

TENET HEALTHCARE CORP
Form 10-Q
November 06, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

Form 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934 for the quarterly period ended September
30, 2007**

OR

o **Transition report pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934 for the transition period
from to**

Commission file number 1-7293

TENET HEALTHCARE CORPORATION

(Exact name of Registrant as specified in its charter)

Nevada
(State of Incorporation)

95-2557091
(IRS Employer
Identification No.)

13737 Noel Road
Dallas, TX 75240
(Address of principal executive offices, including zip code)

(469) 893-2200
(Registrant's telephone number, including area code)

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Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Exchange Act Rule 12b-2). Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the Registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes ☐ No ☒

As of October 31, 2007, there were 474,099,243 shares of the Registrant's common stock outstanding.

TENET HEALTHCARE CORPORATION

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PART I.

ITEM 1. FINANCIAL STATEMENTS

TENET HEALTHCARE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

Dollars in Millions

(Unaudited)

	September 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 655	\$ 784
Investments in marketable debt securities	34	39
Accounts receivable, less allowance for doubtful accounts (\$478 at September 30, 2007 and \$498 at December 31, 2006)	1,354	1,413
Inventories of supplies, at cost	181	184
Income tax receivable	5	171
Deferred income taxes	71	69
Assets held for sale	60	119
Other current assets	233	246
Total current assets	2,593	3,025
Investments and other assets	369	383
Property and equipment, at cost, less accumulated depreciation and amortization (\$2,726 at September 30, 2007 and \$2,548 at December 31, 2006)	4,403	4,299
Goodwill	600	601
Other intangible assets, at cost, less accumulated amortization (\$176 at September 30, 2007 and \$149 at December 31, 2006)	270	231
Total assets	\$ 8,235	\$ 8,539
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 1	\$ 22
Accounts payable	637	775
Accrued compensation and benefits	362	390
Professional and general liability reserves	148	145
Accrued interest payable	110	130
Accrued legal settlement costs	113	71
Other current liabilities	502	392
Total current liabilities	1,873	1,925
Long-term debt, net of current portion	4,766	4,760
Professional and general liability reserves	565	586
Accrued legal settlement costs	185	251
Other long-term liabilities and minority interests	646	646
Deferred income taxes	99	107
Total liabilities	8,134	8,275
Commitments and contingencies		
Shareholders' equity:		
Common stock, \$0.05 par value; authorized 1,050,000,000 shares; 530,395,334 shares issued at September 30, 2007 and 527,384,164 shares issued at December 31, 2006	26	26

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Additional paid-in capital	4,401	4,372
Accumulated other comprehensive loss	(45)	(45)
Accumulated deficit	(2,802)	(2,610)
Less common stock in treasury, at cost, 56,301,997 shares at September 30, 2007 and 55,798,815 shares at December 31, 2006	(1,479)	(1,479)
Total shareholders' equity	101	264
Total liabilities and shareholders' equity	\$ 8,235	\$ 8,539

See accompanying Notes to Condensed Consolidated Financial Statements.

TENET HEALTHCARE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Dollars in Millions,

Except Per-Share Amounts

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net operating revenues	\$ 2,212	\$ 2,058	\$ 6,601	\$ 6,337
Operating expenses:				
Salaries, wages and benefits	983	927	2,941	2,817
Supplies	383	373	1,167	1,154
Provision for doubtful accounts	159	149	433	385
Other operating expenses, net	510	495	1,525	1,439
Depreciation	83	76	245	226
Amortization	8	6	24	18
Impairment of long-lived assets and goodwill, and restructuring charges, net of insurance recoveries	13	1	24	26
Hurricane insurance recoveries, net of costs		(4)		(14)
Litigation and investigation costs	3	7	1	751
Operating income (loss)	70	28	241	(465)
Interest expense	(105)	(104)	(315)	(306)
Investment earnings	10	15	36	49
Minority interests		(1)	(3)	(2)
Net gains on sales of investments				2
Loss from continuing operations, before income taxes	(25)	(62)	(41)	(722)
Income tax (expense) benefit	(10)	43	78	291
Income (loss) from continuing operations, before discontinued operations and cumulative effect of change in accounting principle	(35)	(19)	37	(431)
Discontinued operations:				
Loss from operations	(11)	(24)	(46)	(47)
Impairment of long-lived assets and goodwill, and restructuring charges, net of insurance recoveries	(6)		(18)	(107)
Hurricane insurance recoveries, net of costs		(6)		187
Litigation settlements, net of insurance recoveries				24
Net gain (loss) on sales of facilities	(5)	3	(4)	2
Income tax (expense) benefit	(2)	(43)	17	(47)
Income (loss) from discontinued operations, net of tax	(24)	(70)	(51)	12
Loss before cumulative effect of change in accounting principle	(59)	(89)	(14)	(419)
Cumulative effect of change in accounting principle, net of tax				2
Net loss	\$ (59)	\$ (89)	\$ (14)	\$ (417)

Basic and diluted earnings (loss) per common
share and common equivalent share

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Continuing operations	\$	(0.07)	\$	(0.04)	\$	0.08	\$	(0.92)
Discontinued operations		(0.05)		(0.15)		(0.11)		0.03
Cumulative effect of change in accounting principle, net of tax								
	\$	(0.12)	\$	(0.19)	\$	(0.03)	\$	(0.89)
Weighted average shares and dilutive securities outstanding (in thousands):								
Basic		473,984		471,227		473,111		470,635
Diluted		473,984		471,227		474,506		470,635

See accompanying Notes to Condensed Consolidated Financial Statements.

TENET HEALTHCARE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in Millions

(Unaudited)

		Nine Months Ended September 30,	
	2007	2006	
Net loss	\$	(14)	\$ (417)
Adjustments to reconcile net loss to net cash from operating activities:			
Depreciation and amortization		269	244
Provision for doubtful accounts		433	385
Deferred income tax benefit		(2)	(2)
Stock-based compensation charges		31	34
Impairment of long-lived assets and goodwill, and restructuring charges, net of insurance recoveries		24	26
Litigation and investigation costs		1	751
Pretax (income) loss from discontinued operations		68	(59)
Cumulative effect of change in accounting principle			(2)
Other items, net		(11)	(12)
Increases (decreases) in cash from changes in operating assets and liabilities:			
Accounts receivable		(487)	(345)
Inventories and other current assets		(8)	(31)
Income taxes		74	(270)
Accounts payable, accrued expenses and other current liabilities		(151)	(227)
Other long-term liabilities		23	32
Insurance recoveries for business interruption and other costs			161
Payments against reserves for restructuring charges and litigation costs and settlements		(39)	(683)
Net cash provided by (used in) operating activities from discontinued operations, excluding income taxes		3	(26)
Net cash provided by (used in) operating activities		214	(441)
Cash flows from investing activities:			
Purchases of property and equipment continuing operations		(386)	(338)
Construction of new hospitals.		(43)	(5)
Purchases of property and equipment discontinued operations		(11)	(48)
Purchase of business or joint venture interest		(36)	(28)
Proceeds from sales of facilities and other assets discontinued operations		83	161
Proceeds from sales of marketable securities, long-term investments and other assets		652	19
Purchases of marketable securities		(644)	(18)
Proceeds from hospital authority bonds		31	4
Proceeds from cash surrender value of insurance policies		32	
Insurance recoveries for property damage			115
Other items, net		(1)	16
Net cash used in investing activities		(323)	(122)
Cash flows from financing activities:			
Repayments of borrowings		(21)	(3)
Other items, net		1	2
Net cash used in financing activities		(20)	(1)
Net decrease in cash and cash equivalents		(129)	(564)
Cash and cash equivalents at beginning of period		784	1,373
Cash and cash equivalents at end of period	\$	655	\$ 809
Supplemental disclosures:			

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Interest paid, net of capitalized interest	\$	(314)	\$	(312)
Income tax (payments) refunds, net	\$	168	\$	(28)

See accompanying Notes to Condensed Consolidated Financial Statements.

TENET HEALTHCARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

Description of Business

Tenet Healthcare Corporation (together with our subsidiaries, referred to as *Tenet*, the *Company*, *we* or *us*) is an investor-owned health care services company whose subsidiaries and affiliates (collectively, *subsidiaries*) operate general hospitals and related health care facilities, and hold investments in other companies (including health care companies). At September 30, 2007, our subsidiaries operated 58 general hospitals (including four hospitals not yet divested at that date that are classified as discontinued operations), a cancer hospital and a critical access hospital, with a combined total of 15,268 licensed beds, serving urban and rural communities in 12 states. We also own or lease: various related health care facilities, including a rehabilitation hospital, a long-term acute care hospital, a skilled nursing facility and a number of medical office buildings all of which are located on, or nearby, one of our general hospital campuses; physician practices; captive insurance companies; and other ancillary health care businesses (including outpatient surgery centers, diagnostic imaging centers, and occupational and rural health care clinics).

Basis of Presentation

This quarterly report supplements our Annual Report on Form 10-K for the year ended December 31, 2006 (*Annual Report*). As permitted by the Securities and Exchange Commission (*SEC*) for interim reporting, we have omitted certain notes and disclosures that substantially duplicate those in our Annual Report. For further information, refer to the audited Consolidated Financial Statements and notes included in our Annual Report.

Certain balances in the accompanying Condensed Consolidated Financial Statements and these notes have been reclassified to give retrospective presentation to the discontinued operations described in Note 3. In addition, certain prior-year balances have been reclassified to conform to current-year presentation. Unless otherwise indicated, all financial and statistical data included in these notes to the Condensed Consolidated Financial Statements relate to our continuing operations, with dollar amounts expressed in millions (except per-share amounts).

Although the Condensed Consolidated Financial Statements and related notes within this document are unaudited, we believe all adjustments considered necessary for fair presentation have been included. In preparing our financial statements in conformity with accounting principles generally accepted in the United States of America (*GAAP*), we must use estimates and assumptions that affect the amounts reported in our Condensed Consolidated Financial Statements and accompanying notes. We regularly evaluate the accounting policies and estimates we use. In general, we base the estimates on historical experience and on assumptions that we believe to be reasonable, given the particular circumstances in which we operate. Actual results may vary from those estimates. Financial and statistical information we report to other regulatory agencies may be prepared on a basis other than GAAP or using different assumptions or reporting periods and, therefore, may vary from amounts presented herein. Although we make every effort to ensure that the information we report to those agencies is accurate, complete and consistent with applicable reporting guidelines, we cannot be responsible for the accuracy of the information they make available to the public.

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Operating results for the three-month and nine-month periods ended September 30, 2007 are not necessarily indicative of the results that may be expected for the full fiscal year 2007. Reasons for this include, but are not limited to: overall revenue and cost trends, particularly trends in patient accounts receivable collectibility and associated provisions for doubtful accounts; the timing and magnitude of price changes; fluctuations in contractual allowances and cost report settlements and valuation allowances; managed care contract negotiations or terminations and payer consolidation; changes in Medicare regulations; Medicaid funding levels set by the states in which we operate; levels of malpractice expense and settlement trends; impairment of long-lived assets and goodwill; restructuring charges; losses, costs and insurance recoveries related to natural disasters; litigation and investigation costs; acquisitions and dispositions of facilities and other assets; income tax rates and valuation allowances; the timing and amounts of stock option and restricted stock unit grants to employees and directors; and changes in occupancy levels and patient volumes. Factors that affect patient volumes and, thereby, our results of operations at our hospitals and related health care facilities include, but are not limited to: the business environment and demographics of local communities; the number of uninsured and underinsured individuals in local communities treated at our hospitals; seasonal cycles of illness; climate and weather conditions; physician recruitment, retention and attrition; advances in technology and treatments that reduce length of stay; local health care competitors; managed care contract negotiations or terminations; unfavorable publicity about us, which impacts our relationships with physicians and patients; and the timing of elective procedures. These considerations apply to year-to-year comparisons as well.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Change in Accounting Principle

Effective January 1, 2007, we adopted Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, as amended by FASB Staff Position No. 48-1 (FIN 48), and recorded a cumulative effect adjustment to beginning of year retained earnings of \$178 million. See Note 11 for additional information.

Effective January 1, 2006, we adopted Statement of Financial Accounting Standard (SFAS) No. 123(R), Share-Based Payment, and recorded a \$2 million credit, net of tax expense and related deferred tax valuation allowance, (\$0.00 per share) as a cumulative effect of a change in accounting principle. See Note 6 for further information.

NOTE 2. ACCOUNTS RECEIVABLE AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

The principal components of accounts receivable are shown in the table below:

	September 30, 2007	December 31, 2006
Continuing operations:		
Patient accounts receivable	\$ 1,687	\$ 1,704
Allowance for doubtful accounts	(427)	(431)
Estimated future recoveries from accounts assigned to collection agencies	33	38
Net cost report settlements payable and valuation allowances	(9)	(43)
	1,284	1,268
Discontinued operations:		
Patient accounts receivable	122	203
Allowance for doubtful accounts	(51)	(67)
Estimated future recoveries from accounts assigned to collection agencies	3	4
Net cost report settlements (payable) receivable and valuation allowances	(4)	5
	70	145
Accounts receivable, net	\$ 1,354	\$ 1,413

As of September 30, 2007, our total estimated collection rates on managed care accounts and self-pay accounts were approximately 98% and 36%, respectively, which included collections from point-of-service through collections by our in-house collection agency or external collection vendors. The comparable managed care and self-pay collection rates as of December 31, 2006 were approximately 97% and 32%, respectively. Collection rates are calculated based on a weighted average look-back period of 18 months of collections.

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Accounts that are pursued for collection through regional or hospital-based business offices are maintained on our hospitals' books and reflected in patient accounts receivable with an allowance for doubtful accounts established to reduce the carrying value of such receivables to their estimated net realizable value. We estimate this allowance based on the aging and historical collection experience of our accounts receivables by hospital and for each type of payer, and other relevant factors. Changes in these factors could have an impact on our estimates.

Accounts assigned to collection agencies (both in-house and external) are written off and excluded from patient accounts receivable and allowance for doubtful accounts; however, an estimate of future recoveries from all accounts at collection agencies is determined based on historical experience and recorded on our hospitals' books as a component of accounts receivable in the Condensed Consolidated Balance Sheets.

We provide charity care to patients who are financially unable to pay for the health care services they receive. Most patients who qualify for charity care are charged a per diem amount for services received, subject to a cap. Except for the per diem amounts, our policy is not to pursue collection of amounts determined to qualify as charity care; therefore, we do not report these amounts in net operating revenues or in the allowance for doubtful accounts. For the three and nine months ended September 30, 2007, \$163 million and \$493 million, respectively, in charity care gross charges were excluded from net operating revenues and the allowance for doubtful accounts compared to \$153 million and \$447 million for the three and nine months ended September 30, 2006, respectively. Had these charges been reflected in revenue, they would have been at amounts significantly reduced under our *Compact with Uninsured Patients*.

TENET HEALTHCARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. DISCONTINUED OPERATIONS

On August 31, 2007, our lease agreement to operate RHD Memorial Medical Center and Trinity Medical Center in the Dallas, Texas area expired; we had previously disclosed that another company had been selected to manage these two hospitals after the expiration of our lease. Also in the three months ended September 30, 2007, we decided to sell North Ridge Medical Center in Fort Lauderdale, Florida, and we began actively seeking potential buyers for that facility. In addition, on October 3, 2007, we announced that we entered into a definitive agreement to sell Shelby Regional Medical Center in Center, Texas. As a result of moving these four hospitals into discontinued operations in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144), during the three months ended September 30, 2007, we wrote off goodwill of \$3 million.

Of the seven hospitals held for sale at December 31, 2006, we completed the sale of Alvarado Hospital Medical Center in California and Graduate Hospital in Pennsylvania during the three months ended March 31, 2007, the sale of the real estate of Lindy Boggs Medical Center in Louisiana during the three months ended June 30, 2007, and the sale of Roxborough Memorial Hospital and Warminster Hospital, both in the Philadelphia area, during the three months ended September 30, 2007. We are continuing to negotiate with buyers for the Encino and Tarzana campuses of Encino-Tarzana Regional Medical Center, which have been slated for divestiture since January 2004. The longer we continue to operate these hospitals, while trying to finalize a sales agreement, the higher the likelihood that we will have to record additional impairment and restructuring charges. We have classified the results of operations of the seven hospitals held for sale at the end of 2006 and the four hospitals discussed above, as well as the wind-down operations of hospitals previously divested, as discontinued operations in accordance with SFAS 144 for all periods presented.

We classified \$48 million and \$114 million of assets of the hospitals included in discontinued operations as assets held for sale in current assets in the accompanying Condensed Consolidated Balance Sheets at September 30, 2007 and December 31, 2006, respectively. These assets primarily consist of property and equipment and were recorded at the lower of the asset's carrying amount or its fair value less estimated costs to sell. The fair value estimates were derived from independent appraisals, established market values of comparable assets, or internal estimates of future net cash flows. These fair value estimates can change by material amounts in subsequent periods. Many factors and assumptions can impact the estimates, including the future financial results of these hospitals and how they are operated by us until they are divested, changes in health care industry trends and regulations until the hospitals are divested, and whether we ultimately divest the hospital assets to buyers who will continue to operate the assets as general hospitals or utilize the assets for other purposes. In certain cases, these fair value estimates assume the highest and best use of the assets in the future to a market place participant is other than as a hospital. In these cases, the estimates are based on the fair value of the real property and equipment if utilized other than as a hospital. These fair value estimates do not include the costs of closing these hospitals or other future operating costs, which could be substantial. Accordingly, the ultimate net cash realized from the sale of the hospital assets could be significantly less than the fair value estimates. Because we do not intend to sell the accounts receivable of these hospitals, the receivables, less the related allowance for doubtful accounts, estimated future recoveries from accounts assigned to collection agencies, and net cost report settlements (payable) receivable and valuation allowances, are included in our consolidated net accounts receivable in the accompanying Condensed Consolidated Balance Sheets.

Net operating revenues and income (loss) before income taxes reported in discontinued operations for the three and nine months ended September 30, 2007 and 2006 are as follows:

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	Three Months Ended September 30,				Nine Months Ended September 30,			
	2007		2006		2007		2006	
Net operating revenues	\$	101	\$	306	\$	410	\$	953
Income (loss) before income taxes		(22)		(27)		(68)		59

We recorded \$18 million of net impairment and restructuring charges in discontinued operations during the nine months ended September 30, 2007, consisting of \$10 million for the write-down of long-lived assets to their estimated fair values, less estimated costs to sell, and \$10 million of employee severance and retention costs, offset by a \$2 million credit to reduce an estimated asset retirement obligation related to asbestos.

We recorded \$107 million of impairment and restructuring charges in discontinued operations during the nine months ended September 30, 2006 primarily consisting of \$157 million for the write-down of long-lived assets to their estimated fair values, less estimated costs to sell, \$12 million in goodwill impairment, \$2 million for employee severance and retention costs,

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

and \$1 million in lease termination and other costs, offset by \$65 million in insurance recoveries related to Hurricane Katrina property claims.

In addition to the \$65 million in insurance recoveries recorded as a reduction to the impairment charges in discontinued operations, we also recorded \$193 million of insurance recoveries in the three months ended June 30, 2006 related to the disruption of our discontinued operations by Hurricane Katrina.

We have sought up to \$275 million in recovery under our excess professional and general liability insurance policies in connection with our \$395 million settlement, in December 2004, of the patient litigation related to our former Redding Medical Center. Certain of our insurance carriers have raised objections to coverage under our policies. We are pursuing all means available against the insurance carriers in seeking coverage and, in January 2005, we filed for arbitration against each of the three carriers to resolve the dispute. Subsequently, we reached a settlement with one of the excess carriers in the amount of \$45 million, which we recorded as an insurance recovery in the three months ended March 31, 2006 and collected in July 2006. This insurance recovery reduced the total remaining excess limits available under our excess policies to \$230 million (including up to a maximum of \$200 million for the Redding claims) for all occurrences prior to June 1, 2003. We continue to pursue recovery from the other two carriers under these excess policies up to a maximum of \$200 million for the Redding claims. We currently maintain other excess liability insurance policies having a maximum aggregate coverage limit of \$275 million for occurrences from June 1, 2003 through May 31, 2008.

In addition to the \$45 million insurance recovery related to Redding Medical Center, we recorded a \$21 million charge during the three months ended June 30, 2006 related to the civil settlement of a matter involving Alvarado Hospital Medical Center. This charge is reflected in litigation settlements, net of the \$45 million insurance recovery, in discontinued operations in the accompanying Condensed Consolidated Statements of Operations.

As we move forward with our previously announced divestiture plans, or should we dispose of additional hospitals in the future, we may incur additional asset impairment and restructuring charges in future periods.

NOTE 4. IMPAIRMENT AND RESTRUCTURING CHARGES

During the nine months ended September 30, 2007, we recorded net impairment and restructuring charges of \$24 million, consisting of \$15 million of employee severance and other related costs, \$7 million in lease termination costs, a \$1 million impairment charge for the write-down of long-lived assets to their estimated fair values in accordance with SFAS 144, and \$1 million for the acceleration of stock-based compensation expense.

During the nine months ended September 30, 2006, we recorded net impairment and restructuring charges of \$26 million. Prior to our decision to divest five of our six hospitals in Louisiana, we recorded a \$35 million goodwill impairment related to the formation of our NOLA Regional Health Network, which consisted of those six hospitals that were previously part of our Texas-Gulf Coast Region, primarily due to the then

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adverse current and anticipated future financial trends of those six hospitals. In addition, we had a \$3 million recovery of previous write-offs and \$3 million of insurance recoveries for property damage caused by Hurricane Katrina, as well as approximately \$1 million in employee severance and related costs and \$2 million in lease termination costs that were recorded as restructuring charges during the nine months ended September 30, 2006, offset by a \$6 million reduction in restructuring reserves recorded in prior periods. As we move forward with our restructuring plans, or should we restructure our hospitals in the future, or if the operating results of our hospitals do not meet expectations, or if we expect negative trends to impact our future outlook, additional impairments of long-lived assets and goodwill, and restructuring charges may occur.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The tables below are a reconciliation of beginning and ending liability balances in connection with restructuring charges recorded during the nine months ended September 30, 2007 and 2006 in continuing and discontinued operations:

	Balances at Beginning of Period	Restructuring Charges, Net	Cash Payments	Other	Balances at End of Period
Nine Months Ended September 30, 2007					
Continuing operations:					
Severance costs in connection with hospital cost-control programs and general overhead-reduction plans	\$ 23	\$ 23	\$ (14)	\$ (5)	\$ 27
Discontinued operations:					
Lease cancellations and estimated costs associated with the sale or closure of hospitals and other facilities	16	10	(10)		16
	\$ 39	\$ 33	\$ (24)	\$ (5)	\$ 43

	Balances at Beginning of Period	Restructuring Charges, Net	Cash Payments	Other	Balances at End of Period
Nine Months Ended September 30, 2006					
Continuing operations:					
Severance costs in connection with hospital cost-control programs and general overhead-reduction plans	\$ 37	\$ (3)	\$ (15)		\$ 19
Discontinued operations:					
Lease cancellations and estimated costs associated with the sale or closure of hospitals and other facilities	28	3	(13)		18
	\$ 65	\$	\$ (28)	\$	\$ 37

The above liability balances are included in other current liabilities and other long-term liabilities in the accompanying Condensed Consolidated Balance Sheets. Cash payments to be applied against these accruals at September 30, 2007 are expected to be approximately \$7 million in 2007 and \$36 million thereafter. The other column represents non-cash charges that are recorded in other accounts, such as the acceleration of stock-based compensation expense related to severance agreements.

NOTE 5. LONG-TERM DEBT, LEASE OBLIGATIONS AND GUARANTEES

The table below shows our long-term debt as of September 30, 2007 and December 31, 2006:

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	September 30, 2007	December 31, 2006
Senior notes:		
6 3/8%, due 2011	\$ 1,000	\$ 1,000
6 1/2%, due 2012	600	600
7 3/8%, due 2013	1,000	1,000
9 7/8%, due 2014	1,000	1,000
9 1/4%, due 2015	800	800
6 7/8%, due 2031	450	450
Capital leases and mortgage notes	8	29
Unamortized note discounts	(91)	(97)
Total long-term debt	4,767	4,782
Less current portion	1	22
Long-term debt, net of current portion	\$ 4,766	\$ 4,760

Credit Agreement

In November 2006, we entered into a five-year, \$800 million senior secured revolving credit facility that replaced our \$250 million letter of credit facility. The revolving credit facility is collateralized by patient accounts receivable at our acute care and specialty hospitals, and bears interest at our option based on the London Interbank Offered Rate plus 175 basis points or

TENET HEALTHCARE CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Citigroup's base rate, as defined in the credit agreement, plus 75 basis points. At September 30, 2007, there were no cash borrowings outstanding under the revolving credit facility, and we had approximately \$231 million of letters of credit outstanding. Based on our eligible receivables, the borrowing capacity under the revolving credit facility was \$561 million at September 30, 2007.

Senior Notes

All of our senior notes are general unsecured senior debt obligations that rank equally in right of payment with all of our other unsecured senior indebtedness, but are effectively subordinated to the obligations of our subsidiaries and any obligations under our revolving credit facility to the extent of the collateral.

Covenants

Our revolving credit agreement contains customary covenants for an asset-backed facility, including a minimum fixed charge coverage ratio to be met when the available credit under the facility falls below \$100 million, as well as limits on debt, asset sales and prepayments of senior debt. The revolving credit agreement also includes a provision, which we believe is customary in receivables-backed credit facilities, that gives our banks the right to require that proceeds of collections of substantially all of our consolidated accounts receivable be applied directly to repay outstanding loans and other amounts that are due and payable under the revolving credit facility at any time that unused borrowing availability under the revolving credit facility is less than \$100 million or if an event of default has occurred and is continuing thereunder. In that event, we would seek to re-borrow under the revolving credit facility to satisfy our operating cash requirements. Our ability to borrow under the revolving credit facility is subject to conditions that we believe are customary in such facilities, including that no events of default then exist.

The indentures governing our senior notes contain covenants and conditions that have, among other requirements, limitations on (1) liens on principal properties and (2) sale and lease-back transactions with respect to principal properties. A principal property is defined in the indentures as a hospital that has an asset value on our books in excess of 5% of our consolidated net tangible assets, as defined. The above limitations do not apply, however, to (1) debt that is not secured by principal properties or (2) debt that is secured by principal properties if the aggregate of such secured debt does not exceed 15% of our consolidated net tangible assets, as further described in the indentures. The indentures also prohibit the consolidation, merger or sale of all or substantially all assets unless no event of default would result after giving effect to such transaction.

Physician Relocation Agreements and Other Minimum Revenue Guarantees

Consistent with our policy on physician relocation and recruitment, we provide income guarantee agreements to certain physicians who agree to relocate to our communities to fill a need in the hospital's service area and commit to remain in practice there for a specified period of time. Under such agreements, we are required to make payments to the physicians in excess of the amounts they earn in their practices up to the amount of the income guarantee. The income guarantee periods are typically 12 months. Such payments are recoverable from the physicians if

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they do not fulfill their commitment period to the community, which is typically three years subsequent to the guarantee period. We also provide minimum revenue collection guarantees to hospital-based physician groups providing certain services at our hospitals with terms ranging from one to three years.

At September 30, 2007, the maximum potential amount of future payments under these guarantees was \$58 million. In accordance with FASB Staff Position FIN 45-3, Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners, at September 30, 2007, we had a liability of \$47 million for the fair value of these guarantees included in other current liabilities.

NOTE 6. EMPLOYEE BENEFIT PLANS

At September 30, 2007, there were approximately 10.4 million shares of common stock available under our 2001 Stock Incentive Plan for future stock option grants and other incentive awards, including restricted stock units. Options generally have an exercise price equal to the fair market value of the shares on the date of grant and generally expire 10 years from the date of grant. A restricted stock unit is a contractual right to receive one share of our common stock in the future. Options and restricted stock units typically vest one-third on each of the first three anniversary dates of the grant.

Effective January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment (SFAS 123(R)), using the modified prospective application transition method. Prior to 2006, we used the Black-Scholes option-pricing model to estimate the grant

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date fair value of stock option awards. For grants subsequent to the adoption of SFAS 123(R), we estimate the fair value of awards on the date of grant using a binomial lattice model. We believe that the binomial lattice model is a more appropriate model for valuing employee stock awards because it better reflects the impact of stock price changes on option exercise behavior. As a result of adopting SFAS 123(R) during the three months ended March 31, 2006, we recorded a \$2 million credit as a cumulative effect of a change in accounting principle, net of tax expense and related valuation allowance. This adjustment related to the requirement under SFAS 123(R) to estimate the amount of stock-based awards expected to be forfeited rather than recognizing the effect of forfeitures only as they occur.

Prior to our adoption of SFAS 123(R), benefits of tax deductions in excess of recognized compensation costs were reported as operating cash flows. SFAS 123(R) requires excess tax benefits be reported as a financing cash inflow. We have not recognized any excess tax benefits during the nine months ended September 30, 2007 or 2006.

Our income from continuing operations for the nine months ended September 30, 2007 includes \$32 million pre-tax of compensation costs related to our stock-based compensation arrangements (\$20 million after tax, excluding the impact of the deferred tax valuation allowance). Our loss from continuing operations for the nine months ended September 30, 2006 includes \$34 million pre-tax of compensation costs related to our stock-based compensation arrangements (\$21 million after tax, excluding the impact of the deferred tax valuation allowance).

Stock Options

The following table summarizes stock option activity during the nine months ended September 30, 2007:

	Options	Weighted Average Exercise Price Per Share	Aggregate Intrinsic Value	Weighted Average Remaining Life
Outstanding as of December 31, 2006	38,690,973	\$ 20.41		
Granted	1,418,000	6.60		
Exercised	(5,100)	6.25		
Forfeited/Expired	(2,721,529)	15.19		
Outstanding as of September 30, 2007	37,382,344	\$ 20.26	\$	4.2 years
Vested and expected to vest at September 30, 2007	37,246,431	\$ 20.31	\$	4.1 years
Exercisable as of September 30, 2007	33,147,186	\$ 21.79	\$	3.6 years

There were 5,100 options with a minimal aggregate intrinsic value exercised during the nine months ended September 30, 2007, and no options were exercised during the nine months ended September 30, 2006.

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As of September 30, 2007, there were \$9 million of total unrecognized compensation costs related to stock options. These costs are expected to be recognized over a weighted average period of 1.1 years.

The weighted average estimated fair value of options we granted in the nine months ended September 30, 2007 and 2006 was \$2.77 per share and \$3.13 per share, respectively, as calculated based on each grant date, using a binomial lattice model with the following assumptions:

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	
	All Employees	Top Four Employees	All Other Employees
Expected volatility	40%	41%	41%
Expected dividend yield	0%	0%	0%
Expected life	5.75 years	6.25 years	4 years
Expected forfeiture rate	3%	0%	15%
Risk-free interest rate range	4.49%	4.47% - 5.06%	4.47% - 5.06%
Early exercise threshold	50% gain	50% gain	50% gain
Early exercise rate	50% per year	50% per year	50% per year

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The expected volatility used in the binomial lattice model incorporates historical and implied share-price volatility and is based on an analysis of historical prices of our stock and open-market exchanged options, and was developed in consultation with an outside valuation specialist. The expected volatility reflects the historical volatility for a duration consistent with the contractual life of the options, and the volatility implied by the trading of options to purchase our stock on open-market exchanges. The historical share-price volatility excludes the movements in our stock price during the period October 1, 2002 through December 31, 2002 due to unique events occurring during that time, which caused extreme volatility of our stock price. The expected life of options granted is derived from the output of the binomial lattice model, and represents the period of time that the options are expected to be outstanding. This model incorporates an early exercise assumption in the event of a significant increase in stock price. The risk-free interest rates are based on zero-coupon United States Treasury yields in effect at the date of grant consistent with the expected exercise timeframes.

The following table summarizes information about our outstanding stock options at September 30, 2007:

Range of Exercise Prices	Number of Options	Options Outstanding	Weighted Average Exercise Price	Number of Options	Options Exercisable
		Weighted Average Remaining Contractual Life			Weighted Average Exercise Price
\$0.00 to \$10.639	8,172,233	7.8 years	\$ 8.98	3,969,523	\$ 9.74
\$10.64 to \$13.959	5,984,108	4.3 years	11.82	5,951,660	11.81
\$13.96 to \$17.589	6,187,587	3.8 years	17.25	6,187,587	17.25
\$17.59 to \$28.759	8,692,503	1.7 years	23.77	8,692,503	23.77
\$28.76 and over	8,345,913	3.3 years	35.94	8,345,913	35.94
	37,382,344	4.2 years	\$ 20.26	33,147,186	\$ 21.79

Restricted Stock Units

The following table summarizes restricted stock unit activity during the nine months ended September 30, 2007:

	Restricted Stock Units	Weighted Average Grant Date Fair Value Per Unit
Unvested as of December 31, 2006	7,101,474	\$ 9.31
Granted	5,821,924	6.58
Vested	(3,205,066)	9.59
Forfeited	(747,345)	8.40
Unvested as of September 30, 2007	8,970,987	\$ 7.48

Included in the grants of restricted stock units for the nine months ended September 30, 2007 are 3,319,424 restricted stock units that vest ratably over three years. The fair value of these restricted stock units was based on our share price on the grant date. Also, 1,402,500 restricted stock units that include cliff vesting conditions, based on the average closing price of our shares on the last 40 trading days of 2009, were granted in the three months ended March 31, 2007 to certain of our executives. Vesting is based on the following share price criteria and is calculated on a straight-line basis for share prices between the following benchmarks:

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Average Share Price	Vesting%
\$10.25 or above	100%
\$8.50 or above, but less than \$10.25	66.67% - 99.99%
\$6.75 or above, but less than \$8.50	33.33% - 66.66%
Less than \$6.75	33.33%

One exception to the above vesting criteria is that 100,000 restricted stock units granted to our chief executive officer vest on the first anniversary of the grant and an additional 100,000 restricted stock units vest on the second anniversary, with the remaining 700,000 restricted stock units granted vesting based on the average closing price of our shares on the last 40 trading days of 2009 as follows: 100,000 restricted stock units vest if the average closing price of our common stock is \$6.75 or less, 400,000 restricted stock units vest if the average closing price of our common stock is at least \$8.50, and 700,000 restricted stock units vest if the average closing price of our common stock is \$10.25 or more. The number of restricted stock units vesting will be determined using a straight-line interpolation if the average closing price is between the above benchmarks. The fair value of all of the

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restricted stock units that include cliff vesting conditions is \$4.71 per share, which was estimated based on a Monte Carlo valuation model.

In addition to the above grants, 1,100,000 restricted stock units were granted during the three months ended March 31, 2007 to a group of employees for retention purposes. The fair value of these restricted stock units was based on our share price on the grant date. These units vest 25% on each of the third, fifth, seventh and tenth anniversary dates of the grant.

As of September 30, 2007, there were \$43 million of total unrecognized compensation costs related to restricted stock units. These costs are expected to be recognized over a weighted average period of 2.6 years.

Restricted Stock

In January 2003, we issued 200,000 shares of restricted stock to our chief executive officer. The stock vested on the second, third and fourth anniversary dates of the grant.

The following table summarizes restricted stock activity during the nine months ended September 30, 2007:

	Shares	Weighted Average Grant Date Fair Value Per Share
Unvested as of December 31, 2006	66,667	\$ 18.64
Granted		
Vested	(66,667)	18.64
Forfeited		
Unvested as of September 30, 2007		\$

NOTE 7. SHAREHOLDERS EQUITY

The following table shows the changes in consolidated shareholders equity during the nine months ended September 30, 2007 (dollars in millions, shares in thousands):

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	Shares Outstanding	Issued Par Amount	Additional Paid-in Capital	Other Comprehensive Loss	Accumulated Deficit	Treasury Stock	Total Shareholders Equity
Balances at December 31, 2006	471,585	\$ 26	\$ 4,372	\$ (45)	\$ (2,610)	\$ (1,479)	264
Cumulative effect of adopting FIN 48					(178)		(178)
Net loss					(14)		(14)
Stock-based compensation expense and issuance of common stock	2,508		29				29
Balances at September 30, 2007	474,093	\$ 26	\$ 4,401	\$ (45)	\$ (2,802)	\$ (1,479)	101

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NOTE 8. OTHER COMPREHENSIVE INCOME (LOSS)

The table below shows each component of other comprehensive income (loss) for the three and nine months ended September 30, 2007 and 2006:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net loss	\$ (59)	\$ (89)	\$ (14)	\$ (417)
Other comprehensive income (loss):				
Reclassification adjustments for realized losses included in net loss	1	1	2	
Foreign currency translation adjustment			(2)	
Other comprehensive income before income taxes	1	1		
Income tax (expense) benefit related to items of other comprehensive income				
Other comprehensive income	1	1		
Comprehensive loss	\$ (58)	\$ (88)	\$ (14)	\$ (417)

NOTE 9. PROPERTY AND PROFESSIONAL AND GENERAL LIABILITY INSURANCE*Property Insurance*

We have property, business interruption and related insurance coverage to mitigate the financial impact of catastrophic events or perils that is subject to deductible provisions based on the terms of the policies. These policies are on an occurrence basis. For the policy period April 1, 2007 through March 31, 2008, we have coverage totaling \$600 million per occurrence, after deductibles and exclusions, with annual aggregate sub-limits of \$100 million each for floods and earthquakes and a per-occurrence sub-limit of \$100 million for windstorms with no annual aggregate. The insurance program has a deductible for wind-related claims of 5% of insured values. With respect to fires and other perils, excluding windstorms, floods and earthquakes, the total \$600 million limit of coverage per occurrence applies. Deductibles are also 5% of insured values for floods and California earthquakes, 2% of insured values for New Madrid fault earthquakes, and \$1 million for fires and other perils.

Professional and General Liability Insurance

At September 30, 2007 and December 31, 2006, the current and long-term professional and general liability reserves on our Condensed Consolidated Balance Sheet were approximately \$713 million and \$731 million, respectively. These reserves include the reserves recorded by our captive insurance subsidiaries and self-insured retention reserves recorded based on actuarial estimates for the portion of our professional

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and general liability risks, including incurred but not reported claims, for which we do not have insurance coverage. We estimated the reserves for losses and related expenses using expected loss-reporting patterns discounted to their present value under a risk-free rate approach using a Federal Reserve seven-year maturity composite rate of 4.66% and 4.76% at September 30, 2007 and December 31, 2006, respectively.

For the policy period June 1, 2007 through May 31, 2008, our hospitals generally have a self-insurance retention per occurrence of \$2 million for losses incurred during the policy period. Our captive insurance company, The Healthcare Insurance Corporation, has a self-insured retention of \$13 million per occurrence above our hospitals' \$2 million self-insurance retention level. The next \$10 million of claims in excess of \$15 million are 100% reinsured by The Healthcare Insurance Corporation with independent reinsurance companies. Claims in excess of \$25 million are covered by our excess professional and general liability insurance policies from major independent insurance companies, on a claims-made basis, subject to an aggregate limit of \$275 million.

Included in other operating expenses in the accompanying Condensed Consolidated Statements of Operations is malpractice expense of \$40 million and \$45 million for the three months ended September 30, 2007 and 2006, respectively, and \$134 million for each of the nine months ended September 30, 2007 and 2006.

NOTE 10. CLAIMS AND LAWSUITS

Currently pending and recently resolved material claims, legal proceedings and investigations that are not in the ordinary course of business are set forth below. Where specific amounts are sought in any pending legal proceeding, those amounts are disclosed. For all other matters, where a loss is reasonably possible and estimable, an estimate of the loss or a

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range of loss is provided. Where no estimate is provided, a loss is not reasonably possible or an amount of loss is not reasonably estimable at this time.

1. Shareholder Derivative Actions and Securities Matter In January 2006, we announced that we had reached an agreement in principle to settle the shareholder derivative action entitled *In Re Tenet Healthcare Corporation Derivative Litigation*, which was pending against certain current and former members of our board of directors and former members of senior management in California Superior Court in Santa Barbara. In March 2006, we paid a \$5 million award of attorneys' fees in connection with the settlement, which we recorded as a charge during the three months ended March 31, 2006. The shareholder derivative settlement received final court approval in May 2006; however, a notice of appeal of the settlement was filed in July 2006. On September 20, 2007, the appellate court upheld the Superior Court's decision and affirmed the settlement.

A consolidated shareholder derivative action is pending in federal district court in California against certain current and former members of our board of directors and former members of senior management. Tenet is also named as a nominal defendant. The shareholder plaintiffs allege various causes of action on behalf of the Company and for our benefit, including breach of fiduciary duty, insider trading, unjust enrichment and securities law violations. We anticipate that this matter will be dismissed now that the state appellate court has affirmed the settlement of the state derivative litigation, as described above. The federal court has stayed all proceedings in this case until our motion to dismiss is filed and resolved.

In June 2006, four purported Tenet shareholders who opted out of the settlement of the federal securities class action lawsuit entitled *In Re Tenet Healthcare Corporation Securities Litigation* filed a civil complaint in federal court in California against the Company, certain former executive officers of the Company and KPMG LLP ("KPMG"), the Company's former independent registered public accounting firm. Plaintiffs allege that the Company, KPMG and the former executives are liable for securities fraud under Section 10(b) of and Rule 10b-5 under the Securities Exchange Act of 1934, and that each of the former executive defendants are liable for control person liability pursuant to Section 20(a) of the Exchange Act. Plaintiffs seek an undisclosed amount of compensatory damages and reasonable attorneys' fees and expenses.

2. SEC Settlement In April 2007, we announced that the Company entered into a \$10 million civil settlement with the Securities and Exchange Commission that concluded an SEC investigation into two separate matters—the first primarily concerning whether our disclosures in our financial reports relating to Medicare outlier reimbursements and stop-loss payments under managed care contracts were misleading or otherwise inadequate, and the second relating to whether inappropriate contractual allowances for managed care contracts were established at certain of our hospitals. In the three months ended December 31, 2006, we recorded an accrual of \$10 million as an estimated liability to address the potential resolution of the SEC investigation. The civil settlement, filed on April 2, 2007 in the U.S. District Court in Los Angeles, arose from a civil complaint filed simultaneously by the SEC against Tenet and four former officers of the Company, alleging violations of certain anti-fraud and disclosure provisions of the federal securities laws. The settlement, in which Tenet neither admitted nor denied the allegations, was approved by the court on April 4, 2007 and resolved the SEC complaint against the Company. As part of the settlement, the SEC said it would seek to deposit the \$10 million civil penalty paid by Tenet into a fair fund to be distributed to eligible individuals and entities that demonstrate losses related to the value of their Tenet shares purchased or sold between April 12, 2002 and November 7, 2002.

3. Wage and Hour Actions We are defending a proposed class action lawsuit alleging that our hospitals violated certain provisions of the California Labor Code and applicable California Industrial Welfare Commission Wage Orders with respect to (a) meal breaks, (b) rest periods,

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(c) the payment of compensation for meal breaks and rest periods not taken, (d) rounding off practices for time entries on timekeeping records, (e) the information shown on pay stubs and (f) certain overtime payments. Plaintiffs are seeking back pay, statutory penalties and attorneys' fees, and seek to certify this action on behalf of virtually all nonexempt employees of our California subsidiaries. Another proposed class action pending in Southern California also involves allegations regarding unpaid overtime. The lawsuit alleges that our pay practices since 2000 for California-based 12-hour shift employees violate California and federal overtime laws by virtue of the alleged failure to include certain payments known as Flexible (or California) Differential payments in the regular rate of pay that is used to calculate overtime pay. This case has been provisionally certified as a collective action under the federal Fair Labor Standards Act for the purpose of giving notice to potential class members. Plaintiff is seeking back pay, statutory penalties and attorneys' fees. We oppose class certification in each case. We have recorded an accrual of \$21 million as an estimated liability for the wage and

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hour actions and other unrelated employment matters (we recorded \$18 million in the three months ended September 30, 2006 and \$6 million in prior years, offset by a \$3 million reduction in the estimated liability in the three months ended March 31, 2007).

4. **Investigation by Louisiana Attorney General's Office** In connection with an investigation into patient deaths that occurred at various hospitals and nursing homes following Hurricane Katrina, the Louisiana Attorney General's Office conducted a review of events that occurred during the hurricane at two Tenet hospitals in New Orleans—Memorial Medical Center and Lindy Boggs Medical Center (both of which have since been divested). On October 1, 2005, representatives of the Louisiana Attorney General's Office conducted a search of Memorial's campus pursuant to a search warrant issued by an Orleans Parish state judge on September 30, 2005. Certain records and other materials were removed, including materials from a long-term acute care facility on Memorial's campus, which was managed and operated under separate license by LifeCare Holdings Inc., which is not affiliated with us. The Attorney General's Office also issued subpoenas to the Company and Memorial requesting documents pertaining to the matters under investigation and events occurring at the hospital during and after the hurricane. In addition, the Attorney General subpoenaed certain individuals he wanted to question on these matters, including a number of our employees. Subsequently, we learned in mid-July 2006 that the Louisiana Attorney General had referred the findings of his ten-month investigation to the New Orleans District Attorney. The Attorney General's Office also announced in July 2006 that it had issued arrest warrants for two nurses who were employees of Memorial and one doctor who was not our employee, but was on the medical staff at Memorial, alleging that they may have administered pain medication that hastened the deaths of four patients of LifeCare's facility in the aftermath of the hurricane. These individuals repeatedly denied the Attorney General's allegations. We learned in July 2007 that the New Orleans District Attorney's Office refused to press charges against the two nurses after they testified before a grand jury. Subsequently, the District Attorney's Office announced that the grand jury had declined to return any indictments in the matter.

5. **Tax Disputes** See Note 11 for information concerning disputes with the Internal Revenue Service (IRS) regarding our federal tax returns.

Our hospitals are also routinely subject to sales and use tax audits and personal property tax audits by the state and local government jurisdictions in which they do business. The results of the audits are frequently disputed, and such disputes are ordinarily resolved by administrative appeals or litigation.

6. **Qui Tam Actions** We have been defending a qui tam action in Texas that alleged violations of the federal False Claims Act by our hospitals in El Paso arising out of the alleged manipulation of the hospitals' charges in order to increase outlier payments. On April 13, 2007, we filed a motion for summary judgment seeking dismissal of the case. On the same day, the government also filed a summary judgment motion. On July 20, 2007, the court found that the relators had no direct and independent knowledge of the information on which their allegations were based and granted both motions, thereby dismissing this case. The relators have since filed an appeal to the U.S. Court of Appeals for the Fifth Circuit. We believe that the trial court's dismissal was correct and intend to defend that decision on appeal.