



**DOCKET NO. : OAG 15-486-02**

**IN RE APPLICATION FOR ASSET : OFFICE OF THE ATTORNEY  
PURCHASE BY PROSPECT MEDICAL : GENERAL  
HOLDINGS, INC., OF GREATER :  
WATERBURY HEALTH SYSTEMS, INC. : JULY 15, 2016**

**FINAL DECISION**

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## I. INTRODUCTION

The proposed asset purchase agreement between Greater Waterbury Health Network, Inc. (“GWHN”), and Prospect Medical Holdings, Inc. (“PMH”) (collectively, the “Applicants”), is the third Application filed by GWHN with the Office of the Attorney General (the “OAG”) for its review pursuant to the Nonprofit Hospital Conversion Act, Conn. Gen. Stat. § 19a-486 et seq. (the “Conversion Act”).

On April 23, 2012, GWHN submitted a proposed transaction with LHP that was withdrawn by the purchaser in late August of the same year. On January 22, 2013, GWHN submitted a proposed transaction with Vanguard Health Systems, Inc., that was withdrawn prior to the completion of the OAG’s review under the Conversion Act.<sup>1</sup> This Application comes approximately two and a half years later.

This is PMH’s second Application with the OAG. The first application proposed an asset purchase agreement with the Eastern Connecticut Health Network, Inc. (“ECHN”), OAG Docket No. 15-486-01. The Final Decision in the ECHN Conversion Application was issued on June 10, 2016. Because PMH is the same purchaser for both transactions and because both transactions are asset purchases, many of the issues addressed by the OAG in this decision are similar to those addressed in the ECHN Final Decision.

The difficulties faced by hospitals in delivering quality healthcare services in a changing and increasingly challenging fiscal landscape have become, appropriately, a subject of national concern and debate. A number of forces in recent years have contributed to the financial challenges to local hospitals, including those in Connecticut. Against the

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<sup>1</sup> Between the submission of the letter of intent by GWHN and Vanguard and the withdrawal of the application, Tenet Healthcare Corporation purchased Vanguard.

backdrop of a changing regulatory and fiscal landscape at the federal and state level, the delivery of healthcare services remains a local issue of extreme importance to the communities in which nonprofit hospitals operate. These issues are no less true for GWHN than for any other community hospital or hospital system in Connecticut. It is in this context that GWHN has decided to sell substantially all of its assets to PMH. Its stated goal in making this decision is to ensure and enhance access to GWHN's services and facilities and to improve the financial health of GWHN. (Application of GWHN and PMH re a Proposed Asset Purchase Agreement, OAG Docket 15-486-02, p. 12; hereinafter, "App., p. \_\_\_.")

Pursuant to the Conversion Act, the legislature has authorized the Attorney General to review and investigate proposed nonprofit to for-profit hospital transactions, to disapprove them if he finds that any of the criteria set forth in Conn. Gen. Stat. § 19a-486c(a) are not met, or to approve the transaction subject to any modifications or conditions that the Attorney General deems appropriate. Conn. Gen. Stat. § 19a-486b. Under the law, the Attorney General is required to assess both the procedural and financial fairness of the transaction and to protect and preserve the charitable assets of GWHN.

Contemporaneously with the OAG's review of the proposed Asset Purchase Agreement (the "APA"), the Office of Health Care Access, Department of Public Health ("OHCA"), has been reviewing the transaction to determine whether a certificate of need should be issued in this case and also whether OHCA's criteria in the Conversion Act have been fulfilled by the Applicants. In contrast to the Attorney General's focus, OHCA's review encompasses issues involving the impact of the proposed transaction on access to, and the quality of, health care in the GWHN service area.

As explained in detail below, we grant the Application with conditions necessary to conform the proposed transaction to the requirements of the Conversion Act. I would like to thank GWHN and PMH for their cooperation throughout this process. I would also like to thank the many witnesses, public officials, and members of the public who testified or commented on the proposed transaction in our proceedings. Last, I would like to thank my staff, Assistant Attorney General Henry Salton, head of the Health and Education Department, Assistant Attorney General Gary W. Hawes, and Paralegal Specialist Cheryl A. Turner for their diligent efforts on this matter.

## II. EXECUTIVE SUMMARY

### A. The Conversion Act – An Overview

Pursuant to the requirements of the Conversion Act, the OAG is required to review a proposed transaction for compliance with specifically articulated standards that were established by the legislature. § 19a-486c(a). In sum, these criteria require the OAG to make certain determinations: whether the nonprofit hospital's decision to sell its assets was reasonable, whether it chose the ultimate purchaser in an open and fair process, whether it received fair market value for its assets, whether the funds generated by the sale will be held by an independent charitable foundation that will use them for the promotion of healthcare in the nonprofit hospital's community, and whether use restrictions on any charitable asset held by GWHN will be preserved.<sup>2</sup>

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<sup>2</sup> Conn. Gen. Stat. § 19a-486c(a) provides in full:

The Attorney General shall deny an application as not in the public interest if the Attorney General determines that one or more of the following conditions exist:

The Conversion Act authorizes the Attorney General to review and investigate proposed nonprofit to for-profit hospital transactions, to disapprove them if he finds that any of the criteria set forth in the Conversion Act are not met, or to approve the transactions subject to modifications that the Attorney General deems appropriate. Under the law, the Attorney General is required to assess the fairness of the transaction, both

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(1) the transaction is prohibited by Connecticut statutory or common law governing nonprofit entities, trusts or charities;

(2) the nonprofit hospital failed to exercise due diligence in (A) deciding to transfer, (B) selecting the purchaser, (C) obtaining a fairness evaluation from an independent person expert in such agreements, or (D) negotiating the terms and conditions of the transfer;

(3) the nonprofit hospital failed to disclose any conflict of interest, including, but not limited to, conflicts of interest pertaining to board members, officers, key employees and experts of The Waterbury Hospital, the purchaser or any other party to the transaction;

(4) the nonprofit hospital will not receive fair market value for its assets, which, for purposes of this subsection, means the most likely price that the assets would bring in a sale in a competitive and open market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably and in their own best interest, and with a reasonable time being allowed for exposure in the open market;

(5) the fair market value of the assets has been manipulated by any person in a manner that causes the value of the assets to decrease;

(6) the financing of the transaction by the nonprofit hospital will place the nonprofit hospital's assets at an unreasonable risk;

(7) any management contract contemplated under the transaction is not for reasonable fair value;

(8) a sum equal to the fair market value of the nonprofit hospital's assets (A) is not being transferred to one or more persons to be selected by the superior court for the judicial district where the nonprofit hospital is located who are not affiliated through corporate structure, governance or membership with either the nonprofit hospital or the purchaser, unless the nonprofit hospital continues to operate on a nonprofit basis after the transaction and such sum is transferred to the nonprofit hospital to provide health care services, and (B) is not being used for one of the following purposes: (i) For appropriate charitable health care purposes consistent with the nonprofit hospital's original purpose, (ii) for the support and promotion of health care generally in the affected community, or (iii) with respect to any assets held by the nonprofit hospital that are subject to a use restriction imposed by a donor, for a purpose consistent with the intent of said donor; or

(9) the nonprofit hospital or the purchaser has failed to provide the Attorney General with information and data sufficient to evaluate the proposed agreement adequately, provided the Attorney General has notified the nonprofit hospital or the purchaser of the inadequacy of the information or data and has provided a reasonable opportunity to remedy such inadequacy.

procedural and financial, and to protect and preserve the charitable assets of The Waterbury Hospital.

**B. The Proposed Transaction**

GWHN and PMH propose an asset purchase whereby GWHN will sell substantially all of its assets to PMH or one or more affiliates of PMH (hereinafter, "PMH").

Substantially all of the assets of GWHN will be transferred to PMH in exchange for approximately \$31,800,000, subject to adjustments regarding net working capital at the time of closing. Additional adjustments to the purchase price will be made for the value of GWHN liabilities assumed by PMH. Pursuant to the APA, PMH will commit to spend not less than \$55,000,000 on capital items over seven years, less certain amounts such as capital leases in excess of \$3,000,000, the cash shortfall of GWHN at closing, and certain post-closing losses, all as more particularly described in the APA. (App., pp. 1977.)

After the closing, PMH will be advised by a local community advisory board regarding the hospital's mission, medical staff credentialing, and the development of strategic plans, among other things. PMH will offer employment to all active employees in good standing as of the closing. (App., p. 176.) In addition, PMH will maintain GWHN's current policies on charity care and indigent care for a minimum of five years. (App., p.189.)

After the closing, GWHN will establish a new charitable entity (the "Independent Foundation") that will receive the net proceeds of the transaction and the appropriate charitable gift assets held by GWHN.



**C. The Proposed Transaction Meets the Requirements of the Conversion Act Provided the Applicants Comply with the Attorney General’s Conditions and Modifications.**

**1. Findings and Conclusions**

Based on our review of the record and the standards set forth in § 19a-486c(a), we conclude that the proposed transaction meets the requirements of the Conversion Act, provided that GWHN and PMH comply with the modifications and conditions that are imposed herein.

First, we conclude that the process employed by GWHN in deciding to transfer substantially all of its assets to a for-profit hospital reflects reasonable and prudent due diligence by GWHN’s Board of Directors. The GWHN Board reworked its management team to better equip it to conduct due diligence, sought out the advice of experts, and administered several RFP processes to evaluate and select a transaction partner—all in an effort to serve the best interests of The Waterbury Hospital and the provision of healthcare in the Waterbury community. The Board’s efforts have been diligent, without conflicts of interests, and, in our opinion, have complied with its fiduciary obligations to GWHN.

Second, we conclude that GWHN will receive fair market value for its assets as a result of the proposed transaction. Based primarily on the opinions of two independent financial valuation experts, the price negotiated for the sale of GWHN’s assets equals or exceeds the price those assets would command in an open and competitive market.<sup>3</sup> This

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<sup>3</sup> The nonprofit hospital conversion review process provides the Attorney General with the opportunity to have two separate, independent financial experts review the proposed transaction for compliance with the provisions of § 19a-486c(a). The first expert opinion is required by § 19a-486c(a)(2)(C), which provides that the nonprofit hospital obtain a fairness evaluation from an independent person expert in such agreement. GWHN hired Principle Valuation, LLC, for these

conclusion is buttressed by the fact that the process followed by the GWHN Board to select a capital partner was itself open and competitive.

Third, assuming compliance with the modifications and conditions set forth below, we conclude that the charitable assets of GWHN will be adequately protected and preserved after the proposed transaction closes. The charitable assets of GWHN, which have been held in trust for the public, will continue to be held by GWHN after the closing (GWHN after the closing is referred to herein as “Legacy GWHN”), and with respect to unrestricted funds, will be used in the interim to pay off GWHN’s pre-closing liabilities. Ultimately, all charitable funds will be transferred to the Independent Foundation and used to promote healthcare in the Waterbury area.

We also conclude that a sum equal to the fair market value of GWHN’s assets (the “net proceeds” from the sale) will be transferred to the Independent Foundation and will be restricted to charitable uses consistent with The Waterbury Hospital’s original purpose and for the support and promotion of healthcare generally in the Waterbury community.<sup>4</sup>

## **2. Conditions and Modifications**

The General Assembly has assigned the OAG significant responsibility and flexibility to modify the terms of the proposed transaction, if necessary, to fulfill the statutory purposes of the Conversion Act (§ 19a-486b), and—in particular—to fulfill the

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purposes, and its opinion is included in the record. In addition, § 19a-486c(c) allows the Attorney General to contract with a financial expert to assist in the review of the nonprofit hospital’s compliance with the provisions in § 19a-486c(a). Through an RFP process, the Attorney General retained the services of Navigant Consulting, Inc. (“Navigant Consulting”), to provide an additional independent analysis of the APA.

<sup>4</sup> As discussed further below, the current projected value of the net proceeds at closing is negative due to the liabilities Legacy GWHN will carry after closing.

Attorney General's statutory charge to serve the public interest in the protection of gifts, legacies or devises for public or charitable purposes. Conn. Gen. Stat. § 3-125.

Consequently, although we approve the APA, that approval is contingent on a number of conditions and modifications to the terms of the APA that must be made or met to ensure that the interests of the public and the requirements of the Conversion Act are met. These modifications and conditions, which are more fully described in Section V of this decision, are as follows:

1. The Applicants must delete the last sentence of section 6.10 from the APA.
2. The Applicants shall notify the OAG in writing of the closing date of the Asset Purchase as soon as reasonably possible after the date has been set. If the closing date changes, the Applicants shall notify the OAG in writing of the change as soon as reasonably possible.
3. The Applicants must submit to the OAG, within 30 days of closing, fully executed copies of the Asset Purchase Agreement, without schedules.
4. As soon as reasonably possible after the Applicants have agreed to a Final Closing Statement of the transaction, the Applicants must provide the OAG a final accounting of the transaction that sets forth the balance sheets of GWHN immediately prior to and after the closing and that provides a net proceeds analysis. Legacy GWHN shall also provide a financial outlook for Legacy GWHN and its expected liability payment schedule going forward.
5. After the closing, Legacy GWHN shall hold and protect all charitable gift funds and any net proceeds from the Asset Purchase in its possession until they are transferred to the Independent Foundation or other charitable organization by order of a

court of competent jurisdiction. Notwithstanding the above condition, Legacy GWHN may use any unrestricted funds it has or receives, net proceeds, to pay any and all obligations of the pre-closing GWHN, the administrative costs of Legacy GWHN, and the costs incurred in setting up the Independent Foundation.

6. Legacy GWHN shall report quarterly for the first two years to the OAG regarding (1) any and all income received by Legacy GWHN post-closing, including, but not limited to, Medicare and Medicaid reimbursements, income from charitable assets held by Legacy GWHN prior to transfer to the Independent Foundation, and any additional charitable funds received, and (2) all expenditures for Legacy GWHN.

7. From two years after the closing until all liabilities of Legacy GWHN have been paid, Legacy GWHN shall annually report to the OAG regarding (1) any and all income received by Legacy GWHN post-closing, and (2) all expenditures for Legacy GWHN.

8. Any income or unrestricted gifts received by Legacy GWHN post-closing shall be considered net proceeds.

9. The Independent Foundation shall include paragraph 11, as set forth in the draft Certificate of Incorporation, in the final Certificate of Incorporation of the Independent Foundation, requiring Attorney General approval for changes to paragraphs 3, 5(c), 9, or 11 of the Certificate of Incorporation.

10. Legacy GWHN must present to the Superior Court, in coordination with the OAG, a petition for equitable deviation and approximation to transfer the unrestricted endowments to the Independent Foundation and to change the charitable purpose of the unrestricted endowments to the charitable purpose of the Independent Foundation.

11. Legacy GWHN must, in coordination with the OAG, include the restricted endowments in the Superior Court petition for an equitable deviation order. With respect to the restricted endowments that are not bed funds, Legacy GWHN must seek an order of approximation, in addition to one for equitable deviation, to adjust the funds' charitable purposes, if necessary, to avoid the for-profit hospital status as beneficiary.

12. Legacy GWHN must, in coordination with the OAG, include any restricted, fully expendable funds that still have money in them in the Superior Court petition for an equitable deviation and approximation order.

13. Legacy GWHN must, in coordination with the OAG and the third-party trustees, bring any third-party trusts in need of construction or approximation before a court of competent jurisdiction for appropriate orders.

14. After Legacy GWHN's liabilities have been paid off, any remaining or accumulated net proceeds from this transaction shall be transferred to and then held by the Independent Foundation and used only for the support and promotion of healthcare in the GWHN community. The net proceeds shall never inure to the benefit of the for-profit hospital. The net proceeds shall forever be held by the Independent Foundation for the purposes articulated in the Independent Foundation's Draft Certificate of Incorporation, unless and until a court of competent jurisdiction orders otherwise.

15. Subject to subsequent Court order, the net proceeds held by the Independent Foundation shall be considered an endowment fund, as that term is defined in the Connecticut Uniform Prudent Management of Institutional Funds Act, Conn. Gen. Stat. § 45a-535 et seq. ("CUPMIFA").

### III. PROCEDURAL HISTORY

On July 16, 2015, OHCA and the OAG received GWHN's certificate of need determination letter that set forth in summary fashion the terms of the APA between the Applicants.<sup>5</sup> Because the OAG determined that the APA required approval pursuant to § 19a-486 et seq., the OAG and OHCA on August 6, 2015, jointly sent the Applicants an Application Form regarding the APA.

The Applicants requested an extension of time to submit their Application, which both agencies granted. On October 28, 2015, the Applicants filed their Application for an Asset Purchase, which included 37 exhibits. Upon review of the Application, the OAG and OHCA determined that the Applicants' Application was not complete, and on November 17, 2015, it requested additional information from the Applicants. On December 24, 2015, the Applicants filed responses to the requests set forth by the OAG and OHCA. On January 12, 2016, OHCA issued one last set of completeness questions, to which the Applicants responded on February 16, 2016. On March 4, 2016, the OAG and OHCA determined that the Application was complete. In order to ensure the completeness of the record, the OAG and OHCA took administrative notice of the record in the Proposed Asset Purchase of Eastern Connecticut Health Network, Inc., by Prospect Medical Holdings, Inc., OHCA Docket No. 15-32016-486, OAG Docket No. 15-486-01 (the "ECHN/PMH APA").

Pursuant to Conn. Gen. Stat. § 19a-486e, the OAG and OHCA conducted a public hearing regarding the proposed Asset Purchase in the primary service area of The

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<sup>5</sup> All docket documents referenced in this opinion can be found on the Attorney General's website: [www.ct.gov/ag](http://www.ct.gov/ag).

Waterbury Hospital on May 3rd, 2016, at 1:00 p.m. at the Courtyard by Marriot Waterbury in Waterbury, Connecticut. No person sought intervenor status for the hearing. Conn. Gen. Stat. § 19a-486a(g). All parties submitted pre-filed testimony for the hearing.

The hearing was presided over by representatives from both the OAG and OHCA. Deputy Attorney General Perry Zinn Rowthorn served as the hearing officer for the OAG. Also on the panel for the OAG were Assistant Attorney General Henry A. Salton and Assistant Attorney General Gary W. Hawes. Kevin Hansted served as the hearing officer for OHCA. Also on the panel for OHCA were Kimberly Martone, Director for OHCA, Steven W. Lazarus, Associate Health Care Analyst, and Carmen Cotto, Health Care Analyst.

At the hearing, all parties adopted their pre-filed testimony, and all exhibits on the table of record were entered into the record. The Applicants presented full testimony and were subject to cross-examination by OHCA and the OAG. In addition, the hearing panel heard approximately 40 public comments and accepted any written public comments offered during the hearing. Subsequent to the hearing, the OAG received one additional public comment.

The Applicants filed late-filed exhibits with OHCA and the OAG on May 24, 2016, May 27, 2016, and June 23, 2016.

#### **IV. FINDINGS OF FACT**

Based upon the entire record of this Application, including all statements, testimony, and exhibits submitted by the Applicants and intervenors, all public comments made at the hearing or submitted to the OAG in writing, and the summary reports and exhibits submitted by the independent financial experts, we find the following.

**A. Parties and other relevant corporate entities**

GWHN is a Connecticut non-stock, 501(c)(3) corporation and is the parent company and sole member of The Waterbury Hospital. GWHN's goal in pursuing this transaction is to provide service area patients continued access to The Waterbury Hospital's services and facilities while enhancing, through capital investment and operating efficiencies, those services and facilities. (App., p. 12.)

The Waterbury Hospital, in operation since 1890, is a 357-licensed bed (excluding bassinets) acute care teaching hospital, which provides a full range of inpatient, outpatient and ancillary services in the city of Waterbury near the junctions of Route 8 and Interstate 84. In fiscal year 2015, The Waterbury Hospital, Inc., admitted 10,7299 inpatients, delivered 917 newborns, had 48,500 Emergency Department visits, and performed 1,950 inpatient surgeries and 4,288 outpatient surgeries.

The Waterbury Hospital has interests in several affiliated entities: Alliance Medical Group, Inc. ("AMG"); the Greater Waterbury Imaging Center Limited Partnership; Access Rehab Centers LLC; Imaging Partners, LLC; Waterbury Gastroenterological Co-Management Company, LLC; and Cardiology Associates of Greater Waterbury, LLC.

In addition to the above entities, The Waterbury Hospital has two joint ventures with Saint Mary's Health Systems, Inc. ("SMHS"): the Harold LEEVER Regional Cancer Center, Inc., and the Heart Center of Greater Waterbury, Inc.

GWHN also has numerous subsidiaries: Greater Waterbury Health Services, Inc.; VNA Health at Home, Inc.; Greater Waterbury Management Resources, Inc.; Valley Imaging, LLC; the Children's Center of Greater Waterbury Health Network, Inc.; Healthcare Alliance Insurance Company, Ltd. GWHN's interest in the Children's Center of



Greater Waterbury Health Network, Inc. and the Healthcare Alliance Insurance Company, Ltd., will not be transferred to PMH as a part of the APA.

PMH is a Delaware corporation with its principal place of business located in Los Angeles, California. PMH is a healthcare services company that owns and operates thirteen acute care and behavioral hospitals located in Rhode Island, Texas, and California. PMH also owns a network of specialty and primary care clinics in each of its regions. Through PMH's medical group segment, PMH manages the provision of physician services to approximately 260,000 patients in Southern California, South Central Texas, and Rhode Island through a network of approximately 8,900 physicians.

PMH currently owns the following hospitals: Los Angeles Community Hospital; Los Angeles Community Hospital at Bellflower; Los Angeles Community Hospital at Norwalk; Southern California Hospital at Hollywood; Southern California Hospital at Van Nuys; Southern California Hospital at Culver City; Foothill Regional Medical Center; Nix Health (four campuses); Roger Williams Medical Center (RI); and Our Lady of Fatima Hospital (RI).

PMH aligns its hospitals and physicians under a model referred to as Coordinated Regional Care ("CRC"). CRC provides for clinical integration among hospitals, physicians and other medical, social and community providers working closely with strategic partner health plans and other payers under a value-based, global risk reimbursement payment system to achieve the triple aim of improved patient care and experience, better patient health, and lower costs.

## **B. GWHN's Fiscal Condition**

The evidence in the record reveals that GWHN has faced serious financial difficulties since the turn of the century. From 2006 through 2011, GWHN experienced five consecutive years of losses, ranging from \$2.5 million to \$17.8 million. In an effort to address its fiscal concerns, GWHN engaged Kaufman Hall in 2005 to evaluate the economics of consolidating The Waterbury Hospital and Saint Mary's Hospital ("SMH"). Kaufman Hall concluded that even a consolidated institution would struggle financially. Despite this assessment, however, in 2006, GWHN and SMHS discussed the possibility of an affiliation between the hospitals. The collaboration never materialized.

In 2007, in response to the growing challenges facing the hospitals in Waterbury, OHCA conducted a special study of the status of healthcare services in the city. OHCA concluded that both hospitals located in Waterbury were "in financial distress, had aged facilities, and lacked access to capital." (App., p. 23.) The options identified by the report were either to consolidate the two hospitals or to close Saint Mary's Hospital. Accordingly, discussions between the two hospitals resumed in 2007 and continued into 2008. However, the hospitals were not able to reach an agreement on terms or to secure sufficient capital to fund a possible merger.

Then, in 2008, a deep recession hit the United States. GWHN experienced lower healthcare utilization and, therefore, significant financial difficulty, which led to a default on its bond covenants in 2009. As part of the subsequent negotiations with its bondholders, GWHN hired Price Waterhouse Coopers, LLC ("PWC") to identify the challenges and risks for GWHN, to define operational improvements for GWHN, to define revenue cycle

improvements, and to set physician initiatives. PWC recommended strategies for improving GWHN's performance, but GWHN achieved only limited success in doing so.

In 2010 Kaufman Hall was once again retained, but this time with the purpose to identify near-term capital needs. Kaufman Hall identified over \$50 million in necessary capital improvements over the next five years to keep The Waterbury Hospital operational. GWHN simply did not have access to such capital and could not secure it in the open market.

In late 2010, The Waterbury Hospital refinanced its CHEFA debt in a private offering, but was nevertheless unable to stave off GWHN's fiscal decline. GWHN's financial difficulties and its serious capital needs resulted in its reconsidering its goal of remaining independent.

### **C. The Search for Solutions and Partners**

GWHN engaged a health care investment banker, Cain Brothers, to help assess the options available to address GWHN's capital needs. Cain Brothers has extensive experience advising nonprofit hospitals on strategic alternatives and knowledge of the Connecticut healthcare market. GWHN formed a task force specifically assigned to work with Cain Brothers to pursue a capital partner and formally explore strategic options.

In its first attempt to join forces with a capital partner, GWHN agreed to form a joint venture with LHP Hospital Group, Inc. ("LHP"), and SMHS that would have created a united health system in Waterbury with one new state-of-the-art hospital. The LHP joint venture agreement was the product of a process pursuant to which 14 prospective partners were approached and four written proposals were received. On August 23, 2012, the joint venture was submitted to both the OAG and OHCA for review pursuant to the Conversion

Act, but it became clear as the review proceeded that there were significant impediments to the proposed joint venture. As a result, LHP terminated the proposed joint venture in August of 2012.

Immediately thereafter, the GWHN Board reconvened and directed Cain Brothers to seek new additional proposals from other prospective capital partners. Eleven parties were contacted for possible partnership. Two submitted proposals. This second process resulted in GWHN's selection of Vanguard as its capital partner and a joint venture as the preferred transaction.

In the fall of 2013, Vanguard was acquired by Tenet. Upon learning of the acquisition, GWHN met with Cain Brothers to learn about Tenet and to discuss the implications of the purchase. In addition, GWHN's CEO, the Board Chair, and the VP of medical affairs visited two of Tenet's hospitals that are similar in size to The Waterbury Hospital to examine the company's approach to operating its hospitals.

In the spring of 2014, Tenet announced its intention to acquire the assets of SMHS. At that time, GWHN sought the advice of Cain Brothers and Principle Valuation LLC regarding the effect the SMHS transaction would have on the governance of the JV Hospital, the purchase price for GWHN's assets, and the other terms and conditions of the transaction. GWHN concluded that it continued to be satisfied with the proposed transaction.

On December 11, 2014, Tenet informed GWHN that it was withdrawing its application for the joint venture with GWHN, citing the proposed regulatory conditions that had been placed on its Application to form a joint venture with GWHN.<sup>6</sup>

GWHN quickly regrouped and asked Cain Brothers to re-canvass the market for capital partners. Although Tenet's withdrawal of its Applications to acquire the five hospitals in Connecticut had lessened for-profits' interests in investing in the state, Cain Brothers was able to identify several out-of-state candidates for partnership, two of which submitted proposals to GWHN. The PMH proposal was superior to the other proposal, and so, the GWHN Board authorized executing the letter of intent with PMH. Both GWHN and PMH performed their due diligence, and both the GWHN Board and the GWHN members approved the proposed transaction.

#### **D. The Proposed Transaction**

PMH will purchase substantially all of the assets of GWHN, including the properties, assets and businesses, or ownership interests, of GWHN affiliates. PMH will also purchase GWHN's interests in its or its affiliates' joint ventures, including the Harold Leever Cancer Center.<sup>7</sup>

PMH will acquire real property, leased property, tangible personal property, and net working capital (*i.e.*, non-cash current assets less the value of all current liabilities) of GWHN and the GWHN affiliates. PMH will assume several key liabilities, including

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<sup>6</sup> On December 11, 2014, Tenet withdrew its applications with respect to the Greater Waterbury Health Network, Inc., Saint Mary's Health System, Inc., Eastern Connecticut Health Network, Inc., and Bristol Hospital and Health Care Group, Inc.

<sup>7</sup> The assets of the Children's Center of Greater Waterbury Health Network, Inc. and the Healthcare Alliance Insurance Company, Ltd., will not be included in the assets purchased by PMH.

GWHN's capital lease obligations, unfunded pension obligations, and asbestos abatement liability.

GWHN will retain several liabilities that will become the responsibility of GWHN's residual corporation following the transaction, Legacy GWHN. For example, GWHN will retain its outstanding workers compensation liabilities. GWHN will also maintain ownership of certain designated assets post-closing, including cash and cash equivalents, beneficial interests in charitable trusts, and donor-restricted assets.

PMH will pay GWHN \$31,800,000 for the assets of GWHN, subject to an adjustment for actual Net Working Capital transferred at closing. This amount will be reduced by a value equal to the value of the unfunded pension liabilities, the asbestos abatement liability, and the other acquired liabilities. GWHN has committed to make complete payment of its bonds obligations at the time of closing so that all the liens and mortgages on GWHN assets are released at the time of closing.

PMH has committed to spend within seven years of the closing not less than \$55,000,000 (the "Commitment Amount") on capital projects, including, but not limited to capital projects, including routine and non-routine capital expenditures, for the benefit of The Waterbury Hospital and the acquisition, development, and improvement of hospital, ambulatory or other health care services in the greater Waterbury, Connecticut, community. Subject to the limitations set forth in the APA, the Commitment Amount may be reduced as a result of capital lease obligations greater than \$3,000,000, a GWHN cash shortfall at closing, and/or for unpaid losses.

As of the closing, PMH will offer employment to all active employees in good standing who satisfy customary pre-employment screening procedures in positions similar

to those then being provided by GWHN. PMH will provide such employees with regionally competitive wages and employees benefits comparable to the wages and benefits generally offered to employees of other hospitals owned and operated by PMH. PMH will assume and honor GWHN's (and its affiliates') collective bargaining agreements.

Following the closing, the for-profit Waterbury Hospital will maintain a local community advisory board ("Local Board"), which, among other things, will:

- make recommendations and suggestions to PMH regarding the mission, vision and value statements with respect to the for-profit Waterbury Hospital;
- make recommendations and suggestions with respect to medical staff credentialing, disciplinary action of staff physicians, and compliance with accreditation requirements;
- provide input on policies and clinical programs;
- provide input in the development and review of strategic plans;
- provide input on operating and capital budgets;
- provide input and support physician recruitment efforts;
- provide input on succession plans for executive leadership at the for-profit Waterbury Hospital;
- promote community health initiatives, foster community relationships, and identify service and education opportunities; and
- monitor the commitment to maintain and improve quality indicators.

(App., p. 190.)

**E. The Charitable Assets of The Waterbury Hospital**

Throughout its history, The Waterbury Hospital has received numerous charitable gifts, legacies, and devises from generous individual donors and community fundraising efforts.<sup>8</sup> As part of its Application, GWHN provided information and documentation of the charitable trusts and gifts of which it is the beneficiary or in which it claims an interest. Specifically, it provided copies of the gift documents themselves and a spreadsheet (the “Gift Analysis”) that included a narrative description of each charitable gift, succession language where applicable, the name of the trustee of each gift, and a designation of whether each gift was use restricted and spending restricted. The value of all the charitable gifts as of March 31, 2016, was \$53,831,077.

The OAG has reviewed the Gift Analysis provided by GWHN for accuracy and completeness. In addition, the OAG questioned GWHN on the due diligence undertaken to identify all of the underlying gift documents for the charitable funds. The OAG is satisfied that GWHN has identified all the charitable funds in its possession and has met its burden to produce the underlying gift documents for each fund.

**1. Unrestricted Endowments**

Unrestricted endowments are charitable funds, the original gift instrument of which specifies that the sum donated is to be held and preserved as “principal,” as a “fund,” as an “endowment,” or directs that the sum be held and invested, or added to an existing endowment fund, and further specifies that the annual income earned on said principal be applied to the hospital’s “general purposes,” “general expenses,” “general fund,” or used “at

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<sup>8</sup> The Waterbury Hospital, and not GWHN, holds all of GWHN’s charitable funds.



the discretion of the board.”

The following gifts are unrestricted endowments: Brooker, Forester, and Karl & Margaret Hallden Memorial Fund, and the George B. Lambe and Harriet Welton Lambe Endowment Fund. As of March 31, 2016, the total value of these unrestricted endowments was \$600,755.

## **2. Restricted Endowments**

Restricted endowments are charitable funds, the original gift instrument of which specifies that the sum donated is to be held and preserved as “principal,” as a “fund,” as an “endowment,” or directs that the sum be held and invested, or added to an existing endowment fund, and further specifies that the annual income earned on said principal be applied to a specific purpose such as free beds, indigent care, a building fund, or a particular program of the hospital.

The following gifts are restricted endowments: Anderson, At Risk Kids, Chase, Crozier, Fulling, Hayden, Heminway, Junior League Fund, Kazanjian Memorial Fund, Kazanjian Student Nurse Scholarship Fund, Kingsbury, Meigs, Nursing School Alumnae, Permanent Bed Fund,<sup>9</sup> Flora S. Page and George W. Smith, Sperry, Terry, Various Gifts, and the Richard Vincent Warner Memorial Fund. As of March 31, 2016, the total value of these restricted endowments was \$8,787,054.

One of the restricted endowments, the Permanent Bed Fund, is comprised of 61 individual funds, created either through trusts or will bequests. Based on the responses to

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<sup>9</sup> Although the Gift Analysis provided by GWHN does not provide a separate review of each bed fund, it did provide a list of the individual funds, with accompanying gift documents, from which it derived the value of the Permanent Bed Fund.

our discovery requests, we were able to determine that the Permanent Bed Fund contains the following funds: Adt, Benedict, Bristol, Bronson, Burdsall and Burritt Bed Fund, Edith & Melrose Burritt Bed Fund, Castle, Coffin, Curtis, Driggs, First Church Guild, Fitzsimons, Goss, Graves, Greenberg, Gross, Hart, Hill, Judson, Kazanjian, Kellogg, Kimble, Beth Kirk Memorial Fund, Henry and Bethia Kirk Fund, Margaret Kirk Bed Fund, Leavenworth, Lewis, Lott, Merchant, Helen Merriman Bed Fund, William Buckingham Merriman and Sarah Kingsbury Parsons Merriman Bed Fund, William Buckingham Merriman, Jr. Bed Fund, Charlotte B. Merriman, Minor and Northrop, Mitchell, Montague, Peck, Pomeroy and Hill, Poole, Powell, Rosemary, Scovill, Shipley, Skilton, C. Sanford Bull Memorial Fund, J. Richard Smith Memorial Bed Fund, Elizabeth L. Spencer, Julia V. Warner Spencer Fund, Julia V. Warner Spencer Memorial for Miss Emaline D. Warner Fund, Stiles, Stone, Swenson, Terry, Tuttle, Second Congregational Church, Wade, Oscar Warner, Welton, Whiton and Upson, J.H. Whittemore Endowed Room, and Julia S. Whittemore Memorial Room. The Permanent Bed Fund is valued at \$4,801,340 as of March 31, 2016.

### **3. Restricted, Fully Expendable Gifts**

The third category of funds includes restricted, fully expendable Gifts. These are funds not structured as endowments, and therefore fully expendable to be administered and used by the hospital for restricted purposes specified by the donor.

The following gifts are restricted, fully expendable gifts: Bevans and Mayo. As of March 31, 2016, the total value of these unrestricted endowments was \$22,157.

### **4. Unrestricted, Fully Expendable Gifts**

The fourth category of gift assets held by The Waterbury Hospital is Unrestricted Fully Expendable Gifts, which are not structured as endowments, and therefore fully

expendable, to be administered and used by the hospital for its general purposes. The only fund that falls into this category is the Gift Annuity, which as of March 31, 2016, had a total value of \$127,798.

#### **5. Third Party Trusts**

The fifth category of gift assets is Trusts held by third party trustees—trusts created and held by a third party, a portion of the annual income of which is designated for donation to The Waterbury Hospital to be used for one or more of its charitable purposes. Within this category, there are two subsets of trusts: those with use restrictions and those without.

The following gifts are third party trusts with use restrictions: the Harriet S. Anderson Trust, the Hopkins Memorial Fund, the Mary Kingsbury Bull Fund, and the Warner Memorial Fund.

The following are third party trusts without use restrictions: the Almon B. Dayton Trust, the John Elton Trust, the I. Kent Fulton Trust, the Sibillia Hellmann Fund, the Frank Keeling Fund, the Jacob Keeling Fund, the Harriet Kirk Trust, the Henry H. Peck Trust, the Francis A. and Florence A. Poole Fund, and the Howard Easton Smith Fund.

#### **6. Future Interests**

A final category of charitable assets is Future Interests, where gifts are either held in charitable remainder trusts (including charitable remainder unitrusts or annuity trusts, held by outside banks or trustees, in which The Waterbury Hospital has no current income or principal interest) or provided as contingent remainders in wills. The future interests held by third party trustees are as follows: the Natalie M. Dodd Trust, the Fenn Trust, the Gibson Trust, the Snowden Trust, and the Stoughton Trust. In addition, the Estate of

Molly Patricia Lenner was identified as a future interest that is not held by a third party trustee.

## V. LEGAL ANALYSIS AND REQUIRED MODIFICATIONS

As explained above, the Conversion Act directs that any nonprofit hospital that enters into an agreement to transfer a material amount of its assets or operations with an entity operated for profit must first obtain the approval of OHCA and the OAG. Any agreement made without these approvals is deemed void. With particular respect to the Attorney General's review, the Conversion Act requires that he shall disapprove a proposed sale of a nonprofit hospital to a for-profit entity as not in the public interest if he determines the existence of one or more of nine criteria specified in § 19a-486c.<sup>10</sup> The Conversion Act, however, allows the Attorney General to approve an application while setting forth modifications and/or conditions that would bring the proposed transaction into compliance with the conditions in § 19a-486c. What follows, therefore, is the OAG's analysis and discussion of the statutory criteria in § 19a-486c and the modifications and conditions to the Asset Purchase Agreement that are necessary to satisfy those criteria.

**A. The transaction is not prohibited by Connecticut statutory or common law governing nonprofit entities, trusts or charities.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(1), the Attorney General shall disapprove a proposed agreement if he determines that the transaction is prohibited by Connecticut statutory or common law governing nonprofit entities, trusts, or charities. Subject to the modifications and conditions set forth in Section II(C)(2) of this decision, we

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<sup>10</sup> See footnote 1.

conclude that the Asset Purchase is not prohibited by statutory or common law governing nonprofit entities, trusts, or charities.

**B. GWHN exercised due diligence.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(2), the Attorney General is required to determine whether the nonprofit hospital exercised due diligence in four distinct areas. The phrase “due diligence” is not defined by the Conversion Act, but Black’s Law Dictionary (6<sup>th</sup> ed. 1990) defines it as: “Such a measure of prudence, activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case.” In short, therefore, we review the level of care and prudence that the GWHN Board exercised in deciding to enter into the APA with PMH.

Based upon our and our expert’s review of the materials presented as a part of the GWHN and PMH Application and the testimony given at the public hearings, it is clear that GWHN undertook an extensive and diligent process to explore strategic options and to identify a capital alternative that would enable it to address its dire financial position and continue its mission of providing quality healthcare to the Waterbury community. GWHN’s efforts extended over a ten-year period, from 2005 to 2016, and included consultation with two experienced healthcare investment banking firms in Kaufman Hall & Associates and Cain Brothers, as well as the nationally recognized healthcare consulting firm of PricewaterhouseCoopers. GWHN pursued discussions with multiple strategic partners, evaluated a range of transaction structures, and explored multiple strategies to access capital. Our specific due diligence findings follow.

**1. GWHN exercised due diligence in deciding to participate in the APA.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(2)(A), the Attorney General shall disapprove a proposed agreement if he determines that the nonprofit hospital failed to exercise due diligence in deciding to transfer the assets of GWHN. The record supports the reasonableness of the decision by GWHN to transfer substantially all of its assets as a means to assure the long-term viability of The Waterbury Hospital.

GWHN engaged in a decision-making process that was reasonable, thoughtful, and thorough. In making the ultimate decision to transfer its assets, GWHN demonstrated due diligence under the circumstances. As noted in the findings of fact, GWHN pursued a broad range of strategic initiatives to address the hospital's operating losses, aging facilities, and limited access to capital. It sought a range of options including a merger with SMHS, an operational restructuring and realignment, and a private placement in the bond market. When these options did not cure GWHN's financial distress, the Board reasonably sought a capital partner. GWHN sought to enter into a joint venture with Vanguard, but for reasons beyond its control, that partnership was not completed. GWHN's immediate action afterwards resulted in the APA with PMH. We conclude that GWHN exercised due diligence in deciding to transfer substantially all of its assets as a part of the proposed APA.

**2. GWHN exercised due diligence in selecting PMH to Purchase Substantially All of Its Assets.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(2)(B), the Attorney General shall disapprove a proposed agreement if he determines that the nonprofit hospital failed to exercise due diligence in selecting the purchaser. Based on the record in this case, GWHN has established that it exercised due diligence in selecting PMH to purchase substantially all of its assets.

The full history of GWHN's difficult search for a capital partner is described in the findings of fact. With respect to the initiative that resulted in the APA with PMH, however, GWHN took appropriate and deliberate steps to identify the best situation for The Waterbury Hospital. GWHN retained Cain Brothers to re-canvass the market for possible capital partners. PMH's proposal was the superior proposal of the two received, and after due consideration, the Board authorized the execution of the letter of intent.

On or about the beginning of February 2016, after the hospital conversion application process had begun with the OAG and OHCA, GWHN learned that recent Medicare and Medicaid surveys at two of PMH's California hospitals (Los Angeles Community Hospital and Southern California Hospital at Culver City) had resulted in findings of Immediate Jeopardy by regulatory authorities at both hospitals.

In response, GWHN formed a Task Force comprised of GWHN physicians, The Waterbury Hospital Chief Nursing Officer, and GWHN's Director of Performance Improvement, all of whom had significant expertise in the areas of regulatory surveys, CMS conditions of participation, and hospital quality standards. The Task Force reviewed extensive amounts of information relating to PMH's history of regulatory surveys, quality metrics, and quality improvement programs. The Task Force interviewed members of PMH's management on the root causes of the Immediate Jeopardy findings and the efforts underway to address the identified problems. Some members of the Task Force also made site visits to the Los Angeles Community Hospital, Culver City and the CharterCARE hospitals in Rhode Island.

On April 14, 2016, the Task Force reported its findings to the Board and recommended that GWHN seek written assurances from PMH regarding the maintenance

and improvement of quality care at GWHN. GWHN received this written assurance, and GWHN committed to proceed with the transaction.

Based on the evidence presented to the OAG, we conclude that GWHN exercised due diligence in selecting PMH for the APA and in confirming that selection after learning of PMH's Immediate Jeopardy findings.

**3. GWHN exercised due diligence in obtaining a fairness evaluation.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(2)(C), the Attorney General shall disapprove a proposed agreement if he determines that the nonprofit hospital failed to exercise due diligence in obtaining a fairness evaluation (also known as a "fairness opinion") from an independent person expert in such agreements.

GWHN hired Principle Valuation, LLC ("Principle Valuation"), to perform its independent fairness evaluation. Principle Valuation has extensive hospital valuation experience regarding valuations to meet regulatory compliance needs. Principle Valuation has also had recent experience in the local market, having provided fairness opinions for GWHN's proposed transactions with LHP and Vanguard/Tenet, SMHS's proposed transaction with Vanguard/Tenet, and Bristol Hospital Health Care Group, Inc.'s proposed transaction with Vanguard/Tenet. Neither Principle Valuation nor its staff members have any known conflicts of interest with the parties to the transaction or to the transaction itself. And, Principle Valuation's compensation was a flat non-contingent fee, i.e., was not dependent on the opinion it rendered.

Therefore, we conclude that the GWHN Board exercised due diligence in obtaining a fairness evaluation regarding the terms of the proposed transaction from an independent entity expert in such agreements.



4. **GWHN exercised due diligence in negotiating the terms and conditions of the APA.**

Our review of the transaction leads us to conclude that GWHN exercised due diligence in negotiating most of the terms and conditions of the APA. As discussed below, we believe GWHN will receive at least the fair market value for its assets. In addition, GWHN negotiated a capital commitment of \$51.5 million for the for-profit GWHN hospital system (“PMH/GWHN”) over the next seven years. Other highlights include PMH’s retention of GWHN employees, the assumption by PMH of the unfunded pension liabilities, the formation of a local advisory board for the hospital, and PMH’s commitment to maintain GWHN’s current policies regarding charity care, indigent care, and community benefits for five years.

One provision in the APA, however, stands out as unreasonable in light of the details of the transaction as a whole. Section 6.10 of the APA concerns PMH’s \$51.5 million capital commitment, and provides in relevant part:

*Notwithstanding the above capital commitment, in the event that any Legal Requirement is enacted or imposed after Closing that (i) discriminates against, or adversely or disproportionately affects for-stock or for-profit hospitals or other for-profit health care entities or (ii) causes Buyer to suffer a material decline in EBIDTA on a consolidated basis, then, in either event, Buyer shall be relieved of its obligation to provide the above capital commitment and shall be required to consult with the Local Board to determine an alternate mutually agreeable capital commitment of Buyer that is reasonable and appropriate in light of the changed circumstances caused by the new Legal Requirement.*

(Exhibit Q3-2, Draft Asset Purchase Agreement; App., 189.)

Although PMH may wish to hedge against future changes in the legal landscape, it cannot hold the GWHN capital investment hostage by such a provision. To do so would render the \$51.5 million capital commitment – a key term of the deal – subject to delay

upon the future actions of legislators. Put differently, we believe that PMH must bear the risk of future legislation and not PMH/GWHN. The \$51.5 million capital commitment is indeed a commitment, and the deadline by which it must be spent must be honored.

Accordingly, as a condition to approval of the proposed transaction, the OAG requires that the Applicants modify the APA by deleting the above-quoted language from section 6.10 from the APA.

**C. No GWHN Board Member, Officer, Key Employee, or Expert Has a Conflict of Interest With Respect to the APA.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(3), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the nonprofit hospital failed to disclose any conflict of interest, including but not limited to, conflicts of interest pertaining to board members, officers, key employees, or experts of GWHN, the purchaser, or any other party to the transaction.

The Applicants provided the OAG with individual conflict of interest statements for each relevant individual (board member, officer, etc.) employed by GWHN, its experts, and PMH. Each individual was required to respond to individual questions regarding possible financial, beneficial, and/or employment related conflicts of interest. If any of the questions were answered with anything other than an unqualified “No,” the individual was required to attach an explanation to the statement. These statements were reviewed by the OAG and Navigant Consulting, Inc. (“Navigant Consulting”).

Section 5.03(a) of the APA requires PMH to “offer employment to all active employees in good standing as of the Closing Date . . . .” (Exhibit Q3-2, Asset Purchase Agreement; App., 176.) Therefore, employees of GWHN, including GWHN’s officers and key employees, have been offered employment with PMH as a part of the transaction. This

general provision, however, does not create a conflict of interest for the purposes of this statutory element.

After a careful review of all the conflict of interest responses, there do not appear to be any conflicts of interest with this proposed transaction that exist outside of the APA itself. In addition, no intervenor or other participant in the proceeding has offered any credible evidence that any conflict existed at any time during the negotiation of the APA. Accordingly, we conclude that no conflicts of interest exist that would require disapproval of the APA.

**D. GWHN will receive fair market value for its assets.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(4), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the nonprofit hospital will not receive fair market value for its assets. For purposes of the Conversion Act, “fair market value” is defined as

the most likely price that the assets would bring in a sale in a competitive and open market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably and in their own best interest, and with a reasonable time being allowed for exposure in the open market.

Conn. Gen. Stat. § 19a-486c(a)(4).

PMH has agreed to pay \$31.8 million as compensation for substantially all of GWHN’s assets. Two independent financial experts have reviewed the transaction to determine whether GWHN will receive fair market value for its assets, and both have concluded that the purchase price of \$31.8 million equals or exceeds the fair market value of GWHN’s assets to be transferred.

As discussed above, GWHN retained Principle Valuation to provide it with an independent fairness opinion regarding the transaction.<sup>11</sup> Principle Valuation considered the three principal methods of valuation: the Cost Approach (Adjusted Book Value Approach), the Market Approach, and the Income Approach. With respect to the market based value approach to valuation, Principle Valuation used both a Guideline Company Approach and a Guideline Transaction Approach. After considering the strengths and weaknesses of each approach, and assigning a representative weight to each of the approaches, Principle Valuation derived an overall weighted value for GWHN's assets of \$25.4 million. As such, Principle Valuation was able conclude in its fairness opinion that the purchase price for GWHN's assets is fair from a financial point of view to GWHN.<sup>12</sup>

Navigant Consulting was hired through an RFP process to be the OAG's financial expert for the purposes of reviewing certain aspects of the proposed transaction. Navigant Consulting has also concluded that GWHN will receive fair market value for the transfer of its assets.<sup>13</sup> In performing its fair market value analysis, Navigant Consulting also considered the three generally accepted approaches to value: income, market, and cost, but

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<sup>11</sup> The OAG has previously concluded that GWHN exercised due diligence in selecting Principle Valuation to perform the independent fairness evaluation on its behalf.

<sup>12</sup> Principle Valuation performed its analysis when the purchase price was \$45 million. Subsequent to the valuation, however, GWHN's liquidity and financial performance deteriorated and the size of the pension liabilities was found to be greater than anticipated. The purchase price was therefore revised to \$31.8 million. Principle Valuation's conclusion, however, is not affected by the reduction in purchase price because it estimated the value of GWHN's assets to be transferred at \$25.4 million.

<sup>13</sup> Navigant Consulting's report is attached hereto as Exhibit A.

Navigant Consulting concluded that GWHN and its assets should be valued under the premise of “value-in-place” and not as a “going concern.”<sup>14</sup>

The value-in-place premise of value was also consistent with the premise of value assumed in Principle Valuation’s fairness opinion analysis of GWHN on a standalone basis as evidenced by the absence of positive projected cash flow in its discounted cash flow method.

Navigant Consulting performed an independent fair market valuation of GWHN’s real and personal property, as well as GWHN’s 50% joint venture equity interest in the Harold Leever Regional Cancer Center, and added this total to GWHN’s net working capital target of \$6.8 million per the proposed asset purchase agreement. Navigant Consulting concluded that GWHN will contribute assets valued at \$30.2 million in exchange for the purchase price of \$31.8 million. Navigant Consulting’s analysis supports the conclusion that GWHN will receive fair market value for the transfer of its assets.

Based on the independent financial assessments of two respected firms who specialize in healthcare and hospital valuation analysis, and the lack of evidence to the contrary in the record, we conclude that GWHN will receive fair market value for its assets.

**E. The fair market value of the assets has not been manipulated by any person in a manner that causes the value of the assets to decrease.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(5), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the

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<sup>14</sup> The premise of value-in-place assumes that the Hospital’s assets are in place, but not as part of a going-concern business enterprise. Furthermore, this premise of value assumes that all assets will continue to be used in the manner for which they were originally intended, which assumption is consistent with PMH’s stated intent to operate The Waterbury Hospital as a general acute care hospital with similar levels and types of services.

fair market value of the nonprofit hospital's assets has been manipulated by any person in a manner that causes the value of the assets to decrease.

Both independent financial experts have concluded that the fair market value of the nonprofit hospital's assets has not been manipulated. Principle Valuation performed reviews of GWHN's financials and assets and found no indication that the fair market value of GWHN's assets had been manipulated. Navigant Consulting also conducted a thorough review of GWHN's assets and financials and concluded that the fair market value of GWHN's assets had not been manipulated.

No participant in the proceeding has offered any evidence that the fair market value of GWHN's assets has been manipulated to artificially lower the payment price. Based on these factors, we conclude that the fair market value of GWHN's assets has not been manipulated.

**F. The financing of the transaction will not place The Waterbury Hospital's assets at an unreasonable risk.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(6), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the financing of the transaction by the nonprofit hospital will place the nonprofit hospital's assets at an unreasonable risk. Consistent with the OAG's interpretation of this provision in *Sharon*, we interpret this statutory provision to require our examination of the proposed financing of the transaction to ensure that the APA does not "burden the for-profit entity with so much debt that the transferred assets of the former nonprofit hospital, albeit now operated for profit, will be placed at an unreasonable financial risk of closure or bankruptcy—an event that would result in a loss of healthcare for the affected community."

*In re Sharon Hospital*, Docket No. 01-486-01, p. 64 (2001).

Based upon the record, we conclude that the financing of this transaction will not place GWHN's assets at risk. PMH confirmed on the record that the purchase price for GWHN's assets will be financed with operating cash from PMH. More specifically, PMH represented that it has the financial capacity to provide the necessary capital to purchase GWHN's assets without transaction-specific financing arrangements. After its review of the transaction, Navigant Consulting concluded that PMH will not incur any debt financing to consummate the transaction, and so, GWHN's assets would not be put at an unreasonable risk. Similarly, Principle Valuation found that the transaction "does not encumber GWHN with any financing for the completion of this transaction; consequently, there is no financing of the transaction that would place the nonprofit hospital's assets at an unreasonable risk." (Exhibit Q7-5, Fairness Evaluation prepared by Principle Valuation, App., p. 831.)

As such, we conclude that the assets of GWHN will not be placed at an unreasonable risk due to the financing of the transaction.

**G. The management contract contemplated under the transaction is for reasonable fair value.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(7), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that any management contract contemplated under the transaction is not for reasonable fair value. No management contract is contemplated under the APA. Accordingly, we conclude that this element of the analysis has been met.

**H. Assuming compliance with the modifications imposed below, a sum equal to the fair market value of GWHN's assets is being transferred to the Independent Foundation to provide only for charitable health care services in the affected community.**

Pursuant to Conn. Gen. Stat. § 19a-486c(a)(8), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that:

a sum equal to the fair market value of the nonprofit hospital's assets (A) is not being transferred to one or more persons to be selected by the Superior Court who are not affiliated through corporate structure, governance or membership with either the nonprofit hospital or the purchaser, unless the nonprofit hospital continues to operate on a nonprofit basis after the transaction and such sum is transferred to the nonprofit hospital to provide health care services, and (B) is not being used for one of the following purposes: (i) For appropriate charitable health care purposes consistent with the nonprofit hospital's original purpose, (ii) for the support and promotion of health care generally in the affected community, or (iii) with respect to any assets held by the nonprofit hospital that are subject to a use restriction imposed by a donor, for a purpose consistent with the intent of said donor.

This provision in the Conversion Act advances the important policy that the value of the nonprofit hospital be preserved for charitable healthcare purposes in the service area that the nonprofit hospital previously served. In addition, it restates the OAG's statutory responsibility to protect the public interest in the protection of gifts made for charitable or public purposes codified at Conn. Gen. Stat. § 3-125.

The language of Conn. Gen. Stat. § 19a-486c(a)(8) requires the OAG to assess several different issues in connection with the APA. We must first analyze, determine, and approve a value that is the "sum equal to the fair market value of the nonprofit hospital's assets." Second, we must analyze the nature and purpose of the entity to which that sum is being transferred. Third, we must determine and require that the transferred sum is used only for the statutorily identified charitable purposes. Last, we are required to inventory



all gift documents and restricted charitable assets currently held by GWHN and identify any approximation and/or equitable deviation needs in connection with these assets.

**1. A Sum Equal to the Fair Market Value of The Waterbury Hospital is Being Transferred to the Independent Foundation.**

The term “fair market value” is used in several places in subsection (a) of § 19a-486c. As discussed in the OAG’s *Sharon* decision, and more fully below, fair market value has two distinct meanings depending on which section of the Conversion Act the term is used.

Subsection (4) of § 19a-486c requires us to ensure that the nonprofit hospital receives fair market value for its assets. As discussed earlier, subsection (4) defines “fair market value” as the likely price that the assets would bring in a sale in a competitive and open market. Subsection (4) is looking for the gross asset value.

If fair market value were computed for purposes of subsection (8) as it is for subsection (4), though, the nonprofit hospital might be left transferring to a conversion foundation the proceeds of its sale, but leaving the nonprofit hospital no ability to pay off its liabilities post-closing with some portion of those proceeds. Such a result is nonsensical, because a primary goal of a nonprofit hospital’s sale of assets is the extinguishment of corporate liabilities. For example, in the case of GWHN, its long-term bond debt will be paid off with proceeds from the sale of its assets.

The definition we use for fair market value for purposes of subsection (8), therefore, is more appropriately the price paid for the nonprofit hospital’s asset minus the amount of its debt obligations and other liabilities that it will resolve using the proceeds of the proposed transaction. In other words, fair market value equals the net proceeds of the nonprofit hospital. *In re Sharon Hospital*, OAG Docket No. 01-486-01, p. 69 (2001). With respect to GWHN, the net proceeds value calculation must take into account all retained

assets and liabilities, including, for example, cash, accounts receivable, any adjustment to the net working capital figure, its long-term debt, workers' compensation and medical malpractice liability relating to events occurring prior to closing, and any payor liabilities and obligations from reporting periods prior to closing.

Late Filed Exhibit 3 (App., 1847-49) sets forth the most current numbers on what proceeds will remain after netted with GWHN's closing liabilities and expenses. In short, because GWHN will have insufficient assets to cover its liabilities at closing, it will retain liabilities post-closing that will need to be paid off over time by Legacy GWHN. Given GWHN's difficult financial situation, we conclude that the sum that is equal to the fair market value of GWHN is currently zero.

Similar to the situation in the ECHN/PMH asset purchase transaction, Legacy GWHN may receive funds after the close while it is paying down its outstanding liabilities. For example, Legacy GWHN may receive reimbursements due from Medicare and Medicaid for the years prior to the closing. Also, Legacy GWHN will receive income from the unrestricted endowments during the time period between the close of the transaction and the Superior Court order that will transfer all charitable assets from Legacy GWHN to the Independent Foundation. Any unrestricted income received will be used to pay off Legacy GWHN's liabilities and wind down costs. After these obligations are paid off, however, any funds remaining will constitute net proceeds for the purposes of this decision.

Because the value of the final net proceeds of the nonprofit hospital cannot be precisely identified at this time, the determination of a sum equal to the fair market value for the purposes of subsection (8) must await a post-closing accounting and the payment of liabilities. Accordingly, as soon as reasonably possible after the Applicants have agreed to a

Final Closing Statement of the asset purchase, the Applicants must provide the OAG a final accounting of the transaction that sets forth the balance sheets of GWHN immediately prior to, and Legacy GWHN immediately after, the closing and that provides a net proceeds analysis, substantially similar to Late Filed Exhibit 3 with explanations of any changes to the figures. Legacy GWHN shall also provide a financial outlook for Legacy GWHN and its expected liability payment schedule going forward. These requirements are a condition of approval for the proposed transaction.

Additionally, because Legacy GWHN may receive income post-closing that will constitute net proceeds, Legacy GWHN shall, as a condition to the OAG's approval of the transaction, initially report quarterly and then annually to the OAG regarding (1) any and all post-closing income received by Legacy GWHN, and (2) all post-closing expenditures for Legacy GWHN.

Last, if the transaction ultimately produces net proceeds, that amount will be transferred to the Independent Foundation for use consistent with the charitable purpose of the Independent Foundation.

**2. The Nature of the Independent Foundation Complies with the Conversion Act.**

The Conversion Act requires that the net asset value of the nonprofit hospital be transferred to "one or more persons to be selected by the Superior Court who are not affiliated through corporate structure, governance or membership with either the nonprofit hospital or the purchaser, unless the nonprofit hospital continues to operate on a nonprofit basis after the transaction and such sum is transferred to the nonprofit hospital to provide health care services." Conn. Gen. Stat. § 19a-486c(8)(A). This provision prohibits improper affiliation with the new for-profit hospital.

GWHN has submitted a draft certificate of incorporation (“COI”) and draft bylaws for the Independent Foundation. By these submissions, GWHN is proposing to create an “independent conversion foundation.” This particular type of foundation is completely independent from both the nonprofit hospital and the for-profit purchaser and must be approved by the Superior Court. There can be no affiliation by corporate structure, governance, or membership.

The draft documents comply with the requirements of the statute. The Independent Foundation will have no corporate relationship with PMH/GWHN, and the governing members of the Independent Foundation will not contemporaneously serve in any governing position at PMH/GWHN or at any of its affiliates. In addition, any individual who serves as member of a governing board at PMH/GWHN must wait one year before serving on the governing board of the Independent Foundation. We conclude that the Independent Foundation meets the affiliation requirements of § 19a-486c(8)(A).

The Independent Foundation will also be operated for the proper purposes, as required by the Conversion Act. Section 19a-486c(a)(8)(B) provides that the Independent Foundation must be operated:

- (i) For appropriate charitable health care purposes consistent with the nonprofit hospital’s original purpose, (ii) for the support and promotion of health care generally in the affected community, or (iii) with respect to any assets held by the nonprofit hospital that are subject to a use restriction imposed by a donor, for a purpose consistent with the intent of said donor . . . .”

§ 19a-486c(a)(8)(B).

In its draft COI, the Independent Foundation lists its purposes as follows:

- (a) To provide for the healthcare needs of the greater Waterbury area, including the towns of Beacon Falls, Bethlehem, Cheshire,

Middlebury, Naugatuck, Prospect, Southbury, Waterbury, Watertown, Wolcott and Woodbury (the “Communities”);

(b) To support or conduct community health needs assessments and encourage and support efforts to improve the health of the Communities;

(c) To support and engage in community projects, grants, activities and programs that will improve access to healthcare and enhance the health of the Communities, including the provision of preventive health programs and health education, education and training of healthcare providers and educators in the Communities; and

(d) In furtherance of the foregoing activities and purposes, but subject to the restrictions of this Certificate of Incorporation, the Foundation may engage in any lawful act or activity for which nonstock corporations may be formed under the Nonstock Act.

(Exhibit Q10-1, Independent Foundation Certificate of Incorporation (Draft); App.,

924.) These purposes are consistent with the requirements in the Conversion Act.

**3. The Transferred Sum Will Be Used Only For The Statutorily Identified Charitable Purposes.**

GWHN currently predicts that it will have no net proceeds to transfer to the Independent Foundation after the closing. Should a subsequent accounting of the transaction reveal net proceeds, however, we must ensure that they will forever be used for their proper charitable purpose. The draft COI established the proper charitable purposes, but the primary mechanism to ensure that they will be used as such forever is the requirement that the Independent Foundation Board receive the consent of the Attorney General for the amendment of specific sections of the COI, specifically, paragraphs 3, 5(c), 9, and 11. In this way, the purposes of the Independent Foundation (paragraph 3 of the COI) cannot change unless the Attorney General agrees. Accordingly, as a condition to the Attorney General’s approval of the Application, the Independent Foundation must include paragraph 11 of the draft COI in the final COI of the Independent Foundation, requiring

Attorney General approval for changes to paragraphs 3, 5(c), 9, and 11 of the Certificate of Incorporation.

**4. Description and Quantification of the Nonprofit Hospital's Charitable Assets to be Held by the Independent Foundation.**

Our final area of concern is to ensure that the charitable assets of The Waterbury Hospital, which have been held in trust for the public, are safeguarded and used for the promotion of healthcare in the area served by The Waterbury Hospital after the sale of GWHN's assets to PMH. We must also ensure that any restrictions contained in these charitable gifts and trusts are protected.

*a. Purpose of Attorney General's Review of Charitable Gifts*

A full analysis and review of GWHN's charitable gifts and trusts at this time is essential for several reasons. First, it permits us to fulfill our statutory obligation to ensure that all of GWHN's charitable gifts and trusts are used for a purpose consistent with the intent of the donor. In other words, this review ensures that GWHN's analysis and treatment of charitable funds in the Application correctly interprets the donors' charitable use restrictions. Second, it ensures that, with respect to the charitable gifts, no aspect of the transaction is "prohibited by Connecticut statutory or common law governing nonprofit entities, trusts or charities." Conn. Gen. Stat. § 19a-486c(a)(1). Finally, it provides subsequent holders of the funds, i.e., the Independent Foundation, with accurate information about whether and how the gifts are restricted under Connecticut law so that it can administer them in accordance with donor restrictions, charities law, the terms of the contractual agreements, and modifications required in this decision.

*b. Documents Reviewed and Legal Standards*

As part of the Application, GWHN provided a review and analysis of its charitable gifts and endowments. (Exhibit Q11-1, Charitable Gift Analysis, App., p. 938-58.) GWHN was required to provide copies of the gift instruments (including wills, inter vivos trust agreements, and documentation of inter vivos gifts), to document the current values of the funds, and to describe the donor's restrictions or directives reflecting how the gift was to be used by GWHN. The purpose of the OAG's request was to obtain the information necessary to: (1) review the gift instrument for each of GWHN's gifts to determine whether its language would permit the gift to be transferred to another nonprofit, or whether a reverter clause or gift-over provision would be triggered by the sale of assets that would require the donation to revert to a different person, and (2) determine whether the donor restricted the use of a fully expendable gift, or the income earned on an endowment fund, to a particular charitable purpose set out in the gift instrument, for example, free beds, charity care, maintenance, a building fund, or research.

The OAG reviewed each charitable gift and its supporting documentation to confirm the accuracy of GWHN's conclusions regarding the proper charitable purpose of the fund and any spending restrictions on the fund.

*c. Amount Stated by Hospital in Application*

GWHN has stated, that as of March 31, 2016, the Independent Foundation would receive approximately \$9,409,966 in charitable assets, \$600,755 of unrestricted endowments; \$8,787,054 from restricted endowments; and \$22,157 from restricted gifts that are fully expendable. (App., p. 1852-54.)

*d. GWHN's Charitable Gifts and Trusts.*

The law on approximation, or cy pres, is well-developed in Connecticut. Indeed, the OAG brought an approximation action in the *Sharon* matter to address those charitable purposes that could no longer be fulfilled due to the sale of Sharon Hospital's assets. In that case, the court set forth the standards for approximation.

In determining the construction of a charitable trust upon the failure of its stated purpose, the court applies the common law doctrine of cy pres, or approximation to as near as possible reflect the donor's intent. When it becomes illegal or otherwise impossible to carry out the terms of a charitable trust, rather than allow it to fail, the court will apply the doctrine of cy pres or approximation in order to carry out the charitable intentions of the donor as near as possible. "The rule of cy pres is a rule for the construction of instruments in equity, by which the intention of the party is carried out *as near as may be*, when it would be impossible or illegal to give it literal effect. . . . The doctrine of cy pres may be applied without the consent of the donor." (Citations omitted; emphasis in original; internal quotation marks omitted.) *Carl J. Herzog Foundation, Inc. v. University of Bridgeport*, 243 Conn. 1, 10 n.8, 699 A.2d 995 (1997).

*Blumenthal v. Sharon Hosp., Inc.*, 2003 Conn. Super. LEXIS 1657, 11-12 (Sup. Ct. 2003).

Also relevant to the conversion of a nonprofit hospital is the law on equitable deviation, which is similar to that of approximation but concerns the administration of a gift fund and not its charitable purpose. The equitable doctrine of deviation has been applied to preserve the "dominant [charitable] purpose by modifying what is described as [a] secondary purpose, often the method or means for carrying out the dominant purpose." 8 G. Bogart, *Trusts and Trustees* (2d Ed. Rev.Repl.1991) § 396, p. 330. Courts use this legal doctrine to order a change in the administration of a charitable fund from one charitable entity to another. Equitable deviation will be necessary in this case to move the charitable funds from GWHN to the Independent Foundation or another appropriate entity.



The Attorney General's office inventoried the gift documents in Section IV(E) in the Findings of Facts. Based upon this inventory and GWHN's and our analyses of these charitable gifts, we have determined that as a condition of approval, the following actions must be taken with respect to these funds.

i. Unrestricted Endowments.

An endowment fund is defined as "an institutional fund or any part thereof not wholly expendable by the institution on a current basis under the terms of a gift instrument." Conn. Gen. Stat. § 45a-535a(2). The institution that holds an endowment fund cannot fully expend such fund, but may only appropriate so much of an endowment's funds for expenditure or accumulation as the institution determines to be prudent for the uses, benefits, purposes for which the endowment fund is established. Unless stated otherwise in a gift document, the assets in an endowment fund are donor-restricted assets until appropriated for expenditure by the institution. Conn. Gen. Stat. § 45a-535c(a).

As a condition to the OAG's approval of the Application, Legacy GWHN must present to the Superior Court, in coordination with the OAG, a petition for equitable deviation and approximation to transfer these funds to the Independent Foundation or another appropriate entity and to change the charitable purpose of the unrestricted endowments to the charitable purpose of the Independent Foundation. This condition applies to all unrestricted endowments.

ii. Restricted Endowments

The Conversion Act requires the recipient of the hospital's gift funds to use assets that are subject to a use restriction imposed by a donor for purposes that are consistent with the intent of the donor. Conn. Gen. Stat. § 19a-486c(a)(8)(B)(iii).

With respect to GWHN's restricted endowments, most of the charitable purposes can be fulfilled even though the funds will not be held by a hospital. For example, a free bed fund, which is used to provide charity care at a hospital, can still be used to pay for hospital bills for indigent individuals. These funds will simply need to be transferred to the Independent Foundation; no change in charitable purpose is needed. There are, however, a number of restricted endowments that will need their charitable purposes adjusted by the Superior Court as a result of the sale of GWHN's assets to a for-profit entity.

Accordingly, as a condition to the OAG's approval of the Application, Legacy GWHN must, in coordination with the OAG, include the restricted endowments in the petition for equitable deviation and approximation that will be presented to the Superior Court.

iii. Restricted, Fully Expendable Gifts

GWHN has categorized two funds as restricted and fully expendable. Similar to restricted endowments, these funds have a specific purpose for which they are used. Unlike the restricted endowments, however, these funds can be completely used up; they are fully expendable. Therefore, to the extent that there is any money remaining in a special fund at the time the transaction closes, that fund will need to be a part of the equitable deviation and approximation action in order to transfer it and adjust its charitable purpose, if necessary.

Accordingly, as a condition to the OAG's approval of the Application, Legacy GWHN must, in coordination with the OAG, include any restricted, fully expendable fund, for which any funds remain, in the petition for deviation and approximation that will be presented to the Superior Court.

iv. Trust Held by Outside Trustees.

The last category of funds that the OAG must address as part of its hospital conversion review responsibilities are those charitable assets held by third party trustees for which GWHN holds the beneficial interest. GWHN has identified two groups of third party trusts for which it holds the beneficial interest: third party trusts with use restrictions and those without.

In each of the cases identified by GWHN, the sale of GWHN's assets will not affect the structure of the trust, i.e., will not require the transfer of the trust to another entity. What may be necessary, among other things, is a switch of the charitable beneficiary and an adjustment to the trust's charitable purpose. If the trusts themselves do not address disposition under these circumstances, then the trusts must be presented to a Court for legal disposition. Consultation with the third-party trustees is necessary in these cases.

Accordingly, as a condition to the OAG's approval of the Application, Legacy GWHN must, in coordination with the OAG and the third-party trustees, bring any third-party trust in need of construction or approximation before a court of competent jurisdiction for appropriate orders.

v. Future Interests

According to the Gift Analysis provided to the OAG, there is one open estate pursuant to which The Waterbury Hospital might receive charitable gifts: Lenners. GWHN's portion of the distribution in the Lenners estate (and any other unrestricted gift to GWHN), if distributed prior to the Superior Court order transferring GWHN's charitable assets to the Independent Foundation or other charitable organization, shall be included in the net proceeds of the transaction and treated as such.

To the extent there are unknown future charitable interests for the benefit of GWHN, the disposition of those interests will be addressed on a case-by-case basis by a court under the doctrine of approximation. Only when a future interest becomes a present interest can a probate or superior court determine to whom the remainder will pass or whether the gift will fail and revert to the donors' heirs-at-law. Therefore, any future interests that have not yet vested cannot be included in the Superior Court action to address the identified charitable funds.

**I. GWHN and PMH Have Provided The Attorney General With Information And Data Sufficient To Evaluate The Proposed APA.**

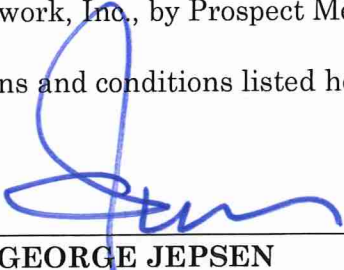
Pursuant to Conn. Gen. Stat. § 19a-486c(a)(9), the Attorney General shall disapprove the proposed transaction as not in the public interest if he determines that the nonprofit hospital or the purchaser has failed to provide the Attorney General with information and data sufficient to evaluate the proposed agreement adequately, provided the Attorney General has notified the nonprofit hospital or the purchaser of the inadequacy of the information or data and has provided a reasonable opportunity to remedy such inadequacy. The Applicants have provided all relevant information and sufficient data to evaluate adequately the proposed Asset Purchase Agreement.

**VII. CONCLUSION**

The OAG therefore concludes that the Application for the purchase of substantially all of the assets of Greater Waterbury Health Network, Inc., by Prospect Medical Holdings, Inc., is hereby approved subject to the modifications and conditions listed herein.

Date:

7/15/16

  
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GEORGE JEPSEN  
ATTORNEY GENERAL