New Jersey
Appleseed

June 3, 2015

Atty. Gen. John Hoffman
Office of the Attorney General
PO Box 080
Trenton, New Jersey 08525-080
Att: Jay Ganzman, DAG

Re: Proposed Acquisition of East Orange General Hospital By Prospect Medical Holdings, Inc., an out of state for-profit corporation.

Dear Mr. Ganzman:

I am writing to you on behalf of New Jersey Appleseed Public Interest Law Center to express some of our concerns regarding the sale of East Orange General Hospital ("EOGH") to Prospect Medical Holdings, Inc. ("Prospect"). Our concerns have less to do with the corporate status or business practices of the purchaser or the process employed by Essex Valley Healthcare, Inc. the sole member of EOGH and its Foundation, than they have to do with certain terms of the conversion, as reflected in the Asset Purchase Agreement, dated May 31, 2014.

To begin, we want to acknowledge the generosity of EOGH, its former CEO, Kevin Slavin, and its attorneys, McCarter & English, who permitted us to review the Hospital's CHAPA filings at the offices of McCarter & English in Newark. We reviewed the documents last January, and a phone call to such attorneys has confirmed that as of April 2015, EOGH had not filed additional papers or had responded to additional questions.

We further want to acknowledge that the reorganization/sale process employed by the EOGH - i.e., the retention of experts, the selection criteria developed and applied (EOGH 13—2-68), the

New Jersey Appleseed
Public Interest Law Center of New Jersey
744 Broad Street, Suite 1525
Newark, New Jersey 07102

Phone: 973.735.0523; 917-771-8060
Email: steinhagen_pilc@yahoo.com
Website: www.njappleseed.org

RFP process implemented and the involvement of the full Board of Directors— appears, based on the record, to have been exemplary. The community stakeholders appreciate the Board's efforts; Board members, officers and management seem to have taken their community mission seriously. In this regard, the selection of Prospect Medical Holdings, Inc., over the two other bidders, Prime Healthcare, LLC, and CarePoint Health appears to be the "the best alternative in carrying out its mission and purposes." N.J.S.A. 26:2H-7.11(d)(5). See EOGH 15-00754-56 (commitment to focus on physician alignment and improving the quality of care through population health management); EOGH 15-00769-772 (commitment to focus on Behavioral Health and to work with local community leaders and advisory board in determining future services and projects).

We understand that beginning in 2006, the Board had explored affiliation options with other Essex-based health systems and nonprofit hospitals, including Barnabus Health, University Hospital and Newark Beth Israel Medical Center; but as of 2013, they had come to naught (i.e., in April 2013, Barnabus definitively stated that it cannot "undertake formal affiliation discussions." (Resp. Question 1). Nevertheless, in light of the Navigant Report that was issued in the beginning of March of this year, we think that such discussions must once again be commenced. However, unlike the situation in Newark (where St. Michael's Medical Center has applied for approval of the sale of its hospital to Prime Healthcare, LLC), we believe that such discussions need not hold up the sale of EOGH to Prospect Medical Holdings, Inc. since Prospect's plans for EOGH may not be inconsistent with many of the goals of the Navigant Report. A review of Prospect's answers to questions regarding the services they would seek to maintain at EOGH indicates that it may be amenable to coordinating care at the hospital within a broader network of hospitals, with a specialization and emphasis on Behavioral Health, Forensics and Dialysis. Prospect's orientation toward coordination of medical groups within the hospital, use of data driven management and application of metrics as the basis of their business model (EOGH 15-00772)is very different than the practices that prevail at CarePoint's New Jersey's hospitals and Prime's hospitals in other states. Prospect's stated willingness to work with community leaders in determining future services at EOGH also makes it a likely partner in implementing the Navigant Report for the Greater Newark Area (in contrast to Prime Healthcare). Notwithstanding our speculations, we urge the Attorney General, with the Commissioner of Health, to undertake discussions with Prospect about its willingness to implement the Navigant Report in order to ensure that approval of this sale is not "likely to result in the deterioration of the quality, availability or accessibility of health care services in the affected community." N.J.S.A. 26:2H-7.11(b).

On the other hand, we are not starry-eyed about Prospect Medical Holdings. It appears from the documents submitted that Prospect is highly leveraged (EOGH 13-02229); and as of 2012, its Moody's rating was B2 and Standard & Poor's rating was B- (EOGH 13-02238). It does not offer any pension or 401(k) plans to its employees (EOGH 13-02241, and to the best of our knowledge, the documents do not address Prospect's relationship with its unionized employees at its California hospitals. The Draft Due Diligence Report, prepared by ParenteBeard, does state that Prospect does not have any significant compliance issues at its hospitals, and that as of November 2012, Leonard Green Partner's "original investment had been returned in full and there is no further required annual dividend." EOGH 13-02245.(emphasis added), both factors weighing in favor of Prospect Medical as an appropriate buyer of EOGH.

Moving away from the selection of Prospect Medical Holdings, we have some concerns about the structure of the transaction and the amount of money that is being allocated to the conversion foundation. A review of the documents, including the proposed Asset Purchase Agreement (APA), makes it very difficult to figure out what Prospect Medical Holdings is actually paying for the hospital. An insistence to include a Projected Capital Expenditure Commitment (that allegedly will be applied to new capital projects and deferred capital maintenance projects), a Projected Capital Maintenance Commitment and a Working Capital Amount –— all of which end up in the hands of the buyer –—obscure the consideration that is actually paid. It appears to us that a little more than $20m. is being paid to EOGH (i.e., $10m. DSH Commitment to satisfy EOGH's Medicaid Disproportionate Share Hospital Liability, $10m. contribution to the Foundation, and approximately $1m.plus of the $4m. indemnification holdback, as explained in Sec. 13.4 of the APA).[1]

[1] We assert, as was the case with respect to the sale of Salem Memorial Hospital, another nonprofit hospital that was not part of a system, that the Attorney General should compel payment of the whole amount of the holdback (minus any amount spent due to actual misrepresentations) to the conversion foundation as soon as possible. Similarly, we are suspect of the allocation of some amount of the Projected CapEx Commitment to "deferred capital maintenance projects," and assert that the Foundation

Whether that amount constitutes the FMV and is reasonable is something that we request that the Attorney General's office further analyze. Furthermore, although there is some discussion in the documents that the Medical Arts Building could be sold for $10.5-14 m. in a sale/leaseback transaction (Response to Question 77), we are unable to determine whether that asset was considered in either the June 27, 2013 Valuation Report (assessing EOGH's FMV at $26.5m. to $32.5 m.) or the February 10, 2014 Valuation Report (estimating EOGH's FMV at $19m. to $27m.). Moreover, in the event that such asset is sold after the sale, there is no provision in the APA that would require the revenue of the sale to be applied to the conversion Foundation. Sec. 6.2(e)of the APA does not discuss distribution of the proceeds, only that the building will be leased to staff of EOGH. In any case, if the building is sold prior to sale and reduces Prospect's DSH Commitment, we would expect that the $10m. SSH Commitment would also be applied to the Foundation.

Finally, we have serious concerns about the proposed governance of the for-profit Hospital, as well as the conversion Foundation. It appears that the current Board of EOGH wants to retain control over the fate of the Hospital, through the establishment of a "Local Advisory Board," ("LAB") whose Chairperson will have a voting, ex officio seat on the six-person board of directors of Prospect, (Resp. Question 30; Ex. K to APA: Foundation Agreement). From the description of the LAB, the Chairperson may also be the one person Prospect gets to appoint to the Local Advisory Board. This LAB has the responsibility of making "recommendations and suggestions," and thus does not retain ultimate authority for the Hospital. We believe that there should be a locally based board that does have such authority and the fiduciary responsibilities that accompany that authority. LABs sound good, but are not the same as control. We would hope that Prospect would create a local board with full fiduciary duties to EOGH, not a mere advisory one. CHAPA requires the Attorney General to consider "whether officers, directors, board members or senior management will receive future contracts in existing, new or affiliated

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should not have to wait five-years to receive the remaining balance of that amount pursuant to the APA, Ex. K(1)9(c). Payment of FMV for the Hospital, as it is, must be made to EOGH, and net of debt that amount must be applied to the Foundation. Allocating portions of the consideration for "deferred capital improvements" seems to be an invalid way to keep a significant portion of the consideration in the hands of the buyer.

hospitals or foundations," N.J.S.A.26:2H-7.11(d)(7). In order to respect the spirit of CHAPA, we suggest that the Attorney General inquire whether people currently affiliated with EOGH and who have accepted positions on the LAB actually have received contracts from Prospect, and if so, whether those contracts are reasonable.

Moreover, we believe that the placement of the Chairperson of the Board of Trustees of the proposed Foundation on the LAB, the continuing relationship of the Foundation to the hospital (use of hospital space and staff), and the appointment of current Board members of EOGH to the Foundation all pose problems for this transaction. N.J.S.A.26:2H-7.11(h(1) and (2) have strong prohibitions against maintaining ties between EOGH and the Foundation. "No officer, director or senior manager of the [Foundation] shall have been a director, officer, agent trustee or employee of the nonprofit hospital during the three years immediately preceding the effective date of the acquisition," and "there must be a mechanism . . . to prohibit grants that benefit the board of directors and management of the acquiring entity." We understand that the first prohibition against previous management holding a position in the Foundation can be rebutted, but we think that in this case such justification has to be made much clearer in the record to ensure the public that competency and expertise is driving the decision rather than other considerations. The Foundation is tasked with monitoring compliance of Prospect with this transaction and is also given a right of first refusal for a period of ten years. (EOGH 23-00441). Again, we see that current Board members of EOGH are trying to maintain their relationship to the hospital. But CHAPA makes clear that the Foundation is supposed to be independent from the new, for-profit hospital, and its governance would probably be best in the hands of persons who have had no involvement in the sale to Prospect.

We also want to make sure that Foundation trustees understand that the purpose of the Foundation also includes "serv[ing] and support[ing] the charitable health care needs of the community historically serviced by EOGH." APA, Ex. K(2)(a)(ii). This prong of the Foundation's mission is required by CHAPA, and it must be given equal weight to the Foundation's purpose to provide certain services to the Supportive Housing Partnership and the Supportive Housing Program.

We understand that the current Board of EOGH is trying to do what is best to ensure the future viability of the hospital and to protect the current supportive housing program. However, the principles embedded in CHAPA must be appropriately applied, and the Foundation must be operated independently from EOGH, and should be governed by persons who are not involved in the governance or operation of the for-profit hospital, and were not involved in the operation of the nonprofit within three years of the transaction.

Thank you for your consideration of our comments.

Respectfully submitted,

Renée Steinhagen, Esq.
Executive Director

Cc: Richard Myslinski, Esq.