

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

Date: April 17, 2013

DECISION

In Re: Expedited Review Hospital Conversion Initial Application of Westerly Hospital Healthcare, Inc., The Westerly Hospital, LMW Healthcare Inc., LMW Physicians, Inc., and Lawrence + Memorial Corporation

The Department of Attorney General has considered the above-referenced application pursuant to R.I. Gen. Laws § 23-17.14-12.1, the expedited review process pursuant to the Hospital Conversions Act. In accordance with the reasons outlined herein, the application is **APPROVED WITH CONDITIONS.**

I. BACKGROUND

Recently, the Hospital Conversions Act was modified to allow expedited review for hospital conversions deemed by the Department of Health (“DOH”) to meet certain criteria, including that the acquired hospital is considered a “distressed” hospital. *See* R.I. Gen. Laws § 23-17.14-12.1(a). The move from a full review to an expedited review changed several aspects of the process. First, the review time was reduced from 120 days to 90 days. Second, the information required in the initial application was reduced. And finally, DOH and the Attorney General no longer conduct a joint review. DOH conducts an expedited review based upon the process set forth in R.I. Gen. Laws § 23-17.14-12.1 and the Attorney General performs “a review of the proposed transaction as it deems necessary.” *See* R.I. Gen. Laws § 23-17.14-12.1(h). For efficiency, and as a testament to the cooperative relationship between DOH and the Attorney General, both agencies worked together to draft Expedited Review Hospital Conversion Initial Application forms to be utilized by the respective agencies. The Attorney General’s application

form builds upon the information required in the DOH form, saving the Transacting Parties from duplicative filings. Given the Legislature's intent that the expedited review process be more limited than a full HCA review, the Attorney General's form and subsequent review focused primarily on areas traditionally examined by the Attorney General, such as the disposition of charitable assets and issues with corporate governance and conflict of interests.¹ Accordingly, the first step in traversing the expedited review process through the Department of Attorney General is the filing of an Expedited Review Hospital Conversion Initial Application.

The Transacting Parties filed their Expedited Review Hospital Conversion Initial Application on November 2, 2012 ("AG Initial Application"). The parties (collectively, "Transacting Parties") to the AG Initial Application are identified below:

- Westerly Hospital Healthcare, Inc. is a Rhode Island non-profit corporation that was incorporated on December 6, 1983.
- The Westerly Hospital is a non-profit general acute care community hospital located in Westerly, Rhode Island. The hospital was incorporated on June 17, 1921.
- The Atlantic Medical Group, Inc. ("AMG") is a multi-specialty physician group practice with offices in Westerly and Charlestown, Rhode Island and Stonington and Mystic, Connecticut. AMG is a Rhode Island non-profit corporation that was incorporated on June 26, 2008.
- North Stonington Health Center, Inc. ("NSHC") is a Connecticut non-profit corporation that was incorporated on September 17, 2009. NSHC operated urgent care, physical therapy, laboratory/radiology, and primary care practices in North Stonington, Connecticut.
- Women's Health of Westerly, LLC, operates an obstetric/gynecological practice in Westerly and is a Rhode Island limited liability company that was incorporated on November 29, 2001.
- Ocean Myst, MSO, LLC is a Rhode Island limited liability company that provides billing and administrative services to the above referenced practices. It was incorporated on November 22, 2010.

¹ The Attorney General notes that there may be a situation in the future where a more expansive review may be necessary.

- LMW Healthcare, Inc. is a Rhode Island non-profit corporation that was incorporated on May 29, 2012. This is a newly created entity formed to purchase certain assets of the Westerly Hospital.
- LMW Physicians, Inc. is a Rhode Island non-profit corporation that was incorporated on May 29, 2012. This is a newly created entity formed to hold the assets of the Westerly Hospital physician medical practices.
- Lawrence + Memorial Corporation is a Connecticut non-profit corporation that was incorporated on July 10, 1984. This entity is the sole corporate member of several affiliates including but not limited to the following: LMW Healthcare, Inc., LMW Physicians, Inc., Lawrence + Memorial Hospital, Inc. and L&M Physicians Association, Inc.
- Lawrence + Memorial Hospital, Inc. is a Connecticut non-profit community service organization² that, according to the Transacting Parties, has operated a hospital in New London, Connecticut for one hundred years.³

See Department of Health Expedited Review Hospital Conversion Initial Application (“DOH Initial Application”) Question 2, Exhibit 2, and Question 6. Certain corporate information was also verified via the Secretary of State websites for Rhode Island and Connecticut.

In its simplest form, the structure of the transaction outlined in the AG Initial Application (the “Proposed Transaction”) is a sale of the assets pursuant to an asset purchase agreement (“APA”) of Westerly Hospital Health Care, Inc., The Westerly Hospital, Atlantic Medical Group, Inc., Ocean Myst MSO, LLC, Women’s Health of Westerly, LLC, and North Stonington Health Center, Inc. (the “Westerly Hospital and Related Entities”) to LMW Healthcare, Inc., LMW Physicians, Inc., and Lawrence + Memorial Hospital Corporation (collectively, “L&M”).

II. REVIEW CRITERIA

Pursuant to R.I. Gen. Laws § 23-17.14-12.1(h), the Department of Attorney General “shall perform a review of the proposed transaction as it deems necessary, including, at a

² The date of Lawrence + Memorial Hospital, Inc.’s registration with the Connecticut Secretary of State was not available online.

³ See DOH Request for Expedited Review, Attachment 4, dated September 6, 2012.

minimum, its impact upon the charitable assets of the transacting parties.” The Attorney General has reviewed the information provided in the AG Initial Application. Further, the Attorney General sent over fifty (50) supplemental follow-up questions to the Transacting Parties to elaborate on information provided in the AG Initial Application. The Attorney General also had access to and reviewed the DOH Initial Application filed by the Transacting Parties, along with the Department’s supplemental follow-up questions and responses.

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

Westerly

- W. Mark Russo, Special Master for Westerly Hospital Health Care, Inc., The Westerly Hospital, Atlantic Medical Group, Inc., Ocean Myst MSO, LLC, Women’s Health of Westerly, LLC, and North Stonington Health Center, Inc.
- James O’Keefe, Chief Financial Officer and Chief Restructuring Officer, The Westerly Hospital
- Charlie C. White, Controller, The Westerly Hospital
- Nicholas Stahl, CFRE, Executive Director, The Westerly Hospital Foundation
- Jennifer Schwindt, Board Chair, The Westerly Hospital Foundation (AG only)
- Mary Lou Walters, President, The Westerly Hospital Auxiliary (AG only)
- Christopher Lehrach, MD, MBA, Chief Transformation Officer-Interim Operations, The Westerly Hospital

Lawrence + Memorial Hospital

- Bruce Cummings, President and Chief Executive Officer
- Lugene Inzana, Vice President and Chief Financial and Support Services Officer
- William Stanley, Vice President, Development and Community Relations

- Daniel Rissi, MD, Vice President and Chief Medical Officer

Unlike a full review under the Hospital Conversions Act, the expedited review does not require a public informational meeting. However, it is the Attorney General's position that the public's input is vital to this process. Accordingly, a public notice issued jointly with DOH was published advertising informational meetings as well as soliciting written comments regarding the Proposed Transaction. The Attorney General and DOH jointly held these meetings at the Westerly Middle School.⁴ They were held on March 27, 2013 from 4:00 p.m. to 5:30 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. These meetings were sparsely attended and only eight (8) speakers provided public comment. The comments were in favor of the Proposed Transaction generally, with a few individuals expressing unhappiness about the termination of delivery of babies at the hospital. Also, some individuals expressed their disappointment that the hospital found itself in its current circumstances, but supported the merger with L&M to save the hospital. Surprisingly, not one written comment was received by the Attorney General in response to the notice soliciting written comment.⁵

The AG 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.

⁴ The Attorney General would like to thank the representatives of the Town of Westerly and especially the staff of the Westerly Middle School for their hospitality and for assisting us with use of the school.

⁵ Two individuals submitted their testimony in writing at the public meeting, however, no other written comments were received.

III. PROCEDURAL HISTORY

On December 7, 2011, a petition of the Chief Executive Officer and Trustee, Charles S. Kinney, was filed with the Superior Court seeking appointment of a special master to oversee the operation of The Westerly Hospital and Related Entities⁶ (“Westerly Special Mastership”). On January 17, 2012, the Court appointed attorney W. Mark Russo (the “Special Master”) to act as special master for the Westerly Hospital and Related Entities.⁷

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. 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.

As part of the appointment of a Special Master to oversee Westerly Hospital, the presiding justice, the Honorable Brian P. Stern used some innovative tools to assist the Special Master throughout the process. One was the establishment of two (2) advisory committees: the Stakeholder Committee and the Regulatory and Public Protection Committee. *See* Order, dated December 12, 2011, Para. 8 and 9. The Court also established a Westerly Area Residents’ Committee. *See* Order dated, April 2, 2012. A Patient Care and Privacy Ombudsman was also appointed to assist with any patient care and privacy issues at the hospital. *See* Order dated February 7, 2012.

Shortly after his appointment, the Special Master began to market the hospital. He filed a Petition for Instructions on February 14, 2012 to establish a “process to secure proposals for the

⁶ Charles S. Kinney, et.al. v. Westerly Hospital Health Care, Inc., et al. Rhode Island Superior Court - W.B. No. 2011-0781. All pleadings cited herein pertain to this case unless otherwise noted.

⁷ *See* Order Appointing Permanent Special Master, dated January 17, 2012.

acquisition, strategic partnership and/or repositioning of the Westerly Hospital and Related Entities.”⁸ The recommended process consisted of four phases. In the first phase, the Special Master would engage a consultant and assemble documents in an electronic data room to facilitate due diligence. He also prepared a memorandum of certain relevant information to provide to potential purchasers. In the second phase, letters of interest would be solicited from potential purchasers or partners (“Potential Purchaser/Partner”) with certain minimum information including:

- a. A description of the Potential Purchaser/Partner’s organization, including its history and operation, financial resources, educational and religious affiliations;
- b. An overview of the Potential Purchaser/Partner’s experience in affiliating with, or acquiring, and operating, financially-distressed hospital(s) and/or healthcare systems;
- c. A transaction structure including but not limited to assets to be acquired, purchase price, assumption of liabilities, and assumptions regarding working capital expected to be delivered at closing;
- d. The model or strategic plan for the operation of Westerly Hospital and/or Related Entities, post-acquisition;
- e. A description of the amount and sources of financing, the timing to complete such financing, and any contingencies related hereto;
- f. A description of the due diligence process required for closing the transaction;
- g. The authorizations and approvals necessary to be obtained prior to executing all definitive Mastership Transaction documentation; and
- h. The anticipated timing to close the Mastership Transaction.

In the third phase, the letters of interest would be evaluated to determine qualified Potential Purchasers/Partners. Those qualified Potential Purchasers/Partners would be given access to an additional level of due diligence. The third phase would conclude with binding

⁸ See Petition for Instructions, dated February 14, 2012.

asset purchase agreements. At the end of the process, a bid hearing would be scheduled to review the bids. The Petition for Instructions mentioned, but did not highlight, the potential for a so called “stalking horse bid.” *See* Petition for Instructions, dated February 14, 2012, Para 2. In general, a stalking horse bid is an initial baseline bid to garner interest from other potential buyers. *See 1500 Mineral Spring Assoc. v. Gencarelli*, 353 B.R. 771, 776 (D.R.I. 2006). This procedure is used in bankruptcy or receivership and is subject to higher/better bids. A Court Order of March 12, 2012 (“Mastership Transaction Process Order”) resulting from this Petition for Instructions approved a mastership transaction process. The Mastership Transaction Process Order substantially adopted the Special Masters proposed process.

On May 17, 2012, an Emergency Petition for Instructions was submitted to authorize the Special Master to bring a stalking horse bid.⁹ The Special Master’s rationale for this request was that “a stalking horse bid would have a positive impact on the process, especially if a stalking horse bid committed not only to certain economics, but to address the weighted factors set forth in Section 7 of the Mastership Transaction Process Order...”¹⁰ While the stalking horse bidder would receive certain protection, the bid would be subject to competitive bidding and a higher and better offer.¹¹ This Petition was heard on May 23 and 24, 2012 and the court allowed the Special Master to bring a stalking horse bid via Order entered on May 29, 2012.

On May 30, 2012, the Special Master submitted a Petition for Instructions regarding the Presentation and Acceptance of a Stalking Horse Offer. This offer was from LMW Healthcare, Inc. and LMW Physicians, Inc., whose obligations were guaranteed by Lawrence + Memorial

⁹ *See* Emergency Petition for Instructions, dated May 17, 2012.

¹⁰ *Id.*

¹¹ *Id.*

Corporation.¹² An asset purchase agreement was filed along with this petition. The Special Master set forth the specifics of the offer, including certain protections that would be afforded to the stalking horse bidder. The Special Master also outlined how he believed that a stalking horse bidder would encourage competitive bidding and recommended acceptance of the L&M stalking horse bid offer.

On June 13, 2012, the Court held a hearing on the Special Master's Petition for Instructions regarding the Presentation and Acceptance of a Stalking Horse Offer by LMW Healthcare, Inc., and LMW Physicians, Inc., as guaranteed by L&M. The Petition, referencing the APA, outlined the specifics of this stalking horse offer:

1. Assumption (or satisfaction) of over \$22 Million in the Westerly Hospital and the Related Entities' liabilities;
2. A commitment to pay for a "tail" malpractice insurance policy that Westerly Hospital will require upon the sale at an estimated cost of approximately \$2 Million;
3. Commitment to pay closing costs and transactional expenses that Westerly Hospital will incur in the proceeding at an estimated cost of \$1.5 Million;
4. Commitment to fund "cure" costs not captured in assumed liabilities;
5. A commitment to continue the Westerly Hospital identity and name, including non-profit status and community mission;
6. Commitment to establish a Hospital Board with members drawn from residents of the Westerly service area. Moreover, a commitment to put residents of the Westerly service area on the reconstituted Board of Trustees of the Hospital as well as the Board of Trustees of the Buyer's parent;
7. Commitment to carry out a broad-based community capital campaign in support of Westerly Hospital and a commitment that such funding will be raised in the Hospital's name and remain for the benefit of the Hospitals non-profit community mission;

¹² The Attorney General notes that L&M had previously been in negotiations for purchase of the Westerly Hospital prior to the Special Mastership.

8. Commitment to maintain the Westerly Hospital as an acute care, community hospital for a minimum of 5 years after the Closing. Included within this commitment, is a commitment not to discontinue clinical services being provided by Westerly Hospital for 2 years after the Closing. Furthermore, if L&M's targeted goal of a 3% operating margin on a roll-up basis of the Westerly Hospital and Related Entities is achieved, a commitment to augment services;
9. A commitment to inject \$6.5 Million of working capital into Westerly Hospital during the first 2 years after Closing to fund the turnaround plan (subject to final review by Buyer) that the Mastership has begun to bring the Hospital to a state of profitability;
10. Consistent with the commitments to continue the mission of the Hospital and maintain it as an acute care, community hospital, a commitment during the first 5 years after Closing, to make or incur contractual obligations to make \$30 Million in capital expenditures including without limitation, investment in technology, equipment, and/or expanded services;
11. Commitment to offer employment, commencing on the Closing Date to all union and non-union clinical, trade and services personnel of the Sellers (excluding certain management personnel and general and administrative support services personnel) and, a further commitment to maintain certain minimum staffing levels per adjusted average occupied bed;
12. A commitment to assume physician contracts and to strengthen the Westerly Hospital's relationship with the physician community (subject to Buyer's due diligence review, including but not limited to, compliance with law, inclusive of current review being undertaken by the US Department of Health and Human Services, Office of Inspector General and the US Attorney);
13. A commitment to expedite the Rhode Island Hospital Conversion Act and Change in Effective Control process;
14. During the critical period between the Sale Hearing and the completion of the Hospital Conversion Act process, a commitment pursuant to the Interim Advisory Agreement to loan monies to the Hospital to cover operational losses...; and
15. A commitment to fund the lease obligations (approximately \$68,000 per month) for the North Stonington Health Center up and until Closing subject to the Special Master deeming such payments necessary in his discretion.

On June 20, 2012, the Court entered an Order Approving Procedures for the Sale of Substantially All Assets, Scheduling a Final Hearing and Granting Related Relief. This Order authorized the Special Master to accept the stalking horse offer submitted by LMW Healthcare,

Inc and LMW Physicians, Inc.¹³ The L&M bid was subject to higher and better offers and a future sale hearing to ascertain whether other offers would be made.

A sale hearing was held on August 28, 2012 where representatives of L&M took the stand and were available to answer questions regarding their bid. No other bidder came forward to submit a higher or better offer. On September 12, 2012,¹⁴ an Order was entered approving the sale of the assets of the Westerly Hospital and the Related Entities to LMW Healthcare, Inc and LMW Physicians, Inc.

Once the APA was approved, the next step in the process was the DOH's consideration of the Special Master's request for expedited review. The Special Master filed a Request for Expeditious Review with DOH on September 6, 2012. Pursuant to R.I. Gen. Laws § 23-17.14-12.1(a), parties qualify for expedited review if certain criteria are met. First, both the acquiree and the acquiror must be nonprofit corporations that have directly or indirectly continuously operated at least one licensed hospital for at least 3 prior years.¹⁵ Secondly, "the acquiree must operate a distressed Rhode Island hospital facing significant financial hardship that may impair its ability to continue to operate effectively without the proposed conversion..."¹⁶ The Director of the Department of Health is charged with determining whether the subject hospital can be defined as distressed based upon whether its circumstances meet one or more of the following criteria:

- (i) Operating loss for the two (2) most recently completed fiscal years;
- (ii) Less than fifty (50) days cash on hand;
- (iii) Current asset to liability ratio of less than one point five (1.5);

¹³ See Order Approving Procedures for the Sale of Substantially All Assets, dated, June 20, 2012.

¹⁴ The Attorney General notes that this Order provides DOH with the responsibility of enforcing the commitments made by L&M through the APA. See Order dated, September 12, 2012, Para.

3.

¹⁵ R.I. Gen. Laws § 23-17.14-12.1(a)(1).

¹⁶ R.I. Gen. Laws § 23-17.14-12.1(a)(2).

- (iv) Long-term debt to capitalization greater than seventy-five percent (75%);
- (v) Inpatient occupancy rate of less than fifty percent (50%);
- (vi) Would be classified as below investment grade by a major rating agency.

See R.I. Gen. Laws § 23-17.14-12.1(a)(2)(i)-(vi). On September 21, 2012, the Director granted the Special Master's Request for Expeditious Review.

As stated above, the AG's Initial Application pursuant to the Hospital Conversions Act represents a starting point for the information necessary to address the issues reviewed by the Department of Attorney General in an expedited review. The information requested represents the minimum amount of information required. Because each hospital conversion transaction is unique, additional follow-up requests are asked in response to information included in the AG Initial Application or information generated during the investigation. The AG Initial Application was filed by the Transacting Parties on November 2, 2012.

On November 21, 2012, the Department of Attorney General deemed the AG Initial Application incomplete as several questions required additional information. It is not unusual for an AG Initial Application to be deemed incomplete given the nature and amount of information requested. On December 14, 2012, the Transacting Parties provided the requested information. Additional information was requested by the Attorney General to deem the AG Initial Application complete on December 21, 2012. The Transacting Parties responded and the AG Initial Application was deemed complete on January 29, 2013. A first set of follow-up questions was sent to the Transacting Parties on February 19, 2013 consisting of fifty (50) questions. The Transacting Parties responded in writing to this first request as a supplement to the AG Initial Application. During the pendency of the review, two (2) additional sets of supplemental questions were sent and responded to by the Transacting Parties.

IV. DISCUSSION

As outlined above, this is the first review performed by the Attorney General pursuant to the expedited review process contained in R.I. Gen. Laws § 23-17.14-12.1(h). As stated therein, the Attorney General must perform “a review of the proposed transaction as it deems necessary.” R.I. Gen. Laws § 23-17.14-12.1(h). Although the change to the Hospital Conversion Act regarding expedited review left unclear the intended role of the Attorney General, there was little time to contemplate the parameters of an expedited review as the first contact requesting an expedited review was in August 2012. Therefore, in deciding what constitutes a necessary review by the Attorney General pursuant to the expedited process, the Attorney General first reviewed the criteria necessary for a full review pursuant to the Hospital Conversions Act. Review criteria contained in the Hospital Conversions Act applicable in a full review involving either non-profit or for-profit buyers consists of twenty-one (21) or thirty (30) requirements respectively. *See* R.I. Gen. Laws §§ 23-17.14-10 and 23-17.14-7. The Attorney General also reviewed the criteria used by DOH in both a full and expedited review process as well as the Change in Effective Control process. Thereafter, for efficiency, the Attorney General decided to develop a form to begin its expedited review process. While it is possible that this form may not be appropriate in a particular transaction, the existence of the form helps organize the review and raises the transacting parties’ awareness of what information will be required of them on a preliminary basis for the review. As stated above, the form requests information that is of traditional focus by the Attorney General in a full review pursuant to the Hospital Conversions Act. The topics below do not reflect all of the information that the Attorney General has reviewed regarding the Proposed Transaction. Further, it is possible that a particular review in the future may include additional topics for Attorney General review. However, for this

Proposed Transaction, the Attorney General provides the basis of its review and decision regarding the following general categories: (1) Charitable Assets; (2) Governance; and (3) Conflict of Interest. The statutory criteria contained in the Hospital Conversions Act have been used, as appropriate, for consistency in reviews.

A. CHARITABLE ASSETS

The Department of Attorney General has the statutory and common law duty to protect charitable assets within the State of Rhode Island.¹⁷ In addition, the expedited review section of the Hospital Conversions Act requires that the Attorney General review at a minimum, the Proposed Transaction's "impact upon the charitable assets of the transacting parties." *See* R.I. Gen. Laws §23-17.14-12.1(h). The full review process of 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. During Mastership

During the pendency of the Special Mastership, the Special Master took steps to protect the charitable donations provided to the Westerly Hospital pursuant to a Petition for Instructions which resulted in a Court Order. The Court Order required that "monies to be donated to the Westerly Hospital Foundation and/or directly to the Westerly Hospital, shall be maintained by the Special Master in a segregated account that cannot be liened, claimed and/or encumbered by creditors of the Westerly Hospital and Related Entities." *See* Order, dated January 11, 2012, Para. 1. Any such funds were to be used as directed by the specific donor or otherwise, to further Westerly Hospital's mission. *Id.* at Para. 2. They were not to be used for the "day-to-day operational expenses" absent further Order of the Court. *Id.* The protection of these charitable

¹⁷ *See, e.g.*, R.I. Gen. Laws §§ 18-9-1 to 17.

donations was vital to the continued generosity of the Westerly Hospital community. Indeed, it was reported by the Special Master that even though an annual letter went out from the Westerly Hospital Foundation that did not request donations given that the ownership of the hospital was in flux, significant donations were sent in response anyway. This fact evidences that the Westerly Hospital enjoys the continued generous support of its community.

2. Initial Application Process

In the AG Initial Application, the Transacting Parties provide information about two entities that play a critical role in the ability of the Westerly Hospital to thrive in the area of charitable donations, namely, the Westerly Hospital Foundation, Inc. (“Westerly Hospital Foundation”) and the Westerly Hospital Auxiliary, Inc. (“Westerly Hospital Auxiliary”).¹⁸

a. The Foundation

The Westerly Hospital Foundation is a non-profit Rhode Island corporation that was incorporated on June 10, 1999. Its stated purpose¹⁹ is:

- (a) To promote the charitable, educational, and scientific purposes of The Westerly Hospital by coordinating and furthering the delivery of health care.
- (b) To support The Westerly Hospital by encouraging and advancing the provision of quality patient care.
- (c) To acquire, hold, manage, maintain, develop and/or dispose of real and personal property for the benefit of The Westerly Hospital and its affiliated organizations so long as they are exempt from tax under section 501(c)(3) of the Internal Revenue Code of 1986, as amended.
- (d) To engage generally in any other educational or charitable activities that may lawfully be carried on by a corporation formed under Chapter 6 of the Rhode Island Non-Profit Corporation Act as now in force or as hereafter

¹⁸The Transacting Parties have certified that no other Westerly entity other than the Westerly Hospital itself, the Westerly Foundation and the Westerly Auxiliary hold charitable assets. AG Initial Application Response to Supplemental Question 6.

¹⁹ See the Westerly Hospital Foundation’s Articles of Incorporation, Para. 3A.

amended and that is not inconsistent with the organization's qualification as an organization exempt from tax under section 501(c)(3) of the Internal Revenue Code of 1986, as amended.

The Westerly Hospital Foundation was not a named entity in the Special Mastership and has continued to operate throughout the Special Mastership. The Westerly Hospital Foundation was governed by a Board of Directors numbering nineteen (19) in 2012. There were also four (4) ex-officio members and two (2) courtesy members. *See* DOH Initial Application Exhibit 3. The sole member of the Westerly Hospital Foundation is the Westerly Hospital.²⁰ Minutes beginning in January 2011 for the Westerly Hospital Foundation were provided and reviewed. The Foundation generally is operated by a Board of Directors and has an Executive Director and small staff. It serves several important purposes to the Hospital and has performed functions such as public relations and marketing, which are not traditionally done by a hospital foundation.²¹ Its main purpose is fundraising, including oversight of planned giving to the Westerly Hospital. Total gifts received by the Westerly Hospital Foundation in 2011 were over \$2 Million Dollars. *See* AG Initial Application, Supplemental Exhibit 3. Nick Stahl, Executive Director and Jennifer Schwindt, Chair of the Foundation Board of Directors were interviewed. The Attorney General finds that continuation of the Westerly Hospital Foundation is in the best interests of Westerly Hospital.

b. The Auxiliary

The Westerly Hospital Auxiliary is a Rhode Island non-profit corporation that was incorporated on December 6, 1983. Its stated purpose²² is:

²⁰ *See* Section 2.1 of the Westerly Hospital Foundation Bylaws, AG Initial Application Supplemental Exhibit 1.

²¹ Assertions in this Section are based upon information provided in the minutes of meetings of the Westerly Hospital Foundation Board of Directors as well as interviews.

²² *See* Paragraph 3 of the Westerly Hospital Auxiliary's Articles of Association.

fostering, encouraging and increasing the community's understanding of The Westerly Hospital, (the "hospital") promoting greater involvement in the services of the hospital, helping provide supplementary financial assistance for hospital projects, giving services to the hospital in cooperation with and support of other volunteers, and assisting the hospital and any charitable organization affiliated with the hospital in such manner as the directors may determine.

The Westerly Hospital Auxiliary was not a named entity in the Special Mastership and has continued to operate throughout the Special Mastership. The Westerly Hospital Auxiliary was governed by a Board of Directors numbering sixteen (16) in 2012. *See* DOH Initial Application Exhibit 3. The sole member of the Westerly Hospital Auxiliary is the Westerly Hospital.²³ Minutes beginning in January 2011 for the Westerly Hospital Auxiliary were provided and reviewed. Mary Lou Walters, President of the Auxiliary, was interviewed by the Attorney General. In general, the Auxiliary is comprised of numerous volunteer Auxiliary members who pay dues to support the mission of the Auxiliary. It serves several important purposes to the Hospital, among those are operation of the gift shop, raising money for medical equipment and supplies requested by the Hospital, providing scholarships and holding a number of annual events and fund raisers in support of the Hospital.²⁴ The Attorney General finds that continuation of the Westerly Hospital Auxiliary is in the best interests of Westerly Hospital.

c. The Westerly Hospital

In addition to the assets held by the Westerly Hospital Foundation and the Westerly Hospital Auxiliary, the Westerly Hospital also has a variety of sources of charitable assets. Pursuant to the Westerly Hospital Consolidated Balance Sheet, dated September 30, 2012, Total Restricted Assets for the Westerly Hospital were Twelve Million Four Hundred Seventeen Thousand Fifty-two Dollars (\$12,417,052). *See* DOH Initial Application, Supplemental Exhibit

²³ *See* Section 1 of the Westerly Hospital Auxiliary Bylaws, Supplemental Exhibit 2.

²⁴ Assertions in this Section are based upon information provided in the minutes of meetings of the Westerly Hospital Auxiliary Board as well as interviews.

9(b). Voluminous detailed information regarding these charitable assets was provided in response to questions posed by the AG Initial Application and resulting follow-up questions. It will not be outlined in detail herein, but was thoroughly reviewed.

A significant portion of the charitable assets of the Westerly Hospital consists of four (4) trusts (the "Trusts") that are outlined in Section B(2)(c)(i)-(v) below. Also, the AG Initial Application identified charitable assets in addition to the Trusts of approximately \$5.6 Million Dollars.²⁵ These assets consist of either cash earnings on specific balance funds, accumulated earnings on permanent endowment funds or specific fund balances. Each amount is currently held subject to restriction for a particular purpose or donor intent. The balance of these funds has been diminished over the past few years to pay for hospital operations Id. For example, the balance of these funds in September of 2009 was approximately \$8 Million Dollars. Id. According to information in the AG's Initial Application, it appears that these amounts were disbursed from funds in accordance with any applicable restriction or with donor intent (which was sometimes unrestricted, i.e. for hospital operations).

During the review of the AG Initial Application, there were some amounts of restricted assets held by the Westerly Hospital for which no documents exist outlining the restriction. Accordingly, the specific purpose of such funds is unknown. The amount of funds of this nature is as follows: Westerly Health Promotion, \$4,049;²⁶ Morgan Fund Donations \$6,314 and Westerly Community Endowment, \$890,892.²⁷ It is not within the norm to have restricted funds

²⁵ Total amounts dated as of December 31, 2012, contained in a chart at Bates Stamp number RIAGSUC 1000002 in Supplemental Confidential Exhibit 4. At the request of the Attorney General the parties consented to this one page chart being deemed public.

²⁶ This amount was as of September 30, 2011, but is currently \$0 as it was utilized as outlined in the next paragraph.

²⁷ Information provided from AG Initial Application Supplemental Confidential Exhibit 4, (Bates Stamp number RIAGSUC 1000002).

whose legal documentation is not retrievable and therefore, apparently its restrictions are not known. It is not acceptable to the Attorney General to hand this problem to L&M. Fortunately, some funds are held under names that provide a clue to the possible purpose of the fund, i.e., the Westerly Health Promotion Fund. The most significant of these is the Westerly Community Endowment. During the cy pres process, the Transacting Parties and the Attorney General will resolve this issue and assign a purpose to these funds in order for L&M to have the ability to fulfill its promise to use charitable assets in accordance with donor intent. The Attorney General will request that a hearing be held on the cy pres where the public may appear and comment. On a going forward basis L&M should institute procedures at the Westerly Hospital to hold and manage charitable assets appropriately, including to ensure that this issue does not arise again.

Another issue involving the Westerly Hospital charitable assets discovered during the Initial Application process was a decision made by the Special Master to close certain small accounts containing restricted assets due to the administrative expense of keeping these accounts open. This decision was justified, in essence, by the assertion that the amounts had already been spent for the purposes required and therefore could be considered unrestricted and transferred to general hospital operations. *See* Response to Question 24 of the AG 1st Set of Supplemental Questions. While the amounts of these accounts may be considered small and the reasoning for closure makes practical sense, after the fact justification for the expenditure of charitable assets is not the preferred course. This was not an issue created by the Special Master, but one he had to deal with. These accounts could have been spent prospectively as required by their restrictions with concrete evidence that they were used in accordance with donor intent. Individuals give donations with particular purposes in mind, and, at times, the amount of a donation may not be considered enough to a particular institution to manage the administrative burden of grappling

with specific purposes of a donation. However, in accepting a gift, the institution obligates itself to implement the donor's intent. (*See, e.g., People's Sav. Bank v. Webb et al.* 21 R.I. 218, 218 (1899) "[w]here one appears to have made a purely gratuitous disposition of his funds for the benefit of another, free from any legal or moral obligation to the donee, the act should be construed with liberality, rather than with strictness, towards the original owner. If he has completed a trust or gift, a court must execute it. If it is inchoate, there is nothing for a court to carry out. The underlying question, both in trusts and gifts, is the intention and act of the donor.") Again, on a going forward basis, L&M should institute procedures at the Westerly Hospital to hold and manage charitable assets appropriately, including to ensure that this issue does not arise again.

There are a number of planned gifts currently expected by the Westerly Hospital that will be transferred pursuant to Section 1.2(p) of the APA. These particular planned gifts are outlined in Schedule 1.2(p) of the APA.²⁸ The value of the majority of the planned gifts is unknown as, at this point, they are merely expectations of future gifts.

i. The Trusts

Within the AG Initial Application at Exhibit 3, the Transacting Parties have provided a draft *cy pres* petition²⁹ (the "Petition") to be filed with the Superior Court.³⁰ The Petition identifies four (4) trusts, namely: (1) the Charles A. Morgan Trust ("Morgan Trust"), (2) the Louise D. Hoxsey Trust f/b/o Foundation Fund for a Hospital in Westerly Rhode Island (Hoxsey

²⁸ This APA Schedule was deemed confidential.

²⁹ A *cy pres* petition is requested by Question 3 of the Initial Application and a draft petition was provided by the parties. The Transacting Parties and the Department of Attorney General will coordinate the filing of a final *cy pres* petition that is consistent with this Decision and the Conditions contained herein.

³⁰ The *cy pres* petition will also address naming rights regarding past gifts. In Response to Question 5 of the AG 1st Set of Supplemental Questions, L&M has stated that they have no plans to change or remove the names associated with the gifts associated therein.

Trust”), (3) the Howard E. Thorp Trust (“Thorp Trust”) and (4) the Irene Vose Trust (“Vose Trust”)(collectively, the “Trusts”). The Trusts total approximately Four Million Dollars (\$4,000,000).³¹

ii. Morgan Trust

As outlined in the Petition and evidenced by the documents provided with the AG Initial Application, the Morgan Trust was a bequest to the Westerly Hospital from Charles A. Morgan with its purpose “for the furnishing of free hospital services to such members of the public as may be in need thereof, and unable, in whole or in part to pay for such service.” *See* Petition, Para. 11. As stated in the Petition, the funds in the Morgan Trust total approximately Three Million Four Hundred Thousand Dollars (\$3,400,000). *See* Petition, Para. 13. The Petition requests that, after the Proposed Transaction, LMW Healthcare Inc., be substituted for the Westerly Hospital as beneficiary of the Morgan Trust. *See* Petition at Request for Relief, Para. 2.

iii. Hoxsey Trust

As outlined in the Petition and evidenced by the documents provided with the AG Initial Application, the Hoxsey Trust was a trust fund established by Louise D. Hoxsey for the purpose “establishment and maintenance of a hospital” in Westerly. *See* Petition at Para. 18. As stated in the Petition, the funds in the Hoxsey Trust total approximately One Hundred Eighty-Five Thousand Dollars (\$185,000). *See* Petition Para. 17. The Petition requests that, after the Proposed Transaction, the Hoxsey Trust be dissolved and all of its funds be placed in a restricted account to be held by LMW Healthcare Inc., and used “solely for the maintenance of a hospital

³¹ Total amounts dated as of December 31, 2012, contained in a chart at Bates Stamp number RIAGSUC 1000002 in Supplemental Confidential Exhibit 4. At the request of the Attorney General the parties consented to this one page chart being deemed public.

in Westerly in accordance with Ms. Hoxsey's intentions." *See* Petition at Request for Relief, Para. 3.

iv. Thorp Trust

As outlined in the Petition and evidenced by the documents provided with the AG Initial Application, the Thorp Trust was a trust created by a bequest to the Westerly Hospital from Howard E. Thorp. Washington Trust serves as the trustee. The net proceeds from the trust are divided annually into five (5) equal parts, one of which is to be paid to the Westerly Hospital. *See* Petition, Exhibit C. As stated in the Petition, the funds in the Morgan Trust allocated to the Westerly Hospital total approximately Seven Thousand Seven Hundred Dollars (\$7,700). *See* Petition, Para. 22. The Petition requests that, after the Proposed Transaction, all of its funds be placed in a restricted account to be held by LMW Healthcare Inc., and used "solely in accordance with Mr. Thorp's intentions." *See* Petition at Request for Relief, Para. 4.

v. Vose Trust

As outlined in the Petition and evidenced by the documents provided with the AG Initial Application, the Vose Trust was a trust created by a bequest to the Westerly Hospital from Irene Vose. Rhode Island Foundation currently serves as the trustee. The net proceeds from the trust are divided annually into three (3) equal parts, one of which is to be paid to the Westerly Hospital "for general hospital purposes". *See* Petition, Exhibit D. As stated in the Petition, the funds in the Vose Trust allocated to the Westerly Hospital total approximately Fifty-Five Thousand Dollars (\$55,000). *See* Petition, Para. 27. The Petition requests that, after the Proposed Transaction, LMW Healthcare Inc., be substituted for the Westerly Hospital as beneficiary of the Vose Trust. *See* Petition at Request for Relief at Para. 5.

d. L&M

As stated above, the proposed buyer, LMW Healthcare, Inc., is a non-profit Rhode Island corporation whose corporate parent and sole member is the Lawrence + Memorial Corporation. Lawrence + Memorial Corporation is a non-profit Connecticut corporation. L&M had a separate foundation corporation, Lawrence and Memorial Foundation, Inc., that was formed in the 1980s, but never commenced operations.³² According to L&M, all unrestricted gifts are deposited in a development fund held by the parent, Lawrence + Memorial Corporation and all designated funds are deposited with Lawrence + Memorial Hospital in reserve accounts.³³ The funds are managed by the Finance Department of the Lawrence + Memorial Hospital. The Office of Development and Community Relations includes within its responsibilities the development of charitable gifts to the Lawrence + Memorial Hospital. Id. The Office is run by Vice President, Development and Community Relations, William A. Stanley. Id. Mr. Stanley has held this position since 1999. Id. The Attorney General interviewed Mr. Stanley in the context of this Proposed Transaction.

Lawrence + Memorial Hospital also has an auxiliary supporting its hospital, namely the Auxiliary of the Lawrence and Memorial, Inc.³⁴ It is a separate corporation and has approximately 400 members.³⁵ It has been in existence since 1914. Id. Its general purpose is to “support Lawrence + Memorial Hospital and help to fulfill its mission statement, especially in its effort to improve the health of the region’s population.”³⁶ Accordingly, L&M has experience

³² See Response to Question 6 of the DOH Initial Application. See also, Response to Question 4 of the AG 3rd Set of Supplemental Questions.

³³ See Response to Question 4 of the AG 3rd Set of Supplemental Questions.

³⁴ See Response to Question 1 of the AG 3rd Set of Supplemental Questions.

³⁵ See Responses to Questions 1 and 2 of the AG 3rd Set of Supplemental Questions.

³⁶ See Response to Question 3 of the AG 3rd Set of Supplemental Questions.

with interacting with a hospital auxiliary and due to its long relationship with its own auxiliary, likely understands the value of such organization.

No adverse action against L&M has been reported to the Attorney General through the Initial Application process or otherwise through this review process. Further, independent research did not reveal any such information. In addition, regarding its handling of charitable assets, L&M has certified that in the past 14 years, it has not been “involved with or threatened with any form of legal action involving the use of charitable and/or restricted (designated) assets” *See* Response to Question 41 of the AG 1st Set of Supplemental Questions.

3. Documents Governing Proposed Disposition

a. APA Provisions

The APA governs the expectations regarding the disposition of the charitable assets in the Proposed Transaction. *See* APA, Section 10.2. With regard to the Westerly Hospital Foundation and the Westerly Hospital Auxiliary, as stated above, while these entities were not directly included in the Special Mastership they are direct subsidiaries of the entities within the Special Mastership. Therefore, the assets of the Westerly Hospital Foundation and the Westerly Hospital Auxiliary will pass to LMW Healthcare, Inc., through the APA.

Not only does the APA impact the assets of Westerly Hospital Foundation and the Westerly Hospital Auxiliary, but the APA governs substantially all of the assets of the Westerly Hospital Healthcare and the Westerly Hospital, including the charitable assets. For example, among the defined assets in the APA are:

Any right to receive or expectancy of the Sellers in any charitable gift, grant, bequest or legacy (including any income or remainder interest in or under any trust or estate) (i) listed on Schedule 1.2(p) or (ii) received or arising after the date hereof that is specifically designated by the terms of such gift, grant, bequest or legacy to be applied or used solely in respect of the Business and not the Excluded Assets.

See APA at Section 1.2(p).

In addition, Section 5.6 of the APA specifically requires that the Special Master “use his best efforts to cause Buyer to become the successor beneficiary to the Sellers under that certain Charles A. Morgan Trust.” L&M has promised to “use the trust funds according to the terms of the Trust and in accordance with the donor’s intent.” *See* AG Initial Application Response A-4.

b. Initial Application

It has been represented in the AG Initial Application that the charitable assets of the Westerly Hospital will be transferred to LMW Healthcare, Inc., after the proposed conversion. *See* AG Initial Application Response to Question 2. It is further stated that “[t]he charitable assets will be managed in the same manner that they were managed prior to the conversion and consistent with the donors’ intent.” *Id.* L&M has agreed to continue the current practice of the Westerly Hospital whereby restricted funds and gifts “are being accounted for and separated, to be spent only for the donor restricted purposes”. *See* AG Initial Application Response to Question A-3.

Pursuant to the LMW Healthcare Bylaws, Lawrence + Memorial Corporation is the sole member of LMW Healthcare. Accordingly, the Bylaws provide to Lawrence + Memorial Corporation expansive reserved powers. *See* LMW Healthcare Bylaws, Exhibit 2 to the DOH Initial Application. With regard to charitable assets, the Bylaws specifically include the powers to:

- [a]pprove the philosophy, mission and values of the Hospital and any change thereto (Section 1.02(a)).
- [o]versee the Hospital’s use, management and investment of its permanent and temporarily restricted endowment funds (Section 1.02 (l)).

Therefore, if the Proposed Transaction is approved as requested, LMW Healthcare, Inc., whose sole member is Lawrence + Memorial Corporation, will become the successor beneficiary to the assets outlined above. As the sole member of LMW Healthcare, Inc., Lawrence + Memorial Corporation will have the specific ability to oversee the Westerly Hospital's use, management and investment of its permanent and temporarily restricted endowment funds.

c. Disposition of Charitable Assets

L&M is an established non-profit entity in existence for almost 100 years. *See* DOH Request for Expeditious Application Attachment 4, dated September 6, 2012. It has a current program in place to manage charitable assets held by its hospital that appears to be successful. There were no red flags uncovered regarding its management or use of charitable assets through the Initial Application process. The disposition of the charitable assets will be governed by the provisions of the APA, Orders of the Court and the Conditions outlined in this Decision, including certain oversight by the Attorney General. They will also be subject to a cy pres petition process that will take place after this Decision is rendered. All of these mechanisms together are designed to ensure that charitable assets are used for their intended purpose and will continue to be utilized to benefit the Westerly Hospital.

With regard to the issue of proceeds, the Hospital Conversion Act addresses the situation whereby a for-profit purchases a non-profit and there are "proceeds" of the sale. *See* R.I. Gen. Laws § 23-17.14-22. In the instant situation, there is a certain amount of cash that will stay with the Mastership Estate post-conversion. Due to the nature of a special mastership, it is unknown at this time whether any of that cash will remain after the Mastership is complete. In that remote possibility, the Special Master has agreed that any amount remaining in the Special Mastership prior to dissolution will be donated to the Westerly Hospital Foundation.

4. Maintenance of the Mission, Agenda and Purpose of the Westerly Hospital

The full review contained in the Hospital Conversion Act at R.I. Gen. Laws §§ 23-17.14-7(c)(16) and 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.

As with other factors contained within the full review, the Attorney General has chosen to apply these standards in review of the Proposed Transaction.

According to the original Articles of Association for the Westerly Hospital, the organization's purpose states:

Said corporation is constituted for the purpose of establishing and maintaining a hospital in the Town of Westerly; of rendering medical and surgical aid to those in need thereof especially those unable to pay therefore; and of otherwise carrying out the charitable and humane intentions of the corporation; and of receiving and applying for the above purposes, gifts, devises and bequests of money or property and the income and principal of any trust fund or funds now or hereafter available for the establishment, maintenance or support of a hospital in said Westerly.

See DOH Initial Application Exhibit 2. More generally included in the information provided in the AG Initial Application, the current mission statement of the Westerly Hospital is to

“[C]ompassionately provide a superior standard of community healthcare across generations.”³⁷

Technically, the Westerly Hospital assets are being sold to LMW Healthcare, Inc. Its corporate purpose is stated as:

The purpose is to establish, maintain and carry on an institution with permanent facilities for inpatients and ambulatory patients, with medical services to provide diagnosis and treatment, to carry on all associated services, and to engage in any lawful at or activity for which a corporation may be organized under the Rhode

³⁷ See Response to Question 1(a) of the AG 1st Set of Supplemental Questions.

Island Nonprofit Corporation Act, as the same may be amended from time to time.

Because LMW Healthcare, Inc. was created to hold the assets of the Westerly Hospital, in essence Lawrence + Memorial Corporation as the sole member of LMW Healthcare, Inc. will have significant control over LMW Healthcare, Inc. Lawrence + Memorial Corporation provided as its mission statement to “improve the health of this region.”³⁸ According to its Articles of Certificate of Incorporation, Lawrence + Memorial Corporation’s official corporate purpose is stated as:

Sec. 2. The nature of the activities to be conducted, or the purposes to be promoted or carried out by the Corporation shall be exclusively charitable, scientific and educational within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as the same may be amended from time to time, and the corresponding provisions of any future United States Internal Revenue Law (the “Code”) and shall include the following:

(a) To benefit, perform the functions of, carry out the purposes of, and uphold, promote and further the welfare, programs and activities of Lawrence + Memorial Hospital, Inc. (the “Hospital”) and the Hospital’s subsidiaries:

(i) By initiating, developing, recommending and carrying out for the Hospital goals and priorities for new or expanded programs for the benefit of the Hospital;

(ii) By continuously reevaluating, maintaining and revising a master plan for the programs and facilities of the Hospital;

(iii) By considering and recommending the acquisition of properties or the construction of facilities by or for the use of the Hospital;

(iv) By planning for the acquisition and placement of new facilities and equipment by or for the use of the Hospital; and

(v) By performing public relations work on behalf of the Hospital, and soliciting and receiving subscriptions and gifts for the exclusively charitable purposes of the Hospital.

(b) To initiate, develop, operate and maintain, for the Hospital and for other hospitals and health care facilities, programs directed toward improving the efficiency of

³⁸ See Response to Question 1(b) of the AG 1st Set of Supplemental Questions.

utilization of health care facilities and services in the State of Connecticut, and in New London County and surrounding areas in particular, and reducing the cost of health care to the public while maintaining a high quality of such care.

Accordingly, the Westerly Hospital's assets will be sold to a Rhode Island non-profit corporation, whose parent is also a non-profit corporation. All three entities have similar corporate purposes. In further consideration of whether the new entity will operate with a similar purpose, pursuant to Section 10.1 of the APA entitled "Commitment to The Westerly Hospital Mission as an Acute Care Community Hospital" L&M has agreed to maintain the Westerly Hospital as an acute care community hospital for a period of five (5) years after the Closing. In addition, L&M has agreed that for the term of two (2) years after the Closing to "not commit to discontinue any clinical service (including maternity) being provided by the Hospital as of the date of the Sale Order."³⁹

The Attorney General notes that despite the provision regarding termination of services, the Special Master, with the input of L&M, is currently seeking to terminate obstetrical labor and delivery services at Westerly Hospital starting June 1, 2013. *See* Supplemental Application for Approval from the Director of the Rhode Island Department of Health for Elimination of Obstetrical Labor and Delivery Services at Westerly Hospital. On April 15, 2013, the Director of the Department of Health decided to grant this request and deliveries at the Westerly Hospital will cease as of June 1, 2013.⁴⁰ Accordingly, given that L&M already has participated in

³⁹ This provision is not without significant caveat as the remainder of this section states:

so long as there are no safety or quality issues associated with provision of such clinical serve and so long as such clinical service is still being provided by the Hospital immediately prior to the Closing Date and so long as there are no safety or quality issues associated with provision of such clinical serviced based among other things, upon the volume of services provided in such a clinical setting as reviewed by the hospital Board.

⁴⁰ An Amended Decision was issued on April 16, 2013.

changing a service which the Westerly Hospital has provided for several generations, the Proposed Transaction includes a risk that L&M will change additional services provided at the Westerly Hospital. That is not to suggest that such change will violate the APA, it is simply the reality that the promise in the APA regarding clinical services comes with significant caveat.

Further commitments contained in the APA include Section 10.2 whereby L&M:

commits to continue the Hospital identity and name, nonprofit status and community mission. Buyer expects to carry out a broad-based community capital campaign in support of the foregoing and commits that all such funding will be raised in the Hospital's name and remain for the benefit of the Hospital nonprofit and community mission. Buyer commits to maintain charity care responsibilities and services consistent with level historically maintained by The Westerly hospital. Finally, any restricted funds or charitable bequests transferred to the Buyer as part of the Transaction shall be used for such purposes and in compliance with any and all restrictions for the benefit of the Hospital community.

Given the information outlined above, the Proposed Transaction is in keeping with the original purposes of the existing hospital.

B. GOVERNANCE

1. Prior to Special Mastership

A full review pursuant to the Hospital Conversions Act requires a review of the actions of the board of directors of the existing hospital.⁴¹ In addition, the expedited review requires information regarding the Transacting Parties' board of directors and their decision to propose conversion.⁴² Due to the circumstances in this Proposed Transaction, which involve the appointment of a Special Master for the Westerly Hospital, we have outlined the actions of the board of directors and the Special Master, including action taken before and after special mastership.

⁴¹ See e.g., R. I. Gen. Laws §§ 23-17.14-7(c) (3), (4), (5), (8), (9), (10), (11), (13), (14), (15), and (23).

⁴² See R. I. Gen. Laws § 23-17.14-12.1(b)(5).

The filing of a Petition for Special Mastership was the initial action leading Westerly to the Proposed Transaction.⁴³ Included in the AG Initial Application were certain board minutes of the Westerly Hospital for time periods immediately prior to the filing of the Petition for Special Mastership.⁴⁴ After review of the board minutes, the Attorney General is satisfied that the board fulfilled its fiduciary duties to the hospital in placing the hospital in special mastership.

2. Special Mastership

As a result of the board's decision, a Petition for Special Mastership was filed by Charles Kinney, then Chief Executive Officer and a Trustee of the Westerly Hospital.⁴⁵ At Paragraph 3 the Petition states that "[Westerly Hospital] has not generated a surplus for twenty (20) years and operated at a loss of over \$5,700,000.00 in its most recent fiscal year. Accordingly, [Westerly Hospital] has faced, and continues to face, financial distress because it is unable to pay its debts as they come due."⁴⁶ Accordingly, given that the Superior Court granted the Petition based upon the verified petition of the Chief Executive Officer of the Westerly Hospital and considering 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 hospital's continued survival.

Once appointed, the Special Master has, in essence, acted in the capacity of the board of directors at the hospital, making all major decisions with regard to the fate of Westerly Hospital with court approval of certain actions. The absence of a board of directors is not contemplated by the Hospital Conversion Act. In a full review, the Act requires review of the decisions

⁴³ See Petition for the Appointment of a Special Master, dated December 6, 2011.

⁴⁴ See AG Initial Application Confidential Exhibits 1 and 4. These minutes were determined to be confidential in accordance with R.I. Gen. Law §23-17.14-32.

⁴⁵ See Petition for the Appointment of a Special Master, dated December 6, 2011.

⁴⁶ See Id. at Para. 3.

leading up to a conversion to ascertain whether the directors fulfilled their fiduciary duties to the hospital. Similarly, in an expedited review the Transacting Parties are required to submit an application to DOH that provides “all documents, reports, meeting minutes and presentations relevant to the transacting parties’ board of directors’ decision to propose the conversion.”⁴⁷ Because the Special Master has taken on the responsibility of the board, the Attorney General will review his actions taken in its place.

In reviewing the actions of the Special Master in pursuing a conversion, the Attorney General prefaces these remarks with the fact that a conversion certainly appeared inevitable given the filing of the Petition for Special Mastership. However, as described in greater detail earlier in the Decision, this Special Master took an active role in repositioning the Westerly Hospital from the start. He included input from a variety of sources, such as the advisory committees set up through the Court. He developed and gained Court approval for a process to find either a purchaser for the Westerly Hospital, or in the right circumstances, a strategic partner. That process ultimately resulted in a bid from L&M that retained the Westerly Hospital as an acute care community hospital for a period of five (5) years and secured other obligations. This process from its inception has moved with all deliberate speed and will likely conclude within a year and a half from the filing of the Petition for Special Mastership. The actions of the Special Master were in the best interests of the Westerly Hospital. If the Proposed Transaction takes place as contemplated, this Special Mastership represents a great success for the Westerly Hospital and the people it serves.

⁴⁷ See R.I. Gen. Laws § 22-17.14-12.1(b)(5).

3. New Entity

The Attorney General also reviewed the proposed corporate governance of the new hospital after the completion of the Proposed Transaction including the conversion's impact on bylaws and articles of incorporation and board of directors.⁴⁸

a. Bylaws and Articles of Incorporation

One issue that should be examined is the proposed new entity's bylaws and articles of incorporation. The new corporate entities that will purchase the assets of Westerly Hospital and Westerly Hospital Healthcare are LMW Healthcare, Inc., LMW Physicians, Inc.⁴⁹ respectively and their parent, Lawrence + Memorial Corporation. As stated above, LMW Healthcare, Inc. is a Rhode Island corporation. *See* DOH Initial Application Exhibit 2. The Transacting Parties have submitted the current bylaws for LMW Healthcare, Inc. *See* DOH Initial Application Exhibit 2(e). In addition, the relevant corporate documents have been provided for Lawrence + Memorial Corporation and LMW Physicians, Inc. *See* DOH Initial Application Exhibits 2, Supplemental 2(c) and Supplemental 2(e).

b. Board Composition

The Hospital Conversions Act includes several provisions requiring analysis of the composition of the new board.⁵⁰ The post-conversion board composition for the Westerly Hospital and Lawrence + Memorial Corporation is addressed in several transaction documents including the APA, the Order Approving the Sale of the Westerly Hospital and the Related

⁴⁸ *See e.g.*, R. I. Gen. Laws §§ 23-17.14-7(c)(25) (i), (v), (vi), (vii), (viii), and (ix).

⁴⁹ LMW Physicians, Inc., was originally formed to hold the certain assets of the Westerly Hospital medical practices, however, the Transacting Parties have indicated that the practices will join the current L&M physician group instead. *See* AG Initial Application Question 2.

⁵⁰ *See e.g.*, R. I. Gen. Laws §§ 23-17.14-7(c)(25)(vi), (vii), (viii) and (ix).

Entities Free and Clear of Liens and Liabilities⁵¹ (“Sale Order”) and the bylaws of LMW Healthcare, Inc.⁵² and Lawrence + Memorial Corporation. For example, APA Section 10.3 states as follows:

Commitment regarding Post-Closing Governance: Post Closing, The Westerly Hospital and Related Entities shall be reestablished as subsidiaries of Buyer’s parent. Buyer commits that post-Closing, representatives of the Westerly community shall be included in the reconstituted Board of the Hospital (the “Hospital Board”), as well as the Buyers’ parent’s Board.

See also, Sale Order Paragraph 6 pages 2-3:

A commitment to establish a Hospital Board with members drawn from residents of the Westerly service area. Moreover, a commitment to put residents of the Westerly service area on the reconstituted Board of Trustees of the Hospital as well as the Board of Trustees of the Buyer’s parent.

Further, the Attorney General notes that the Report of the Committee of the Health Services Council on the Application of Lawrence + Memorial Corporation for Change in Effective Control of The Westerly Hospital, dated April 2013, contains, as a condition of approval, at Condition #5:

LMW Healthcare shall comply with the Buyer Commitments as defined in the September 10, 2012 [Sale Order] and identified in Section 10 of the Asset Purchase Agreement by and among [the Transacting Parties] dated as of June 20, 2012, and for the time periods set forth therein.

While each corporation’s bylaws, which were revised and approved by each board in November of 2012, contain the requirements regarding the composition of their respective board of directors,⁵³ the APA and Sale Order specifically express the commitment to include board members from the Westerly Hospital Service Area.

⁵¹ The Order Approving the Sale of the Westerly Hospital and the Related Entities Free and Clear of Liens and Liabilities, dated September 6, 2012.

⁵² *See* DOH Initial Application, Exhibit 21.

⁵³ *Id.*

In Response to Question 13 of the AG Initial Application, the Transacting Parties state that specific board seats for the post-conversion Westerly Hospital have not yet been assigned to particular individuals. However, an Ad Hoc Governance Subcommittee of the Lawrence + Memorial Corporation has proposed the following regarding governance post-conversion for Lawrence + Memorial Corporation:

- A. The members of the L + M Corporation Board of Directors would be elected by the Corporators.
- B. There would be one universe of Corporators for the L + M system of health care.
- C. Currently, the Corporators consist of approximately 175 members. It is recommended that the membership increase to between 200 and 225 with the increased membership coming from The Westerly Hospital service area. Over time, the membership of the Corporators would be reduced to the current level of about 175 through attrition in the ranks of the membership from the L + M service area.
- D. The Nominating Committee for the Corporation would accept recommendations for the initial new members of the Corporators from interested stakeholders in the Westerly Hospital service area, including the Westerly Hospital Area Residents Committee and The Westerly Hospital Foundation.
- E. The Corporators would elect 3 members to the parent board from a list of up to 15 individuals from The Westerly Hospital service area suggested to the L + M Corporation nominating committee.
- F. The Corporators would elect 6 members to the L + M Corporation Board of Directors from a list of up to 15 individuals from the L + M Hospital service area suggested to the L + M Corporation nominating committee.
- G. Members of the L + M Corporation Board of Directors would elect the officers of said board from among its membership.

See AG Initial Application Exhibit 13.

Additionally, the Sub-committee provided recommendations for the Westerly Hospital board post-conversion. This included a board consisting of eleven (11) directors as follows:

- 1 System CEO, who will also be CEO of The Westerly Hospital;
- 1 Hospital Senior Executive;
- 3 medical staff members (as per L + M Hospital current practice the President, Past President, and Vice President of medical staff);
- 6 community directors with appropriate skill sets.

See AG Initial Application Exhibit 13.

The Sub-committee also provided recommendations for the post-conversion L + M Corporation's board of directors to be revised to consist of sixteen (16) directors as follows:

- ex officio members (system CEO, L + M Hospital Board Chair, The Westerly Hospital Board Chair, and Visiting Nurses Association of Southeastern Connecticut, Inc. Board Chair; L + M Physicians Board Chair);
- 2 MDs (one per each of L + M Hospital and The Westerly Hospital selected from a group of 5 candidates from each hospital proposed by respective medical staff);
- 9 Community members with desired skill sets (6 community directors from L + M service area and 3 community directors from The Westerly Hospital service area).

See AG Initial Application Exhibit 13.

Although particular individuals have not yet been chosen, a method for selecting board members has been provided and includes representatives of the hospital medical staff and community members with ties to the Westerly Hospital Service Area. Therefore, the Attorney General is satisfied with the board composition of the Westerly Hospital to be instituted post-conversion. The Attorney General is also assured by representation on the new Westerly

Hospital's parent board, Lawrence + Memorial Corporation, of members from the Westerly Hospital Service Area.

C. CONFLICTS OF INTEREST

Several provisions of the Hospital Conversions Act governing a full review deal with conflicts of interest that are applicable in an expedited review.⁵⁴ The expedited review also requires information regarding conflicts of interest.⁵⁵ The Attorney General has reviewed the criteria in the Act to determine whether the Transacting Parties and their consultants have avoided conflicts of interest.

Both Westerly and L&M provided their corporate conflict of interest policies along with the AG Initial Application. Additionally, certain individuals associated with the Transacting Parties were required to submit conflict of interest forms. These included officers, directors and senior management for Westerly and L&M. Individuals completing the conflict of interest forms were asked to supply 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. Westerly submitted forty-seven (47) executed conflict of interest forms and L&M submitted thirty-seven (37) forms. All forms submitted were signed and notarized. After reviewing all forms, the Attorney General determines that none of the submitted materials revealed any conflict of interest.

Throughout the Special Mastership process, the Attorney General monitored issues that could result in the possibility of a conflict of interest. On behalf of Westerly Hospital, the Special Master engaged consultants to assist and guide him through the mastership and the proposed conversion. For example, early on in the mastership Ralph Palumbo, from the

⁵⁴ See e.g., R.I. Gen. Laws §§ 23-17.14-7(c) (6), (7), (12), (22) and (25) (iv).

⁵⁵ See R.I. Gen. Laws §§ 23-17.14-12.1(b)(6) and (9).

accounting firm of DiGennaro & Palumbo LLP (“D&P”),⁵⁶ was retained by the Special Master “to address payables, cash flow reporting, and cash flow projections.”⁵⁷ In an email to the Stakeholders attached to the Second Interim Report recommending the engagement of D&P, the Special Master disclosed that Attorney Vincent Indeglia, who is affiliated with the Special Master’s firm, Ferrucci Russo P.C., utilizes D&P for his personal accounting and has a business interest in an entity that also involves Ralph Palumbo.⁵⁸ Within that email correspondence the Special Master stated that despite Attorney Indeglia’s relationship with D&P, he did not feel there was a conflict of interest.⁵⁹ Neither Mr. Indeglia nor Mr. Palumbo disclosed any information regarding their relationship on the Conflict of Interest Statements provided to the Attorney General, nor did either note any monetary benefit, other than payment for services rendered, in connection with the Proposed Transaction.

Transition Healthcare Company, LLC (“Transition”) was also retained as a consultant by the Special Master.⁶⁰ Thomas Reardon and Barbara Groux from Transition were hired to analyze and to provide advice regarding the hospital’s financial operations.⁶¹ In the Special Master’s Report wherein he recommended the engagement of Transition, he disclosed that Ferrucci Russo P.C., the Special Master’s law firm, had previously represented an entity which Transition was involved with relative to an offer to purchase Landmark Medical Center.⁶²

⁵⁶ See Second Interim Report of the Temporary Special Master, dated December 23, 2011.

⁵⁷ See, Special Master’s First Interim Report, dated January 13, 2012.

⁵⁸ Id.

⁵⁹ Id.

⁶⁰ See Order granting the Special Master’s Petition for Instructions regarding Retention of a Consultant to Assist in the Marketing and Sales/Strategic Partnership/Reposition of the Westerly Hospital and Related Entities, dated March 12, 2012.

⁶¹ Id.

⁶² See Special Master’s Report and Recommendation to Stakeholders and Interested Parties Regarding Retention of a Consultant to Assist in the Marketing and Sale/Strategic

Rather than viewing that arrangement as a negative or as a conflict, the Special Master commented that Transition's prior experience with the Rhode Island mastership process would be a useful asset in the current proceeding.⁶³ It was represented by the Special Master that Transition would not bid on the Westerly Hospital.

A final circumstance in the course of the Special Mastership that required disclosure by the Special Master again involved Attorney Indeglia and his affiliation with an outside vendor. On August 6, 2012, the Special Master filed a Petition for Instructions Regarding a Conflict of Interest. The Petition explained that AMG had been operating without employees performing accounting and bookkeeping functions for approximately one year. At some point, the Special Master classified the circumstances as "exigent" and without conducting an extensive search, he retained American Labor Services, Inc. ("American Labor"), a temporary staffing company owned in part by Mr. Indeglia.⁶⁴ Unfortunately, American Labor placed a temporary employee at AMG who allegedly engaged in criminal activity.⁶⁵ Admittedly, the choice of another temporary labor company may not have avoided this from happening but as the Attorney General stated in its Response to the Special Master's Petition, had the Special Master sought the Court's permission to retain American Labor, their engagement would have been subject to review by this Court and this situation may have been avoided.⁶⁶ Ultimately the Court issued an Order instructing the Special Master to avoid engaging any additional business entities affiliated with

Partnership/Repositioning of the Westerly Hospital and Related Entities, heard February 28, 2012.

⁶³ *Id.*

⁶⁴ *See* Petition for Instructions with Regard to Addressing a Conflict of Interest, dated August 6, 2012.

⁶⁵ *Id.*

⁶⁶ *See* Response of Attorney General to Special Master's Petition for Instructions with Regard to Addressing a Conflict of Interest, dated August 24, 2012.

the Special Master or the Law Firm of Ferrucci Russo P.C. or the Law Offices of Vincent Indeglia without further court approval.⁶⁷

Other than the events outlined above, no other significant issues arose regarding conflict of interest during the Special Mastership or were revealed in the hospital conversion expedited review process.

V. CONCLUSION

As stated above, this is the first expedited review pursuant to the Hospital Conversions Act. The Attorney General and the Department of Health chose to work together on this review to the significant benefit of the parties. One downfall of the expedited review process is the splitting of the Attorney General and Department of Health's reviews. This may become an issue with future administrations where there is not the unprecedented cooperation and coordination of these Departments. Without this voluntary cooperation, this process could prove to be burdensome, inefficient and possibly contradictory. The Attorney General has endeavored to make the expedited review process work in the most practical way possible and has utilized the statutory provisions of a full review as appropriate for consistency.

This review represents one of three reviews currently being processed by the Attorney General, with a fourth reportedly forthcoming. It is clear that the landscape of hospitals in Rhode Island is changing. With the trend toward pushing care to settings other than hospitals, Rhode Island hospitals will by necessity have to adapt. The instant flurry of hospital conversions is only one way in which healthcare will change in the future for the people of the State of Rhode Island. Hopefully, these changes taken together will result in better healthcare for all Rhode Islanders and the continued success of our hospitals.

⁶⁷ See Order, dated September 12, 2012.

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

VI. CONDITIONS

1. That the Proposed Transaction be implemented as outlined in the AG Initial Application.
2. 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.
3. The closing of the Proposed Transaction shall take place by June 1, 2013.
4. A cy pres petition be filed and granted prior to closing of the Proposed Transaction. The filing of such cy pres petition shall be coordinated with the Attorney General and shall be in accordance with the Conditions outlined in this Decision.
5. L&M shall to continue utilize the Westerly Hospital identity and name, nonprofit status and community mission.
6. With input from the Westerly Hospital Foundation, L&M will carry out a broad-based community capital campaign in support of the Westerly Hospital and all such funding will be raised in the Westerly Hospital's name and remain for the benefit of the Westerly Hospital nonprofit and community mission.
7. L&M, in coordination with the Westerly Hospital Foundation, shall institute procedures at the Westerly Hospital to hold and manage charitable assets appropriately, including to ensure that charitable assets are used in accordance with donor intent.
8. All charitable assets transferred by the Asset Purchase Agreement shall be utilized for the benefit of Westerly Hospital only.
9. Current and future charitable assets of the Westerly Hospital shall not be utilized for projects or programs situated outside the State of Rhode Island without the consent of the Department of Attorney General.
10. The Westerly Hospital Foundation, Inc., and the Westerly Hospital Auxiliary, Inc., not be dissolved or otherwise significantly altered from their current operations for a period of five (5) years without notice to and consent of the Attorney General.


11. The assets of the Westerly Hospital Foundation, Inc. be held by the Westerly Hospital Foundation, Inc., in its own accounts and not those of the Westerly Hospital or LMW Healthcare, Inc. The parties shall have thirty (30) days to comply with this Condition after the Closing.
12. For the next five (5) years, the Attorney General shall be provided notice of any singular or aggregate in any one year of use of \$200,000 in restricted funds, including the amount, use and certification of compliance with the fund's restriction.
13. The Board of Directors⁶⁸ of LMW Healthcare, Inc. shall include at least six (6) community directors all of which shall: (i) be independent of and not employed by or affiliated with L&M or its affiliates; and (ii) not be an elected official or an individual that is subject to the Rhode Island Code of Ethics.
14. The Board of Directors of Lawrence + Memorial Corporation shall have two community directors⁶⁹ from the Westerly Hospital Service Area who shall (i) be independent of and not employed by or affiliated with L&M or its affiliates; and (ii) not be an elected official or an individual that is subject to the Rhode Island Code of Ethics.
15. For the next three (3) years, the Transacting Parties shall 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, including the Special Master, his law firm and its affiliates.
16. All Westerly entities identified subject to Special Mastership 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. Any assets of these entities remaining prior to dissolution shall be donated to the Westerly Hospital Foundation.
17. For a period of five (5) years, LMW Healthcare Inc. and L&M provide corporate documents requested by the Department of Attorney General to evidence the changes to the boards of such entities required by the AG Initial Application and this Decision. In addition, LMW Healthcare Inc. and L&M shall provide any proposed amendments to their corporate documents 30 days prior to amendment.

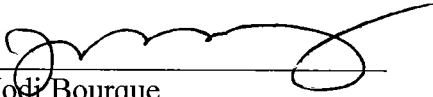
⁶⁸ A community director shall be defined as an individual that resides or works within the Westerly Hospital Service Area and has the appropriate skill sets to serve on a hospital's board of directors. The "Westerly Hospital Service Area" is comprised of the following towns in Rhode Island: Westerly; Hopkinton; Charlestown; West Kingston; Wyoming; Carolina; and Wood River Junction and the following towns in Connecticut: Stonington; Groton; and Ledyard. See Report of the Committee of the Health Services Council on the Application of Lawrence & Memorial Corporation for Change in Effective Control of the Westerly Hospital, April 9, 2013 at Page 1.

⁶⁹ Id.

18. LMW Healthcare Inc. and L&M shall provide information requested by the Department of Attorney General to determine its compliance with the Conditions contained in this Decision.

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 Closing of the Proposed Transaction shall not take place until Conditions 2 and 4 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 17th day of April, 2013, a true copy of this Decision was sent via electronic and first class mail to counsel for the Transacting Parties:

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