December 19, 2003

By Facsimile and Regular Mail

Attorney General Peter C. Harvey
Office of the Attorney General
Division of Law and Public Safety
P.O. 112
Trenton, New Jersey 08625-0112

Re: Hospital Center at Orange, NJ

Dear Attorney General Harvey:

I am writing to you on behalf of the communities served by the Hospital Center at Orange ("HCO" or the "Hospital"), Mayor Mims Hacket of Orange, the Orange City Council and both the unionized and professional staff of the Hospital to request your immediate action regarding the possible closure of HCO. As members of the public and public officials we have a special interest in preserving the charitable healthcare assets of HCO for use by the medically underserved populations currently served by the Hospital. We are requesting your intervention to solve the Hospital's problems by conducting a process to disaffiliate HCO from Cathedral Healthcare System, Inc., ("Cathedral"), which we believe would improve the health care system in an area in need of services.

HCO is located in a Health Professional Shortage Area, and serves a Medically Underserved Population. Unfortunately, Cathedral in its control of HCO has systematically drained resources from this entity through mismanagement in an effort to boost other facilities in its system and eventually close HCO. In our opinion, Cathedral cannot close a facility primarily because of a business opportunity without any consideration of its obligation to the community and the vital health care needs in Orange, NJ. It is because of these reasons that we are appealing to you.

Cathedral's Control over HCO through OMH

In brief, the Hospital is controlled by Cathedral Healthcare System, Inc.. This control is exerted through its power to appoint 45% of the Board of Orange Mountain Healthcare, Inc. ("OMH"), the sole member of HCO, and approve all members of the newly constituted Boards of each of OMH's subsidiaries,[1] including HCO. Harold Sterling, Esq., who is currently vacationing in Palm Springs, California, has also served as the Chairman of OMH and HCO since an affiliation agreement was consummated in 1997 (the "Affiliation Agreement").

Under the Affiliation Agreement, Cathedral was also given the authority to appoint an administrator to manage HCO and a budget officer. <u>The administrator was required by agreement to report to the President of Cathedral, and Cathedral, by a majority vote of its Board, has the authority to transfer assets, including cash, from HCO to Cathedral.</u> Most importantly, Cathedral's Board has had the authority to overrule, by a two-thirds (2/3) vote, any decision by OMH to reject Cathedral's proposal to curtail or terminate any services at HCO or to close the facility in whole or part. In essence, the Affiliation Agreement gave Cathedral control over both the management and corporate governance of OMH and its subsidiaries, including HCO. This we believe has shown itself to be detrimental to the health of the Hospital and the communities it serves.

The business pages are replete with horror stories arising from corporate governance situations where Boards of Directors are controlled by management. In this case, the Board of HCO should represent the public in the community it is mandated to serve as a not-for-profit organization. Cathedral is essentially a competitor of HCO. Only an independent HCO board, acting responsibly, can avoid the evils of conflict of interest that have been a major cause of bringing HCO to the brink of disaster. It has already deprived its constituency of vital services that such constituency surely needs.

Cathedral's Failure to Meet Promises

In the Affiliation Agreement, Cathedral stated its intent to improve the infrastructure, programs and finances of HCO; however, since the closing of the Agreement, none of these improvements have been made and there has been no independent, organized voice to enforce the Agreement. Promised improvements include the regulatory and financial steps necessary to integrate the operations of HCO and St. Mary's, a neighboring long-term care facility, by constructing a new hospital facility to house HCO operations. Cathedral has also not advanced $10 million for purposes of interim financing necessary to implement the intent and purposes of the Agreement; and, Cathedral has not proceeded to develop a premier cancer center at HCO nor consolidated all orthopedic care performed by Cathedral at the Hospital. Instead, <u>services have been terminated (radiation oncology, obstetrics and pediatrics have been transferred to Cathedral facilities in Newark,</u> and just last week, the orthopedic clinic at HCO was closed while a new orthopedic clinic was opened at St. Michael's), corporate fees for

[1] Orange Mountain Health Services Corp., Meals on Wheels of Orange, Inc. ("Meals on Wheels"), and Hospital Center at Orange Foundation, Inc. (the "Foundation"), each a non-profit charitable corporation.

services have been significantly increased, the pension fund of the nonunion employees may have been mismanaged and certainly has been underfunded, the Foundation's assets have been reduced to insignificant sums, HCO has been put on significant credit hold, and Cathedral has stated to the Department of Health and Senior Services that OMH is insolvent. *See infra*. Inadvertently or intentionally, Cathedral appears to have exercised its governance and management responsibilities to the benefit of its flagship affiliates in Newark while adversely affecting the ability of HCO to deliver needed healthcare services to the residents of the Oranges.

Cathedral's Mismanagement of HCO

Cathedral has continued to transfer significant and increasing amounts of money from HCO for corporate fees, terminate income-producing services and diminish the Foundation's funds. During the first two years of affiliation, HCO did not pay Cathedral any fees. As Cathedral integrated HCO into its system, corporate fees increased. In 2001, HCO was assessed $4.6 million; in 2002, $3.39 million, and in 2003, the assessment significantly leaped to approximately $10.6 million—a $7 million increase. This amount includes $326,358 toward the salary of Cathedral's president and $221,823 toward Cathedral's "COO and Increase Executive Bonus." In addition to increased corporate fees, HCO's laundry bill went up approximately $300,000 with no increase in volume in 2002, and its pharmaceutical bill also went up a similar amount. We have also been told that there has been no audit trail to determine whether equipment and supplies, which were paid for by HCO, were actually received, remained in the Hospital or transferred to other Cathedral affiliates. As a result, although in 2001, HCO had a $1.87 million profit from operations, which increased to $2.01 million in 2002, this year, Cathedral has operated HCO to cause a $7 million deficit.

In addition to the transfers of assets, revenue has been siphoned away from HCO through the elimination of services. For instance, obstetric, oncology, and pediatric clinics were closed over the past few years, and patients were referred by Cathedral to other facilities within its system,[2] whereas Cathedral has not brought any income producing services to HCO from those same affiliates. Instead, last week Cathedral closed HCO's profitable orthopedic clinic, and we were just informed that Cathedral has ceased billing government Medicare and Medicaid programs for patients currently being treated at the Hospital. By removing services from the Hospital, which are its only revenue source, and failing to bill government insurance programs, Cathedral is attempting to close the hospital before any required public process takes place. Not only is this an inappropriate step, it demonstrates a complete disregard for the Department of Health and Senior Service's Certificate of Need ("CON") process.

Cathedral's mismanagement of the HCO pension fund is also apparent. During 1998 and 1999, the so-called "boom" years in the U.S. capital markets, the pension fund

[2] HCO received a Certificate of Need ("CON") for a Linear Accelerator sometime during 2001-2002. Soon after receipt, Cathedral transferred this CON to St. Michael's, and effectively closed radiation oncology services at HCO; letters were sent to HCO patients informing them that their care had moved to St. Michael's.

did not make any money. According to information given to physicians, the pension fund subsequently lost $8.498 million in 2001, and $6.4 million in 2002. Around that time, Cathedral received permission from the Internal Revenue Service to convert HCO's ERISA pension plan to an independent church plan retroactive to 1998. Accordingly, members of the HCO plan are no longer protected by federal law, and there is a question as to whether Cathedral will be held to the fiduciary standards imposed by ERISA. It is our understanding, that the plan remains underfunded to the amount of $17 million.

Furthermore, the Foundation's assets have drastically plummeted. Over the past few years, members of HCO's Board were told that there was approximately $1.2 million held by the Foundation. At a recent Foundation Board meeting held in mid-November—the first in approximately two years, --- trustees were told that only $150,000 of those assets remained. Documents were not produced indicating how such funds were spent. According to the HCO's IRS form 990 filing available on the internet, we do know that Cathedral appropriated, in 2001, over $800,000 of the Foundation's funds for "operations."

OMH's Operations of HCO Prejudice the Interests of its Creditors

To the best of our knowledge, there are several major creditors of HCO in addition to the members of the employees pension fund. They include, the City of Orange, which is owed approximately $500,000 for water charges and penalties due to fire safety code violations, PSE & G, which is owed approximately $1 million, and certain doctors, who are owed significant fees (*e.g.*, Anesthesiology Group is owed $1 million, Radiology Group is owed $25,000-30,000). Also, Eclipse Corporation is owed approximately $500,000, Abbott Labs is owed an estimated $100,000, Beckman & Coulter is owned about $100,000, and Cardinal Distributing is owed approximately $675,000. We have also been told that Cathedral recently delayed payments to the pharmacy wholesaler so that drugs were not delivered to HCO on December 16, 2003. Although Cathedral did send out a check for $500,000 to the wholesaler, the real outstanding balance is close to $1 million, only $300,000 of which constitutes HCO's balance. <u>This kind of financial management jeopardizes the interests of creditors and, more importantly, jeopardizes the safety of patients.</u>

In short, when HCO affiliated with Cathedral in 1998, it had a respectable credit rating and St. Michaels, a Cathedral affiliate, was in significant credit hold. To date, the situation has reversed and HCO is in significant credit hold, whereas St. Michael is not. It is clear that Cathedral has been operating HCO to the prejudice of its creditors.

Requested Action

OMH ostensibly selects the Board of HCO and a number of related Orange medical entities governed by the Affiliation Agreement. Since the current composition of OMH's Board reflects a significant majority of persons controlled by Cathedral, and Cathedral has additional veto power over that Board's decisions, an independent Board of OMH and HCO is necessary to represent and safeguard the interests of the community, the employees and physicians of HCO and the other nonprofit subsidiaries of OMH. We believe that action by the Attorney General is necessary to eliminate the conflicts of interest that have arisen since HCO/OMH's affiliation with Cathedral and that these conflicts have prevented the Hospital from effectively serving the very public to which, as a nonprofit, it should be directly accountable. We request that you exercise your authority, as enforcer of charitable trusts, to return HCO to the very independence that is necessary to permit it to fulfill its dedicated health care mission in the "City of Orange, and the Townships of East Orange, West Orange and South Orange."[3] As we noted above, HCO serves the resident of the above cities, which include census tracts that have been designated as Medically Underserved Areas and whose residents have been designated as a Medically Underserved Population. The zip code where the Hospital is located is also a Health Professional Shortage Area, which thus qualifies it for an additional 10% reimbursement from Medicare.

Toward satisfying your office's responsibilities as the protector of charitable trusts, we suggest exploring the Attorney General's authority to bring an action in the Superior Court to dissolve OMH. This will sever Cathedral's control over HCO, OMH Health Services, Inc., Meals on Wheels and the Foundation. Pursuant to N.J.S.A. 15A:12-11, the Attorney General may bring an action in the Superior Court for the dissolution of a corporation upon several grounds, some of which do not require proof of wrongdoing or fraud. These grounds include that the corporation is insolvent[4] , the corporation is conducting its activities with prejudice to the interests of its creditors[5] , and the corporation is acting in a manner that is prejudicial to the public[6]. We believe that the Attorney General has sufficient information to satisfy action under all three of these prongs. (Insolvency and prejudice to the public will be addressed below; prejudice to creditors has been discussed *supra.*)

OMH is Insolvent

Cathedral has stated to the physicians at HCO, the Commissioner of Health and Senior Services, and the community that OMH is insolvent. It has further stated to employees that OMH will have no money to make payroll after December 31, 2003.[7] Physicians have been told that HCO has accounts receivable approximating $10 million, accounts payable of about $17 million, a pension liability of approximately $17 million, and cash reserves this week down to $200,000. As of December 2, 2003, there was approximately $2 million in cash reserves, and as of June 31, 2002, between $4 and $5 million. Moreover, no one has accounted for the $1.8 million in permanently restricted assets held by HCO.

[3] Orange Memorial Hospital Certificate of Incorporation dated May 9, 1878.
[4] N.J.S.A. 15A:12-11(7)
[5] N.J.S.A. 15A:12-11(10)
[6] N.J.S.A. 15A:2-11(11)
[7] Although in letter dated November 12, 2003, HCO informed employees that their "last day of employment at the Hospital Center at Orange is expected to be during the time period between Sunday, January 18, 2004 and Saturday, January 31, 2004." (the "WARN notice).

HCO is thus operating at a $7 million loss to date, with an outstanding pension liability to a plan that it has, or is in the process, of terminating. Instead of attempting to keep HCO financially solvent, Cathedral is draining funds away from the Hospital and eliminating revenue sources that may help defray some of the pension liability.

OMH's/Cathedral's Control of HCO is Prejudicial to the Public

Coterminous with the deteriorating financial situation of HCO specified above, OMH has permitted Cathedral to operate HCO in a manner that is detrimental to the public. A review of the Affiliation Agreement indicates that the OMH entered into an agreement that, on its face, did not protect the continuity of services to persons residing in the Oranges in exchange for Cathedral's mere intent to build a new facility and invest $10 million toward that end. There is nothing in the agreement that revokes Cathedral's management and governance authority over HCO in the event that they did not act upon their stated intentions, and the "Orange Trustees" of the OMH Board have not taken any steps to enforce Cathedral's intent to invest in the Hospital.

OMH's Board has not only failed to act affirmatively to protect the delivery of health care services, it has also failed to prevent Cathedral from defying basic principles of corporate governance. It is our understanding that roll calls were never taken at OMH/HCO Board meetings, and trustees' votes were not registered except for the recent decisions to seek de-certification of the Hospital and mail employees a WARN notice. Before HCO's Strategic Planning Committee received a presentation from the physicians at HCO proposing a plan for reorganization, or submitted its recommendations to the HCO Board for the Board to consider, Cathedral took out a full-page advertisement in *The Star Ledger* announcing that there is "no hope" for HCO's survival, and made a presentation to the Orange City Council announcing HCO's closure.

During this same time, a job fair was scheduled to be held the day after the HCO Board was to meet and was "anticipated" to vote in favor of submitting to the State an application to close the Hospital. The job fair that was held at the Hospital was designed to entice HCO's employees to transfer to Cathedral's other affiliates. Cathedral also held employee meetings around-the-clock and in each department of the Hospital to "inform" HCO employees of its "closure plan" (also before the Board vote to close the Hospital took place). Employees were confronted with the Hobbesian choice of accepting jobs at other Cathedral affiliates or facing discharge with no receipt of unemployment insurance benefits. Cathedral has refused to discuss with HCO's employees the issues of severance pay or compensation for accrued vacation and unused sick and personal time.

OMH is currently moving to terminate HCO's pension plan at the same time that Cathedral is not paying pharmaceutical bills and continuing to assess HCO for unreasonable corporate fees. The OMH Board is effectively permitting Cathedral to dismantle the largest employer in Orange and the primary healthcare provider in Orange prior to receiving permission to do so from the State pursuant to the CON process.

OMH must be prevented from taking further steps that will cause irreparable harm to the residents of the community, employees, medical staff and patients of HCO. As we stated in our letter to Commissioner Clifford Lacy, the parties named above do not want to see the Hospital liquidated or decertified but rather returned to it original independence, apart from the control of Cathedral. In doing so, they would like to see HCO's Board independent with a charter to represent the interests of the community. Once reconstituted, HCO will be in a position to evaluate the viability of an independently governed community oriented health care facility in Orange, and take the steps necessary to ensure that HCO's charitable healthcare assets continue to serve their intended beneficiaries.

Cathedral cannot be permitted to close HCO simply because it desires to close one hospital in its otherwise Newark-based system. Cathedral has demonstrated a clear disregard for the communities it services by closing other hospitals in New Jersey for the benefit of its system while creating holes in our health care delivery system in this State. In the case of HCO, Cathedral through OMH must be accountable to the people of Orange, not just Cathedral.

Sincerely yours,

Renée Steinhagen
Executive Director

Cc: Comm'r Clifford Lacy
Gov. James McGreevey
Jay Ganzman, DAG