From Joe Talley (Tyler) 860-646-1030

Competent, but not daring

Hospitals run by ECHN's new suitor seen as well-run but not interested in treating sickest cases

By Don Michak
Journal Inquirer

Prospect Medical Holdings, the California-company now expected to acquire Eastern Connecticut Health Network, is a for-profit business that scoops up hospitals in financial troubles — just like Tenet Healthcare, the Texas-based corporation that last winter left ECHN at the buyout altar.

Both offer their targets access to new capital, agree to assume debt and pension obligations, and make qualified pledges to maintain services and employment levels and to keep facilities open for several years.

But there are some big differences between ECHN's past and latest suitors, with the most obvious being Tenet's billion-dollar record of settling fraud, overbilling, kickback, and other allegations by its biggest customer, the federal government.

Prospect has not faced any similar allegations, although its San Antonio, Texas, hospital system and one of the two Rhode Island hospitals it purchased last year are among the hundreds of U.S. hospitals penalized by Medicare for high rates of "hospital-acquired conditions" — avoidable mistakes that harm patients.

Prospect, with just over 2,000 employees, also has been merely a regional player in the national health care game. It currently owns 14 hospitals in three states, compared to Tenet's 80 hospitals in 14 states.

Moreover, Prospect has been in the hospital business for only about a decade. The company, which in 1996 began acquiring physician organizations in California, bought a minority interest in its first hospital there in 2005. It bought four more California hospitals in 2007 and two others in Texas in 2012 and 2013.

Prospect in 2012 also announced plans to buy Raritan Medical Center in Perth Amboy, New Jersey, but that deal fell apart when Raritan decided instead to merge with an in-state nonprofit hospital system.

Undeterred, the company in 2014 signed a "definitive partnership agreement" with another nonprofit facility in New Jersey, East Orange General Hospital, under which it would assume ownership and make $84 million in operational and capital commitments. That deal is now under review by the state's health department and attorney general.

Prospect last year also formed a joint venture with CharterCare Health Partners in Rhode Island, owner of the 220-bed Roger Williams Medical Center in Providence and the 278-bed Our Lady of Fatima Hospital in North Providence. The company paid about $45 million for an 85 percent ownership stake, with most of the money going to pay off debt and pension funding. It also promised to invest $95 million over four years, preserve jobs, and maintain all services for a five-year period after the deal is formalized.

In Connecticut, Prospect is poised to buy not only ECHN and its Manchester Memorial and Rockville General hospitals, but also Waterbury Hospital, which like ECHN had been expected to be bought by Tenet.

Prospect now also is reported to be among the possible new suitors for the nonprofit Daughters of Charity Health System, the Catholic owner of six northern California hospitals whose $843 million buyout deal with the for-profit Prime Healthcare Services recently collapsed, according to an industry publication, Healthcare Finance News.

Prospect, which is incorporated in Delaware, is a holding company essentially owned by a Los Angeles-based leveraged-buyout firm, Leonard Green & Partners, through a corporate parent, Ivy Intermediate Holdings Inc. Prospect is led by a buyout industry veteran, Samuel S. Lee.

The privately held company doesn't file reports with federal securities regulators that would describe its financial condition, identify its principal stockholders, and disclose its executives' compensation packages.

But the decision issued last year by the director of Rhode Island's Health Department approving Prospect's takeover of the Providence-area hospitals provides some critical details about the company's business model, its financial status, and the quality of its care.

The 87-page document written by Dr. Michael Fine said that Prospect's purchase of 14 physician organizations in its first decade provided it with "a substantial concentration of HMO enrollees."

Fine, who has since retired, said the company then "used its community hospitals to facilitate growth" at its biggest hospital — Brotman Medical Center, now called Southern California Hospital at Culver City — and "used its medical group enrollment to drive business to its hospital facilities."

Fine added that Prospect also "leveraged its medical groups to enhance payor diversification" and "expanded its HMO contracts by offering a combined hospital-physician provider solution."

Prospect in 2005 had bought the 420-bed Brotman hospital, together with a group of hospital physicians and private investors, from a Tenet Healthcare subsidiary for $27 million, the Los Angeles Times reported.

Faced two years later with an annual loss of $12 million, the hospital filed for bankruptcy protection. Prospect led the reorganization of the hospital, increasing its ownership from 33 percent to 72 percent.

Fine wrote that that during Prospect's "six years of ownership of hospitals," the company has had "success in operating hospitals that had financial difficulties" and that its facilities "enjoy a good reputation for delivery of quality care and service to the under-served."

In a document appended to the decision, a consultant reported that Prospect's earnings before interest, taxes, depreciation, and amortization ranged between 8.9 percent and 13.8 percent between 2010 and 2013, indicating that it could "service existing debt and make routine and strategic investments."

Prospect intended to pay for the Rhode Island deal with cash generated from operations, the consultant added, including $86 million in cash and equivalents, and the company had a $60 million "revolving credit facility."

The consultant also found that Prospect used more debt to finance assets than similar publicly traded companies. And he reported that the company had a deficit in stockholders' equity because of payments made to its corporate parent of $88 million in 2012 and $100 million in 2013, although the company had said it had no intention to make additional "distributions."

In another appended report, a second consultant who reviewed "quality" issues at Prospect described all Prospect's hospitals as "community hospitals, non-academic" with "limited beds and services."

"They rely on hubs in the southern California or Texas regions, none of which they own, to take care of sicker patients who require more complex care," she wrote, adding that as a result Prospect doesn't have to pay for maintaining the more complex facilities.

The medical consultant also reported that she found no "citations of fraud or abuse or any criminal penalties" against Prospect hospitals, and that in the grades handed out by companies including U.S. News, Consumer Reports, and Leapfrog, all the facilities "fared similarly, with C the most common grade."

Meanwhile, Fine disclosed that Prospect had "never been required to undertake" or had "never undertaken" health needs assessments or equivalent studies of the health needs of residents in the communities where it operates. Such studies are required of nonprofit hospitals under the Affordable Care Act, and failure to meet that requirement can result in a $50,000 excise tax and possible revocation of tax-exempt status.

The official also wrote that Prospect's business model and record "do not provide any indication that it will improve hospital care affordability in its service area."

Prospect, Fine added, "will not be seeking to provide essential but under-reimbursed services to its service population but will be looking for services that generate higher margins and revenue growth."

He said the point wasn't that he was critical of the company's business model, "but merely that the business model must be evaluated with regard to its impact on affordable care statewide."

Mel Evans / Associated Press

Preparing the Green

David Clark places flags for the Fourth of July celebrations along the Town Green today in Middlebury, Vt.