



October 21, 2015

Honorable Walter Koprowski, Jr., P.J.Ch.
Superior Court of New Jersey
Wilentz Justice Complex
212 Washington Street, 8th Fl.
Newark, N.J. 07102

Re: In the Matter of the Application of East General Hospital,
Essex Valley Healthcare, Inc. and the Foundation for East General
Hospital Pursuant to N.J.S.A. 26:2H-7.10 et seq.,
Docket No. ESX-C-104-12

Dear Judge Koprowski:

I am writing to you on behalf of New Jersey Appleseed Public Interest Law Center ("NJ Appleseed"), a nonprofit legal advocacy corporation, which participated in the public Community Healthcare Assets Protection Act ("CHAPA") hearing related to the afore-captioned application, and submitted written comments during the administrative process below. (New Jersey Appleseed's written comments, dated June 3, 2015, as well as those presented at the public hearing are attached here to as Exhibit A) Please accept this letter in lieu of a more formal memorandum in response to the Complaint and Order to Show Cause, returnable October 28, 2015, in this matter seeking approval of the proposed sale of substantially all the assets of East Orange General Hospital ("EOGH") and Essex Valley Healthcare, Inc. ("EVHI"), nonprofit

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

charitable corporations, to Prospect EOGH, a wholly-owned subsidiary of Prospect Medical Holdings, Inc., a for-profit Delaware corporation (“Prospect”).

Please be advised that NJ Appleseed has no objection to the proposed acquisition as conditioned by the Attorney General (Attorney General Review Opinion, dated October 7, 2015, at 54-56, as restated in its letter to the Court, dated October 20, 2015, hereinafter “AG Opinion”) and the Acting Commissioner of Health (CN Decision, dated September 16, 2015, at 12-19), and has no objection to proceeding in a summary manner to approve this transaction. Indeed, we would like to commend the Commissioner and the Attorney General for their thorough review of the transaction, and believe for the reasons more fully set forth below that this Court should impose not only those conditions recommended by the Attorney General, but also those imposed by the Acting Commissioner pursuant to the CN process in its final order approving the proposed transaction. Both sets of conditions are necessary and sufficient to protect the public’s interest; that is, to ensure that EOGH’s charitable assets are safeguarded and irrevocably dedicated for charitable health purposes, and that the transaction will not deteriorate quality and access to health services in the surrounding community. See N.J.S.A. 2H-7.11(b).

Nature of this Proceeding and Standard of Review

Pursuant to N.J.S.A. 2H-7.11(l),

Upon completion by the Attorney General of the review of the application required by this act, the nonprofit hospital shall apply to the Superior Court for approval of the proposed acquisition. In that proceeding, the Attorney General shall advise the court as to whether he supports or opposes the proposed acquisition, with or without any specific modifications, and the basis for that position.

In this way, the Attorney General merely advises the court as to whether he supports or opposes the proposed acquisition, and the Superior Court retains its common law authority (reflected in the New Jersey Constitution) over charitable trusts and corporations. Township of

Cinnaminson v. First Camden Nat'l Bank and Trust, 99 N.J. Super. 115, 127-129 (Ch. 1968).

That is, this Court hears this matter in its ultimate capacity as supervisor and protector of charitable trusts and corporations, and its determination does not entail review of a final agency decision based on the record below. Pursuant to its jurisdiction over charitable corporations, the Court must make its own determination of whether the decision of the nonprofit's board of trustees should be approved, and thus it need not afford the Attorney General the "deference" typically afforded to an agency implementing a legislative program or acting in a "quasi-legislative" capacity. Even if this court were to give the Attorney General some level of deference, it is certain that the court is not bound by the Attorney General's interpretation of CHAPA or its determination of a strictly legal issue. See In re Amendment to Recreation & Open Space Inventory of City of Plainfield, 353 N.J. Super. 310, 328 (App. Div. 2002)("[a]n appellate tribunal is . . . in no way bound by the agency's interpretation of a statute or its determination of a strictly legal issue.").¹

In its silence, the CHAPA statute also permits the court to hear additional testimony to that presented to the Attorney General during the public hearing and comment period, and parties to the application may request discovery from the applicant (though NJ Appleseed does not seek discovery or the right to present additional testimony in this matter; however, we did request discovery in the first transaction under CHAPA, that of the sale of Memorial Hospital of Salem Memorial Hospital). In fact, there is nothing in the statute requiring that this matter be heard on

¹ See also Tumpson v. Farina, 431 N.J. Super. 164 (App. Div. 2013)(municipal agency not entitled to deference with respect to questions of law), rev'd in part and aff'd in part 218 N.J. 450 (2014); Toll Bros., Inc. v. Twp. Of Windsor, 173 N.J. 502, 549 (2002)(issues on appeal that present questions of law are thus reviewed *de novo*); Balsamides v. Protameen Chemical, Inc. 160 N.J. 352, 372 (1999)(same);and Finderme Management Co. v. Barrett, 401 N.J. Super. 546 (App. Div. 2008), cert. denied, 199 N.J. 542 (2009)(to the degree that parties challenge the trial court's legal conclusions, its decision is not owed any special deference).

a summary basis. Contrast N.J.S.A. 17:48E-67(f) (statute governing conversion of a health service corporation where Attorney General advises Superior Court as to whether he supports or opposes foundation plan to proceed “in a summary manner”). Notwithstanding, we feel that this point must be repeated to preserve the right of parties in the future to request discovery or present testimony in appropriate circumstances. More importantly, we would like to state that in this instance, despite the summary nature of this plenary hearing, we and other potential parties were given adequate notice to submit a response to the court, an opportunity that in the past we did not always have.

Community Interest in Implementing the Navigant Report to Improve Access to Quality Care

In particular, we applaud the Acting Commissioner of Health for her thoughtful analysis presented in her CN Decision. To the best of our knowledge it was the first CHAPA transaction in which the Department considered outside resources, such as the Final Report for Greater Healthcare Services Evaluation issued by Navigant Consulting, Inc. , dated March 2, 2015, (the “Navigant Report”) and a letter submitted by the Department of Mental Health and Addiction Services within the Department of Human Services, in order to evaluate both the statutory and regulatory CN criteria as well as the CHAPA standard. We would like to bring the Court’s attention not only to the Department of Health’s assertion that “the Navigant Report is a useful planning tool,” (CN Decision at.3), but also to certain conditions the Acting Commissioner imposed upon the transaction that were consistent with that Report’s recommendations. See also NJ Appleseed’s CHAPA testimony requesting the Department of Health to make sure that “Prospect’s plans for EOGH are not inconsistent with many of the goals of Navigant Report.”

First and foremost it is important to note that although “Prospect stated that it had no intentions to downsize services or reduce any service currently provided at EOGH,” in its

response to the “last round of completeness questions, Prospect acknowledged that it would work with the Department and other area providers to properly align bed need and capacity as suggested by the Navigant Report.” CN Decision at 6-7. See also Ibid at 11 (“Prospect has agreed to work with the Department and other area providers to ensure that service need and capacity in the area are properly aligned.”) This response was incorporated into conditions 5 and 6, where Prospect is required to participate in Regional Planning Collaboratives and must provide the Division written reports detailing its plan to reduce unnecessary and duplicative services and excess inpatient beds while addressing the need for expansion of or additional ambulatory care services. Indeed, it is NJ Appleseed’s opinion that it is Prospects commitment to support the “*No Regret*” *Initiatives* detailed in the Navigant Report, including support for developing a network of ambulatory access sites to facilitate access to “care in cost-effective settings,” and increasing “collaboration among and between health providers in the service area” that justifies the Department’s approval of this transaction. See also condition 13 (requiring Prospect to report on certain initiatives including the adoption of a transitions-of-care program to prevent unnecessary hospital admissions and readmissions, the institution of a community outreach program to meet the primary care needs of the community, and the hospital’s work with the Federally Qualified Health Centers within its service area) and condition 7 (requiring Prospect to invest in programs designed to improve public health, community health services and health and wellness programs).

In addition, we would like to point out several conditions imposed on this transaction that are directed at enhancing community accountability and transparency on the for-profit hospital. These conditions are responsive to many of the criticisms NJ Appleseed and others have lodged against previous for-profit conversions, and we assert that they should set a floor for any future

transaction. These include the establishment of a Local Governing Board² that must adopt bylaws, maintain minutes of monthly meetings, develop and implement a Community Health Needs Assessment that aligns itself with” Healthy New Jersey 2020,” “maintain suitable representation of the residing population of EOGH’s service area,” and report to the Division, on a quarterly basis, a description of the Board’s governance authority vis-a vis the national Prospect Board (condition 11); the establishment of Community Advisory Group (CAG) that provides ongoing community input to the hospitals CEO and Local Governing Board(condition 13); the imposition of an annual reporting requirement to the Division detailing investments made in the hospital, transfer of funds from the hospital to any parent, subsidiary or corporate affiliate, a list of completed capital projects and other financial data and measures (condition 15); the imposition of a requirement to post on the hospital’s website audited annual financial statements and quarterly financial statements prepared in accordance with Generally Accepted Accounting Principles (condition17); the imposition of a requirement to hold an Annual Public Meeting in New Jersey and attendant requirements to make that meeting accessible and meaningful for members of the local community to present their concerns (condition18); and various requirements directed at keeping the hospital in-network with commercial insurers in the State at rates comparable to similarly situated in-network hospitals in northern New Jersey, including a requirement of the hospital to post on its website the status of all insurance contracts related to patient care between the hospital and insurance plans, including those with which EOGH contracted at the time of submission of the CN application (condition 19).³

² In its opinion the Attorney General refers to this board as the local community governing advisory board (“LAB”). See AG Opinion at 51. This governing board is different than the community advisory board that the Commissioner is also requiring to be established.

³ In this regard, we note that one of the key reasons the Board of EOGH selected Prospect over the two other bidders, Prime Healthcare Services, LLC (“Prime”) and CarePoint, was that

In general, the record indicates what we perceive to be a genuine intent on the part of Prospect to continue to provide access to health care services to the community, especially those in need of inpatient and outpatient behavioral health services and the medically indigent and medically underserved population currently within EOGH's service area. The Acting Commissioner came to similar conclusions and has acted accordingly. We thank her for her efforts, and assert that the conditions she imposed in her CN decision should be included in this Court's final order, as has been the precedent in almost all previous CHAPA decisions.

Community Interest in the Preservation of Charitable Assets

In our June 3, 2015 letter and reinstated in our CHAPA testimony, NJ Appleseed expressed certain concerns regarding the value and disposition of the charitable proceeds netted from the proposed transaction, perceived weaknesses in the "local governing board" model employed by Prospect (and other out-of-state for-profit companies that have entered the State), and governance issues concerning the Foundation. In light of the stated commitment of the current EOGH trustees to stay involved in order to ensure that Prospect maintains its obligations to the East Orange community, we believe that the Attorney General has adequately resolved our concerns by imposing reasonable conditions upon the transaction. Accordingly, we would like to use this opportunity to highlight our points of agreement with the Attorney General, especially where we agree with the Attorney General's legal interpretation and application of several CHAPA criteria.

unlike Prime and CarePoint, "Prospect had no negative industry feedback and had success without relying on an out-of-network model." AG Opinion at 31. Another reason, which concurred with NJ Appleseed's statements made in other CHAPA transactions, is that "Carepoint and Prime both had used sale/leaseback of acquired assets to finance prior hospital acquisitions, while Prospect had not." Id.

But before we do so, we would like to acknowledge EOGH's former CEO, Kevin Slavin, and its Board trustees for what appears on the face of the documents we reviewed to be a thoughtful and serious change of control process, which was focused and driven by an attempt to maintain and make financially sustainable the essential health services (primarily behavioral health services) needed by EOGH's beneficial owners, that is, the residents of East Orange and other adjacent communities. Some of the facts of this application reveal a steadfast attempt by the EOGH to maintain the hospital's nonprofit corporate status (first by expending financial and other resources in an effort to develop a strategic partnership with Barnabus Health System and/or University Hospital), and only when that effort became impossible did EOGH consider sale of the charitable corporation to a for-profit entity. Furthermore, during and after the RFP process, the Board employed a host of factors, assigning them differing weights that reflect to NJ Appleseed's satisfaction that the Board satisfied all its fiduciary duties. In fact, it must be noted that not since the approval of the sale of Memorial Hospital of Salem County to CHS approximately thirteen years ago (in 2002) has a nonprofit hospital board negotiated a deal that has generated enough cash to establish a conversion foundation, and which has given that foundation a right of first refusal. (AG Opinion at 45).⁴ We applaud this outcome, and thank the Board for its diligence.

Regarding the Attorney General's Recommendation to this Court, NJ Appleseed emphasizes the following issues:

⁴ With respect to the Salem hospital transaction, the full and fair market value of the nonprofit hospital was transferred to a newly created foundation that was given a relatively robust right of first refusal. This transaction was then followed by the sale of Mountainside Hospital to Meritt Health Systems, L.L.C. that did not create enough cash to transfer new funds to the then existing hospital foundation. That foundation, however, had sufficient resources to continue and was given a qualified right of first refusal. Several conversions later, until this proposed transaction,

- Along with a board's duty of care and loyalty, the Attorney General acknowledges the duty of obedience. He notes that the "duty of obedience requires trustees to be faithful to the advancement of the hospital's charitable mission and purpose." (AG Opinion at 27). NJ Appleseed concurs and asserts that a trustee's understanding of the duty of obedience is essential to his/her understanding on how to proceed when considering a significant change of control decision like that implicated by CHAPA. That is, one must try to maintain the charitable, nonprofit mission to the extent possible.⁵ We believe that EOGH's Board properly appreciated its duty of obedience.
- The Attorney General cited with implicit approval several aspects of EOGH's selection process. These included, the Hospital's decision not to limit its RFP to a sale of asset structure, but to offer other legal structures (AG Opinion at 30); the Hospital's decision to give "great" weight to certain non-financial aspects of the competing proposals, such as Prime's and CarePoint's history of employing sale-leaseback financing, and reliance on an out-of-network business model (AG Opinion at 31-32); and the Hospital's selection of a for-profit entity only because it had no other choice. (AG Opinion at 32). In fact, the Attorney General stated:

the public has not seen the establishment of another hospital conversion foundation despite the purchase of several hospitals by for-profit companies.

⁵ A trustee's understanding of the duty of obedience is essential; otherwise common misconceptions as to the nature and extent of a board of trustees' fiduciary duty to the charitable corporation may reign. It is fundamentally necessary for board members to communicate to the public that once a transaction like the one occurring here is approved, the hospital will not continue to function in much the same way as it has as a nonprofit hospital, and in fact, its "mission" does change. A for-profit hospital does not provide essential health services to the neediest members of the community because of its mission. It does so because the State, as a regulator, requires it to do so. In New Jersey, the provision of charity care is a function of licensure, not corporate status; and, no matter what spin is attached, the provision of hospital services by a for-profit entity does not, as a legal matter, constitute a charitable purpose.

The Hospital Board established an appropriate set of criteria to evaluate potential purchasers and enlisted expert assistance to do so. And, only for-profit companies bid on the Hospital. Thus, the trustees had no choice but to consider a conversion of the Hospital in carrying out its mission and purpose. N.J.S.A. 26:2H-7.11(d)(4).

NJ Appleseed concurs with this legal interpretation of CHAPA. It has been previously established that CHAPA codifies the Attorney General's and this Court's respective supervisory role over *cy pres* proceedings; which, in turn, requires that this Court must first find that the maintenance of the charitable mission is "impossible or impracticable" before conversion of assets is permitted.⁶ In general, the EOGH appropriately designed the selection process and employed a reasonable decision-making process.

- For several years, NJ Appleseed and other public participants in CHAPA proceedings have protested the inclusion of post-closing commitments for working routine, deferred capital as well as new capital investments within the Attorney General's calculation as to whether a hospital received fair market value (FMV) for its charitable assets. We welcome the Attorney General's clear position on this issue as stated in its opinion on page 40, where it states that such "amounts will benefit Prospect post-closing, not the former Hospital corporation or Foundation, and thus should not be counted." Id. NJ Appleseed raised this issue in its June 3, 2015 letter, and appreciates the Attorney General's resolution of the matter. Unfortunately for the public, the \$10 million cash payment from Prospect to the Foundation represents the FMV of EOGH only because the

⁶ That is, CHAPA imposes additional factors on an acquisition that involves a fundamental change in mission that are absent when change of control does not involve such change, and one of such factors is whether "the hospital considered the proposed conversion as the only alternative or as the best alternative in carrying out its mission and purposes." N.J.S.A. 26:2H-7.11(d)(4). Accordingly, it is a fundamental principle that the *cy pres* doctrine allows the court to modify the terms of a charitable corporation's original purpose when achieving that purpose becomes impossible or impracticable.

financial situation of the Hospital has deteriorated since the filing of the application. Specifically, when the application was first filed, EOGH thought that its FMV was between \$19 million to \$27 million. Through such lens, the purchase price would be insufficient. Now, however, at the time of court approval the FMV has been assessed as \$3million to \$11 million, and thus, the Attorney General is correct in deeming the consideration appropriate. Ibid. at 37-41.

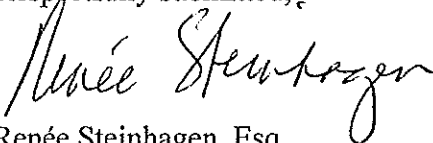
- In our comments, NJ Appleseed expressed concern that over time the Local Governing Board could be controlled by Prospect, who could be responsible for monitoring Prospect's compliance with the Asset Purchase Agreement if the Foundation's Board requests. In general we were troubled by the continuation of EOGH Board members on the Board of the Foundation, and the Foundation's continuing ties to the Local Governing Board. The Attorney General has addressed our concerns (at 51-52) and we are satisfied with the several conditions it is imposing on both the Local Governing Board and the Foundation with respect to a prohibition of compensation from Prospect, and a written justification from former board trustees who seek to serve on the Foundation's Board.

Standing in Future *Cy Pres* Hearings

The Attorney General's Recommendation contemplates that there may be further *cy pres* hearings "in the event that the Foundation uncovers or receives any funds restricted for use by the Hospital." AG Op., condition (iv) at 56 and page 3 of letter dated October 20, 2015). At this time, NJ Appleseed respectfully requests that NJ Appleseed be specifically designated as an interested party in order to enable the community's participation in any such hearings, if held. NJ Appleseed has been granted such status with respect to previous transactions governed by CHAPA (*e.g.*, conversion of Mountainside Hospital, and the sale and ultimate closing of St. James Hospital), and should be accorded such status with respect to this sale.

For the foregoing reasons, we support the approval of EOGH's application to sell its assets to Prospect, and request that this Court include both the Attorney General's conditions and the Acting Commissioner's conditions in its final order.

Respectfully submitted,



Renée Steinhagen, Esq.

On Behalf of New Jersey Appleseed

Cc: Gerald G. Brew, Esq.
Jonathan B. Peitz, Acting Director



NJ APPLESEED PILC STATEMENT BEFORE THE ATTORNEY GENERAL AND THE
DEPARTMENT OF HEALTH REGARDING THE PROPOSED SALE OF EAST ORANGE
GENERAL HOSPITAL TO PROSPECT MEDICAL HOLDINGS, INC.

N. J. Appleseed is a nonprofit legal advocacy center and in the case of nonprofit hospital change of control decisions, we seek to protect the interest of the communities within the service area of the hospital in retaining control of their charitable healthcare asset, and ensuring that the services that are actually retained, or newly provided, by the hospital are the very services that are needed by the residents using the hospital; not necessarily those that bring in more revenue, but in the case of a small community based hospital, like East Orange General Hospital (EOGH), those services most needed to ensure well-being of the community, including behavioral health services.

Tonight, I seek to express some of our concerns regarding the sale, which have less to do with the corporate status or business practices of the purchaser or the process employed by EOGH and its Foundation than with certain terms of the conversion, as reflected in the Asset Purchase Agreement, dated May 31, 2014. My comments are more fully expressed in a letter, dated June 3, 2015, which I sent to the Attorney General and which I am resubmitting tonight for the benefit of the Department of Health. I apologize if a modified Asset Purchase Agreement has been submitted since June of this year.

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

Phone: 973.735.0523 Email: steinhagen_pilc@yahoo.com
Website: www.njappleseed.org

- Exhibit A

As fully set forth in our letter, we want to acknowledge publicly that the reorganization/sale process employed by the EOGH – i.e., the retention of experts, the selection criteria developed and applied, the RFP process implement and the involvement of the full Board of Directors –appears 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. Notwithstanding, in light of the Navigant Report that was issued in March of this year, we want the Commissioner of Health and the AG to make sure that Prospect’s plans for EOGH are not inconsistent with many of the goals of the Navigant Report , that the Hospital will continue to participate actively in the Greater Newark Healthcare Coalition, and that its new owners will be amenable to coordinating care at the hospital within a broader network of hospitals, with its current specialization and emphasis on Behavioral Health, Forensics and Dialysis.

Moving away from the selection of Prospect Medical Holdings (PMH) , 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 makes it very difficult to figure out what PMH is actually paying for the hospital. An insistence to include a Projected Capital Expenditure Commitment (that 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.

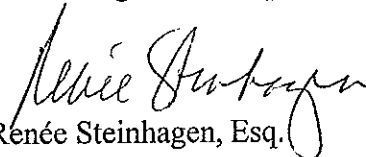
In addition, we have serious concerns about the proposed governance of the for-profit hospital, as well as the conversion foundation. It appears that the current Board of EOGH wants to retain control over the fate of the Hospital, through the establishment of a “Local Advisory

Board” (“LAB”), whose Chairperson will have a voting, ex officio seat on the six-person board of directors of Prospect. 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 has full authority and the fiduciary responsibilities that accompany that authority. LABs sound good, but are not the same as control. Furthermore, 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. CHAPA has strong prohibitions against maintaining ties between EOGH and the Foundation. Although the prohibition against previous management holding a position in the Foundation can be rebutted, we think that in this case such justification has to be made 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. Again, we see that current Board members of EOGH are trying to maintain their relationship to the hospital. But CHAPA makes clear 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.

Finally, we also want to make sure that the 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” and not just to provide certain services to the Supportive Housing Partnership and the Supportive Housing Program.

We trust that in your respective capacities, you will make a transaction that on the whole is good for the community a better one in accord with the requirements set forth in CHAPA, including that law's requirement that approval of the 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).

Thank you for the opportunity to express NJ Appleseed's thoughts on this proposed asset sale to a for-profit.


Renée Steinhagen, Esq.
Ex. Director



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 -- obscures 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

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.

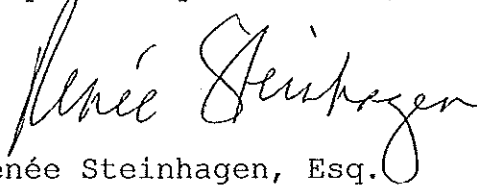
We also want to make sure that Foundation trustees understand that the purpose of the Foundation also includes "serv[ing] and support[ing] the charitable health care needs of the community historically serviced by EOGH." APA, Ex. K(2)(a)(ii). This prong of the Foundation's mission is required by CHAPA, 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,

A handwritten signature in cursive script, reading "Renée Steinhagen". The signature is written in dark ink and is positioned above the printed name and title.

Renée Steinhagen, Esq.
Executive Director

Cc: Richard Myslinski, Esq.