opportunities;

- c. HealthSouth's belief that a "pure play" post-acute strategy builds upon its core competencies in inpatient rehabilitation and responds to industry trends; and
 - d. The use of the funds made available from the divestiture of the various divisions would be used to deleverage the company and allow HealthSouth to pursue growth opportunities in its inpatient division and complementary post-acute care businesses. *(August 3, 2007, Initial CON Application, pages 7 and 8)*

17. Select Medical was selected by HealthSouth because of Select Medical's extensive healthcare experience and ability to deliver quality outpatient rehabilitative care. In addition, Select Medical expressed its intention to retain current employees in order to maintain the continuity of care provided at the Connecticut Facilities. *(August 3, 2007, Initial CON Application, page 8)*

18. In the outpatient rehabilitation center market, Select Medical identified the following competitive strengths associated with HealthSouth's Outpatient Rehabilitation Division, which led to its decision to acquire the Division:
 - a. Leading national franchise;
 - b. The strong reputation of the Outpatient Rehabilitation Division for providing clinical quality and effective outcomes;
 - c. Favorable payer mix, with limited exposure to any single payer; and
 - d. Stable revenues. *(August 3, 2007, Initial CON Application, page 9)*

19. As the proposal does not involve the addition or termination of any services at any of the Connecticut Facilities, the request is expected to have little effect on existing providers in the service areas of the Connecticut facilities. The Connecticut Facilities have been in operation in their respective communities for many years and each has a solid base of referring physicians, which is not expected to diminish with the transfer of ownership. *(August 3, 2007, Initial CON Application, page 12)*

20. Following its acquisition of the Outpatient Rehabilitation Division, Select Medical's operating strategy will include:
 - a. Combining the Connecticut Facilities with its business operations;
 - b. Streamlining of systems and operations throughout the Connecticut Facilities;
 - c. Cash collections and billing operations will be integrated into the Select Medical system allowing for more efficient billing;
 - d. Employees of the Connecticut Facilities will be able to take advantage of broader benefits packages;
 - e. Certain overhead expenses, such as legal and accounting services will be allocated across the company rather than specifically to the Connecticut Market. *(August 3, 2007, Initial CON Application, page 30)*

Financial Feasibility and Cost Effectiveness of the Proposal and its Impact on the Applicants' Rates and Financial Condition
Impact of the Proposal on the Interests of Consumers of Health Care Services and the Payers for Such Services
Consideration of Other Section 19a-637, C.G.S. Principles and Guidelines

21. The sales transaction for the Connecticut facilities will be accomplished pursuant to a stock purchase agreement, dated January 27, 2007 between the Applicants. *(August 3, 2007, Initial CON Application, page 2)*
22. The estimated value in the sale of the 32 Connecticut Facilities is \$14,459,087. *(August 3, 2007, Initial CON Application, page 24)*
23. The total purchase price for HealthSouth's Outpatient Rehabilitation Division is \$245,000,000. *(August 3, 2007, Initial CON Application, page 24)*
24. On May 1, 2007, Select Medical acquired substantially all of the assets of the Outpatient Rehabilitation Division of HealthSouth, which included nearly 600 outpatient rehabilitation centers nationwide and excluded the Connecticut Facilities as well as other outpatient rehabilitation centers in other regulated states. *(August 3, 2007, Initial CON Application, page 24)*
25. The acquisition was funded with \$180,000,000 of the borrowings under Medical Select's senior credit facility with a group of lenders and JP Morgan Chase Bank, N.A. as administrative agent. The balance of the purchase was funded with cash on hand. *(August 3, 2007, Initial CON Application, page 24)*
26. Select Medical and HealthSouth negotiated a holdback of a portion of the total purchase price resulting in a payment of \$213.9 million on the April 30, 2007 closing date to HealthSouth. The holdback related to various issues such as the Connecticut Facilities and other outpatient rehabilitation centers that required regulatory approval before transfer to Select Medical and other issues between the Applicants. *(August 3, 2007, Initial CON Application, page 24)*
27. The purchase price for the Outpatient Rehabilitation Division is subject to adjustment for the transfer of the Connecticut Facilities. Any additional purchase price due under the stock purchase agreement, including additional purchase price related to the Connecticut Facilities, will be funded through additional borrowings under the Select Medical's senior credit facility and cash on hand. *(August 3, 2007, Initial CON Application, page 24)*
28. The Applicants' projected revenue and expense statements for the Connecticut Facilities in aggregate and individually for each of the 32 outpatient rehabilitation centers is presented in **Attachment 2**. *(August 3, 2007, Initial CON Application, page 29 and Exhibit T)*
29. The Applicants' current and projected payer mix information for each of the 32 outpatient rehabilitation centers is presented in **Attachment 3**. *(October 29, 2007, Additional Information submitted by the Applicants)*

30. The current operating entities will bill for services provided after the acquisition by Select Medical. *(August 3, 2007, Initial CON Application, page 26)*
31. Select Medical proposes to maintain an experienced team of management personnel, who will draw on its experience to improve operating efficiencies at, and to further develop, the Connecticut Facilities as an integrated component of the company's existing outpatient rehabilitation business. *(August 3, 2007, Initial CON Application, page 5)*
32. There is no State Health Plan in existence at this time. *(August 3, 2007, Initial CON Application, page 5)*
33. The Applicants have adduced evidence that the proposal is consistent with their long-range plans. *(August 3, 2007, Initial CON Application, page 5)*
34. In the past year HealthSouth has undertaken actions to improve productivity and contain costs, including strategies to improve cash flow, standardization of labor and supply chain practices, and reduction of fixed costs. *(August 3, 2007, Initial CON Application, page 17)*
35. This proposal will not result in changes to the Applicants' teaching and research responsibilities. *(August 3, 2007, Initial CON Application, page 18)*
36. There are no distinguishing characteristics of the Applicants' patient/physician mix. *(August 3, 2007, Initial CON Application, page 18)*
37. The Applicants' proposal will result in no change in the technical and managerial competence currently in place and providing efficient and adequate service to the public. *(August 3, 2007, Initial CON Application, pages 14 & 15 and Exhibit E)*
38. The Facilities' rates are sufficient to cover the operating costs associated with the proposal. *(August 3, 2007, Initial CON Application, page 30 and Exhibit U)*

Rationale

The Office of Health Care Access ("OHCA") approaches community and regional need for Certificate of Need ("CON") proposals on a case-by-case basis. CON applications do not lend themselves to general applicability due to a variety of factors, which may affect any given proposal; e.g., the characteristics of the population to be served, the nature of the existing services, the specific types of services proposed to be offered, the current utilization of services and the financial feasibility of the proposal.

HealthSouth Corporation ("HealthSouth"), through the subsidiaries of its Outpatient Rehabilitation Division, owns and operates nearly 600 outpatient rehabilitation centers nationally. Thirty-two of the outpatient rehabilitation centers are located in separate office sites throughout Connecticut ("Connecticut Facilities"). HealthSouth entered into an agreement to sell its Outpatient Rehabilitation Division, to Select Medical Corporation ("Select Medical"). HealthSouth proposes to include in the sale to Select Medical the 32 Connecticut Facilities.

HealthSouth terminated services at the Norwalk center site in June 2007 and transferred operation of the services to Coastal Orthopedic Physical Therapy (“COPT”). Therefore, patients of the Norwalk center will continue to be treated by COPT or be referred to Select Medical’s Fairfield and Trumbull centers. Since OHCA was deprived of the opportunity to review the information prior to closure, it is unable to determine whether patient access was adversely impacted at the time of closing of the Norwalk site.

The total purchase price for HealthSouth’s Outpatient Rehabilitation Division is \$245 million. On May 1, 2007, Select Medical acquired almost all of the assets of the Outpatient Rehabilitation Division of HealthSouth, which included nearly 600 outpatient rehabilitation centers nationwide and which did not include the Connecticut Facilities as well as other outpatient rehabilitation centers in other regulated states. The \$213.9 acquisition cost was funded with \$180 million of the borrowings under Medical Select’s senior credit facility with a group of lenders and JP Morgan Chase Bank, N.A. as administrative agent. The balance of the purchase was funded with cash on hand.

The May 1, 2007 purchase price for the Outpatient Rehabilitation Division was subject to a holdback and adjustment for the transfer of the Connecticut Facilities. The estimated value in the sale of the 32 Connecticut Facilities is \$14,459,087. Any additional purchase price due under the stock purchase agreement, including additional purchase price related to the Connecticut Facilities, will be funded through additional borrowings under the Select Medical’s senior credit facility and cash on hand.

Select Medical will be acquiring the Connecticut Facilities and will be operating the Connecticut Facilities in substantially the same manner as HealthSouth. There are no projected incremental revenues, expenses, or volumes as a result of the sale of the outpatient rehabilitation centers. Even though a few of the 32 outpatient rehabilitation centers will continue to experience operating losses, the Applicants will experience a combined Connecticut Facilities’ increase in income from operations of \$2,163,148, \$2,206,411 and \$2,250,539 for FYs 2008 through 2010 respectively with the sale of the centers. The Applicants’ financial projections, and the volumes that they were based upon, appear to be reasonable and achievable. The sale of HealthSouth’s Connecticut Facilities to Select Medical will improve the accessibility and quality of the outpatient rehabilitation services offered, as well as provide for continuity of these services for the residents served by the Connecticut Facilities.

Order

Based upon the foregoing Findings and Rationale, the Certificate of Need application of HealthSouth Corporation to terminate its Connecticut Outpatient Rehabilitation Division by selling its 32 Connecticut outpatient rehabilitation centers to Select Medical Corporation at a total capital cost of \$14,459,087, is hereby GRANTED, subject to conditions:

1. HealthSouth Corporation is authorized to sell the 32 Connecticut outpatient rehabilitation centers, as specifically identified in Attachment 1, to Select Medical Corporation.
2. Select Medical Corporation, through its wholly owned subsidiaries, will own 100% of the interests in the Connecticut outpatient rehabilitation centers.
3. Select Medical Corporation will continue to operate, without any interruption in service, the 32 Connecticut outpatient rehabilitation centers.
4. Select Medical Corporation shall hereafter notify OHCA of any and all proposed termination of services prior to finalizing any decision to terminate any services or programs. Failure to notify OHCA in advance of any proposed termination of services may be considered as not filing required information and subject Select Medical Corporation to civil penalties pursuant to Section 19a-653, C.G.S.
5. This authorization shall expire on November 1, 2008. If the sale of the 32 outpatient rehabilitation centers to Select Medical Corporation has not been completed by that date, the Applicants must seek further approval from OHCA to complete the transaction beyond that date.
6. The Applicants shall not exceed the approved total capital cost of \$14,459,087. In the event that the Applicants learn of a potential cost increase or expect that the final capital cost for the Connecticut outpatient rehabilitation centers will exceed that which is approved, the Applicants shall notify OHCA immediately.
7. The Applicants must report date of the commencement of operations for each Connecticut outpatient rehabilitation center under Select Medical Corporation, as the parent company, to OHCA within one month of each respective commencement date.
8. HealthSouth Corporation shall be required to file either a Certificate of Need Determination Request or a Certificate of Need Letter of Intent to terminate outpatient rehabilitation services at the Norwalk Outpatient Rehabilitation Center, located at 40 Cross Street in Norwalk.
9. Should Select Medical Corporation propose to change ownership or change, expand, or terminate services at any of the 32 outpatient rehabilitation centers Select Medical Corporation shall file with OHCA appropriate documentation regarding such proposal, including either a Certificate of Need Determination Request or a Certificate of Need Letter of Intent.

Should the Applicants fail to comply with any of the aforementioned conditions, OHCA reserves the right to take additional action as authorized by law.

All of the foregoing constitutes the final order of the Office of Health Care Access in this matter.

By Order of the
Office of Health Care Access

Date

Cristine A. Vogel
Commissioner

CAV: jah