

Update on New Jersey's Community Health Care Assets Protection Act

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The current national economic crisis comes at a time when many New Jersey hospitals are already struggling financially. The last year has seen several New Jersey hospitals close and it is expected that others will follow. Hospital closures in New Jersey are subject to Certificate of Need (CN) review and approval by the Commissioner of the Department of Health and Senior Services (DHSS). When a hospital sells all or substantially all of its assets, DHSS and State Attorney General review and Superior Court approval are also required under the Community Health Care Assets Protection Act (CHAPA).¹ These processes are not only lengthy, but also costly and burdensome to hospitals already in financial distress.

In the last 18 months, Pascack Valley Hospital Association (PVHA) and Barnert Memorial Hospital (Barnert) both declared bankruptcy, closed and sold their assets in a process overseen by the bankruptcy court. In each case, the New Jersey Attorney General's office determined that CHAPA did not apply to the sale of these assets. The Attorney General has provided insight into several important factors that, if present, may make CHAPA inapplicable to other New Jersey hospitals facing bankruptcy and closure.

Requirements of CHAPA

CHAPA requires New Jersey's nonprofit hospitals to apply to the Attorney General prior to entering into a transaction that would result in the acquisition of the hospital by another New Jersey nonprofit corporation or by any for-profit or out-of-state entity. For purposes of CHAPA, "acquisition" is broadly defined as "the purchase, lease, exchange, conversion, restructuring, merger, division, consolidation, transfer of control or other disposition of a substantial amount of assets or operations, whether through a single transaction or series of transactions, with one or more persons or entities." CHAPA calls for the proposed acquisition to be reviewed by the Attorney General, in conjunction with the Commissioner of DHSS, to determine whether the acquisition is in the public interest. In

¹ N.J. Stat. Ann. § 26:2H-7.11.

making this determination, the Attorney General must consider whether:

- > The acquisition is permitted under the New Jersey Nonprofit Corporation Act;
- > The nonprofit hospital exercised due diligence in deciding to effectuate the acquisition, selecting the other party and negotiating the terms and conditions of the acquisition;
- > Appropriate procedures were used in making its decision, including whether appropriate expert assistance was used;
- > Any conflicts of interest were disclosed;
- > Any management contract is for reasonable fair value; and
- > The acquisition proceeds will be used for charitable health care purposes consistent with the nonprofit hospital's original purpose or for the support and promotion of health care and whether the proceeds will be controlled as charitable funds independently of the purchaser or parties to the acquisition.

When a for-profit or out-of-state entity is involved, the Attorney General considers several additional factors, including whether:

- > The hospital will receive full and fair market value for its assets;
- > Charitable funds are placed at an unreasonable risk;
- > A right of first refusal has been retained to repurchase the assets by a successor nonprofit corporation;
- > The nonprofit hospital established appropriate criteria in deciding to pursue a conversion in relation to carrying out its mission and purposes;
- > The nonprofit hospital considered the conversion the only alternative or the best alternative in carrying out its mission;
- > The nonprofit hospital exercised due care in assigning a value to the existing hospital and its charitable assets; and
- > Officers, directors, board members or senior management will receive future contracts in existing, new or affiliated hospitals or foundations.

In all transactions, the Attorney General may consider any other criteria she establishes by regulation.

CHAPA was designed to provide transparency and oversight to the process of an acquisition of a New Jersey nonprofit hospital. An important aspect of a CHAPA proceeding is the requirement that the Attorney General hold at least one public hearing where any person may file written comments, or appear and make a statement. The Attorney General will make the information received by the parties to the proposed acquisition available at no cost for inspection by the public. The CHAPA review process can significantly delay consummation of the transaction and be burdensome to both parties to the transaction.

In determining that CHAPA did not apply in either the PVHA or Barnert transactions, the Attorney General identified three factors. First, the hospital was closed and was no longer licensed. Second, the license for the acute care hospital was not being

transferred. Third, the asset transfer from the nonprofit hospital corporation to the for-profit entity was overseen by the bankruptcy court and a second layer of judicial review of the transaction, in addition to that already provided by the bankruptcy court, was deemed redundant.

Closed Hospital

Significantly, both PVHA and Barnert were no longer treating patients at the time they were ready to proceed with the sale of their assets and review of the transaction by the Attorney General under CHAPA. At the time of review of the PVHA case, PVHA had been closed and had received CN approval from DHSS to close. The Barnert CN application to close was still under review by the Commissioner of DHSS (and the decision that CHAPA did not apply was contingent upon DHSS granting the CN application). In each case, the Attorney General determined that CHAPA does not apply to a closed, unlicensed hospital. The Attorney General relied on statutory language that states “a nonprofit hospital licensed pursuant to N.J.S.A. 26:2H-1 shall satisfy the requirements of [CHAPA].”² The Attorney General acknowledged in letters to PVHA and Barnert that CHAPA does not define hospital, but incorporates by reference the Health Care Facilities Planning Act and hospital licensure regulations. The regulations define a hospital as “an institution,...which maintains and operates facilities for the diagnosis, treatment or care of two or more non-related individuals suffering from illness, injury or deformity and where emergency, out-patient, surgical, obstetrical, convalescent or other medical and nursing care is rendered for periods exceeding 24 hours.”³ Therefore, the Attorney General concluded that the physical assets of a facility (real estate and fixtures) that has been closed pursuant to a CN was no longer operating as a licensed hospital, and where surgical, obstetrical, convalescent or other medical and nursing care were no longer being rendered, these assets did not constitute a licensed hospital within the meaning of CHAPA. Since both hospitals were no longer operating, according to the Attorney General the physical assets of the hospitals did not constitute a licensed hospital.

No Transfer of Acute Care License

Another key factor in both the PVHA and Barnert transactions was that the acute care hospital license was not being transferred and all parties to the transactions represented they were not going to operate an acute care hospital on the premises after closing. In the sale of PVHA to Hackensack University Medical Center (HUMC) and Touro University College of Medicine (Touro), HUMC represented that it intended to use the assets for a satellite emergency department and Touro intended to use a portion of the premises to operate a new medical school. Although the CN approval letter issued to PVHA by DHSS permitted PVHA to reactivate its hospital license within two years, PVHA represented that the right to reactivate the hospital’s license was not being transferred in the transaction, PVHA intended to dissolve following the liquidation of its assets and any possible future transfer of PVHA’s right to reactivate its license would not occur without obtaining all necessary and required approvals. Barnert sold its assets to Community Healthcare Associates, LLC, which represented to the Office of the Attorney General that it planned to operate outpatient and ambulatory health care services to the local community that had previously been served by Barnert.

² N.J. Stat. Ann. § 26:2H-7.11.

³ N.J. Admin. Code §8:43G-1.2.

Bankruptcy Court Review

In determining that CHAPA did not apply, the Attorney General also relied on the determinations made by the bankruptcy court and decided that additional CHAPA review of the same factors considered in the bankruptcy proceeding would be redundant.

Barnert and PVHA both faced insurmountable economic challenges leading up to the closure of their respective hospitals and were forced to file for bankruptcy. The bankruptcy court reviewed the PVHA and Barnert transactions in order to determine that creditors' interests were properly considered. In each case, the Attorney General noted that because the asset transfer occurred under the auspices of the bankruptcy court, a substantial number of the CHAPA factors would not be pertinent to the consideration of these transactions.

Attorney General's Common Law Authority

Although the Attorney General determined CHAPA did not apply to the PVHA and Barnert transactions, the Attorney General retained authority to review the transactions under her common law duty to oversee the activities of New Jersey charitable corporations. The Attorney General, under the *cy pres* doctrine, has a duty to protect, supervise and enforce charitable trusts, and has applied this doctrine to review transactions involving the sale or transfer of charitable assets, which are not otherwise subject to CHAPA. In conducting her common law duty to oversee the transfer of the PVHA and Barnert charitable assets, the Attorney General inquired into whether the directors of the charitable corporation exercised reasonable care in performance of their duties concerning the sale, whether any conflict or duality of interest was disclosed, whether there was fair valuation for the disposition of assets and whether the proceeds from the sale would be used for appropriate charitable purposes. In both instances, due to the financial circumstances of the hospitals, any sale would be used to satisfy the outstanding liabilities to the hospitals' secured and unsecured creditors. In both cases, outside consultants were used to market the sale of the hospital assets.

According to the Attorney General, many of the issues she ordinarily reviews under *cy pres* were addressed by the bankruptcy court in each case, including whether there was proper, timely and sufficient notice of the sale motion and the bankruptcy hearing was provided according to Bankruptcy Rules; the notice was good, sufficient and appropriate under the circumstances; there was a reasonable opportunity to be heard by all interested parties; the bidding process provided a full, fair, and reasonable opportunity for any entity to make a competing bid for the assets; the acquirer's offer was the highest and best offer received for the purchased assets; and the hospital articulated sound business reasons for selling its assets and consummating the transaction. In both the PVHA and Barnert transactions, the Attorney General determined that the issues she would ordinarily examine in a review of a transfer of the charitable assets of a nonprofit corporation were suitably considered in the procedures used by the bankruptcy court to identify the buyer and determine the purchase price. Therefore, the Attorney General determined that in both cases where CHAPA review was deemed to be inapplicable, a second layer of judicial review of the transactions under the common law, in addition to that already provided by the bankruptcy court, would be redundant.

Conclusion

While the Attorney General identified three factors that made CHAPA inapplicable to the sale of assets by PVHA and Barnert, other hospitals in financial distress or bankruptcy that are considering the sale of substantial assets will be evaluated by the Attorney General based upon the factors present in their individual situations. The Attorney General may determine that CHAPA applies if all three factors cited in PVHA and Barnert are not present or if there are other circumstances involved. It is also possible, however, that the Attorney General may determine that CHAPA does not apply to a particular transaction based upon other factors in addition to one or more of the factors cited in the PVHA and Barnert letters. Such a determination would substantially reduce the time and costs of transferring the assets of a New Jersey nonprofit hospital.

Health Law Practice Group

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