

**STATE OF RHODE ISLAND  
DEPARTMENT OF ATTORNEY GENERAL**

May 25, 2012

**DECISION**

**In Re: Affiliation of Steward Health Care System, LLC, Steward Medical Holdings, LLC, Blackstone Medical Center, Inc. and Blackstone Rehabilitation Hospital, Inc. and Jonathan N. Savage, Esq., in his capacity as the court-appointed Special Master for Landmark Health Systems, Inc., Landmark Medical Center and Northern Rhode Island Rehab Management Associates, L.P. d/b/a Rehabilitation Hospital of Rhode Island**

The Department of Attorney General has considered the above-referenced application pursuant to R.I. Gen. Laws §§ 23-17.14-1, *et seq.*, the Hospital Conversions Act. In accordance with the reasons outlined herein, the application is **APPROVED WITH CONDITIONS**.

**I. BACKGROUND<sup>1</sup>**

The first step in traversing the Hospital Conversions Act is the filing of an initial application with the Department of Attorney General and Department of Health (“DOH”). The parties filed their initial application (“Initial Application”) on October 14, 2011. The Parties (collectively, “Transacting Parties”) to the Initial Application are identified below:

- **Landmark Medical Center** is a Rhode Island non-profit corporation that operates a 214 licensed bed acute care hospital located in Woonsocket, Rhode Island.
- **Northern Rhode Island Rehab Management Associates, L.P., doing business as Rehabilitation Hospital of Rhode Island** (the “Rehabilitation Hospital of Rhode Island”) is a Delaware limited partnership operating a rehabilitation hospital located in North Smithfield, Rhode Island.
- **Landmark Health Systems, Inc.** is a Rhode Island non-profit corporation and the parent of Landmark Medical Center and Rehabilitation Hospital of Rhode Island.

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<sup>1</sup> A careful reader may realize that the Background and Procedural History sections of this Decision and sections of the Decision of the DOH are similar. In the spirit of inter-agency cooperation, the Department of Attorney provided DOH with a draft copy of such section for its reference.

- **Steward Health Care System, LLC** (“Steward”) is a Delaware for-profit corporation operating 10 hospitals in the Commonwealth of Massachusetts and various other affiliated entities.
- **Steward Medical Holdings, LLC** is a Delaware for-profit corporation and a subsidiary of Steward holding certain Steward hospitals.
- **Blackstone Medical Center, Inc.** is a Delaware for-profit corporation and a subsidiary of Steward Medical Holdings that was formed to purchase the assets of Landmark Medical Center.
- **Blackstone Rehabilitation Hospital, Inc.** is a Delaware for-profit corporation and a subsidiary of Steward Medical Holdings that was formed to purchase the assets of the Rehabilitation Hospital of Rhode Island.

In its simplest form, the structure of the transaction outlined in the Initial Application (the “Proposed Transaction”) is a sale of the assets of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island, to Blackstone Medical Center and Blackstone Rehabilitation Hospital, respectively.

## **II. REVIEW CRITERIA**

The review criteria utilized by the Department of Attorney General for a hospital conversion involving a conversion of a non-profit hospital to a for-profit hospital<sup>2</sup> is as follows:

- (1) Whether the proposed conversion will harm the public's interest in trust property given, devised, or bequeathed to the existing hospital for charitable, educational or religious purposes located or administered in this state;
- (2) Whether a trustee or trustees of any charitable trust located or administered in this state will be deemed to have exercised reasonable care, diligence, and prudence in performing as a fiduciary in connection with the proposed conversion;
- (3) Whether the board established appropriate criteria in deciding to pursue a conversion in relation to carrying out its mission and purposes;
- (4) Whether the board formulated and issued appropriate requests for proposals in pursuing a conversion;
- (5) Whether the board considered the proposed conversion as the only alternative or as the best alternative in carrying out its mission and purposes;

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<sup>2</sup> R.I. Gen. Laws § 23-17.14-7(c).

- (6) Whether any conflict of interest exists concerning the proposed conversion relative to members of the board, officers, directors, senior management, experts or consultants engaged in connection with the proposed conversion including, but not limited to, attorneys, accountants, investment bankers, actuaries, health care experts, or industry analysts;
- (7) Whether individuals described in subdivision (c)(6) were provided with contracts or consulting agreements or arrangements which included pecuniary rewards based in whole, or in part on the contingency of the completion of the conversion;
- (8) Whether the board exercised due care in engaging consultants with the appropriate level of independence, education, and experience in similar conversions;
- (9) Whether the board exercised due care in accepting assumptions and conclusions provided by consultants engaged to assist in the proposed conversion;
- (10) Whether the board exercised due care in assigning a value to the existing hospital and its charitable assets in proceeding to negotiate the proposed conversion;
- (11) Whether the board exposed an inappropriate amount of assets by accepting in exchange for the proposed conversion future or contingent value based upon success of the new hospital;
- (12) Whether officers, directors, board members or senior management will receive future contracts in existing, new, or affiliated hospital or foundations;
- (13) Whether any members of the board will retain any authority in the new hospital;
- (14) Whether the board accepted fair consideration and value for any management contracts made part of the proposed conversion;
- (15) Whether individual officers, directors, board members or senior management engaged legal counsel to consider their individual rights or duties in acting in their capacity as a fiduciary in connection with the proposed conversion;
- (16) Whether the proposed conversion results in an abandonment of the original purposes of the existing hospital or whether a resulting entity will depart from the traditional purposes and mission of the existing hospital such that a cy pres proceeding would be necessary;
- (17) Whether the proposed conversion contemplates the appropriate and reasonable fair market value;
- (18) Whether the proposed conversion was based upon appropriate valuation methods including, but not limited to, market approach, third party report or fairness opinion;
- (19) Whether the conversion is proper under the Rhode Island Nonprofit Corporation Act;
- (20) Whether the conversion is proper under applicable state tax code provisions;

- (21) Whether the proposed conversion jeopardizes the tax status of the existing hospital;
- (22) Whether the individuals who represented the existing hospital in negotiations avoided conflicts of interest;
- (23) Whether officers, board members, directors, or senior management deliberately acted or failed to act in a manner that impacted negatively on the value or purchase price;
- (24) Whether the formula used in determining the value of the existing hospital was appropriate and reasonable which may include, but not be limited to factors such as: the multiple factor applied to the "EBITDA" – earnings before interest, taxes, depreciation, and amortization; the time period of the evaluation; price/earnings multiples; the projected efficiency differences between the existing hospital and the new hospital; and the historic value of any tax exemptions granted to the existing hospital;
- (25) Whether the proposed conversion appropriately provides for the disposition of proceeds of the conversion that may include, but not be limited to:
- (i) Whether an existing entity or a new entity will receive the proceeds;
  - (ii) Whether appropriate tax status implications of the entity receiving the proceeds have been considered;
  - (iii) Whether the mission statement and program agenda will be or should be closely related with the  
  
purposes of the mission of the existing hospital;
  - (iv) Whether any conflicts of interest arise in the proposed handling of the conversion's proceeds;
  - (v) Whether the bylaws and articles of incorporation have been prepared for the new entity;
  - (vi) Whether the board of any new or continuing entity will be independent from the new hospital;
  - (vii) Whether the method for selecting board members, staff, and consultants is appropriate;
  - (viii) Whether the board will comprise an appropriate number of individuals with experience in pertinent areas such as foundations, health care, business, labor, community programs, financial management, legal, accounting, grant making and public members representing diverse ethnic populations of the affected community;
  - (ix) Whether the size of the board and proposed length of board terms are sufficient;
- (26) Whether the transacting parties are in compliance with the Charitable Trust Act, chapter 9 of title 18;
- (27) Whether a right of first refusal to repurchase the assets has been retained;

(28) Whether the character, commitment, competence and standing in the community, or any other communities served by the transacting parties are satisfactory;

(29) Whether a control premium is an appropriate component of the proposed conversion; and

(30) Whether the value of assets factored in the conversion is based on past performance or future potential performance.

In addition to reviewing the Initial Application submitted by the Transacting Parties and other publically available information, the Attorney General and DOH jointly interviewed the following individuals:

1. Jonathan Savage, Esq., Special Master
2. Robert Guyon, Executive Vice President of Steward
3. Matthew Cotti, Interim Vice President of Finance for Landmark Medical Center
4. Robert Crausman, M.D., Chief Medical Officer, Landmark Medical Center
5. Ralph de la Torre, M.D., Chairman and Chief Executive Officer of Steward
6. Richard Charest, President of Landmark Medical Center and President/CEO of the Rehabilitation Hospital of Rhode Island
7. Mark Rich, Executive VP, Corporate Strategy of Steward
8. Joshua Putter, Chief Operating Officer of Steward
9. Charles Jones, President/CEO of Thundermist Health Center in Woonsocket, Rhode Island
10. Chris Callaci, General Counsel, United Nurses and Allied Professionals

The Hospital Conversions Act requires a public informational meeting. *See* R.I. Gen. Laws § 23-17.14-7(b)(3)(iv). A public notice was published regarding informational meetings as well as soliciting written comments regarding the Proposed Transaction. The Attorney General and DOH jointly held these meetings in Woonsocket. They were held on April 9, 2012 from 2 p.m. to 4 p.m. and resumed for evening hours from 6 p.m. to 8 p.m. At each session, the Transacting Parties were provided an opportunity to give a presentation regarding the Proposed

Transaction, afterwards, public comment was taken. Over the course of the meetings, over fifty (50) speakers provided public comment. The comments were overwhelmingly in favor of the Proposed Transaction, with only one person in opposition. Several written comments were also received, the majority of which supported the Proposed Transaction.

The Initial Application, along with the supplemental information provided, information gathered from the investigation, including publically available information and information resulting from interviews and public comment, were all considered in rendering this Decision.

### **III. PROCEDURAL HISTORY**

The plight of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island dates back to at least 2008. At that time, it became apparent that due to the financial situation at the hospitals, it was necessary to search for a strategic partner in order to continue operations. According to interviews conducted by the Department of the Attorney General as well as our review of the documents submitted in the Initial Application, a strategic partner was not located in a timeframe that could guarantee the continued viability of Landmark Medical Center, and therefore, the Board of Directors of Landmark Medical Center voted to place the hospital into Special Mastership. Accordingly, on June 25, 2008, a petition of then Chief Executive Officer of Landmark Medical Center, Gary Gaube, was filed with the Superior Court for the County of Providence for appointment of a special master to oversee the operation of Landmark Medical Center.<sup>3</sup> Shortly thereafter similar petitions were brought and granted with regard to Landmark Health System and the Rehabilitation Hospital of Rhode Island.<sup>4</sup> The Court appointed attorney Jonathan Savage (the “Special Master”) to act as special master for the three entities.

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<sup>3</sup> Gaube v. Landmark Medical Center P.M. No.: 08-437 (“Landmark Special Mastership”).

<sup>4</sup> Gaube v. Landmark Health Systems C.A. No.: 08-5893 (“LHS Special Mastership”) and Charest v. Northern Rhode Island Rehab Management Associates, Limited Partnership PB No.: 08-7186 (“RHRI Special Mastership”).

Special mastership is a form of receivership whereby the Court appoints an individual to, in essence, take over a business and operate it. A matter is designated as a special mastership as opposed to a receivership based upon the role that the public interest plays in the proceeding.<sup>5</sup> While the role of a receiver in a typical business receivership is to preserve assets for the benefit of creditors, the role of a special master has as its ultimate concern the public interest.

With the Court's supervision, the Special Master became the sole governing authority for Landmark Medical Center, Landmark Health System and the Rehabilitation Hospital of Rhode Island (collectively, "Landmark").<sup>6</sup> Therefore, once the mastership was initiated, any then-existing governing body at Landmark was disbanded and the search for a strategic partner began.<sup>7</sup> There were several interested entities throughout 2008 through 2010. On August 27, 2010, as a result of negotiations, an Asset Purchase Agreement was signed with CCHC Healthcare, Inc., a Rhode Island affiliate of Caritas Christi, a Catholic-affiliated organization

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<sup>5</sup> See Landmark Special Mastership Transcript at pg. 18 (May 17, 2010) where Justice Michael A. Silverstein refers to receivership cases involving health care facilities as "tinged with the public interest and the public health."

<sup>6</sup> Certain jurisdictions allow a receiver to act as the governing body of the business. The Court in this matter has proceeded upon such a precedent. See 65 Am. Jur. 2d Receivers § 94:

"[A]uthority holds that the appointment of a receiver suspends the authority of the corporation and of its directors and officers over its property and effects and over its functions because that authority passes to the receiver. In this respect, a receivership is equivalent to an injunction to restrain the officers and agents of the corporations from intermeddling with the property of the corporation in any way. The appointment operates to suspend the incidental powers of the board of directors necessary to carry on the corporate business. The authority of the receiver, as executive in control, is subject to the court alone."

<sup>7</sup> Because the Special Masterships have been in effect for nearly four (4) years at the time of this Decision, this overview is merely a summary of relevant events to this Decision. Numerous related events transpired during the past four (4) years and the Department of Attorney General has participated, as appropriate, in the Special Masterships throughout.

operating six (6) community hospitals in Massachusetts.<sup>8</sup> For reasons that are not entirely certain, Caritas Christi walked away from the Landmark deal in late 2010. During this same timeframe, the assets of Caritas Christi were purchased by Steward effective November 2010. As a result, the Caritas Christi hospitals became the first hospital assets of Steward.<sup>9</sup>

After the split with Caritas Christi, the Special Master began the work of seeking other bidders for Landmark. This was done using a formal bidding process through the Court. Because of the numerous conditions in the Caritas Christi Asset Purchase Agreement and the resulting difficulties dealing with those conditions, a deal was sought with no conditions to avoid a bidder being chosen that could not close due to contingent issues.

Several bidders presented themselves as interested in purchasing Landmark's assets.<sup>10</sup> On April 14 and 15, 2011, detailed bid hearings were held to review the bids. The Court heard testimony from all bidders and their representatives were subject to cross-examination. As a result of the bid hearings, the Court gave the bidders additional time to "satisfy any and all of their respective contingencies to closing other than court and regulatory approval." *See* Landmark Special Mastership Order at Para. 1, (April 29, 2011). An additional hearing was held on May 10, 2011. At that hearing, it was evident that all bidders had outstanding issues that the Court would like resolved before rendering a decision choosing a bidder.

During the time the bid hearing process was pending, it was learned that Caritas Christi, now Steward, was possibly interested in coming back into the deal and that the Special Master

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<sup>8</sup> This Asset Purchase Agreement was signed only by CCHC Healthcare, Inc. and was not placed before the Court for approval.

<sup>9</sup> The Caritas Christi hospitals consisted of: Carney Hospital, Norwood Hospital, Good Samaritan Medical Center, Holy Family Hospital, St. Anne's Hospital and St. Elizabeth's Medical Center.

<sup>10</sup> One bidder, HealthSouth was only interested in purchase of the assets of the Rehabilitation Hospital of Rhode Island.



had been in discussions with them to return to the table. Because the bid hearings were still pending and because Steward did not participate in the formal bid hearing, the Court instructed the Special Master not to conduct any further negotiation with Steward, but to continue to concentrate on the pending bids. *See Id.*, at Para. 5. Surprisingly, after the bid hearings, but before decision, one by one, each bidder withdrew its bid leaving no bidder for Landmark.

Days later, on May 27<sup>th</sup>, 2011, a Petition was filed to approve an Asset Purchase Agreement for the purchase of Landmark by Steward. It was represented to the Court at that time that Steward has utilized former bidder Regional Healthcare's Asset Purchase Agreement as its template. *See* Landmark Special Master Transcript at pg. 3, line 5-13 (May 31, 2011). Because the Steward Asset Purchase Agreement was based upon the Regional Healthcare Asset Purchase Agreement, it did not have the numerous conditions of its previous deal through Caritas Christi and was not subject to the any of the contingencies that were seemingly fatal to the other bidders.<sup>11</sup> The Court approved the Steward Asset Purchase Agreement on May 31<sup>st</sup>, 2011, finding Steward's bid the most promising and authorized the Special Master to execute the Asset Purchase Agreement.

Once the Asset Purchase Agreement was approved, the next step in the process was the filing of an Initial Application pursuant to the Hospital Conversions Act. The Initial Application includes information necessary to address the statutory review criteria of the Department of Attorney General and DOH, as well as other information relevant to a hospital conversion in general. The information requested represents the minimum amount of information required. Because each hospital conversion transaction is unique, additional follow-up requests are made in response to information included in the Initial Application or information generated during the

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<sup>11</sup> For example, Regional Healthcare did not have a Collective Bargaining Agreement with the Union; Steward did not have such issue.

investigation. Although the importance of a speedy review and decision by the Department of the Attorney General and the DOH was repeatedly emphasized throughout this process by the Special Master and Steward, the Initial Application was not filed until October 14, 2011, nearly 4 ½ months after the Asset Purchase Agreement was filed with the Court.

On November 10, 2011, the Department of Attorney General and DOH deemed the Initial Application incomplete as several required items were not included, resulting in necessary follow-up on 51 out of the 73 questions on the application. After a second attempt filed by the Transacting Parties, the Initial Application was again deemed incomplete on December 22, 2011, but this time with only a handful of issues. Finally, the Transacting Parties provided the requested information. The Initial Application was deemed complete on January 17, 2012 and the review process began. Several follow-up questions were sent to the Transacting Parties who responded in writing as supplements to the Initial Application. During the pendency of the review, four (4) sets of supplemental questions were sent and responded to by the Transacting Parties.

The Asset Purchase Agreement that was approved by the Court had a provision that allowed termination by Steward if a closing on the Transaction was not completed by December 31, 2011. Because it was clear given that the Hospital Conversions Application was not filed until October and was not even accepted for review until after December 31<sup>st</sup>, the Asset Purchase Agreement was amended until shortly after such date, specifically January 17, 2012. *See* Amendment No. 1 to Asset Purchase Agreement. During the pendency of the review, in late 2011, the Department of Attorney General and DOH were informed that Steward would agree to extend the Asset Purchase Agreement for a longer period of time only upon several additional conditions to the Asset Purchase Agreement. Both Departments were informed numerous times

throughout by the Special Master and Steward's representatives in Rhode Island that Steward may walk away from the deal for a variety of reasons, including if these new conditions were not met. After numerous short extensions of the Asset Purchase Agreement and much banter about the conditions, an Emergency Petition for Instructions was filed on March 2, 2012 requesting an Amendment to the Asset Purchase Agreement to add the following conditions to the deal:

- The addition in the term of a "Material Adverse Effect" of the following: (i) "the Buyer is prohibited by law from acquiring additional not for profit hospitals within the same calendar year of the Closing" and (ii) "that changes in law or regulations impose additional burdens or obligations or requirements applicable to operations of for profit hospitals in the state."
- An additional provision regarding Thundermist Health Center: "Buyer shall have entered into a mutually acceptable Memorandum of Understanding with Thundermist Health Center, in a form which is acceptable to Buyer in its sole discretion, which provides for (a) the alignment of Buyer and Thundermist Health Center concerning the areas of primary care, specialty care, laboratory services and diagnostic imaging and (b) an understanding concerning a future relationship between the parties in the area of OB/GYN."
- An addition provision regarding the Cancer Center: "Buyer shall have entered into a definitive agreement with Radiation Therapy Services, Inc. (the entity which holds a 62% membership interest in the Cancer Center) in a form which is acceptable to Buyer in its sole discretion, which definitive agreement sets forth (a) the terms upon which Buyer or an Affiliate thereof would acquire Radiation Therapy Services, Inc.'s membership interest in the Cancer Center, including (i) that the purchase price for such membership interest shall be determined in a manner consistent with current industry valuation methodologies and practice and (ii) timing for the closing of such transaction which takes into account applicable Department of Health certificate of need or other approval requirements and (b) the manner in which all outstanding arrangements between Landmark Medical Center, the Cancer Center and/or Radiation Therapy Services, Inc. would be restructured."
- A change from the original language regarding reductions in force from no additional reductions in force to the following:

(c) in addition to the implementation on or prior to the Closing Date of any reduction in force as contemplated by the Advisory Agreement, Buyer shall not be restricted or otherwise limited on any way from (i) implementing any further reductions in force of the Transferred Employees at either the Hospital or the Rehab Facility after the Closing Date or (iii) making employment decisions with respect to the transferred Employees after the Closing Date as determined in Buyers' sole discretion.

- Section 10.3 in the original Asset Purchase Agreement regarding Maintenance of Services was deleted. It read as follows:

Maintenance of Services. From the Closing Date until the date which is two (2) years after the Closing Date, Buyer agrees not to discontinue any clinical service being provided by the Hospital or the Rehab Facility as of the date of this Agreement (so long as such Clinical service is still being provided by the Hospital or the Rehab Facility, as applicable, immediately prior to the Closing Date).

The Department of Attorney General objected to the addition of any conditions to the Asset Purchase Agreement on the grounds that the Court favored a condition-free deal at the time it approved the Asset Purchase Agreement and would not likely have agreed to these conditions originally. In addition, none of the conditions were based upon events that were unanticipated at the time of the approval of the Asset Purchase Agreement in May of 2011. Over our Objection as well as objections of other parties, the Court granted the Emergency Petition for Instructions allowing these conditions to be added. Even though the substance of these conditions has presumably been worked on by Steward for months, as of the date of this Decision, we have not been informed that any of these conditions have been satisfied.

#### **IV. DISCUSSION**

As outlined above, the review criteria contained in the Hospital Conversions Act applicable to the Proposed Transaction consists of thirty (30) requirements. For organizational purposes we have addressed them grouped by topic below.

## **A. BOARD OF DIRECTORS**

Numerous provisions of the Hospital Conversions Act involve a review of the actions of the board of directors of the existing hospital.<sup>12</sup> Due to the circumstances in this particular matter, we have outlined the actions of the board of directors below in several parts, including action before and after special mastership.

### **1. Decision to Place Landmark Medical Center and Rehabilitation Hospital of Rhode Island into Special Mastership**

As outlined above, the filing of a Petition for Special Mastership was the initial action leading Landmark to the Proposed Transaction. Included with the Initial Application were certain board minutes of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island for time periods immediately prior to the filing of the Petitions for Special Mastership.<sup>13</sup> After review of the board minutes, the Attorney General is satisfied that the respective boards fulfilled their fiduciary duties to the hospitals in placing the hospitals in special mastership.

As a result of the board's decision, a Petition for Special Mastership was filed by Gary Gaube, then Chief Executive Officer of Landmark Medical Center. It states that “[d]espite continued efforts over the past three years to partner with stronger institutions, to improve insurance reimbursements and to reduce costs, [Landmark] has experienced a level of financial distress that is unique among Rhode Island hospitals and is the only Rhode Island hospital in a negative net asset position.” Landmark Special Mastership Petition at Para. 5. A petition on the same grounds was filed regarding the Rehabilitation Hospital of Rhode Island by the hospital President, Richard Charest. Accordingly, given that the Superior Court granted the Petitions

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<sup>12</sup> See e.g., Hospital Conversions Act, R. I. Gen. Laws §§ 23-17.14-7(c) (3), (4), (5), (8), (9), (10), (11), (13), (14), (15), and (23).

<sup>13</sup> See Initial Application Confidential Exhibit S1-37. These minutes were determined to be confidential in accordance with R.I. Gen. Law §23-17.14-32.

based upon verified petitions of the Chief Executive Officer of Landmark Medical Center and the President of the Rehabilitation Hospital of Rhode Island and given the information contained in the board minutes for these entities, the Attorney General determines that the boards and leadership of the hospitals found special mastership to be the only reasonable alternative for the hospitals' continued survival. *See* R.I. Gen. Laws § 23-17.14-7(c)(5).

## **2. Duties of the Board of Directors**

Once the Special Master was appointed, he disbanded the Board of Directors of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island. Since that time, the Special Master has, in essence, acted in the capacity of the Board of Directors at each hospital, making all major decisions with regard to the fate of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island with court approval of certain actions. The absence of a Board of Directors is not contemplated by the Hospital Conversion Act. The Act requires review of the decisions leading up to a conversion to ascertain whether the directors fulfilled their fiduciary duties to the hospital. Because the Special Master has taken on the responsibility of the Board, the Attorney General will review his actions through the lens of the Hospital Conversion Act criteria applicable to the Board of Directors.

The first criteria of the Hospital Conversions Act guiding the review of the actions of the Special Master in pursuing a conversion is governed by R.I. Gen. Laws § 23-17.14-7(c)(3). This section requires review of whether there was “appropriate criteria [used] in deciding to pursue a conversion in relation to carrying out [the hospital’s] mission and purposes.” With regard to this particular provision, the Special Master was presented with a situation where a conversion was inevitable given the filing of the Petitions for Special Mastership. While the criteria he used to

find a strategic partner before the bid process established by the Court is unclear,<sup>13</sup> it is not directly relevant as the bid process that ultimately resulted by default in the Asset Purchase Agreement with Steward was dictated by the Rhode Island Superior Court. The criteria necessary in order to be a successful bidder through the bid process was included in the Court's Order in the Landmark Special Mastership of February 14, 2011. These criteria included:

- (i) The purchase price;
- (ii) The experience of the Qualified Purchaser in running healthcare facilities, and, if appropriate, financially-distressed healthcare facilities;
- (iii) The capitalization or access to capital of the Qualified Purchaser;
- (iv) The minimum amount of capital that the Qualified Purchaser is willing to contractually commit to the successor LMC and/or NRIRMA entity(ies) (exclusive of capital dedicated to the purchase price);
- (v) A five year pro forma cash flow projection of the successor LMC and/or NRIRMA entity(ies);
- (vi) The period of time that the Qualified Purchaser is willing to contractually commit not to sell the assets and business or equity interest in LMC if it becomes the successful purchaser; and
- (vii) How the Qualified Purchaser intends to meet the healthcare needs of the community currently serviced by LMC including, without limitation, (i) any services that the Qualified Purchaser anticipates terminating, and
- (viii) the approximate number of employees that the Qualified Purchaser anticipates retaining.

While these particular criteria did not directly result in the Steward Asset Purchase Agreement, the template agreement upon which it was based was a direct result of this court process. The criteria considered in broad strokes sought an entity that could continue to operate Landmark Medical Center and the Rehabilitation Hospital of Rhode Island in as close to their

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<sup>13</sup> The Attorney General notes that the power of the Special Master in making decisions with regard to negotiations with potential purchasers of the hospitals was vast and seemingly unfettered. Because such decision impacts not only the hospital and its immediate surrounding community, the Attorney General suggests for future special masterships a more defined role for a special master in this regard, especially in decisions regarding the favoring or rejection of any particular bidder.

current forms as possible. While the wisdom of that path remains to be seen, for the purposes of the Hospital Conversion Act review, we find that the Special Master met the minimum requirements of R.I. Gen. Laws § 23-17.14-7(c)(3).

The next section, R.I. Gen. Laws § 23-17.14-7(c)(4) requires a review of “[w]hether the board formulated and issued appropriate requests for proposals in pursuing a conversion.” An additional section requires review of “whether the board exercised due care in assigning a value to the existing hospital and its charitable assets in proceeding to negotiate the proposed conversion.” *See* R.I. Gen. Laws § 23-17.14-7(c)(10). These two requirements are so intertwined with the Court approved bid process discussed in the previous section, we find such criteria are also met based upon the information set forth above.

### **3. Board Use of Consultants**

Two criteria in the Hospital Conversions Act deal with a board’s use of consultants. *See* R.I. Gen. Laws §§ 23-17.14-7(c)(8) and (9):

(8) Whether the board exercised due care in engaging consultants with the appropriate level of independence, education, and experience in similar conversions; and

(9) Whether the board exercised due care in accepting assumptions and conclusions provided by consultants engaged to assist in the proposed conversion.

As outlined in the Initial Application, the Special Master engaged certain consultants during his four (4) year tenure.<sup>14</sup> Consultants relevant to this analysis are PricewaterhouseCoopers and Joshua Nemzoff.<sup>14</sup> The engagements of PricewaterhouseCoopers and Joshua Nemzoff were both approved by the Superior Court in the Special Mastership. The Department of Attorney General has no reason to second guess the judgment of the Court

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<sup>14</sup> *See* Initial Application Exhibit 60(b).

<sup>14</sup> We have chosen not to include the various other consultants utilized by the Special Master, such as lobbyists, accounts, public relations advisors, etc., but only those that have been represented as being utilized to locate potential bidders.



regarding the propriety of engagement of these consultants and have not revealed anything during the pendency of the Special Mastership proceedings or through the Hospital Conversions review to question the level of independence, education and experience in similar conversions of these consultants.

With regard to the care given “in accepting assumptions and conclusions provided by consultants,” the Department of Attorney General is not privy to the advice provided by these consultants other than any documents submitted with the Initial Application or through the court process. No final reports regarding the bidders were produced from either consultant although we are aware based upon statements of the Special Master and review of his fee invoices that Mr. Nemzoff was utilized and consulted frequently during the bid process. Accordingly, given the consultants’ approval by the Court as experts in the field of hospital conversions, the Department of Attorney General has found nothing to refute that the Special Master’s decision to accept the assumptions and conclusions provided by the consultants was with due care.

#### **4. Remaining Board Criteria**

Regarding the remaining criteria of this type, it has been represented by the Transacting Parties that there will be no management contracts with regard to the Proposed Transaction. While an Advisory Services Agreement<sup>15</sup> was executed between Steward and Landmark for the time period between the approval of the Asset Purchase Agreement and closing for Steward to provide certain advisory services, no monetary compensation will result from this agreement<sup>16</sup>

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<sup>15</sup> See Advisory Services Agreement Approved by the Court pursuant to Landmark Special Mastership Order dated June 8, 2011.

<sup>16</sup> A fee of \$35,000 per month will be due in the event that the Asset Purchase Agreement is terminated other than for an uncured breach of such agreement by Steward. See Advisory Services Agreement at Article IV.

and this agreement will terminate upon closing.<sup>17</sup> *See* R.I. Gen. Laws § 23-17.14-7(c)(14). The Asset Purchase Agreement does not include consideration that is based upon future or contingent value based upon success of the new hospital. *See* R.I. Gen. Laws § 23-17.14-7(c)(11). The Special Master is an attorney and was also represented by and consulted with various attorneys at his law firm throughout the Special Mastership. *See* R.I. Gen. Laws § 23-17.14-7(c)(15). The Department of Attorney General has no information that the “officers, board members, directors, or senior management deliberately acted or failed to act in a manner that impacted negatively on the value or purchase price.” *See* R.I. Gen. Laws § 23-17.14-7(c)(23). According to his conflict of interest statement, the Special Master will not “retain any authority in the new hospital.” *See* R.I. Gen. Laws § 23-17.14-7(c)(13). Therefore, the additional miscellaneous Hospital Conversions Act criteria that must be reviewed regarding board actions have been satisfied.

As outlined above, the decision to place Landmark Medical Center and the Rehabilitation Hospital of Rhode Island into special mastership was supported based upon the information that has been reviewed. In addition, with regard to the Hospital Conversions Act board criteria, the actions of the Special Master and approved by the Court complied with the Hospital Conversions Act.<sup>18</sup>

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<sup>17</sup> A previous Management Agreement between Caritas Christi and the Special Master was approved by the Court. *See* Landmark Special Mastership Order of May 25, 2010. This Management Agreement was subsequently terminated. *See* Landmark Special Mastership Order of February 14, 2011 at Para. 1.

<sup>18</sup> *See* Hospital Conversions Act, R. I. Gen. Laws §§ 23-17.14-7(c)(3), (4), (5), (8), (9), (10), (11), (13), (14), (15) and (23).

## **B. CONFLICTS OF INTEREST**

Numerous provisions of the Hospital Conversions Act deal with conflicts of interest.<sup>19</sup> The Attorney General has reviewed the criteria in the Act to determine whether the Transacting Parties and their consultants have avoided conflicts of interest.

### **1. Conflict of Interest Forms**

As part of the Initial Application, certain individuals associated with the Transacting Parties were required to execute conflict of interest forms. These included officers, directors and senior management for Landmark and Steward. Individuals completing the conflict of interest forms were asked to provide information to determine conflicts of interest such as their affiliation with the Transacting Parties, their relationships with vendors and their future involvement with the Transacting Parties.

Steward submitted twenty-seven (27) executed conflict of interest forms and Landmark submitted fifty-nine (59) forms. After reviewing all forms, the Attorney General determines that none of the submitted materials revealed any conflict of interest.

### **2. Consultants**

On behalf of Landmark, the Special Master engaged several entities for consultation and advice including PricewaterhouseCoopers LLP (“PWC”), a health industry advisory company; Nemzoff & Company, LLC, a hospital acquisition advisor; Vector Group; JACA Architects; True North Communications; Kahn, Litwin, Renza & Co. Ltd. and Capitol City Group, Ltd.<sup>20</sup>

PWC was retained to assist with reviewing Landmark’s operations. Their assessment included evaluating Landmark’s leadership structure and management processes, evaluating the delivery of patient care, evaluating financial performance and also reviewing the status of

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<sup>19</sup> See R.I. Gen. Laws §§ 23-17.14-7(c) (6), (7), (12), (22) and (25) (iv).

<sup>20</sup> See Initial Application Response to Questions 60(b).

previously recommended corrective actions and initiatives.<sup>21</sup> Upon the advice of PWC, the Special Master engaged Joshua Nemzoff (“Nemzoff”), the president of Nemzoff & Company, LLC, as a “Hospital Acquisition Advisor.”<sup>22</sup>

The terms of Nemzoff’s engagement required him to coordinate negotiations and accomplish a transaction with an identified purchaser.<sup>23</sup> Pursuant to the arrangement, if a court-approved asset purchase agreement for Landmark Medical Center and the Rehabilitation Hospital of Rhode Island was facilitated by Nemzoff, he would be entitled to fees including an hourly rate as well as an additional advisory fee (“the Finder’s Fee”)(the hourly rate and the Finder’s Fee, collectively, the “Fees”).<sup>24</sup> The Finder’s Fee provision, however, would not be applicable in the event that either Lifespan, Caritas Christi Healthcare or CharterCare were the approved purchaser, as those entities had been identified prior to Nemzoff’s involvement.<sup>25</sup>

Pursuant to the terms of the engagement, the Special Mastership Estate is responsible to satisfy the Fees. As part of the negotiation of the Asset Purchase Agreement, the Department of Attorney General was informed by the Special Master that Steward agreed to assume the payment of the Fees, including the full amount of the Finder’s Fee. Accordingly, an original draft of Asset Purchase Agreement included payment of Nemzoff’s fees in that amount of \$475,000.00, which includes the Finder’s Fee. At the hearing on the approval of the Asset Purchase Agreement, however, the Attorney General objected to Steward’s payment of the Finder’s Fee because it was not owed to Nemzoff based upon the agreement he had with the Special Master that was approved by the Court. While the Special Master could have negotiated

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<sup>21</sup> See Landmark Special Mastership Order Appointing Special Master dated July 25, 2008 at Para. 5.

<sup>22</sup> See Landmark Special Mastership Order dated March 8, 2011.

<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

with Steward to pay the actual fee that was owed to Nemzoff, he decided to simply remove the payment of any fees from the approved Asset Purchase Agreement. Despite these actions and for reasons that are completely unknown, the Special Master insisted after approval of the Asset Purchase Agreement that Nemzoff would be paid by Steward for the Finder's Fee even though it is not due. The following response was provided regarding Nemzoff's Fees in the Initial Application: "[I]n connection with the Initial Application, Nemzoff submitted a conflict of interest statement which indicates in paragraph 5 that 'Steward has agreed to pay the remainder of my fee at closing. The Special Master is not a party to that agreement and is unaware if that agreement has been formalized.'" *See* Response to 1<sup>st</sup> Supplemental Response S1-30. The Department of Attorney General has not been provided any agreement for payment of Nemzoff's fees by Steward and finds that Nemzoff is not due the Finder's Fee.<sup>26</sup> Indeed, the payment by a bidder to a special master's consultant without justification likely violates the Hospital Conversions Act, including, but not limited to the fact that it could be viewed as "pecuniary rewards based in whole, or in part on the contingency of the completion of the conversion." *See* R.I. Gen. Laws § 23-17.14-7(c)(7). Therefore, Nemzoff should not be permitted to collect the Finder's Fee from Steward or otherwise.

Finally, in reviewing the provision of the Hospital Conversions Act regarding conflicts of interest, the Attorney General notes that the position of an attorney special master is certainly a difficult one in which to maintain neutrality due to the significant amount of income these types of cases provide. For example, the amount requested by the Special Master in his Interim

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<sup>26</sup> Indeed, by all accounts Chris Callaci of the United Nurses and Allied Professionals was the individual to contact Steward to bring them back to the table.

Reports on all three special masterships totals approximately \$3,589,969.43.<sup>27</sup> In addition, the Special Master hired his own firm, Schectman, Halperin, Savage, LLP, for litigation ancillary to the Mastership proceeding, including litigation involving Blue Cross Blue Shield of Rhode Island, 21<sup>st</sup> Century Oncology and RehabCare, therefore this Special Mastership has certainly yielded substantial legal fees for the Special Master's firm.<sup>28</sup> As a practical matter, all attorneys deal with the conflict between swift resolution of matters for their clients and the fact that they are typically paid by the hour. Four years of special mastership from everyone's perspective, is longer than ideal. With regard to litigation, the Court in the Special Mastership has considered, but not ruled upon the necessity for a Special Master to request permission from the Court to bring complex litigation under the authority granted in a standard order for special mastership. There has been no definite resolution as of this date of the issue of an attorney special master bringing litigation in a mastership and hiring his own law firm. The issue of the inherent conflicts that arise from special mastership involving an attorney special master are inherent in the process and will continue to be grappled with in future proceedings.

### **3. Negotiations And Conflicts**

With the exception of the discussions outlined above, no information that the individuals who represented the existing hospital in negotiations of the Proposed Transaction had any impermissible conflicts of interest.<sup>29</sup>

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<sup>27</sup> This amount is based upon the Landmark Medical Center 1<sup>st</sup> to 27<sup>th</sup> Interim Reports and Fee Requests of the Special Master as well as the Fee Requests regarding Landmark Health Systems and the Rehabilitation Hospital of Rhode Island. The Attorney General is aware that the entire amount of those fees is not finally determined. The Special Master has agreed to a few of the Attorney General's requests to remove fees and some amounts in dispute remain outstanding. However, this is the amount that was requested.

<sup>28</sup> The amount of legal fees generated by ancillary litigation is currently unknown. Some of these matters will presumably continue well into the future.

<sup>29</sup> R.I. Gen. Laws § 23-17.14-7(c)(22).

#### **4. Sale Proceeds And Conflicts**

As contemplated by the structure of the purchase price outlined in the Asset Purchase Agreement, there will be no proceeds from the Proposed Conversion. Therefore, there is no need to address whether the Transacting Parties have appropriately provided for the disposition of proceeds.<sup>30</sup>

#### **5. Steward Conflicts Of Interest**

In response to various questions, Steward has indicated that no final determinations have been made regarding future positions at Blackstone Medical Center and Blackstone Rehabilitation Hospital.<sup>31</sup> Given that response, the Attorney General cannot determine if future conflicts of interest will exist.<sup>32</sup>

### **C. VALUE OF TRANSACTION**

The following Hospital Conversions Act criteria deals with valuation of the Proposed Transaction. *See* R.I. Gen. Laws §§ 23-17.14-7 (c)(17), (18) and (24):

(17) Whether the proposed conversion contemplates the appropriate and reasonable fair market value;

(18) Whether the proposed conversion was based upon appropriate valuation methods including, but not limited to, market approach, third party report or fairness opinion; and

(24) Whether the formula used in determining the value of the existing hospital was appropriate and reasonable which may include, but not be limited to factors such as: the multiple factor applied to the "EBITDA" – earnings before interest, taxes, depreciation, and amortization; the time period of the evaluation; price/earnings multiples; the projected efficiency differences between the existing hospital and the new hospital; and the historic value of any tax exemptions granted to the existing hospital.

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<sup>30</sup> *See* R.I. Gen. Laws § 23-17.14-7(c)(25)(iv).

<sup>31</sup> *See* Initial Application Response to Questions 35, 36, 39 and 42.

<sup>32</sup> R.I. Gen. Laws § 23-17.14-7(c)(12).

Given their relevant expertise in this area, the Attorney General consulted with its expert, Health Strategies & Solutions, Inc., ("HS&S"), in making a determination regarding valuation.

According to the analysis of HS&S:

According to the Asset Purchase Agreement, Steward will pay a total purchase price of \$40.1 million (subject to various adjustments), plus the value of Net Working Capital as of the closing date for the acquisition of LHS. Steward states it will also spend \$4.5 million in the first five years following closing for the purposes of physician recruitment to meet the needs of the community.

A third party valuation analysis or fairness opinion was not completed with regard to the proposed transaction. One valuation methodology that is utilized for non-profit health care organizations is a multiple of earnings before interest, taxes, depreciation, and amortization (EBITDA). Because LHS has had a negative EBITDA margin over each of the past several years, a multiple of earnings calculation yields a negative value for LHS. Given that LHS lost more than \$10 million on operations in the most recent fiscal year, the impact of projected efficiency differences between the existing operation and likely future operations would result in minimal (if any) positive cash flow. The discounted value of these projected future cash flows for LHS would not yield a substantial value.

The purchase commitment for LHS was the result of a lengthy process whereby requests for proposals were solicited and meetings and negotiations took place with multiple organizations that had varying levels of interest in acquiring or affiliating with LHS. Several parties submitted formal proposals to acquire LHS. With the exception of Steward, each organization that submitted a proposal to acquire LHS ultimately withdrew their proposal. Steward's proposal was viewed by LHS leadership and the Special Master to be comparable to or better than any other proposals that had been received.

Based on review of relevant documentation, analysis of LHS's current and historical operating performance, and interviews and discussions with individuals that participated in the process to sell LHS, the purchase commitment for LHS is fair and reasonable.

While it was clear at the public informational meetings that the value of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island to the people of Northern Rhode Island is without measure, this does not translate into cash proceeds. It is clear this is an usual situation. Typically, there are proceeds in a hospital conversion, however, the Proposed Transaction is designed such that Steward will pay certain obligations of Landmark Medical



Center and the Rehabilitation Hospital of Rhode Island as well as provide future promises of capital. In determining whether the valuation of the Proposed Transaction is correct, the report of HS&S regarding the financial status<sup>33</sup> of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island as steadily deteriorating is also of assistance. Further, the bid process itself was instructive as to what the relevant market would pay for Landmark Medical Center and the Rehabilitation Hospital of Rhode Island.

Accordingly, given the information provided by HS&S, as well as the amount offered by other bidders through the court process, the criteria regarding valuation of the Proposed Transaction has been met.

#### **D. CHARITABLE ASSETS**

The Department of Attorney General has the statutory and common law duty to protect charitable assets within the State of Rhode Island.<sup>34</sup> In addition, the Hospital Conversions Act specifically includes provisions dealing with the disposition of charitable assets in a hospital conversion generally to ensure that the public's interest in the funds is properly safeguarded.

##### **1. Disposition of Charitable Assets**

In the Initial Application, the Transacting Parties identified the amount of \$21,266.98 in restricted funds (the "Restricted Funds").<sup>35</sup> There is also an additional amount of \$52,576.00 allotted for the HRSA Hospital Preparedness Program ("HRSA Grant").<sup>36</sup> In addition, Landmark reported that it received amounts from an endowment fund, the John R. Higgins

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<sup>33</sup> See Final Report of HS&S, Assessment of Operating and Financial Performance.

<sup>34</sup> See e.g., R.I. Gen. Laws § 18-9-1, *et seq.*

<sup>35</sup> See 4<sup>th</sup> Supplemental Response S4-4(a) noting that the restricted funds are held in six separate categories in the following amounts: \$91.24; \$526.61; \$2,964.00; \$3,369.30; \$6,356.00; and \$7,959.83.

<sup>36</sup> See 4<sup>th</sup> Supplemental Response S4-4(b). It has been represented that it is possible for the HRSA grant to be transferred to Steward.

Residuary Trust. Landmark has provided documentation that the funds in the Higgins Trust that were disbursed to Landmark in 2007 and were exhausted by Landmark, with the last amounts being spent in 2011.<sup>37</sup> It has represented that this trust was terminated in May 2007 and no longer holds any assets.<sup>38</sup> In accordance with the Hospital Conversions Act criteria regarding the duties of trustees of charitable trusts,<sup>39</sup> Landmark has represented that the funds in the Higgins Trust were used in accordance with the purpose of such Trust, specifically for care of children without parents or whose parents are unable to afford care.<sup>40</sup> Therefore, the Attorney General finds that there is no violation of the Charitable Trust Act regarding the Higgins Trust based upon the information that has been provided.<sup>41</sup>

With regard to the Restricted Funds, per the Hospital Conversions Act, in a hospital conversion involving a not-for-profit corporation and a for-profit corporation, it is required that any endowments, restricted, unrestricted and specific purpose funds be transferred to a charitable foundation.<sup>42</sup> In furtherance of that requirement, Landmark has indicated that it intends to transfer all currently held specific purpose and restricted funds to the Rhode Island Foundation,<sup>43</sup> which will use the funds in accordance with the designated purpose. With an appropriate agreement with the Rhode Island Foundation to manage these assets, the Attorney General finds that the Proposed Transaction will not harm the public's interest in the property given, devised or bequeathed to Landmark for charitable purposes.<sup>44</sup> The Attorney General notes that the Rhode

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<sup>37</sup> *Id.*

<sup>38</sup> See 2<sup>nd</sup> Supplemental Response S2-23.

<sup>39</sup> See R.I. Gen. Laws § 23-17.14-7(c)(2).

<sup>40</sup> See 2<sup>nd</sup> Supplemental Response S2-23.

<sup>41</sup> See R.I. Gen. Laws § 23-17.14-7(c)(26).

<sup>42</sup> R.I. Gen. Laws § 23-17.14-22(a).

<sup>43</sup> See 2<sup>nd</sup> Supplemental Response S2-25.

<sup>44</sup> R.I. Gen. Laws § 23-17.14-7(c) (1).

Island Foundation is specifically mentioned as an appropriate entity to manage funds as a result of a hospital conversion.<sup>45</sup>

## 2. Maintenance of the Mission, Agenda and Purpose of Landmark

The Hospital Conversion Act at R.I. Gen. Laws § 23-17.14-7(c)(16) and R.I. Gen. Laws § 23-17.14-7(c)(25)(iii) requires consideration of the following:

- Whether the proposed conversion results in an abandonment of the original purposes of the existing hospital or whether a resulting entity will depart from the traditional purposes and mission of the existing hospital such that a cy pres proceeding would be necessary; and
- Whether the mission statement and program agenda will be or should be closely related with the purposes of the mission of the existing hospital.

According to the original Articles of Incorporation for Woonsocket Community Health, Inc.,<sup>46</sup> the organization's purpose was to:

[support] the advancement of the health of all persons through improving the knowledge and practice of medicine, surgery, nursing, health planning, and other activities related the care and treatment of such persons, and to support and encourage charitable, scientific, and educational services and programs which are consistent with such purposes...

*See* Initial Application Exhibit 10(a).

According to information provided in the Initial Application, the current mission statement of Landmark Medical Center is to “provide a continuum of exceptional quality, patient-centered services that improve health in a culturally competent manner that is creative and consistent with values aligned with our diverse communities.”<sup>47</sup> The mission statement of the Rehabilitation Hospital of Rhode Island is of a similar nature: “[C]ommit[ment] to providing

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<sup>45</sup> R.I. Gen. Laws § 23-17.14-7-22(e).

<sup>46</sup> Woonsocket Community Health Inc. was the sole member of Woonsocket Hospital, which later became LMC. *See* HCA Application Response, resubmitted December 13, 2011, Exhibit 10(a). LMC was created in 1988 through the merger of Woonsocket Hospital and John E. Fogarty Hospital. *See* Initial Application Response 68.

<sup>47</sup> *See* 2<sup>nd</sup> Supplemental Response S2-16.

competent and compassionate comprehensive medical rehabilitation services, respectful of every patient's dignity and cultural values, assuring patient's of achieving their greatest functional outcomes in the most cost-effective manner.”<sup>48</sup>

Steward provided as its mission statement to “provide the highest quality care with compassion and respect.”<sup>49</sup> While implied in Steward’s for-profit status that profit is an issue that will be considered, Steward’s stated vision is in keeping with the current purposes of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island.<sup>50</sup> Although there is no evidence that the Proposed Transaction will differ significantly from the stated purposes of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island, it is necessary that a cy pres be filed and granted to ensure the proper utilization of the remaining restricted funds and because this hospital conversion includes the conversion of two non-profit entities’ assets for use by for-profit entities.<sup>51</sup>

In further consideration of whether “a resulting entity will depart from the traditional purposes and mission of the existing hospital,” the Attorney General reviewed Steward’s intention to work with hospital leadership, the hospital board and the community to establish a community benefits advisory council.<sup>52</sup> Steward represents that after the health needs of the community have been assessed, the council will assist in the development of a community benefits mission statement and will produce an annual community benefits plan outlining

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<sup>48</sup> See 2<sup>nd</sup> Supplemental Response S2-17.

<sup>49</sup> See 2<sup>nd</sup> Supplemental Response S2-18.

<sup>50</sup> R.I. Gen. Laws §§ 23-17.14-7(c)(16) and (25)(iii).

<sup>51</sup> *Id.*

<sup>52</sup> See Initial Application Response to Question 33.

programs, goals and expenditures. The plan and the report on its implementation will be available to the public.<sup>53</sup>

Further, Rhode Island law requires that all licensed hospitals, whether non-profit or for-profit, provide unreimbursed healthcare services to patients with an inability pay.<sup>54</sup> Therefore, Steward will be required even as a for-profit hospital to provide a certain amount of charity care. In addition, in support of its commitment to charity care within its system, Steward has provided information in the Initial Application demonstrating their provision of charity care in their Massachusetts hospitals.<sup>55</sup>

Finally, in consideration of whether the new entity will operate with a similar purpose, pursuant to Section 10.3 of the Asset Purchase Agreement entitled "Maintenance of Services" Steward initially agreed to maintain Landmark Medical Center as an acute care hospital with the same clinical services. However, as outlined above, Amendment Number Eight to the Asset Purchase Agreement omitted this section of the Agreement. Accordingly, the Proposed Transaction does include a risk that Steward will change the services provided at Landmark.

### **3. Foundation for Proceeds**

In addition to dealing with charitable assets, the Hospital Conversions Act requires an independent foundation to hold and distribute proceeds from a hospital conversion consistent with the acquiree's original purpose.<sup>56</sup> With regard to the Proposed Transaction, the Asset Purchase Agreement does not include a purchase price that will produce traditional proceeds as it is structured upon payment of certain obligations and commitment to future investments in the

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<sup>53</sup> *Id.*

<sup>54</sup> R.I. Gen. Laws §§ 23-17.14-15(a)(1), (b) and (d).

<sup>55</sup> *See* Initial Application (re-submitted 2/27/12) Exhibit 32(a).

<sup>56</sup> R.I. Gen. Laws § 23-17.14-22(a) and R.I. Gen. Laws § 23-17.14-7(c)(16).

hospital. Accordingly, R.I. Gen. Laws § 23-17.14-22 does not require a foundation for receipt of proceeds.

#### **E. TAX IMPLICATIONS**

There are three criteria in the Hospitals Conversions Act that deal with the tax implications of the Proposed Transaction.<sup>57</sup> Currently, Landmark Medical Center and Landmark Health Systems are non-profit corporations organized pursuant to Rhode Island law. Northern Rhode Island Rehab Management Associates, L.P. is a limited partnership organized pursuant to the laws of Delaware. Upon the purchase of their assets by Blackstone Medical Center and Blackstone Rehab Hospital, the resulting entities will be for-profit entities and no longer immune from certain tax obligations. Clearly, this has an impact on the tax status of these entities.<sup>58</sup> This transaction represents the first full service hospital in Rhode Island to change from a non-profit to a for-profit hospital. It is a marked change in how hospitals in Rhode Island have traditionally been held. While some may be cautious about allowing a for-profit entity to purchase Landmark Medical Center and Rehabilitation Hospital of Rhode Island, in the instant matter this decision was not made in a typical fashion, but was made by a Special Master with approval of the Rhode Island Superior Court in a situation involving a distressed hospital and only one potential bidder. Accordingly, the wisdom of choosing a for-profit company to purchase a non-profit hospital is not a matter that warrants in-depth consideration given the circumstances.

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<sup>57</sup> See R.I. Gen. Laws §§ 23-17.14-7(c)(20), (21) and (25)(ii).

<sup>58</sup> The question posed by R.I. Gen. Laws § 23-17.14-7(c)(21) is whether the tax status of the existing hospital is “jeopardized.” This characterization does not apply to the Proposed Transaction as not only is it jeopardized, it is knowingly being changed from non-profit to for-profit.

With regard to tax implications, it is important to note that consistently throughout the various public forums surrounding the Proposed Transaction, Steward has discussed the benefit to the local community of their addition to the tax rolls of the City of Woonsocket, a city that at the time of this Decision is on the brink of financial disaster. In supplemental questions Steward was asked to provide an estimate of real estate taxes it will pay upon closing the Proposed Transaction. See Supplemental Question S2-2. Initially, Steward responded that it was working on such a calculation. Subsequently, Steward stated that it could not provide an accurate calculation as it was unable to do so. Although the Attorney General informed Steward that its response was difficult to fathom given their experience with a number of other non-profit hospital conversions in Massachusetts, Steward was firm that it was unable to provide an estimated tax. During these discussions, the Special Master produced a document prepared for him pertaining to the previous deal with Caritas Christi entitled: "*Landmark Medical Center – Pro Forma Property and Tangible Tax Calculation (April 30, 2010)*". This document calculated an estimated tax to Woonsocket for Landmark Medical Center of approximately \$2.2 Million Dollars based upon various assumptions and including the planned improvements contemplated by the Caritas Christi Asset Purchase Agreement. Further, a review of the public record reveals that Landmark Medical Center currently has an assessed value of \$27,370,600<sup>59</sup> and the Cancer Center on the hospital campus has a separate assessed value of \$2,638,500.<sup>60</sup> Accordingly, using the available documents, the tax payable to Woonsocket will be significant. The payment by Steward of substantial real estate taxes is a significant factor in this Department's decision with regard to the Proposed Transaction. The payment of real estate taxes to Woonsocket, that so

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<sup>59</sup> See <http://data.visionappraisal.com/WoonsocketRI/findpid.asp?iTable=pid&pid=101507> (last accessed May 22, 2012)

<sup>60</sup> See <http://data.visionappraisal.com/WoonsocketRI/findpid.asp?iTable=pid&pid=10626> (last accessed May 22, 2012).

desperately needs the resources, is a clear, tangible benefit directly resulting from the Proposed Transaction. While it remains a question whether this benefit will outweigh the possible risks of allowing Rhode Island hospitals to be purchased by for-profit entities remains to be seen, payment of real estate taxes to Woonsocket certainly represents a positive attribute of Steward.<sup>61</sup> Of note, Steward has promised to pay its “fair share of taxes.” See 2<sup>nd</sup> Supplemental Response S2-2, (as updated May 24, 2012).

In addition to real estate taxes, typically Steward would be required to pay Rhode Island sales and use tax in certain situations. See R.I. Gen. Laws § 44-18-1 *et seq.*, and 44-19-1, *et seq.* However, in 2010, legislation was passed to exempt Landmark Medical Center and any successor in interest from payment of such taxes for the term of 12 years.<sup>62</sup> Accordingly, Steward will be exempt from significant Rhode Island sales and use tax that it would have owed until 2022. As a result, Steward has already realized favorable tax treatment provided to no other existing hospital in Rhode Island.<sup>63</sup>

As for the remaining review criteria contained in R.I. Gen. Laws §23-17.14-7(c)(20), regarding “whether the conversion is proper under applicable state tax code provisions,” in response to Question 54 of the Initial Application, the Transacting Parties have indicated that

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<sup>61</sup> While a letter agreement of January 19, 2011 has been produced in response to supplemental questions outlining a tax treaty with the City of Woonsocket, the Department of Attorney General does not support any situation whereby Woonsocket would not fully realize the tax benefits of the Proposed Transaction as outlined in the Initial Application and as represented publically by Steward.

<sup>62</sup> The result of such legislation was a new statutory provision codified at R.I. Gen. Laws § 23-17.25-2.

<sup>63</sup> This considerable concession bolsters the position that a tax treaty regarding real estate taxes is not necessary.



“Steward did not engage a third party for an analysis of state or local taxes.”<sup>64</sup> Accordingly, the Attorney General makes no finding with regard to whether the Proposed Transaction is proper under applicable state tax code provisions. Regarding the tax statutes of the entity receiving the proceeds, no proceeds are contemplated and the new entities will be for-profit. *See* R.I. Gen. Laws § 23-17.14-7(c)(25)(ii).

## **F. NEW ENTITY**

The Attorney General must review certain criteria pursuant to the Hospital Conversions Act that deals with the corporate governance of the new hospitals after the completion of the Proposed Transaction.<sup>65</sup> Below is an outline of the review of such requirements.

### **1. Bylaws and Articles of Incorporation**

One issue that must be examined is whether the new entity has bylaws and articles of incorporation. The new corporate entities that will purchase the assets of Landmark Medical Center and the Rehabilitation Hospital of Rhode Island are Blackstone Medical Center, Inc. and Blackstone Rehabilitation Hospital, Inc., respectively. Originally, the Asset Purchase Agreement was executed reflecting Steward Medical Holdings Subsidiary Four, Inc., as the purchaser. Steward Medical Holdings Subsidiary Four, Inc., is a Delaware corporation incorporated on May 26, 2011. *See* Initial Application Exhibit S1-41(a). On October 12, 2011, a Certificate of Amendment was filed with the Delaware Secretary of State changing the name to Blackstone Medical Center, Inc. *See* Initial Application Exhibit 10(j). The current bylaws for Blackstone Medical Center, Inc., were provided by the Transacting Parties. *See* Initial Application Exhibit

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<sup>64</sup> The information provided in the response to Question 54 with regard to Landmark merely discusses the tax implications of a closure of Landmark Medical Center and is not relevant to this review criteria.

<sup>65</sup> *See e.g.*, Hospital Conversions Act, R. I. Gen. Laws §§ 23-17.14-7(c)(25) (i), (v), (vi), (vii), (viii), and (ix).

10(k). Therefore, bylaws and articles of incorporation have been provided for Blackstone Medical Center.

Blackstone Rehabilitation Hospital, Inc. is identified as the entity that will operate the Rehabilitation Hospital of Rhode Island. The original name of this corporation was Steward Medical Holdings Subsidiary Four Rehab. It was incorporated in Delaware on July 25, 2011. *See* Initial Application Exhibit S1-41(b). The name was changed to Blackstone Rehabilitation Hospital, Inc., on October 12, 2011. *See* Initial Application Exhibit 10(l). The right to purchase the assets of Rehabilitation Hospital of Rhode Island was assigned to Blackstone Rehabilitation Hospital, Inc., pursuant to Paragraph 8 of Amendment Number Eight to the Asset Purchase Agreement. Therefore, bylaws and articles of incorporation have been provided for Blackstone Rehabilitation Hospital, Inc. In addition, the relevant corporate documents have been provided for Steward Health Care, LLC, and Steward Medical Holdings, LLC. *See* Initial Application Exhibits 10(f), 10(g)(1), 10(g)(2), 10(h) and 10(i). Accordingly, R.I. Gen. Laws § 23-17.14-7(c)(25)(v) has been satisfied.

## **2. Board Composition**

In addition to bylaws and articles of incorporation, specific criteria that must be considered regarding the new corporate entities include analysis of the composition of the new boards.

Specifically, the Hospital Conversions Act requires review of:

(vi) whether the board of any new or continuing entity will be independent from the new hospital;

(vii) whether the method for selecting board members, staff, and consultants is appropriate;

(viii) whether the board will comprise an appropriate number of individuals with experience in pertinent areas such as foundations, health care, business, labor, community programs, financial management, legal, accounting, grant making and public members representing diverse ethnic populations of the affected community; and

(ix) whether the size of the board and proposed length of board terms are sufficient.

See R.I. Gen. Laws §§ 22-17.14-7(c)(25)(vi), (vii), (viii) and (ix).

In Response to Question 7 of the Initial Application, the Transacting Parties state that the existing Board of Directors of Blackstone Medical Center and Blackstone Rehabilitation Hospital are Ralph de la Torre, M.D., the Chief Executive Officer of Steward, Michael Callum M.D., President of Steward Medical Holdings, and Mark Rich, Executive Vice President of Corporate Strategy and Marketing of Steward.<sup>66</sup> The response further states:

Within 90 days of closing, Steward will establish full boards for Blackstone Medical and Blackstone Rehab of between 7 and 11 individuals and elect members in roughly the following portions: 3 directors serving by virtue of their positions at SHCS (CEO Ralph de la Torre, M.D.; CFO James Renna; General Counsel, Joseph Maher, Jr. Esq); 2 to 3 physicians on the hospital medical staff or with ties to the service area; and the remainder consisting of community and healthcare leaders and/or prominent local business executives who demonstrate the desire to revitalize the hospitals. SHCS is actively pursuing members of the community for the Blackstone Medical and Blackstone Rehab board who are interested in advancing community health care in the hospitals' service areas. The majority of board members will live within the primary service areas of Blackstone Medical and Blackstone Rehab, respectively, and will thus have a personal interest in the health care services provided within the community.

According to lists of the members of the Board of Directors for the other hospitals affiliated with Steward on Initial Application Exhibit 7, no other Steward hospital has less than 13 board members. Pursuant to the Blackstone Medical Center and Blackstone Rehabilitation Hospital Bylaws,<sup>67</sup> the number of directors on each board is determined by vote of the stockholders. Art. IV, Sec. 2. There is no indication that there will be between seven (7) and eleven (11) directors as stated in the Initial Application.<sup>68</sup>

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<sup>66</sup> Job titles obtained at, <http://www.steward.org/about-steward.html>, last accessed May 16, 2012.

<sup>67</sup> This section of bylaws of the Blackstone Medical Center and Blackstone Rehabilitation Hospital are identical.

<sup>68</sup> The Bylaws of these entities also allow for an Executive Committee of the boards. No information was provided as to the use of an Executive Committee in the Proposed Transaction,

Accordingly, the proposal that the Landmark Medical Center and the Rhode Island Rehabilitation Hospital of Rhode Island boards have as few as seven (7) members, three (3) of which are employed by Steward is not adequate to either independence from the hospital or the diversity of experience required by the Hospital Conversions Act. No method for selecting board members has been provided other than they will be selected by Steward and will either be a physician on the hospital medical staff or with ties to the service area or a community and healthcare leaders and/or prominent local business executives who demonstrate the desire to revitalize the hospitals. Therefore, the Hospital Conversions Act criteria regarding the Boards of the new entities have not been met.

**G. CHARACTER, COMMITMENT, COMPETENCE AND STANDING IN THE COMMUNITY**

An important and encompassing portion of the Hospital Conversions Act review criteria requires review of “[w]hether the character, commitment, competence and standing in the community, or any other communities served by the transacting parties are satisfactory” *See* R.I. Gen. Laws § 23-17.14-7(c)(28). Such a review with regard to the Proposed Transaction is difficult given the lack of track record of Steward and its affiliates. As stated herein, Landmark Medical Center and the Rehabilitation Hospital of Rhode Island are being purchased by Blackstone Medical Center and Blackstone Rehabilitation Hospital, which are Delaware for-profit corporations that were set up to purchase the assets involved in the Proposed Transaction. Both Blackstone Medical Center and Blackstone Rehabilitation Hospital are newly formed entities and have no track record to review. Because they are wholly owned subsidiaries of

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however, all of Steward’s other hospitals each have Executives Committees consisting of between three (3) and fourteen (14) members.

Steward, the Department of Attorney General will review Steward for the requirements of this statutory provision.

### **1. Character**

Steward was incorporated on March 18, 2010. *See* Initial Application Exhibit 10(f). Steward was formed to purchase the Caritas Christi hospitals in order to gain the investment of Cerberus Capital Management, L.P. Accordingly, the track record of Steward in its current form is also relatively brief. Of note, but not conclusive upon Steward's character and standing in the community is the fact that Steward satisfied the Department of Attorney General in Massachusetts in its bids for the original six (6) Caritas Christi hospitals, as well as subsequent hospital acquisitions of Morton Hospital and Quincy Mutual Hospital.<sup>69</sup> While Rhode Island and Massachusetts have separate Departments of Attorney General, it at least bodes well that our sister state was satisfied with its review of Steward to grant it permission to purchase eight (8) hospitals in Massachusetts. Otherwise, the Department of Attorney General has not revealed anything in the Hospital Conversion review process that negatively impacts upon Steward's character.

### **2. Commitment**

Pursuant to the Asset Purchase Agreement, Steward has agreed to commit \$30 Million Dollars in capital expenditures to improve Landmark Medical Center and the Rehabilitation Hospital of Rhode Island. *See* Asset Purchase Agreement, Section 1.6(a). These improvements include renovation to the existing emergency department, new equipment, updated informational technology and various other improvements. *See* Initial Application Exhibit 43(d). Also, on a

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<sup>69</sup> The Massachusetts Attorney General Opinions are available at: <http://www.mass.gov/ago/doing-business-in-massachusetts/public-charities-or-not-for-profits/hospital-conversions/> (last accessed May 17, 2012).

going forward basis for the first five (5) years, 2.5 % of annual net patient revenues will be spent on routine capital expenditures. *See* Asset Purchase Agreement, Section 10.1. In addition, Steward has agreed to spend \$4.5 Million Dollars in physician recruitment. *Id.* Steward's monetary contributions also include previous amounts provided to the hospitals of nearly \$7 Million Dollars which including a \$5 Million Dollar line of credit.<sup>70</sup>

In addition to monetary commitments, Steward has made specific commitments regarding employment of the hospital employees such as its acceptance of a collective bargaining agreement, as well as certain commitments regarding future sale of the hospitals. *See* Asset Purchase Agreement 10.4. On the other hand, Steward has back tracked on its original commitments to not terminate services at the hospitals and to limit layoffs. *See* Amendment Number Eight to the Asset Purchase Agreement.

### **3. Competence**

As stated above, the track record for Steward is short. With regard to competence, such term could have several meanings. The Department of Attorney General finds the relevant competence in this matter to be the ability to successfully operate the hospitals after the Proposed Transaction. The central function of operating hospitals is patient care. Because the Rhode Island Department of Health's review focuses more directly upon provision of health services and because it has identical review criteria regarding these topics,<sup>71</sup> the Department of Attorney General will rely upon their expertise with regard to Steward's track record for provision of quality services in its other hospitals. However, of note is that in the Initial Application Steward reports that it has no "pending or adjudicated citations, violations or charges brought by any

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<sup>70</sup> The Working Capital Loan Note can be located at Initial Application Confidential Exhibit 25(b). It was determined to be confidential in accordance with R.I. Gen. Laws § 23-17.14-32.

<sup>71</sup> *See* R.I. Gen. Laws § 23-17.14-8 (b)(1).

governmental or accrediting agency.” *See* Initial Application Response to Question 22. Also, it represents that its hospitals are currently JCAHO accredited and in good standing. *See* Initial Application Response to Question 64.

The other component to competence is the ability to run the business side of a hospital. As was provided during interviews conducted pursuant to the Hospital Conversions Act review, Steward’s management team has years of experience in operating community hospitals, including at their previous iteration as Caritas Christi. As outlined hereafter, the Attorney General’s expert has found that the finances of Steward are in line with company acquiring distressed community hospitals. In addition, specifically to Landmark Medical Center and the Rehabilitation Hospital of Rhode Island, Steward has stated that senior managers who have operated the hospitals during the four (4) years of special mastership will remain at the hospitals. *See* Initial Application Response to Question 1.

#### **4. Standing in the Community**

The issue of standing in the community is very similar to the discussion above regarding character. No one has provided information in the Hospital Conversion review process that negatively impacts upon the standing in the community of Steward.

Overall, given the totality of the circumstances, the Attorney General finds that Steward’s character, competence, commitment and standing in the community is satisfactory for the purposes of a Hospital Conversions Act review. However, because of Steward’s lack of track record in these categories, it remains to be seen how these issues will play out in the future.

## **H. MISCELLANEOUS**

In addition to the provisions outlined above, there are also a few additional requirements of the Hospital Conversions Act that do not fit into any of the categories outlined above. They are outlined individually below.

### **1. Rhode Island Nonprofit Corporations Act**

The Hospital Conversions Act requires that a hospital conversion comply with the Rhode Island Nonprofit Corporations Act. R.I. Gen. Laws §§ 7-6-1, *et. seq.* (the "Nonprofit Act").<sup>72</sup> The Nonprofit Act is comprised of 108 sections. Many of these sections discuss the governance requirements of non-profit corporations. The Attorney General makes no finding with regard to whether the Transacting Parties have complied with the Nonprofit Act and has not reviewed their corporate minute books. First, the Steward affiliated corporations: Steward Health Care; Steward Medical Holdings; Blackstone Medical Center; and Blackstone Rehabilitation Hospital are neither non-profit entities nor Rhode Island corporations, therefore, the Nonprofit Act does not apply to them. Second, Rehabilitation Hospital of Rhode Island is a limited partnership not subject to the Nonprofit Act. Finally, the remaining Transacting Parties, Landmark Medical Center and Landmark Health System both have been subject to Special Mastership for nearly four years. These corporations have been operating without a board since that time. Accordingly, it would not be a useful exercise to determine if the Nonprofit Act has been complied with as it is uncertain as to the application of most of the provisions of the law given the instant circumstances.

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<sup>72</sup> See R.I. Gen Laws § 23-17.14-7 (c)(19).



## **2. Right of First Refusal**

The Hospital Conversions Act requires review of whether the Proposed Transaction involves a right of first refusal. The Asset Purchase Agreement contains no right of first refusal. The only right of first refusal contained in the Proposed Transaction is for a certain tract of land originally conveyed by the Special Master with permission of the Court. *See* Landmark Special Mastership Order dated April 7, 2011. Pursuant to such Order, the Special Master was allowed to convey certain tracts of land abutting the roadside at the Rehabilitation Hospital of Rhode Island to CVS Pharmacy, Inc. Section 21 of the Purchase and Sale Agreement contains a right of first refusal allowing re-purchase of the land from CVS for a five-year period from the date of the closing. The Purchase and Sale Agreement also includes a provision imposing a future deed restriction that the land cannot be used for a drug store or pharmacy. *Id.* This restriction will run with the land if the right of first refusal is exercised. The Department of Attorney General has no information whether this right of first refusal will be exercised by Steward.

## **3. Control Premium**

With regard to the one remaining review provision of the Hospital Conversions Act, there is no control premium included in the Proposed Transaction. R.I. Gen. Laws § 23-17.14-7(c)(29).

## **4. Additional Issues**

There are two issues that the Attorney General will address in addition to the enumerated review criteria that have come to light during the review process. The first is the relationship between Steward and Cerberus Capital Management, L.P. (“Cerberus”) and the second is the ability of Steward to fund the financial commitments of the Proposed Transaction.

**a. Cerberus Capital Management**

There are several references to Cerberus in the Initial Application as well as in other publically available information.<sup>73</sup> According to Steward's Chief Executive Officer, Ralph de la Torre, Cerberus is a private equity firm that provided the original capital to fund Steward.<sup>74</sup> It is not obligated to provide any further funding to Steward.<sup>75</sup> It has been represented that all decision making for Steward is performed by the Steward Management Board<sup>76</sup> and that Cerberus has no role in the operation of the hospitals in Steward's network or the decision making of the Steward Management Board.<sup>77</sup> Despite Steward's position, it is of interest that four (4) of the seven (7) members of the Steward's Management Board have roles at Cerberus.<sup>78</sup> Clearly, Steward's interaction with Cerberus is complex. Although Steward's position is that it functions wholly independently of Cerberus,<sup>79</sup> there is some uncertainty regarding the future impact of Steward's affiliation with Cerberus. However, given the representations in the Initial Application with no other evidence, the Attorney General finds that the role of Cerberus, as represented by Steward, should not negatively impact the Proposed Transaction.

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<sup>73</sup> See Change in Effective Control Application of Steward Health Systems, LLC for this transaction (as re-submitted March 1, 2012).

<sup>74</sup> See Affidavit of Ralph de la Torre at Para. 3.

<sup>75</sup> *Id.*

<sup>76</sup> *Id.* at Para. 7.

<sup>77</sup> *Id.* at Para. 8.

<sup>78</sup> See 1<sup>st</sup> Supplemental Response S1-10. These parties include: (1) James Lenehan, Senior Operations Advisor for Cerberus; (2) W. Brett Ingersoll, Co-Head of Private Equity for Cerberus; (3) Arthur Halper, Senior Operations Executive at Cerberus and (4) Lisa Gary, General Counsel for Cerberus.

<sup>79</sup> See Affidavit of Ralph de la Torre at Para. 9.

**b. Steward's Ability to Fund Transaction**

During the pendency of the Change in Effective Control process, the DOH's expert questioned certain aspects of Steward's financial position.<sup>80</sup> The Attorney General's expert, HS&S has reviewed the financial information provided by Steward and has concluded as follows:

**Current Financial Status of Steward**

Based on the Steward Health Care System, LLC March 2012 Summary Income Statement (Consolidated), Steward generated \$40.8 million in adjusted earnings before interest, taxes, depreciation, and amortization (EBIDTA). This represents the first six months of the current fiscal year and results in an adjusted EBITDA margin of 4.4% of total revenues.

The March 2012 Summary Income Statement provided by Steward did not include year to date figures for depreciation, interest, and non-operating categories. However, those statistics were provided on Steward's February Summary Income Statement (Consolidated). Steward showed a net loss of \$16.6 million over the five month year to date period ending 2/29/12. In their April 27, 2012 Supplement 3 Response, Steward's counsel states that the Steward Board-approved plan calls for positive net income in fiscal year 2012 and that year to date, Steward is performing ahead of this plan.

Steward's Balance Sheet for the fiscal period ending 3/31/12 indicates that Steward had \$107.1 million in cash and cash equivalents and \$402.6 million in current assets. Steward's total assets as of 3/31/2012 were \$1,127.9 million. Steward's total liabilities were \$1,025.9 million, which includes \$361.0 million in current liabilities and \$664.9 million in non-current liabilities. Steward's shareholder's equity (net assets) was \$102.0 million as of 3/31/2012.

Steward's financial performance and position leave significant room for improvement, but are not unusual for what is still a fairly new operation.

**Does Steward have the capacity to fulfill its promise regarding capital commitments to LHS?**

According to the Asset Purchase Agreement, Steward will pay a total purchase price of \$40.1 million (subject to various adjustments), plus the value of Net Working Capital as of the closing date for the acquisition of LHS. Steward states it will also spend \$4.5 million in the first five years following closing for the purposes of physician recruitment to meet the needs of the community.

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<sup>80</sup> See Enterprise Management Corporation Letter to Melinda Thomas, dated April 23, 2012.

The purchase price will be payable as follows:

(a) \$30,000,000 shall be paid for capital expenditures during the first five (5) years following the Closing;

(b) \$2,000,000 shall be deemed paid at Closing by virtue of Steward, as successor-in-interest to Caritas Christi, providing evidence that Sellers' outstanding indebtedness to Caritas Christi is cancelled;

(c) \$1,600,000 shall be payable at Closing in satisfaction of Sellers' indebtedness to CRB Holdings, Inc.;

(d) \$2,000,000 shall be payable at Closing in satisfaction of Sellers' indebtedness to Blue Cross Blue Shield;

(e) \$3,500,000 shall be payable at Closing by payment of the premium for "tail" insurance;

(f) \$1,000,000 shall be considered part of the purchase price and shall be released from the Special Master Escrow.

In the May 23, 2012 affidavit of Steward chief executive officer Dr. Ralph de la Torre, he states that Steward's current maximum borrowing ability under the existing terms of its asset-based line is \$200 million. Steward has drawn down \$60 million from the \$200 million line of available credit and of that \$60 million, Steward has used \$40 million for operating and/or investment purposes. The remaining \$20 million (of the drawn funds) is included in cash on the balance sheet. Based on their 3/31/12 Balance Sheet, Steward has a total of \$107.1 million in cash and short-term investments.

Steward reports that the organization will put \$90 million toward preexisting pension liabilities over the next three years. Steward expects to reach a settlement related to a preexisting Stark Law violation that will range between \$1 million and \$35 million. Steward states in the April 27, 2012 response in Supplement 3 to the Hospital Conversion Application that they believe that the true amount will fall much closer to the \$1 million mark, but that they are "capable of absorbing a \$35 million liability" related to this matter.

Based on the financial statements submitted by Steward, and the representations of Steward's leaders, the organization appears to have the capacity to finance the transaction. Steward's capacity to meet future capital commitments could be compromised if the organization enters into other transactions that (in total) exceed their available financial resources and access to capital, or if their financial performance/position does not materially improve.

Given the opinion of HS&S, absent any exigent circumstances or, as aptly pointed out by HS&S, any acquisition plan or other commitments that would over-extend Steward, currently Steward appears to have the financial ability to fund the Proposed Transaction.

## V. CONCLUSION

Much has been said about the Hospital Conversions Act, especially in the recent legislative session. Many hospitals have voiced their opinion that the Act is too burdensome and discourages those who may wish to either purchase a hospital in Rhode Island or merge with another hospital. However, the Department of Attorney General takes its responsibilities pursuant to the Act very seriously. While the Act is no guarantee that a hospital will not be sold to an entity who has a different plan in mind than what the surrounding community may value, the Act at the very least provides a minimum framework for review of a hospital transaction. With a state that has so few hospitals and when so much of a community's economic activity is intertwined with these hospitals, it seems that a process where hospitals in Rhode Island are not simply handed to the highest bidder is in order. While there has been constant pressure on the Department to race through this process, this Decision represents this Department's best efforts and a careful review of the Proposed Transaction given the information available.


Wherefore, based upon the information provided above in this Decision, the Proposed Transaction is **APPROVED WITH CONDITIONS**. These conditions are outlined below.

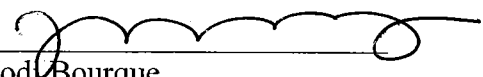
## VI. CONDITIONS

1. Upon their appointment and for the next three (3) years, please provide the names, addresses and affiliations of all members appointed to any board of Blackstone Medical Center, Inc. or Blackstone Rehabilitation Hospital, Inc.
2. For the next three (3) years, identify any contracts between any of the Transacting Parties and any of the current officers, directors, board members or senior management other than employment agreements.

3. The Board of Directors of Blackstone Medical Center, Inc., and Blackstone Rehabilitation Hospital, Inc., shall consist of no less than seven (7) members, at least three (3) of which shall: (i) be independent of and not employed by or affiliated with Steward Health System, LLC or its affiliates; and (ii) not be an elected official or an individual that is subject to the Rhode Island Code of Ethics.
4. The closing shall take place within sixty (60) days of the date of this Decision.
5. The closing regarding any purchase by Steward of any interest in the Cancer Center shall occur simultaneously with the closing of the Proposed Transaction or the condition contained in Asset Purchase Agreement including, Amendment Number Eight to the Asset Purchase Agreement regarding the Cancer Center shall be waived prior to closing.
6. All conditions added pursuant to Amendment Number Eight to the Asset Purchase Agreement shall be fulfilled or expressly waived prior to closing.
7. All Landmark entities identified in Exhibit 12(b) shall be wound down and all necessary documents must be filed with applicable state agencies, including, but not limited to the Secretary of State and the Division of Taxation.
8. That a binding agreement acceptable to the Department of Attorney General with the Rhode Island Foundation or other appropriate entity for disbursement of all charitable assets be provided.
9. A cy pres petition be filed and granted prior to closing of the Proposed Transaction allowing all charitable assets to be transferred to the Rhode Island Foundation or other appropriate entity for disbursement in accordance with donor intent.
10. That the Proposed Transaction be implemented as outlined in the Initial Application.
11. That the Transacting Parties comply with applicable state tax laws.
12. That all costs and expenses due from the Transacting Parties pursuant to the Reimbursement Agreement be paid in full prior to closing of the Proposed Transaction.
13. That neither Joshua Nemzoff nor Nemzoff & Company, LLC be paid the Finder's Fee by Steward or otherwise.
14. That the Transacting Parties enter into an agreement with the Department of Attorney General for enforcement of the terms of the Asset Purchase Agreement by the Department of Attorney General prior to closing.
15. That Steward enters into an agreeable Reimbursement Agreement prior to closing for retention by the Attorney General of an expert to assist the Attorney General, if necessary, to enforce compliance with the Asset Purchase Agreement or these conditions.
16. That Steward provides information requested by the Department of Attorney General to determine its compliance with the Asset Purchase Agreement, including but not limited to information regarding capital expenditures and physician recruitment expenditures.

All of the above Conditions are directed related to the proposed conversion. The Attorney General's APPROVAL WITH CONDITIONS is contingent upon the satisfaction of the Conditions. The Proposed Transaction shall not take place until Conditions 5, 6, 12, 14 and 15 have been satisfied. The Attorney General shall enforce compliance with these Conditions pursuant to the Hospital Conversions Act including R.I. Gen. Laws § 23-17.14-30.

  
Peter F. Kilmartin  
Attorney General  
State of Rhode Island

  
Jodi Bourque  
Assistant Attorney General

### NOTICE OF APPELLATE RIGHTS

**Under the Hospital Conversions Act, this decision constitutes a final order of the Department of Attorney General. Pursuant to R.I. Gen. Laws § 23-17.14-34, any transacting party aggrieved by a final order of the Attorney General under this chapter may seek judicial review by original action filed in the Superior Court.**

### CERTIFICATION

I hereby certify that on this 25<sup>th</sup> day of May, 2012, a true copy of this Decision was sent via electronic and first class mail to counsel for the Transacting Parties:

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