STATE OF RHODE ISLAND
OFFICE OF THE ATTORNEY GENERAL

Peter F. Neronha
Attorney General

DECISION IN PROPECT MEDICAL HOLDINGS HCA REVIEW:
ROGER WILLIAMS MEDICAL CENTER AND OUR LADY OF FATIMA HOSPITAL
JUNE 1, 2021

The Decision:
Safeguarding Healthcare for Our Communities

Approval, but with unprecedented conditions — including $80 million guaranteed in escrow — that will:

- Provide **Financial Security and Stability** to ensure continued viability and operations of Roger Williams and Fatima hospitals.
- **Guarantee Future Investment** by requiring significant, meaningful capital investments.
- **Ensure Accountability** on the part of the transacting parties.

The Result of a Comprehensive Hospital Conversion Act Review

- Revealed significant, financial vulnerabilities that may threaten the viability of our hospitals within the next two years.
- Revealed the root causes of those financial vulnerabilities—the transacting parties putting shareholder profits before financial security and their healthcare mission.
- Informed the conditions necessary to address those vulnerabilities and provide the appropriate financial security.

The Parties

Prospect Medical Holdings (PMH):

- California-based, for-profit healthcare company
- Owns 17 hospitals across the country
- Has owned Roger Williams Medical Center and Our Lady of Fatima Hospital since 2014

The Parties

Prospect Medical Holdings has two principal ownership groups:

- **Leonard Green Equity Partners, a private equity firm based in California, owns 60 percent**
- **Samuel Lee and David Topper, two wealthy individuals, own the remaining 40 percent**

The Parties

Leonard Green's investors include:

- **Public pensions**
- **Endowments**
- **Foundations**
- **Corporate pensions**
- **Financial institutions**

Leonard Green raises capital from investors and then invests that money in companies, seeking returns on those investments for Leonard Green partners and investors.

The Proposed Transaction

Leonard Green wants to sell its 60 percent ownership interest to Lee and Topper.

- **Proposed Price: $12 million, to be paid by PMH – not Sam Lee and David Topper**

- **Leonard Green is absolved of $3.1 billion in PMH debt**

The Proposed Transaction

- **If approved: Leonard Green Equity Partners is out.**

- **Lee and Topper, through PMH, would now own 100% of Roger Williams and Fatima hospitals.**

Attorney General Regulatory Authority: The HCA

The Attorney General is a healthcare regulator under the Rhode Island Hospital Conversion Act (HCA), which requires the Attorney General to:

- Ensure "the acquiror's adherence to a minimum investment to protect the assets, financial health, and well being of [Roger Williams and Fatima hospitals] and for community benefit."

R.I.G.L. § 23-17.14-28(c)

Attorney General's Regulatory Review

- **Requested and received thousands of pages of records from the parties.**

- **Took the statements under oath of 16 people, including:**
  - **Sam Lee**
  - **David Topper**
  - Leonard Green partners **Alyse Wagner** and **John Baumer**
  - **Jeffrey Liebman**, CEO, Prospect CharterCare, the local entity that owns Roger Williams and Fatima hospitals

- **Held a public hearing via Zoom in December 2020.**

- **Reviewed written public comments.**

Top Level Conclusions

Roger Williams and Fatima hospitals have been and remain financially dependent on PMH.

PMH is in a significantly less secure financial position today than it was when it purchased Roger Williams and Fatima Hospitals in 2014.

Strong conditions, including a substantial amount of upfront money placed in escrow or irrevocable letters of credit, are necessary.

Roger Williams and Fatima Need Financial Support from PMH Every Year

Prospect Medical Holdings has had to cover Roger Williams' and Fatima's operating losses every year, in the millions of dollars.

Prospect Medical Holdings has had to pay for Roger Williams' and Fatima's necessary capital improvements every year, in the millions of dollars.

According to the auditors of Roger Williams and Fatima, these hospitals are "financially dependent on [their] parent companies." *Carris Report, pp. 4-7*

The Rhode Island Hospitals are "totally dependent on" PMH and are "not substantially viable" without support from PMH. *Carris Report, pp. 4-7*

Roger Williams and Fatima Need Financial Support from PMH Every Year

Conclusion:

As PMH goes, so go Roger Williams and Fatima.

Roger Williams and Fatima Need Financial Support from PMH Every Year

Roger Williams and Fatima are financially secure only to the extent that PMH is financially secure.

Therefore, to approve this transaction, this Office needs to be assured that Roger Williams and Fatima hospitals are independently secure, now and in the future.

Our review raised real concerns about that.

Causes for Concern

Prospect Medical Holdings is not in the same financial condition today that it was when it bought the Rhode Island Hospitals in 2014.

In 2017, PMH's assets exceeded its liabilities by $67 million.

In 2020, PMH's liabilities exceeded its assets by over $1 billion.

Causes for Concern

Much of PMH's assets (its network of hospitals around the country) have already been leveraged by being sold and leased back.

"PMH is a highly leveraged company that continues to have large annual losses." *Carris Report, p.11*

What does that mean? When you don't own your assets, it's harder to raise money. You are in a weaker financial position.

How Did We Get Here?

PMH’s Board of Directors consists of:

- Three Leonard Green partners
- Sam Lee
- David Topper

PMH’s Board of Directors has authorized financial transactions that have greatly benefitted Lee, Topper, and Leonard Green and its investors – all while selling or mortgaging PMH’s real estate assets (most of its hospitals) – and increasing its debt by hundreds of millions of dollars.

How Did We Get Here?

In 2018, PMH's Board – Lee, Topper and Leonard Green – did a $457 million leveraged dividend recapitalization that "substantially weakened the balance sheet of PMH, benefitting the shareholders while providing minimal or no funds to any of the local operating entities." ***Carris Report, pp. 2-3***

To put it plainly: In 2018, they took out a $1.12 billion loan, paid off some existing debt, and paid $457 million in dividends to Lee, Topper, and Leonard Green partners and investors.

How Did We Get Here?

In 2019, to pay down debt and raise cash, PMH (Leonard Green, Lee and Topper) sold all but three of PMH's hospitals to a real estate investment trust, Medical Properties Trust, Inc. (MPT), for $1.4 billion, then leased them back for 15 years.

PMH now no longer owns these hospital facilities.

They have fewer assets, thus less of an ability to borrow money.

Cause for Concern

- The Rhode Island hospitals (and one California hospital) were **not** sold and leased back in 2019.
- BUT: in 2019, PMH also **borrowed $113 million** from MPT, and **repayment is due in July 2022**.
- Roger Williams and Fatima hospitals could have been **sold and leased back** to pay off that note.

Cause for Concern

PMH, Roger Williams and Fatima hospitals **received hundreds of millions of dollars** in federal CARES Act funds.

Some of those amounts **will need to be paid back**, by PMH and by Roger Williams and Fatima.

$27 million is due from Roger Williams and Fatima hospitals – money that these hospitals do not have.

Recap – In the Words of Our Expert

- **Our expert: "PMH is a highly leveraged company that continues to have large annual losses."** ***Carris Report, p. 11***
- **Our expert: PMH's "liabilities exceed assets by over $1 billion and the cumulative losses exceed $600 million for the six-year period under review."** ***Carris Report, p. 11***
- **Our expert: "[T]he current owners issued over $500 million in dividends since PMH purchased the Rhode Island [hospitals] which benefitted the shareholders and weakened the financial position of PMH."** ***Carris Report, p. 11***

Recap – In the Words of Our Expert

- **Our expert: "PMH has sold substantially all its real property except for [one California hospital] and the Rhode Island properties. There is very little leverage to provide liquidity."** ***Carris Report, p.9***
- **Our expert: PMH's "[g]rowth has been primarily funded through debt and sale-leaseback of certain properties to MPT."** ***Carris Report, p.7***

Recap – In the Words of Our Expert

- **Our expert: "Green has been a net drain on [PMH's] assets."** *Carris Report, p. 11*
- **Our expert: "Management seems to be relying on debt and the $200 million line of credit to fund the Company."** *Carris Report, p. 11*
- **Our expert: "However, there is no guarantee that lending institutions will leave that facility in place if losses continue to mount and there is no profitability forecasted."** *Carris Report, p. 11*

The Forecast

- **Our expert**: "While I do not believe that PMH faces a liquidity crisis in the next 12 months, I believe it will come sooner rather than later, probably within 18 to 24 months." *Carris Report, p. 11*
- **Our expert**: "They cannot continue to have significant operating losses and fund necessary capital projects and expect to survive long-term." *Carris Report, p. 11*
- **Our expert**: "The situation is complicated by the TRS note [which the Rhode Island hospitals can be sold and leased back to pay off] which is due in July 2022 and the fact that most of the real property has already been sold to MPT." *Carris Report, p. 11*

Given This Forecast, What Should We Do?

Now is the time to act – when Leonard Green wants out – not later.

We cannot simply accept promises alone from Lee and Topper that PMH, if solely in their hands, will be willing and able to support Roger Williams and Fatima hospitals.

Given This Forecast, What Should We Do?

We need security:

- Committed, up-front money we know will be there to keep these hospitals going if the promises of support and capital investment aren't kept and/or the storm hits.

Conditions of Approval

$80 Million in Escrow

- $80 million up front is sufficient security to ensure that Lee and Topper keep their commitments:
    - To cover all operating expenses for the next five years.
    - To cover necessary capital expenditures for the next five years.
    - To pay back the $27 million in federal CARES Act relief funds owed by Roger Williams and Fatima hospitals.

Three Escrow Accounts Totaling $80 Million

$12 million in the "Global Conditions Escrow":

➡ $8 million from PMH ➡ $4 million from Leonard Green

$41 million in the "CapEx Escrow":

➡ $14.2 million from PMH ➡ $26.8 million from Leonard Green

$27 million in "MAAP Escrow":

➡ Funded by PMH

Schedule of Capital Expenditures

- By 9/30/21, PMH must have invested **at least $12 million** in capital expenditures at Roger Williams and Fatima.
- Between 10/1/21 - 9/30/26, PMH must invest at least an additional **$60 million** in capital expenditures with a minimum commitment of $10 million/year and interim benchmarks.
- **REAL** capital expenditures: facilities renovation and expansion, new equipment, implementation of new service lines, and similar investments.

Conditions of Approval

$80 million in Escrow

- Escrow/letters of credit **can only be drawn down** as PMH **meets commitments** and **with Attorney General approval.**
- If PMH doesn't keep its commitments, it **doesn't get the money back**; the money goes to the hospitals.
- If PMH becomes insolvent, it **doesn't get the money back**; the money goes to the hospitals.

What about Leonard Green?

- Leonard Green contributing over $34 Million of the $80 million of security in escrow/letters of credit.
- By participating in the guarantees, Leonard Green also has an incentive to ensure that PMH keeps its commitments.
- If PMH doesn’t – Leonard Green doesn’t get its money back.

Conditions of Approval

No Sale/Leaseback of Roger Williams or Fatima

- Roger Williams and Fatima hospitals **cannot be sold and leased back** to pay off that $113 million debt next July.
- Cannot be sold or leased back for **the next five years**.
- **After that**, any transfer of assets, including sale/leaseback, **must be approved** by the Attorney General.
- **PMH cannot take out new loans, mortgages**, or other encumbrances on these hospitals **without Attorney General approval.**

Conditions of Approval

Must Cover All PACE Financing Debt/ No Management Fees

- PMH must make payments on all existing debt owed by Roger Williams and Fatima for Property Assisted Clean Energy (PACE), which has financed approximately $60 million. $33 million has already been spent; $27 million (already in escrow) will be spent for capital expenditures at the hospitals going forward.

- PMH previously charged Roger Williams and Fatima management fees. Those fees, at about $7 million/year, must be eliminated. Also, PMH cannot collect previously assessed fees.

Conditions of Approval

Maintain Operations

- For the next five years, PMH must keep Roger Williams and Fatima hospitals "open and operational."

- For the next five years, PMH must maintain and continue to provide the full complement of existing "Essential Health Services" at Roger Williams and Fatima.

Conditions of Approval

No Reduction in Services

- **“Essential Health Services” – defined in the conditions:**
  - 24-hour emergency department
  - Medical/Surgical Services and Intensive/Coronary Care Unit
  - Acute Dialysis Services
  - Inpatient and Outpatient Rehabilitation Services
  - Ambulatory Care Services
  - Emergency Services, including emergency behavioral health services
  - Inpatient & Outpatient Psychiatric/Mental Health/Addiction Services

Conditions of Approval

No Reduction in Services

- **"Essential Health Services" – defined in the conditions:**
  - Diagnostic Imaging and Interventional Radiology Services, including diagnostic Cardiac Catheterization
  - Laboratory/Pathology
  - Inpatient and Outpatient Cancer Services including Blood and Marrow Transplantation/Surgical and Radiation Oncology
  - Sleep Lab
  - Wound Care/Hyperbaric Services
  - Homecare/Hospice Services
  - Any other primary care service not otherwise listed

Conditions of Approval

Retirement Plan/Charity Care

- For the next five years, PMH **must guarantee funding** of the Roger Williams and Fatima hospitals' **401(k) retirement plans.**

- For the next five years, PMH must provide **charity care,** consistent with DOH regulations and state law.

Conditions of Approval

Board of Directors Composition

- Prospect CharterCare Board of Directors must include Sam Lee, a licensed practicing physician, and consist of 40% to 49% directors who live in the Roger Williams/Fatima service area.
- All board members of PMH and Prospect CharterCare must complete annual fiduciary training and certify completion to the Attorney General.

Conditions of Approval

Monitoring

- **Attorney General and outside Monitor (selected by the Attorney General) will monitor the transaction and its conditions for longer than the full five years allowed by the Hospital Conversions Act.**

- **Monitoring period extended to September 30, 2026.**

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