



January 22, 2014

ELECTRONIC MAIL

John Calabria, Director  
Certificate of Need and Facility Licensure  
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P.O. Box 360  
Trenton, New Jersey 08625-0360

DAG Jay Ganzman  
NJ Dept. of Law and Public Safety  
Division of Law  
P.O. Box 106  
Trenton, New Jersey 08625-0106

Re: Proposed Sale of St. Mary's Hospital to  
Prime Healthcare Services, LLC.

Dear Director Calabria and DAG Ganzman:

In conjunction with the January 16, 2014, public hearing regarding the proposed sale of St. Mary's Hospital ("St. Mary's") to Prime Healthcare Services, LLC ("Prime"), we are writing to provide our comments pursuant to the Community Health Assets Protection Act ("CHAPA"), N.J.S.A. 26:2H-7.11. These comments are made on behalf of New Jersey Appleseed Public Interest Law Center ("New Jersey Appleseed"), and are intended to assist the Attorney General in his role as "protector, supervisor and enforcer of charitable trusts and charitable corporations." N.J.S.A. 26:2H-7.11. They supplement a written version of our oral comments submitted to DHSS pursuant to the CN process on January 15, 2013 (which were not presented since the hearing was ended at 8:00pm), and our verbal statement presented at the CHAPA hearing.

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It is our understanding that CHAPA "codifies" the Attorney General's common law responsibilities with respect to nonprofit hospitals, and supplements his "authority under the common law to act in the public interest to oversee and protect charitable trusts and charitable corporations." Governor's Conditional Veto Message, Assembly Bill No. 1439-L.2000, c.143. The Act also delegates a portion of these responsibilities to DHSS that must affirmatively find that the proposed transaction "is not likely to result in the deterioration of the quality, availability or accessibility of health care services in the affected communities." N.J.S.A. 26:2H-7.11(b).

A review of the factors the Attorney General must consider when determining whether a "fundamental corporate change that involves transfer of ownership or control of charitable assets or a change of the nonprofit's mission or purpose" (in the event of a for-profit conversion) N.J.S.A. 26:2H-7.11, is in the public interest indicates that CHAPA also codifies the common law fiduciary duties of directors of nonprofit corporations. Those duties include the duty of obedience to purpose,<sup>1</sup> the duty of care and the duty of loyalty. See Peregrine and Schwartz, "The Nonprofit Board's Duties When Considering a Change of Control," Health Law Analysis, (April 2008)p. 26-27. Although CHAPA applies certain criteria to all proposed acquisitions regardless of the nature of the acquiring entity, and applies certain criteria only to for-profit acquisitions (due to the fact that in the latter circumstance, the board has decided to abandon the hospital's charitable mission), all the Act's strict standards for board review and approval are intended to assure that the board does not exceed or fail to carry out the corporation's charitable purpose. Id. at 27. In this way, CHAPA's review criteria supplant the application of the common law business judgment rule. Id.

New Jersey Appleseed recognizes the importance of adhering to standards set forth in CHAPA in order to ensure against (i) deterioration in the quality of and access to community-based health care services, and (ii) unnecessary loss of hospital assets otherwise irrevocably dedicated to charitable health care purposes. We respectfully urge both the Attorney General and the Commissioner of Health to consider the long-term effects of this transaction on the quality, accessibility and affordability of health care services at St. Mary's, and in Passaic County

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1 Peregrine and Schwartz, "The Application of Nonprofit Corporation Law to Health-Care Organizations," American Health Lawyers Association, (2002), p.40-41.

generally, and not to permit short-term lobbying efforts to overwhelm such considerations. We want St. Mary's to become financially viable and continue to exist as a small community hospital that is "right" sized, provides the very services needed by the community (as outlined in the Community Needs Assessment undertaken by St. Mary's) in contrast to emphasizing surgical interventions and admissions through the emergency room; a hospital that emphasizes well-being and prevention over acute care treatment.

We understand that there were only two bidders as a result of the hasty search that was undertaken by St. Mary's CEO in the summer of 2012 after the proposed sale to Ascension Health fell through. These two bidders, both for-profits, employ the same out-of-network business model, and both explicitly coveted St. Mary's cardiac surgical program. Indeed, Prime Healthcare Services described itself to the Board as a "medical-surgical" hospital system, and there was no discussion in the Board minutes or during the presentations by the two bidders about the willingness of these two entities to provide the health services found wanting in the Community Needs Assessment Survey, to bring back many of the out-patient services that St. Mary's has shed since it took over Passaic Beth Israel in 2005, or to maintain the Sisters' notable strength and reputation in delivering mental health services. Moreover, we believe that the demand that any potential purchaser lend the Hospital \$5 million prior to approval unfairly prejudiced other potential bidders who would only be able to release any monies at the time of closing, such as CHA (who desired to right size the hospital, redevelop excessive space in the hospital as a "medical mall" and to build supportive housing on the campus).

In short, if the Board would have considered alternative ways to finance its operation, including selling its facility and leasing back only portions thereof needed to house a 130 licensed bed hospital, with a fully functioning emergency room, or transforming portions of its facility and campus for other related health uses, such as long-term care, nursing homes, assisted or supportive housing, etc. NJ Appleseed believes that the license of the hospital could have remained in the hands of a nonprofit without the attendant elimination of St. Mary's charitable purposes and detriment to its specific mission to "respond to the changing healthcare needs of the diverse communities [it] serves." (Cover Letter, dated February 6, 2013, to first "fully comprehensive analysis" of Community Health Needs Assessment, attached hereto). Instead, the Board sought to sell the Hospital solely with the intent to keep its doors open,

with little or no real analysis of the type of hospital that is needed within the regional hospital and healthcare system prevailing in the area. Such short sightedness does not serve the community in the long run nor the efficiency and integrity of our State's hospital infrastructure.

As currently described in the documents provided by the parties to the Department of Health and Senior Services ("DHSS") and the Attorney General, the proposed sale is not in the public interest. See N.J.S.A. 26:2H-7.11(b). Unless properly conditioned, the proposed sale is "likely to result in the deterioration of the quality, availability or accessibility of health care services in the affected communities," *id.*, and constitutes a transformation of charitable assets that was not the best alternative to carry out the Hospital's social justice and healthcare mission.

Though more fully explained in our comments submitted pursuant to the CN process, our chief concern addressed to the Commissioner is:

**The business model employed by Prime Healthcare Services at its other California hospitals contradicts its commitment to the community that it will enjoy access to affordable health services that are actually needed by the residents of the City of Passaic and surrounding municipalities in contrast to provision of services currently available at St. Joseph's and Hackensack Hospitals (located within a reasonable proximity to the current hospital).**

With respect to the matters within the Attorney General's jurisdiction, the value and mission of St. Mary's charitable assets have not been properly safeguarded and preserved in violation of CHAPA. *Id.* As detailed more fully *infra* at Point II, we have the following key concerns.

**The Board did not exercise due diligence in negotiating the terms and conditions of the acquisition.**

**There is no right of first refusal; nor provisions ensuring that the nonprofit hospital will receive full and fair market value for the real estate assets sold to Prime Healthcare Services, LLC.**

- I. **The Proposed Sale is "Likely to Result in the Deterioration of the Quality, Availability or**

**Accessibility of Health Services in the Affected Communities."**

As we stated in our CN comments, dated January 15, 2013, attached hereto, New Jersey Appleseed asserts that the business model employed by Prime and its track record as developed in the files of Rhode Island regulators contradicts its commitment to the community that it will enjoy continued access to affordable health services; let alone services that emphasize well-being and prevention over high tech surgical interventions and unnecessary admissions through the emergency room. The fact that many of the abusive practices that commentators have brought to your attention are based on allegations set forth in at least three lawsuits that have not yet been resolved (including a very recent whistleblower action filed in federal court regarding emergency room admissions) and there is a pending Medicaid fraud investigation (concerning up-coding that may undermine the data underlying Prime's quality awards) that also has not been completed does not allay consumers' fears. Prime is a "bad" actor and we fear that it will destabilize the cost and delivery of services in Passaic County, rather than serve the people who currently rely on the Hospital.

In previous CN comments concerning other hospital conversions, New Jersey Appleseed has pointed out the Department's obligation under its CN criteria not merely to accept the allegations of the applicant but to make its own findings as to the impact the transfer of license will have on other urban hospitals. This obligation is explored in the New Jersey Supreme Court decision In re Application of Virtua-West Jersey Hospital Voorhees for a Certificate of Need, 194 N.J. 413, 436 (2008). Here, we highlight the Department's independent obligation to find that the proposed conversion will not result in the deterioration in health services in Passaic County and portions of Bergen County. We point to the impact analysis undertaken by the California Attorney General prior to denying the purchase of Victor Valley Hospital by Prime, a purchase that had been approved by the relevant Bankruptcy Court, as an example of the analysis the DHSS must undertake prior to recommending approval of this transaction. See Effect of the Acquisition by Prime Healthcare Services Foundation, Inc. of Victor Valley Hospital on Availability or Accessibility of Healthcare Services, prepared by Medical Development Specialists (August 5, 2011). In short, we are calling for a report that takes Prime's business model into consideration when undertaking its impact analysis and is not only focused on the proposed acquisition's effect on St. Joseph's Hospital -- the other major

urban hospital in the area that serves a significant portion of the County's low income and uninsured residents, but also on the accessibility and affordability of health services to affected consumers who will use the Hospital.

Furthermore, given the track record of the proposed operators of St. Mary's, DHSS must appoint an independent health care monitor for a period of three years in order to ensure the public that there will be no adverse health consequences to this sale. CHAPA permits DHSS to do so. N.J.S.A. 26:2H-7.11(i)(1).

Residents have grave concerns about this sale, and they need to be protected. DHSS cannot rely on solely on potential whistle-blowers to advise them of violations of CN conditions or other business practices and policies that will have an adverse impact on patients; rather DHSS must have its own eyes and ears at the hospital to monitor activities that will impact on community health care access. Such activities include levels of uncompensated care for indigent person, emergency room admissions, provision of unnecessary medical treatment, up-coding of proper diagnoses, termination of insurance contracts, waiver of cost sharing, excessive average daily charges, and nurse/patient ratios to maintain hospital quality and safety standards. If Prime intends to act as the board members, physicians and residents who spoke in favor of this transaction expect it to do, such a monitor will not be a hindrance; rather, the monitor will simply be recording Prime's alleged standard of care and excellence.

In this regard, NJ Appleseed also supports the further conditions the New Jersey Health Plans have recommended in their testimony submitted to the Department of Health. See Testimony of Ward Sanders, dated January 15, 2014. Ultimately, a redirection of monies to the hospital away from insurers through employment of an out-of-network model is borne by consumers as a whole (through imposition of higher premiums) even if individual consumers are protected from higher co-pays under the law.

## **II. The Value and Mission of MHMC's Charitable Assets Have Not Been Properly Safeguarded As Required By CHAPA.**

Pursuant to N.J.S.A. 26:2H-7.11(n), the Attorney General, in consultation with the Commissioner of Health and Senior Services, is directed to adopt regulations "to carry out the purposes of this act." As we have commented in previous submissions, no such regulations have been issued. As a result, the opinions rendered by the Attorney General and the Orders

issued by the Commission (which are then approved or modified by the Superior Court) are the primary source of legal interpretation and precedent governing hospital transactions that fall within the ambit of CHAPA. Each factor delineated in the statute must be considered and the Attorney General should explain why failure to satisfy any one factor does or does not impugn the transaction as a whole.

Most importantly, the Board, despite its sincere and conscientious efforts (as evidenced by Board minutes) seemed to manage its way into a financial crisis, whereby it was facing bankruptcy or selling to someone as quickly as possible who had the resources to lend the Hospital money while waiting for approvals, and was willing, at minimum, to pay off Medicaid and Medicare liabilities. State bondholders were given short shrift and there did not seem to be any particular effort to explore nonprofit options in a systematic way prior to deciding to convert. Critically absent are any discussions of a potential merger with St. Joseph's Hospital in Paterson, which shared the same Catholic sponsor and charitable mission and was a potential partner in the deal with Ascension Health. The Board's failure to protect state taxpayers and to understand the paramount importance of its duty of obedience to the charitable purposes of the entity cannot be overlooked. The Attorney General must make clear that CHAPA's standards matter, they reflect a deep legal and moral commitment to preserving charitable assets, and they should be followed, by other nonprofit hospitals seeking to sell charitable assets to for-profit entities, as closely as possible.

**1. The Board did not exercise due diligence in negotiating the terms and conditions of the acquisition.**

As noted above, St. Mary's Board has fiduciary duties to the corporation itself that are reflected in the various review criteria set forth in CHAPA. One of the primary factors to be considered is whether the board "exercised due diligence in selecting the other party to the acquisition and negotiating the terms and conditions of the acquisition" N.J.S.A. 26:2H-7.11(c)(2) and "whether the nonprofit board considered the proposed conversion as the only alternative or as the best alternative to carrying out its mission." N.J.S.A. 26:2H-7.11(d)(5).

In discussion with a certain local assemblyman particularly concerned with the fate of St. Mary's Hospital, we heard that Prime Healthcare Services was the only option to keeping the

hospital open and it was the "better of the two devils." Even if this is true, one must evaluate the process that resulted in only two for-profits making similar financial bids for the hospital, and secondly, the terms and conditions of the acquisition to determine whether they adequately protect the hospital's beneficiaries given the track record of the selected purchaser.

The record reveals an appropriate national search for a potential buyer with the employment of appropriate experts during 2011. This search ended with the selection of Ascension Health, a catholic, for-profit hospital chain. Unfortunately, Ascension did not complete this transaction (because St. Joseph's Hospital declined from participating), and the former CEO of St. Mary's Hospital felt compelled to do a very quick truncated search himself. Minutes filed with the Attorney General's office indicate that the CEO felt that he had no choice but to just contact several hospitals which he hoped would be interested. Although St. Barnabus and Hackensack were contacted, there does not seem to have been any outreach to St. Joseph's Hospital or any other nonprofit hospital in the state. In addition, the Hospital had to demand a loan of \$5m from any potential purchaser just to keep its doors open until the transaction would be approved. No other alternative way to preserve the Hospital's services was contemplated; just sell to Prime or Care Point or close the hospital. Not to belabor the point, but NJ Appleseed urges nonprofit boards to think more creatively and to seek capital partners without selling the acute care license to the financier; thus enabling them to keep the hospital's nonprofit status, while bringing in new sources of capital. The self-made crisis in which this Board found itself should not be used as a justification for abandoning the hospital's charitable mission.

Nonetheless, once the Board selected Prime Healthcare Services, they had a duty to negotiate terms that protected the healthcare services needed by the community and the taxpayer's investment in the Hospital, especially in light of Prime's track record which was disclosed in the hospital's attorney's due diligence report (i.e., pending Medicare fraud investigation). NJ Appleseed believes that the Board did not meet its fiduciary duty in this regard when it (1) did not require the buyer to defease the full value of the outstanding bonds that have been guaranteed by New Jersey taxpayers; (2) did not require the buyer to provide the services needed by the community as set forth in St. Mary's Community Health Needs Assessment, and in particular, did not take particular caution that mental health

services will be continued at the same or higher level than currently provided; (3) did not require Prime Healthcare Services to create a fully operational local governance board, and (4) did not strengthen the language in the APA with respect to the \$30m capital improvement funds.

The fact is that unlike the Hoboken Municipal Hospital Authority when it sold Hoboken University Hospital, an equally money losing entity, the Hospital's Board did not demand full repayment of the outstanding bonds. In Hoboken, the hospital's board demanded full repayment of the approximately \$52m in bonds that Hoboken taxpayers had guaranteed. Here, the Board of St. Mary's did not satisfy its duty to the taxpayers of New Jersey by not getting the purchaser to assume, or in the case of a for-profit like Prime, to defease the full value of the outstanding bonds.

Secondly, pursuant to §5.10 of the APA, Prime is committed to establishing only an advisory board here in New Jersey. The lack of a local board with full fiduciary responsibility to the hospital is not acceptable. To the best of NJ Appleseed's organizational knowledge this would be the first hospital in New Jersey not to have a local board. Salem Memorial Hospital was bought by an out-of-state for-profit hospital system, and nonetheless, CHS established a local board that was legally responsible for the operation of the hospital.

In addition, pursuant to §5.6 of the APA, Prime has committed to "either spend or commit to spend" \$30m. on capital improvements within 5 years of closure. The language of this provision must be strengthened and Prime must spend that amount of money, not just commit to do so in that period of time.

2. **There is no right of first refusal; nor provisions ensuring that the nonprofit hospital will receive full and fair market value for the real estate assets sold to Prime Healthcare Services, LLC.**

The enactment of CHAPA in New Jersey was in great part a response to a trend in other states where nonprofit hospitals were sold to for-profit entities, who in a matter of months, re-sold the hospital assets for significantly more money. Therefore, the Attorney General in the case of a conversion, must not only determine whether "the acquisition proceeds will be used for appropriate charitable health care purposes consistent with the nonprofit hospital's original purpose", N.J.S.A. 26:2H-7.11(c)(6), but also whether the "nonprofit

hospital will receive full and fair market value for the assets." N.J.S.A. 26:2H-7.11(d) (6)

We acknowledge that there are two valuations in the file: one that was prepared in February 2010 by Principal Valuations, under the auspices of former CEO Michael Sniffen (valuing St. Mary's at 24.9ml) and another dated February 1, 2013, which lowered the value to \$19.4m. One reviews these valuations and wants to conclude that they are objective. However, in each case since the conversion of Salem Memorial Hospital, the valuation presented to the Attorney General is exactly what the parties negotiate (if the valuation is prepared prior to the public auction) or have already negotiated (if the valuation is prepared after the letter of intent has been signed). In this case, St. Mary's decided to sell St. Mary's for \$25m., perhaps based on the 2010 valuation; although we understand that Ascension Health intended to pay back the full value of the outstanding bonds which at that time were closer to \$40m. That is, the Board of St. Mary's, in that process, was able to secure significantly more than the 2010 valuation.

In this process, however, in 2012, St. Mary's was not only not able to get a buyer who was willing to pay off all the bonds (though we were told that CHA intended to do so if they had been able to move forward with their plan to transform the hospital and its campus), but additionally required a \$5m. payment prior to approval (which in the APA produced to the Attorney General is set to be deducted from the purchase price). Although a recent letter to the Attorney General states that the \$5m. loan will be forgiven upon approval of this transaction, in February 2013 there was an issue of whether a \$20m. purchase price would pass muster under the 2010 valuation. Hence, the production of a new valuation that simply values the Hospital \$5m. less.

Based on this sequence of activities, we question both these valuations, just like we did in the case of the conversion of Mountainside Hospital. In that transaction, a valuation was produced after-the-fact to justify the \$30m. purchase price offered by the out-of-state investors. The Attorney General approved that purchase price and several years later Mountainside was sold for approximately five times that amount. From the public's point of view, it seems that hospitals in the hands of nonprofits are significantly undervalued. This may be the case because the hospitals have been mismanaged, and the goodwill and potential operational revenue are grossly underestimated. Nonetheless, we assert that makes no sense that taxpayers lent the Hospital \$40m. and the Hospital is now valued

at significantly less than that amount. Why would the State make such an investment?

In any event, we believe that the Attorney General has the authority to prevent the new owners from realizing a windfall to the detriment of the community, if the foregoing conclusion is prescient. Based upon the past practice of Prime Healthcare Services, New Jersey Appleseed believes that Prime intends to sell the real estate assets of St. Mary's Hospital to Medical Trust Properties in the near term to realize a significant profit to cushion themselves against any operational losses, to acquire more hospitals, to raise the money it has committed to invest in the Hospital or simply to reward Mr. Prem Reddy.

We base our belief on the fact that Prime has done so after almost every acquisition that it has undertaken, and it has left open the possibility to do so in this case when directly asked by the Attorney General. Accordingly, in order to protect the public's interest in the preservation of charitable assets, the Attorney General must condition this transaction on a 5-year claw-back provision (the duration the new owners commit to operate the hospital as an acute care facility), which would result in at least 50% of the profits made on such sale placed in a "conversion" foundation in furtherance of St. Mary's charitable purpose. This 50% claw-back is further justified by the fact that taxpayers are in effect investing an additional \$22-\$25m. in this deal insofar as they have to pay back the outstanding bonds that are not covered by Prime's purchase price.

The public interest in preserving charitable assets also requires the Attorney General to direct St. Mary's Hospital to renegotiate the purchase agreement to secure a right of first refusal. N.J.S.A. 26:2H-7.11(d)(4). A review of the Asset Purchase Agreement indicates that there is no mention of a right of first refusal of any sort. A right of first refusal like that secured by the trustees of Salem Memorial Hospital or the more limited right negotiated by the trustees of Mountainside Hospital is absent from this transaction; further indicating the indifference by the St. Mary's Board of Trustees to its fiduciary obligations to preserve the charitable mission of St. Mary's Hospital.

We understand from comments made at the CHAPA hearing that St. Mary's Foundation has been designated to be the party with the right to monitor the enforceable covenants in the APA. However, that Foundation does not seem to have any resources to

do since it intends to turn over all their non-dedicated funds to St. Mary's pension fund prior to closing.<sup>2</sup> Prime's commitment to pay the Foundation's attorney's fees if the Foundation is the "prevailing" party in a breach action is a promise to do nothing more than would be required by a court if in fact the Foundation prevailed. Notwithstanding the financially strapped status of the Foundation, we assert that it should be given the right of first refusal, should receive revenue from the claw-back requested above, and should be properly funded by Prime to enable the Foundation to function as a monitor.

Thank-you for your anticipated consideration of our comments.

Sincerely,

Renée Steinhagen, Esq.  
On behalf of NJ Appleseed

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<sup>2</sup> The remaining dedicated funds are relatively insignificant and we assume will be subject to a cy pres hearing. Accordingly, we respectfully request that participants in the CHAPA proceeding be deemed "persons of special interest" for purposes of standing at such future proceedings.