

Exhibit 36

January 9, 2015 OCI Recommendation Memorandum regarding the Acquisition of  
Control of MercyCare Insurance Company and MercyCare HMO, Inc.

[REDACTED]

Exh #	36
Date	1-12-15
Case	15-C90781
Ins. Comm.	





State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Scott Walker, Governor
Theodore K. Nickel, Commissioner

Wisconsin.gov

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DATE: January 12, 2015 - REDACTED

TO: Rebecca Easland
Peter Medley
Richard Hinkel

FROM: Kristin Forsberg

SUBJECT: Form A - Acquisition of Control of MercyCare Insurance Company and MercyCare HMO, Inc. by Interstate Alliance, Inc. [Case No. 15-C40481]

Form A filing contacts:

Table with 2 columns: Primary Contact and Additional Contact. Rows include names, titles, addresses, and phone numbers for William J. Toman and Paul T. Van Den Heuvel.

Parties to the transaction:

The Acquirer/Applicant:

- Interstate Alliance, Inc. ("Applicant" or "IAI"): The Applicant, located in Rockford, IL, was organized as an Illinois not-for-profit corporation on October 24, 2014. The Applicant currently has no affiliates, but is intended to be the parent organization that creates an affiliation between the Mercy Health System (a Janesville, WI-based, nonprofit health system that includes MCIC and MCHMO (collectively, the "MercyCare Companies")), and Rockford Health System, a Rockford, IL-based, not-for-profit health system.

The Applicant's 9-member board of directors will include the CEO of IAI, who initially will be the Mercy Health System President and CEO (who shall serve in an ex officio capacity, with voting power), along with four representatives from Rockford Health System, and four representatives from Mercy Health System.

The Parties to be Acquired (directly):

- Mercy Alliance, Inc. ("MAI"): MAI is a nonprofit Wisconsin holding company with no members that was formed in 1989 to serve as the parent holding company for the Mercy Health System. The Mercy Health System, headquartered in Janesville, Wisconsin, is a vertically integrated multi-specialty health care delivery system serving southern Wisconsin and northern Illinois. The system includes three hospitals, two insurance companies, and a provider network of over 400 multi-specialty physicians. The Mercy Health System's three hospitals include:
  - Mercy Hospital and Trauma Center in Janesville, WI (a level 2 trauma center),
  - Mercy Walworth Hospital and Medical Center in Lake Geneva, WI, and
  - Mercy Harvard Hospital in Harvard, IL
  
- Rockford Health System ("RHS"): RHS is a nonprofit Illinois holding company that serves as the parent holding company for the Rockford Health System. The Rockford Health System, headquartered in Rockford, Illinois, includes:
  - Rockford Memorial Hospital (a 396-bed tertiary care hospital),
  - Rockford Health physicians in outpatient clinics with locations throughout northern IL and southern WI,
  - Van Matre HealthSouth Rehabilitation Hospital (a 55-bed inpatient rehabilitation hospital),
  - Visiting Nurses Association (which provides home health care services), and
  - Rockford Memorial Development Foundation (which raises funds in support of the Rockford Health System's mission)

The Rockford Health System includes no health insurers (its only insurance company, Rockford Health Insurance, Ltd., is a professional liability captive).

The Wisconsin Domestic Insurers to be Acquired (indirectly):

- MercyCare Insurance Company ("MCIC"): Is a Wisconsin for-profit health insurer licensed under Chapter 611, Wis. Stat. MCIC offers indemnity-type (POS) health plans to its commercial members in south central Wisconsin. MCIC is also licensed as a health insurer in Illinois.
  
- MercyCare HMO, Inc. ("MCHMO"): Is a Wisconsin for-profit health maintenance organization (HMO) licensed under Chapter 611, Wis. Stat. MCHMO offers comprehensive HMO plans to individuals and groups, and Medicare Select plans to individuals in south central Wisconsin.

**The Proposed Transaction:**

The Applicant intends to become the sole voting member of both health care systems (Mercy Health System and Rockford Health System), in accordance with the terms and conditions set forth in the System Formation Agreement dated October 24, 2014 between MAI and Rockford Health System. Since MAI indirectly owns 100% of MCIC's outstanding stock, and MCIC owns 100% of MCHMO's outstanding stock, the proposed transaction would result in the Applicant's indirect control of the two Wisconsin insurers.

According to Javon Bea, the President and CEO of the Mercy Health System<sup>1</sup>:

"Combined, we will have about \$1.1 billion in net revenues, which is significant because it will help us get better bond ratings that will get us better access to capital at lower costs... In addition to essentially doubling each organization's income statements, the merger is significant because the systems do not compete for each other's patients...Without

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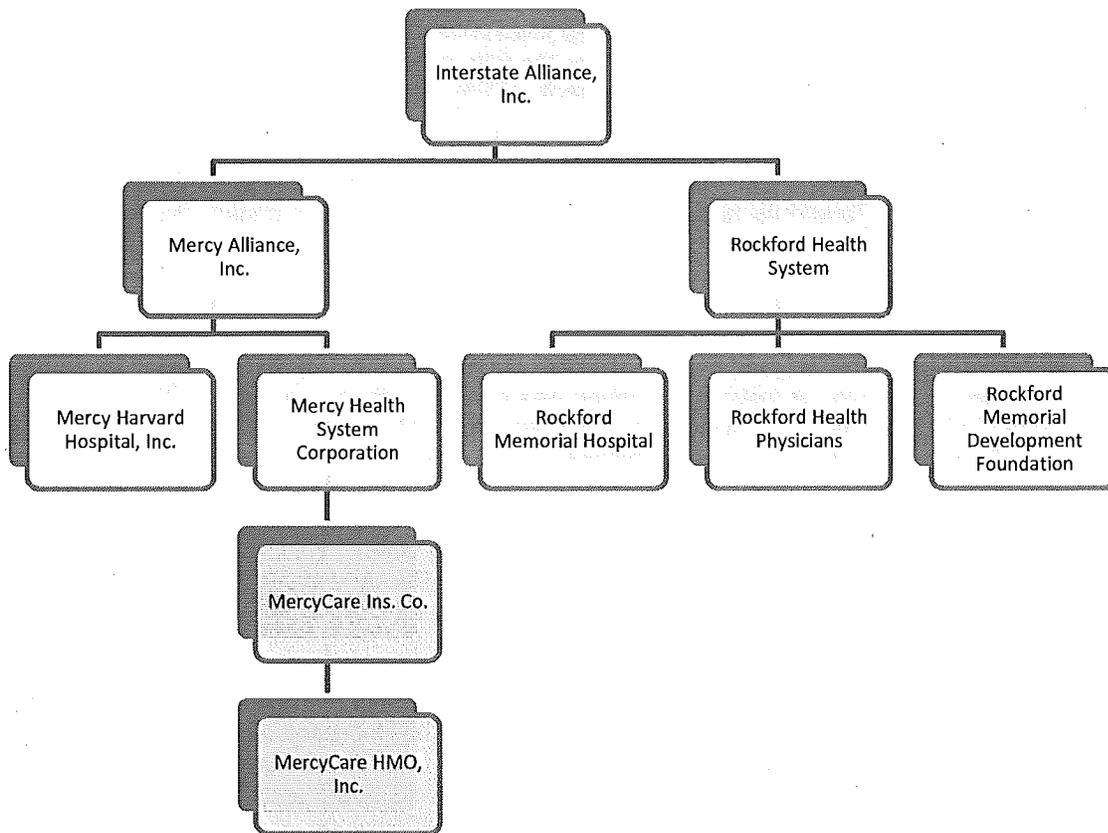
<sup>1</sup> As quoted in the October 27, 2014 Janesville GazetteXtra.

poaching patients, the two systems will create a contiguous regional network that will expand patients' health care options...

It positions us for even greater success as an ACO<sup>2</sup> [Accountable Care Organization] by adding the population base Rockford currently serves, expanding ACO contracts and population health initiatives over a larger market area...as well as expanding MercyCare insurance into the Illinois market...all these reasons increase our agility in today's rapidly changing health care market so we can efficiently and effectively respond to health care reform."

**Organizational Chart – Post-Acquisition:**

Below is an abbreviated organizational chart showing how the two health systems will be affiliated if the proposed transaction is completed<sup>3,4</sup>.



<sup>2</sup> A primary goal of the Affordable Care Act is to reduce health care costs through the formation of accountable care organizations (ACOs). [ACOs are groups of doctors, hospitals and other providers that work together to coordinate and provide high quality care to their Medicare patients. The goal is to ensure that patients get the right care at the right time without unnecessary duplication of services and medical errors. When an ACO meets certain benchmarks, it shares in the savings it generates for the Medicare program.] Mercy Health System is currently an ACO, while Rockford Health System is not.

<sup>3</sup> The pre-acquisition organizational charts are essentially the same – with the exception that the two health systems currently operate as separate unaffiliated health systems under Mercy Alliance, Inc. and Rockford Health System, respectively.

<sup>4</sup> Members of the Obligated Group (for purposes of future bond issuances under Interstate Alliance) will be: Mercy Alliance, Inc., Mercy Health System Corporation, Mercy Harvard Hospital, Inc., Mercy Assisted Care, Inc., Rockford Memorial Hospital, Rockford Health Physicians, and Rockford Memorial Development Foundation.

**Item 1: Method of Control: System Formation Agreement**

The Applicant intends to become the sole voting member of both health care systems (MercyCare and Rockford), in accordance with the terms and conditions set forth in the System Formation Agreement dated October 24, 2014 between MAI and Rockford Health System. Material terms of the System Formation Agreement are summarized as follows:

**Purpose:** To create a strong, mission-driven organization whose combined resources and attributes will further the ability of its affiliated primary, secondary and tertiary providers to offer personalized, high-quality, coordinated care and access to all members of the diverse communities they serve.

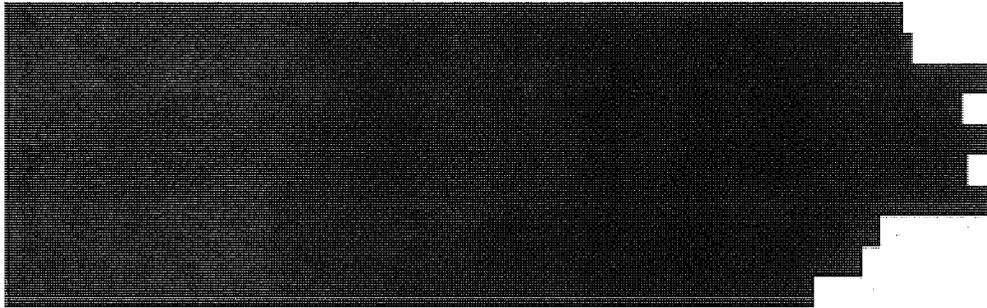
**Material Terms:**

- 2.1: Formation of New Parent: Effective on the Closing, the Parties shall consummate the Transaction by having a new Illinois not-for-profit entity become the sole member of RHS and MAI, and by amending and restating the organizational documents of RHS and MAI and, as applicable, of certain Rockford Affiliates and Mercy Affiliates.
- 3.1 Branding Strategy: The Parties shall develop a branding strategy for the use and marketing of the name of the New Parent (and/or its assumed or trade name), to be used in conjunction with the RHS and Mercy names.
- 3.2(a) Board of Directors: The Board of Directors of the New Parent shall be comprised of the following (9) individuals: (i) four (4) appointed by RHS, at least one of whom is a current or former member of the Active Medical staff of RMH, and two (2) of whom are members of the RHS Board of Directors; (ii) four (4) appointed by MAI, at least one of whom is a current or former member of the Active Medical Staff of MHS and two (2) of whom are members of the MAI Board of Directors; and (iii) the CEO of New Parent, as an *ex officio* voting member.
- 4.1 Reorganization of RHS and MAI: Each of RHS and MAI shall amend and restate their respective Articles of Incorporation and Bylaws effective as of the Closing Date to set forth terms consistent with the New Parent Governing Documents, provide that New Parent shall be its sole member, and make other related changes to fulfill the terms and conditions of this Agreement.
- 4.2 Composition of the Boards: From and after the Closing Date, the Boards of Directors of each of RHS and MAI shall be those same individuals who serve as directors thereon immediately prior to the Closing Date; provided, however, that: (i) the MAI Board shall increase by two (2) directors by RHS appointing two (2) directors to serve thereon effective as of such date (and those two (2) directors shall also sit on the New Parent Board); and (ii) the RHS Board shall increase by two (2) directors by MAI appointing two (2) directors to serve thereon effective as of such date (and those (2) directors shall also sit on the New Parent Board). All directors, officers, and committee members of RHS and MAI shall continue to serve in such capacities as of the Closing Date.
- 5.1 Operations of the Affiliates: Each Affiliate's corporate and governance structure shall remain substantially the same as of the Closing Date, subject to such changes as may be required or appropriate to reflect the existence of the New Parent for the New System.
- 7.3(a) Capital Commitment – Growth Capital: In furtherance of the objective of sustaining and enhancing the Rockford Entities' status as a regional health system and acute care hub... Mercy acknowledges the need and desirability of making a substantial financial commitment to ensure that appropriate ongoing investments are made to support the capital, programmatic, clinical and market development needs of the patients served by the Rockford Entities, both in the short and the long-term. Mercy also recognizes the importance of investments to the Rockford area economy and the

maintenance of an engaged workforce in the service area. RHS has estimated that over the next five (5) years, in order to realize the Parties' common objectives, the Rockford Entities will require a minimum of \$105 million in routine capital expenditures ("Routine Capital") and \$110 million for growth projects related to facility improvements, clinical initiatives and service line expansions ("Growth Capital").<sup>5</sup>

7.3(b) Capital Commitment – Initial and Subsequent: Mercy hereby commits on behalf of the New System that, during the five (5)-year period immediately following the Closing Date, the New System shall make available to the Rockford Entities an aggregate amount of at least \$250 million for purposes of Routine and Growth Capital (the "Initial Capital Commitment"). Thereafter, the New System shall ensure capital expenditures on behalf of the Rockford Entities in amounts not less than eighty percent (80%) of RHS's rolling five-year average depreciation expense (together with *the "Mercy Commitment"*, the "Subsequent Capital Commitment").

**Note:** OCI requested clarification as to what the "Mercy Commitment" will be in its December 30, 2014 follow-up letter. The Applicant responded as follows:



14.13 Applicable Law: This Agreement shall be governed by and construed and enforced in accordance with the laws of Wisconsin.

**Item 2: Identity and Background of the Applicant**

The name and address of the Applicant is:

Interstate Alliance, Inc.  
2400 N. Rockton Ave.  
Rockford, IL 61103

There are currently no court proceedings involving a reorganization or liquidation pending with respect to the Applicant or any of its affiliates. [Note: Interstate Alliance's Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code was filed in November, 2014.]

**Item 3: Identify and Background of Individuals Associated with the Applicant**

Biographical Affidavits were reviewed for the Directors and Executive Officers of the Applicant as listed below. No exceptional responses requiring further comment were noted.

<sup>5</sup> According to Crain's Chicago Business (1/31/14), the Mercy System has invested about \$220M in its facilities in the last several years.

Rowland McClellan (Chairman of the Mercy Health System Board)		
Tom Pool (Chairman of the Strategic Planning Committee for the Mercy Health System Board)		
Javon Bea (President and CEO of Mercy Health System)		
Mark Goelzer, M.D. (Director of Medical Affairs for the Mercy Health System)		
Dave Syverson (Illinois State Senator and Member of the Mercy Health System Board)		
Connie Vitali, M.D. (Chairman of the Rockford Health System Board)		
Jack Becherer, Ed.D. (Member of the Rockford Health System Board)		
Thomas D. Budd (Member of the Rockford Health System Board)		
Paul A. Green (Member of the Rockford Health System Board)		

**Item 4: Nature, Source and Amount of Consideration**

The transaction will not entail any tangible consideration; instead, MAI and Rockford Health System will each forego their status as independent entities in exchange for the benefits that will be achieved through the affiliation. The terms of the transaction were derived through arm's length negotiations between the parties, and are consistent with their respective status as non-profit organizations (and the intended non-profit status of Interstate Alliance, Inc.).

**Item 5: Applicant's Future Plans for the Insurer**

Interstate Alliance does not plan to cause MCIC or MCHMO (collectively, the "MercyCare Companies") to declare an extraordinary dividend, to liquidate either of the MercyCare Companies, to sell the assets of the MercyCare Companies, or to merge them with any person or persons or to make any other material change in their business operations or corporate structure or management.

**Item 6: Voting Securities to Be Acquired**

Pursuant and subject to the provisions of the System Formation Agreement, Interstate Alliance will indirectly acquire control of the 10,000 shares of MCIC's common stock owned by Mercy Health System and the 100 shares of the MCHMO common stock owned by MCIC.

**Item 7: Ownership of Voting Securities**

Other than as set forth in the Form A, neither Interstate Alliance, nor any of its affiliates, nor any person listed in Item 3, beneficially owns any voting securities of MCIC or MCHMO or has the right to acquire beneficial ownership of any voting securities of MCIC or MCHMO.

**Item 8: Contracts, Arrangements, or Understandings with Respect to Voting Securities of the Insurer**

None, other than as set forth in this Form A.

**Item 9: Recent Purchases of Voting Securities**

None.

**Item 10: Recent Recommendations to Purchase**

None.

**Item 11: Agreements with Broker-Dealers**

None.

**Item 12: Financial Statements**

OCI requested the Consolidated Audited Financial Statements for the Rockford Health System for the years ended December 31, 2013, 2012, 2011, 2010, and 2009.

**Below is a summary of key financials and ratios for RHS from 2009 – 2013:**

<b>Rockford Health System and Affiliates - Consolidated Financials:</b>					
<i>In thousands (except for ratios):</i>					
<b>For the Year Ended December 31:</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>	<b>2009</b>
<b>Financials:</b>					
Patient Accounts Receivable	66,020	70,525	65,852	47,859	44,320
Current Assets	165,573	179,886	136,948	150,544	105,797
Total Assets	542,730	535,696	549,333	559,488	495,971
Current Liabilities	77,718	83,274	96,777	90,631	70,082
Long-Term Liabilities	161,235	192,848	201,461	203,818	209,798
Total Liabilities	238,953	276,122	298,238	294,449	279,880
Total Net Assets	303,777	259,574	251,095	265,039	216,091
Net Patient Revenue	383,175	381,269	379,737	387,142	367,121
Total Revenues	428,913	415,731	423,290	441,032	425,373
Total Expenses	428,250	412,585	434,453	405,722	406,375
Total Operating Gain/(Loss)	663	3,146	-11,163	35,310	18,998
Total Non-Operating Gain/(Loss)	18,502	13,391	-4,776	12,013	25,460
Total Gain/(Loss)	19,165	16,537	-15,939	47,323	44,458
Net Cash from Operations	9,556	-18,422	618	59,997	23,127
<b>Ratios:</b>					
Total Margin	4.5%	4.0%	-3.8%	10.7%	10.5%
Operating Margin	0.2%	0.8%	-2.6%	8.0%	4.5%
Current Ratio	2.1	2.2	1.4	1.7	1.5
Days in Accounts Receivable	62.9	67.5	63.3	45.1	44.1
Debt Service Coverage*	2.97	5.37	1.78	7.42	3.44

\*Covenant Requirement under Financing Documents: 1.10x

For comparison purposes, below is a summary of key ratios for Mercy Alliance, Inc. and Affiliates for the FY ended 6/30/13:

<b>Ratios:</b>	<b>2013</b>
Total Margin	4.7%
Operating Margin	2.6%
Current Ratio	1.5
Days in Accounts Receivable	75.2
Debt Service Coverage**	3.93

\*\*Covenant Requirement under Financing Documents: 1.25x

In addition, OCI obtained and reviewed the unaudited consolidated financial for RHS and Affiliates for the nine months ended September 30, 2014. Key highlights from that report were:

**YTD through 9/30/14  
In thousands (except for ratios)**

Total Operating Gain (Loss):	(\$5,775)
Non-Operating Gain (Loss)	\$3,763
Net Income (Loss)	(\$2,012)
Net Assets	\$301,861
Total Margin:	-0.6%
Operating Margin:	-1.8%
Current Ratio:	1.87x

**Public Comments Regarding the Filing**

None to date.

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**Wisconsin Specific Requirements**

**The following checklist addresses the requirements of s. 611.72 (3) (am), Wis. Stat. (Grounds for Disapproval):**

- a) After the change of control, the domestic stock insurance corporation or any domestic stock insurance corporation controlled by the insurance holding corporation would be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed?

**Did the Filing Adequately Address this Concern? Yes**

Comments: The proposed transaction will have no direct impact on the capital and surplus of MCIC or MCHMO, and will not otherwise impair either entity's ability to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which each is presently licensed.

- b) The effect of the merger or other acquisition of control would not be to create a monopoly or substantially lessen competition in insurance in this state?

**Did the Filing Adequately Address this Concern? Yes**

Comments: Because there are no insurers currently within the Rockford Health holding company system, the proposed transaction will not create a monopoly, and is unlikely to substantially lessen competition in the State of Wisconsin.

- c) The financial condition of any acquiring party is not likely to jeopardize the financial stability of the domestic stock insurance corporation or its parent insurance holding corporation, or prejudice the interests of its Wisconsin policyholders?

**Did the Filing Adequately Address this Concern? Yes**

Comments: There were no immediate issues or concerns noted that would suggest that the financial condition of the Applicant and its affiliates is likely to jeopardize the financial stability of MCIC or MCHMO, or prejudice the interests of their Wisconsin policyholders.

- d) The plans or proposals which the acquiring party has to liquidate the domestic stock insurance corporation or its parent insurance holding corporation, sell its assets, merge it with any person or make any other material change in its business or corporate structure or management, are fair and reasonable to policyholders of the domestic stock insurance corporation or in the public interest?

**Did the Filing Adequately Address this Concern? Yes**

Comments: As indicated in Item 5, Interstate Alliance does not plan to cause MCIC or MCHMO (collectively, the "MercyCare Companies") to declare an extraordinary dividend, to liquidate either of the MercyCare Companies, to sell the assets of the MercyCare Companies, or to merge them with any person or persons or to make any other material change in their business operations or corporate structure or management.

- e) The competence and integrity of those persons who would control the operation of the domestic stock insurance corporation or its parent insurance holding corporation are such that it would be in the interest of policyholders of the corporation and of the public to permit the merger or acquisition of control?

**Did the Filing Adequately Address this Concern? Yes**

Comments: Review of the Biographical Affidavits did not raise any concerns regarding the competence or integrity of the Officers and Directors of Interstate Alliance.

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**Hearing Requirement: Per s. 611.72 (3m), Wis. Stat.: "A hearing is not required under sub. (3) Before approval of a proposed plan of merger or other plan for acquisition of control if the proposed merger is with, or the proposed acquirer is, an affiliate of the insurer and the proposed merger or other acquisition of control does not change the controlling person of the insurer." Is a hearing required for this filing? (Y/N)**

**Yes.** The Applicant is not an affiliate of the insurer, and the proposed transaction will result in indirect control of MCIC and MCHMO (by becoming the sole corporate member of MAI). Therefore, a hearing is required.

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**Follow-up Items**

The Applicant adequately addressed the issues identified in OCI's December 30, 2014, January 2, 2015 and January 5, 2015 application follow-up letters, respectively.

**Conclusion**

It is recommended that the proposed acquisition of control of MercyCare Insurance Company and MercyCare HMO, Inc. be approved on the basis that there are no statutory grounds for denial pursuant to s. 611.72 (3), Wis. Stat.

