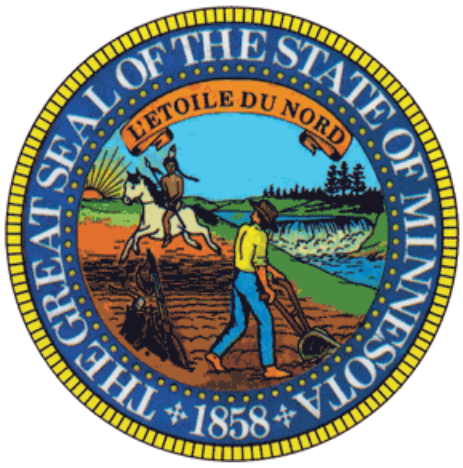
STATE OF MINNESOTA

OFFICE OF THE ATTORNEY GENERAL

Compliance Review of Fairview Health Services' Management Contracts with Accretive Health, Inc.

Volume 1
The Accretive Management Contracts



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VOLUME ONE

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<u>Executive Summary</u>: Fairview Health Services is registered as a charitable organization under Chapter 309 of the Minnesota Statutes, and its assets are held in charitable trust under Chapter 501B. The State of Minnesota and its citizens have given Fairview exemption from paying property taxes, income taxes, and sales taxes, and investors who buy its bonds receive tax-exempt status on the dividends. Accretive's management activities jeopardize the mission of Fairview as a charitable organization.

I. Accretive's "Revenue Cycle" Agreement Empowers a Wall Street For-Profit Corporation to "Infuse" Its Employees into Fairview, Usurping Management Control of the Charitable Organization.

1.1. Fairview Health Services. Fairview Health Services ("Fairview") owns ten hospitals and directly or indirectly employs 2,500 physicians based at many Fairview-owned clinics, including through Fairview Physician Associates and the University of Minnesota physician group. (Ex. 1.) In 2010, Fairview had revenue of approximately $2.8 billion. (Ex. 2.)

Fairview is registered as a charitable organization with the Attorney General's Office pursuant to Minnesota Statutes section 303.52 (2010). It is exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code. Fairview's mission statement is:

> "To improve the health of the communities we serve. We commit our skills and resources to the benefit of the whole person by providing the finest in health care, while addressing the physical, emotional and spiritual needs of individuals and their families. We further pledge to support the research and education efforts of our partner, the University of Minnesota, and its tradition of excellence."

(Ex. 3.)

On March 29, 2010, Fairview entered into a Revenue Cycle Operations Agreement ("RCA") with Accretive Health, Inc. ("Accretive"). (Ex. 4.) On November 9, 2010, Fairview entered into an Infrastructure Services Agreement with Accretive, which Accretive calls the Quality and Total Cost of Care ("QTCC") agreement. (Ex. 5.)

1.2 Accretive Health, Inc. Accretive Health, Inc. was originated by principals of Accretive, LLC, a New York private equity fund, in 2003. Accretive began principally as a consultant for Ascension Health, a national non-profit health system. (Ex. 6, p. 11.) In 2009, the Minnesota Attorney General shut down, directly or indirectly, the activities of three affiliates of Accretive, LLC that engaged in disreputable collections activity: National Arbitration Forum (an arbitration company based in Minnesota), Axiant (a debt collection agency), and Mann Bracken (the nation's largest debt collection law firm). (*See, e.g.*, Ex. 7.) Over the last five years, Accretive Health has rapidly expanded its operations and is now a public company. (Ex. 6.)

Accretive provides "revenue cycle" management services to hospitals. Accretive claims in its Annual Report that:

"We are not a traditional outsourcing company focused solely on cost reductions."

(*Id*., p. 4.)

A review of over 100,000 pages of documents produced by Accretive and Fairview indicates that Accretive is, in essence, an India-outsourced über-collection agency. Accretive has two offices in India. (Ex. 8, p. 3.) A majority of its employees are located in India. (Ex. 9.) The work of Accretive's India staff includes insurance authorizations, medical coding, transcription services, cash posting, correspondence, Medicaid eligibility, small balance collections, secondary billing, and posting of late charges. (Ex. 8, p. 3.) In management meetings, Accretive states that the function of the India office is to "[l]ower labor factor costs [and] allow for more incremental functions to be performed and lower dollar thresholds to be worked" (as a collection agency). (*Id*., p. 4.) In December, 2011, Accretive prepared an overview of its work, noting that Fairview receives a portion of the 25% in cost savings that are produced from outsourcing or slashing the Fairview workforce. (Ex. 10, p. 5.)

In late 2010, Accretive announced to its investors that it entered into an "inaugural" "Quality and Total Cost of Care" ("QTCC") contract with Fairview. (Ex. 11, p. 2.) The QTCC contract has not been accepted by any other hospital. Up until the time Fairview hired Accretive to perform QTCC services, Accretive had only performed the über-collections-type revenue cycle functions.

1.3 The Revenue Cycle Agreement ("RCA"). Accretive generated approximately $826 million of revenue in 2011. (Ex. 12, p. 49.) About 12%, or approximately $100 million, was from the Fairview RCA. (*Id*., p. 23.) Approximately $[redacted] million of the $100 million paid by Fairview is for "round tripped" payroll. Fairview pays Accretive in advance for the quarterly payroll of Fairview "revenue cycle" employees. Accretive then repays Fairview its payroll cost before each pay period. (Page 7 of exhibits to Ex. 4.)

Accretive describes its role as a managed-service contractor of hospitals in this way:

> "[W]e assume responsibility for the management and cost of the customer's revenue cycle or population health management operations…."

(Ex. 6, p. 19.)

Pursuant to the RCA, Fairview pays Accretive:

- a base technology fee of $[redacted] million per year, which increases each year thereafter, up to $[redacted] million per year. (Page 17 of exhibits to Ex. 4.)
- [redacted] of the "dormant receivables" (*e.g.*, patient bills older than one year) collected. (Page 20 of exhibits to Ex. 4.)
- a fee for Accretive's Physician Advisory Service (PAS), which consults with physicians regarding the characterization of treatment. (Pages 19-20 of exhibits to Ex. 4.)
- savings realized from reduced payroll and expenditures. Fairview pays an annual base fee (prepaid on a quarterly basis), which is equivalent to Fairview's baseline expenditures for revenue cycle operations, such as costs related to labor, technology, and third-party services. (Page 21 of the exhibits to Ex. 4.) Accretive takes control of these functions, and earns [redacted]% of any reduction in payroll and

[redacted]% of any reduction in expenditures. (*Id*.) This total base fee is about $[redacted] million, of which approximately $[redacted] million is payroll.

Accretive told its investors that it would receive over $100 million from Fairview in 2011 from just the RCA. (Ex. 12, p. 23.)

Under the RCA, Fairview delegates to Accretive the authority to manage all day-to-day aspects of the revenue cycle operations, going so far as to execute a power of attorney to fully empower Accretive to make billing decisions for the hospital as it relates to Medicaid, Medicare, and third-party insurers. (Page 6 of exhibits to Ex. 4.) Accretive emphasizes in its financial reports that it directs the work of its client hospitals' "revenue cycle [operations] teams." (Ex. 6, pp. 11-12.) For example, Fairview delegates management authority to Accretive as it relates to patient scheduling, preregistration, eligibility verification, patient registration, authorization, admitting, coding, transcription, medical record retention, chart analysis, billing, secondary billing, underpayment review, denial management, third-party collections, collection of dormant receivables, lost charge capture, and analytical support. (Pages 1, 7 of exhibits to Ex. 4.) Accretive also manages clinical documentation, patient records, insurance, benefit verification, medical records documentation, and billing follow-up. (*Id*.)

The RCA recognizes that the contract poses regulatory risks. The RCA may be terminated if a nationally recognized law firm determines that its continuation would violate any laws or regulations, or jeopardize the hospital's non-profit status. (Ex. 4, p. 21.)

II. The Revenue Cycle Agreement Unnecessarily Places at Risk the Assets of a Minnesota Charitable Organization and Place the Interests of Accretive, a For-Profit Company, Ahead of the Mission of Fairview as a Charitable Organization.

1.4 The Revenue Cycle Agreement Inappropriately Places at Risk Tens of Millions of Dollars of Fairview Assets. The RCA requires Fairview to pay its base fees on a

quarterly basis. (Ex. 4, p. 6.) As noted above, the base fees include "round tripped" payroll of the hospital. In Fairview's case, Accretive has stated that the annual base fee is approximately $[redacted] million, of which about $[redacted] million, or [redacted]%, is "round tripped" payroll. The quarterly payment is made at the beginning of the quarter. (*Id*.) This means that Fairview prepays approximately $[redacted] million in advance to Accretive, of which about $[redacted] million is for Fairview's payroll.

Thus, if Accretive files for bankruptcy, becomes insolvent, or has a regulatory or civil lien filed against its assets, the hospitals may place at risk tens of millions of dollars.

Under the terms of the "round trip" payroll provision between Accretive and Fairview, the charitable organization entrusts up to $[redacted] million each quarter in advance payroll costs. Accretive appears not to deposit these funds in an escrow or trust account. Rather, it appears that Accretive simply records the base fees as deferred income. (Ex. 6, p. F-8, n. 2.)

As a matter of prudent business practice, employers who advance payroll, as sometimes occurs in the employee leasing industry, generally require the advance payments to be deposited in an escrow or trust account in order to be secure from creditors.

Accretive has RCAs with over 60 hospitals. (Ex. 6, p. 4.) Fairview represents about twelve percent of Accretive's 2011 revenue, according to its 2011 Annual Report. (Ex. 12, p. 23.) Assuming that Accretive has revenue cycle relationships with the other 60 hospitals that are similar to Fairview, and Fairview's "round tripped" advance fees are paid by the other hospitals, it is conceivable that Accretive has custody of up to $150 million in advanced fees (for payroll) from charitable organizations at the beginning of each quarter. It appears that this money is not deposited in an escrow or trust account, and there is an issue of how much of this prepayment is identified as a liability on Accretive's balance sheet. (Ex. 12.)

Simply put, the RCA entered into with Accretive by Fairview appears to unnecessarily put at risk significant assets of a large Minnesota charitable organization.

1.5 The Revenue Cycle Agreement Inappropriately Places at Risk Tens of Millions of Minnesota Charitable Dollars by Requiring that Incentive Payments be Advanced to Accretive on a Quarterly Basis Even Though the Parties Have Not Yet Agreed that Accretive Has Earned These Incentive Payments. The RCA also requires Fairview to pay an incentive fee (called a "gain-sharing fee") to Accretive each quarter, before the fee is even earned. (Pages 13-16 of exhibits to Ex. 4.) Fairview must pay an advance incentive fee, or bonus, of $[redacted] million in each quarter during the first year of operation, which increases to $[redacted] million per quarter in the third contract year. (Page 16 of exhibits to Ex. 4.) The pre-pay amounts were apparently based on what Accretive alleges to be its historical performance with other hospitals.

The RCA also provide that, at the end of each contract year, Fairview and Accretive will "true-up" the incentive fees for the year. (Pages 15-16 of exhibits to Ex. 4.) That is, the parties will analyze Accretive's actual performance to ensure that Accretive has actually earned the pre-paid incentive payments. By the time the Fairview RCA was entering its third year, it did not appear that Accretive had yet attempted to "true-up" the incentive fees. Rather, Accretive appears to simply accept the quarterly advance bonuses and deposit them in its general accounts.

Fairview has noted that Accretive has been paid $[redacted] million in gain share fees (bonuses). Fairview has questioned whether Accretive's performance under the RCA has resulted in any gain-share. Accretive disputes this and believes that it has earned the gain-share fees.

A footnote to Accretive's Annual Statement indicates that incentive fees are not recognized as revenue unless the parties agree to the amount of the gain-share. (Ex. 6, pp. F-8-9,

n. 2.) Even though Fairview has not yet agreed that Accretive earned the incentive payments, Accretive's financial statements (Ex. 12, p. 49) do not appear to make reference to "reserving" the $[redacted] million in advance gain share fees paid by Fairview. Assuming that the other hospitals have similar arrangements and incentive pre-payments, the accounts payable of Accretive for pre-paid gain share fees could be as high as $150 million. There does not appear to be a reference to such a category on Accretive's 2011 financial statements.

A charitable organization should not put millions of dollars of charitable assets at risk by pre-paying advance bonuses to a for-profit company, particularly when it questions whether the fees have been earned.

1.6 The Revenue Cycle Agreement Undermines the Reciprocity of the State of Minnesota and Its Citizens with Its Charitable Organization by Outsourcing Portions of Its Administration to Another Country. Under the RCA, Accretive has the authority to control and direct the activities of the hospital employees. (Ex. 4, p. 5.) As stated in Accretive's financial reports: "We have the right to control and direct the work activities of the[] staff persons and are responsible for paying their compensation out of the base fees…." (Ex. 12, p. 22.) Accretive acknowledges its control over management of the Fairview functions as follows:

> "We refer to our management and staff employees that we devote on-site to customer operations as infused management."
>
> "Under our contracts with customers, we directly manage our customers' employees engaged in the activities we have contracted to manage for our customers."

(*Id*., pp. 42, 26.)

Accretive may fire or reassign a hospital employee, determine whether a departing employee will be replaced, and determine if her pay is increased. (Ex. 4, p. 5.) Accretive has the

authority to hire Fairview employees and to promote them. (*Id*.) The only restriction (required by personnel laws) is that the hospital must give its approval. (*Id*.)

Accretive is aware that this arrangement exposes Fairview to considerable regulatory review. In its security prospectus, Accretive acknowledges:

> "Under our contracts…we directly manage our customers' employees engaged in revenue cycle activities. Our management service contracts establish the division of responsibilities between us and our customers for various personnel management matters, including compliance with and liability under various employment laws and regulations. We could…have liability…under various employment laws and regulations…."

(Ex. 14, p. 15.)

Accretive's control over Fairview is breathtaking. For instance, in 2011, Accretive advised Fairview that it would charge an additional $3 million in base fees because Fairview did not obtain prior approval to hire more than 20 mental health and home and other health care employees. (Ex. 15.)

Accretive's control over Fairview personnel appears to be one of the most significant profit centers for Accretive. Accretive earns profits in part by down-sizing Fairview staff and by out-sourcing work to Accretive's operations in India. Over one-half of Accretive's employees are in India. (Ex. 9.) Accretive's India staff appears to be the fastest growing segment in the company. (*Id*.) For various hospitals, Accretive staff in India perform medical transcription, medical coding, medical billing, and pre-registration of patients; obtain insurance pre-approvals; calculate deductibles, co-pays, and patient shares of bills; register patients; maintain accounts receivable; conduct underpayment analytics (collections); audit; and develop software and perform other analytics. (Ex. 13.) Accretive notes in its Annual Report that:

- "[W]e are able to reduce operating costs further by transferring selected internal operations to our centralized shared services centers located in the United States and India." (Ex. 6, p. 8.)

- "Any slowdown or reversal of existing industry trends towards offshore outsourcing would increase the cost of delivering our services if we had to relocate aspects of our services from India to the United States where operating costs are higher." (*Id*., p. 36.)

As a for-profit, private corporation, Accretive may boost its stock value by off-shoring jobs to India. It is troubling, however, for Accretive to do so with the assets of a Minnesota charitable organization. As discussed in Section 1.10, Minnesota taxpayers significantly subsidize charitable organizations by paying their share of property taxes, sales taxes, and income taxes. Minnesota taxpayers also subsidize the tax-exempt status of the bonds which fund a hospital's capital infrastructure. The effect of the Accretive RCA is that Minnesota taxpayers end up subsidizing a for-profit corporation that makes substantial sums of money by reducing Minnesota employment, including by outsourcing it to India. This does not seem consistent with the mission of a Minnesota charitable organization.

III. The "Quality and Total Cost of Care" Contract Empowers a Wall Street Company to Improperly Assert Control over Fairview's Health Care Delivery.

As set forth below, Accretive, a for-profit company whose executives appear to mostly be business types without training in the healing arts, entered into a "cost of care" contract with Fairview to profit from cutbacks to health care and potentially the corporate opportunities of Fairview.

1.7 The "Quality and Total Cost of Care" Contract and Risk Scoring. On November 11, 2010, Accretive heavily touted to its investors that it entered an "inaugural" contract with Fairview relating to the "Quality and Total Cost of Care." (Ex. 11, p. 2.) No other hospital anywhere in the country has entered into a QTCC contract with Accretive. Under the QTCC contract, Accretive works with Fairview to negotiate contracts with HMOs and insurance companies. (Ex. 5, pp. 7-9.) Pursuant to the terms of the QTCC contract, under these negotiated

managed-care agreements, Fairview receives incentive pay of [redacted]% of all cost reductions in treatment from the prior year. The insurer or HMO, in turn, keeps [redacted]% of the cost reductions. Fairview divides up its [redacted]%, with [redacted]% going to Accretive, [redacted]% to Fairview, and [redacted]% to the physicians. (Ex. 16, p. 5.)

The history of the QTCC program is brief. One of the earliest conferences between Accretive and Fairview regarding the QTCC contract occurred on December 9, 2009. (Ex. 17.) The meeting notes indicate that the participants concluded that non-profit health systems like Fairview are hesitant to talk about "cost savings" because of concern that it affects quality. (*Id*., p. 1.) The attendees accordingly determined that on any occasion that Accretive brings up "cost savings," it must also use the term "quality":

> "*At all times, in both discussions and written materials, quality and cost should be linked and any discussion of cost should always be conjoined with quality.*"

(*Id*., p. 1, emphasis in original.)

From this discussion, the name of the program was created: "Quality and Total Cost of Care." The attendees primarily discussed whether AccretiveQ, a computer program prepared by Accretive to analyze patient data, could assist physicians to manage health care costs. (*Id*., pp. 3-4.) The attendees discussed how AccretiveQ could assess the problem of "*patient leakage*," or the referral by Fairview-affiliated physicians of patients to specialists outside Fairview's network. (*Id*., p. 5.) After the meeting, it was concluded that there was division between the University of Minnesota physicians and the Fairview physicians and that AccretiveQ might be able to contain the "leakage." (*Id*., p. 8.)

By March 11, 2010, the national debate on the Patient Protection and Affordable Care Act highlighted the concept of hospital-based "Accountable Care Organizations." (Ex. 18, p. 8.) With this debate as a backdrop, Accretive presented AccretiveQ to Fairview as the infrastructure

of an Accountable Care Organization, or ACO. (*Id*., p. 13.) The ACO would have the goal of reducing emergency care usage, increasing formulary care compliance, providing incentives for alternative care, and keeping treatment inside the Fairview provider network. (*Id*., pp. 14-15.) Accretive represented to Fairview that its analytics would apply a *Six Sigma* approach to processing data to analyze the scheduling, treatment, and referral data of physicians and patients. (*Id*., p. 22.) The administration of the analytics would be undertaken by Accretive. (*Id*.)

Accretive continued to refine its presentation to Fairview about the purpose of the QTCC. For instance, it represented that AccretiveQ develops "risk scores" on individual patients and develops or manages health risk assessments, automated care plans, care and pharmacy management, and duration of hospital stays. (Ex. 19, pp. 6-8.) The "risk score" is developed by feeding the patient's health data into a computer program that purportedly predicts each patient's risk, or cost of care, for the year. (*Id*., p. 9.) An average patient is assigned a risk score of 1.0. (*Id*.) A higher risk patient is assigned a risk score above 1.0, and a lower risk patient is assigned a risk score below 1.0. (*Id*., p. 6.) The computer model is supposed to identify "high priority" patients, who Accretive states are the sickest 5% of the population that cause 50% of the costs. (*Id*., p. 7; Ex. 26.)

Accretive also planned for its "risk modeling" management system to address "patient leakage" and measure the efficiency of each Fairview primary care physician ("PCP"). (Ex. 19, pp. 3-6.) PCPs—such as family practitioners, internists, pediatricians, and OB/GYNS—would be measured by the "efficiency" of their referrals to specialists in and out of the Fairview network. Their rankings would be modified by the risk score of each patient treated by the PCP. (*Id*., p. 5.) In the end, the "efficiency" of the PCP would define the outcome of any "gain-share" to be paid to the PCP.

While a risk modeling score may seem benign in the abstract, the application of the system has troubling implications. In July of 2011, an Accretive employee had a laptop stolen with data on over 23,000 Minnesota patients. There was detailed information about patients' diagnostics and treatment costs. The screen shot below was provided to a Fairview patient after she demanded to know what information was disclosed about her:

First Name	Last Name	Mid. Initial	HMO ID	Patient ID	Group Number	Subscriber Number	Dependent Code	Gender	Date of Birth
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	0	[redacted]	[redacted]

Age	Months Enrolled	Active Last Day	Address 1	Address 2	City	State	Zip Code	Phone Number	Attributed TIN
[redacted]	12	Yes	[redacted]		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Attributed Clinic	Attributed Provider	Provider (Short)	Predicted Complexity	Total Provider Allowed	Probability of IP Stay	Frail Condition	# Hospital Dominant Conditions	# Chronic Conditions	Macular Degeneration
FAIRVIEW[redacted]	[redacted]	[redacted]	2.287	$4,984.90	0.06	No	0	4	0

Bipolar Disorder	CHF	Depression	Diabetes	Glaucoma	HIV	Lipid Metabolism Disorder	Hypertension	Hypothyroidism	Immune Suppresion / Transplant
1	0		1	0	0	1	0	1	0

Ischemic Heart Disease	Osteo-porosis	Parkinsons	Asthma	Arthritis	Schizo-phrenia	Seizure Disorder	COPD	Renal Failure	Low Back Pain
0	0	0	0	0	0	1	0	0	0

Bipolar Disorder	CHF	Depression	Diabetes	Glaucoma	HIV	Lipid Metabolism Disorder	Hypertension	Hypothyroidism	Immune Suppresion / Transplant
--	--		Good	--	--	Good	--	Good	--

Ischemic Heart Disease	Osteo-porosis	Parkinsons	Asthma	Arthritis	Schizo-phrenia	Seizure Disorder	Predicted Complexity (SORTED)	Total Provider Allowed	Probability of IP Stay
--	--	--	--	--	--	--	1600	2136	1206

# Hospital Dominant Conditions	# Chronic Conditions	Top - Complexity	Top - Allowed Amt	Top - Both Complexity & Allowed Amount	Top -Either Complexity & Allowed Amount
243	366	0	0	0	0

The screen shot indicates that the patient has four chronic conditions, including diabetes, a seizure disorder, bipolar disorder, and a metabolic disorder. It indicates that she has a complexity score of 2.287, a probability of an inpatient stay of 0.6, and that the total "allowed" to the provider is $4,984.90.

1.8 Accretive May Want to Gain Advantage from Fairview's Business Opportunities and Transfer Them to [redacted]. On

October 21, 2010, Fairview agreed to sign the QTCC contract, becoming Accretive's "inaugural" QTCC client. (Ex. 5.)

Within two weeks, on November 2, 2010, Accretive's Board of Directors was told that Accretive would receive a $ million annual administrative fee, plus % of the cost savings attributed to the QTCC contract. (Ex. 20, p. 3.) The Accretive Board was told that the QTCC contract would reduce Fairview treatment costs by $ million in 2011, and that Accretive would receive % of the savings, or $ million, in addition to the $ million base fee. (*Id*., p. 5.)

[redacted]

1.9 Accretive Has a Strategy to, by 2015, Reduce Health Care Costs by Almost $500 Million as it Relates to Treatment of Fairview Patients. On January 18, 2011, the QTCC program was presented to Fairview as a means to have "shared distribution" savings, where physicians (Ex. 22, p. 8) and patients (*id*., p. 7) are individually and collectively measured on treatment utilization. Any cost savings would then be divided among the physicians, with a 5% reduction in treatment costs resulting in a distribution to each provider of approximately $26,000 (*id*., p. 15), or ultimately, $60,000. (*Id*., p. 16.) If a 20% savings were attained on a system-wide basis, the distribution to each provider would vary between $94,000 and $241,000. (*Id*., pp. 15-16.)

Accretive projected a potential reduction of $482 million in treatment costs at Fairview by 2015, of which Accretive would receive $[redacted] million. (Ex. 20, p. 6.) Accretive CEO Mary Tolan claimed at an investor conference in August of 2011 that Accretive's QTCC program will reduce health care treatment costs by 25% over a three-year period. (Ex. 23, p. 4.) In August of 2011, Accretive advised the Fairview physicians that the target for reduced treatment costs is 10% for 2011. (Ex. 16, p. 9.)

Accretive has alternatively described various measures that would be taken to reduce heath care treatment costs:

- On February 9, 2012, Accretive prepared a major QTCC initiative to reduce Emergency Room admissions by 20%. (Ex. 24, p. 8.) The reduction would be made by distributing a registry of "frequent flyer"

patients by name and thereafter devising a protocol that "improve[s] care planning" for the frequent flyer patients. (*Id*.)

- On November 29, 2010, it was claimed that patients who called for physician appointments would be offered a telephone consultation with a nurse practitioner. (Ex. 25.)

- On May 4, 2011, an Accretive memorandum states that Accretive would identify the 5% of the population that consumes 50% of the health care and then target efforts on that population to reduce health care costs. (Ex. 26.)

- On August 10, 2011, Mary Tolan, the CEO of Accretive, told Wall Street investors that Accretive has reduced re-admission rates at Fairview by 30% and that total charges were reduced by 8%. (Ex. 23, p. 11.)

While it appears that Accretive's QTCC program has not yielded any profits to Accretive,[1] Accretive's Board was told that the company would receive $[redacted] million per year from Fairview to maintain the project. (Ex. 20, p. 3.) Similarly, in its 2011 Annual Report, Accretive told Wall Street that it expected to make $60 million per year off the Fairview QTCC contract, including up to $10 million in base fees. (Ex. 12, p. 41.)

Fairview may terminate the QTCC contract for any number of reasons. For example, Fairview may terminate the QTCC contract if a national law firm opines that the contract would violate any laws or regulations or would jeopardize Fairview's nonprofit tax-exempt status. (Ex. 5, pp. 25-26.) Fairview may also terminate the QTCC agreement if Accretive is sanctioned or under investigation by a government agency for material violations of law that would impact Fairview's reputation. (*Id*., p. 25.)

1.10 Charitable Organizations. Fairview is a 501(c)(3) tax-exempt public charity and is registered with the Minnesota Attorney General as a charitable organization under Minnesota Statutes section 309.52. Fairview has benefited from significant tax exemptions from

[1] *See, e.g.*, Accretive Q4 2011 Earnings Conference Call, p. 10.

the State of Minnesota and its citizens. Fairview does not pay income taxes (Minn. Const. Art. X, § 1), property taxes (Minn. Stat. § 272.02, subd. 7), or sales taxes on its purchases (Minn. Stat. § 397A.70, subd. 7). Fairview does not pay federal income tax and donations to it are tax-deductible. 26 U.S.C. § 501(a) and (c); 26 U.S.C. § 170. Fairview may issue tax-exempt bonds. 26 U.S.C. § 145 (qualified 501(c)(3) bonds); 26 U.S.C. § 103(a) (tax-exempt bonds).

In exchange for these benefits, Fairview has strict obligations regarding the administration and use of its charitable assets under Minnesota and federal law. A hospital is not automatically eligible for tax-exempt status. *Sonora Cmty. Hosp. v. IRS*, 46 T.C. 519, 525 (1966). The United States Supreme Court has held that qualification for tax-exempt status "depends on meeting certain common law standards of charity—namely, that an institution seeking tax-exempt status must serve a public purpose and not be contrary to established public policy." *Bob Jones Univ. v. United States*, 461 U.S. 574, 586 (1983). In other words, "charities were to be given preferential treatment because they provide a benefit to society." *Id.* at 589. As one court has explained: "[C]haritable exemptions from income taxation constitute a *quid pro quo*: the public is willing to relieve an organization from paying income taxes because the organization is providing a benefit to the public." *Geisinger Health Plan v. Comm'r of Internal Revenue*, 985 F.2d 1210, 1215 (3rd Cir. 1993). Or, as another court recently put it in upholding the denial of a nonprofit hospital's property tax exemption: "[E]ach tax dollar lost to a charitable exemption is one less dollar affected governmental bodies will have to meet their obligations directly. If a charitable institution wishes to avail itself of funds which would otherwise flow into a public treasury, it is only fitting that the institution provide some compensatory benefit in exchange." *Provena Covenant Med. Ctr. v. Dep't of Revenue*, 925 N.E.2d 1131, 1148 (Ill. 2010).

The assets of Fairview are held in charitable trust under Minnesota law. Minn. Stat. § 501B.35, subd. 3; *In re Peterson's Estate*, 277 N.W. 529, 532 (Minn. 1938) (charity takes a charitable devise "not beneficially, but as trustee, to use the funds in furtherance of [its] charitable purpose."); *In re Quinlan's Estate*, 45 N.W.2d 807, 810 (Minn. 1951) (gift to "an institution whose sole reason for existence is charitable is a charitable trust"); *People v. Orange County Charitable Servs.*, 87 Cal. Rptr. 2d 253, 268 (Cal. Dist Ct. App. 1999) (impressing charitable trust upon charitable corporation's assets). All assets held in charitable trust, including all revenue generated from fees for services, must be used for charitable purposes. Minn. Stat. § 501B.35, subd. 3.

The Attorney General's broad common law authority to regulate charitable organizations and charitable trusts, including the authority to seek appropriate relief to redress their improper administration, has a long history. As one court stated:

> "In England the records show that even before the enactment of the Statute of Charitable Uses in 1601 suits were brought by the Attorney General to enforce charitable trusts. The community has an interest in the enforcement of such trusts and the Attorney General represents the community is seeing that the trusts are properly performed. [citations omitted.] The state, as parens patriae, superintends the management of all public charities or trusts, and in these matters acts through her attorney general."

Brown v. Mem'l Nat'l Home Found., 329 P.2d 118, 132 (Cal. Dist. Ct. App. 1958), *cert. denied*, 358 U.S. 943 (1959). *See also, Longcor v. City of Red Wing*, 289 N.W. 570, 574 (Minn. 1940) ("purpose of vesting in some public official like the Attorney General the exclusive power to begin proceedings to enforce charitable trusts is obvious"); *In re Quinlan's Estate*, 45 N.W.2d at 812 ("attorney general has not only the right but the duty to enforce charitable trusts"); *Schaeffer v. Newberry*, 35 N.W.2d 287, 288 (Minn. 1948) ("attorney general is entrusted with the duty of representing the beneficiaries of a charitable trust, and it is his duty to enforce such trusts").

The Attorney General also has extensive statutory authority to regulate charitable organizations and trusts under Chapters 309 and 501B of the Minnesota Statutes. Under Minnesota Statutes section 501B.40, subd. 1, the Attorney General may conduct investigations for purposes of "determining whether property held for charitable trust is properly administered." The Attorney General may pursue an action for breach of trust to secure compliance with Minnesota law, including injunctive relief, recovery of damages, removal of trustees, and other remedies. Minn. Stat. § 501B.4l. Under Minnesota Statutes section 309.57, the Attorney General may petition the district court for relief to restrain, enjoin, and redress violations, including injunctions, restitution, appointment of a receiver, and suspension of an organization's registration. The failure to "administer and manage property held for charitable purposes in accordance with the law or consistent with fiduciary obligations constitutes a breach of trust." Minn. Stat. § 501B.41, subd. 6.

Fairview must operate exclusively for charitable purposes to maintain its tax-exempt status. Fairview must have charity care programs for needy patients, *see* Rev. Rul. 56-185, and these programs must be advertised and promoted to patients. *Allina Med. Clinics v. County of Meeker*, 2005 WL 473908 at *10 (Minn. T.C. Feb. 18, 2005) (no charitable purpose where the charity care program was not advertised in the local paper or radio, a majority of patients pay for services, all patients are asked to pay, and charity care not available until all other avenues of payment are exhausted); *see also, Riverside Med. Ctr. v. Dep't of Revenue*, 795 N.E.2d 361, 365-366 (Ill. Ct. App. 2003) (nonprofit clinic not entitled to property tax exemption where 97 percent of revenues came from patients and clinic did not advertise charity care). As the Illinois Court of Appeals in *Provena Covenant Medical Center v. Dep't of Revenue* said: "Charity is more than rhetoric. The term 'charitable purpose' signifies 'concrete, practical, objective charity,

manifested by things actually done for the relief of the unfortunate and the alleviation of suffering or in some work of practical philanthropy.'" *Provena Covenant Med. Ctr. v. Dep't of Revenue*, 894 N.E.2d 452, 470 (Ill. Ct. App. 2008), *aff'd by Provena Covenant Med. Ctr. v. Dep't of Revenue*, 925 N.E.2d 1131 (Ill. 2010) (citing *In re Estate of Schureman*, 8 Ill.2d 125, 132-133 (Ill. 1956)).

A charitable organization may jeopardize its tax-exempt status by entering into ventures with for-profit corporations that cause the charitable organization not to operate exclusively for a charitable purpose. A charity can lose its tax-exempt status if it becomes part of a for-profit "franchise system which is operated for private benefit in [that] its affiliation with this system taints it with a substantial commercial purpose." *Est. of Hawaii v. IRS*, 71 T.C. 1067, 1080 (1979). A charity may not be an "instrument to subsidize" a for-profit corporation, nor may a for-profit corporation "trad[e] on such [non-profit] status." *Id*. at 1081-82. A joint venture with a for-profit company that allows a for-profit company to control a hospital may put the hospital's tax-exempt status at risk. *See, e.g., St. David's Health Care Sys. v. United States*, 349 F.3d 232 (5th Cir. 2003). In *St. David's*, a tax-exempt healthcare organization partnered with a for-profit company that operated hundreds of hospitals nationwide. The IRS revoked St. David's tax-exempt status, claiming its partnership with the for-profit caused it to no longer exist for a charitable purpose. *Id.* at 234-235. The Fifth Circuit held that providing a community benefit alone is not sufficient, stating:

> "It is important to keep in mind that § 501(c)(3) confers tax-exempt status only on those organizations that operate *exclusively* in furtherance of exempt purposes. As a result...we do not simply consider whether the organization's activities further its charitable purpose, we must also ensure that those activities do *not* substantially further other (non-charitable) purposes."

Id. at 236-237 (emphasis in original). The court further stated, "St. David's cannot qualify for tax-exempt status under § 501(c)(3) if its activities via the partnership substantially further the

private, profit-seeking interests of [the for-profit partner]." *Id.* at 237. The court also noted that a for-profit which manages the day-to-day operations of the facilities is not likely to serve the nonprofit's charitable interests. *Id.* at 242.

Conclusion. The RCA and QTCC contracts go to great lengths to try to make their terms confidential and hidden from public scrutiny. Both contracts recognize that their terms and existence could draw adverse regulatory scrutiny and may be terminated if they jeopardize the status and/or reputation of Fairview. As noted in this and subsequent volumes, the activities of Accretive have not been undertaken in a manner that is consistent with the mission of a charitable hospital.

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