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Acting Commissioner

March 7, 2016

VIA UNITED PARCEL SERVICE

David A. Ricci
President/Chief Executive Officer
Saint Michael's Medical Center
111 Central Avenue
Newark, New Jersey 07102

Re: Transfer of Ownership – Saint Michael's
Medical Center
CN# FR 13-0405-07-01
Acquisition Cost: \$62,200,000
Expiration Date: March 7, 2021

Dear Mr. Ricci:

I am approving your certificate of need (CN) application submitted on April 1, 2013, pursuant to N.J.A.C. 8:33-3.1, for the transfer of the ownership of St. Michael's Medical Center, Inc. (St. Michael's or SM), a New Jersey non-profit corporation, to Prime Healthcare Services - Saint Michael's, LLC (Prime St. Michael's or Applicant), a Delaware Limited Liability Company. Prime Healthcare Services, Inc. (PHSI) is the sole member of Prime St. Michael's. PHSI has its own board of directors, of which Dr. Prem Reddy is the Chairman. Prime Healthcare Holdings, Inc. (PHHI) is the sole shareholder of PHSI. Dr. Reddy is the sole director of PHHI. The sole shareholder of PHHI is the KASP Trust whose sole grantor is Dr. Reddy. It should also be noted that Dr. Reddy is the sole director of Prime Healthcare Management, Inc. (PHMI), which will provide administrative support to Prime St. Michael's in such areas as finance, laboratory, clinical operations, radiology, supply chain, etc. PHMI is solely owned by Dr. Reddy's Family Trust. A transfer of ownership of an entire general hospital is subject to the full CN review process, in accordance with N.J.A.C. 8:33-3.3(a)1. I evaluated this application according to the standards set forth in statute (N.J.S.A. 26:2H-1 et seq.) and by administrative rule (N.J.A.C. 8:33). I am satisfied that the application submitted by Prime St. Michael's is consistent with those requirements. The application is being approved at the acquisition cost noted above.

This CN approval is limited to the transfer of ownership of St. Michael's, a general acute care hospital with 358 beds. Categorically, the bed composition would be 281 Medical/Surgical beds, 36 Adult ICU/CCU beds, 35 Adult (Open) Acute Psychiatric beds and 6 Adult (Closed) Acute Psychiatric beds. The hospital's service complement would include the existing 7 Inpatient Operating Rooms (ORs), 2 Adult Cardiac Surgery ORs, 6 Adult Cardiac Catheterization Laboratories, 1 Cystoscopy Room, Acute Hemodialysis services, 2 Linear Accelerators, 2 Fixed CT Units, 1 Closed MRI Unit and 1 Sleep Center.

According to the Applicant, in late 2010, Catholic Health East (CHE) determined that it was necessary to make operational and financial changes, and engaged a professional services firm to develop and implement an operational turnaround plan. The year-end closing for 2010 revealed an operating loss of \$23 million. Applicant states that, during the first quarter of 2011, and then through the summer of 2011, two operational plans, the second plan more robust than the first, were developed and implemented to turn around performance. However, due to continuing declines in volumes and revenue, the FY 2011 year-end loss from operations was \$27 million. It became clear to the Board of Directors that the hospital's current path was not sustainable.

After an in-depth analysis of current market and utilization changes, the Board of Directors unanimously agreed to seek a joint venture or other strategic partnership that would improve St. Michael's ability to continue to provide inpatient and outpatient healthcare services to the community. This process began in February 2012 with CHE management retaining an outside financial organization to determine all options that might exist for St. Michael's, including the sale of the hospital. In November 2012, CHE management accepted the offer from PHSI to acquire St. Michael's and continue its mission to the community.

Prime St. Michael's CN application clearly expresses its commitment to the continuity of services in Newark for at least five years. The Applicant has indicated that it intends to operate the hospital as a general acute care hospital following the transfer of ownership and maintain the existing service complement and programs at the hospital's existing location in Essex County. Prime St. Michael's also plans to hire substantially all current hospital employees who are employed at St. Michael's. In addition, Prime St. Michael's has made a commitment to invest \$25 million in capital expenditures over the first five years.

For the reasons that follow, I am approving, with conditions, the application submitted for the transfer of ownership of St. Michael's to Prime St. Michael's. My decision to approve this CN application is consistent with the recommendation of the State Health Planning Board (SHPB), which unanimously recommended approval of CN# 130405-07-01 at its February 4, 2016 meeting. In reaching this decision, I considered the CN application for the transfer of ownership of St. Michael's, completeness questions and responses, the public hearing transcript, written comments and exhibits, Department of Health (Department) staff recommendations, SHPB recommendations, the Final Report for Greater Newark Healthcare Services Evaluation

(Navigant Report) issued by Navigant Consulting, Inc. (Navigant), St. Michael's Response to the Navigant Report, dated April 6, 2015 (SM's Response), the hospital's Supplemental Response to the Navigant Report, dated May 5, 2015 (SM's Supplemental Response), Navigant's Response to Saint Michael's Medical Center Comments on the Greater Newark Healthcare Services Evaluation Report, dated May 11, 2015 (the Navigant Response), and a letter from the Department of Human Services, Division of Mental Health and Addiction Services (DMHAS) submitted in support of Prime St. Michael's application. The referenced materials are incorporated and made a part of this final decision.

Public Hearing

As part of the review process, the SHPB is required to hold at least one public hearing in the service area of the health care facility within 30 days of the application being declared complete by the Department. A public hearing was held on December 15, 2015, from 6:00 pm until 8:00 pm, at the New Jersey Institute of Technology, located at 323 Martin Luther King Boulevard in Newark, NJ. There were over 200 individuals in attendance, and thirty-two of them spoke - all in favor of approval of the application. Several speakers noted hospital closures over the years, particularly in the Newark area, and maintained that the hospital was clearly needed. A number of speakers stated that the community could not, and should not, suffer the loss of another hospital and the array of health services, jobs and economic benefits it brings to the many vulnerable members of the community. Others noted the investment in the hospital promised by PHSI. Approval of the application was endorsed by all elected officials who spoke (Councilwoman Mildred Crump, Councilman Joseph McCallum and Councilwoman Gayle Chaneyfield-Jenkins of the Newark City Council; Freeholder Britnee Timberlake, President of the Essex County Freeholder Board; and State Assemblyman Thomas Giblin). Several speakers also praised PHSI as a good corporate entity. Members of St. Michael's Board of Directors noted the high bar that was set for a potential buyer of the hospital and stated that Prime St. Michael's was the best choice in the interest of the hospital and its values and the community as a whole.

In response to a completeness question, the Applicant stated that it expected letters of support from elected as well as public officials and community leaders. Response to Completeness Question #32, Round 1, dated June 26, 2013. Letters of support were received from Councilman Augusto Amador (East Ward), Council Member-at-Large Carlos M. Gonzalez, Mayor Luis A. Quintana (City of Newark) and Councilman Anibal Ramos, Jr. (North Ward). In addition, several hundred letters of support were received from residents of Newark and surrounding communities, employees of St. Michael's, community groups and local healthcare providers.

Two groups, New Jersey Appleseed (Appleseed) and the Committee of Interns and Residents/SEIU Healthcare (CIR), submitted written comments expressing concerns that PHSI's record in California and in other states is suspect in a number of areas and should be taken into consideration by the Department and the SHPB during its review. Specifically, Appleseed stated that PHSI's business model does not serve the public interest and is "antithetical" to the recommendations of the Navigant Report referenced below. According to Appleseed, there are "deeply disturbing aspects of" PHSI's business model, including a pending Medicaid fraud investigation, allegations in three pending lawsuits of up-coding, excessive admissions through the emergency department rather than the utilization of observation status, rendering unnecessary medical services, use of an out-of-network insurance model, and "other abusive, if not illegal practices." Among the conditions Appleseed proposed was the appointment of a monitor under N.J.S.A. 26:2H-7.11(i). CIR, which states that it is the nation's oldest and largest housestaff union, representing more than 14,000 interns, residents and fellows, also expressed concern regarding allegations that some of PHSI's business practices "have crossed an ethical or legal line." In particular, CIR expressed "doubts that [PHSI's] intended operation of the hospital based on its track record, public statements, and either indifference or hospitality to the legitimate questions raised by the Navigant Report about the state of healthcare in the greater Newark [area] will yield a positive outcome for the patient population of Newark." CIR also noted that it was "further concerned that [PHSI's] intended operation of Saint Michael's Medical Center post-sale might yield a real and credible threat to the continued operation of University Hospital in an economically secure fashion.

I acknowledge these concerns, which are addressed in some of the recommended conditions found later in this approval letter. The Department also consulted with the Office of the Attorney General as to its investigation of PHSI under the Community Health Care Assets Protection Act. The Department is unaware of any finding that a Prime entity or any of its principals are guilty of any criminal action related to the operation of hospitals in any state.¹

¹ Allegations of wrongdoing by PHSI gave rise to a request by Appleseed for appointment of a monitor. Staff supports requiring facilities to use consultants for particular purposes but the use of a general monitor will not be a condition. In past instances where the Department has appointed an independent health care monitor, the cost of the monitor substantially outweighed the benefits derived from the monitor. A general monitor is typically not as effective as state oversight. The Department is able to oversee compliance and monitor care through the following mechanisms: ongoing evaluation of compliance with Certificate of Need (CN) Conditions; regulatory enforcement such as plans of correction, on-site revisits and civil monetary penalties, as necessary; on-site monitoring visits, which are unannounced; review of facility reporting, including financial performance; complaint investigations; and consultation with Centers for Medicare and Medicaid Services, as necessary. In addition, the Department has authority to have direct input into fiscal and management decisions of a financially distressed hospital. N.J.S.A. 26:2H-5; 2H-5.1b. The Department also may place conditions on CNs that are tailored to for-profit purchases.

Navigant Report

In July 2014, the New Jersey Health Care Facilities Financing Authority (HCFFA) engaged Navigant Consulting, Inc. (Navigant) “to evaluate the current inventory of healthcare services in the Greater Newark area to determine whether there is duplication of services, unused capacity, or an insufficiency of necessary services in this area, and if so, propose recommendations to the Commissioner of the New Jersey Department of Health ... for consolidation or regionalization of services.” Navigant Report, p. 3. On March 2, 2015, Navigant issued its report, setting forth its findings and recommendations. The Department believes the Navigant Report is a valuable tool to help it fulfill its responsibility for the development and administration of the State's policy with respect to health care planning, including hospital and related health care services.

Several of the Navigant Report's findings are of particular relevance to the review of the current application. For example, Navigant concluded that “there is currently excess inpatient capacity in every inpatient bed type (pediatrics, obstetrics, psychiatry, and medical/surgical)[, and that] this surplus is expected to increase in the future.” Navigant Report, p. 84. Navigant also found that “there appears to be substantial duplication of services and relatively few unique services in the Planning Area.” Id. In addition, Navigant noted that

[p]hysicians on staff at the Planning Area hospitals have a higher average age than nationally and their practice model ... is predominately solo and small group practices. This combination of an older age profile and a traditional practice mode will make replacing Planning Area physicians who retire or otherwise leave practice increasingly difficult, given that newly trained physicians are choosing hospital employment or large group practice settings.

Navigant Report, p. 86.

Finally, Navigant notes that “[t]here appears to be a high degree of fragmentation in the organization and delivery of healthcare services in the Planning Area as evidenced by the significant and increasing excess bed capacity and the comparable paucity of accessible, appropriately distributed ambulatory care facilities in the Planning Area.” Id.

Navigant also found that St. Michael's “financial position does not appear sustainable and would likely require a significant additional ongoing subsidy without fundamental changes in the organization's operations and/or business model.” Navigant Report, p. 49.

With respect to payer mix, Navigant found that St. Michael's discharges from Medicare were higher proportionally than those for the Planning Area overall.

St. Michael's Bankruptcy Filing:

On August 10, 2015, St. Michael's filed for bankruptcy under Chapter 11 of the Bankruptcy Code. The Bankruptcy Court set November 3, 2015 as the deadline by which potential purchasers were to submit bids for the purchase of St. Michael's.

Only one other potential purchaser, Prospect St. Michael's, Inc. (Prospect), submitted a bid by the November 3rd deadline, and on November 5, 2015, St. Michael's conducted an auction. On November 6, 2015, St. Michael's and the Applicant entered into the First Amended and Restated Asset Purchase Agreement (Amended APA), which replaced the Asset Purchase Agreement that was submitted with the application. On November 9, 2015, the bids resulting from the auction were presented to St. Michael's Board of Directors, and the Board determined that Prime St. Michael's was the successful bidder. The Board designated Prospect as the "Back-up Bidder," meaning that if Prime St. Michael's fails to close as a result of its breach or default, the assets may be sold to Prospect.

On November 12, 2015, the Bankruptcy Court held a hearing to consider the proposed bids and, at the conclusion of the hearing, the Court approved the Board's designation of Prime St. Michael's as the Successful Bidder, and Prospect as the Back-up Bidder. The only transaction that is currently before the Department is the acquisition by Prime St. Michael's as set forth in the Amended APA.

DMHAS:

DMHAS submitted a letter in support of Prime St. Michael's application, dated September 4, 2015, noting that "SMMC provides a range of voluntary and involuntary inpatient behavioral-health services, as well as an intensive outpatient [alcohol and substance use] day program."

DMHAS indicated that it currently contracts with St. Michael's for 24 slots in the outpatient substance use treatment service. Eliminating the outpatient treatment slots at St. Michael's would create a gap in needed services, leaving DMHAS to secure substance use treatment services from other addiction treatment providers.

According to DMHAS, St. Michael's currently has a behavioral health unit that consists of 14 voluntary beds and six involuntary (DMHAS-designated Short Term Care Facility) beds. If these beds were decreased or eliminated, DMHAS states that the decrease or elimination would "take away the choice for individuals to obtain mental health treatment in their community." In addition, DMHAS notes that

overall system data from the County System Review Committee, responsible for reviewing the Essex County acute care system, indicates that the need for inpatient behavioral health resources exceeds the current inpatient services provided. The system in Essex County consistently notes system delays such as screening programs being unable to place

persons within 24 hours of physician certification. This is evidenced by the fiscal year 2015 data which reflects 251 episodes in Essex County where placement was not possible within 24 hours of a physician certificate, equaling approximately 20 cases per month. These delays will increase if the number of involuntary beds is decreased.

DMHAS also notes that St. Michael's behavioral health services "have been in a state of transition for the past five years" and "[i]ncreased oversight of the [DMHAS-designated Short Term Care Facility] beds by the new ownership is recommended to ensure that we maximize the use of these beds."

The Applicant's Concerns Regarding Certain Conditions

During the SHPB's February 4, 2016 meeting, counsel for the Applicant raised concerns about several of the conditions proposed in the staff recommendations and asked for changes to those conditions. First, Prime St. Michael's expressed concerns regarding Condition 12, which requires the establishment of a Local Governing Board. The Applicant wanted the condition to provide that Prime St. Michael's was only obligated to operate a Local Governing Board for five years. John Calabria, on behalf of the Department, explained that the intent was to require the Applicant to maintain the Governing Board as long as the hospital was under Prime St. Michael's management. The Applicant also requested that the requirement in Condition 12 requiring Prime St. Michael's to submit certain information to the Department on a quarterly basis, be changed to submission on an annual basis. The SHPB declined to recommend either proposed change to Condition 12.

Prime St. Michael's also expressed concerns regarding Condition 18, which relates to the creation of an Advisory Board. The Applicant asked that any reference to the Advisory Board's directive to "supervise" Prime St. Michael's compliance be changed to review, assess, or evaluate. The SHPB recommended that the Department consider such language changes.

Finally, Prime St. Michael's asked that Condition 19 be revised to take out the requirement that the Applicant post its quarterly financial statements on its website. Initially, counsel for the Applicant argued that posting the unaudited quarterly financial statements would be "onerous and burdensome." However, in response to questioning from the chairperson of the SHPB, the Applicant's President of Operations acknowledged that such quarterly financial statements would be presented to the hospital's Local Governing Board (required by Condition 12) and, thus, would not be onerous or burdensome to post on its website. Nevertheless, he noted that placing these unaudited statements on the hospital's website and making them available to the public would be "unique." He also questioned the necessity of doing so and suggested that it might entail more work. The members of the SHPB then discussed the Applicant's concerns regarding Condition 19. Some members of the Board opined that unaudited quarterly financial statements were not necessary and could be difficult to understand, while others thought such statements were an important transparency tool

for the public, especially for a hospital that has been in financial distress. After discussion, the SHPB voted on whether to recommend that change and decided by a vote of three to two to recommend that the phrase “and quarterly financial statements” be deleted from Condition 19.

Analysis

N.J.S.A. 26:2H-8, as well as N.J.A.C. 8:33-4.9(a), provide for the issuance of a CN only where the action proposed in the application for such certificate is necessary to provide required health care in the area to be served, can be economically accomplished and maintained, will not have an adverse economic or financial impact on the delivery of health services in the region or statewide, and will contribute to the orderly development of adequate and effective health care services. In making such determinations, I must take into consideration: (a) the availability of facilities or services which may serve as alternatives or substitutes; (b) the need for special equipment and services in the area; (c) the possible economies and improvement in services to be anticipated from the operation of joint central services; (d) the adequacy of financial resources and sources of present and future revenues; (e) the availability of sufficient manpower in the several professional disciplines; and (f) such other factors as may be established by regulation.

As to the specifics of this application, N.J.S.A. 26:2H-8(a) requires that I consider the availability of facilities or services which may serve as alternatives or substitutes. The Applicant has demonstrated that while there are alternative hospitals within the primary service area of St. Michael's, Essex County residents would likely experience limitations on access in health care services if St. Michael's were to close or significantly downsize its outpatient services. Navigant found that St. Michael's discharges from Medicare were higher proportionally than those for the Planning Area overall; this suggests that if St. Michael's were to close, the Medicare population would be negatively impacted. The acquisition of the hospital by Prime St. Michael's will preserve the current level of health care services in the area. I have taken into consideration the decision of St. Michael's Board of Directors and their fiduciary accountability to the community served by St. Michael's. In its application, Prime St. Michael's stated that it had no intentions to downsize services or reduce any service currently provided at St. Michael's and that this will provide for accessibility and continuity of health care in this community. I have also taken into consideration that there are other hospitals in Essex County that may serve as alternatives for the inpatient services at St. Michael's, but find that, at least in the near term, this transfer of ownership will not significantly impact the ability of these hospitals to coexist, or adversely impact the current level of care or services in the area. I also recognize that in its Response to Completeness Question #3, dated June 24, 2015, Prime St. Michael's acknowledged that it would work with the Department to expand or consolidate beds or services as necessary. I read this to mean that the Applicant is willing to consider the expansion of outpatient services as well as the consolidation or reduction of inpatient beds and services, both of which are in line with what the Navigant Report recommends.

I agree that the proposed transfer of ownership, as opposed to closure of St. Michael's, will preserve appropriate access to health care services for the community, including the medically indigent and medically underserved population. A number of the speakers at the public hearing spoke of the importance of the hospital in the community as a provider of health care, a major employer, and a contributor to the financial viability of Newark through tax payments.

I also find that the requirement at N.J.S.A. 26:2H-8(b) to consider the need for special equipment and services in the area would be met in this case. One example is the need for inpatient and outpatient behavioral health services in Essex County and, specifically, how data suggests that the current need for inpatient behavioral health resources exceeds the current level of those services provided. Decreasing or eliminating these services provided by Saint Michael's would exacerbate that problem. Prime St. Michael's agrees to offer the same services that are currently licensed at the present facility.

With respect to N.J.S.A. 26:2H-8(c) regarding the possible economies and improvement in services to be anticipated from the operation of joint central services, there are economies of scale to be realized by this acquisition. For example, in response to completeness questions, PHSI stated that PHMI "will provide administrative support to Prime St. Michael's in such areas as finance, laboratory, clinical operations, radiology, supply chain, etc." In addition, PHSI has allocated corporate money to establish an integrated information technology system among its acquired hospitals (St. Mary's, St. Clare's Dover and St. Clare's Denville) and this pending hospital acquisition (St. Michael's) in New Jersey. This integrated system would allow these hospitals and their physicians to share both medical and patient information and is expected to be completed within 18 to 24 months.

N.J.S.A. 26:2H-8(d) requires me to examine the adequacy of financial resources and sources of present and future revenues. A financial analysis of Prime St. Michael's application undertaken by the Department indicates that the Applicant will have sufficient resources to implement and sustain the project. In the first nine months of 2015, PHSI generated a positive bottom line of \$161 million, which translates to a 6.7% profit margin. As of September 30, 2015, PHSI had \$108 million in cash on hand. In addition, in October 2015, PHSI completed a financing that provides a \$400 million line of credit and a \$200 million term loan. These loans will provide funds for acquisitions and working capital for PHSI facilities, including Prime St. Michael's. As evidenced by the St. Michael's bankruptcy filing, I am convinced that continuation of the operating losses at St. Michael's could put the future of the hospital at risk and lead to the hospital's closure.

With respect to N.J.S.A. 26:2H-8(e), regarding the availability of sufficient manpower in the several professional disciplines, I am satisfied that there will be sufficient qualified personnel because Prime St. Michael's plans to operate all of the existing beds and services presently at St. Michael's and retain substantially all of the current employees when the transfer of ownership is completed. Prime St. Michael's

plans to actively recruit new physicians and encourage those physicians who previously utilized the hospital to once again return to provide care. Part of Prime St. Michael's plan is to work in conjunction with community leaders and their own medical staff as well as surrounding hospitals to identify health care needs for more specialized services and recruit appropriate medical staff to fill any service gaps. Prime St. Michael's also plans to implement a community outreach program to provide more accessible primary care in an effort to change the community culture of using the Emergency Department as a primary care provider thereby allowing the Emergency Department to function as intended for the delivery of emergency care.

N.J.S.A. 26:2H-8(f) requires consideration of such other factors as may be established by regulation. Therefore, I have taken into consideration the applicable administrative rules governing the services subject to full review (i.e., N.J.A.C. 8:33-1.1 et seq.). Prime St. Michael's is in compliance with the access requirements set forth in N.J.A.C. 8:33-1.1 et seq. and N.J.A.C. 8:33-4.10(a). Specifically, the Applicant will continue to maintain its commitment to the community to preserve access to health care for the residents, including the medically indigent and medically underserved populations. Prime St. Michael's states that it will provide care in accordance with N.J.S.A. 26:2H-18.64 and N.J.A.C. 8:43G-5.2(c) regarding the provision of healthcare services regardless of the patient's ability to pay or payment source.

N.J.A.C. 8:33-4.9(a) requires a demonstration by the Applicant that this transfer of ownership shall not have an adverse impact on the population being served in regards to access and quality of care. The Applicant indicates that the transfer of ownership of St. Michael's will preserve and enhance the financial viability of the hospital and allow it to continue as a general acute care hospital providing the same level of health care services in the community. Prime St. Michael's also intends to continue to serve the same payer mix,² thereby maintaining all of the established bridges to access and care. I find that denial of the CN transfer of ownership application would adversely affect the medically indigent and underinsured because the hospital is a major provider of emergency and urgent care for those populations.

With respect to the Navigant Report's findings identified above, I find the Applicant's responses to the Department's completeness questions related to the Navigant Report to be somewhat troubling. For example, Prime St. Michael's calls the Navigant recommendations "completely tainted," and states that "none of the Navigant recommendations provide useful information." Response to Completeness Question #1, dated June 24, 2015. The Applicant cites SM's Response and Supplemental Response to the Navigant Report as support for its view that the Department should disregard the Report. I disagree.

St. Michael's primary objection to the Navigant Report is its assertion that implementation of Navigant's recommendations would create an "unregulated monopoly

² According to Applicant, in year 2014, St. Michael's payer mix was 46% Medicare; 15% Medicaid; 9% Blue Cross; 2% Commercial Insurance; 1% Self Pay; 7% Indigent and 20% Other, which totals 100%.

in inpatient hospital services in the Newark area.” SM’s Response, p. 1. Navigant refutes that assertion, noting that residents

would continue to have access to the ten (10) hospitals (in addition to the hospitals in the Planning Area) located within a 15-mile radius of downtown Newark. And as the report clearly showed, many residents of the Greater Newark area are already traveling to facilities other than the five hospitals included in the report, as approximately 33% of the residents of the Planning Area defined in the study leave the Greater Newark area for their inpatient care. Secondly, the State of New Jersey currently has a well-defined regulatory system in place that includes Certificate of Need requirements, so the assertion that the recommendations would create an “unregulated monopoly” are clearly overstated and incorrect.

Navigant Response, p. 1.

As noted above, several of the findings in the Navigant Report are of particular relevance to the review of the current application, including excess inpatient capacity and duplication of services, physician practice models in the region, and the lack of accessible, appropriately distributed ambulatory care facilities in the Planning Area compared to the significant and increasing excess bed capacity. With respect to excess inpatient capacity and duplication of services, Prime St. Michael’s states that it “does not believe that services should be reduced merely because they are ‘duplicative’” (Response to Completeness Question #2, dated June 24, 2015), but indicates that, “[o]nce the transfer is complete and we have had an opportunity to carefully evaluate the needs of the community, Prime is willing to work with the Department to expand or consolidate beds or services as necessary.” Response to Completeness Question #3, dated June 24, 2015.

With respect to Navigant’s finding that “[p]hysicians finishing their training today overwhelmingly seek employment opportunities, as opposed to pursuing solo practices or joining small groups,” which are the practice models currently employed in Newark, the Applicant limited its response to hospital employment, without addressing the region’s higher average age than nationally, and the trend toward newly trained physicians choosing large group practice settings over the practice models currently employed in the service area. Response to Completeness Question #9, dated June 24, 2015.

Finally, when asked whether the Applicant was willing to explore discussions with any of the area providers to identify and reduce unnecessary or duplicated services, or enhance ambulatory care services that would provide greater access to the community served by St. Michael’s, Prime St. Michael’s responded that it “will engage in, where appropriate, efficiency enhancing joint ventures with other hospitals in the market in order to improve ambulatory care,” but “cannot agree with its competitors to reduce services, outside an integrated joint venture.” Response to Completeness Question #2, dated June 24, 2015.

Despite my concerns regarding Prime St. Michael's response to the Navigant Report, I find that there is sufficient evidence of the Applicant's commitment to address many of the issues identified in the Report. A national health-care services delivery company, PHSI has shown its ability to respond to the rapidly changing reimbursement and care-delivery models in health care in other states. The Applicant's objective in this transfer of ownership is to reshape the healthcare delivery system at St. Michael's and provide more efficient and effective services, without causing any disruption in the continuity of care for its patients. Moreover, based on DMHAS' concerns set forth in its September 4, 2015 letter of support, I find that there is a need in the community for the behavioral health services currently provided by St. Michael's, and that "[i]ncreased oversight of the [DMHAS-designated Short Term Care Facility] beds by the new ownership is recommended to ensure that we maximize the use of these beds."

I find that Prime St. Michael's has provided an appropriate project description, information as to the financial impact of the transfer of ownership, including operating costs and revenues, services affected, equipment involved, source of funds, utilization statistics, and justification for the proposed project (N.J.A.C. 8:33-4.10(b)), assurance that all residents of the area, particularly the medically underserved, will have access to services (N.J.A.C. 8:33-4.10(a)), and assurance that it will meet appropriate licensing and construction standards (N.J.A.C. 8:43G-1.1 et seq. and N.J.A.C. 8:33-4.10(d)).

In accordance with factors set forth at N.J.A.C. 8:33-4.10, the Department analyzed PHSI's track record in various states where it has operated. Hospital regulators in California, Nevada, Pennsylvania, Rhode Island and Texas provided track record information for each PHSI-owned hospital in these states. In addition, in response to a completeness question, the Applicant provided a written attestation, dated November 30, 2015, stating that no hospitals owned, operated or managed by PHSI have been subject to any track record violation set forth in N.J.A.C. 8:33-4.10(d)4 or 5, with the exception of two facilities in California, both of which corrected the cited deficiencies. Department staff identified no track record violations sufficiently serious to warrant denial of the application.

Finally, I address Prime St. Michael's request that Conditions 12, 18 and 19 be revised. With respect to Prime St. Michael's request that Condition 12 be revised, I agree with the SHPB's recommendation that no change is necessary. Regarding the Applicant's request that the term "supervise" in Condition 18 be changed, I agree, and have made changes to more accurately describe the scope of the Advisory Board's oversight. With respect to Prime St. Michael's request that the phrase "and quarterly financial statements" be deleted from Condition 19, I decline to make such a change. The requirement that the Applicant post its quarterly financial statements on its website is based on a report issued by the Department in 2014, entitled "Hospital Financial Transparency."³ In that report, the Department recommended that quarterly unaudited financial statements "be made available to the public on each hospital's website within 60 days of the end of the quarter except when it conflicts with the SEC or other federal

³ See http://nj.gov/health/documents/hospital_transparency_report.pdf.

requirements. . . . The reporting of quarterly unaudited financial statements would not overly burden hospitals because the information is routinely prepared.” Hospital Financial Transparency at p. 15. Representatives of Prime St. Michael’s acknowledged in response to questioning by the SHPB that quarterly financial statements will be prepared for the Local Governing Board. Although a bare majority of the SHPB voting members recommended that the reference to quarterly financial statements be removed from Condition 19, I believe those who voted to remove the reference may not have fully appreciated the importance of hospital financial transparency. Therefore, I decline to make the recommended change to Condition 19.

Approval With Conditions

Based on the foregoing, I am approving the application for the transfer of ownership of St. Michael’s to Prime St. Michael’s. My decision to allow this transfer of ownership is based on the fact that the operation of St. Michael’s under the proposed new ownership would be beneficial to the population in its service area and will preserve access to health care services for the community, including the medically indigent and medically underserved population, and will preserve and appropriately utilize DMHAS’ behavioral health beds. This transfer of ownership will strengthen the financial viability of St. Michael’s, making it better equipped to provide the health care services needed to serve the core population of its primary service area. I believe that this approval will not have an adverse impact on the other existing hospitals in Essex County or the surrounding counties. There is no existing data to suggest that this transfer of ownership would alter St. Michael’s relationship with the other existing Essex County/regional hospitals or adversely impact the health status of any of the communities served by all hospitals in Essex County and surrounding counties.

My decision to approve this application also factors in the Applicant’s plans to rebuild the healthcare delivery system at St. Michael’s by enhancing its medical and non-medical supportive technology, and its intention to implement the initiatives set forth in Condition 14 below.

Finally, I acknowledge that St. Michael’s has had a commitment to the residents in its service area, and I believe that this approval will enable the hospital, under its new ownership, to maintain its commitment to the community into the foreseeable future. For the reasons set forth in this letter and noting the recommendations of the SHPB and DMHAS, I am approving Prime St. Michael’s application for the transfer of ownership of St. Michael’s subject to the following conditions:

1. The Applicant shall complete the Office of Attorney General Community Health Care Assets Protection Act, N.J.S.A. 26:2H-7.10 et seq., review for the proposed transfer of ownership of assets of St. Michael’s to Prime St. Michael’s.
2. The Applicant shall file a licensing application with the Department’s Division of Certificate of Need and Licensing (Division) to execute the transfer of the ownership of the assets of St. Michael’s to Prime St. Michael’s.

3. The Applicant agrees to retain substantially all of the current employees at St. Michael's. Six months after licensure, Prime St. Michael's shall document to the Division the number of full-time, part-time and per diem employees retained and provide the rationale for any workforce reductions.
4. Within 60 days of licensure, the Applicant shall notify the Division, in writing, of specifically who is responsible for the safekeeping and accessibility of all St. Michael's patients' medical records (both active and stored) in accordance with N.J.S.A. 8:26-8.5 et seq. and N.J.A.C. 8:43G-15.2.
5. Prime St. Michael's shall participate in meetings that address inpatient and outpatient medical and behavioral health care trends, needs, service reallocations, consolidations, and Regional Planning Collaboratives necessary to ensure a quality, accessible system of care for Newark and the surrounding areas.
6. Within twelve months of licensure, and annually thereafter for five years, Prime St. Michael's shall provide the Division with a written report detailing:
 - a. Its plan to reduce unnecessary and duplicative services and excess inpatient beds, if any;
 - b. Its plan for addressing the need to expand or add ambulatory care services; and
 - c. Capital improvement plans, including physical plant improvements, equipment upgrades and additions (including IT), and other capital projects.
7. Prime St. Michael's shall invest in programs designed to improve public health, community health services, and health and wellness and, within twelve months of licensure, shall provide the Division with a written sustainability plan detailing how it intends to ensure the financial viability of such programs. Prime St. Michael's investment in such programs shall be coordinated with its development and implementation of the Community Health Needs Assessment (CHNA) referenced in Condition 12 below.
8. Prime St. Michael's shall participate in, cooperate with, and support the Greater Newark Healthcare Coalition (GNHC) in its regional planning activities and services.
9. Prime St. Michael's shall operate St. Michael's as a general hospital, in compliance with all regulatory requirements, including the operation of behavioral health services as designated by DMHAS and other State agencies, including, but not limited to, the Department of Children and Families, currently involved with St. Michael's provision of behavioral and mental health services. Any changes involving either a reduction, relocation

out of St. Michael's current service area, or elimination of clinical services or community health programs offered by St. Michael's former ownership shall require prior written approval from the Department and shall be subject to all applicable statutory and regulatory requirements.

10. Prime St. Michael's shall continue compliance with N.J.A.C. 8:43G-5.21(a), which requires that "[a]ll hospitals . . . provide on a regular and continuing basis, out-patient and preventive services, including clinical services for medically indigent patients, for those services provided on an in-patient basis." Within 30 days of the issuance of the license and every six months thereafter for a period of five years, Prime St. Michael's shall submit documentation of compliance with this condition to the Division. Such documentation of clinical services shall include, but not be limited to, a list of all physician specialties, the number of physicians within each specialty and the number of those physicians within each specialty that accept Medicaid reimbursement.
11. Prime St. Michael's shall comply with federal Emergency Medical Treatment and Active Labor Act requirements, and provide care for all patients who present themselves at St. Michael's without regard to their ability to pay or payment source, in accordance with N.J.S.A. 26:2H-18.64 and N.J.A.C. 8:43G-5.2(c), and shall provide unimpaired access to all services offered by the hospital.
12. Within 60 days of licensing, Prime St. Michael's shall establish a Local Governing Board for the hospital responsible for (a) representing the Acute Care Hospital in the community and taking into account the views of the community in its deliberations; (b) participating in Prime St. Michael's community outreach programs; (c) supervising the Hospital's Charity Care policies and practices; (d) monitoring financial indicators and benchmarks; (e) monitoring quality of care indicators and benchmarks; and (f) developing and implementing a CHNA that aligns itself with "Healthy New Jersey 2020," the State's health improvement plan and health promotion and disease prevention agenda for the decade.

The Local Governing Board shall adopt bylaws and maintain minutes of monthly meetings. Prime St. Michael's shall submit to the Division, on a quarterly basis, a current working description of the Local Governing Board's authorities, roles and responsibilities, governance authority, and shall clearly define those in comparison to its working relationship with the national PHSI Board. On an annual basis, Prime St. Michael's shall provide the Division with the Local Governing Board's roster and advise the Division of any significant changes to the Local Governing Board's policies governing Board composition, governance authority and Board appointments made during each year that the hospital is in operation. The Local Governing Board shall maintain suitable representation of the residing population of St. Michael's service area who are neither themselves employees of, nor related to employees or owners of, any parent, subsidiary

corporation or corporate affiliate. A member of the Advisory Board established pursuant to Condition 18 shall be an ex-officio member of the Local Governing Board.

13. Within 30 days of licensing, Prime St. Michael's shall provide the Division with an organizational chart of the hospital and each service that shows lines of authority, responsibility, and communication between PHSI and hospital management and the Local Governing Board.
14. Every twelve months for the next five years, starting on the date a license is issued to Prime St. Michael's, Prime St. Michael's shall report to the Division the progress on the implementation and measured outcomes of the following initiatives noted in the application and in this approval letter (a through j below) to improve the operational efficiency and quality of care at St. Michael's, and shall present the most current report to the public at the hospital's Annual Public Meeting:
 - a. The establishment and progress in management of a proposed Accountable Care Organization (ACO), its growth, and how the ACO is clinically and administratively integrated with the hospital;
 - b. Measures that the ACO has taken to support the orderly development of efficient and effective health-care services and improve the quality of patient care management, thereby reducing unnecessary emergency department visits;
 - c. Negotiations with health insurers on new contracts to increase better access for patients at St. Michael's;
 - d. Efforts to fill service gaps to actively recruit new physicians and encourage those physicians who previously utilized the hospital to once again return to provide care;
 - e. The plan to work in conjunction with community leaders and their own medical staff as well as surrounding hospitals to identify health care needs for more specialized services and recruit appropriate medical staff to fill any service gap;
 - f. Plans to increase the operational efficiencies of the Emergency Department by decreasing "wall time" (the time paramedics and EMT's are required to wait in the Emergency Department) to increase overall community access;
 - g. Plans to implement a community outreach program to provide more accessible primary care in an effort to change the community culture of using the Emergency Department as a primary care provider thereby allowing the Emergency Department to function as intended for the delivery of emergency care;

- h. Collaborations with the GNHC;
 - i. Plans to expand outpatient services and reduce or eliminate duplicative services and excess inpatient beds; and
 - j. Compliance with Conditions 7 and 12.
15. Within 90 days of licensure, Prime St. Michael's shall develop and participate in a Community Advisory Group (CAG) to provide ongoing community input to the hospital's CEO and the hospital's Local Governing Board on ways that Prime St. Michael's can meet the needs of the residents in its service area. This would include participating in the development and updating of the CHNA referred to in Condition 12.
- a. Prime St. Michael's shall determine the membership, structure, governance, rules, goals, timeframes, and the role of the CAG in accordance with the primary objectives set forth above, and within 60 days from the date of formation of the CAG, shall provide a written report setting forth that information to the hospital's Local Governing Board, with a copy to the Division and subject to the Department's approval.
 - b. Prime St. Michael's may petition the Department to disband the CAG not earlier than three years from the date of licensure and on a showing that all of the requirements in Condition 15 have been satisfied for at least one year.
16. For the initial five years following the transfer of ownership, Prime St. Michael's shall submit annual reports to the Division detailing:
- a. The investments it has made during the previous year at the hospital. Such reports shall also include a detailed annual accounting of any long- or short-term debt or other liabilities incurred on the hospital's behalf and reflected on the Prime St. Michael's balance sheet;
 - b. The transfer of funds from the hospital to any parent, subsidiary corporation, or corporate affiliate. Such reports shall also detail the amount of funds transferred, in order to document that assets and profits reasonably necessary to accomplish the healthcare purposes remain with the hospital. Transfer of funds shall include, but not be limited to, assessment for corporate services, transfers of cash and investment balances to centrally controlled accounts, management fees, capital assessments, and/or special one-time assessments for any purpose;
 - c. All financial data and measures required pursuant to N.J.A.C. 8:31B and from the financial indicators monthly reporting; and

- d. A list of completed capital projects itemized to reflect both the project and its expenditure.
17. Within 15 business days of approval of this application, Prime St. Michael's shall provide a report to the Division detailing its plans for communications to St. Michael's staff, the community, including but not limited to elected officials, clinical practitioners, and EMS providers, concerning the approval of the transfer of the license and the availability of fully-integrated and comprehensive health services.
18. Prime St. Michael's shall agree to take steps to ensure transparency, provide quality care to patients, and provide assurances to the Department of its continued financial viability. St. Michael's shall designate an Advisory Board, which shall be comprised of at least three individuals. Three individuals shall be selected by St. Michael's and two individuals may be selected by the Commissioner of Health. The Advisory Board shall meet quarterly to (a) review and assess Prime St. Michael's compliance with the Capital Commitments, (b) evaluate Prime St. Michael's compliance with the charity care policies, (c) evaluate Prime St. Michael's compliance with the ethical and religious directives, (d) evaluate Prime St. Michael's compliance with maintenance of all pastoral services, and (e) review and assess Prime St. Michael's compliance with State and Federal laws, statutes, regulations, administrative rules, and directives and the impact on community health care access and quality, and all conditions in any approval letter, and report such findings to the Department. Department staff may attend meetings of the Advisory Board.

Prime St. Michael's shall agree to release, discharge and hold harmless members of the Advisory Board from any and all claims, liability, demands, causes of action or suits that may be made by or on behalf of Prime St. Michael's, direct and indirect parent companies, direct and indirect subsidiary companies, companies under common control with any of the foregoing, affiliates and assigns, and all persons acting by, through, under, or in concert with them, that arise out of or are incidental to acts, omissions or reports issued in good faith by the Advisory Board, in accordance with this Condition. This release shall not apply to any loss, damage, liability or expense incurred as a result of any unlawful or malicious acts or omissions by any member of the Advisory Board.

The Advisory Board shall: (i) be independent of any Prime entity, having no current or previous familial or personal relationship to any Prime entity, its principals, board members and/or managers, or be owned by any Prime entity in whole or in part and (ii) shall be acceptable to the Department. A member of the Advisory Board shall serve as an ex-officio, non-voting member of the Local Governing Board referenced above in Condition 12.

The Advisory Board shall also monitor the following, and these findings shall be reported semi-annually, in writing, to both the hospital's Local Governing Board and the Department:

- Levels of uncompensated care for the medically indigent;
- Emergency department admissions;
- Provision of clinic services;
- Compliance with standard practices related to coding of diagnoses;
- Rationale for termination of insurance contracts;
- Insurance participation and policies related to out-of-network charges;
- Compliance with Department licensing requirements related to staffing ratios and overtime, and Department of Labor and Workforce Development (DOLWD) Wage and Hour requirements;
- Compliance with all other CN conditions within the required timeframes required by each condition.

Prime St. Michael's shall provide information to the Advisory Board upon request, and in the form requested. The Advisory Board shall be active for a minimum period of at least two years and shall provide all reports, findings, projections, and operational or strategic plans to the Department and Prime St. Michael's Local Governing Board for assessment. In the event Prime St. Michael's does not fulfill the commitments set forth in this Condition, the failure may be considered a licensing violation subject to maximum penalty and/or license revocation.

19. Prime St. Michael's shall post on the hospital's website annual audited financial statements within 180 days of the close of the hospital's fiscal year, and shall post quarterly unaudited financial statements within 60 days of the close of the hospital's fiscal quarter. All annual and quarterly statements shall be prepared in accordance with Generally Accepted Accounting Principles. With respect to the posting of quarterly unaudited financial statements, Prime St. Michael's may include disclaimer language regarding the unaudited nature of the Quarterly Financial Statements on its website where such statements are posted.
20. Within 60 days of posting its Audited Annual Financial Statements to its website, Prime St. Michael's shall hold an Annual Public Meeting in New Jersey, pursuant to N.J.S.A. 26:2H-12.50, and shall make copies of those audited annual financial statements available at the Annual Public Meeting. The Advisory Board referenced in Condition 18 shall be invited to attend the Annual Public Meeting, and to hear concerns expressed by community members. Prime St. Michael's shall develop mechanisms for the meeting that address the following:
 - a. An explanation, in layperson's terms, of the audited annual financial statement;
 - b. An opportunity for members of the local community to present their concerns to Prime St. Michael's and the Advisory Board regarding local health care needs and hospital operations;

- c. A method for Prime St. Michael's to publicly respond, in layperson's terms, to the concerns expressed by community members at the Annual Public Meeting; and
- d. Prime St. Michael's shall develop these methods (a through c above) within 90 days of the date of this approval letter and provide them to the Division.

21. After the transfer is implemented:

- a. Prime St. Michael's shall use its commercially reasonable best efforts to negotiate in good faith for in-network HMO and commercial insurance contracts, with commercially reasonable rates based on the rates that HMOs and commercial insurance companies pay to similarly situated in-network hospitals in the northern New Jersey region.
- b. Prime St. Michael's shall convene periodic meetings with the Department and the Department of Banking and Insurance (DOBI) to review and evaluate all issues arising in contract negotiations within the first year of licensure and provide written documentation to the Department on a monthly basis during that first year which shall include, but not be limited to, a description of the number and subject of telephone calls, correspondence and meetings with existing HMO and commercial insurance carriers, as well as follow-up telephone calls, correspondence and meetings. At a minimum, Prime St. Michael's shall have monthly contact with the existing HMO and commercial insurers. If the existing HMO and commercial insurers fail to respond to requests for negotiations, then Prime St. Michael's shall notify the Department and DOBI to request assistance.
- c. Within 10 days of licensure, Prime St. Michael's shall post on the hospital's website the status of all insurance contracts related to patient care between the hospital and insurance plans, including all insurance plans with which St. Michael's contracted at the time of submission of this CN application, April 2013. Prime St. Michael's shall also provide notices to patients concerning pricing and charges related to coverage during termination of plans.
- d. Within the first year of licensure, Prime St. Michael's shall notify the Department of the status of notices to terminate any HMO or commercial insurance contract that will expand out-of-network service coverage. Prime St. Michael's shall meet with representatives from the Department and DOBI to discuss the intent to terminate such contract, willingness to enter into mediation, and shall document how it will provide notice to patients and providers, as well as the impact that such action is reasonably expected to have on access to health care.

- e. During the first year from the date of licensure, Prime St. Michael's shall report to the Department, for each six-month period, the hospital's payer mix and the number and percent of total hospital admissions that came through the emergency department. For four years thereafter, St. Michael's shall report the aforesaid information to the Department on an annual basis.
22. In accordance with the provisions of N.J.S.A. 26:2H-18.59h, Prime St. Michael's shall "offer to its employees who were affected by the transfer, health insurance coverage at substantially equivalent levels, terms and conditions to those that were offered to the employees prior to the transfer." This condition does not prohibit good faith contract negotiations in the future.
23. Prime St. Michael's shall maintain compliance with the United States Department of Health and Human Services Standards for Culturally and Linguistically Appropriate Services in Health and Healthcare. Compliance shall be documented and filed with the Division with annual licensing renewal.
24. For at least five years, Prime St. Michael's shall not enter into any contract or other service or purchasing arrangements, or provide any corporate allocation, or equivalent charge to affiliated organizations within PHSI except for contracts or arrangements to provide services or products that are reasonably necessary to accomplish the healthcare purposes of the hospital and for compensation that is consistent with fair market value for the services actually rendered, or the products actually provided.
25. Prime St. Michael's shall submit any proposed plan including documented compliance with law and regulations as it relates to out-of-network cost sharing with patients to DOBI prior to the implementation. Prime St. Michael's shall not implement any out-of-network cost sharing plans if DOBI objects thereto.
26. Prime St. Michael's shall comply with requirements of the DOLWD's Division of Wage and Hour Compliance that address conditions of employment and the method and manner of payment of wages.
27. Prior to licensure, Prime St. Michael's shall identify a single point of contact to report to the Division concerning the status of all of the conditions referenced within the time frames noted in the conditions.
28. All of the conditions shall also apply to any successor organization to Prime St. Michael's who acquires St. Michael's within five years from the date of CN approval.

Failure to satisfy any of the aforementioned conditions of approval may result in sanctions, including license suspension, monetary penalties and other sanctions in accordance with N.J.S.A. 26:2H-1 et seq. and all other applicable requirements. Acceptance of these conditions will be presumed unless written objections are submitted to the Department within 30 days of receipt of this letter. Upon receipt of such objections, this approval will be deemed suspended and the project shall be re-examined in light of the objections. We look forward to working with you and helping you to provide a high quality of care to the patients of St. Michael's. If you have any questions concerning this Certificate of Need, please do not hesitate to contact John Calabria, Director, at (609) 292-8773.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Cathleen D. Bennett', with a horizontal line extending to the right.

Cathleen D. Bennett
Acting Commissioner

c: John A. Calabria, DOH